

## **Understanding the NAIC Filing Exemption (FE) Rule**

This document provides general information and answers to frequently asked questions regarding the new filing exemption (FE) rule adopted by the Valuation of Securities Task Force of the NAIC Financial Conditions Committee. While every attempt has been made to set forth accurate information in this document, the *Purposes & Procedures Manual of the NAIC Securities Valuation Office (the P&P Manual)* is the official NAIC source for filing requirements.

### **What is FE?**

FE or filing exemption, is a new rule adopted by the NAIC which grants an exemption from filing with the SVO for bonds and preferred stock that have been assigned a current, monitored rating by an NRSRO. FE replaces the PE or provisionally exempt rule. FE also includes filing exemption for public common stock but the basis for the exemption is the same as it was under the PE policy – that is, public common stock that is not restricted to transferability and is listed on the New York Stock Exchange, American Stock Exchange or traded on the NASDAQ National Market System does not need to be filed with the SVO.

### **How is FE Defined?**

Until the publication of the July 1, 2004 P&P Manual, the definition for FE appears in the Special Insert section of the December 31, 2003 version of the SVO P&P Manual. FE is defined as follows:

“FE means exempt from filing with the SVO and is used by an insurance company to report an NAIC Designation for an exempt security on the NAIC Financial Statement Blank. The administrative symbol FE is used with an NAIC 1 through 6 Designation and signifies that the reported security meets the criteria set forth in Part Four, Section 2 (c) of this Manual and that the NAIC Designation was arrived at by the insurer by converting the NRSRO rating(s) into a corresponding NAIC Designation in accordance with Section 4 of the Appendix to this Manual.”

### **What are the criteria for FE?**

The only FE criterion is that the security, at the CUSIP/PPN/CINS level, has an NRSRO rating. It is only necessary to have one NRSRO rating. If more than one NRSRO rating exists, then the second highest NRSRO rating is used. Split ratings are resolved in accordance with the “second highest” portion of the rule. Split rated securities are not filed with the SVO. In addition, please note that Dominion Bond Rating Service (DBRS) was added to the approved NRSRO list in October 2003. Its ratings may be used for a security to qualify as FE. DBRS data is expected to be included in the SVO/NAIC systems sometime in 2004.

### **When is FE effective?**

The FE policy is effective January 1, 2004.

However, be aware that the NAIC/SVO systems were not fully operational at this date. As of January 15, 2004 the NAIC/SVO system is able to process securities with the equivalent of NAIC 1 and 2 Designations. Securities with NAIC Designations 3 – 6 will be operational on March 5, 2004. Despite the system lag, the policy is still effective for all NAIC Designations. Also be aware that the first P&P Manual for 2004 is the July 1, 2004 Manual. This will contain the final FE language that is now contained for informational purposes in the Special Insert.

### **Will SVO filing fees change?**

Yes. For 2004, it is anticipated that the SVO’s revenue would decrease due to the implementation of “FE” or SVO Filing Exemption. As a result, the NAIC Internal Administration (EX1) Subcommittee adopted **revised SVO filing fees** and a **new aggregate fee assessment** for 2004, which will be reviewed annually.

The revised filing fees are listed in the Special Insert section of the December 31, 2003 SVO P&P Manual.

For 2004, the aggregate fee assessment will be calculated using data from the 2003 statutory annual statement. To determine an individual company estimate, use Column 1 of the Schedule D Summary by Country, then take Line 26 (bonds) - Line 1(US Government bonds) + Line 40 (preferred stock). If this number is less than \$1 billion then no aggregate fee assessment is required. If it is equal to or greater than \$1 billion, then multiply this number by a pro rata factor of .0000008567 (Note: This factor will be determined by the NAIC. It will be different for 2004; however, for estimation purposes it may be used). The number that results will then be the estimated aggregate fee assessment.

Please note the aggregate fee calculation is done on an individual company basis, not a group basis. The NAIC will determine the exact pro rata factor and bill for 50% in June 2004 and the other 50% in December 2004.

### **Who adopted the FE Rules?**

The FE Rules began as a proposal from the New York Insurance Department to enhance the SVO process. It was first exposed for comment at the March 2003 NAIC SVO Oversight Working Group meeting. The FE Rules were adopted in two steps. The first step occurred at the September 2003 NAIC quarterly meeting, when securities with NRSRO ratings equivalent to NAIC 1 or 2 were adopted as filing exempt. Securities with NRSRO ratings equivalent to NAIC 3-6 were adopted as filing exempt at the December NAIC quarterly meeting. Both steps have an effective date of January 1, 2004.

### **Frequently Asked Questions (FAQ)**

The FAQ's are divided into the following categories:

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### **GENERAL QUESTIONS:**

- Q1) What does filing exempt designation mean for the filer?**  
A1) A filing exempt status means a filer is not required to submit a NRSRO rated security with the SVO. If the filer chooses to ignore the filing exempt status of the security, then an NRSRO rated security will be reviewed using the FE based rule.
- Q2) What is the difference between PE and FE Designations?**  
A2) PE guidelines required that securities had to meet three tests: NRSRO Ratings, Sovereign Ceiling and Optionality. FE rules require that securities have to meet only the NRSRO ratings test.
- Q3) When is the new policy effective?**  
A3) The effective date of this proposal is January 1, 2004.

**Q4) Does this mean that NAIC/SVO filing fees will be revised for the securities that still have to be filed?**

A4) Yes. The NAIC/SVO's filing fees were revised and are included in the Special Insert section of the December 31, 2003 SVO Purposes and Procedures Manual. In addition, a new aggregate fee will be assessed to certain companies.

**Q5) What securities are filing exempt?**

A5) 1. All current and monitored bonds, including structured securities with NRSRO ratings.  
2. All preferred stock with NRSRO ratings that are current and monitored.  
3. Public common stock that is not restricted as to transferability and is listed on the New York Stock Exchange or the American Stock Exchange or traded on the NASDAQ National Market System.

**Q6) Will the NAIC/SVO monitor exempt securities?**

A6) SVO staff will not; however, the NAIC has computer system capabilities to compare insurer holdings of FE securities to NRSRO data feeds. Insurance regulators are responsible for determining insurance company compliance with exemption requirements

**Q7) What types of asset-backed securities are filing exempt?**

A7) All asset-backed securities with an NRSRO rating are FE.

**Q8) Are Commercial Mortgage-Backed securities eligible for FE?**

A8) Yes, as long as it has an NRSRO rating.

**Q9) How will FE securities get into the NAIC database?**

A9) Similar to the PE process, securities reported as FE in an insurer's quarterly/annual Schedule D will be added to the NAIC database. A systems compare to the NRSRO data feeds will then be done.

**Q10) What does "Unconfirmed FE" mean?**

A10) "Unconfirmed FE" refers to securities that are:

- In Schedule D or were individually submitted for FE status, **and**
- Failed to achieve FE status, **and**
- Is one of the following:
- In VOS but not currently reviewed; or
- Not in VOS.

### **FILING QUESTIONS:**

**Q11) What if there is only one NRSRO rating available?**

A11) The security is filing exempt and the NRSRO rating is translated to the NAIC Designation equivalent.

**Q12) What happens if there is more than one NRSRO rating?**

A12) In this case, the second highest NRSRO rating is used. For example, if there are three NRSRO ratings which translate to the equivalent of NAIC 1, NAIC 1 and NAIC 2, then the second NAIC 1 is the second highest.

**Q13) A company determines that a security is FE, but the security has been filed by a second company and rated by the NAIC/SVO. How should the first company report the security?**

A13) The rating that is selected by the NAIC when it conducts its cross check of the NRSRO data feeds controls, and all owners of the security must report their holdings using the determinations of the NAIC.

**Q14) Can a company do its own conversion of ratings for filing exempt securities?**

A14) Yes. For a complete listing of NRSRO ratings and NAIC Designation equivalents, please refer to the Appendix, Section 4 of the SVO P&P Manual.

**Q15) What do I do if the security no longer qualifies under the FE rules?**

A15) Since all rated securities are exempt from filing with the SVO, the only way a security becomes ineligible for FE is if it is no longer rated by an NRSRO. In that case, the normal NAIC/SVO filings procedures apply, and securities no longer qualifying for FE must be filed with the NAIC/SVO within 120 days of the loss of the FE status.

**Q16) Is it permissible to file a security for an NAIC Designation even though the security is FE?**

A16) Yes. An insurer or its authorized agent may file a security with the NAIC/SVO even if that security is FE. If a security is filed, however, it loses its FE status and becomes subject to the appropriate SVO filing rules and fees.

**Q17) Is the insurer responsible for checking ratings from all NRSROs?**

A17) Due diligence requires that all NRSRO ratings be known before FE is claimed by a company.

**Q18) If an insurer is uncertain if a security is filing exempt or not, what should it do?**

A18) It should confirm the existence of an NRSRO rating for that CUSIP.

**Q19) Are U.S. government securities still exempt from filing?**

A19) Yes; however, the filing exemption for U.S. government securities are based on different rules. The specific filing exemptions are detailed in Appendix, Sections 16, 17, and 18 of the SVO P&P Manual. Securities listed in these sections are reported on Schedule D as an NAIC 1 without an FE suffix.

**Q20) If the issuer is rated, but the CUSIP is not, is this FE?**

A20) No. The CUSIP must have the NRSRO rating in order to qualify for FE.

**Q21) For structured securities, Bloomberg recently changed the terminology for the rating date from confirmed date to effective date. Is this date acceptable for a current NRSRO rating?**

A21) Yes.

**Q22) Will the filer be charged for submitting a security to find out the filing exempt status?**

A22) No

**Q23) If a filer submits a security and the ATF process determines it is FE, will the filer be charged?**

A23) No. The filer will only be charged if they choose to continue the ATF process and submit the ATF to the SVO for review. The filer will then be charged the appropriate ATF Filing Fee.

**Q24) What should a filer do if a security is an unconfirmed FE within the FE database, and they feel it qualifies as FE?**

A24) The filer can “Submit the CUSIP for Filing Exempt” through the ISIS system. There’s a “Filing Exempt” link at the top of the ISIS Screen, on the blue bar. The system will determine if the CUSIP qualified as FE and will display a message on the screen.

**Q25) What would happen to a security that only has a valid rating from the new NRSRO DBRS?**

A25) DBRS ratings have not yet been incorporated into ISIS. If DBRS is the only NRSRO rating for this security, the system will consider it not rated by an NRSRO and, therefore, will generate the message “Unconfirmed FE”. However, the filer should report this security as FE on their Annual and Quarterly Statutory Statements and maintain appropriate documentation for their examiners.

### **REPORTING QUESTIONS:**

**Q26) What is the procedure for assigning a suffix of "FE" to a security?**

A26) The insurer is responsible for assigning the FE suffix to the Designations it reports for filing exempt securities in its Annual and Quarterly Statutory Statements.

**Q27) If a security is filing exempt (FE), will it require a "Z" suffix in the quarterly and annual statements?**

A27) No.

**Q28) Will common stock be reported on Schedule D with an “FE” or “L” or both?**

A28) As with the PE process, common stock will only report “L” on Schedule D.

**Q29) If we have a private rating letter for a security, do we have to submit evidence of it to designate the security as FE, or just be able to support the FE designation and answer questions from the state examiners?**

A29) At this point in time, the company should just maintain evidence of the private letter rating to support its FE designation. Industry is exploring the possibility of having private letter ratings included in the data feeds.

**Q30) In the past, the SVO has categorized a debt security as preferred. How should I classify this for FE purposes?**

A30) If the FE security is classified by the NRSRO as debt, it should be reported as debt. If it is classified by the NRSRO as preferred stock, it should be reported as preferred stock.

### **PRICING QUESTIONS:**

**Q31) Will the SVO be pricing FE securities and equities that are filing exempt?**

A31) To the extent that prices are received through a regular data feed, the SVO will continue to provide prices for filing exempt securities.

**Q32) PE securities displayed a price but not a price date or price code. What pricing information will display for FE securities?**

A32) FE securities will display a price, price date, price code and market indicator when pricing is available.

**AVS/ISIS SYSTEM QUESTIONS:**

- Q33) How can a CUSIP be checked to determine if it is included in the VOS Publication as FE?**  
A33) A person may check: (1) using AVS, (2) the quarterly VOS CD-ROM or (3) enter the CUSIP in the ISIS Inquiry system (<http://isis.naic.org/cgi-bin/iqlookup.cgi>). However, please keep in mind that the answer received may not always be correct. One reason is that a security with a current private letter rating that is also monitored is FE eligible but because the NRSRO data feeds exclude private letter ratings, the system assumes it is not FE eligible. A second reason is that DBRS ratings have not yet been incorporated into ISIS.
- Q34) How will the Valuation of Securities on CD-Rom display a security that is filing exempt?**  
A34) Filing Exempt securities will be reflected in a separate Filing Exempt database menu option, just like the Provisionally Exempt database appeared in the past.
- Q35) When I try to do an ATF for a CMBS and I enter the CUSIP number and click the next button, the next screen responds with – “This CUSIP # you entered is FE eligible, do you want to continue filing?”. Does that mean we do not have to file those?**  
A35) No. The message is informing the user that according to the NAIC/SVO system, an NRSRO rating exists. Since an NRSRO rating exists, an SVO filing is not required.
- Q36) A security was SVO rated in 2003, but has not been reviewed for 2004. We have until the end of 2004 to file the annual update if we want. NRSRO ratings exist for this security, so it is FE eligible. How would I handle this?**  
A36) We would recommend reporting this as FE beginning first quarter 2004.
- Q37) What is the definition of the “Filing Year” field on the ATF screen/documents?**  
A37) “Filing Year” is the year the filer is requesting the review be applied to. For instance, under normal circumstances, the filing year would be the current year. However, if the filer is asking for a review for a previous year, they would enter that year in this field on the screen.
- Q38) Yesterday the CUSIP was FE and today it is in VOS. What happened?**  
A38) An ATF was filed and the security was assigned an NAIC designation and current year review date using the FE rule.
- Q39) For 2003, some common stock securities had a market indicator of “L” or appeared with a NAIC Designation of ”L”. Currently they are now appearing with no market indicator and with a blank NAIC Designation?**  
A39) Common stocks do not have NAIC Designations. The only information that will appear for common stocks will be the price, price date and price code, when available, and in the 2004 AVS format files a Classification Code of “C” for Common Stocks. If a market indicator is present within the information that is supplied to the NAIC, then it will also be present for 2004 information.
- Q40) How can I identify within my valuation file from AVS whether or not a security is Unconfirmed FE?**  
A40) Within the 2004 AVS file format, Unconfirmed FE securities are identified by a blank in the Source Column.
- Q41) How will FE Preferred Stocks appear in the AVS/ISIS system?**  
A41) If a Preferred stock is FE, it will appear as 1FE, 2FE, etc. The filer will assign the P or RP suffix when they report the security on their Quarterly or Annual Statutory Statements.

