MEMORANDUM

TO: Members of the Valuation of Securities (E) Task Force

FROM: Stewart Guerin, Chair, Valuation of Securities (E) Task Force
       Kevin Fry, Vice Chair, Valuation of Securities (E) Task Force

CC: Bob Carcano, Senior Counsel, NAIC Investment Analysis Office
    Charles Therriault, Director, NAIC Securities Valuation Office

DATE: May 11, 2017

RE: Enhancements to the Administration of the FE Designation Process

Regulator Objectives:

- Reduce the number of filing exceptions.
- Create uniformity and efficiency in the application of the FE process.
- Gain a better understanding of the FE universe of securities.

We are proposing modifications to allow the NAIC Investment Analysis Office (IAO) to oversee the production of FE designations and to partner with state regulators in verifying the FE process. This responsibility will include working with industry and state regulators to reduce reporting exceptions that arise as a result of the FE Designation process. There will also be a responsibility to monitor the types of securities both public and private that make up the FE universe and report to the TF any relevant information about these rated securities. Regulators realize the benefit of relying on credit ratings, but do not want to do so blindly. Consideration will be given to the potential impact of any policy changes to avoid unnecessarily penalizing insurers if it would not meet regulatory objectives.

In order to effectuate the enhancements to the FE process, there are policy decisions that need to be made. Once these policy decisions are made, we will be in a position to draft new language for the P&P Manual. The technical administrative details will be discussed in future meetings after the policies have been adopted by the Task Force.

Below is a list of the major policy decisions that need further discussion.

1. **IAO Role and Responsibility** - In order to accomplish the goal of reducing reporting differences, the IAO must have ability to make necessary changes to the automated FE designations. This should be limited to certain circumstances that require the correction of an error in computing the FE designations produced incorrectly by the automated process or correcting some other NAIC designation anomaly. The Task Force should confirm that the IAO should have responsibility for studying and recommending ways to improve how NAIC designations are produced; including those based on credit ratings.

2. **Producing designations for Private Letter Ratings** - Beginning 1/1/2018, private letter ratings will need to be either included in the rating agency feeds which are used for the automated FE process or filed with the IAO to be manually added to the FE database. When private letter rating securities are reported in the annual statement, there will be a PL suffix added onto the end of the designation. For those private letter ratings that cannot be added to the rating agency feeds immediately and cannot be filed with the IAO for confidentiality or other reasons existing filing options can be used. Over time, it is expected that this gap with private letter ratings will be eliminated by insurers working with the rating agencies to expand their feeds and adjusting the nondisclosure agreements to allow for sharing with the IAO. Due consideration shall be given to private letter ratings acquired prior to January 1, 2018,
which may result in a bifurcated approach when viewed against post-1/1/2018 transactions. Other solutions may also be available.

3. **Resolving discrepancies between the official NAIC designations and insurer’s computations of the designations.** - In those instances when an insurer believes that the official NAIC designation is incorrect, we are proposing that the insurer be allowed to report their computed designation with a RE suffix added onto the end of the designation. This RE suffix will flag the discrepancy and cause the company to follow up with the IAO to resolve the conflicting designations. Over time this interaction should materially reduce these types of discrepancies. It is necessary for the TF to establish what are reasonable grounds for the use of this process.

4. **Reviewing the policy of requiring rated securities to be filed with the IAO.** - Currently, the TF and state regulators have the authority to require a rated security to be filed with the IAO. The TF or state regulators may require the filing of a security with the IAO so that it can better understand its characteristics and enable the IAO to make recommendations to the TF. This current policy should be reviewed for potential changes or enhancements.

5. **Any other items.** - Determine what changes will need to be made to the regulatory process including Jumpstart as a result of the changes contemplated above. As well as recommend further enhancements to the infrastructure and control environment of the IAO to improve their data.

**Timeline:** The goal is to have multiple TF calls before the Summer National Meeting to work out the above issues. Once we decide on these issues, we will be in a position to amend the P&P manual to effectuate these changes. The goal is to have these changes in place to be effective for the year-end 2018 annual statement filing.
MEMORANDUM

TO: Members of the Valuation of Securities (E) Task Force

FROM: Stewart Guerin, Chair, Valuation of Securities (E) Task Force
       Kevin Fry, Vice Chair, Valuation of Securities (E) Task Force

CC: Bob Carcano, Senior Counsel, NAIC Investment Analysis Office
    Charles Therriault, Director, NAIC Securities Valuation Office

DATE: June 21, 2017

RE: Topics Related to Implementing Enhancements to the Administration of the FE Designation Process

The following items are included for discussion purposes only.

IAO Role & Responsibility

- Identify the relevant P&P Manual Sections for revision to give the IAO responsibility to oversee the production of FE designations;
- Determine the circumstances in which the IAO may use its discretion to change an FE designation;
- Determine what quality assurance protocols can be implemented by the IAO once it undertakes oversight of the production of FE designations;

Private Letter Ratings

- Identify the relevant P&P Manual Sections for PL revision;
- Determine whether Private Placements should be defined;
- Formulate a grandfathering methodology to ease the transition of treatment for PL’s issued prior to January 1, 2018;
- Determine the treatment of PL transactions issued on or after January 1, 2018 in instances when they are not included in CRP ratings feeds and/or confidentiality provisions prohibit manual filing with the IAO;
- Determine who assigns the PL designation modifier;
- Determine whether 43R securities should be carved out of the PL framework;
- Determine the criteria for an acceptable CRP rating whether public or private;
- Determine how RE and PL interrelate to each other;
- Determine the information required in a Private Rating Letter (pre/post 1/1/2018);
- Determine whether the current Private Letter Rating definition needs revision;
- What standards should a Private Letter Rating have to be FE eligible (i.e. issue specific, covers principal & interest, reviewed annually, etc.);

Resolving discrepancies

- Identify the relevant P&P Manual Sections for revision;
- Determine who assigns the RE designation modifier;
- Determine who changes the RE designation once it has gone through the difference resolution process;
- Formulate a process that will be utilized to resolve reporting differences indicated by an RE designation modifier? Non-RE related differences;
- Determine what type of appeals process will exist in instances where insurers disagree with the IAO’s designation determination (after the RE resolution process has been concluded);
- Determine how long a security remain RE;
- Determine what types of documentation is expected to support an RE reporting;
- Determine the RE-related communication protocols;

Policy requiring the filing of FE securities
- Perform a review of the current policy requiring FE securities to be filed if requested by the Task Force or IAO;

Other Items
- Discuss what enhancements to the IAO’s infrastructure/controls are necessary to implement the policies & procedures adopted herein;
- Determine what changes need to be made to examiner/analyst tools (e.g. Jumpstart, Examiners’ Handbook, etc.) as a result of the changes contemplated herein;
- Consider the timing for implementation of the various aspects of this project;
- Determine whether the current IRBC proposal impacts this project;
MEMORANDUM

TO: Stewart Guerin, Chair, Valuation of Securities (E) Task Force
    Members of the Valuation of Securities (E) Task Force

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

CC: Charles Therriault, Director, NAIC Securities Valuation Office

DATE: July 5, 2017


1. Introduction – On June 22, 2017 the Task Force adopted policy statements in connection with a project to enhance the administration of the filing exempt (FE) process (Attachment One). The Task Force asked the SVO to review the policy recommendations and propose amendments to the P&P Manual. To facilitate the review of the proposed amendments the Task Force also asked the SVO to break out proposed P&P Manual amendments to correspond to the five components in its policy statement. This memorandum focuses on the component of the policy statement adopted by the Task Force reproduced below:

    “IAO Role and Responsibility – In order to accomplish the goal of reducing reporting differences, the IAO must have ability to make necessary changes to the automated FE designations. This should be limited to certain circumstances that require the correction of an error in computing the FE designations produced incorrectly by the automated process or correcting some other NAIC designation anomaly. The Task Force should confirm that the IAO should have responsibility for studying and recommending ways to improve how NAIC designations are produced; including those based on credit ratings.”

2. Discussion

a. Discretion – The policy directive, applicable to publicly and privately rated securities, envisions that the IAO not alter the result obtained by the application of the filing exempt rule except to correct errors in the NAIC Designation produced by the automated process. Part Two, Section 4 (c) (iv) of the P&P Manual¹ provides that the SVO has discretion to ignore a credit rating. The Task Force should consider whether it wants to delete or modify that provision or provide guidance as to its meaning.

¹ Disclosures and Considerations Related to the Translation of Credit Ratings into NAIC Designations

    The presumption of convertibility accorded to a credit rating of a NAIC CRP should not be interpreted to indicate that NAIC Designations and NAIC CRP credit ratings are produced using identical methodologies or that they are intended to communicate the same information. SVO credit assessment is conducted for regulatory purposes and may therefore include considerations or address concerns unique to the regulatory community. Accordingly, the SVO staff has discretion to ignore the rating of any given NAIC CRP if and when it is called upon to consider how to translate a credit rating issued by a NAIC CRP into an NAIC Designation. (Emphasis Added)
b. **Monitor/Study/Recommend** – The policy directive imposes responsibility on the IAO to study and recommend ways to improve how NAIC Designations are produced. Language in the preamble of the adopted policy statement speaks to the same issue: “… modifications to allow the … IAO to oversee the production of FE designations … [includes] … a responsibility to monitor the types of securities both public and private that make up the FE universe and report to the TF any relevant information about these rated securities. Regulators realize the benefit of relying on credit ratings, but do not want to do so blindly …”

The concept that IAO study and report on risks in rated securities must be considered against the practical likelihood that the IAO can acquire and maintain the staff and necessary skill set to track the activities of a very large industry on an ongoing or consistent basis. It seems more realistic and more consistent with long range NAIC objectives that IAO focus on identifying rated securities populations that can be regulated by other means and on the development of alternative analytical or regulatory frameworks for such populations. This suggested orientation of the policy would lever regulatory skill sets, at the departments, the IAO, FRS and other staff groups and reflect a number of important considerations. It is crucially important to recognize that the relationship of the NAIC to NRSROs can never be more than that of a consumer. The only accountability tool a consumer has is to take his or her business elsewhere. However, blind reliance negates the ability to do that because the filing exempt process builds NRSROs into NAIC processes. This reality is fundamentally at odds with the changed federal perception relative to the use of credit ratings in regulation and the NAIC’s own 2010 policy decision to actively reduce reliance on credit ratings. The incompatibility of reliance is further illustrated by the NAIC process. NAIC discussions on regulatory issues must be public. Yet public discussions in which IAO staff expresses concerns about the credit rating industry, specific NRSROs, specific credit ratings or concerns with methodology can negatively impact NRSROs, the industry as well as the capital markets and create negative exposures for the NAIC.

c. **Revisions to the Compilation Text** – The following amendments to the P&P Manual:

- Revise the general directives to the SVO to modernize their expression and add the obligation to conduct a check of data quality to the compilation process and to resolve reporting exceptions;
- Integrate FE and PL securities into the SVO quarterly compilation process;
- Provide a framework for a data quality assessment procedure within the SVO compilation function.

**Part One - Purposes, General Policies and Instructions to the SVO**

**Section 2. Policies Defining the SVO Staff Function**

a) **Directive to Conduct Ongoing SVO Operations**

To support the implementation of the standards specified in the NAIC Financial Conditions Framework, the SVO shall conduct the following ongoing operations:

(i) Produce NAIC Designations in accordance with the various methodologies, procedures and criteria established by the Valuation of Securities (E) Task Force in this Manual.

(ii) Determine values, in the form of a Unit Price, for insurer owned securities as and when required to do so and in accordance with the procedures specified in this Manual.

(iii) Identify and analyze securities that contain other non-payment risk (as defined in this Manual) and communicate the result of the analysis by assignment of an appropriate NAIC Designation and the subscript that identifies that the security is subject to this methodology.

(iv) Such other analytical assignments as may be requested by the Valuation of Securities (E) Task Force; another NAIC regulator group or members of the NAIC; in accordance with the directives, procedures and general methodologies described in this Manual.

(v) Compile and publish the SVO List of Securities in the AVS+ products and conduct any and all ancillary processes to ensure an accurate publication; including the periodic assessment of data quality and the resolution of reporting anomalies in
the data associated with securities reported as owned by insurers in accordance with the instructions provided in this Manual …

[Related to the SVO Quarterly Compilation Function]

Section 3. Internal Administration

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, (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 Valuation of Securities Process. The Valuation of Securities Process is used to store NAIC Designations produced by the SVO on the basis of an independent analysis under the analytical methodology in Part Three, Section 1 (a) of this Manual; or such other methodologies or procedures specified in this Manual for the population of securities.

The SVO shall not add a Regulatory Transaction, as defined in Part Three, Section 2 (e) of this Manual, to the Valuation of Securities 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 pursuant to the filing exemption in Part One, Section 4 of this Manual and is subject to the procedure specified in Part Three, Section 1 (b) of this Manual. Insurance companies report FE securities to the NAIC as part of the NAIC Financial Blank reporting process. SVO staff subsequently compiles a sub-list of such securities and information about them in the Filing Exempt Securities Process. SVO produces and assigns NAIC Designations to FE securities using a computer process that applies the procedure specified in Part Three, Section 1 (b) of this Manual.

The SVO shall not add an FE security that is a Regulatory Transactions, (defined in Part Three, Section 2 (e) of this Manual), to the Filing Exempt Securities Process.

h) PL Securities Process

A security subject to private letter rating, i.e., a PL security, is an Investment Security, as defined in Part Two, Section 2 (a) of this Manual, that is exempt from filing with the SVO pursuant to the filing exemption in Part One, Section 4 of this Manual and is subject to the procedure specified in Part Three, Section 1 (b) of this Manual. Insurance companies report PL securities to the NAIC as part of the NAIC Financial Blank reporting process. SVO staff subsequently compiles a sub-list of such securities and information about them in the PL Securities Process. SVO produces and assigns NAIC Designations to FE securities using a computer process that applies the procedure specified in Part Three, Section 1 (b) of this Manual.

The SVO shall not add a PL security that is a Regulatory Transactions, (defined in Part Three, Section 2 (e) of this Manual), to the Filing Exempt Securities Process.

l) Compilation and Publication of the SVO List of Securities

(i) Publication Instructions

Until such time as the Valuation of Securities (E) Task Force shall instruct the SVO to publish the SVO List of Securities (discussed in this sub-section) in a different location, the SVO shall publish the List of Securities only in the AVS+ Product. As identified in Part Section 5 (a) of this Part One, and reflected in the definition of AVS + products in Part Two, Section 1 of this Manual, the AVS+ Product is the NAIC’s official source of NAIC Designations to ensure uniformity and consistency across all insurer reporting.

(ii) Data Quality Assessment Procedure
1. The SVO shall develop, maintain and apply procedures to identify and resolve reporting exceptions for Investment Securities. Such procedures shall be consistent with the methodology used to produce NAIC Designations for the securities that belong in the specific process where data about that group of securities is collected and maintained. The procedures to be developed would include the ability for a user of VISION to identify the Process to which the security belongs, the information to be provided to the SVO by the insurer and the logic to be applied to determine whether or not a reporting exception exists and how to correct it. For purposes of illustration, because the SVO produces NAIC Designations for FE securities and for PL securities on the basis of the credit ratings assigned to the security by NAIC CRPs, a reporting exception involving an FE or PL security involves an examination whether SVO obtained and used the latest and most accurate NAIC CRP credit ratings available to produce the NAIC Designation.

2. The administrative symbol RE shall initially be used solely in connection with FE and PL securities, although the objective is to expand the use of the RE symbol in the VISION platform to facilitate communication between insurers and the SVO for all securities. For FE and PL securities, the insurer shall provide to the SVO whatever information it has that the credit ratings used to produce the NAIC Designation is not accurate. Please refer to Section 3 (b) (v) (A) above for discussion of the administrative symbol RE.

3. In any given year, in addition to the information obtained by the SVO through the use of the RE symbol by insurers, the SVO shall also engage in other activity to identify, and with the VOS/TF to resolve, reporting exceptions. The SVO shall obtain the latest NAIC year-end reporting data on insurer owned securities, assess the accuracy of the data presented and resolve reporting exceptions anomalies in the reported data as specified in this sub-section.

4. If the reported exception is not resolved by the next reporting year the insurer must report it again to the SVO until it is resolved or the SVO indicates that it is unable to resolve the exception and advises the insurer to address it with their domiciliary state insurance department.

5. As used herein, a reporting exception means that an Investment Security, defined in Part Two Section 2 (a) of this Manual, was not filed with the NAIC for assignment of an NAIC Designation in accordance with the applicable methodology or procedure specified in this Manual; or that the security was reported as having been designated by the SVO when it was not; or that the security is a Regulatory Transaction and not eligible for treatment as an Investment Security; or that the security is a form of indebtedness not subject to assignment of an NAIC Designation or that some other reporting inconsistency exists – which if not corrected would make the data used in the compilation of the SVO List of Securities inaccurate.

(iii) On a quarterly basis, the SVO shall:


When compiling or publishing the SVO List of Securities the NAIC shall not publicly show, display or disseminate the credit ratings of NAIC CRP’s in the AVS+ product or in any other NAIC publication associated with the VOS/TF.

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 such other methodology or procedure 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”).

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.

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.

CRP stands for Credit Rating Provider and refers to the NRSROs on the NAIC Credit Rating Provider List discussed in Part Three, Section 1 (b) of this Manual.

Filing Exempt Securities Process 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 (FE securities). The SVO produces NAIC Designations for FE securities as discussed in Part Three, Section 1 (b) of this Manual and publishes the results in AVS+ Products.

PL Securities Process refers to an electronic file within NAIC electronic computer systems used by the SVO to store the names and descriptions of securities owned by state-regulated insurance companies filed with the SVO that are exempt from filing with the SVO because they are assigned private letter ratings by NAIC CRPs (PL securities). The SVO produces NAIC Designations for PL securities as discussed in Part Three, Section 1 (b) of this Manual and publishes the results in the AVS+ 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 after independent quality assessment and that is used in connection with the publication of the AVS+ products.

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MEMORANDUM

TO: Stewart Guerin, Chair, Valuation of Securities (E) Task Force
    Members of the Valuation of Securities (E) Task Force

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

CC: Charles Therriault, Director, NAIC Securities Valuation Office

DATE: July 5, 2017


1. Introduction – On June 22, 2017 the Task Force adopted policy statements in connection with a project to enhance the administration of the filing exempt (FE) process (Attachment One). The Task Force asked the SVO to review the policy recommendations and propose amendments to the P&P Manual. To facilitate the review of the proposed amendments the Task Force also asked the SVO to break out proposed P&P Manual amendments to correspond to the five components in its policy statement. This memorandum focuses on the component of the policy statement adopted by the Task Force reproduced below:

"Producing designations for Private Letter Ratings – Beginning 1/1/2018, private letter ratings will need to be either included in the rating agency feeds which are used for the automated FE process or filed with the IAO to be manually added to the FE database. When private letter rating securities are reported in the annual statement, there will be a PL suffix added onto the end of the designation. For those private letter ratings that cannot be added to the rating agency feeds immediately and cannot be filed with the IAO for confidentiality or other reasons existing filing options can be used. Over time, it is expected that this gap with private letter ratings will be eliminated by insurers working with the rating agencies to expand their feeds and adjusting the nondisclosure agreements to allow for sharing with the IAO. Due consideration shall be given to private letter ratings acquired prior to January 1, 2018, which may result in a bifurcated approach when viewed against post-1/1/2018 transactions. Other solutions may also be available."

2. Discussion – The above policy directive is concerned with securities subject to private letter ratings. While this memorandum addresses that population of securities, it also addresses filing exempt securities which receive publicly disclosed ratings. This reflects that in the view of the SVO, securities subject to private letter ratings are a sub-population of filing exempt securities. The SVO proposed amendments shown below:

- Retain the existing filing exempt rule and process and extends them to securities subject to private letter ratings.
- Modifies the definition of the administrative symbol FE; retains current practice to have insurers identify FE securities to the NAIC and modifies the text to reflect that SVO assigns NAIC Designations to FE securities.

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- Adds and defines a new administrative symbol PL applicable to securities subject to private letter ratings and specifies that the insurer identifies PL securities to the NAIC as they do FE securities.
- Creates a new 5th channel for PL securities issued on or after Jan. 1, 2018.
- Articulates the procedure for assigning NAIC Designations to PL securities and integrates that procedure into the procedure used for FE securities.
- Collects the three components of the FE process into Part Three and revises the text to form a single coherent procedure—i.e.,
  o The List of Credit Rating Providers and Their Equivalent of their Credit Ratings to NAIC Designation – now in Part One, Section 7 (d).
  o The filing exempt rule – now in Part Two, Section 4 (d).
  o Special instructions providing SVO with parameters on how to use credit ratings – outside of the context of the FE process – now in Part One, Section 2 (c) (iv).


Part One—Purposes, General Policies and Instructions to the SVO

Section 3. Internal Administration

b) Definitions of NAIC Designation Categories, Valuation Indicators, Administrative Symbols and Conventions

(v) SVO Administrative Symbols

SVO administrative symbols convey information about a security or an administrative procedure instead of an opinion of credit quality or Unit Price. The administrative symbols in use by the SVO and their meanings are described below.

(A) SVO analytical department symbols (except for the SVO SCA Companies Group)

All SVO analytical departments except the SVO SCA Companies Group use the following administrative symbols:

**FE** means exempt from filing with the SVO and is used by an insurance company to identify an exempt security. NAIC Designations for FE securities are assigned by the SVO pursuant to the instructions and procedures in Part Three Section 1 (b) of this Manual. The NAIC Designation determined by the SVO is disseminated in the SVO List of Securities compiled and published pursuant to the SVO’s compilation function as described in Section 3 (k) of this Part One. The administrative symbol FE is used with an NAIC 1 through 6 Designation, and in the case of preferred stock, in combination with the P and RP Valuation Indicators.

**PL** stands for a private letter rating and refers to an insurer owned security that has been assigned a private rating by an NAIC CRP which rating is not publicly disseminated in the CRP’s data-feeds but is instead published in a letter provided by the CRP to the issuer of the security and to the insurer as an investor or that has subsequently been obtained by the insurer and submitted to the SVO under the procedures specified in Part Three, Section 1 (b) of this Manual. The administrative symbol PL is assigned to the security by the insurer in conjunction with reporting instructions to identify such securities. The administrative symbol PL is used with an NAIC 1 through 6 Designation, and in the case of preferred stock, in combination with the P and RP Valuation Indicators.

Comment [RC1]: This text modifies an existing definition so it reflects SVO involvement in the production of NAIC Designations for FE securities.

Comment [RC2]: This is a new definition for private letter rated securities. It defines PL securities by reference to the lack of a public rating, for the security and the presence of a private letter. This text also extends the FE rules to PL securities.
Part Two

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.

CRP stands for Credit Rating Provider and refers to the NRSROs on the NAIC Credit Rating Provider List discussed in Part Three, Section 1 (b) of this Manual.

Section 4. Reporting Exemptions

d) Filing Exemption for Public Common Stock

Insurers must report values for all securities on their NAIC Financial Statement Blank including for FE securities as defined in Part Three, Section 1 (b) of this Manual. Refer to Part Five, Section 1 of this Manual for valuation instructions. Documentation requirements for securities filed with the SVO are set forth in Part Two, Sections 10 and Part Two, Section 11. These documentation requirements apply when a security must be filed with the SVO.

Section 5. Special Reporting Instruction

a) NAIC Designations Related to the Special Reporting Instruction

NAIC 5* is assigned by the SVO to certain obligations when an insurer certifies: (1) that documentation necessary to permit a full credit analysis of a security does not exist and (2) the issuer or obligor is current on all contracted interest and principal payments and (3) the insurer has an actual expectation of ultimate payment of all contracted interest and principal. This use of an NAIC 5* Designation is connected with the Special Reporting Instruction contained in Section 5(b) of this Part below.

i) Other Permitted Uses of the Principal and Interest Certification Form and the NAIC 5* and 6* Designations

(viii) PL Securities

For private letter ratings issued on or after January 1, 2018, the NAIC 5* Designation may be used in connection with the designation of PL securities not rated by an NAIC CRP when the documentation necessary for the SVO to assign an NAIC Designation is not available. For purposes of this section a security is considered to be unrated if the NAIC CRP credit rating is not included in the applicable CRP credit rating feed and the insurer is unable to provide a copy of the private letter rating documentation necessary for the SVO to assign an NAIC Designation. Please see Part Three, Section 1 (b) of this Manual for related guidance.

Part Three

Section 1. Corporate Bonds and Preferred Stock

a) Methodology for Independent Credit Quality Assessments

Corporate bonds defined as the Obligations of domestic and foreign corporations, and preferred stock shall be distinguished on the basis of the categories discussed below. The creditworthiness of the issuer of any particular category of Obligation shall be assessed by reference to the general, and any special, rating methodology discussed in this Part, unless the Valuation of Securities (E) Task Force has specified the use of a different methodology in this Manual.
(i) **Independent Assessment**

If the security under consideration is unrated, or if an analyst has conducted an independent analysis of the NAIC CRP rated security, the analyst shall make an independent assessment of the issuer, the security or both.

(b) **Procedure Applicable to Filing Exempt (FE) Securities and to Private Letter (PL) Rating Securities**

(i) **Filing Exemption**

Bonds, [excluding RMBS and CMBS] and Preferred Stock that have been assigned an Eligible NAIC CRP Rating, as described in Part One, Section 4 (c) (B) of this Manual, are exempt from filing with the SVO (FE securities).

(ii) **Identification of FE Securities**

Insurance companies identify FE securities to the NAIC as part of the NAIC’s Financial Statement Blank reporting process. The SVO subsequently collects the securities insurers have identified as FE securities by identifying securities reported using the Administrative Symbol FE when it conducts the quarterly compilation of the SVO List of Securities. SVO then performs the procedures discussed in sub-section (iii) below to produce the most accurate NAIC Designation equivalent for purposes of the NAIC Financial Condition Framework. Please refer to Part One, Section 3 (i) of this Manual for a discussion of the compilation process.

(iii) **Direction and Procedure**

The SVO shall produce NAIC Designations for FE securities by applying the following procedure in conjunction with the List of Credit Rating Providers and the Equivalent of their Credit Ratings to NAIC Designations, shown below.

- A Bond or Preferred Stock that has been assigned an Eligible NAIC CRP Rating will be assigned the equivalent NAIC Designation.
- If two Eligible NAIC CRP Ratings have been assigned, then the lowest credit rating will be used to assign the equivalent NAIC Designation.
- In case of a Bond or Preferred Stock that has been assigned three or more Eligible NAIC CRP Ratings, the Eligible NAIC CRP Ratings for the Bond or Preferred Stock will be ordered according to their NAIC equivalents and the credit rating falling second lowest will be used to determine the equivalent NAIC Designation, even if that rating is equal to that of the first lowest.

The SVO shall not in any manner whatsoever, show, display or disseminate the credit ratings of NRSROs as part of the compilation or publication of the SVO List of Securities in the AVS Plus product or in any other NAIC publication associated with the operations of the Valuation of Securities (E) Task Force.

(iv) **PL Securities**

(A) **For PL securities issued on or before December 31, 2017:**

1) that are either included in the NAIC CRP Rating feeds, or the insurer is not prohibited from providing a copy of the private rating letter to the SVO, the procedure in (B) below shall be applicable; or

2) the private rating letter shall be filed upon request with the insurer’s domiciliary regulator.

(B) **For PL securities issued on or after January 1, 2018:** The SVO shall produce NAIC Designations for securities subject to private letter ratings as follows:

Comment [RC6]: This section collects all of the rules for FE in this new location and extends them to PL. Part Three is where the majority of methodology and procedures for assignment of NAIC Designations reside. The text is best approached as new text because it has been revised to make text formerly in different parts of the P&P into a coherent whole.

Comment [GS7]: There have been questions regarding the applicability/impact of the FE/PL project to 43R securities. The fact that they are excluded here, and that we are not amending any P&P language in Part Seven would imply no impact. We may need to get Eric’s input as to whether he sees any issues that warrant revision as part of this project.

Comment [RC8]: I agree.

Comment [GS9]: To provide for the bifurcated approach discussed on prior VOSTF calls (i.e. grandfathering)

Regarding pre-12/31/2017 PL securities, further discussion is necessary on what the procedure should be.
The insurance company shall file a copy of the private rating letter with the SVO if not included in the applicable NAIC CRP Rating feed(s). In instances where the PL security is included in the applicable NAIC CRP Rating feed(s), the SVO shall follow the procedure in (iii) above.

In instances where a private letter is filed, the SVO shall evaluate the private letter to determine whether the security has been assigned an Eligible NAIC CRP Rating in accordance with Part One, Section 4(c)(ii).

If the SVO verifies that the security has been assigned an Eligible NAIC CRP Rating, it assigns an NAIC Designation in accordance with the policy and procedure specified in sub-paragraphs (i) and (ii) above. The assumption in the application of this step of the procedure is that PL securities are typically assigned a credit rating by only one NAIC CRP. However, if this assumption is inaccurate for any PL security, the SVO applies the same procedure specified for FE securities above.

If the SVO verifies that the security:

- Has been assigned a credit rating but that the credit rating is not an Eligible NAIC CRP Credit Rating; or
- Has not been rated by an NAIC CRP; or
- Is no longer subject to a private letter rating;

SVO shall notify the company that the security is not eligible for filing exemption. The insurance company shall then either file that security and necessary documentation with the SVO for an independent credit assessment per Section 1 (a) of this Part or assign an NAIC 5* Regulatory Designation to the security in the related Interrogatory.

(v) Application of the FE Procedure to Specific Populations

- The filing exemption procedure does not apply to investments required to be filed pursuant to Part Five, Section 2 of this Manual.
- Catastrophe-Linked Bonds are filing exempt provided the credit rating assigned to them by a CRP was derived in a specified manner. Please refer to Part Four, Section 4 of this Manual.

(vi) List of NAIC CRPs

The CRPs that provide Credit Rating Services to the NAIC are:

- Moody's Investor's Service,
- Standard and Poor's,
- Fitch Ratings,
- Dominion Bond Rating Service (DBRS),
- A.M. Best Company (A.M. Best)
- Morningstar Credit Ratings, LLC (for All Structured Finance Securities)
- Kroll Bond Rating Agency and
- Egan Jones Rating Company.
Table of Equivalents of Eligible NAIC CRP Ratings to NAIC Designations

### (A) Moody's Investor's Service

<table>
<thead>
<tr>
<th>Corporate, Government Counterparty and Municipal Ratings</th>
<th>SVO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aaa; Aa 1, 2, 3; A1, 2, 3</td>
<td>1</td>
</tr>
<tr>
<td>Baa 1, 2, 3</td>
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<tr>
<td>Ba 1, 2, 3</td>
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</tr>
<tr>
<td>B1, 2, 3</td>
<td>4</td>
</tr>
<tr>
<td>Caa, 1, 2, 3</td>
<td>5</td>
</tr>
<tr>
<td>Ca, C</td>
<td>6</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Commercial Paper and Short Term Counterparty Ratings</th>
<th>SVO</th>
</tr>
</thead>
<tbody>
<tr>
<td>P 1</td>
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<tr>
<td>P 2</td>
<td>2</td>
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<tr>
<td>P 3</td>
<td>3</td>
</tr>
<tr>
<td>N P (Not prime)</td>
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</table>

<table>
<thead>
<tr>
<th>Preferred Stock</th>
<th>SVO</th>
</tr>
</thead>
<tbody>
<tr>
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<td>1</td>
</tr>
<tr>
<td>Baa 1, 2, 3</td>
<td>2</td>
</tr>
<tr>
<td>Ba 1, 2, 3</td>
<td>3</td>
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<td>B1, 2, 3</td>
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<td>Ca, C</td>
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</table>

### (B) Standard and Poor's

<table>
<thead>
<tr>
<th>Corporate Counterparty and Municipal Ratings -- Public Bonds</th>
<th>SVO</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA, AA+, AA, AA-, A+, A, A-</td>
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</tr>
<tr>
<td>BBB+, BBB, BBB-</td>
<td>2</td>
</tr>
<tr>
<td>BB+, BB, BB-</td>
<td>3</td>
</tr>
<tr>
<td>B+, B, B-</td>
<td>4</td>
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<tr>
<td>CCC+, CCC, CCC-</td>
<td>5</td>
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<tr>
<td>CC, C, D</td>
<td>6</td>
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<table>
<thead>
<tr>
<th>Commercial Paper (Standard &amp; Poor's continued)</th>
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</tr>
</thead>
<tbody>
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<td>A, A 1</td>
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<td>A 3</td>
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<th>Preferred Stock</th>
<th>SVO</th>
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<td>AAA, AA+, AA, AA-, A+, A, A-</td>
<td>1</td>
</tr>
<tr>
<td>BBB+, BBB, BBB-</td>
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</tr>
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<td>BB+, BB, BB-</td>
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<tr>
<td>B+, B, B-</td>
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<tr>
<td>CCC</td>
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<tr>
<td>CC, C, D</td>
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### (C) Fitch Ratings

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<tr>
<th>Fixed Income and Counterparty Ratings</th>
<th>SVO</th>
</tr>
</thead>
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<td>AAApre *</td>
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<tr>
<td>AAA, AA+, AA-, A+, A-</td>
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</tr>
<tr>
<td>BBB+, BBB, BBB-</td>
<td>3</td>
</tr>
<tr>
<td>BB+, BB, BB-</td>
<td>4</td>
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<tr>
<td>CCC</td>
<td>5</td>
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<tr>
<td>CC, C, DDD, DD, D</td>
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</tr>
</tbody>
</table>

* This rating is assigned to pre-refunded municipal debt.

<table>
<thead>
<tr>
<th>Commercial Paper</th>
<th>SVO</th>
</tr>
</thead>
<tbody>
<tr>
<td>F 1+, F 1</td>
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<tr>
<td>F 3</td>
<td>2</td>
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<tr>
<td>B</td>
<td>4</td>
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<tr>
<td>C</td>
<td>5</td>
</tr>
<tr>
<td>D</td>
<td>6</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Preferred Stock</th>
<th>SVO</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA, AA+, AA, AA-, A+, A-</td>
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</tr>
<tr>
<td>BBB+, BBB, BBB-</td>
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</tr>
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<td>BB+, BB, BB-</td>
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<tr>
<td>B+, B, B-</td>
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</tr>
<tr>
<td>CCC</td>
<td>5</td>
</tr>
<tr>
<td>CC, C</td>
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### (D) Dominion Bond Rating Service

<table>
<thead>
<tr>
<th>Bond and Long Term Debt</th>
<th>SVO</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA, AA (high), AA, AA (low), A (high), A, A (low)</td>
<td>1</td>
</tr>
<tr>
<td>BBB (high), BBB, BBB (low)</td>
<td>2</td>
</tr>
<tr>
<td>BB (high), BB, BB (low)</td>
<td>3</td>
</tr>
<tr>
<td>B (high), B, B (low)</td>
<td>4</td>
</tr>
<tr>
<td>CCC (high)</td>
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<tr>
<td>CC, C (low), D</td>
<td>6</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Preferred Stock</th>
<th>SVO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pfd-1 (high), Pfd-1, Pfd 1 (low)</td>
<td>1</td>
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<tr>
<td>Pfd-2 (high), Pfd-2, Pfd-2 (low)</td>
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<tr>
<td>Pfd-3 (high), Pfd-3, Pfd-3 (low)</td>
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<tr>
<td>Pfd-4 (high), Pfd-4, Pfd-4 (low)</td>
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<tr>
<td>Pfd-5 (high), Pfd-5 (low), D</td>
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<table>
<thead>
<tr>
<th>Commercial Paper and Short Term Debt</th>
<th>SVO</th>
</tr>
</thead>
<tbody>
<tr>
<td>R 1 (high), R-1 (middle), R-1 (low)</td>
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<tr>
<td>R 2 (high), R-2 (middle), R-2 (low)</td>
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<td>R-3</td>
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<td>R-4</td>
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<td>R-5, D</td>
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</table>

### (E) A.M. Best Company

<table>
<thead>
<tr>
<th>Bond, Long Term Debt and Preferred</th>
<th>SVO</th>
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<tbody>
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### Valuation of Securities (E) Task Force

<table>
<thead>
<tr>
<th>Rating</th>
<th>Description</th>
<th>NAIC 6</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA, AA+, AA, AA-, A+, A, A-</td>
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<td>BBB+, BBB, BBB-</td>
<td>2</td>
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</tr>
<tr>
<td>BB+, BB, BB-</td>
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<td></td>
</tr>
<tr>
<td>B+, B, B-</td>
<td>4</td>
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<tr>
<td>CCC+, CCC, CCC-</td>
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<tr>
<td>CC, C, D</td>
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#### Commercial Paper and Short Term Debt

<table>
<thead>
<tr>
<th>Rating</th>
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</tr>
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<tbody>
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<td>AMB-1+</td>
<td>AMB-1</td>
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</table>

### (F) Morningstar Credit Ratings, LLC

#### for All Structured Finance Securities

<table>
<thead>
<tr>
<th>Rating</th>
<th>Description</th>
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</tr>
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<tbody>
<tr>
<td>AAA, AA+, AA, AA-, A+, A, A-</td>
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</tr>
<tr>
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<td>2</td>
<td></td>
</tr>
<tr>
<td>BB</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>B</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>CCC, CC, C*</td>
<td>6</td>
<td></td>
</tr>
<tr>
<td>D</td>
<td>6</td>
<td></td>
</tr>
</tbody>
</table>

* Morningstar defines CCC, CC, C as "likely to default" which we here equate to the NAIC 6 definitional concept of a security "in or near default."

Morningstar's D, defined as "in default" is also equated to an NAIC 6.

### (G) Kroll Bond Rating Agency

#### Long-Term Corporate, Counterparty and Municipal Ratings

<table>
<thead>
<tr>
<th>Rating</th>
<th>Description</th>
<th>SVO</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA, AA+, AA, AA-, A+, A, A-</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>BBB+, BBB, BBB-</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>BB+, BB, BB-</td>
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<td></td>
</tr>
<tr>
<td>B+, B, B-</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>CCC+, CCC, CCC-</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td>CC, C, D</td>
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#### Short-Term and Commercial Paper Ratings

<table>
<thead>
<tr>
<th>Rating</th>
<th>Description</th>
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<tbody>
<tr>
<td>K1+, K1</td>
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<td>K2</td>
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<tr>
<td>K3</td>
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</tr>
<tr>
<td>B</td>
<td>4</td>
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<td></td>
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<tr>
<td>D</td>
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</table>

#### Preferred Stock Ratings

<table>
<thead>
<tr>
<th>Rating</th>
<th>Description</th>
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<tbody>
<tr>
<td>AAA, AA+, AA, AA-, A+, A, A-</td>
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<td></td>
</tr>
<tr>
<td>BBB+, BBB, BBB-</td>
<td>2</td>
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<tr>
<td>BB+, BB, BB-</td>
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<tr>
<td>B+, B, B-</td>
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<tr>
<td>CCC+, CCC, CCC-</td>
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### (H) Egan Jones Rating Company

<table>
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<tr>
<th>Corporate Ratings</th>
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<tr>
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<td>BBB+, BBB, BBB-</td>
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</tr>
<tr>
<td>BB+, BB, B-</td>
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</tr>
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<td>B+, B, B-</td>
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</tr>
<tr>
<td>CCC+, CCC, CCC-</td>
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<table>
<thead>
<tr>
<th>Commercial Paper</th>
<th>SVO</th>
</tr>
</thead>
<tbody>
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<td>A3</td>
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<td>D</td>
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<table>
<thead>
<tr>
<th>Preferred Stock</th>
<th>SVO</th>
</tr>
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<tbody>
<tr>
<td>AAA, AA+, AA, AA-, A, A-</td>
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<tr>
<td>B+, B, B-</td>
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</tr>
<tr>
<td>CCC</td>
<td>5</td>
</tr>
<tr>
<td>CC, C, D</td>
<td>6</td>
</tr>
</tbody>
</table>

### (viii) Securities no longer assigned an Eligible NAIC CRP Credit Rating

Any Bond or Preferred Stock that at one time was assigned an Eligible NAIC CRP Credit Rating by an NAIC CRP but is no longer rated must be filed with the SVO within 120 days of the loss of the credit rating, as if the security had never been filing exempt.

### (ix) Limitations on Use of NAIC CRP Ratings

#### (A) NAIC Designation Is Capped To Highest NAIC CRP Rating

The SVO shall not assign an NAIC Designation for a rated security that reflects an opinion of credit quality greater than that indicated by the rating assigned by an NAIC CRP, except as provided in Paragraph (B) below, and except that the SVO may assign the NAIC Designation it deems appropriate to:

1. Municipal bonds and;
2. Military housing bonds or securities as defined in Part Four, Section 5(b) of this Manual.

#### (B) Split Ratings

For filing exempt securities as defined in Part Two, Section 4(d) of this Manual, the NAIC Designation assigned will be the NAIC Designation equivalent that results from the application of the filing exemption process described in Part Two, Section 4(d) of this Manual. This rule will also apply to replication transactions defined in Part Four, Section 2(a) of this Manual and other instances where NAIC CRP ratings are used by the SVO.

#### (C) Unrated Transaction of Issuer with NAIC CRP Rated Debt

When presented with an unrated security of an issuer that has another issue rated by an NAIC CRP, the staff may consider the rated issue and its position in the capital structure of the issuer to arrive at an NAIC Designation for the unrated security, provided that the staff shall first consult with the rating agency and independently consider the terms of the unrated security and its impact on payment risk.
MEMORANDUM

TO: Stewart Guerin, Chair, Valuation of Securities (E) Task Force
    Members of the Valuation of Securities (E) Task Force

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

CC: Charles Therriault, Director, NAIC Securities Valuation Office

DATE: July 5, 2017


1. **Introduction** – On June 22, 2017 the Task Force adopted policy statements in connection with a project to enhance the administration of the filing exempt (FE) process (Attachment One). The Task Force asked the Securities Valuation Office (SVO) to review the policy recommendations and propose amendments to the P&P Manual. To facilitate the review of the proposed amendments, the Task Force also asked the SVO to break out proposed P&P Manual amendments to correspond to the five components in its policy statement. This memorandum focuses on the component of the policy statement adopted by the Task Force reproduced below:

   “Resolving discrepancies between the official NAIC designations and insurer’s computations of the designations. In those instances when an insurer believes that the official NAIC designation is incorrect, we are proposing that the insurer be allowed to report their computed designation with a RE suffix added onto the end of the designation. This RE suffix will flag the discrepancy and cause the company to follow up with the IAO to resolve the conflicting designations. Over time this interaction should materially reduce these types of discrepancies. It is necessary for the TF to establish what are reasonable grounds for the use of this process.”

2. **Discussion** – The following amendments to the P&P Manual are proposed to implement this policy directive. The proposed amendments integrate the FE and PL functions by:

   - Providing for an insurer to report a security with an “RE” suffix in instances where the insurer believes the Investment Analysis Office (IAO)-determined FE designation is incorrect.
   - Providing for a right to request clarification of and an appeal process of SVO determinations.
   - Creating a process to permit an insurer to ask the SVO to reexamine the accuracy of an automated determination for FE or PL securities.

The IAO would be happy to review and discuss the proposals and to take comments and direction from the Task Force.

G:\DATA\Vos-tf\Meetings\2017July\July 14\Task Force 2017 Enhance FE Memo on Resolving Discrepancies.docx
3. **Proposed Amendments to the P&P Manual**

**Part One – Purposes, General Policies and Instructions to the SVO**

**Section 2. Policies Defining the SVO Staff Function**

**g) Review of SVO Credit, Classification or Valuation Decisions**

(i) **Requests for Clarification of SVO Decisions**

Any insurer that owns a security for which the SVO has provided an NAIC Designation, a classification or a valuation, or which is an SCA investment, may request a clarification of the decision from the SVO. The SVO analyst responsible for the decision may respond informally to informal requests for clarification and, in response to written requests, shall provide as much clarification as possible in writing within 10 days after receipt of the written request. Any reply from the SVO shall be a confidential communication between the SVO and the insurer.

Any insurer that owns a FE security including conversion of a PL security, as defined in **Part Three Section 1 (b) of this Manual**, for which the SVO has produced an NAIC Designation under that procedure, may request a clarification of the determination made from the SVO. The SVO may respond informally to informal requests for clarification and, in response to written requests, shall provide as much clarification as possible in writing within 10 days after receipt of the written request. Any reply from the SVO shall be a confidential communication between the SVO and the insurer.

(ii) **Appeals of SVO Analytical Decisions**

(A) **Condition to Filing of an Appeal**

Any insurer that owns a security for which the SVO has performed a credit assessment, a classification analysis or a valuation, a compilation of an FE or PL security, or which is an SCA investment, may appeal the SVO credit assessment, classification or valuation decision, provided that the appeal must be filed within 120 days of the SVO decision. Any insurer can ascertain the date of the original SVO decision by accessing the ISIS Inquiry Service and noting the Review Date shown therein. The Review Date is the date of the original decision.

An appeal is initiated by filing a completed Appeal ATF with a written correspondence specifically and clearly identifying the analytic basis of the appeal, supported by such documents or financial or other information or data as in the insurer’s opinion supports the claim that the original decision of the SVO should be reviewed.

Any insurer that owns an FE security including conversion of a PL security for which the SVO has produced an NAIC Designation may appeal the resulting NAIC Designation on the grounds that the SVO did not follow the procedure prescribed in **Part Three, Section 1 (b) of this Manual**. This right of appeal shall not apply if the difference between the result that would be obtained by application of the procedure prescribed in **Part Three, Section 1 (b)** and the SVO determination is the result of the correction of an error in computing the FE designations produced incorrectly by the automated process or correcting some other NAIC designation anomaly.; provided, that in that case, the insurer shall have a right to an explanation from the SVO with respect to the basis and reason for the correction.

(B) **Procedure for Filing an Appeal**

Filing an appeal with the SVO is accomplished through a computer linkup with the ISIS computer system of the SVO. The following is a summary description of the steps in the filing process. See **Part Two, Section 6 of this Manual** for a more complete description of the filing process.

(1) Link up with ISIS
(2) Login by presenting an appropriate username and password
(3) Go to the Authorization to File (ATF) process
(4) Enter the valid CUSIP/PPN/CINS identifier of the security to be filed
(5) Select the analytical Department involved in the decision
(6) Select an Option for Security Type and the Appeal option under the Filing Type List
(7) Enter the relevant information into the Appeal ATF
(8) Finish and submit the Appeal ATF. Include a letter in support of the appeal.

This appeal procedure applies only to situations where the SVO has expressed an analytical conclusion in the exercise of its credit, classification, valuation functions or its analysis of Subsidiary, Controlled and Affiliated (SCA) investments. The stated procedure encompasses initial filings, annual updates and securities not rated by an NAIC CRP.

Securities rated by an NAIC CRP may be appealed if the security has been submitted to the SVO for the assignment of an NAIC Designation under the procedures specified in Part Three, Section 1 (a) of this Manual instead of the procedures specified under Part Three, Section 1 (b) of this Manual and the appeal is only concerned with the SVO’s determination.

Any insurer that owns an FE security including conversion of a PL security for which the SVO has produced an NAIC Designation may provide the SVO with such information as to NAIC CRP credit ratings that it believes would lead to a different NAIC Designation different from the one the SVO has or would produce if it followed the procedure prescribed in Part Three, Section 1 (b) of this Manual. The SVO shall consider such information.

(iii) SVO Review of the Appeal …

Section 3. Internal Administration

b) Definitions of NAIC Designation Categories, Valuation Indicators, Administrative Symbols and Conventions

(v) SVO Administrative Symbols

SVO administrative symbols convey information about a security or an administrative procedure instead of an opinion of credit quality or Unit Price. The administrative symbols in use by the SVO and their meanings are described below.

(A) SVO analytical department symbols (except for the SVO SCA Companies Group)

All SVO analytical departments except the SVO SCA Companies Group use the following administrative symbols:

RE stands for reporting exception and is assigned to an FE security or a PL security by an insurer to request that the SVO examine the accuracy of the credit ratings it used to produce the NAIC Designation assigned to the security. RE is used to avoid characterization of a security as a reporting exception under the SVO compilation process that may result from the unintentional use of inaccurate information. The RE symbol is used with the FE or PL symbol, as appropriate, and the NAIC Designation the insurer believes is accurate. On completion of its examination the SVO communicates the NAIC Designation to be applied to the security which the insurer then uses. SVO then cancels the RE for that security. Related instructions are discussed in Section 3 (l) (ii) of this Part One.

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, (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 Valuation of Securities Process. The Valuation of Securities Process is used to store NAIC Designations produced by the SVO on the basis of an independent analysis under the analytical methodology in Part Three, Section 1 (a) of this Manual; or such other methodologies or procedures specified in this Manual for the population of securities.

The SVO shall not add a Regulatory Transaction, as defined in Part Three, Section 2 (e) of this Manual, to the VOS Process.
MEMORANDUM

TO: Stewart Guerin, Chair, Valuation of Securities (E) Task Force
   Members of the Valuation of Securities (E) Task Force

FROM: Bob Carcano, Senior Counsel, NAIC Investment Analysis Office (IAO)

CC: Charles Therriault, Director, NAIC Securities Valuation Office (SVO)

DATE: June 29, 2017


1. Introduction – On June 22, the Task Force adopted policy statements in connection with a project to enhance the administration of the filing exempt (FE) process (Attachment One). The Task Force asked the SVO to review the policy recommendations and propose amendments to the P&P Manual. To facilitate the review of the proposed amendments, the Task Force also asked the SVO to break out proposed P&P Manual amendments to correspond to the five components in its policy statement. This memorandum focuses on the component of the policy statement adopted by the Task Force reproduced below:

   “Reviewing the policy of requiring rated securities to be filed with the IAO - Currently, the TF and state regulators have the authority to require a rated security to be filed with the IAO. The TF or state regulators may require the filing of a security with the IAO so that it can better understand its characteristics and enable the IAO to make recommendations to the TF. This current policy should be reviewed for potential changes or enhancements.”

2. Discussion – This memorandum provides information to assist the Task Force in its deliberations on the policy statement noted above.

   a. Authority – The authority of the Task Force to direct insurers to file NAIC credit rating provider (CRP)-rated securities with the SVO is inherent in its charges,¹ which constitute a delegation of authority from the NAIC Financial

¹ The mission of the Valuation of Securities (E) Task Force is to provide regulatory leadership and expertise to establish and maintain all aspects of the NAIC’s credit assessment process for insurer-owned securities … Ongoing Support of NAIC Programs, Products or Services.

   1. The Valuation of Securities (E) Task Force will:
   B. Maintain and revise the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual) to provide solutions to investment-related regulatory issues for existing or anticipated investments.
   C. Monitor changes in accounting and reporting requirements resulting from the continuing maintenance of the Accounting Practices and Procedures Manual (AP&P Manual), as well as financial statement blanks and instructions, to ensure that the P&P Manual continues to reflect regulatory needs and objectives.
   D. Consider whether improvements should be suggested to the measurement, reporting and evaluation of invested assets by the NAIC as the result of:
   1) newly identified types of invested assets; 2) newly identified investment risks within existing invested asset types; or 3) elevated concerns regarding previously identified investment risks.
   H. Coordinate with other NAIC working groups and task forces—including, but not limited to, the Capital Adequacy (E) Task Force, the Investment Risk-Based Capital (E) Working Group, the Statutory Accounting Principles (E) Working Group and the Blanks (E) Working Group—to formulate recommendations and to make referrals to such other NAIC regulator groups to ensure expertise relative to investments, or the purpose and objective of guidance in the P&P Manual, is reflective in the guidance of such other groups and that the expertise of such other NAIC regulatory groups and the objectives of their guidance is reflected in the P&P Manual.
Condition (E) Committee. A reading of the charges suggests that three broad duties are imposed on the Task Force: 1) provide solutions to investment-related regulatory issues for existing or anticipated investments; 2) modify guidance in the P&P Manual so that it is consistent with other existing related NAIC guidance; and 3) share expertise with other NAIC regulatory groups and assist them in the creation of necessary or appropriate regulations related to investments.

b. The P&P Manual – The P&P Manual is the official publication of the Task Force. It contains four sections that express how the Task Force will exercise its broad responsibility to establish and maintain all aspects of the NAIC’s credit assessment process for insurer-owned securities. The decision of the Task Force to use credit ratings to derive some NAIC Designations is reflected in Part One, Section 4. In that section, the Task Force indicates it may specify an alternative to credit ratings for a rated security or for an asset class. That section also specifies that the Task Force can, in its sole and absolute discretion, modify or change in any manner whatsoever how it uses credit ratings. In furtherance of its objectives, Part One, Section 2 (f) provides that the Task Force may, on its own initiative, place a security under regulatory review if it determines after a public hearing that the development of new guidance (whether analytical methodology or regulatory) is necessary. Part One, Section 2 (e) makes clear that the Task Force can lever SVO resources to assist NAIC members and individual states assess investment risk in new securities and financial products. A provision in the FE rule (Part Two, Section 4 (d) (ii)) provides that the SVO has authority to require an insurer to file a filing exempt security to study its provisions and report its findings and recommendations to the Task Force. This is an ill-conceived rule as demonstrated by a decision of the Task Force in 2006 to have the SVO review so-called debt-equity hybrids, which were rated instruments and as such not part of the analytical workload of the SVO. SVO decisions, though analytically sound, lead to significant upheaval in the capital markets. In turn, capital market upheavals caused the Task Force to seek to overturn the analytical determinations of the SVO, which was not permitted by NAIC’s Executive (EX) Committee. The end result of this effort was a congressional hearing. That hearing led to the development of the regulatory review process, an expansion of the regulatory treatment assessment service and other approaches for the Task Force to manage the impact of financial innovation on insurers and on insurance regulation without roiling the capital markets, including for nationally recognized statistical rating organization (NRSRO) rated securities.

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2 NAIC By-Laws; as amended October 2011; ARTICLE VI Standing Committees and Task Forces - 1. General … Specific Duties

3 The standing committees of the NAIC, their duties and responsibilities shall be as follows: … Financial Condition (E) Committee: This standing committee shall consider both administrative and substantive issues as they relate to accounting practices and procedures; blanks; valuation of securities; the Insurance Regulatory Information System (IRIS), as it relates to solvency and profitability; the call, monitoring and concluding report of Zone Examinations; and financial examinations and examiner training. …"

4 The following sections of the P&P Manual are relevant to the objectives of the policy directive under discussion: Part One – Section 2 (e) – SVO Responsibility for Investment Risk Analysis of New Financial Products; Section 2 (f) – Process for Placing Securities Under Regulatory Review; When Analytical Instructions Are Insufficient or Inadequate; Section 4. NAIC Policy on the Use of Credit Ratings of NRSROs and Part Two, Section 4 (d) (i) Filing Exemption for Certain NAIC CRP Rated Securities. See the Appendix to this memorandum for the relevant text.

5 Part One, Section 5 (b) of the P&P Manual.


7 See, 2006 - 4 NAIC Proc.1903 (2006 Winter National Meeting, Dece. 9–12, 2006). The SVO would: 1) post its determinations on publicly traded securities on the NAIC website; 2) permit issuers and broker-dealers to obtain SVO determination of regulatory treatment before a security comes to market; 3) describe SVO classification methodology in research reports; 4) clarify or change the P&P Manual to explain classification; 5) reconstitute the Invested Asset Working Group with a more formal procedure as to its agenda and priority of projects. Report on Transparency of the NAIC Securities Valuation Office, Attachment Two in 2006-4 NAIC Proc.1903; 2007-2 NAIC Proc. 1045, Attachment Eight for the SVO proposal; 2007 – 4 NAIC Proc. 1322 for the motion to adopt amendment to EIV-ARS (Sept. 30, 2007); 2007 – 4 NAIC Proc. 615 conference call held Nov. 29, 2007 (American Council of Life Insurers [ACLI] concerned text suggests intent to limit distribution of SVO’s opinion). “… Mr. Moriarty said … (while the Task Force did not adopt any of the (ACLI or Bermuda Monetary Authority [BMA]) proposals …, he believes the recommendations being made are constructive and are directionally consistent with the proposals made by interested persons — and, he said, they open up the SVO process to entities that had no access previously. The steps also respond to the two key concerns expressed by the House Subcommittee that information be provided to all market participants at the same time and that the NAIC communicate more details on the methodology it uses. Mr. Moriarty noted that the SVO was not created to function like an NRSRO and it does not have the resources to act like a rating organization in terms of the product they create. But the recommendations do address the issues raised … See, 2006-4 NAIC Proc.1903.

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Appendix

P&P Manual Text Relevant to Require Filing of a Rated Security with the SVO

- **Part One – Section 2 (e) – SVO Responsibility for Investment Risk Analysis of New Financial Products** – 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 …

- **Section 2 (f) – Process for Placing Securities Under Regulatory Review** – When Analytical Instructions Are Insufficient or Inadequate (ii) Deliberation – ... The VOS/TF may, on its own initiative place a security under regulatory review as discussed in this section. (iii) Hearing and Declaration – If the VOS/TF … determines that a security should be formally declared to be under regulatory review, it shall hold a public hearing to discuss the issue and make a formal declaration of this decision …

- **Section 4. NAIC Policy on the Use of Credit Ratings of NRSROs** – (ii) Definition – Credit Ratings Eligible for Translation to NAIC Designations … Credit ratings of a NAIC CRP that meet this definition are entitled to a presumption of convertibility to the equivalent NAIC Designation published in the NAIC Credit Rating Provider List, in Section 7 (d) of this Part, except that the presumption of convertibility is subject to the following limitations: … (C) The NAIC may determine that the rated security or investment is of a type that is not eligible to be reported on Schedule D of the NAIC Financial Statement Blank or that the NAIC determines is not appropriate for NRSRO credit ratings to be used to determine the regulatory treatment of a specific asset class. (e) No Waiver/Express Reservation of Authority – Nothing in this Section 4 should be interpreted or construed as a waiver of the authority of the VOS/TF, in its sole and absolute discretion, to modify or change, in any manner whatsoever, the NAIC Policy on the Use of Credit Ratings of NRSROs, including but not limited to: … directing any other action or activity the VOS/TF may deem to be useful or necessary to the creation, maintenance or discharge of state based regulatory policy.

- **Part Two, Section 4 (d) (i) Filing Exemption for Certain NAIC CRP Rated Securities** – (i) SVO Authority to Require Filing of Filing Exempt Securities – The filing exemptions described above do not limit the authority of the SVO to require filings with respect to any security that is otherwise filing exempt at any time for the purpose of reviewing the provisions, terms, covenants or structural features of the security and designating the quality of the security. Upon completion of such review, the SVO is authorized to report its findings and recommendations to the VOS/TF.
MEMORANDUM

TO: Stewart Guerin, Chair, Valuation of Securities (E) Task Force
    Members of the Valuation of Securities (E) Task Force

FROM: Bob Carcano, Senior Counsel, Investment Analysis Office

CC: Charles Therriault, Director, NAIC Securities Valuation Office
    Julie Gann, Senior Manager NAIC, Financial Regulatory Services

DATE: April 26, 2017

RE: Referral from the Statutory Accounting Principles (E) Working Group on a Policy Statement on Staff Interactions

1. Introduction – The Statutory Accounting Principles (E) Working Group advises that it has exposed a proposed policy statement outlining the interaction of Task Force and Working Group staff. The policy statement includes a new clause that requires staff notifications when changes are considered to processes that govern assignment of NAIC Designations.

2. Summary of Referral – The Working Group requests that the Task Force comment on the proposed clause, shown below.

   “SVO staff will notify the VOSTF and SAPWG staff, for purposes of notifying the SAPWG, if securities are placed under regulatory review, or upon consideration of: 1) changes in designation methodology; and/or 2) possible discontinuation of NAIC designations to certain assets. This notification ensures regulator consideration in an open forum and allows assessment of any potential accounting impacts.”

3. Investment Analysis Office (IAO) Observations – The IAO is in general agreement with the intent of the proposed clause but is concerned that the proposed wording does not identify areas of staff interactions. The IAO believes the intent of the proposed clause would be better expressed as shown below but that fulfillment of its intent would flow from other existing NAIC procedures—not staff interactions.

   “IAO and FRS staff shall provide notice to, and consult with, each other when either staff determine that existing technical guidance or procedures administered by the staff are no longer adequate to secure the original regulatory objective for which it was designed. Upon receipt of such notice, both staff will formulate a statement of the issues and if possible, recommendations, and thereafter coordinate discussion between the SAPWG and the VOSTF consistent with the NAIC procedures and policies that apply to the situation.”

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1 The project began as a joint SVO/FRS initiative. The SVO proposal was received and released for a 90-day comment period on Feb. 22, 2016. The proposal was discussed on June 8, on a Task Force conference call in which Dale Bruggeman, Working Group chair, participated. It was agreed between the two chairmen to extend the comment deadline so that industry could provide specific suggested changes to the text and that the Task Force would defer further consideration of its proposal pending the conclusion of the Working Group project, reflecting the expectation of both groups that the policy statements would be nearly identical.
• Staff interactions revolve around ongoing technical and operational issues arising from administration of technical and professional functions assigned to staff. A review of the proposed text elicits the following observations:

  o When an obligation to notify the Task Force exists, the IAO would exercise that obligation directly with the Task Force. Task Force determinations may then suggest discussions with staff to ensure coordination or a referral to the Working Group. But the discussion with the Task Force and its determination on how to proceed must precede the other activity suggested in the first line of the proposed text.

  o An IAO recommendation that the Task Force should impose the “regulatory review” procedure would be privately communicated to the Task Force and would not involve discussion with Financial Regulatory Services (FRS) staff unless and until the Task Force decided how it wished to proceed.

  o Public discussion and adoption of an amendment by the Task Force must precede addition of a new IAO methodology. Prior discussion between NAIC staff is likely as part of staff support operations—but not in the sense of the administration of existing analytical functions. However, existing methodologies are always adjusted to fit specific situations. If an issue arises from this, the insurer can ask for clarification or file an appeal. It is not clear that such situations would normally be the subject of staff discussions.

  o NAIC policies and procedures require notice and an opportunity to be heard before the NAIC adopts regulatory standards. Staff support activities are an inextricable part of those public meetings. Discussion among and between NAIC staff as part of the exercise of existing functions is not directly related to public notice and due process considerations.

• The adoption of a policy level statement on staff interaction would simply acknowledge that NAIC staff functions are highly technical, full-time, ongoing, complex operations, the proper administration of which requires that staff have access to staff expertise beyond its own. The sole objective of the policy statement is to make transparent that such discussions occur as a natural part of NAIC operations and to define their scope and purpose.
To: Stewart Guerin, Chair of the Valuation of Securities (E) Task Force
From: Dale Bruggeman, Chair of the Statutory Accounting Principles (E) Working Group
Re: New Policy Statement
Date: April 19, 2017

The purpose of this memo is to provide notification to the Valuation of Securities (E) Task Force (Task Force) of the proposed new policy statement that was exposed during the 2017 Spring National Meeting by the Statutory Accounting Principles (E) Working Group (Working Group). The intent of this policy statement is to establish guidance that outlines the coordination and collaboration between 1) the Purposes and Procedures Manual of the Investment Analysis Office (P&P Manual) and the Accounting Practices and Procedures Manual (AP&P Manual); 2) the Task Force and Working Group; and 3) the NAIC support staff for the two groups.

Pursuant to the previous discussions and interaction of the groups on this project, coordination and collaboration between the Task Force and the Working Group would be enhanced by articulating and publishing descriptive guidance in the P&P Manual and the AP&P Manual detailing the relationship between the two Manuals and communication expectations between the groups. As previously identified, there is precedence for a coordination statement to be included in the AP&P Manual, and Appendix F currently includes the NAIC Policy Statement on Coordination of the Accounting Practices and Procedures Manual and the Annual Statement Blank.

After considering comments received on the previously-exposed policy statement (exposed Jan. 24, 2017), and discussing with interested party representatives, NAIC staff of the Working Group has proposed inclusion of an additional element within the coordination and communication section. This element incorporates notification of key changes in the process to assess investments for NAIC designations. As identified in the proposed policy statement, this notification would ensure regulator consideration of these changes and allow the Working Group to consider any potential accounting impacts.

With the exposure of the proposed, updated policy statement during the 2017 Spring National Meeting, the Working Group directed notification of the exposure to the Task Force with a request for comment on the noted changes. The Working Group identified that it would be preferred for the policy statements between the Task Force and the Working Group to be consistent, therefore would like to receive input, if possible, from the Task Force prior to the comment period end date of May 19, 2017.

Thank you for considering this referral. Please contact NAIC staff of the Statutory Accounting Principles (E) Working Group if you have any questions.

Cc: Julie Gann/Robin Marcotte/ Fatima Sediqzad/Jake Stultz/Charles A. Therriault/Robert Carcano

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Proposed Policy Statement with Highlighted Revisions for Exposure:


The purpose of this policy statement is to detail the coordination and collaboration between the Securities and Valuation Office (SVO) and the Statutory Accounting Principles (E) Working Group (Working Group) support staff, the relationship between the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual) and Accounting Practices and Procedures Manual (AP&P Manual) and the expectations of the Valuation of Securities (E) Task Force (VOSTF) and the Working Group.

A. NAIC Designations Do Not Communicate Statutory Accounting Or Reporting

The assessment of credit risk for an obligation or asset, as specified in the P&P Manual, is a separate and distinct process from the determination of statutory accounting or reporting under the AP&P Manual. The manner in which an NAIC designation is used within statutory accounting guidance is limited to that, if any, specified in a SSAP and cannot be derived or implied by language in the P&P Manual. Obtaining an NAIC designation does not change an investment's applicable SSAP, annual or quarterly statement reporting schedule, or override other SSAP guidance required for the investment to be an admitted asset. There are limited instances in which a SSAP specifically identifies, within its scope, the inclusion of specific SVO-Identified investments. The SVO review required for an investment to be included on a SVO listing is a separate evaluation process that focuses on the structure of the investment. This process is distinct from the SVO's assessment of an investment's credit risk, which results in a NAIC designation. As stated in the Statutory Hierarchy, Section V of the Preamble, the AP&P Manual is the highest level of authoritative guidance.

B. Sources and Application of Statutory Accounting Guidance

The authority to determine and interpret existing statutory accounting guidance in, or to develop new statutory accounting guidance for, the AP&P Manual, is a charge assigned by the Financial Condition (E) Committee through its Accounting Practices and Procedures (E) Task Force to the Statutory Accounting Principles (E) Working Group. The application of statutory accounting guidance to any specific obligation or asset to determine its status under the AP&P Manual is the obligation of the insurance company and its management. The state of domicile is the final authority with respect to statutory accounting and reporting guidance. Deviations from the authoritative guidance in the Statutory Accounting Hierarchy are reflected as a permitted or prescribed practice.

C. Impact on SVO Operations

Because SVO analytical determinations of credit quality do not convey opinions, conclusions or informational content relative to statutory accounting status, the SVO may assign an NAIC designation to any obligation or asset that is filed by an insurer, provided that its credit quality can be assessed consistently with the polices and methodologies specified in the P&P Manual.

D. Communication and Coordination Between SVO and SAPWG Staff

The following processes are intended to assist optimum communication and coordination between the SVO and SAPWG support staff functions.

- Maintain ongoing dialogue regarding investments, investment related SSAPs and relevant developments in the areas assigned to support staff of both groups.
- Maintain an ongoing dialogue relative to obligations and assets filed with the SVO, including communications about new types of obligations or assets filed with the SVO and their likely treatment under existing investment related SSAPs.
- Maintain an ongoing dialogue relative to new obligations or assets, in which no statutory accounting guidance exists, or uncertainty exists about how current statutory accounting guidance applies to features or characteristics of the obligation or asset.
• SVO staff will notify the VOSTF and SAPWG staff, for purposes of notifying the SAPWG, if securities are placed under regulatory review, or upon consideration of: 1) changes in designation methodology; and/or 2) possible discontinuation of NAIC designations to certain assets. This notification ensures regulator consideration in an open forum and allows assessment of any potential accounting impacts.

• In situations in which NAIC staff (SVO or FRS) is contacted directly with questions on statutory accounting application, it shall be noted that opinions of NAIC staff are not authoritative and are based on the information provided and existing authoritative statutory accounting guidance. Information and issues can be submitted to the SAPWG for consideration, as detailed in the NAIC Policy Statement on Statutory Accounting Principles Maintenance Agenda Process.
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: Appendix F – Policy Statement on Coordination with P&P Manual, SVO and VOSTF

Check (applicable entity):

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<tr>
<th>Modification of existing SSAP</th>
<th>P/C</th>
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<th>Health</th>
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Description of Issue:

Through discussions with the Valuation of Securities (E) Task Force (VOSTF) support staff and review of the Purposes and Procedures Manual of the Investment Analysis Office (P&P Manual) and Accounting Practices and Procedures Manual (AP&P Manual), it was identified that no formal guidance exists outlining the coordination and collaboration between 1) the two manuals; 2) the VOSTF and Statutory Accounting Principles (E) Working Group (Working Group) and 3) the VOSTF and SAPWG support staff.

Coordination and collaboration between the VOSTF and the SAPWG staff would be enhanced by articulating and publishing descriptive guidance in the P&P Manual and the AP&P Manual that details the relationship between the P&P Manual and AP&P Manual and the expectations of the VOSTF and the Working Group. Consistent with these considerations, the VOSTF and SAPWG staff jointly recommend policy level guidance be proposed for inclusion in both the P&P Manual and AP&P Manual. On a Feb. 22 conference call, the VOSTF exposed proposed revisions to the P&P Manual detailing the coordination process. These revisions are included in Appendix A of this agenda item. With respect to the AP&P Manual, staff recommends that a new policy statement be drafted for inclusion in Appendix F—Policy Statements. There is precedence for a coordination statement being included in the AP&P Manual, as Appendix F currently includes the NAIC Policy Statement on Coordination of the Accounting Practices and Procedures Manual and the Annual Statement Blank.

Existing Authoritative Literature: Appendix F—Policy Statements

Activity to Date (issues previously addressed by the SAPWG, Emerging Accounting Issues WG, SEC, FASB, other State Departments of Insurance or other NAIC groups): On a February 22nd conference call, the VOSTF exposed proposed revisions to the P&P Manual detailing the coordination process. These revisions are included in Appendix A of this agenda item.

Information or issues (included in Description of Issue) not previously contemplated by the SAPWG: None

Convergence with International Financial Reporting Standards (IFRS): N/A

Staff Recommendation: Staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose revisions to Appendix F—Policy Statements, as detailed in the “Spring 2016 National Meeting Revisions” section of the agenda item.

Staff Review Completed by: Josh Arpin, NAIC Staff — February 2016

Status:

On April 3, 2016, the Working Group moved the agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to add a new policy statement to Appendix F detailing the coordination between the Working Group and VOSTF and the AP&P Manual and P&P Manual as shown below (Spring National Meeting Exposed Language). For ease of review, the proposed policy statement is not shown with tracked changes. On June 9, 2016, in response to a proposal from the Valuation of Securities (E) Task Force, the Working Group agreed to extend the comment deadline on this agenda item to July 10, 2016, with a request for industry to
provide specific recommendations for revisions to the exposed language. This comment deadline was established to allow for a joint conference call to be held by the Working Group and the Valuation of Securities (E) Task Force to discuss the exposed policy statements and comment letters received by both groups.

**2016 Spring National Meeting Exposed Language**


The purpose of this policy statement is to detail the coordination and collaboration between the Securities and Valuation Office (SVO) and the Statutory Accounting Principles (E) Working Group (Working Group) support staff, the relationship between the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) and *Accounting Practices and Procedures Manual* (AP&P Manual) and the expectations of the Valuation of Securities (E) Task Force (VOSTF) and the Working Group.

**A. NAIC Designations Do Not Communicate Statutory Accounting Status**

The assignment of an NAIC designation to an obligation or asset as detailed within the P&P Manual does not determine the status of that obligation or asset under the AP&P Manual. The assessment of credit risk as specified in the P&P Manual is a separate and distinct process from the determination of the statutory accounting status under the AP&P Manual. The manner in which an NAIC designation is used within statutory accounting guidance is limited to that, if any, specified in a SSAP and cannot be derived or implied by language in the P&P Manual.

**B. Sources and Application of Statutory Accounting Guidance**

The authority to determine and interpret existing statutory accounting guidance in, or to develop new statutory accounting guidance for, the AP&P Manual, is a charge assigned by the Financial Conditions (E) Committee through its Accounting Practices and Procedures (E) Task Force to the Statutory Accounting Principles (E) Working Group. The application of statutory accounting guidance to any specific obligation or asset to determine its status under the AP&P Manual is the obligation of the insurance company and its management.

**C. Impact on SVO Operations**

Because SVO analytical determinations of credit quality do not convey opinions, conclusions or informational content relative to statutory accounting status, the SVO may assign an NAIC designation to any obligation or asset that is filed by an insurer, provided that its credit quality can be assessed consistently with the policies and methodologies specified in the P&P Manual.

**D. Communication and Coordination Between SVO and SAPWG Staff**

The following processes are intended to assist optimum communication and coordination between the SVO and SAPWG support staff functions.

- Maintain ongoing dialogue regarding investments, investment related SSAPs and relevant developments in the areas assigned to support staff of both groups.
- Maintain an ongoing dialogue relative to obligations and assets filed with the SVO, including communications about new type of obligations or assets filed with the SVO and their likely treatment under existing investment related SSAPs.
- If SAPWG staff believes that an obligation or asset filed with the SVO is not within an existing investment SSAP, or uncertainty exists about how statutory accounting guidance applies to features or characteristics of the obligation or asset, the SAPWG staff shall assist the SVO to structure suitable communication to the insurer. The purpose of the communication is solely to alert the filer to the possible existence of a statutory accounting status issue and not to express any opinion on any noted issues. Opinions of NAIC staff have no authority and are based on the information provided and existing NAIC guidance. The state of domicile should be contacted with any specific questions as to the appropriate accounting or reporting, as the insurance
departments decisions are the final authority for statutory accounting and reporting when
guidance is not specific.
- If SVO and/or SAPWG staff observe that a new obligation or asset is of broad interest to insurers,
  but existing statutory accounting guidance does not apply to the obligation or asset, the SVO and
  SAPWG staff shall discuss the matter with the VOSTF and the Working Group to solicit guidance
  and determine whether to pursue formulation of credit and statutory guidance.

**September 2016 Update**
In response to the exposed Policy Statement, interested parties’ requested for the Working Group to reject the
proposed Policy Statement. In addition to comments on specific sections of the Policy Statement, interested
parties’ commented the following:

“In summary, we request that the Working Group reject this proposal. We do not believe that the proposal
is necessary, nor has any substantive problem or issue been identified which warrants its adoption. We
believe the proposed new policy statement weakens the oversight role that regulators must maintain in
order to effectively carry out their responsibilities. We also believe the proposed new policy statement is
in direct contradiction of the NAIC Policy Statement on Maintenance of Statutory Accounting Principles,
which states: “The promulgation of new or revised SAPWG guidance by the NAIC ultimately requires
action of the entire membership” and “Research and drafting of new or substantially revised SSAPs will
be performed by the NAIC staff under the direction and supervision of the SAPWG…” (emphasis added).”

To address the concerns of interested parties, the chair of the Working Group directed NAIC staff to review the
comments provided by interested parties and prepare a revised version of the Policy Statement for consideration
by the Working Group.

**January 2017 Update**
Staff recommends that the following proposed *NAIC Policy Statement on Coordination of the Accounting
Office*, be exposed for public comment. Tracked revisions below represent changes from the April 3, 2016
exposed language.

**NAIC Policy Statement on Coordination of the Accounting Practices and Procedures Manual and the
Purposes and Procedures Manual of the NAIC Investment Analysis Office**

The purpose of this policy statement is to detail the coordination and collaboration between the Securities and
Valuation Office (SVO) and the Statutory Accounting Principles (E) Working Group (Working Group) support staff,
the relationship between the *Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P
of Securities (E) Task Force (VOSTF) and the Working Group.

**A. NAIC Designations Do Not Communicate Statutory Accounting Status**

- The assignment of an NAIC designation to an obligation or asset as detailed within the P&P Manual does not
determine the status of that obligation or asset under the AP&P Manual. The assessment of credit risk **for an
obligation or asset**, as specified in the P&P Manual, is a separate and distinct process from the determination of
the **statutory accounting status** under the AP&P Manual. The manner in which an NAIC designation is used within
statutory accounting guidance is limited to that, if any, specified in a SSAP and cannot be derived or implied by
language in the P&P Manual. **Obtaining an NAIC designation does not change an investment’s applicable SSAP, seasonal or quarterly statement reporting schedule, or override other SSAP guidance required for the investment to be an admitted asset. There are limited instances in which a SSAP specifically identifies, within its scope, the inclusion of specific SVO-Identified investments. The SVO review required for an investment to be included on a SVO listing is a separate evaluation process that focuses on the structure of the investment. This process is distinct from the SVO’s assessment of an investment’s credit risk, which results in a NAIC designation. As stated in the Statutory Hierarchy, Section V of the Preamble, the AP&P Manual is the highest level of authoritative guidance.**
B. Sources and Application of Statutory Accounting Guidance

The authority to determine and interpret existing statutory accounting guidance in, or to develop new statutory accounting guidance for, the AP&P Manual, is a charge assigned by the Financial Condition (E) Committee through its Accounting Practices and Procedures (E) Task Force to the Statutory Accounting Principles (E) Working Group. The application of statutory accounting guidance to any specific obligation or asset to determine its status under the AP&P Manual is the obligation of the insurance company and its management. The state of domicile is the final authority with respect to statutory accounting and reporting guidance. Deviations from the authoritative guidance in the Statutory Accounting Hierarchy are reflected as a permitted or prescribed practice.

C. Impact on SVO Operations

Because SVO analytical determinations of credit quality do not convey opinions, conclusions or informational content relative to statutory accounting status, the SVO may assign an NAIC designation to any obligation or asset that is filed by an insurer, provided that its credit quality can be assessed consistently with the policies and methodologies specified in the P&P Manual.

D. Communication and Coordination Between SVO and SAPWG Staff

The following processes are intended to assist optimum communication and coordination between the SVO and SAPWG support staff functions.

- Maintain ongoing dialogue regarding investments, investment related SSAPs and relevant developments in the areas assigned to support staff of both groups.

- Maintain ongoing dialogue relative to obligations and assets filed with the SVO, including communications about new types of obligations or assets filed with the SVO and their likely treatment under existing investment related SSAPs.

- Maintain ongoing dialogue relative to new obligations or assets, in which no statutory accounting guidance exists, or uncertainty exists about how current statutory accounting guidance applies to features or characteristics of the obligation or asset.

- In situations in which NAIC staff (SVO or FRS) is contacted directly with questions on statutory accounting application, it shall be noted that opinions of NAIC staff are not authoritative and are based on the information provided and existing authoritative statutory accounting guidance. Information and issues can be submitted to the SAPWG for consideration, as detailed in the NAIC Policy Statement on Statutory Accounting Principles Maintenance Agenda Process.

If SAPWG staff believes that an obligation or asset filed with the SVO is not within an existing investment SSAP, or uncertainty exists about how statutory accounting guidance applies to features or characteristics of the obligation or asset, the SAPWG staff shall assist the SVO to structure suitable communication to the insurer. The purpose of the communication is solely to alert the possible existence of a statutory accounting status issue and not to express any opinion on any noted issues. Opinions of NAIC staff have no authority and are based on the information provided and existing NAIC guidance. The state of domicile should be contacted with any specific questions as to the appropriate accounting or reporting, as the insurance departments decisions are the final authority for statutory accounting and reporting when guidance is not specific.

If SVO and/or SAPWG staff observe that a new obligation or asset is of broad interest to insurers, but existing statutory accounting guidance does not apply to the obligation or asset, the SVO and SAPWG staff shall discuss the matter with the VOSTF and the Working Group to solicit guidance and determine whether to pursue formulation of credit and statutory guidance.

On January 24, 2017, the Statutory Accounting Principles (E) Working Group exposed revisions to the proposed policy statement, as illustrated above within the January 2017 Update. Tracked revisions represent changes from the April 3, 2016 exposed language.
Staff recommends that the Working Group expose policy statement with the revisions which are based on interested parties’ comments, as illustrated below. Staff recommends that the VOSTF be notified of the exposure. (It is anticipated that the adopted policy statement would be consistent between the two groups.) Staff believes the proposed policy statement supports enhanced communication / coordination efforts between the SAPWG and VOSTF and would not result with the development of any new or revised SAP guidance without the involvement of the SAPWG.

**Proposed Policy Statement with Highlighted Revisions for Exposure:**


The purpose of this policy statement is to detail the coordination and collaboration between the Securities and Valuation Office (SVO) and the Statutory Accounting Principles (E) Working Group (Working Group) support staff, the relationship between the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual) and Accounting Practices and Procedures Manual (AP&P Manual) and the expectations of the Valuation of Securities (E) Task Force (VOSTF) and the Working Group.

<table>
<thead>
<tr>
<th>A. NAIC Designations Do Not Communicate Statutory Accounting Status Or Reporting</th>
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</table>

The assessment of credit risk for an obligation or asset, as specified in the P&P Manual, is a separate and distinct process from the determination of statutory accounting status or reporting under the AP&P Manual. The manner in which an NAIC designation is used within statutory accounting guidance is limited to that, if any, specified in a SSAP and cannot be derived or implied by language in the P&P Manual. Obtaining an NAIC designation does not change an investment's applicable SSAP, annual or quarterly statement reporting schedule, or override other SSAP guidance required for the investment to be an admitted asset. There are limited instances in which a SSAP specifically identifies, within its scope, the inclusion of specific SVO-Identified investments. The SVO review required for an investment to be included on a SVO listing is a separate evaluation process that focuses on the structure of the investment. This process is distinct from the SVO’s assessment of an investment’s credit risk, which results in a NAIC designation. As stated in the Statutory Hierarchy, Section V of the Preamble, the AP&P Manual is the highest level of authoritative guidance.

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The authority to determine and interpret existing statutory accounting guidance in, or to develop new statutory accounting guidance for, the AP&P Manual, is a charge assigned by the Financial Condition (E) Committee through its Accounting Practices and Procedures (E) Task Force to the Statutory Accounting Principles (E) Working Group. The application of statutory accounting guidance to any specific obligation or asset to determine its status under the AP&P Manual is the obligation of the insurance company and its management. The state of domicile is the final authority with respect to statutory accounting and reporting guidance. Deviations from the authoritative guidance in the Statutory Accounting Hierarchy are reflected as a permitted or prescribed practice.

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<th>C. Impact on SVO Operations</th>
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Because SVO analytical determinations of credit quality do not convey opinions, conclusions or informational content relative to statutory accounting status, the SVO may assign an NAIC designation to any obligation or asset that is filed by an insurer, provided that its credit quality can be assessed consistently with the polices and methodologies specified in the P&P Manual.

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<tr>
<th>D. Communication and Coordination Between SVO and SAPWG Staff</th>
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The following processes are intended to assist optimum communication and coordination between the SVO and SAPWG support staff functions.
- Maintain ongoing dialogue regarding investments, investment related SSAPs and relevant developments in the areas assigned to support staff of both groups.

- Maintain an ongoing dialogue relative to obligations and assets filed with the SVO, including communications about new types of obligations or assets filed with the SVO and their likely treatment under existing investment related SSAPs.

- Maintain an ongoing dialogue relative to new obligations or assets, in which no statutory accounting guidance exists, or uncertainty exists about how current statutory accounting guidance applies to features or characteristics of the obligation or asset.

  * SVO staff will notify the VOSTF and SAPWG staff, for purposes of notifying the SAPWG, if securities are placed under regulatory review, or upon consideration of: 1) changes in designation methodology, and/or 2) possible discontinuation of NAIC designations to certain assets. This notification ensures regulator consideration in an open forum and allows assessment of any potential accounting impacts.

- In situations in which NAIC staff (SVO or FRS) is contacted directly with questions on statutory accounting application, it shall be noted that opinions of NAIC staff are not authoritative and are based on the information provided and existing authoritative statutory accounting guidance. Information and issues can be submitted to the SAPWG for consideration, as detailed in the **NAIC Policy Statement on Statutory Accounting Principles Maintenance Agenda Process**.

On April 8, 2017, the Statutory Accounting Principles (E) Working Group exposed the proposed new policy statement, with revisions from the prior exposure highlighted above in the “Updated Recommendation for Spring 2017 National Meeting Discussion.” With the exposure, the Working Group directed notification of the exposure to the Valuation of Securities (E) Task Force.
June 16, 2017

Stewart Guerin, Chair
NAIC Valuation of Securities (E) Task Force
1100 Walnut Street
Suite 1500
Kansas City, MO 64106-2197

Kevin Fry, Vice Chair
NAIC Valuation of Securities (E) Task Force
1100 Walnut Street
Suite 1500
Kansas City, MO 64016-2197


Dear Messrs. Guerin and Fry:

The American Council of Life Insurers (ACLI)\(^1\) would like to thank the NAIC Valuation of Securities (E) Task Force (VOSTF) for the opportunity to comment and provide input on the following two exposures:

1) Referral from Statutory Accounting Principles (E) Working Group on a Policy Statement on NAIC Staff Interaction
2) Change to Adopted Text of the List of Qualified U.S. Financial Institutions to Clarify Monitoring Instructions

Referral from Statutory Accounting Principles (E) Working Group (SAPWG) on a Policy Statement on NAIC Staff Interaction

ACLI supports the IAO in its agreement with the intent of SAPWG’s additional proposed clause to the policy statement and generally believes that the IAO’s proposed replacement is consistent with that intent. ACLI also believes both proposals have certain elements that articulate key points with better clarity. Therefore, ACLI proposes the following additional sentence (underlined) to the IAO’s proposal to ensure all key elements are appropriately captured.

IAO and FRS staff shall provide notice to, and consult with, each other when either staff determines that existing technical guidance or procedures administered by the staff are no longer adequate to secure the

\(^1\) The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with approximately 290 member companies operating in the United States and abroad. ACLI advocates in state, federal, and international forums for public policy that supports the industry marketplace and the 75 million American families that rely on life insurers’ products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing 94 percent of industry assets, 93 percent of life insurance premiums, and 97 percent of annuity considerations in the United States. Learn more at [www.acli.com](http://www.acli.com)
original regulatory objective for which it was designed. Upon receipt of such notice, both staff will formulate a statement of issues and, if possible, recommendations, and thereafter coordinate discussions between the SAPWG and the VOSTF consistent with the NAIC procedures and policies that apply to the situation. Such proposed recommendations shall be discussed in an open forum, and exposed for comment for a period of time commensurate with the significance of the change, to provide a formal forum for interested parties and regulators to provide input and allow for adequate due process.

The additional changes would provide explicit language that: 1) significantly reduces the risk for unintended consequences; 2) ensures proper communications with all regulators; and 3) provides considerable advance notice to interested parties of future potential critical policy or administrative changes that are critical to operations such as capital planning.

**Change to Adopted Text of the List of Qualified U.S. Financial Institutions to Clarify Monitoring Instructions.**

ACLI supports the proposed changes.

***

Again, thank you for considering our comments. Please do not hesitate to reach out should you have any questions regarding our submission.

Sincerely,

[Signature]

Mike Monahan
Senior Director, Accounting Policy

cc: Charles Therriault, Director, Securities Valuation Office
    Robert Carcano, Senior Counsel, Securities Valuation Office
MEMORANDUM

TO: Stewart Guerin, Chair, Valuation of Securities (E) Task Force
     Members of the Valuation of Securities (E) Task Force

FROM: Bob Carcano, Senior Counsel, Investment Analysis Office

CC: Charles Therriault, Director, NAIC Securities Valuation Office
    Eric Kolehinsky, Director, NAIC Structured Securities Group
    Julie Gann, Senior Manager NAIC, Financial Regulatory Services

DATE: April 25, 2017

RE: Referral from the Statutory Accounting Principles (E) Working Group on Bank Loans

1. Introduction – The Statutory Accounting Principles (E) Working Group advises that it has removed the reference to bank participations; added the term “bank loans acquired through a participation, syndication or assignment”; and adopted definitions for the glossary to Statement of Statutory Accounting Principles (SSAP) No. 26R—Bonds. Industry wants to include bank loans acquired by insurers, as well as loans made directly by insurers that are financial institutions (FI), in SSAP No. 26R.

2. Summary of Referral – The Working Group asks for information on the following issues:
   
   • Would loans acquired from banks and those made directly by an insurer pose different risks to insurers?
   • What reporting consistency issues should be considered if a different reporting format is created for loans made by insurers that are FIs and for insurers that are not FIs?
   • If bank loans are reported as Schedule D items, how would bank loans be distinguishable from non-collateral loans (non-admitted under SSAP 20—Nonadmitted Assets)?
   • Would it be preferable to create a new SSAP for bank, collateral and non-collateral loans?
   • How should an insurer bank loan to a related party be treated under SSAP No. 25—Affiliates and Other Related Parties?

3. Investment Analysis Office (IAO) Observations – The treatment of bank loans is a coordinated project between the Task Force and Working Group:

   • IAO experience with bank loans and the bank loan market supports industry comments about the nature, structure and characteristics of bank loans reflected in the Form A.

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The SVO proposed an amendment to provide methodology, documentation requirements and other instructions for this asset class in a memorandum dated Jan., 25, 2016, titled: Proposed Amendment to the Purposes and Procedures Manual of the NAIC Securities Valuation Office to Define and Identify Documentation Standards, and Provide Credit Assessment Methodology and Criteria for Bank Loans. The proposal was discussed initially during a Feb. 22, 2016, conference call. On June 8, 2016, deferred adoption of the amendment until the Working Group completed its work and referred the document to the Working Group.
• Competitive considerations would likely lead insurers to offer a loan product similar or identical to the product offered by banks.

• Credit assessment methodologies quantify the risk that an obligor will not pay a specific loan to the insurer, whether originated by a bank and acquired by the insurer or made directly by an insurer to an unaffiliated borrower and whether the loan differ from those made by banks.

• IAO credit methodologies would not be useful in assessing operational risk to the insurer as a whole from engaging in lending as a line of business because the IAO does not assess the financial strength of insurers.

• A loan made by an insurer to a related party poses the same concern expressed by the Securities Valuation Office (SVO) in connection with subsidiary, controlled and affiliated (SCA) debt and preferred transactions.

The IAO would be pleased to perform research on the questions addressed by the Working Group to the Task Force.
MEMORANDUM

TO: Stewart Guerin, Chair, Valuation of Securities (E) Task Force
    Members of the Valuation of Securities (E) Task Force

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

CC: Charles Therriault, Director, NAIC Securities Valuation Office
    Eric Kolchinsky, Director, NAIC Structured Securities Group
    Julie Gann, Senior Manager NAIC, Financial Regulatory Services

DATE: May 22, 2017

RE: Technical Aspects of Bank Loans - Referral from the Statutory Accounting Principles (E) Working Group

1. Introduction & Conclusion – The Statutory Accounting Principles (E) Working Group has asked that the Task Force provide its perspective on reporting and statutory accounting issues related to bank loans. This memorandum provides technical information on the subject to assist the Task Force in formulating a response. The Investment Analysis Office (IAO) does not believe that loans acquired by insurers from banks and those made directly by an insurer would pose different credit risks to an insurer’s investment portfolio. Competitive considerations would likely lead insurers to offer a loan product similar to that offered by banks; insurers have experience with loan syndications and the characteristics of loan securities permit insurers to lever their knowledge of debt securities.

   - Loan securities are more likely to be secured while debt securities are frequently unsecured;
   - Loan securities are senior while debt securities are typically subordinated (structurally/contractually);
   - Loan securities can be and are routinely traded. Generally, registered debt securities are transferable while unregistered debt securities may not be freely transferable.
   - Debt securities generally contain few issuer covenants while loan securities usually impose more stringent covenants on the borrower.
   - A loan security typically has a 3 to 7 year term while a debt security on average has a term between 8 to 10 years.

The IAO has no view of the operational risk to an insurer or to the industry of adopting lending as a line of business.

2. Discussion

   The other questions, in summary form, are as follows:
   - Would loans acquired from banks and those made directly by an insurer pose different risks to insurers?
   - What reporting consistency issues should be considered if a different reporting format is created for loans made by insurers that are FIs and for insurers that are not FIs?
   - If bank loans are reported as Schedule D items, how would bank loans be distinguishable from non-collateral loans (non-admitted under Statement of Statutory Accounting Principles (SSAP) 20—Nonadmitted Assets)?
   - Would it be preferable to create a new SSAP for bank, collateral & non-collateral loans;
   - How should an insurer bank loan to a related party be treated under SSAP No. 25—Affiliates and Other Related Parties?
a. **Securities and Loans as Debt** – Debt securities and loan securities share many structural similarities. A debt security is evidence of money loaned and to be repaid. Debt is “traded” by a registered broker-dealer who sells (places) the debt with investors. The investor/holder of a debt security is a creditor, while the issuer is a debtor obligated to repay principal and interest. Loans are also debt. Loan agreements and promissory notes evidence the transfer of money and the obligation to repay principal and stated interest. The lender is the creditor, and the borrower is the debtor obligated to repay principal and interest. There are many different types of debt securities and of loan securities. The proceeds of a debt security or a loan security are used for similar purposes: i.e., to fund acquisitions, provide working capital, to get emergency cash and for general corporate purposes. Loans are frequently issued in combination with debt securities. Loan securities are also freely traded on U.S. and international capital markets.

b. **Loan Types** – Loans are typically made through credit facilities which can provide for different loans. A term loan provides an agreed upon lump sum over a defined time period, (typically between 5 to 8 years) with payment due at or by the end of the term. Amounts borrowed and repaid under a term loan cannot be re-borrowed. Term loans can be designed so the amount is drawn in full on an execution date or drawn at any point in a specified time period and in a specified number of draws after the execution date, called the “availability or commitment period.” Term loans are identified as "A", "B" and "C". Term A loans usually mature within 5 to 6 years and are structured so the borrower repays a low percentage of the principal balance in year one and an increasing percentage in each subsequent year until the maturity date. Term B loans usually mature within 6 to 7 years and are made by investors looking for a long-term total return and willing to hold until the maturity date. Term C loans are generally made by the same type of investors as Term B loans but are less common and typically mature within 7 to 8 years with a bullet repayment due on the maturity date. A revolving credit facility is a commitment to lend a maximum amount of principal to the borrower over an agreed availability period, typically 5 years. Revolving credit loans are generally repaid in one payment at the end of the term of the loan. In some revolving credits, the amount that can be borrowed is the lesser of a specified amount or the amount of a borrowing base comprised of eligible accounts receivable and inventory of the borrower.

c. **Bilateral or Syndicated Facilities** – A bilateral loan is one between a single lender and the borrower. A borrower may have several bilateral facilities, each with a different lender, at the same time and on substantially the same terms and conditions. Bilateral facilities are common in small term loans. A syndicated loan is one between several banks or non-bank financial institutions that agree to lend a proportion of the total amount of money needed by a borrower in separate loans. In a loan syndication, there is always a contract between the borrower and each syndicate member. The syndicated loan market is international and a consistent source of finance for large and medium-sized companies.

d. **Investment Quality Characteristics**

i. **Investment Grade and Leveraged Loans** – Investment grade (IG) loans are those made to entities rated BBB–Baa3 or better. Leveraged loans are those made to speculative grade businesses. Loans from large corporate issuers are called broadly syndicated loans and are usually publicly rated. Loans to issuers having less than $300 million in total syndicated debt are called small and medium-sized enterprise (SME) loans and are usually unrated.

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2 Practical Law, Practice Note – Debt Finance: Debt Securities Versus Syndicated Loans
3 Practical Law, Practice Note – Lending: Overview
4 Practical Law, Practice Note – Acquisition Finance: Overview.
5 Practical Law, Practice Note – Debt Finance: Debt Securities Versus Syndicated Loans
6 Practical Law, Practice Note – Lending: Overview
7 For a history of the development of the syndicated loan market and an assessment of market mechanics and key players, see Blaise Gadanecz, “The syndicated loan market: structure, development and implications,” BIS Quarterly Review, December 2004
9 Practical Law, Practice Note – Lending: Overview
ii. **Secured and Unsecured Loans** – Investment grade loans are usually unsecured. Leveraged loans are typically secured by a *first lien* or a *second lien*. First liens are senior to the borrower’s other capital and secured by a senior claim on assets. A first lien loan is entitled to be paid in full from collateral proceeds before second lien loans can be paid from proceeds of the same collateral.

![Figure 1 - Source: Moody's](image1.png)

iii. **Tenor** – Leveraged loans are typically prepaid and refinanced frequently so that the average life of term loans is around 3.5 years, compared to legal maturities of 5 to 8 years.\(^{12}\) Borrowers also commonly refinance leveraged loans to lower interest rates, or extend or re-price existing loans without exchanging any principal.

**e. Market Trading** – Secondary market trading has increased over the years as a result of improved transparency and liquidity stemming from efforts to standardize loan documents and make loan data and issuers’ ratings more available to investors. However, commentators suggest that loan trading execution is still subject to some technology and system obstacles.\(^ {13}\)

**f. Transferring Loans** – Loans are transferred by assignment or by participation. In an assignment the loan purchaser replaces the original lender in the agreement. In a participation, a new contract is created between the original lender and the loan buyer, but the contract between the borrower and the original lender is not changed.\(^ {14}\) A participant is exposed to the credit and counterparty risk of the lender and to bankruptcy risk.\(^ {15}\) If the borrower files for bankruptcy, the participant is not a recognized creditor. If the lender files for bankruptcy, the participant’s interest in the loan may not be recognized as a true sale (the sale of an undivided interest in the loan with a corresponding perfected security interest in the collateral). The participant can protect against this risk by ensuring the lender’s security interest in the collateral securing the borrower’s loan is perfected. This way, if the participation is not deemed to constitute a true sale, it may be deemed a loan to the lender secured by a pledge of an interest in the loan to the borrower.\(^ {16}\)

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\(^{13}\) See Loan Trading, Online CLE (Handout) – LawLine.com; Julie Globus of Sabharwal, Globus & Lim LLP

\(^{14}\) Practical Law, Practice Note – Assignment and Participation of Loans


To: Stewart Guerin, Chair of the Valuation of Securities (E) Task Force
From: Dale Bruggeman, Chair of the Statutory Accounting Principles (E) Working Group
Re: Bank Loans
Date: April 19, 2017

The purpose of this memo is to request information from the Valuation of Securities (E) Task Force on variations between bank loans directly issued, and those acquired, and whether different risks exist for reporting entities.

During the 2017 Spring National Meeting, the Working Group adopted SSAP No. 26R—Bonds, incorporating substantive revisions to 1) the definition of a bond; 2) non-bond, fixed-income investments captured within scope; and 3) specific accounting guidance for SVO-Identified bond investments (ETFs). With the revisions for non-bond, fixed-income investments captured within scope, the Working Group removed the prior reference for “bank participations” (which was not previously defined) and incorporated “bank loans acquired through a participation, syndication or assignment.” The Working Group also adopted the following SSAP No. 26R glossary terms to reflect previous information received from the Task Force, as well as guidance from U.S. GAAP:

Bank Loan – Fixed-income instruments, representing indebtedness of a borrower, made by a financial institution and acquired by a reporting entity through an assignment, participation or syndication:

- **Assignment** – A bank loan assignment is defined as a fixed-income instrument in which there is the sale and transfer of the rights and obligations of a lender (as assignor) under an existing loan agreement to a new lender (and as assignee) pursuant to an Assignment and Acceptance Agreement (or similar agreement) which effects a novation under contract law, so the new lender becomes the direct creditor of and is in contractual privity with the borrower having the sole right to enforce rights under the loan agreement.

- **Participation** – A bank loan participation is defined as a fixed-income investment in which a single lender makes a large loan to a borrower and subsequently transfers (sells) undivided interests in the loan to other entities. Transfers by the originating lender may take the legal form of either assignments or participations. The transfers are usually on a nonrecourse basis, and the originating lender continues to service the loan. The participating entity may or may not have the right to sell or transfer its participation during the term of the loan, depending on the terms of the participation agreement. Loan Participations can be made on a parri-passu basis (where each participant shares equally) or a senior subordinated basis (senior lenders get paid first and the subordinated participant gets paid if there are sufficient funds left to make a payment).

- **Syndication** – A bank loan syndication is defined as a fixed-income investment in which several lenders share in lending to a single borrower. Each lender loans a specific amount to the borrower and has the right to repayment from the borrower. Separate debt instruments exist between the debtor and the individual creditors participating in the syndication. Each lender in a syndication shall account for the amounts it is owed by the borrower. Repayments by the borrower may be made to a lead lender that then distributes the collections to the other lenders of the syndicate. In those circumstances, the lead lender is simply functioning as a servicer and shall not recognize the aggregate loan as an asset. A loan syndication arrangement may result in multiple loans to the same borrower by different lenders. Each of those loans is considered a separate instrument.

Although the Working Group adopted the substantive revisions, comments were received from interested parties supporting the inclusion of all bank loans in scope of SSAP No. 26R, regardless of whether the bank loan was acquired from a financial institution or directly issued by a reporting entity that qualifies as a financial institution.
These comments indicated that the terms of the underlying bank loan (and associated investor protections) do not depend on who originates that loan or otherwise how that loan is originated, and noting the following key points:

- Legal documents that govern bank loans are sophisticated and include abundant representations and warranties, covenants (including financial reporting covenants) and remedies — all of which provide the appropriate level of investor protection.

- Bank loans generally meet the definition of a security and are very similar to any other bond, including as to transferability.

The comments also identified that the adopted guidance will result in arbitrary and confusing distinctions, noting that a loan directly made by an insurer would not immediately qualify as a bank loan, but if the insurer were to (i) assign a portion of that loan to another financial institution and (ii) re-acquire by assignment from that financial institution all of the insurer’s original holdings, then, the portion that had been assigned (and re-assigned) would get picked up by the definition of a bank loan captured in SSAP No. 26R. Comments further identified that a bank loan directly issued by an insurer, and assigned a portion to other insurers, should all have the same reporting scenario (i.e., if the assigned portion of the bank loan is captured in SSAP No. 26R, the direct portion should also). After considering the comments, the Working Group agreed to adopt SSAP No. 26R, with the exposed definitions, but proceed with a new agenda item (Ref #2017-10) to further consider the comments. The Working Group identified that they would address this issue as a priority item, with the intent to have the agenda item addressed in 2017. This will allow reporting entities to have final guidance before completing their 2017 year-end financial statements.

During the 2017 Spring National Meeting, the Working Group exposed the new agenda item with a request for comments and directed a referral to the Task Force. This referral requests details on variations between bank loans directly issued, and bank loans acquired, and whether different risks exist. The Working Group is interested in information from the Task Force on whether a reporting entity, which also meets the definition of a financial institution, should be permitted to report bank loans issued within scope of SSAP No. 26R (reported on Schedule D-1). Since not all reporting entities meet the definition of a “financial institution,” the Working Group will be considering consistency concerns in the reporting of similar items differently based on the type of entity (financial institution and non-financial institution) and a response from the Task Force on this dynamic would be beneficial.

The exposed agenda item has been included as a supplement to this referral, but the specific regulator inquiries from the agenda item have been duplicated below:

- Is there regulatory concern if “bank loans issued by the reporting entity” were captured as bonds on Schedule D? Specifically, if this change was incorporated, is there concern that all “non-collateral loans” (which are currently nonadmitted under SSAP No. 20), would be permitted as a fixed-income instrument in scope of SSAP No. 26 and reported on Schedule D-1? Although interested parties provided comments distinguishing “bank loans” from “collateral loans,” what distinguishing characteristics would drive the differentiation between a “directly issued bank loan” and a “non-collateral loan?”

- Rather than incorporating “bank loans” (either acquired or directly issued) within scope of SSAP No. 26 and Schedule D, should guidance for “loans” (bank loans, collateral loans and non-collateral loans) be moved to a new SSAP and captured within Schedule BA? If this was preferred by the regulators, referrals could be made to address RBC accordingly, potentially resulting with lower RBC charges for the “bank loans” captured on Schedule BA. Staff notes that “Loans” were previously captured on Schedule C and subsequently moved to Schedule BA when Schedule C was eliminated.

- If there is regulator support for bank loans to be in scope of SSAP No. 26 (acquired and/or directly issued), should additional disclosures and/or reporting lines be captured? For example, should new reporting lines be added to separately identify bank loans, and then identify the bank loans directly issued in comparison to those acquired?
If there is regulator support for bank loans to be in scope of SSAP No. 26 (acquired and/or directly issued), how would this guidance interact with SSAP No. 25 and the existing guidance for loans made to the reporting entity’s parent and to other related parties?

Thank you for considering this referral. Please contact NAIC staff of the Statutory Accounting Principles (E) Working Group if you have any questions.

Cc: Julie Gann/Robin Marcotte/ Fatima Sediqzad/Jake Stultz/Charles A. Therriault/Robert Carcano
Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A

Issue: Bank Loans

Check (applicable entity):

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<thead>
<tr>
<th>Modification of existing SSAP</th>
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<th>Life</th>
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Description of Issue:
This agenda item was drafted in response to action taken during the March 16, 2017 conference call, which recommended that the draft language involving bank loans acquired through a participation, syndication or assignment be retained within the proposed SSAP No. 26—Bonds, with consideration of industry comments which requested to also include “bank loans issued directly by the reporting entity” to occur in a separate agenda item.

Comments received from interested parties support the inclusion of all bank loans, whether acquired from a financial institution or directly issued by the reporting entity, to be in scope of SSAP No. 26—Bonds. These comments indicated that the terms of the underlying bank loan (and associated investor protections) do not depend on who originates that loan or otherwise how that loan is originated, noting the following summary points:

- Legal documents that govern bank loans are sophisticated and include abundant representations and warranties, covenants (including financial reporting covenants) and remedies – all of which provide the appropriate level of investor protection.

- Bank loans generally meet the definition of a security and are very similar to any other bond, including as to transferability.

The interested parties have identified that the language in SSAP No. 26, which references “bank loans acquired through a participation, syndication or assignment” will result in arbitrary and confusing distinctions. They have noted that a loan directly made by an insurer would not immediately qualify as a “bank loan” as the definition is currently proposed to be drafted. However, if the insurer were to (i) assign a portion of that loan to another financial institution and (ii) re-acquire by assignment from that financial institution all of the insurer’s original holdings, then, the portion that had been assigned (and re-assigned) would get picked up by the definition of “bank loan.” The interested parties’ comments also provided comments pertaining to bank loans with regards to admissibility, the definition of a security, similarities to private placement bonds and other bonds, the inclusion on Schedule D (versus Schedule BA) and definitional revisions.

Excerpt from Interested Parties’ Comment Letter Dated March 10, 2017:

1. Bank Loans

In addition to adding the definition of a security, the revised definition of SSAP No. 26R bonds, also includes definitions for specifically identified fixed-income investments, including bank loans (Exhibit A - SSAP No. 26R Glossary). Paragraph 32 of the revised issue paper notes that bank loans acquired through a participation may have restrictions preventing the reporting entity from selling or transferring its participation interest. While the Working Group decided that the right to sell or transfer an investment should not be a criteria to determine whether a bank loan is captured within SSAP No. 26R, paragraph 32 of the exposure requests comments on three issues related to bank loans:

A. Rather than having sell/transfer restrictions impact the SSAP governing the investment, comments are requested on whether the sell/transfer restriction should be identified, with consideration on
whether the restriction should result with the bank loan being non-admitted in the statutory financial statements.

B. Although “bank loans” are currently drafted to be retained in SSAP No. 26, comments are requested on whether these items should be moved into SSAP No. 21 (and reported on BA). If there is support to move these investments to SSAP No. 21, specific accounting guidance (e.g., admittance criteria, NAIC designation for valuation) could be considered for inclusion in SSAP No. 21. A referral could also be forwarded to the Capital Adequacy (E) Task Force to consider appropriate RBC charges.

C. The current guidance for bank loans is specific to bank loans made by a financial institution “acquired” through a participation, syndication or assignment. An inquiry has been made on whether a reporting entity, which qualifies as a financial institution, could make qualifying direct loans and report these investments within scope of SSAP NO. 26. These comments have highlighted that the underlying investment is the same as other bank loans proposed to be in scope, but it is only the method in which the bank loan is obtained (issued directly or acquired) that would be different.

Executive Summary of Interested Parties Comments

Interested parties sincerely appreciate the revisions to SSAP No. 26R and the inclusion of specifically enumerated fixed-income instruments to the definition of bonds. However, we believe certain revisions to the proposed definition of “bank loan” are warranted (see Section IV), for the following reasons:

A. The transferability of an investment should not bear upon whether or not such investment is considered an admitted asset.

B. Bank loans (and other similar loans made by financial institutions) are fixed-income debt instruments that should be reported as bonds in Schedule D. There is no reason to consider them non-admitted assets when, in substance, they are similar to other securities reported as bonds, including private placement bonds. Similarly, we do not believe that they should be moved to SSAP No. 21 as collateral loans or any other statutory accounting standard reported on Schedule BA. Bank loans are substantively identical to bonds reported on Schedule D, in that investors are reliant upon the creditworthiness of the borrower for repayment on the loan and there is a fixed schedule for one or more future payments.

C. Whether a bank loan is originated by a financial institution other than the insurer or by the insurer itself, should be irrelevant. The underlying asset (i.e. the bank loan) is unchanged, regardless of how that asset was ultimately acquired.

Discussion

A. Rather than having the sell / transfer restrictions impact the SSAP governing the investment, comments are requested on whether the restriction should result with the bank loan non-admitted in the statutory financial statements

We believe the transferability of an asset should not have any bearing upon whether or not such asset is admitted (or which SSAP such asset relates to). First and foremost – we note that the various insurance regulations expressly permit investments in loans and a wide variety of other assets. Many of these assets may come with some form of transfer restriction (whether contractual, legal or simply by virtue of market practice or a reduced market). For instance, even relatively liquid corporate bonds issued to the market under Rule 144A are subject to certain transfer restrictions under the Securities Act. Non-admitting an asset that (i) the state regulators have already expressly permitted and (ii) provide portfolio diversification and yield benefits, due to transferability concerns, is unnecessarily punitive to both insurers and policyholders.

Also, to the extent there is concern that bank loans are somehow significantly less liquid than other securities which are permitted on Schedule D, we offer the following discussion:

For purposes of this discussion, we note the nuanced difference between a “bank loan” and a “participation” in a bank loan. If the underlying asset is the bank loan itself – the investor is the lender of record and owns all rights as such, directly, vis-à-vis the borrower and other parties to the loan.
agreement. If the underlying asset is a bank loan participation – the investor has not purchased the actual bank loan; instead, it owns the rights to payments with respect to a bank loan. A participation is a back-to-back relationship; a participant’s counterparty is a lender of record, not the borrower.

With regard to the ability to transfer/sell actual bank loans, Interested parties would like to clarify that bank loans generally do not have significant restrictions to transfer/sale that are greater than those found in similar bond transactions (in particular, private placement notes). Bank loans are generally freely assignable, and the assignment process is fairly standardized. In fact, loan agreements will usually have a “form of assignment and assumption agreement” attached as an exhibit. This form generally tracks the standard form created by the LSTA (the Loan Syndications & Trading Association). Bank loan assignments typically require the consent of (i) the borrower (so long as there’s no event of default) and (ii) the administrative agent (which plays a role comparable to a paying agent/collateral agent in a customary private placement deal), in each case, not to be unreasonably withheld. As with any privately negotiated security, (a) there may be some negotiation as to how much of a consent right the borrower may have over assignments and (b) there will be varying levels of liquidity, depending upon a litany of factors specific to the particular investment (some bank loans will be quite liquid, others not as much – same as with any other “security”). None of the foregoing is viewed by investors as significant barriers to transfer. Further, note that loan agreements usually permit assignments to other lenders in the transaction, affiliates of such lenders and approved funds of such lenders, without the consent of the borrower or the administrative agent.

Participations are slightly different and, admittedly, because of contractual terms and the smaller size of the participation market, participations may be a slightly less liquid instrument. However, as stated above, it is our view that transferability should not be a criterion with respect to determining whether or not an asset is admitted.

B. Although “bank loans” are currently drafted to be retained in SSAP No. 26, comments are requested on whether these items should be moved into SSAP No. 21 (and reported on BA). If there is support to move these investments to SSAP No. 21, specific accounting guidance (e.g., admittance criteria, NAIC designation for valuation) could be considered for inclusion in SSAP No. 21. A referral could also be forwarded to the Capital Adequacy (E) Task Force to consider appropriate RBC charges

Interested parties strongly believe that bank loans should continue to be reported on Schedule D and should fall within the accounting provisions of SSAP No. 26 for bonds. Some of the rationale for this treatment is provided below, as these instruments are fixed income instruments similar to corporate bonds:

1. Security Definition

As a preliminary matter, we note that bank loans may generally meet the criteria to be considered securities as follows:

“Security” means a share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has all of the following characteristics:

(a) It is either represented by an instrument issued in bearer or registered form or, if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer.

(b) It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.

(c) It either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

Clause (a) (Registered) – With respect to clause (a) of the above definition, loan agreements require the administrative agent to keep a register (on behalf of the borrower) of all lenders and loans thereunder, including the name of each lender and the amounts owing to such lender.
Clause (b) (Recognized Instrument) – With respect to clause (b) of the above definition, the instrument pursuant to which a loan is made (whether such instrument is entitled a “loan agreement,” “credit agreement” or otherwise) is commonly recognized in the loan market as a medium for investment. Loan agreements have a common structure (as do note purchase agreements and indentures). For instance, the first sections of the loan agreement will typically be devoted to borrowing mechanics. The middle sections will typically constitute the reps/warranties, covenants and events of defaults. The end sections will typically be the boilerplate sections that address, among other things, (i) assignments, (ii) amendments and (iii) indemnities. As discussed above, with respect to assignments, the “assignment and assumption agreement” is typically a standard form based on the one created by the LSTA.

Clause (c) (Identifiable and Divisible) – CUSIP PPNs may be issued for bank loans. Further note that within any loan agreement, there may be multiple classes of loans. For example, many loan agreements contemplate incremental term loans (which may be the same class as any original term loans, or may be of a different class, with a different identifier). Whether or not any particular loan agreement actually provides for different classes of loans within that agreement, the fact remains the same that loans may be divided into separate classes.

2. **Similarities to Private Placement Bonds and Other Bonds**

In addition to generally meeting the definition of a security, we would also like to emphasize that bank loans are identical to private placement debt and other bonds in terms of underwriting, credit analysis and balance sheet presentation. For any given borrower, a customary bank loan made to such borrower and a customary private placement debt security issued by such borrower will be substantively identical, especially with respect to investor protections and transferability:

(i) **Investor Protection; Covenants; Financial Reporting** – Both bank loans and privately placed debt notes are issued pursuant to sophisticated legal documents, containing reps/warranties, covenants and events of default that provide appropriate levels of investor protection based on the credit quality of the borrower. The absolute same level and type of credit analysis, underwriting and monitoring are involved whether a transaction happens to be structured as a bank loan or a private placement note.

Bank loans are typically issued under loan agreements or credit agreements. Private placement notes are typically issued under note purchase agreements or indentures. Although the boilerplate sections of these documents may differ (in ways that are immaterial to the characteristics of the underlying asset), the substance of the reps/warranties, covenants and events of default are incredibly comparable. Importantly, both sets of debt documents will nearly universally require the borrower to deliver to investors regular financial reporting. Third-party audited financial statements and periodic unaudited financial statements (along with a compliance certificate executed by a financial officer of the borrower) are generally always required. Depending on the credit quality of the borrower, the borrower may also be required to deliver, among other things, periodic projections, budgets and insurance reports.

At the end of the day, both bank loans and private placement notes are issued under legal documents which enable the investor/creditor to (i) monitor the business and financial health of the borrower and (ii) take appropriate remedies if repayment of the underlying investment (whether in the form of a bank loan or a private placement note) may potentially be in jeopardy. Many of the characteristics discussed above are also similar to public bonds, including their legal form, protective features, and issuer financial information available to the public.

(ii) **Transferability** – Please refer to the response provide under item (A) under “Discussion “above for discussion on transferability.

3. **Schedule D vs. Schedule BA**

As stated above, Interested parties strongly believe that the most appropriate place to report bank loans is Schedule D, given their substantive similarities with bonds – namely the fact that (i) bank loans are underwritten the same way as bonds are and (ii) both bonds (whether private or public)
and bank loans have an established market, which provides appropriate liquidity to protect policy holders. Because bank loans, private placement debt, and other bonds are substantively the same, these investments belong together on Schedule D. We suggest that if the goal is to nonetheless differentiate bank loans as a reporting matter, the NAIC could create a separate category or line number(s) within Schedule D.

Further we note that the relocation of bank loans to Schedule BA would water down the current, robust reporting that currently exists for Schedule D investments. There are a multitude of additional reporting elements that exist for Schedule D investments that are not practical for Schedule BA. Schedule BA has a more generic template used for atypical types of investments.

Lastly, we would like to highlight that bank loans can be easily distinguished from “collateral loans”, as defined in SSAP No. 21. For a collateral loan, collateral value and/or cash flows therefrom is the primary means of loan repayment, which is why SSAP No. 21 treats collateral loans as admitted assets only to the extent of the value of underlying investments securing the loan. Bank loans are generally full recourse, and full underwriting is done with respect to the borrower’s credit. As with bonds, bank loan underwriting is based on the cash flow profile of the underlying borrower and not necessarily on the physical collateral securing such bank loan. A typical bank loan (and other loans issued by a financial institution) secured by all assets of a borrower is virtually indistinguishable in substance from a typical corporate bond secured by all the assets of the issuer.

C. **The current exposure limits bank loans to those acquired by participation, syndication or assignment. The issue paper asks whether a bank loan made directly by a reporting entity which qualifies as a financial institution be reported as a SSAP No. 26R bond since the underlying investment is the same as other bank loans proposed to be in scope with the only difference being the method of acquisition**

Interested parties believe it is irrelevant whether a loan is originated by a financial institution other than the insurer or by the insurer itself. Regardless of how an insurer ultimately acquires an interest in a loan (i.e. whether by assignment, participation, syndication, direct origination or otherwise), the nature of the underlying loan investment is unchanged. The terms of the underlying bank loan (and associated investor protections) do not depend on who originates that loan or otherwise how that loan is originated. Tying the SSAP No. 26 definition of “bank loan” to how that loan was ultimately acquired by an insurer will result in arbitrary and confusing distinctions. For instance, a loan directly made by an insurer would not immediately qualify as a “bank loan” as the definition is currently proposed to be drafted. However, if the insurer were to (i) assign a portion of that loan to another financial institution and (ii) re-acquire by assignment from that financial institution all of the insurer's original holdings, then, the portion that had been assigned (and re-assigned) would get picked up by the definition of “bank loan”.

To summarize – we believe the pertinent focus should be on the characteristics of the underlying investment. To that end, as discussed more fulsomely above, all of the following are characteristics of bank loans and generally other loans originated by insurers (regardless of how an insurer ultimately acquires that asset):

- The legal documents that govern bank loans are sophisticated and include fulsome representations and warranties, covenants (including financial reporting covenants) and remedies – all of which provide the appropriate level of investor protection.
- Bank loans generally meet the definition of a security and are very similar to any other bond, including as to transferability.

**Other Items - Proposed Revisions**

The proposed definition of a bank loan in the Exhibit A Glossary as “fixed-income instruments, representing indebtedness of a borrower, made by a financial institution” is precise and conveys market expectations for this type of bond investment. As stated under Section III (C) above, these types of loans
may also be originated by the insurer. To that end, we offer the following suggested changes to the proposed definition of a bank loan to capture other ways in which loans can be acquired by an insurer.

Exhibit A – SSAP No. 26R Glossary (Recommendation) – Shows changes from the proposed language, along with footnoted explanations of the changes.

**Bank Loan** – Fixed-income instruments, representing indebtedness of a borrower, made by a financial institution and pursuant to documented terms. **Bank loans, or other similar loans, can be issued directly by a reporting entity or acquired through an assignment, participation or syndication.**

- **Assignment** – A bank loan assignment is defined as a fixed-income instrument in which there is the sale and transfer of the rights and obligations of a lender (as assignor) under an existing loan agreement to a new lender (and as assignee) pursuant to an Assignment and Acceptance Agreement (or similar agreement) which effects a novation under contract law, so the new lender becomes the direct creditor of and is in contractual privity with the borrower having the sole right to enforce rights under the loan agreement.

- **Participation** – A bank loan participation is defined as a fixed-income investment in which a single lender makes a large loan to a borrower and subsequently transfers (sells) undivided interests in the loan to other entities. Transfers by the originating lender may take the legal form of either assignments or participations. The transfers are usually on a nonrecourse basis, and the originating lender continues to service the loan. The participating entity must not have the right to sell or transfer its participation during the term of the loan, depending on the terms of the participation agreement. Loan participations can be made on a pari-passu basis (where each participant shares equally) or a senior subordinated basis (senior lenders get paid first and the subordinated participant gets paid if there are sufficient funds left to make a payment).

- **Syndication** – A bank loan syndication is defined as a fixed-income investment in which several lenders share in lending to a single borrower. Each lender loans a specific amount to the borrower and has the right to repayment from the borrower. **Separate debt instruments exist between the debtor and the individual creditors participating in the syndication.** Each lender in a syndication shall account for the amounts it is owed by the borrower. Repayments by the borrower may be made to a lead lender or an agent that then distributes the collections to the other lenders of the syndicate. In those circumstances, the lead lender is simply functioning as a servicer and shall not recognize the aggregate loan as an asset. A loan syndication arrangement may result in multiple loans.

**Existing Authoritative Literature:**

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1 IP Note: This sentence is factually inaccurate. There are not separate debt instruments. Even in syndicated deals, there is always just the one debt instrument – i.e. the credit/loan agreement. (Staff Note – This provision comes from U.S. GAAP - 470-50-55-2: Based on the definition of a loan syndication, for purposes of applying the guidance in this Subtopic, separate debt instruments exist between the debtor and the individual creditors participating in the syndication. If an exchange or modification offer is made to all members of the syndicate and only some of the creditors agree to the exchange or modification, the guidance in this Subtopic would be applied to debt instruments held by those creditors that agree to the exchange or modification. Debt instruments held by those creditors that do not agree would not be affected.)

2 IP Note: The agent bank may not necessarily be the lead lender. (Staff Note – Term “lead lender” comes from U.S. GAAP.)

3 IP Note: This sentence is factually inaccurate. Each loan is made pursuant to a single instrument – i.e. the credit/loan agreement. (Staff Note – This provision comes from U.S. GAAP - 470-50-55-2: Based on the definition of a loan syndication, for purposes of applying the guidance in this Subtopic, separate debt instruments exist between the debtor and the individual creditors participating in the syndication. If an exchange or modification offer is made to all members of the syndicate and only some of the creditors agree to the exchange or modification, the guidance in this Subtopic would be applied to debt instruments held by those creditors that agree to the exchange or modification. Debt instruments held by those creditors that do not agree would not be affected.)
SSAP No. 26—Bonds: This SSAP includes “bank participations” within scope as a bond. *(This term is not defined in the SSAP.)* Items within scope of SSAP No. 26 are reported on Schedule D- Part 1, Long-Term Bonds Owned.

Proposed SSAP No. 26R—Bonds: This proposed SSAP includes “bank loans acquired through a participation, syndication, or assignment” as fixed-income instruments included within scope of the Statement. This proposed SSAP includes definitions of these terms pulled from FASB guidance. The definitions previously exposed included a restriction that would not have permitted participations to be in scope of SSAP No. 26 if the reporting entity did not have the right to sell or transfer its participation during the terms of the loan, however, that restriction was removed from the proposed SSAP. Items within scope of SSAP No. 26 are reported on Schedule D-1. Excerpt from proposed SSAP (as of March 21, 2017):

**Bank Loan** – Fixed-income instruments, representing indebtedness of a borrower, made by a financial institution and acquired by a reporting entity through an assignment, participation or syndication:

- **Assignment** – A bank loan assignment is defined as a fixed-income instrument in which there is the sale and transfer of the rights and obligations of a lender (as assignor) under an existing loan agreement to a new lender (and as assignee) pursuant to an Assignment and Acceptance Agreement (or similar agreement) which effects a novation under contract law, so the new lender becomes the direct creditor of and is in contractual privity with the borrower having the sole right to enforce rights under the loan agreement.

- **Participation** – A bank loan participation is defined as a fixed-income investment in which a single lender makes a large loan to a borrower and subsequently transfers (sells) undivided interests in the loan to other entities. Transfers by the originating lender may take the legal form of either assignments or participations. The transfers are usually on a nonrecourse basis, and the originating lender continues to service the loan. The participating entity may or may not have the right to sell or transfer its participation during the term of the loan, depending on the terms of the participation agreement. Loan Participations can be made on a pari-passu basis (where each participant shares equally) or a senior subordinated basis (senior lenders get paid first and the subordinated participant gets paid if there are sufficient funds left to make a payment).

- **Syndication** – A bank loan syndication is defined as a fixed-income investment in which several lenders share in lending to a single borrower. Each lender loans a specific amount to the borrower and has the right to repayment from the borrower. Separate debt instruments exist between the debtor and the individual creditors participating in the syndication. Each lender in a syndication shall account for the amounts it is owed by the borrower. Repayments by the borrower may be made to a lead lender that then distributes the collections to the other lenders of the syndicate. In those circumstances, the lead lender is simply functioning as a servicer and shall not recognize the aggregate loan as an asset. A loan syndication arrangement may result in multiple loans to the same borrower by different lenders. Each of those loans is considered a separate instrument.

SSAP No. 20—Nonadmitted Assets: This SSAP identifies that loans unsecured or secured by assets that do not qualify as investments are nonadmitted. Noncollateral loans are reported on Schedule BA- Other Long-term Invested Assets Owned.

4. Consistent with paragraph 2, the following assets shall be nonadmitted:

   b. **Bills Receivable Not for Premium and Loans Unsecured or Secured by Assets That Do Not Qualify As Investments**—In accordance with SSAP No. 5R, amounts determined to be uncollectible or otherwise impaired shall be written off. Amounts in excess of that written off are not considered to be properly collateralized as there are no underlying assets which would otherwise be admitted assets. Such amounts shall be nonadmitted as they may be of questionable economic value if needed to fulfill policyholder obligations. Receivables arising from working capital finance programs designated by the Securities Valuation Office are subject to the guidance in SSAP No. 105;
SSAP No. 21—Other Admitted Assets: This SSAP provides guidance for collateral loans. It identifies that collateral loans secured by assets that do not qualify as investments shall be nonadmitted. Further, it requires that any amount of the loan outstanding which is in excess of the permitted relationship of fair value of the pledged investment to the collateral shall be treated as a nonadmitted asset. Collateral loans are reported on Schedule BA.

4. Collateral loans are unconditional obligations for the payment of money secured by the pledge of an investment\(^3\) and meet the definition of assets as defined in SSAP No. 4, and are admitted assets to the extent they conform to the requirements of this statement. The outstanding principal balance on the loan and any related accrued interest shall be recorded as an admitted asset subject to the following limitations:

a. Loan Impairment—Determination as to the impairment of a collateral loan shall be based on current information and events. When it is considered probable that any portion of amounts due under the contractual terms of the loan will not be collected the loan is considered impaired. The impairment shall be measured based on the fair value of the collateral less estimated costs to obtain and sell the collateral. The difference between the net value of the collateral and the recorded asset shall be written off in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5R);

b. Nonadmitted Asset—In accordance with SSAP No. 20—Nonadmitted Assets, collateral loans secured by assets that do not qualify as investments shall be nonadmitted. Further, any amount of the loan outstanding which is in excess of the permitted relationship of fair value of the pledged investment to the collateral loan shall be treated as a nonadmitted asset.

SSAP No. 25—Affiliates and Other Related Parties: Although the request from industry did not specifically address related parties, it is assumed that the industry’s request for “bank loans issued directly by the reporting entity” could be issued to related parties. Guidance for related party loans is included in SSAP No. 25 and establishes specific guidance for these transactions. Related party loans are captured on Schedule BA.

Related Party Loans

8. Loans or advances (including debt, public or private) made by a reporting entity to its parent or principal owner shall be admitted if approval for the transaction has been obtained from the domiciliary commissioner and the loan or advance is determined to be collectible based on the parent or principal owner’s independent payment ability. An affiliate’s ability to pay shall be determined after consideration of the liquid assets or revenues available from external sources (i.e., determination shall not include dividend paying ability of the subsidiary making the loan or advance) which are available to repay the balance and/or maintain its account on a current basis. Evaluation of the collectibility of loans or advances shall be made periodically. If, in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5R), it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made.

9. Loans or advances by a reporting entity to all other related parties shall be evaluated by management and nonadmitted if they do not constitute arm’s-length transactions as defined in paragraph 12. Loans or advances made by a reporting entity to related parties (other than its parent or principal owner) that are economic transactions as defined in paragraph 12 shall be admitted. This includes financing arrangements with providers of health care services with whom the reporting entity contracts with from time to time. Such arrangements can include both loans and advances to these providers. Evaluation of the collectibility of loans or advances shall be made periodically. If, in accordance with SSAP No. 5R, it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made.

\(^3\) Investment defined as those assets listed in Section 3 of Appendix A-001: Investments of Reporting Entities.
10. Any advances under capitation arrangements made directly to providers, or to intermediaries that represent providers, that exceed one month’s payment shall be nonadmitted assets.

11. Indirect loans are loans or extensions of credit to any person who is not an affiliate, where the reporting entity makes loans or extensions of credit with the agreement or understanding that the proceeds of the transactions, in whole or in substantial part, are to be used to make loans or extensions of credit to, to purchase assets of, or to make investments in, any affiliate of the reporting entity making the loans or extensions of credit. The admissibility of indirect loans made by a reporting entity for the benefit of its parent or principal owner shall be determined in accordance with the guidelines in paragraph 8. Indirect loans or advances made for the benefit of all other related parties shall be evaluated and accounted for consistent with loans or advances to related parties as described in paragraphs 9 and 10.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): Agenda item 2013-36: Investment Classification Project is considering revisions to SSAP No. 26. These revisions have incorporated definitions to clarify what is in scope of the SSAP. Agenda Item 2017-10 was directed as a separate agenda item from agenda item 2013-36 in order to consider “bank loans issued by the reporting entity” per interested parties’ comments.

Information or issues (included in Description of Issue) not previously contemplated by the Working Group: None.

Staff Recommendation:
As directed from the March 16, 2017 conference call, NAIC staff has drafted a separate agenda item to consider the interested parties’ comments involving bank loans. NAIC staff recommends that the Working Group move this agenda item to the active listing, classified as nonsubstantive, and expose the agenda item seeking additional comments from regulators and interested parties on the discussion elements included. NAIC staff also recommends that the Working Group send a referral to the Valuation of Securities (E) Task Force requesting comments on the interested parties’ positions regarding bank loans directly issued by the reporting entity.

As an initial comment, it would be NAIC SAPWG staff’s preference to ensure that instruments are classified on the correct reporting schedule based on the nature of the instrument, and not incorporate more non-bond items on Schedule D – Part 1. If industry’s request to capture more instruments on Schedule D – Part 1 is driven by the measurement method and/or RBC resulting from that reporting schedule, it would be staff’s preference to develop SSAP guidance and reporting revisions (and recommend RBC changes) to ensure the instrument receives the appropriate accounting and RBC treatment when it is reported on the most appropriate investment schedule.

As specific Regulator Inquiries:

- Is there regulatory concern if “bank loans issued by the reporting entity” were captured as bonds on Schedule D? Specifically, if this change was incorporated, is there concern that all “non-collateral loans” (which are currently nonadmitted under SSAP No. 20), would be permitted as a fixed-income instrument in scope of SSAP No. 26 and reported on Schedule D-1? Although interested parties provided comments distinguishing “bank loans” from “collateral loans,” what distinguishing characteristics would drive the differentiation between a “directly issued bank loan” and a “non-collateral loan?”

- Rather than incorporating “bank loans” (either acquired or directly issued) within scope of SSAP No. 26 and Schedule D, should guidance for “loans” (bank loans, collateral loans and non-collateral loans) be moved to a new SSAP and captured within Schedule BA? If this was preferred by the regulators, referrals could be made to address RBC accordingly, potentially resulting with lower RBC charges for the “bank loans” captured on Schedule BA. Staff notes that “Loans” were previously captured on Schedule C and subsequently moved to Schedule BA when Schedule C was eliminated.
• If there is regulator support for bank loans to be in scope of SSAP No. 26 (acquired and/or directly issued), should additional disclosures and/or reporting lines be captured? For example, should new reporting lines be added to separately identify bank loans, and then identify the bank loans directly issued in comparison to those acquired?

• If there is regulator support for bank loans to be in scope of SSAP No. 26 (acquired and/or directly issued), how would this guidance interact with SSAP No. 25 and the existing guidance for loans made to the reporting entity’s parent and to other related parties?

Staff Review Completed by:
Julie Gann – March 2017

Status:
On April 8, 2017, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, classified as nonsubstantive, and exposed this item seeking comments from regulators and interested parties on bank loans, with particular focus on bank loans directly issued by the reporting entity and whether such bank loans should be captured within scope of SSAP No. 26. The Working Group also directed a referral to the Valuation of Securities (E) Task Force requesting details on the variations between bank loans directly issued, and those acquired, and whether different risks exist, as different risks may warrant different accounting.
June 16, 2017

Stewart Guerin, Chair
NAIC Valuation of Securities (E) Task Force
1100 Walnut Street
Suite 1500
Kansas City, MO 64106-2197

Kevin Fry, Vice Chair
NAIC Valuation of Securities (E) Task Force
1100 Walnut Street
Suite 1500
Kansas City, MO 64016-2197


Dear Messrs. Guerin and Fry:

The American Council of Life Insurers (ACLI)\(^1\) appreciates the opportunity to provide comments on the above-referenced referral from the Statutory Accounting Working Group (SAPWG). ACLI further appreciates the Task Force’s comments supporting industry’s views about the nature, structure and characteristics of bank loans, as well as acknowledging insurers’ needs to offer competitive lending products.

On May 19, the industry Interested Parties (IPs) submitted a new comment letter on this topic to SAPWG, excerpts from which have been included as Appendix A below. As stated in the referral, industry had already provided comments on an exposure draft that SAPWG had originally issued on bank loans, asking for feedback on whether bank loans should be reported on Schedule D and whether they should follow the same accounting as the one for bonds prescribed in SSAP No. 26. In the IPs’ response to that exposure draft, they expressed strong support for bank loans to be reported as bonds on Schedule D. In that comment letter, the IPs also stated that loans issued directly by an insurer should not be treated differently for statutory accounting/reporting purposes than any other fixed income investment, such as corporate bonds, or bank loans issued by a financial institution directly, or acquired through assignment, syndication, or participation.

ACLI is providing high-level responses to the five bullet points in the Task Force’s exposure draft below. The IPs’ comments in the Appendix included below provide further detail to support our position.

\(^1\) The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with approximately 290 member companies operating in the United States and abroad. ACLI advocates in state, federal, and international forums for public policy that supports the industry marketplace and the 75 million American families that rely on life insurers’ products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing 94 percent of industry assets, 93 percent of life insurance premiums, and 97 percent of annuity considerations in the United States. Learn more at www.acli.com
Would loans acquired from banks and those made directly by an insurer pose different risks to insurers?

No. There are no differences in the risks from a bank loan issued directly by the insurer or acquired from another financial institution. The legal documents that support these instruments provide the same level of protection to all investors. In addition, having different accounting rules for loans issued directly by the insurer or acquired from a third party creates significant inconsistencies in accounting and reporting for an instrument that is exactly the same. See further details in question 1 in the Appendix below.

What reporting consistency issues should be considered if a different reporting format is created for loans made by insurers that are FIs and for insurers that are not FIs?

Both ACLI and the IPs believe that all insurance companies are financial institutions. There is no single definition of “financial institution,” but the term generally captures any establishment that conducts financial transactions in the financial markets, such as making loans, making investments or taking deposits. Financial institutions include depository institutions such as banks, contractual institutions such as insurance companies and pension funds, and investment institutions such as investment banks and brokerage firms.

By way of example, we note that certain insurance companies have been designated as “systemically important financial institutions (SIFIs)” by the Financial Stability Oversight Council under the Dodd-Frank Act (it being understood that in order to be a SIFI, an entity must first be a financial institution). Further, the U.S. Bank Secrecy Act very clearly includes insurance companies as covered financial institutions.

If bank loans are reported as Schedule D items, how would bank loans be distinguishable from non-collateral loans (non-admitted under SSAP 20—Nonadmitted Assets)?

See further details on this topic in the IPs’ response to question 1 in the Appendix. As stated in that response, insurers do not originate loans unless they are either secured by collateral, or where repayment of the loan is dependent upon the creditworthiness of the borrower (i.e., recourse to the borrower), similar to any other fixed income investment (e.g., typical bonds).

Would it be preferable to create a new SSAP for bank, collateral and non-collateral loans?

ACLI believes that SSAP No. 26 is the right place for bank loans due to their similarity to bonds and other fixed income instruments, as explained throughout the Appendix below.

How should an insurer bank loan to a related party be treated under SSAP No. 25—Affiliates and Other Related Parties?

ACLI agrees with Interested Parties that any loans between the reporting entity and its parent and/or its subsidiaries would continue to follow the guidance under SSAP No. 25. Under such guidance, such transactions must reflect arms-length terms and not result in a mere inflation of surplus. As long as the insurer has met the requirements for admission for related party transactions stipulated under SSAP No. 25, debt transactions entered into by the insurer with related parties should be accounted for based on the nature of the instrument. For example, if the debt instrument meets the definition of a fixed income instrument under SSAP No. 26, then the instrument should be reported as an affiliated bond on Schedule D.
Again, ACLI appreciates the opportunity to comment on this important matter, and welcomes the Task Force’s feedback on our viewpoints stated herein.

Sincerely,

[Signature]

Mike Monahan
Senior Director, Accounting Policy

cc: Charles Therriault, Director – Securities Valuation Office
    Robert Carcano, Senior Counsel – Securities Valuation Office
Appendix A –

The Portion of the Interested Parties Comment Letter, Submitted to SAPWG May 19, 2017, Relating to Ref# 2017-10: Bank Loans

The Working Group exposed a new item related to bank loans, seeking comments from regulators and Interested Parties, with particular focus on bank loans directly issued (the terms issued and originated are intended to have the same meaning throughout this letter) by the reporting entity and whether such bank loans should be captured within scope of SSAP No. 26. The Working Group also directed a referral to the Valuation of Securities (E) Task Force requesting details on the variations between bank loans directly issued, and those acquired, and whether different risks exist, as that may warrant different accounting.

Key items for discussion included the following:

1. Is there regulatory concern if “bank loans issued by the reporting entity” were captured as bonds on Schedule D? Specifically, if this change was incorporated, is there concern that all “non-collateral loans” (which are currently nonadmitted under SSAP No. 20), would be permitted as a fixed-income instrument in scope of SSAP No. 26 and reported on Schedule D-1? Although Interested Parties provided comments distinguishing “bank loans” from “collateral loans,” what distinguishing characteristics would drive the differentiation between a “directly issued bank loan” and a “non-collateral loan?”

2. Rather than incorporating “bank loans” (either acquired or directly issued) within scope of SSAP No. 26 and Schedule D, should guidance for “loans” (bank loans, collateral loans and non-collateral loans) be moved to a new SSAP and captured within Schedule BA? If this was preferred by the regulators, referrals could be made to address RBC accordingly, potentially resulting with lower RBC charges for the “bank loans” captured on Schedule BA. Staff notes that “Loans” were previously captured on Schedule C and subsequently moved to Schedule BA when Schedule C was eliminated.

3. If there is regulator support for bank loans to be in scope of SSAP No. 26 (acquired and/or directly issued), should additional disclosures and/or reporting lines be captured? For example, should new reporting lines be added to separately identify bank loans, and then identify the bank loans directly issued in comparison to those acquired?

4. If there is regulator support for bank loans to be in scope of SSAP No. 26 (acquired and/or directly issued), how would this guidance interact with SSAP No. 25 and the existing guidance for loans made to the reporting entity’s parent and to other related parties?

Executive Summary

Interested Parties believe that loans issued directly by an insurer should not be treated differently for statutory accounting/reporting purposes than any other fixed income investment, such as corporate bonds, private placement bonds, or bank loans issued by a financial institution directly or acquired through assignment, syndication, or participation. Loans issued by the insurer have the same general characteristics as other fixed income investments and thus they should be treated as such and reported on Schedule D. Throughout this comment letter, we will discuss the various characteristics and compare/contrast directly issued loans to other more common instruments to support our position.

It is important to note that the last updates to SSAP 26 now define bank loans as including those loans issued by a financial institution. Insurers are financial institutions and, as a result, we believe that the
current definition of bank loans includes loans originated by the insurer as well. If it is concluded by the Working Group that bank loans originated by the insurer belong in SSAP 26, as supported by this letter, minor modifications will be required to the current definition of bank loans as the current definition implies that such loans can only be acquired through assignment, participation or syndication. We have provided suggestive wording at the end of this letter so that the definition encompasses direct insurer originations as well.

Interested Parties would like to provide the following feedback on the specific questions detailed in the exposure draft for your consideration:

1. **Is there regulatory concern if “bank loans issued by the reporting entity” were captured as bonds on Schedule D? Specifically, if this change was incorporated, is there concern that all “non-collateral loans” (which are currently nonadmitted under SSAP No. 20), would be permitted as a fixed-income instrument in scope of SSAP No. 26 and reported on Schedule D-1? Although Interested Parties provided comments distinguishing “bank loans” from “collateral loans,” what distinguishing characteristics would drive the differentiation between a “directly issued bank loan” and a “non-collateral loan?”**

As stated in our letter dated March 10, 2017, we believe that it is irrelevant whether a loan is originated by a financial institution other than the insurer or by the insurer itself. Regardless of how an insurer ultimately acquires an interest in a loan (i.e. whether by assignment, participation, syndication, direct origination or otherwise), the nature of the underlying loan investment is the same. Bank loans are fixed-income debt instruments that should be reported as bonds in Schedule D. These loans are in essence private placement bonds. As stated in our previous comment letter, we would like to reiterate that we do not believe that bank loans should be moved to SSAP 21 as collateral loans or any other statutory accounting standard reported on Schedule BA.

In addition, reporting and accounting for loans originated by the insurer outside of SSAP 26 and Schedule D, would create inconsistencies in reporting for the same instrument held by different insurers. For example, assume that an insurer issues a loan to a third party borrower. In order to reduce exposure, the originating insurer may sell some amount of the loan to other insurers and financial institutions and keep a percentage of the original loan. Under newly adopted SSAP 26R, the insurers that purchased a portion of the original loan via assignment, would report these investments as bank loans on Schedule D. However, the insurer that originated the loan, may have to report this investment differently if the rules were different for loans originated by the insurer. This would create a significant inconsistency in reporting for one investment held by multiple insurance companies, which is exactly the same.

In regards to the question on what distinguishing characteristics would drive the differentiation between a directly issued bank loan and a non-collateral loan, we note that the bank loans that we refer to are substantively identical to bonds in that investors are reliant upon the creditworthiness of the borrower for repayment on the loan and there is a fixed schedule for one or more future payments. As with bonds, loan underwriting is based primarily on the cash flow profile and creditworthiness of the underlying borrower as a whole and not necessarily solely on any physical collateral (although creditors under both bonds and loans may require collateral for credit reasons or otherwise). A typical bank loan secured by all or certain assets of a borrower is virtually indistinguishable in substance from a typical corporate bond secured by the same assets of the issuer. These loans are supported by sophisticated legal documents that are viewed by many in industry as meeting the definition of a security. Bank loans have covenants and investor protection provisions substantially identical to those found in corporate bonds. Further, investors, as holders of a debt instrument (whether in the form of a bond or a loan), are senior in payment to a borrower’s equity holders. Although we do not have the background on what specific loans the Accounting Purposes and Procedures Manual is trying to address under SSAP 20, with regard to non-collateral loans, insurers do not originate loans unless they are either secured by collateral or
where repayment of the loan is dependent upon the creditworthiness of the borrower (i.e., recourse to the borrower), similar to any other fixed income investment (e.g., typical bonds).

2. Rather than incorporating “bank loans” (either acquired or directly issued) within scope of SSAP No. 26 and Schedule D, should guidance for “loans” (bank loans, collateral loans and non-collateral loans) be moved to a new SSAP and captured within Schedule BA? If this was preferred by the regulators, referrals could be made to address RBC accordingly, potentially resulting with lower RBC charges for the “bank loans” captured on Schedule BA. Staff notes that “loans” were previously captured on Schedule C and subsequently moved to Schedule BA when Schedule C was eliminated.

As stated on our letter dated March 10, 2017, Interested Parties strongly believe that bank loans should continue to be reported on Schedule D and should fall within the accounting provisions of SSAP 26 for bonds. They are fixed income investments underwritten similar to public bonds and private placements. In addition to the response in question 1, the rationale for this treatment, is as follows:

i. **Security Definition**

Bank loans may generally meet the criteria to be considered securities under SSAP 26R, as follows:

“Security” means a share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has all of the following characteristics:

(a) It is either represented by an instrument issued in bearer or registered form or, if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer.

(b) It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.

(c) It either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

Clause (a) (Registered) – With respect to clause (a) of the above definition, loan agreements require the administrative agent to keep a register (on behalf of the borrower) of all lenders and loans thereunder, including the name of each lender and the amounts owing to such lender.

Clause (b) (Recognized Instrument) – With respect to clause (b) of the above definition, the instrument pursuant to which a loan is made (whether such instrument is titled a “loan agreement,” “credit agreement” or otherwise) is commonly recognized in the loan market as a medium for investment. Loan agreements have a common structure (as do note purchase agreements and indentures). For instance, the first sections of the loan agreement will typically be devoted to borrowing mechanics. The middle sections will typically constitute the reps/warranties, covenants and events of defaults. The end sections will typically be the boilerplate sections that address, among other things, (i) assignments, (ii) amendments and (iii) indemnities.

Clause (c) (Identifiable and Divisible) – CUSIP PPNs may be issued for bank loans. Further note that within any loan agreement, there may be multiple classes of loans. For example, many loan agreements contemplate incremental term loans (which may be the same class as any original term loans, or may be of a different class, with a different identifier). Whether or not any particular loan agreement actually provides for different classes of loans within that agreement, the fact remains the same that loans may be divided into separate classes.
ii. Similarities to Private Placement Bonds and Other Bonds

In addition to generally meeting the definition of a security, we would also like to emphasize that bank loans are identical to private placement debt and other bonds in terms of underwriting, credit analysis and balance sheet presentation. For any given borrower, a customary bank loan made to such borrower and a customary private placement debt security issued by such borrower will be substantively identical, especially with respect to investor protection and transferability:

Investor Protection; Covenants; Financial Reporting – Both bank loans and privately placed debt notes are issued pursuant to sophisticated legal documents, containing reps/warranties, covenants and events of default that provide appropriate levels of investor protection based on the credit quality of the borrower. The same level and type of credit analysis, underwriting and monitoring are involved whether a transaction happens to be structured as a bank loan or a private placement note.

Bank loans are typically issued under loan agreements or credit agreements. Private placement notes are typically issued under note purchase agreements or indentures. Although the boilerplate sections of these documents may differ (in ways that are immaterial to the characteristics of the underlying asset), the substance of the reps/warranties, covenants and events of default are substantially identical. Importantly, both documents will nearly universally require the borrower to deliver to investors regular financial reporting, including third-party audited financial statements and periodic unaudited financial statements (along with a compliance certificate executed by a financial officer of the borrower). The borrower may also be required to deliver, among other things, periodic projections, budgets and insurance reports.

In summary, both bank loans and private placement notes are issued under legal documents which enable the investor/creditor to (i) monitor the business and financial health of the borrower and (ii) take appropriate remedies if repayment of the underlying investment (whether in the form of a bank loan or a private placement note) may potentially be in jeopardy. Many of the bank loan characteristics discussed above are also similar to those of public bonds, including legal form, protective features, and issuer financial reporting.

Transferability – As stated in our previous letter, these loans usually do not have significant transfer restrictions. In addition, there is an established market for bank loans, which provides appropriate liquidity to protect policy holders.

iii. Schedule D vs. Schedule BA

We do not believe that the guidance for bank loans should be moved to a new SSAP. We believe bank loans as fixed income investments underwritten similarly to private placement bonds, should continue to be reported on Schedule D. As stated above, Interested Parties strongly believe that Schedule D is the most appropriate place to report bank loans given their substantive similarities with bonds – namely the fact that (i) bank loans are underwritten the same way as bonds are and (ii) both bonds (whether private or public) and bank loans have an established market, which provides appropriate liquidity to protect policy holders. Because bank loans, private placement debt, and other bonds are substantively the same, these investments belong together on Schedule D.

Further we note that the relocation of bank loans to Schedule BA would water down the current, robust reporting that currently exists for Schedule D investments. There are additional reporting elements for Schedule D investments that are not practical for Schedule BA. Schedule BA has a more generic template used for atypical investments.
3. If there is regulator support for bank loans to be in scope of SSAP No. 26 (acquired and/or directly issued), should additional disclosures and/or reporting lines be captured? For example, should new reporting lines be added to separately identify bank loans, and then identify the bank loans directly issued in comparison to those acquired?

While we do not fully understand the benefits of capturing these loans separately, given the similar risk profile as articulated throughout our letter, if regulators would find it beneficial, Interested parties do not object to adding a new indicator to Schedule D to identify loans directly issued/originated by the insurer.

4. If there is regulator support for bank loans to be in scope of SSAP No. 26 (acquired and/or directly issued), how would this guidance interact with SSAP No. 25 and the existing guidance for loans made to the reporting entity’s parent and to other related parties?

Interested Parties note that any loans between the reporting entity and its parent and/or subsidiaries would continue to follow the guidance under SSAP 25. Under such guidance, such transactions must reflect arms-length terms and not result in a mere inflation of surplus. Determination of whether such transactions are reported on Schedule D or Schedule BA, depends on the nature of the instrument.

**Recommended Bank Loan Definition**

Bank Loan – Fixed-income instruments, representing indebtedness of a borrower, made by a financial institution. Bank loans can be issued directly by a reporting entity or acquired through an assignment, participation or syndication.
MEMORANDUM

TO: Stewart Guerin, Chair, Valuation of Securities (E) Task Force
    Members of the Valuation of Securities (E) Task Force

FROM: Bob Carcano, Senior Counsel, Investment Analysis Office

CC: Charles Therriault, Director, NAIC Securities Valuation Office
    Julie Gann, Senior Manager NAIC, Financial Regulatory Services

DATE: May 30, 2017


1. Introduction – This memorandum combines and re-states two previously exposed memoranda on the subject and includes additional analysis and recommendations.1

2. Report – Viewed collectively, the 5*/6* process is a series of certification procedures developed in response to concerns that initially self-designated securities (Z securities) were not being reported with NAIC Designations assigned by the SVO in subsequent reporting cycles. The first procedure is described in Part Two, Section 5 (f) and Section 5 (g). These permits an insurer to obtain the regulatory treatment associated with NAIC 5 or NAIC 6 for a security (i.e., NAIC 5* or NAIC 6*) if it certifies it cannot provide an Audited Financial Statement to the SVO to permit the production of an analytically determined NAIC Designation (an “AFS Certification”). The text describes how the process is administered. Section 5 (i) “Other Permitted Uses” contains eight other certifications. Two of these are AFS Certifications embedded in analytical instructions identified by the SVO to the Task Force in its second memorandum on the issue. Of the other six certifications, one is proposed for the private letter rating project (not yet adopted) and the other five are associated with specific security types that require credit ratings respond to situations involving the unavailability of an NAIC CRP credit rating (a “CR Certification”).2 The AFS Certification and CR Certifications reflect the policy determination that securities which lack an independent assessment of investment quality should be limited to the two lowest NAIC quality categories if

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1 In a Feb. 22 memorandum, the SVO proposed that the core AFS Certification procedure described in Section 5 (f) and Section 5 (g) be removed from SVO auspices and moved to the Interrogatory. During the Spring National Meeting the SVO recommended the removal of two more AFS Certifications embedded in analytical instructions. This memorandum responds to a request from the Task Force that the SVO consider whether the Section 5 (i) “Other Permitted Uses” of 5* should also be removed to the Interrogatory.

2 “Other Permitted Uses”

Existing Uses
- (ii) RMBS and (iii) CMBS not rated by an NAIC CRP. No NAIC CRP credit rating.
- (iv) Foreign Security issued in country not having an NAIC CRP sovereign rating. No NAIC CRP credit rating.
- (vi) Military Housing Bonds issued on/after Dec. 31, 2009. No NAIC CRP credit rating
- (vii) Catastrophe-Linked Bonds. No NAIC CRP credit rating or prescribed methodology not used.

Proposed Use
- (viii) PL Securities – No NAIC CRP or No Audited Financial Statement.
the insurer could make the required certifications. The AFS and CR Certification only differ in the information that does not permit an independent assessment.

3. **Recommendation and Policy Issue** - The SVO recommends that all current uses of NAIC 5*/6* be transferred to the Interrogatory and instructions necessary to guide the use of the NAIC 5*/6* certification procedures in that context be developed. The P&P Manual should retain the policy determination that these NAIC Designations can be used as part of the AFS and CP Certifications and that it define the nature of the required certification. The concept of a certification, unless otherwise limited, is self-effectuating and would apply to any security for which the insurer did not have a legal right to obtain an Audited Financial Statement from the insurer or for which it could not obtain an NAIC CRP credit rating. If the Task Force wants to limit, as a matter of policy, which securities may and may not use the NAIC 5*/6* and Interrogatory it will need to maintain the existing uses as a starting point and clarify that other uses have to be approved by it. At this time AFS Certifications are only limited by the possible population of insurer purchased investments for which the insurer does not also acquire a right to receive an Audited Financial Statement. The CR Certifications are currently listed but it is not clear what parameters would be used to identify securities otherwise rated by NAIC CRPs for which a specific security is not rated.

4. **Discussion of Proposed Amendments to the P&P Manual**

a. **Section 5 (f) and (g)** (Discussed in the Jan. 9, 2017 memorandum of the SVO to the Task Force)

(i) The proposed amendment would transfer the reporting of the population of securities subject to AFS Certifications from the P&P Manual to the Interrogatory. The P&P Manual would house the policy framework permitting the use of the 5*/6* when Audited Financial Statements could not be obtained by the insurer. Because the AFS Certification in Sections 5 (f) and (g) grew out of concerns with populations of "Z securities"; the removal of the AFS Certifications from the P&P Manual suggest that two of the three current uses of the administrative symbol Z are no longer needed.
   - The Z symbol is used by an insurer to self-designate a security purchased too late during the year to obtain an NAIC Designation from the SVO for year-end reporting. This use should be retained.
   - The insurer uses the Z administrative symbol for the first year but must thereafter obtain an SVO assigned Designation or an NAIC 5* or 6*. Adoption of the amendment means the insurer now obtains the 5* by complying with the instructions associated with the Interrogatory.
   - A Z security filed with all required documents that was not designated by the SVO at year-end (presumably due to resource constraints) could be self-designated by the insurer in the subsequent year. In a separate project, the SVO has proposed that in this situation the SVO be permitted to extend the Designation for such securities into the new year and to assign those securities a priority status for designation in the new year.

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1. Part Two, Filing with the SVO - SECTION 7. WHEN TO USE THE SECURITIES ACQUISITION REPORT (SAR) – A security issued by an entity unaffiliated with the reporting company is reported by creating, completing and submitting the SAR form. The reporting insurance company must submit the SAR to the SVO not later than 120 days after the purchase of the security. Part One, Purposes, General Policies and Instructions to the SVO, Section 3 Internal Administration b Definitions (c) SVO Administrative Symbols – Z means that the NAIC Designation reported by the insurance company was not derived by or obtained from the SVO, but has been determined analytically by a reporting insurance company. A security designated with a Z must be submitted to the SVO for valuation within 120 days of the date the security was acquired. The Z symbol should not be used for securities that are exempt from filing with the SVO pursuant to Part Two, Section 4(d) of this Manual.

2. Part Two, Filing with the SVO Section 5 Special Reporting Instruction b Use of the Administrative Symbol Z – An insurance company may report a security with a "Z" suffix on its Schedule D for up to a year after purchase. For the second year after purchase, and thereafter, the insurance company may not report a security with a "Z" suffix except as noted in Section 5(d) of this Part below. The insurer shall either file the security and appropriate documentation with the SVO to obtain an NAIC Designation, file a Principal and Interest Certification Form to obtain an NAIC 5* Designation or report the security with an NAIC 6* Designation on its Schedule D (collectively, the "5*/6* Rule").

3. Part Two, Filing with the SVO Section 5 Special Reporting Instruction d Exemption from Application of the 5*/6* Rule – The 5*/6* Rule will not be held to apply to a security that has been: (i) Filed in a timely manner after purchase of such security (that is, within 120 days); and (ii) For which a complete filing (including any annual filing that would have been required if the original filing had received an NAIC Designation) is received by the SVO by September 1, if the SVO has not reviewed such security by year-end. For these securities, a "Z" suffix is reported on Schedule D.

4. The concept is first discussed in the memorandum dated January 13, 2015, entitled “Discussion – Improvements to NAIC Systems and Rules Governing Insurer Filing of Securities with the SVO” presented to the Task Force for the 2015 Spring National Meeting. The relevant paragraph is as follows: “The Z symbol and process is intended for use at year-end by an insurer that has filed all necessary documentation within 120 days but not received a reply from the SVO by year-end. The Z symbol could instead be assigned by the SVO as part of its year-end process to identify securities the SVO has received in compliance with the filing policies but has not completed it analysis during the year-end process and which the SVO is committed to complete thereafter and disseminate in its Code 99 process.” After further discussion with the American Council of Life Insurers (ACLI), the Private Placement investors
b. Two Additional AFS Certifications Associated with Analytical Instructions (Discussed in the Feb. 27 memorandum from the SVO to the Task Force) Two additional AFS Certification were identified in analytical instructions and proposed for removal to the Interrogatory:

- Part Three, Section 1 (a) (ii) (B) permits the use of NAIC 5* on the basis of a certification when an insurer can only provide the SVO with unaudited financial statements. The SVO proposes deleting the text from the P&P Manual because unaudited financial statements are not sufficiently reliable for use in assigning an NAIC Designation and therefore trigger the policy expressed in the Interrogatory.

- Part Three, Section 1 (a) (ii) (B) permits the SVO to use the audited financial statement of a parent holding company to designate the quality of an issuing subsidiary without audited financial statements in two circumstances. If neither of these circumstances apply, the SVO is authorized to assign a 5* on the basis of a certification. The lack of an audited financial statement is the precise trigger for the AFS Certifications to be transferred to the Interrogatory.

c. The Section 5 (i) “Other Permitted Uses” of 5*/6* - Section 5 (i) “Other Permitted Uses” contain eight certifications; the two AFS Certifications associated with analytical procedures discussed above; a proposed use for private letter rating securities and five certifications concerned with the unavailability of an NAIC CRP credit rating (a CR Certification). AFS Certifications and CR Certifications reflect the policy of limiting securities that lack an independent investment quality assessment to the two lowest NAIC quality categories. The difference between an AFS and CR Certification is that the missing information differs in one case it is lack of an Audited Financial Statement, and in the other, a CRP credit rating. The SVO recommends that the five (or six, assuming the TF adopts the 5*/6* process for PL securities) also be transferred to the Interrogatory.

d. Other Proposed Amendments Related to the 5*/6* Process - There are other references in the P&P Manual to the 5*/6* process, which we identify below. **All proposed amendments to the P&P Manual are shown in Attachment A.**
Attachment D
Valuation of Securities (E) Task Force
7/14/17

Attachment A - Proposed Amendment to the P&P Manual

Part Two – Filing With the SVO

Section 5. Special Reporting Instruction

a) NAIC Designations Related to the Special Reporting Instruction

NAIC 5* GI is permitted to be assigned by insurance companies to certain obligations that meet all of the following criteria: (1) documentation necessary to permit a full credit analysis of a security by the SVO does not exist or an NAIC CRP credit rating for an FE or PL security is not available; and (2) the issuer or obligor is current on all contracted interest and principal payments; and (3) the insurer has an actual expectation of ultimate payment of all contracted interest and principal.

An insurance company that self-assigns a 5*GI must attest that securities receiving this designation meet all required qualifications by completing the appropriate general interrogatory in the statutory financial statements. If documentation necessary for the SVO to perform a full credit analysis for a security does not exist or if an NAIC CRP credit rating for an FE or PL security is not available, but the issuer is not current on contractual interest and principal payments, and/or if the insurer does not have an actual expectation of ultimate payment of all contracted interest and principal, the insurance company is required to self-assign this security an NAIC 6*.

NAIC 6* is assigned by an insurance company to an obligation in lieu of reporting the obligation with appropriate documentation and in instances in which appropriate documentation does not exist, but the requirements for an insurance company to assign a 5* GI are not met.

Securities with NAIC 5* Designations (including NAIC 5*GI and other 5* coding variations) are deemed to possess the credit characteristics of securities assigned an NAIC 5 Designation. A security assigned an NAIC 5* Designation incurs the regulatory treatment associated with an NAIC 5 Designation.

Securities an insurance company previously assigned as NAIC 5*GI are permitted to subsequently receive this designation if the requirements for an NAIC 5*GI designation continue to be met.

Securities with NAIC 6* Designations are deemed to possess the credit characteristics of securities assigned an NAIC 6 Designation. Therefore, a security assigned an NAIC 6* Designation incurs the regulatory treatment associated with an NAIC 6 Designation.

The asterisk (*) after the quality indicator 5 or 6 distinguishes the NAIC 5* and NAIC 6* Designation from an NAIC 5 or NAIC 6 Designation.

Part Three - Credit Assessment

Section 1. Corporate Bonds and Preferred Stock

(B) Unaudited Financial Statement

Assuming the presence of information sufficient to form a credit opinion, filings accompanied by unaudited financial statements, or those not accompanied by any financial statements, may be analyzed by the SVO, but the SVO’s discretion shall be limited to assigning the transaction the NAIC Designation NAIC 5*, and such Designation shall only be assigned if the SVO has received a signed statement by a qualified officer of the reporting insurance company certifying that the issuer is current on its contractual interest and principal payments. If the SVO has issued an InfoReq letter for the transaction, but the...
reporting insurance company has not submitted information responsive to the InfoReq in time for the SVO to conclude its analysis, a Designation will not appear in the VOS Process. This will obligate the insurance company to report the security in its annual statement with a “Z” suffix for that reporting year. Additionally, the reporting insurance company should correct the deficiency with the SVO as soon as possible. If the transaction is assigned an NAIC Designation, the reporting insurance company shall annually file with the SVO either Audited Financial Statements or an annual certification in the form discussed above. In the absence of such certification, the transaction shall be deleted from the VOS Process. This paragraph shall not apply to foreign securities held by a “Subparagraph D Company,” as defined below.

(E) Parent-Subsidiary Situations

In the case of transactions involving a parent holding company with an Audited Financial Statement and an issuing subsidiary without a separate Audited Financial Statement, the SVO may use the financial statements of the parent holding company as if they were prepared for the issuing subsidiary when the consolidating work papers relating to the issuing subsidiary are provided or when the operations of the parent (i) are limited solely to owning the issuing subsidiary and (ii) the issuing subsidiary constitutes at least 97% of the parent's pre-tax income and assets on a consolidated basis. In cases where neither of these conditions are met, the SVO may assess the transaction, but the SVO's rating discretion shall be limited to assigning the transaction the NAIC 5* Designation, and such Designation shall only be assigned if the SVO has received a signed statement by a qualified officer of the reporting insurance company certifying that the issuer is current on its contracted principal and interest payments. Exceptions must be approved by the SVO Credit Committee.

b. Amendments To Other Text in the P&P Manual – The proposed amendments shown below would delete or modify references to the 5*/6* process in other Sections of the P&P Manual.

Part Three — Credit Assessment

Section 1. Corporate Bonds and Preferred Stock

a) Methodology for Independent Credit Quality Assessments

(ii) Financial Analysis

(D) Foreign Securities

(1) Where a reporting insurance company has filed a foreign security accompanied by an Audited Financial Statement, in English, the SVO will assess the security in accordance with the applicable corporate methodology, but the NAIC Designation it may assign shall be limited by the sovereign rating of the issuer's country of origin. This section should not be read as prohibiting the presentation of transactions structured to eliminate foreign sovereign risk.

(2) For a security issued by a company domiciled in a country with no NAIC CRP sovereign rating, the SVO shall be limited to assigning the security an NAIC 5* Designation and such Designation shall only be assigned if the following conditions are met:

(a) the SVO has received a signed statement by a qualified officer of the reporting insurance company certifying that the issuer is current on its contracted principal and interest payments and

(b) for securities neither issued by nor guaranteed by a foreign sovereign government, the SVO has received:

(i) a copy of the most recent covenant compliance certificate detailing the issuer's compliance with various financial coverage ratios and other terms of the transaction.
(ii) — a signed statement from a qualified officer of the reporting insurance company with regard to the insurer’s expectation as to the issuer’s ability to meet the established financial covenants during the next twelve months and

(iii) — a statement of the insurer or other acceptable evidence, that the governmental entity charged with monetary policy has not and is unlikely to adopt, legislation, rules, regulations or foreign exchange controls that would prohibit the issuer from remitting funds to the insurer to meet the obligations represented by the reported security.

If the insurance company is unable to provide the SVO with the information set forth above, the security should be reported with an NAIC 6* Designation.

(23) The insurance company must file all foreign securities for which the information required by this Manual is available. For those foreign securities held by a “Sub-paragraph D Company” as defined below, …

Section 5. Reporting Certain Schedule BA Assets with Underlying Characteristics of Bonds or Preferred Stock

h) NAIC Designation Categories, Valuation Indicators and Administrative Symbols

(iii) — NAIC Designations Related to Special Reporting Instructions

The NAIC 5* and 6* Designations Related to the Special Reporting Instruction as discussed in Part Two, Section 5(a) of this Manual and the instruction regarding Unit Price of NAIC 6* securities discussed in Part Two, Section 5(h) of this Manual, are fully applicable to Schedule BA assets with the underlying characteristics of a bond or preferred stock.

Part Four

Section 2. Replication (Synthetic Asset) Transaction (RSATs)

k) Procedures for Compilation of the RSAT Index List

(ii) Eligibility Requirements

(C) Components Rated

All, or substantially all, of the Index components are rated, or have obligors that are rated, by an NAIC CRP or have received a current year NAIC Designation from the SVO. In the event that not all of the Index components are NAIC CRP rated or have a current year NAIC Designation, the reporting insurance company may either (1) file the component with the SVO to obtain a Designation pursuant to Part Two, Section 10(c) of this Manual, or (2) assign an NAIC 5* Designation to the unrated instrument, as long as it is current on principal and interest or an NAIC 6* Designation if it is not or if the status is not determinable. Instruments assigned an NAIC 5* Designation or NAIC 6* Designation, on a combined basis, can represent no more than 5% of the Index's total value.

Section 2. Catastrophe-Linked Bonds

a) Catastrophe-Linked Securities

(i) Definition

For the purposes of this Manual, Catastrophe-Linked Bonds are financial instruments that:

(A) Are specifically designed to transfer underwriting risk associated with the occurrence of a natural catastrophic event, such as a hurricane, an earthquake or a flood (a “Catastrophe Event”), from an originating insurer to the reporting insurance company investor and other security holders, and
(B) Are structured so that payment of interest or principal to the reporting insurance company depends on the occurrence of a Catastrophe Event of a defined magnitude or, that causes an aggregate insurance loss in excess of a stipulated amount, and

(C) Are structured so that either all or a portion of the principal invested by the reporting insurance company is at risk.

(ii) Filing Exemption Status

Catastrophe-Linked Bonds are eligible for the filing exemption in Part Two, Section 4 (d) of this Manual, provided that: (1) the transaction has been rated by an NAIC CRP; (2) the NAIC CRP rating will be continuously monitored; and (3) the NAIC CRP’s rating results from application of a methodology that incorporates historical information, as well as stochastic probability models and computer simulations; assesses the potential for loss of interest and/or principal from underwriting risk; and correlates the probability of the occurrence of the Catastrophe Event and the loss associated with the damage caused by such event to the statistical probability of bond default and its severity reflected by the NAIC CRP’s alphanumeric ratings.

(iii) Procedure for Other Catastrophe-Linked Bonds

Catastrophe-Linked Bonds that have not been assigned a credit rating by an NAIC CRP and those that have been assigned a credit rating by an NAIC CRP based on the use of a methodology other than that specified in Section 4 (a) (ii) above are subject to the Special Reporting Instruction in Part Two, Section 5 (i) (vii) of this Manual.

Section 5. Military Housing Bonds

c) Status of Other Military Housing Bonds

(iii) Newly Issued Bonds Not Rated by an NAIC CRP

Military housing bonds or securities issued on or after Dec. 31, 2009, that are not rated by an NAIC CRP shall be filed with the SVO pursuant to the Special Reporting Instruction discussed in Part Two, Section 5 of this Manual. The Special Reporting Instruction limits the analytical discretion of the SVO to assignment of an NAIC 5* or 6* Designation.

Part Seven The NAIC Structured Securities Group

Section 3. Policies Defining The NAIC Structured Securities Group

b) SSG Regulatory Products

(i) NAIC Designations

The SSG is authorized to assign NAIC Designations.

(ii) NAIC 5*/6* Designations

The SSG is authorized to assign NAIC 5*/6* Designations to RMBS and CMBS under the Special Reporting Instruction contained in Part Two, Section 5 of this Manual as part of the administration of the annual surveillance discussed in Section 6 (a) of this Part and as may be subsequently authorized.

Section 6. Analytical Assignments
a) Annual Surveillance of RMBS and CMBS –

Modeled and Non-Modeled Securities - General Instructions

(iv) Analytical Procedures Applicable to Securities Not Subject to Financial Modeling Methodology

(B) Securities Not Modeled by the SSG and Not Rated by an NAIC CRP or Designated by the SVO

Securities subject to SSAP No. 43R—Loan-Backed and Structured Securities that cannot be modeled by the SSG and are not rated by an NAIC CRP or designated by the SVO are either (X) assigned the NAIC administrative symbol NR (not rated), requiring subsequent filing with the SVO, or (Y) assigned the NAIC designation for Special Reporting Instruction; i.e., an NAIC 5* or NAIC 6* (five-star or six-star), as discussed in Part Two, Section 5 of this Manual.

1 This endnote shows the existing text of the Special Reporting Instruction

Part Two

Section 5. Special Reporting Instruction

a) NAIC Designations Related to the Special Reporting Instruction

NAIC 5* is assigned by the SVO to certain obligations when an insurer certifies: (1) that documentation necessary to permit a full credit analysis of a security does not exist and (2) the issuer or obligor is current on all contracted interest and principal payments and (3) the insurer has an actual expectation of ultimate payment of all contracted interest and principal. This use of an NAIC 5* Designation is connected with the Special Reporting Instruction contained in Section 5(b) of this Part below. The NAIC 5* Designation is also assigned to certain securities pursuant to policy decisions adopted by the Valuation of Securities Task Force. Securities with NAIC 5* Designations are deemed to possess the credit characteristics of securities assigned an NAIC 5 Designation. Therefore a security assigned an NAIC 5* Designation should incur the same regulatory treatment associated with an NAIC 5 Designation. The asterisk (*) after the quality indicator 5 distinguishes the NAIC 5* Designation from the NAIC 5 Designation that is only assigned by the SVO after a full credit analysis.

NAIC 6* is assigned by an insurer to an obligation in lieu of reporting the obligation with appropriate documentation to the SVO for a full credit analysis or filing the certification required for obtaining an NAIC 5* Designation. This use of an NAIC 6* Designation is connected with the Special Reporting Instruction contained in Section 5(b) of this Part below. An NAIC 6* Designation is also assigned by the SVO to an obligation that was assigned an NAIC 5* Designation in a given year if no Subsequent Report is received by the SVO. Securities with NAIC 6* Designations are deemed to possess the credit characteristics of securities assigned an NAIC 6 Designation. Therefore a security assigned an NAIC 6* Designation should incur the same regulatory treatment associated with an NAIC 6 Designation. The asterisk (*) after the quality indicator 6 distinguishes the NAIC 6* Designation from an NAIC 6 Designation that is only assigned by the SVO after a full credit analysis.

b) Special Reporting Instruction – Use of the Administrative Symbol Z Schedule D

An insurance company may report a security with a “Z” suffix on its Schedule D for up to a year after purchase. For the second year after purchase, and thereafter, the insurance company may not report a security with a “Z” suffix except as noted in Section 5(d) of this Part below.

The insurer shall either file the security and appropriate documentation with the SVO to obtain an NAIC Designation, file a Principal and Interest Certification Form to obtain an NAIC 5* Designation or report the security with an NAIC 6* Designation on its Schedule D (collectively, the “5*/6* Rule”).

An insurance company that decides to file a Principal and Interest Certification Form for a security, pursuant to the 5*/6* Rule, should do so by October 1.

c) Application of the 5*/6* Rule

Insurers are required to apply the 5*/6* Rule to all Annual Statements beginning with the 1999 Annual Statement. The 5*/6* Rule applies only to securities owned in the prior year. For example, in the 1999 Annual Statement filing, the 5*/6* Rule would have applied to securities that had been listed with a “Z” as of December 31, 1998.
d) Exemption from Application of the 5*/6* Rule

The 5*/6* Rule will not be held to apply to a security that has been:

(i) Filed in a timely manner after purchase of such security (that is, within 120 days), and
(ii) For which a complete filing (including any annual filing that would have been required if the original filing had received an NAIC Designation) is received by the SVO by September 1, if the SVO has not reviewed such security by year-end.

For these securities, a “Z” suffix is reported on Schedule D.

e) Documentation

Insurance companies are instructed to maintain a record of the purchase and filing dates of the securities they file with the SVO.

f) Use of NAIC 5* Designation

An insurer may file a Principal and Interest Certification Form with the SVO when it can certify:

(i) That documentation necessary to permit a full credit analysis of a security does not exist;
(ii) The issuer or obligor is current on all required interest and principal payments; and
(iii) The insurer has an actual expectation of ultimate payment of all required interest and principal.

The SVO may assign the NAIC 5* Designation to corporate, municipal and to structured securities that have never been rated by an NAIC CRP.

The SVO shall assign an NAIC 5* Designation upon a review of a fully completed and executed Principal and Interest Certification Form.

The submission of the Principal and Interest Certification Form does not preclude the SVO from conducting an analytical review of the security. Upon such review, in cases where assigning an NAIC 5* Designation appears inconsistent, the SVO shall apply appropriate analytical procedures to assure an accurate designation.

The SVO is not responsible for assessing the truth or accuracy of the Principal and Interest Certification Forms that are filed by insurers or for monitoring any other aspect of this Special Reporting Instruction.

g) Use of NAIC 6* Designation

An insurer may assign an NAIC 6* Designation to corporate and municipal securities and to structured securities that have never been rated by an NAIC CRP.

The SVO may assign a security an NAIC 6* Designation when the security was assigned an NAIC 5* Designation in a previous year but no Subsequent Report has been received by the SVO.

h) Unit Price of NAIC 6* Securities

An insurer that intends to report a security on its annual or quarterly financial statement (NAIC Financial Statement Blank) with an NAIC 6* Designation and a Unit Price not greater than zero is not obligated to file a Principal and Interest Certification Form for the security with the SVO. An insurer that intends to report a security on its annual or quarterly financial statement (NAIC Financial Statement Blank) with an NAIC 6* Designation and a Unit Price greater than zero shall file a Principal and Interest Certification Form for the security with the SVO.

i) Other Permitted Uses of the Principal and Interest Certification Form and the NAIC 5* and 6* Designations

(i) Corporate Bonds and Preferred Stock with Unaudited Financial Statements

The Principal and Interest Certification Form and the NAIC 5* Designation may be used in connection with the designation of corporate securities with unaudited financial statements as specified in Part Three, Section 1(a)(ii)(B) of this Manual.

(ii) Residential Mortgage Backed Securities (RMBS)

The Principal and Interest Certification Form and the NAIC 5* and 6* Designations may be used in connection with a RMBS that has never been rated by an NAIC CRP as specified in Part Seven, Section 6(a)(iv)(B) of this Manual.
(iii) Commercial Mortgage Backed Securities (CMBS)
   The Principal and Interest Certification Form and the NAIC 5* and 6* Designations may be used in connection with a CMBS that has never been rated by an NAIC CRP as specified in Part Seven, Section 6(a)(iv)(B) of this Manual.

(iv) Foreign Securities of Issuers Domiciled with No NAIC CRP Sovereign Rating
   The Principal and Interest Certification Form and the NAIC 5* and 6* Designations may be used in connection with reporting foreign securities issued in countries that have not been assigned a sovereign rating by an NAIC CRP as specified in Part Three, Section 1(a)(ii)(D)(2) of this Manual.

(v) Parent-Subsidiary Situations
   The Principal and Interest Certification Form and the NAIC 5* and 6* Designations may be used in connection with reporting parent-subsidiary situations as specified in Part Three, Section 1(a)(ii)(E) of this Manual.

(vi) Military Housing Bonds or Securities Issued On or After Dec. 31, 2009 and Not Rated by an NAIC CRP
   The Principal and Interest Certification Form and the NAIC 5* Designation may be used in connection with the designation of military housing bonds or securities that were issued on or after Dec. 31, 2009, and were not rated by an NAIC CRP pursuant to the policy determination expressed in Part Four, Section 5(c) of this Manual.

(vii) Other Catastrophe-Linked Bonds
   The Principal and Interest Certification Form may be used to report a Catastrophe-Linked Bond that has not been assigned a credit rating by an NAIC CRP and those that have been assigned a credit rating by an NAIC CRP on the basis of a methodology other than that specified in Part Four, Section 4(a)(ii) of this Manual.

Catastrophe-Linked Bonds not assigned a credit rating by an NAIC CRP and those assigned a credit rating by an NAIC CRP on the basis of a methodology other than that specified in Part Four, Section 4(a)(ii) of this Manual shall be reported to the SVO and assigned an NAIC 6* Designation by the SVO.
Mike Monahan
Senior Director, Accounting Policy

Tracey Lindsey
President

July 12, 2017

Stewart Guerin, Chair
NAIC Valuation of Securities (E) Task Force
1100 Walnut Street
Suite 1500
Kansas City, MO 64106-2197

Kevin Fry, Vice Chair
NAIC Valuation of Securities (E) Task Force
1100 Walnut Street
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Dear Messrs. Guerin and Fry:

The American Council of Life Insurers (ACLI)\(^1\) and the North American Securities Valuation Association (NASVA)\(^2\) would like to thank the NAIC Valuation of Securities (E) Task Force (VOSTF) for the opportunity to comment and provide input on the Staff (Cumulative) Report on the 5*/6* Process (and incorporated Z designation) and Proposed Amendments to the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual) that was exposed for public comment on June 15, 2017 (30 days). ACLI and NASVA have also responded to these issues that were first exposed for public comment on February 22, 2017 (60 days) with our letter dated April 22, 2017.

The ACLI and NASVA support the recommendation that all current uses of NAIC 5*/6* within the P&P Manual be fully transferred to the General Interrogatory (GI) and instructions necessary to guide the use of the NAIC 5*/6* certification procedures in that context be developed. This would more formally eliminate the administrative burden for insurance companies to file principal and interest forms with the Securities Valuation Office (SVO) and pay processing fees as a result. It would also more formally remove the compliance monitoring responsibility and administrative burden from the SVO and return it to the insurance company officers who are responsible for attesting to the company’s compliance with the 5* rules. We believe both of these benefits to be consistent with the intent of developing the GI.

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\(^1\) The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with approximately 290 member companies operating in the United States and abroad. ACLI advocates in state, federal, and international forums for public policy that supports the industry marketplace and the 75 million American families that rely on life insurers’ products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing 94 percent of industry assets, 93 percent of life insurance premiums, and 97 percent of annuity considerations in the United States. Learn more at [www.acli.com](http://www.acli.com)

\(^2\) The North American Securities Valuation Association is an association of insurance company representatives who interact with the National Association of Insurance Commissioners Securities Valuation Office to provide important input, and to exchange information, in order to improve the interaction between the SVO and its users. In the past, NASVA committees have worked on issues such as improving filing procedures, suggesting enhancements to the NAIC’s electronic security filing system, and commenting on yearend processes. Find more information [here](http://www.acli.com).
We also support the recommendation to have the NAIC’s Investment Analysis Office (IAO) assign a suffix to issues that have been filed (but not reviewed) by year end to carry over the existing designations. This provides an opportunity for industry to obtain ratings on their year end files and eliminate the need to self designate a Z suffix to these issues.

However, we do not agree with the exposure’s position that there are no circumstances where a Z designation should be used beyond the first year of purchase. There are reasons why insurers need to temporarily self-designate a security after the first year of ownership. Subsequent to the exposure, Ms. Tracey Lindsey, Nationwide, NASVA President, has discussed this issue with Mr. Charles Therriault, Director, NAIC Securities Valuation Office, and they agreed there were certain situations where this would be appropriate. The following is a list of various situations (and potential solutions) where we believe an insurer would need to temporarily self-designate a security after the first year of ownership:

- NAIC Designations have unexpectedly dropped from AVS+
  - IAO change in analytical process or decision to no longer analyze specific investments or groups of investments (e.g., recent decisions surrounding affiliated investments)
    - Can the IAO assign a special suffix so that the issues will not be dropped from AVS+?
  - Securities that are no longer FE (Filing Exempt) or included in the AVS+ FE population
    - Can a special suffix be assigned to indicate exemption status has been dropped?
  - Information requests for issues that have been historically rated on an annual basis, that expire due to the difficulty in obtaining older documents
    - Could information requests be extended to accommodate insurers when documentation is difficult to retrieve?

- Investments awaiting IAO analysis or decision:
  - RMBS or CMBS awaiting modeling results or changes in modeling status
    - Could these issues be reported as Z after the first year of purchase because of timing of modeling?
  - Issues being submitted for Information Sufficiency Filings
    - Again, can these be reported as Z after the first year of purchase?

Given that this is a complicated and nuanced area, where considerable collaborative attention to detail is required, we have not offered specific and surgical edits to the proposed changes at this juncture. Instead, as a follow-up to Ms. Lindsey’s aforementioned discussion with Mr. Therriault, we propose a collaborative approach (Ms. Lindsey, Mr. Therriault, Mr. Bob Carcano, Senior Counsel, NAIC Investment Analysis Office and ACLI representatives) to work jointly through the remaining issues to develop the necessary changes. Such a collaborative outreach is currently underway and we believe it to be the most efficient way forward.

Additionally, the ACLI and NASVA believe there are additional further nuanced issues that would also benefit from further collaborative discussions in order to ensure an appropriate outcome.

First, we would like further information regarding the basis for assigning the numeric/credit portion associated with any new suffixes. The current thinking of carrying forward the prior year designation could be appropriate for annual updates since the SVO’s prior year analysis could be used as a benchmark. Initial filings for new purchases, however, are completely different. Insurers perform thorough underwriting and credit analysis on new purchases. Insurers should use this analysis to determine a temporary NAIC designation until the SVO can complete their own thorough analysis.

Second, during the June 15, 2017 VOSTF conference call, Mr. Carcano suggested that the VOSTF should consider adding some type of periodic review to the process. What is envisioned here? How would this
process work if the SVO is no longer receiving filings? Additional review is unnecessary, as a new 5* disclosure was developed and adopted in 2016 to data-capture the number and amount of 5*s.

Lastly, we are looking for more information from the SVO around what the process will be for communicating designations on securities for which, after its review of all documentation, the SVO decides that no credit rating higher than a 5* could be assigned, particularly in those situations where a company believes it has the necessary information to support a designation higher than 5*.

We look forward to this collaborative effort to bring this critically important initiative across the finish line.

Sincerely,

[Signature]

Tracey Lindsey

Mike Monahan      Tracey Lindsey
Senior Director, Accounting Policy   President
American Council of Life Insurers   North American Securities Valuation Association

cc: Charles Therriault, Director, NAIC Securities Valuation Office
   Robert Carcano, Sr. Counsel, NAIC Securities Valuation Office
   Marly Kurtzer, NAIC Staff
April 21, 2017

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RE: Proposed Amendment to Remove the 5* (Five Star) Certification Process from the P&P Manual

Dear Messrs. Guerin and Fry:

The American Council of Life Insurers (ACLI)¹, and the North American Securities Valuation Association (NASVA)² appreciates the opportunity to comment on the Proposed Amendment to Remove the 5* (Five Star) Certification process from the Purposes and Procedures Manual (P&P Manual) (Agenda Item 6), introduced at the February 22, 2017 conference call and its subsequent amendment introduced at the Spring National meeting in Denver (Agenda Item 4).

5* General Interrogatory ("GI")

The Blanks Working Group ("BWG") adoption of 5* GI was the culmination of many months of discussions with industry, the SVO and the Statutory Accounting Principles Working Group ("SAPWG") Staff. The agreed-upon purpose of the new GI was to allow insurance companies to self-rate a 5* GI designation in cases where the SVO cannot assign a rating. This would eliminate the need for insurance companies to file principal and interest forms with the SVO, and pay processing fees as a result. It was also to remove the compliance monitoring responsibility from the SVO and return it to the insurance companies' officers that are responsible for attesting that the company is in compliance with the 5* rules. The SVO was asked by the Valuation of Securities Task Force (VOSTF) to look at how this new rule would fit within the filing

¹ The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with approximately 290 member companies operating in the United States and abroad. ACLI advocates in state, federal, and international forums for public policy that supports the industry marketplace and the 75 million American families that rely on life insurers’ products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing 94 percent of industry assets, 93 percent of life insurance premiums, and 97 percent of annuity considerations in the United States. Learn more at www.acli.com

² The North American Securities Valuation Association (NASVA) is an association of insurance company representatives who interact with the National Association of Insurance Commissioners Securities Valuation Office to provide important input, and to exchange information, in order to improve the interaction between the SVO and its users. In the past, NASVA committees have worked on issues such as improving filing procedures, suggesting enhancements to the NAIC's electronic security filing system, and commenting on yearend processes. Find more information here.
framework. The permitted uses and limitations for 5* GI, which are illustrated on Page 5 of the proposal, are conflicting with the intent and spirit of the new 5* GI agreed upon by the VOSTF, the SVO and the SAPWG. We ask that the SVO be instructed to provide the VOSTF and industry detailed information on how they see the process working, and why they do not feel certain asset classes should be candidates for self-designation via 5* GI. We would encourage the Task Force to not make any decisions in this matter until each of these scenarios can be sufficiently vetted.

The Administrative Symbol Z and the Z Rule

The proposal not only introduces new language related to 5* GI, but also suggests that the use of the Z suffix be limited to only specific situations and only assigned by SVO staff. First, the SVO states that the Z should only be used to denote an insurer had self-rated a security because a filing was in the backlog at the SVO over year-end. Second, the SVO suggests that the 5*/6* rule is no longer appropriate with the introduction of 5* GI as it is no longer relevant to VOSTF operations. This proposal, if adopted, would be a dramatic change in SVO policy. Industry believes that the Z suffix and the 5*/6* rule still have a place in VOSTF operations, and do not agree with the SVO’s position that it should only be assigned by SVO Staff.

There has been very limited discussion to date about this proposal at the VOSTF level. We respectfully request the VOSTF to postpone the adoption of this proposal until we can have a meaningful discussion of its components. As always, industry stands ready to work with the SVO to help achieve sound regulatory objectives.

We thank you for allowing us to comment on this proposal. The attached supplement illustrates the more technical questions in detail around this proposal that we encourage the VOSTF to consider in its decision.

Sincerely,

Laurie Armstrong
Laurie Armstrong
President
North American Securities Valuation Association

Mike Monahan
Senior Director, Accounting Policy
American Council of Life Insurers

cc: Charles Therriault, Director, SVO
    Robert Carcano, Sr. SVO Counsel
    Marly Kurtzer, Staff
Supplement

5* GI

This language does not represent the intent of the 5* GI proposal agreed upon by VOSTF and SAPWG. It’s unclear as to why the SVO would be requiring insurance companies on Page 5 of the proposal to file those asset types that currently cannot be rated higher than a 5* in the P&P Manual. If the highest rating we can receive now is a 5*, shouldn’t these asset types be the perfect candidates for self-rating? It was industry’s understanding that these would be allowable for self-rating with a designation of 5* GI, and only those securities that are filed with the SVO – and for which the SVO deems it cannot perform a full review – would be assigned by SVO Staff or they would instruct insurance companies to self-rate. The SVO was no longer going to be performing any validation effort as part of its analysis. The SVO has not provided any rationale as to why they feel such securities should be excluded from the process or why they feel that they still need to review these securities.

The current proposal with its amendments is vague and does not clearly demonstrate to industry and VOSTF the true intent of the proposal. We heard comments at the Spring National meeting in Denver made by Bob Carcano to the effect that this process will be an evolving one, as the SVO needs to review each of the current uses for 5* to see if the new 5* GI can replace the need to file. This idea suggests that there could be processes where the SVO still has a role in the rating of 5*. This is contrary to both to the intent of the 5* GI and lack of regulatory risk that was confirmed by SAPWG’s review of the proposed GI.

We feel that a decision at this time by VOSTF would be premature in light of the fact that the SVO is still reviewing its processes for applicability. This proposal should wait and be introduced after the SVO has completed its review of the processes, at which time the language can be re-written to accurately describe the proposed process changes.

We believe that the 5* GI process should not be replacing the current 5*/6* rule but, rather, modifications should be made to the existing rule if the Z suffix is going to be maintained, so an insurance company continues to have a rating from time of purchase.

Suggested Wording:
An insurance company may report a security with a “Z” suffix on its Schedule D for up to a year after purchase. For the second year after purchase, and thereafter, the insurance company may not report a security with a “Z” suffix except as noted in Section 5(d) of this Part below. The insurer shall either file the security and appropriate documentation with the SVO to obtain an NAIC Designation, report a 5* GI designation provided it meets the requirements in the annual Statement instructions or report the security with an NAIC 6* Designation on its Schedule D (collectively, the “5*/6* Rule”).

The Administrative Symbol Z and the Z Rule

The SVO has expressed under the context of its Filing Modernization Project that the Z suffix should be removed or its purpose changed in light of the fact that, today, documents are available electronically and can be submitted much faster to the SVO, thereby removing the need for the Z suffix. They have suggested that the only use for a Z suffix should be to denote those issues that are purchased too late in the year to receive a rating by the SVO, and that insurance companies only need ratings at year-end. The SVO’s support for this change under footnote #3, page 2, is that the current September 1 deadline creates uneven workflow and an unrealistic expectation for the SVO to be able to complete the filings by this date. It should be noted that the deadline in the P&P Manual is only
related to annual update submissions and not initial filing submissions which have a more market-driven deal flow into the office.

ACLI and NASVA provided public comments to the Task Force on August 11, 2015 regarding their support of the SVO’s suggestion for the use of a suffix to denote the issues in their backlog at year-end, but expressed the need for a different suffix. The Z suffix has been used historically for a different purpose, which could result in unnecessary confusion. It is also unclear from the attachment how the rating would be calculated. Key questions would need to be answered:

- Would it be based on the previous year’s rating assigned by SVO or some other mechanism?
- What would happen in the case of the initial filings where the SVO has not previously reviewed the security? If the issuer had never been in the SVO database, the SVO would not have a basis for assigning a numeric rating.

The SVO is not taking into account that the insurance companies need a rating assigned to a security from the date of purchase in order to perform a variety of reporting functions that require an acquisition rating, such as RBC, IMR/AVR reporting, State Insurance Compliance, surveys, and other reporting requirements. Insurance companies assign an internal rating with a Z suffix for the following reasons below in order to satisfy these reporting functions:

- New purchases that are awaiting documents required for a full filing.
- Securities that have had the ratings dropped and the holder is obtaining appropriate documents for a filing.

Industry would like to understand if the intent of this proposal is to limit the self-deriving of ratings to only 5* GI. The proposal seems to suggest that the SVO wants companies to self-rate these securities as 5* GI until such time that they have been filed with the SVO. If this is the case, this would negatively impact our portfolios.