

## **VALUATION OF SECURITIES (E) TASK FORCE**

Valuation of Securities (E) Task Force March 16, 2024, Minutes

Valuation of Securities (E) Task Force 2023 Fall National Meeting, Minutes

## Draft Pending Adoption

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Valuation of Securities (E) Task Force  
Phoenix, Arizona  
March 16, 2024

The Valuation of Securities (E) Task Force met in Phoenix, AZ, March 16, 2024. The following Task Force members participated: Doug Ommen, Chair, represented by Carrie Mears (IA); Eric Dunning, Vice Chair, represented by Lindsay Crawford and Andrea Johnson (NE); Mark Fowler represented by Sheila Travis and Sanjeev Chaudhuri (AL); Lori K. Wing-Heier represented by David Phifer (AK); Ricardo Lara represented by Laura Clements (CA); Andrew N. Mais represented by Kenneth Cotrone (CT); Michael Yaworsky represented by Carolyn Morgan and Ray Spudeck (FL); Dean L. Cameron represented by Eric Fletcher (ID); Dana Popish Severinghaus represented by Vincent Tsang (IL); Vicki Schmidt represented by Tish Becker (KS); Timothy J. Temple represented by Stewart Guerin (LA); Gary D. Anderson represented by John Turchi (MA); Kathleen A. Birrane represented by Greg Ricci and Matt Kozak (MD); Grace Arnold represented by Fred Andersen (MN); Chlora Lindley-Myers represented by Debbie Doggett and Danielle Smith (MO); Jon Godfread represented by Matt Fischer (ND); D.J. Bettencourt represented by Jennifer Li (NH); Justin Zimmerman represented by John Sirovetz (NJ); Adrienne A. Harris represented by Bob Kasinow (NY); Judith L. French represented by Dale Bruggeman (OH); Glen Mulready represented by Alec Reid (OK); Michael Humphreys represented by Diana Sherman (PA); Cassie Brown represented by Amy Garcia and Rachel Hemphill (TX); Jon Pike represented by Malis Rasmussen (UT); Scott A. White represented by Doug Stolte and Greg Chew (VA); Mike Kreidler represented by Steve Drutz (WA); Nathan Houdek represented by Amy Malm (WI). Also participating was: Trinidad Navarro represented by Stephen Taylor (DE).

### 1. Adopted its 2023 Fall National Meeting Minutes

Phifer made a motion, seconded by Crawford, to adopt the Task Force's Dec. 2, 2023, minutes (*see NAIC Proceedings – Fall 2023, Valuation of Securities (E) Task Force*). The motion passed unanimously.

### 2. Discussed Comments on a Revised Proposed Amendment to the P&P Manual to Update the Definition of an NAIC Designation

Mears said the next item is to receive comments on the exposure of a revision to the proposed *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) amendment to update the definition of an NAIC Designation. After the 2023 Fall National Meeting, the Securities Valuation Office (SVO) was directed to consider the actionable comments from industry members and work with them to further update and simplify the definition. The Task Force exposed those revisions for a 53-day public comment period that ended Jan. 26. The revised proposal incorporated several of the actionable comments received. It aimed to create a concise definition of an NAIC Designation that reflected credit quality but also would reflect inconsistencies with the existing regulatory assumption that a fixed income instrument pays scheduled interest and full repayment of principal on a date certain. These nonpayment type risks for which examples were given, and, when appropriate, consider loss given default and/or "tail" risk. Additionally, references to the concept of Subscript S, the administrative symbol for other non-payment risks, were removed. This type of assessment would be a communication tool for regulators. There were questions in the comment letters about the role this Task Force plays when assessing an insurer's financial solvency, meaning its ability to pay policyholder claims. While the Task Force is not responsible for analyzing individual insurers, the assessment of investment risk is a central component of the solvency-related considerations of the NAIC.

To the extent that an insurer-owned security may impact financial solvency (e.g., the ability to pay policyholder claims), it is important that the Task Force has an important role in contributing to the assessment of that risk. This role is codified in the P&P Manual that the policies adopted by the Task Force "...reflect a decision by NAIC

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members to provide analytical resources to support financial solvency objectives of state insurance regulators as expressed in the NAIC Financial Regulation Standards and Accreditation Program and/or other NAIC regulatory guidance embodied in state law.” The Task Force will consider these issues in the comments, but it is important to consider them when looking at the overall definition of an NAIC designation.

The Task Force received three comment letters on this revision. The SVO staff prepared a summary of the key comments and their recommended response (Attachment One).

Marc Perlman (NAIC) said that, as mentioned at previous meetings, NAIC Designations are currently explained and defined in both Parts One and Two of the P&P Manual. The SVO proposed consolidating the explanations and definitions into Part One because what constitutes an NAIC Designation is a fundamental policy of the Task Force. The revised amendments tried to clarify the meaning of an NAIC Designation, including their use, purpose, and the risks addressed while still maintaining the core regulatory objective. The latest round of revisions considered the feedback received, and the SVO believes that with certain tailored revisions to the current proposal, it is hopefully close to a final definition.

Perlman touched briefly on one of the larger themes in the letters before allowing interested parties to summarize their comments. He said there is a concern with the long-existing regulatory assumption contained in the definition that the issuer of a fixed income instrument should, under the terms of the instrument, be required to make scheduled interest and principal payments, and any terms inconsistent with that assumption could indicate other non-payment risks, which could be reflected in the Designation. Some interested parties contend that an NAIC Designation should only reflect the contractual terms of the investment. They explain that with the implementation of the Principles-Based Bond Definition in 2025, other non-payment risks contained in the contractual terms that deviate from the principles of a bond will prevent those investments from qualifying as bonds eligible for Schedule D. However, the SVO can assess and assign NAIC Designations to investments regardless of which Schedule they are on. With the implementation of the Principles-Based Bond Definition, the SVO expects investments to move from Schedule D to Schedule BA, and the SVO needs the ability to reflect these other risks to payment in the NAIC Designation. Therefore, it is important that the definition specify that a contractual provision inconsistent with the regulatory assumption may be reflected in an NAIC Designation if it is determined to impact the likelihood of principal and/or interest default. For example, the contractual ability to pay in kind (PIK) for a long period would not impact an NAIC Designation in and of itself. Rather, using or consistently using the PIK feature could indicate credit deterioration. Additionally, the SVO will share with state insurance regulators those securities with contractual terms inconsistent with the regulatory assumption, whether the SVO adjusts a Designation to reflect the risk.

As the SVO works through a further revised amendment, it will include some of the suggestions provided by interested parties and come back with a final proposal before the Summer National Meeting.

Mears said the intent of this definition is to be a foundational component within the P&P Manual. There are no actionable items, as this is just policy providing guidance for that foundation. For example, saying that it can consider tail risk, at the point where that is appropriate, the discussions on how it works would occur, particularly when working with the risk-based capital (RBC) groups in terms of what their needs are for the NAIC designations that are utilized. As a reminder, this is that foundational piece. Any P&P Manual amendment guidance related to these policies and actions to be taken would be a different concept that would take place at some other point in time.

The Task Force received three comment letters from interested parties.

Mike Reis (Northwestern Mutual, representing the American Council of Life Insurers [ACLI], the Private Placement Investors Association [PPIA], and the North American Securities Valuation Association [NASVA]) said that this has been worked on for quite a while and the collaborative approach is appreciated. Given some

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of the discussions since the letter was submitted, the Task Force and SVO have a role in the ability to assess claims and assess credit. At times, there is uncertainty commingling the ability to pay claims more broadly within an NAIC Designation, similar to PIKs, so that the Life Actuarial (A) Task Force could assess the ability to pay claims like the Financial Condition (E) Committee framework that is looking to expand the role of the SVO to assess the ability to pay claims. The concern in the letter is the commingling of those two.

John Garrison (Lease-Backed Securities Working Group) said the main point of the letter was to point out how much confusion is being caused by the term “other non-payment risk,” which is an oxymoron to the extent that anything that is spelled out in the contract should not be referred to as a non-payment. This is evidenced by the many comments addressing the concept of non-payment risk. As this progresses, it would be great to clarify by calling it payment risk or variable payment types. This is not part of a credit analysis since credit is defined as the ability of the obligor to honor the terms of the contract. The effort to simplify the definition by not having it be in various parts of the manual is supported.

Christopher Anderson (Anderson Insights) said this risk is real and has been addressed systematically and carefully over the years by the Statutory Accounting Principles (E) Working Group. There are instances (pointed out in the staff memorandum) where highly rated credits might not be paid. The question is how that is best operationalized. Specifically, there are hundreds of thousands of securities/bonds that insurers own, and 10,000–15,000 of them are designated by the SVO. The SVO will not review an overwhelming majority of securities. Putting this language in the P&P Manual to add this requirement is much less efficient than what was already done by the Working Group since the Working Group requirements apply universally. These requirements would be operationally effective for the 10,000–15,000 the SVO looks at. Regarding Perlman's comment as to why it is necessary for this to be part of consideration for items moving to Schedule BA, something that has been determined to not be a bond would be subject to its own kind of analysis. That is apart from what needs to be considered in the definition of bonds to be reviewed.

Mears said that, currently, there is not an updated definition. The intent is to take feedback from the comment letters and what was heard today and work amongst the groups to create a proposed final definition after working with interested parties, which would include some of the simplifications discussed today and address the confusion around another non-payment risk.

If the Task Force does not object, the SVO is directed to continue to work with interested parties and the Task Force on a revised draft of the amendment, incorporating certain suggestions in place. Once completed, the Task Force will expose the updated draft at a future interim meeting for a 30-day public comment period, with the goal of considering it again at the Summer National Meeting.

### 3. Discussed Comments on a Revised Proposed Amendment to the P&P Manual Authorizing the Procedures for the SVO's Discretion Over NAIC Designations Assigned Through the FE Process

Mears said the next item on the agenda is to receive and discuss comments on a revised proposed P&P Manual amendment that would authorize the procedures for the SVO's discretion over NAIC Designations assigned through the filing exemption (FE) process.

The Task Force received many comments on the SVO's initial proposal. The SVO staff took those recommendations and incorporated many of them into this revised proposal exposed at the 2023 Fall National Meeting. Several comments were received on the revised proposal, so there is no final proposal to be exposed today. The Task Force wants to ensure that the comments are fully considered and plans for further time for regulatory review of those comment letters. However, two documents include feedback on comments received to date. The first document, for items that the Task Force considered, discussed, and deliberated at prior meetings, relates to the thematic feedback seen in the letters. The second document includes SVO staff

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recommendations to state insurance regulators regarding comments received that will require further review, which SVO staff will also go through.

It is incredibly important to remember that NAIC Designations ultimately fall under the purview of state insurance regulators and are used solely within the insurance regulatory framework; they are not ratings. Credit rating providers (CRPs) provide an invaluable service given the number of securities and efficiencies gained by the NAIC in using rating agency ratings to assign NAIC Designations. There is no intention of displacing or competing with rating agencies. However, because of how the NAIC uses CRP ratings in its processes, this is not an unconditional usage. This proposal is specific to how state insurance regulators, as responsible consumers of rating agency ratings for regulatory purposes, choose to use them in that regulatory process. It also empowers the SVO staff to take action through a well-defined process, when necessary, as a centralized source of investment expertise supporting the state regulators in this responsibility with the NAIC regulatory oversight that is put forth in the document to date.

There were some comments received on issues the Task Force had previously deliberated that are worth addressing up front, as noted in Attachment Two.

One of the questions relevant throughout many of the comment letters is the level of transparency that the insurer would receive if they were to have a rating that was challenged.

- The insurers impacted will have full transparency into the SVO analysis and rationale. In confidential discussions with insurers who are investors in the transaction and have been authorized by the issuer and rating agency to receive confidential information and share it with state insurance regulators. The SVO will provide more specific information about the issuer and share issues or concerns with the rating agency rating. State insurance regulators strongly agree that the transparency of insurers impacted is key, and they will have that full transparency. As noted in the responses, state insurance regulators will consider comments regarding the various forms that this transparent communication can take.
- The SVO is not a rating agency and, therefore, often relies upon the methodologies of rating agencies, as permitted by the Task Force in the “Use of Generally Accepted Techniques or Methodologies.” The SVO considers multiple methodologies when it reviews a security and will use the one or combinations of methodologies that it believes will produce a reasonable assessment of risk for regulatory purposes. Because the SVO relies upon the methodologies of other entities, it does not publish its own except in rare cases where defined methodologies have been put in place. It is very important to stress that the use of a particular methodology from a rating agency should not be construed as validation of one CRP over another; it is simply a starting point for analysis.
- The SVO highlighted several observable factors in the proposal that it will consider to initially identify a potential issue and the possible need for closer scrutiny. When it performs its full review, the SVO will apply the methodology or combination of methodologies that it believes will produce a reasonable assessment of investment risk as permitted under the “Use of Generally Accepted Techniques or Methodologies.”
- State insurance regulators retain all oversight and authority, and there is an explicit step for regulatory approval, including the involvement of the domiciliary regulator. Additional clarifying language may be added to this step to remove any perception of lack of authority. Domiciliary regulators retain final rights over impact to any individual insurer, subject to broader accreditation standards, as we want to ensure that there is still consistency in the way that designations are used. The Task Force does not want to end up in an instance where two different insurers and two states

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that owned the same bond would have different designations. Through a well-defined process, that kind of situation can be avoided.

- The SVO has been assigned certain responsibilities pursuant to the instructions published in the P&P Manual and does not have a financial interest in the outcome of its financial risk analysis. The proposal balances the SVO's role as the state insurance regulators' independent investment expertise and the regulators' ultimate oversight of domiciliary insurers. State insurance regulators will review suggestions for various approval checkpoints laid out in some of the comment letters; however, this will be balanced against additional bureaucratic steps that do not add value to this further analysis. The Task Force will discuss those issues and consider where there is value in those additional components of approval checkpoints.
- As stated during prior national meetings, it is not an objective of this proposal to address concerns with an asset class or broader investment themes. The FE discretion proposal requires the SVO to discuss any recurring patterns it sees with the Task Force chair to determine the appropriate next steps. That aligns with what has been done over the past several years. The approach that has been taken when issues have been identified that call into question a full asset class or category of investments is to discuss them, address them, and find a path forward. This discretion proposal is to ensure that an entire asset class is not tainted when there are individualized issues in place. The FE discretion amendment is not intended to address asset classes or security structures.
- The proposal is intended to cover all securities with NAIC Designations produced through the translation of a CRP rating (whether through FE or private letter ruling [PLR]) as a fundamental control supporting the use of CRPs in the production of NAIC Designations.
- The proposal explicitly provides for the identification and notification to insurers of securities under review through a new SVO analytical department symbol, "UR," which would mean the NAIC Designation assigned pursuant to the FE process is under review by the Investment Analysis Office (IAO). This symbol will be provided to insurers through the NAIC's AVS+ application along with all other NAIC Designations and SVO Analytical Department Symbols. Additionally, the NAIC's VISION application will notify insurers with the subject security in their portfolio that an information request has been initiated. This component will take time to implement, and the SVO will talk through some of the timing aspects. If adopted today, it would not go into place tomorrow.
- The three-notch threshold for materiality was chosen because moving three notches across NAIC Designation categories would result in an approximately 100% change in the pre-tax RBC factor for a life insurer, with some intervals being a significantly higher percentage change. This is an adequate measure of materiality.
- The FE discretion proposal is complimentary to the holistic investment framework being discussed by the Financial Condition (E) Committee and will still be needed when it is implemented. The investment framework also highlights that the reasonable assessment of insurer investment risk is a valuable use of NAIC resources and fundamental to prudential regulation.
- The SVO has no intention of reviewing every security that uses a rating agency rating in the assignment of an NAIC Designation. Currently, when the SVO or state insurance regulator encounters a security with a rating that looks anomalous, neither the SVO nor any NAIC member has the ability under existing NAIC guidance to address it in a defined and methodical manner. The FE discretion proposal would authorize the SVO to follow the process steps outlined in the proposal and, at the conclusion of that process, potentially remove the anomalous rating from the FE process. The SVO

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staff have no conflicts of interest or financial interests in the outcome of this process. Its only objective is the reasonable assessment of investment risk for NAIC members.

- The SVO is not a regulator. However, the members of the NAIC are prudential insurance regulators within their respective jurisdictions. The SVO has been assigned certain responsibilities pursuant to instructions published in the P&P Manual that were adopted by the Valuation of Securities (E) Task Force, Financial Condition (E) Committee, the Plenary, the chief insurance regulators of the 50 states, DC, and five U.S. territories. If adopted by the Plenary, the recommendations become NAIC policy, reflecting national regulatory consensus and serving as guidance to state insurance departments and state legislatures.
- NAIC Designations and other analytical products of the SVO and Structured Securities Group (SSG) are produced solely for the benefit of NAIC Members in their capacity as state insurance department officials for use in the NAIC Financial Regulation Standards and Accreditation Program.

Mears asked Charles Therriault (NAIC) to review some of the other key comments received for regulatory consideration on the updated process proposal and the SVO's recommendations.

Therriault said there was a recommendation from a Task Force member that Part One of the P&P Manual related to the "Policies Applicable to the Filing Exemption (FE) Process," in paragraph 80, titled "Determinations" be slightly modified with an insertion to identify the use of credit ratings must consider the efficient use of regulatory resources. The first sentence would be revised to read: "The VOS/TF is resolved that the benefit obtained from the use of credit ratings in state regulation of insurance [this would be the inserted text between the parenthesis, open parenthesis] (i.e., most efficient use of regulatory resources) [close parenthesis] must be balanced against the risk of blind reliance on credit ratings."

There was a question regarding the reference to more than one rating having a three or more notch difference for a given security in the proposal. The plural reference was intentional as there are eight CRPs now and 10 nationally recognized statistical rating organizations (NRSROs), with the additional two potentially becoming a CRP at sometime, and any one of them could potentially provide a rating. It is possible that the SVO could see more than one rating on a security that it believes may not reflect its risk. While this scenario is unlikely, it would be an inefficient use of NAIC resources to hold more than one review of the same security. To the extent the SVO sees the situation, it would communicate that more than one rating is being reviewed to the impacted insurers and would also notify the Task Force.

There was a question about what should happen if a CRP rating was removed near year-end. At that point in the process outlined and likely revisions, the security would have gone through a full review by the SVO and the Task Force's subgroup. If there is no alternate CRP rating for the security, the SVO recommends the removal of the CRP rating that was under review and the use of the SVO-determined NAIC Designation for year-end reporting. Any future action that may or may not occur at the conclusion of any appeal process, if one is requested, would be taken when such a decision was made. Likewise, if an alternate CRP rating was subsequently received, it would naturally be incorporated into the FE process.

There was a request that industry be permitted to attend the Task Force's subgroup meeting when hearing the SVO senior credit committee assessment. Consistent with the existing appeal process, if insurers request it, they can present their position and analysis along with supporting information to the SVO credit committee and, in this process, the Task Force's subgroup. The impacted insurers would be involved throughout this process, and it would be up to those insurers to decide how involved they wish to be. As it occurs in the existing appeals process, the insurers could include other parties during their presentation that are permitted access to the material being presented. At the conclusion of the insurer presentation, the SVO senior credit committee and Task Force's subgroup would deliberate in private, just as the credit committee does today

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during an appeal. This procedural clarification can be added to the amendment. The SVO recommends changing the reference from “SVO senior credit committee” to “SVO credit committee” to be consistent with other references in the P&P Manual.

There was a suggestion to post a generic public notice about the security when the security is put under review. The amendment contemplates posting the public anonymized summary of the analytical issue or concern only after the final decision has been made. Anything prior to that decision would be inappropriate to post publicly and would likely have an unnecessary negative impact on the market before any decision had been made. The SVO does not recommend publicly publishing anything other than an anonymized summary. The anonymized summary of the analytical issue should provide insurers and others with sufficient information to understand the core issues.

One comment letter requested that the independent third party adjudicate the decision of the SVO senior credit committee and Task Force’s subgroup be replaced by the option to receive an additional CRP rating that would go through the existing FE process. The SVO agrees that engaging an independent third party to adjudicate these decisions would be challenging. The SVO would welcome more ratings in the FE process, but requiring multiple ratings on a single security in the FE process is beyond the scope of this proposal. The proposal provided an alternate rating, and there should be sufficient time for an alternate rating to be submitted. Assuming the additional CRP rating(s) is less than three notches different from the SVO’s assessment, the SVO would recommend proceeding with the removal of the exception rating and permitting FE to proceed as normal with the alternate rating(s). The reason for continuing with the removal of the exception rating is to avoid being in this same situation if the alternate rating(s) are withdrawn. This will be discussed further with the state insurance regulators.

There was a recommendation that a summary of ratings discretion actions be publicly reported at each national meeting. The SVO recommends the proposal’s existing summary at each Spring National Meeting be maintained. The SVO already provides the Task Force with a public report at that meeting, including today’s, of the filings for the prior year, as required by Part Two of the P&P Manual in the guidance for the “Year-end Carry Over Procedure” and the ratings discretion actions would be made part of that report. The SVO will already publish on a public webpage an anonymized summary of the analytical issue or concern related to a ratings discretion action, which negates the need for any additional reporting as the information will already be publicly available. There will also be identified symbols in the AVS+ platform that insurers will have access to.

There are several other procedural suggestions throughout comment letters. The SVO staff did not provide recommendations for each suggested procedural comment. The SVO will work through comments individually with state insurance regulators to produce a final draft of the proposal. There can be a few minor adjustments to the proposed process, but overall, it is fair, reasonable, sufficiently transparent, and provides the appropriate level of due process.

Mears said that there is no updated draft. The Task Force anticipates taking the comments that have been received, along with staff's recommendations and working in a regulatory environment, to go through each of those individually and ensure the final draft proposal incorporates those that are reasonable additions to the process.

Cotrone asked if the goal of updating the draft would be for the Summer or Fall National Meeting. Mears said the Task Force has a regulator-to-regulator meeting scheduled in May for state insurance regulators to go through the comments. Shortly after that meeting, there should be a draft that can be exposed for a 30-day comment period to get feedback from interested parties, which would position this for the Summer National Meeting.



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Michael Reis (Northwestern Mutual) said the collaborative process is appreciated. Many of the comments were thoughtfully discussed and reflected. Especially the ability to weigh in if two ratings were three notches below and to have the regulatory committee hear the other side of the story.

Joe Engelhard (Alternative Credit Council—ACC) said there were two principal concerns. One is about the negative market impact, as well as concerns about the due process. He said that it is very good to hear comments that this is being taken seriously and that he looks forward to being able to comment on the third round.

Christopher Anderson had two suggestions. One concerns screening, and the other concerns the decision that will need to be made about whether a rating is appropriate or inappropriate. The first thing to bear in mind is the task of identifying credit rating agencies that give unreliable ratings. That is a significant task, as there are eight of them. They rate many different ratings and asset types. If you are to conclude that a rating agency is not qualified to rate a certain type of asset, then it seems that a number of trials and tests are conducted to make that determination. The screening is important, and Anderson Insights suggests that a screening tool be implemented that will look at the history and performance of ratings from rating agencies. That is available from the U.S. Securities and Exchange Commission (SEC), and it is under the administration of the SEC, which may or may not be sufficient for the NAIC. It should identify ratings that are not durable and that go down over time. The data should be mined, and additional data should be combined with the SEC data. It may require AI and further analysis. It will streamline the process because if you cast a net looking for assets with high yields, you will find mis-rated securities, but you will also find any other securities in that net. Screening is very important, and using technology to accomplish it would be beneficial. The second recommendation is to “try before you buy” or road test the procedure before the Summer National Meeting. Is the SVO decision about what a credit rating is correct, or is the rating agency's decision, as represented by an insurance company, correct? It is possible the SVO has rating methodologies, it's been submitted for a long time. The SVO can identify some of the methodologies it would like to explore. It would be very possible, and there is precedent for state insurance regulators to require insurers to file. That kind of inquiry can occur in private, where the insurer is stating the case of the rating agency and where the SVO is stating its case, and sooner or later, someone is going to have to decide. It will be difficult, but having a dry run before the Summer National Meeting will improve the process. Regarding improving screening and testing, doing a dry run of how state insurance regulators' decide this will be completed.

Michael Consedine (Athene) stated that in Athene's letter, Athene remains very supportive of a challenge right that addresses outlier ratings. The challenge rate will help achieve the investment framework's goal of improving due diligence over rating agencies while preserving the important role that credible rating agencies play in the process. The letter offered a few suggestions and observations. First, the SVO discretion should, as it is intended, be used only to eliminate outlier ratings and not provide commentary or perspectives on asset classes or structures. Second, emphasize the importance of transparency, which has been excellent through this process, in candor, to a healthy regulatory environment that the NAIC represents. To that end, it is recommended that the SVO develop a process to ensure consistent assessment methods and challenges and that it is transparent with participants and rating agencies. Also recommended is the continued improvement of communication protocols, as markets generally adjust to regulatory objective concerns when they are fully understood. Finally, as with any new regulatory tool, changes and improvements may be needed over time. Therefore, it is recommended that the Task Force and the SVO conduct an annual review of the challenge right to allow for further adjustments as needed. The opportunity to comment is appreciated, and Athene is committed to supporting this workstream going forward.

Eric Mandelbaum (Egan-Jones Ratings Company) said many of the comments in the letter speak for themselves and were also addressed in the comments made in the beginning and in other comment letters. Because of some of the potential unintended consequences in the market, and there have been a lot of comments about the market impact, consideration should be given to the role of the SVO and whether there must be a

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separation between the policymaking arm and the analytical arm to give more comfort to the market. That is one of the main proposals in the comment letter that has not been addressed.

Mears said that would be part of the investment framework discussion and important for state insurance regulators to consider.

Kathy Belfi (KB Regulatory Solutions) said KB Regulatory Solutions supports the proposal and thinks it has been a collaborative and interactive process. At the opening ceremony, Commissioner Mais talked about one of the major NAIC initiatives, which is the broader initiative for the modernization of the SVO office. The only concern is that when the NAIC goes through this process, which will go forward, there may be an overlap with that greater or broader process. There must be collaboration between the two processes.

Thomas R. Sullivan (Sullivan Strategy and Advisory Services) said robust competition amongst the CRPs needs to be encouraged: narrowing competition and favoring one or two CRPs over the others would be a concern. Domestic regulator involvement needs to be stressed, which was acknowledged. The first version of the proposal said almost nothing about domestic regulator involvement. The second version got slightly better. It is hoped that the third version would vehemently acknowledge the necessity of the domestic regulator driving the process. Secondly, there needs to be a transparent review and appeal process, as mentioned by Christopher Anderson and others. In a previous meeting, a Texas state regulator mentioned that if we hold everyone else to a transparency standard, then this institution also needs to be transparent. Sullivan said that Sullivan Strategy encourages continued transparency in everything involving this process. It is comforting that the proposal is being reviewed methodically here and now and that there is a third version.

The most significant part of the comment letter is the suggestion that there be an independent auditor or third party around the entirety of this process. Those sitting here continue to have unease about where this is headed. It is unknown how many securities will be involved and how broad this effort will be once it is expanded, and there needs to be reassurance that this does not take on a life of its own. Therefore, it is recommended that some kind of third party produce a report or give some type of attestation to let everyone know that this is a well-governed and well-managed process. The duties and rights of the state insurance regulator are understood, and this is not trying to get in the way of that. Numbers have been tossed around saying that it is only going to be a few times or rarely. These concerns can be assuaged by introducing some level of audit or independent third-party review over the process. While the stated intent and direction of the Financial Condition (E) Committee's holistic framework is appreciated, the work of the Committee and its subcommittees continues to meander down a somewhat disconnected path at times. That is not the case here, but there should continue to be close coordination between the groups. The broader initiative of the holistic approach is supported but only if the work of the committees is linked. The Financial Condition (E) Committee chair has said that this work is not going to stop. While everything cannot just freeze, that does not mean it cannot be well-coordinated.

Garrison appreciated the initial comments about transparency leading this off, which has been the focus of the Lease-Based Securities Working Group's comments. Regarding the "anonymized" summary that has been mentioned, it might be helpful for the market, in general, to understand where the SVO or the IAO is coming from, but from the investor's point of view and the security (the holders of security), basic fairness requires that those people be able to see the full analysis produced by the SVO, hopefully in writing. Without that, they are at a disadvantage in making any presentations to either the Senior SVO Credit Committee or the Task Force's subgroup. There is no reason why that cannot be the case since any confidentiality concerns could certainly be addressed with a confidentiality agreement. As pointed out in the letter, the SVO's regulatory treatment analysis service (RTAS) already has a very fulsome application process with pages of terms and conditions. There would be no liability on the part of the SVO, which is important. If the ultimate decision is that nothing is produced in writing for the investors, language was suggested in the letter to be inserted somewhere in the process that would say, "...the IAO agrees to cooperate fully with the holders of the security

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and share its full analysis, including what data was examined, what assumptions were made, what methodologies were used in the analysis, and what specific flaws or omissions were found in the CRP analysis.” That language should be unobjectionable.

Mears said state insurance regulators will discuss that aspect as the Task Force considers updates.

Colleen Scheele (National Association of Mutual Insurance Companies—NAMIC) said NAMIC’s main concern is the level of transparency that has been provided to the insurers who were going through the proposed process, but it will review the next draft and reach out to staff with any questions or suggestions.

Helen Remeza (PineBridge Investments) said that PineBridge Investments appreciates the Task Force’s open and transparent process and the opportunity to comment on important issues such as SVO FE discretion. PineBridge is keen on supporting the Task Force by offering thoughtful comments and sharing its expertise in insurance asset management. It believes the submitted comment letter is self-explanatory.

Mears said the takeaway for state insurance regulators is to work through the comments that have been provided with some initial feedback and staff recommendations. Some of the Task Force members may reach out for clarification on some of the items in the comment letter, as those issues are considered. Expect to see an updated draft sometime after the Task Force’s regulator-only meeting in May. The Task Force will work together on a revised amendment incorporating key suggestions and expose it for a 30-day public comment period at a future interim meeting.

#### 4. Discussed Comments on a Proposed Amendment to the P&P Manual to Add a Practical Expedient to Determine the Issued Date for PLR Filings

Therriault said the SVO has been unable to independently source the date attribute “Issue Date” (e.g., date of legal closing), which is a necessary input to determine the requirement to provide a PLR rationale report. The SVO proposed permitting it to apply a practical expedient by assuming that any security subject to the PLR guidance acquired on or after Jan. 1, 2022, and issued on or after Jan. 1, 2022, unless documentation showing an earlier issue date is provided. The joint comment letter from the ACLI, PPIA, and NASVA offered to work with the SVO on this missing information. The SVO would be happy to work with the ACLI, PPIA, and NASVA on an operational process to resolve the missing data and report back to the Task Force with either an updated P&P Manual amendment or a recommendation to dispose of the current amendment. The SVO has also requested that CRPs also include issue date in their private rating data feeds.

Mears directed the SVO to work with interested parties to develop an operational process to add the required information, in this case issue date (e.g., date of the legal closing) and report back to the Task Force.

#### 5. Exposed a Proposed P&P Manual Amendment to Update the U.S. Government Agency and Other U.S. Government Obligation Abbreviations

Linda Phelps (NAIC) said this is a technical amendment to the P&P Manual. As part of the implementation of the principals-based bond project, there were modifications to the annual statement blanks. As such, the SVO has identified abbreviations for various U.S. government agencies and other entities that will need to be modified for insurance company statement blanks reporting purposes to accommodate space limitations and eliminate conflicting abbreviations. The SVO recommends adoption of this proposed technical amendment in advance of the Jan. 1, 2025, implementation of the new statement blanks.

Mears directed the SVO to expose the proposed amendment to update U.S. government agency and other U.S. government obligation abbreviations for a 30-day public comment period ending April 17.

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### 6. Exposed a Proposed P&P Manual Technical Amendment to Update References to P&P Manual SSAP Guidance for SCAs

Mears said the next item on the agenda is to hear about a proposed P&P Manual technical amendment to update references to the SSAPs in the guidance for subsidiary, controlled, and affiliated (SCA) and related party bonds or preferred stock investments.

Perlman said that at the end of 2022, the Task Force adopted amendments to the subsidiary, controlled, and affiliated (SCA) bonds section of the P&P Manual to more clearly define those investments, including those eligible or not for FE (specifically with regard to structured deals) and to include related party investments. Within the definition of an SCA and related party bond, we made specific reference to paragraph 4.a. in *Statement of Statutory Accounting Principles (SSAP) No. 43R—Loan-backed and Structured Securities* to help define which structured or loan-backed investments would qualify as an SCA or related party bond. Subsequent to the adoption of the P&P Manual amendment, SSAP No. 43R was amended; therefore, the paragraph reference in the P&P Manual is no longer accurate. Additionally, with the implementation of the principals-based bond definition, the paragraph will be changed again, and the name of SSAP No. 43R will be changed from “Loan-backed and Structured Securities” to “Asset-Backed Securities” on Jan. 1, 2025.

To avoid the need for additional P&P Manual updates due to potential future amendments to SSAP No. 43R, the SVO is proposing a technical amendment to: 1) remove that SSAP No. 43R paragraph-specific reference; and 2) to include a note that, as of Jan. 1, 2025, all P&P Manual references to SSAP No. 43R will be updated without any further action necessary by the Task Force to reflect SSAP No. 43R’s new name, “*SSAP No. 43R—Asset-Backed Securities*.”

Mears directed the SVO to expose the proposed technical amendment to update references to the SSAPs in the guidance for SCA and related party bonds or preferred stock Investments for a 30-day public comment period ending April 17.

### 7. Received the SVO’s Annual Report on Year-End Carry Over Filings

Therriault said that, as required in Part Two, Operational and Administrative Instructions Applicable to the SVO, of the P&P Manual, the SVO director must prepare a report for the Spring National Meeting identifying an acceptable annual rate of carryover filings for the year-end reporting period. These carryover filings can be identified with the administrative symbols “IF,” which are initial filings with a self-assigned NAIC Designation, and “YE,” which are annual update filings the SVO has not yet reviewed and the NAIC Designation from the prior review was carried forward until the current year review is complete.

For 2023, the SVO reviewed 15,549 filings comprised of 3,893 initial filings, 11,257 annual updates, 12 appeals, 366 material changes, and 21 renumbering requests (e.g., Committee on Uniform Security Identification Procedures [CUSIP] changes). In comparison, in 2022, the SVO reviewed 12,983 filings comprised of 3,562 initial filings, 9,291 annual updates, 61 material changes, and 17 appeals. The total number of filings includes 3,879 manually processed PLR-related filings comprising 2,407 private ratings, 1,305 rationale reports not billed, and 167 rejected filings. In 2022, there were 1,961 manual processed PLRs.

There were also 1,262 carry-over filings for year-end 2023 versus 1,199 in 2022 and 828 in 2021. There were 312 that received “IF” for an accepted initial filing, and 950 received “YE” for an accepted annual update. This represented a carry-over rate for 2023 of 8.1%, which is slightly lower than the carry-over rate of 9.2%, but the volume was slightly higher. Generally, a carry-over rate of 10% or higher would be an indication that there is an analytical resource constraint issue for the SVO. At this point, we are not identifying one, but there is a lot of volume going into the SVO. As of March 13, there were 163 carry-over filings, which is an excellent job for the team.

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The year-end carry-over rate does not provide any insight into the technology resource needs of the SVO team. The SVO has made some progress on its technology initiatives, which were either approved by the Task Force or initiated by the SVO. The foundational work to permit multiple security identifiers like International Securities Identification Numbers (ISINs) by using the S&P Global Ratings business entity cross reference service (BECRS) and global identifier cross reference service (GICRS) has been added, but full functionality is still in progress. There is some ability to allow analysts to match private rating rationale reports, but that work is ongoing. We are in the process of implementing multi-factor authentication for SVO applications to improve data security. Other initiatives have not begun, such as improving the efficiency of handling the documents received by insurers, improving overall filing efficiency, and completing rating history.

The SVO continues to see significant growth with privately rated securities. In 2020, there were 4,270 privately rated securities, and for year-end 2023, the preliminary indication from statement filings through March 12, there are now 8,152. That is a 20% increase from 2022 to 2023, with an additional 1,360 securities rated privately. The SVO will try to prepare a report for the Task Force with additional details on these changes.

Mike Monahan (ACLI) said that the ACLI appreciates that this is a written rather than an oral report and thanked the Task Force and staff for that.

### 8. Received Updates on the Proposed CLO Modeling Methodology and Ad Hoc Group

Mears said the next item on the agenda is to hear updates on the proposed collateralized loan obligation (CLO) modeling methodology and CLO ad hoc group.

Eric Kolchinsky (NAIC) said the SSG has been working diligently on the CLO methodology. The SSG has published detailed cash flows on our six representative deals for each of the 10 scenarios and received excellent feedback from several parties on all sides of the issues. The SSG is planning and running a set of stress rounds on those tests.

In addition, the SSG has been working closely with the Academy's C1 Working Group and plans to provide them with data and stress runs based on their projects. However, the work has been slower than anticipated, and as mentioned at the Fall National Meeting, the SSG will exercise the "option" to extend the effective date to year-end 2025. This will require a P&P Manual amendment that will need to be exposed during an interim meeting and, hopefully, approved at the Summer National Meeting.

In addition, giving the SSG more time to perfect the methodology will allow better alignment with the approach of other NAIC workstreams, including the holistic framework and that of the Academy's work on RBC.

Mears said there has not been an ad hoc meeting in a while, but work has taken place behind the scenes. Kolchinsky said the SSG has gotten a lot of detailed feedback on the methodology and hopes to have an ad hoc meeting in three to four weeks.

### 9. Received a Report on Statutory Accounting Principles (E) Working Group Projects

Julie Gann (NAIC) highlighted a few investment-related items under the Working Group and Task Force coordination initiative. These are just a few of the items that were addressed, and all adoptions and exposures will be posted on the Working Group's website. First, it adopted *SSAP No. 21R—Other Admitted Assets*. It was the last SSAP revision needed to conclude the principles-based bond project. The revisions detailed the accounting and reporting for non-bond debt securities, as well as accounting and measurement guidance for

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residual interests. The effective date is Jan. 1, 2025, but the residual interest measurement guidance is available for early adoption for this year.

In addition to the conclusion of the SSAP revisions, the blanks revisions to Schedule D, splitting the bonds scheduled to D1-1 and D1-2, and all the other related items have already been adopted. The only piece left is Schedule BA, which is currently exposed and planned to be adopted in May. NAIC staff are working with the NAIC Education & Training Department to put together comprehensive training for the principles-based bond project. They hope it becomes available as soon as possible in 2024. That project is concluded effective one 2025.

The Working Group adopted revisions to *SSAP No. 93—Low-Income Housing Tax Credit Property Investments* and *SSAP No. 94R—Transferable and Non-Transferable State Tax Credits* for new guidance for tax credits. Fundamentally, all investments that predominately provide tax credits or other tax benefits will now fall within SSAP No. 93, regardless of the form of debt or equity, and they will all follow the proportional amortization method. This guidance is also effective Jan. 1, 2025, and the revisions to Schedule BA to rename the reporting lines and make some revisions should be exposed shortly after this national meeting. The last adoption item to highlight is that the Working Group adopted revisions to the interest maintenance reserve (IMR)/asset valuation reserve (AVR) annual statement instructions to clarify that all perpetual preferred stocks and mandatory convertible preferred stocks, regardless of their perpetual or redeemable, will go through the AVR. Those are always reported at fair value, regardless of the reported NAIC Designation.

The Working Group had about five exposures. The first has to do with debt issued from funds. This was a proposed revision to the adopted principles-based bond definition, where guidance specifies that debt issued from SEC-registered funds is an issuer credit obligation. The proposed revision is to make that more principles-based, so the SEC registration requirement would not necessarily have to be in place if the fund was an operating entity. The Working Group re-exposed those items due to informal comments received at the application of that guidance, which was going to be broader than anticipated and perhaps include feeder funds. During the exposure, the Working Group is asking for feedback from industry on how to make sure that guidance is specific to the intent so it cannot be more broadly applied than intended.

The Working Group also exposed the concept agenda item proposing convergence of securities lending and repurchase agreement guidance. Right now, the Working Group is looking to work with industry, and it comes from a referral from the ACLI to the Life Risk-Based Capital (E) Working Group, which then referred to the Statutory Accounting Principles (E) Working Group.

The Working Group also exposed consistency revisions to SAAP No. 21R and a variety of other SSAPs to remove the residual guidance currently in SSAP No. 43R and *SSAP No. 48—Joint Ventures, Partnerships, and Limited Liability Companies* so that they all point to SSAP No. 21R, which will then house all the accounting and reporting guidance for those residual interests.

The Working Group exposed another conceptual agenda item for a new schedule that details the funds withheld and modco assets that would assist state insurance regulators in identifying which assets are on the financial statements that reflect the modco arrangements or funds withheld. It would also assist with the direct pull to those items in the RBC formula. Lastly, one more conceptual agenda item was the exposure for *SSAP No. 56—Separate Accounts* to provide guidance on how the accounting should occur for book value assets that are in separate accounts. Separate accounts guidance focuses on those items held at fair value, and we know there has been an uptick in the guidance of assets held at book value. This is to improve consistency in how those assets are reported in the separate account. The comment deadline for the exposures is May 31.

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### 10. Discussed Other Matters

Mears said an overall investment framework is being discussed in the Financial Condition (E) Committee. There will be an opportunity for verbal comments on the outstanding exposure draft that closes in April. There are components in it that would impact the work of the Task Force. The Task Force is taking that into account and looking at what responsibilities it will be assigned to work holistically together as further efforts move forward at the Financial Condition (E) Committee.

Having no further business, the Valuation of Securities (E) Task Force adjourned.

[https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2024/2024-03-16 NAIC Spring NM/Minutes/VOSTF\\_2024-03-16\\_Spring\\_NM\\_Minutes v5 \(FINAL\).docx](https://naiconline.sharepoint.com/teams/SVOVOSTaskForce/Shared Documents/Meetings/2024/2024-03-16 NAIC Spring NM/Minutes/VOSTF_2024-03-16_Spring_NM_Minutes v5 (FINAL).docx)

Draft: 12/12/2023

Valuation of Securities (E) Task Force  
Orlando, Florida  
December 2, 2023

The Valuation of Securities (E) Task Force met in Orlando, FL, Dec. 2, 2023. The following Task Force members participated: Doug Ommen, Chair, represented by Carrie Mears (IA); Eric Dunning, Vice Chair, represented by Lindsay Crawford and Nolan Beal (NE); Mark Fowler represented by Sheila Travis and Blase Abreo (AL); Lori K. Wing-Heier represented by David Phifer (AK); Ricardo Lara represented by Laura Clements (CA); Andrew N. Mais represented by Kenneth Cotrone (CT); Michael Yaworsky represented by Carolyn Morgan, Jane Nelson, and Ray Spudeck (FL); Dana Popish Severinghaus represented by Vincent Tsang (IL); Vicki Schmidt represented by Tish Becker (KS); James J. Donelon represented by Stewart Guerin (LA); Kathleen A. Birrane represented by Matt Kozak and Dmitriy Valekha (MD); Grace Arnold represented by Fred Andersen (MN); Chlora Lindley-Myers represented by Debbie Doggett (MO); Jon Godfread represented by Matt Fischer (ND); D.J. Bettencourt represented by Jennifer Li (NH); Justin Zimmerman represented by David Wolf (NJ); Adrienne A. Harris represented by Bob Kasinow and Jim Everett (NY); Glen Mulready represented by Diane Carter and Eli Snowbarger (OK); Michael Humphreys represented by Diana Sherman (PA); Carter Lawrence represented by Trey Hancock (TN); Cassie Brown represented by Amy Garcia and Jamie Walker (TX); Jon Pike represented by Jake Garn (UT); Scott A. White represented by Doug Stolte (VA); Mike Kreidler represented by Steve Drutz (WA); and Nathan Houdek represented by Amy Malm (WI). Also participating was: John Tudino (RI).

1. Adopted its Summer National Meeting Minutes

Doggett made a motion, seconded by Clements, to adopt the Task Force's Aug. 14 minutes (see *NAIC Proceedings – Summer 2023, Valuation of Securities (E) Task Force*). The motion passed unanimously.

2. Heard a Staff Report on The History of FE

Mears said the next item is to hear a staff report on the history of filing exemption (FE), the role of the Securities Valuation Office (SVO), and the SVO's discretion. State insurance regulators heard this report during the Fall Education Seminar and found it informative since many have not been around for this entire history. It is also informative as the Task Force moves forward with the review of reliance on rating agencies.

Marc Perlman (NAIC) said at the request of the Task Force chair, the next few minutes of the meeting will be history lesson with a walk-through of the evolution of the use of third parties, rating agencies, the SVO, and FE in the assessment of insurer investments. With the significant debate around reintroducing a form of SVO discretion over ratings, Mears thought a little context might be helpful to demonstrate that this recommendation is not an aberration but rather a return to what had been the norm.

For this report, there was an extensive review of NAIC minutes and old versions of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual). The report covers a lot of ground and a lot of years, so the research is not exhaustive but, especially with those early years, it will give a sense of how centralized valuations developed, who was tasked with doing them, and the use and role of rating agencies in the process.



In September 1907, Massachusetts first raised concerns about discrepancies in insurer valuation practices. This was prescient because a month later there was a financial panic after which the New York Department of Insurance (DOI) and the NAIC Committee on Assets revisited the topic and suggested finding an expert to value insurer investments for all departments.

By 1909, the NAIC had convened a Committee on the Valuation of Securities, which was to become the sole source of values. It decided to outsource this task to an expert in the field. In December 1909, the Committee signed a contract for \$5,000 with Marvyn Scudder, Esq. of 55 Wall Street to produce all valuations. Scudder had been called the country's foremost stock detective and was the editor of the "Marvyn Scudder Manual of Extinct and Obsolete Companies."

Scudder produced a valuations book each year through 1928, at which point the Committee on the Valuation of Securities contracted with Poor's Publishing Company (the predecessor to Standard & Poor's [S&P]), pursuant to which it would determine all values. In 1939, Moody's Investor Service (Moody's) got the contract.

In 1934, the topic was broached of the NAIC creating a Statistical Bureau of its own, available to the Insurance Commissioners of all states to appraise, value, and analyze insurance company portfolios and publish a valuations book much like Scudder and S&P had done. That would not happen for another ten years.

In the early 1930s, there were discussions that not all bonds should be reported at market value because "value" can fluctuate, often for reasons unrelated to the creditworthiness of the issuer. There was discussion that bonds that were deemed "amply secured" should be valued on an amortized—or a long-term stable basis—rather than the market value at which a security would be liquidated.

In 1941, a change was implemented to distinguish between bonds that could be amortized and those that would be valued at market value. Credit ratings were used as a test of amortization eligibility. Bonds rated by any two of Moody's, S&P, and Fitch (the only agencies at the time) in any of the first five grades, would be deemed "amply secured" and eligible for amortization.

In 1943, the Committee stopped using external consultants, as Moody's didn't extend its contract due to wartime responsibilities. The Committee undertook to perform all valuations and amortization determinations itself and leased a space at 61 Broadway. In the next two years that office was staffed and the Office of the Committee on Valuation of Securities was created, which later became the Securities Valuation Office (SVO).

It should be noted that at the time of its establishment, this precursor to today's SVO, just like Marvyn Scudder, S&P, and Moody's, was intended to be an independent, expert, and impartial source of investment values and amortization determinations.

By 1949, the volume of private placements was growing quickly. Each was reviewed by the Office, but there was discussion about expanding the office to meet the growing demand as well as the difficulties the Office faced in producing valuation and amortization determinations for private securities based on whatever financial information it was able to gather because there was no market value. To be clear, these were corporate bond private placements, not the more complex structured private placements we see today.

Two years later, this debate was ongoing and there was an interesting summary presented at the 1951 National Meeting of the analytical standards being used by the Office and critiques of those standards. Regarding the use of ratings to determine amortization eligibility, the report said, "The principal objection to this phase of

current valuation procedure is the Committee's reliance upon the opinions of rating agencies whose approach and objectives may differ from those employed by the technical staff of the Committee." Regarding the Office's valuation of private placements, the report said, "The limitations upon this portion of the valuation method arise primarily from a lack of readily available and sufficient information concerning publicly traded bonds with which to compare the securities under review."

By 1953, the Committee adopted an analytic approach that remained relatively unchanged until 1989. Under this approach, which was refined from time to time, investments were given "Association Values." For bonds, the association value was comprised of two parts: a numerical notation and a statement as to eligibility for amortization. The amortization eligibility component could be thought of as the NAIC's quality opinion. The approach specified two analytic tests containing different standards for different entities, such as railroad, public utility, new enterprise, etc. The tests specified certain levels of standard bond analysis techniques. In Test 1, a corporate obligation would be eligible for amortization if it were rated in one of the four highest grades (i.e., investment grade) by any one of the recognized rating agencies. If it weren't, it could still be amortized if it met certain other financial ratios.

Even then, the results of the two tests were subject to further review and examination for any cases having predominant weakness or strength. In other words, the Office had discretion. As explained by the Office, "Because it is difficult to apply standardized tests to the wide variety of obligations which are purchased by insurers, the valuation procedures provide for the exercise of discretion in determining the qualitative and reserve categories for bonds not susceptible of measurement by such measures."

With the same basic analytic approach in place for 30 years, by the mid-'80s there was a move to revamp the valuation procedures. In December 1986, the Financial Condition (EX4) Subcommittee created a Bond Criteria (EX4) Subgroup of the Valuation of Securities (E) Task Force and charged it "to update and revise the financial ratio criteria and industry breakdowns" in the bond section of the SVO Procedures (precursor to the P&P Manual). Two industry advisory groups (called the A Group and the B Group) were then created to assist the Bond Criteria (EX4) Subgroup. In a 1988 report by the B Group, industry professionals from Morgan Stanley, Merrill, Moody's, S&P, Solomon Brothers, and Drexel Burnham discussed the need for a "reasonable" solution to the SVO's regulatory and analytical charge in light of its resource limitations. The Subgroup recommended the SVO take advantage of publicly available credit analysis and the results of existing financial research to screen out those debt investments that posed nominal default risk so it could focus on the issues with greater risk or where publicly available analysis did not exist. The Subgroup also said that for those investments requiring more in-depth review, the SVO should exercise significant discretionary analysis and authority utilizing all quantitative and qualitative analytical factors that it deemed necessary. It went on to say that it "wholeheartedly" agreed with the A Group, that "the SVO retain discretionary authority to review any situation warranted by specific facts and circumstances."

Finally, in 1989, revamped analytic guidelines were created in the then new P&P Manual. The guidelines said that, where appropriate, the SVO would use the Zeta Services quantitative financial model and past financial statement data to determine a preliminary measure of the relative financial soundness of the issue. The model, however, was not intended to be the sole determinant of the NAIC Designation. Rather, the SVO would review historical financial data and focus on security-specific factors, including covenants, structure, collateral, and ratings, which were just one element of the review.

The following year, the P&P Manual was changed to say that ratings of other recognized rating organizations would be translated directly into an NAIC designation. However, "The SVO staff will have discretionary

authority to downgrade ratings of other organizations but not to upgrade.” It was also the year that “Yes” and “No” designations were replaced with the 1–6 used today.

The 1992 P&P Manual explained the relationship to nationally recognized statistical ratings organization (NRSRO) ratings, saying that NAIC guidelines and procedures promulgated by the Task Force permitted the SVO to incorporate or adopt work product of NRSROs or other reliable securities research organizations in lieu of determining an independent valuation for a security. The P&P Manual had a conversion table, but it did not imply an equivalency between NAIC designations and NRSRO ratings. However, the P&P Manual also said that the SVO retained absolute discretion to apply a lower designation.

In 1996, a distinction between public and private ratings was made with public ratings usually being granted automatic translation, with the caveat that the SVO retained discretion. Private ratings, however, were subject to full SVO review of the factors that may not be included in the NRSROs public ratings.

The following year, the P&P Manual included another qualifier regarding the use of NRSRO ratings. It said “the NAIC uses NRSRO ratings in order to conserve limited regulatory resources and to obtain publicly available high quality credit opinions. While NAIC Designations reflect the staff’s opinion about credit risk, the staff must address concerns unique to the regulatory community. Nothing in this manual should be interpreted as implying that the methodologies by which traditional or special NRSRO ratings are produced are identical to the manner in which the SVO considers credit risk for regulatory purposes, or to imply automatic equivalency of NAIC Designations with the ratings of NRSROs.”

Until this point, with certain rare exceptions (such as highly rated commercial paper, all securities needed to be filed with the SVO. Thus, even if the SVO just looked to ratings for a determination of amortization or to assign a designation, the SVO was seeing every insurance company investment and it had very few blind spots as to what insurers were investing in.

At this point, however, the movement toward what was called provisional exemption had begun. Provisional FE became effective Jan. 1, 2000, and under Provisional FE, both traditional bonds and asset-backed securities (ABS) rated by two or more NRSROs with the equivalent of an NAIC 2 Designation or one NRSRO with the equivalent of an NAIC 1 designation would not need to be filed with the SVO. There were certain other requirements to qualify for Provisional FE. For example, the security had to be issued by a U.S. entity and paid in U.S. dollars, principal had to be paid in full by a fixed maturity date and, in the case of ABS, only certain asset classes were permitted. Even with provisional FE, though, the P&P Manual cautioned that the SVO would not be able to monitor any market innovation or regulatory risk and it maintained SVO discretion. Provisional FE did not limit the SVO’s authority to require a filing that would otherwise be provisionally exempt.

The main question is why provisional FE was adopted. In 1996, there was a letter from the Joint Trades to the Task Force that focused on the SVO’s lack of resources and industry’s dissatisfaction with SVO efficiency at that time. A trade association recommended that insurers not need file non-structured securities rated investment grade by an NRSRO. Around the same time, an SVO Oversight Working Group was created to monitor SVO operations and to be a mechanism by which industry could raise concerns about the SVO. This oversight group conducted what it called the SVO Efficiency and Effectiveness Project, with the intended goal of increasing usage by the SVO of NRSRO ratings. At the same time, the NAIC hired outside consultant KPMG Peat Marwick to produce an independent report of the SVO and an SVO Subgroup of the Executive Committee conducted a study in response, which adopted and rejected some of KPMG’s recommendations. Both reports were presented in regulator-only sessions, and copies of the report have not been located. There was also a

supposed public 8-page summary of the report, but that was also not located. However, based on subsequent minutes, it appears that the reports recommended greater reliance on ratings and provided a basis for provisional FE, likely due to the SVO's efficiency and resource problems at that time.

The Task Force, Oversight Working Group, and some in industry had concerns with reliance on NRSROs, and the joint trades addressed that in another letter. There were concerns, for instance, about private placements. The joint trades argued those were a minority of insurer investments but conceded they might require additional due diligence. There was a concern about ratings shopping or inflation with some arguing that an AAA threshold would promote the search for higher ratings. The Joint Trades did not think that should be concerned since NRSROs are judged by the quality of their ratings, presumably meaning that they would not reduce standards.

Others argued that ratings inflation would be an NRSRO accreditation problem rather than an FE problem. Moody's noted that ratings creep could become a problem if rating agencies were used for regulatory purposes, since the issuer would place more emphasis on receiving a higher rating rather than an accurate one. Moody's also said that reliance on ratings would have more impact on the less liquid markets, including private placements and structured securities. The trade associations, however, did reiterate that the provisional FE proposal did not affect the SVO's ability to request information about any security when it believed it to be necessary.

There was a lot of discussion about which ABS asset classes would be permitted. Certain state insurance regulators, industry, and staff had concerns that the change would limit the SVO's ability to fulfill its "eyes and ears" function, its role in spotting market innovation and risk. One SVO analyst warned of then-recent developments in a potentially riskier "subprime" asset class. There were also discussions about whether NRSROs should or can be differentiated. Some said the SVO could not currently differentiate between agencies because it had not been given the tools to objectively evaluate them. Others said the SVO Oversight Working Group should address NRSRO concerns directly with the NRSROs. Also, a 1994 Federal Reserve Report was cited, which said, "Differences [between rating agencies] can be highly problematic for ratings-based regulation in which ratings of any two NRSROs are substitutable."

Provisional FE was adopted for the start of 2000. In anticipation of its adoption, industry produced a frequently asked questions (FAQ) document for its roll-out. Question #3 was: "Why does the language say, 'provisionally exempt'?" The answer was that insurers have no irrevocable "right" to exemption from the filing of securities and the SVO and state insurance regulators will maintain the authority to request filings of securities that are provisionally exempt.

Soon after provisional FE became effective, attempts to expand the scope of exemption began. The SVO Oversight Working Group charged the SVO and interested parties with analyzing the feasibility of including non-NRSRO ratings, though this did not gain traction because it was argued that the Task Force was relying on U.S. Securities and Exchange Commission (SEC) recognition of NRSROs because the SVO did not have the staff to conduct an independent analysis and make those determination for each rating agency.

Then, there was a proposal for subsequent exemption, which would have exempted certain securities with optionality features from annual updates. That, too, failed to gain traction. Other state insurance regulators discussed the possibility of the SVO reviewing every security at least once but then defining classes of securities that would be FE.

In 2003, there was the first proposal for full FE. It had three components: 1) exemption for all NAIC 1 and 2 rated equivalent securities (ignoring the several limitations imposed by provisional exemption, which, for example, only applied to U.S. issuers paying US dollars); 2) FE for NAIC 3–6 rated equivalent securities; and 3) an alternative to SVO review of unrated securities. This part of the proposal called for insurer self-designation.

Some of the rationale for full FE was that: 1) NRSRO ratings are sufficient to establish quality and the Oversight Working Group said it was comfortable with NRSRO ratings, particularly issues that were rated by multiple NRSROs; 2) the SVO was not using its discretionary authority very often and some said FE would turn an implicit reliance on ratings into an explicit one; 3) a new SVO Research Unit (created as part of the Efficiency and Effectiveness Project) could play the main “eyes and ears” function of the SVO and the SVO’s limited resources could be directed there; 4) it was argued that ratings focus on credit risk, whereas the SVO could focus on other non-credit risks affecting solvency; 5) insurer self-designation would make the SVO more efficient; and 6) it was argued that the NAIC had the power to withdraw an NRSRO from FE eligibility if it did not meet regulatory purposes.

Some argued against the full FE proposal or parts of it. Some of those arguments were that: 1) there was more volatility in below investment grade rated securities; 2) NAIC designations do not match ratings exactly; and 3) self-designation was particularly unpopular with regulators, even those who supported full FE. They said it just does not work since competitive business pressures compromise it and investors focus on risk and return while the regulators’ approach to quality may differ. Additionally, self-designation could result in different designations for the same security and would turn the process, which had been uniform for the 100 years, into a fragmented one once again.

In any event, the SVO Oversight Working Group saw little regulatory risk in relying on NRSROs. A modified version of full FE was adopted and became effective in 2004. This version scoped in NAIC 1–6 rated equivalent securities and included ABS, residential mortgage-backed securities (RMBS), and structured securities. In this version, private ratings were included while principal-only ratings were excluded.

Since then, full FE has undergone occasional adjustments. FE has been trimmed back, with several asset classes being expressly scoped out. Some, like RMBS, commercial mortgage-backed securities (CMBS), and now collateralized loan obligations (CLOs) have been handed to the Structured Securities Group (SSG). In Part Three of the P&P Manual, there is a list of other investments that are no longer eligible for FE. Credit tenant loans (CTLs) and ground leases on that list refer to the those defined in the P&P Manual as mortgage loans in the scope of *Statement of Statutory Accounting Principles (SSAP) No. 37—Mortgage Loans* and not investments in securities that are eligible for FE.

To conclude, FE has been in use for 20 years. It is what most know, is obviously quite important, and is not going away. However, there has never been an absolute right to use rating agency ratings, including today. The Task Force and its predecessors have always retained the right to use ratings as they think appropriate. For most of the Task Force’s and SVO’s existence, even when the Office relied on ratings for certain aspects of valuation or designation, the Office was considered the independent, impartial expert (and remains so today) and its discretion was permitted and viewed by state insurance regulators and many in industry as an important and necessary feature of the valuation/designation process.

Chris Anderson (Anderson Insights LLC) said it is important to distinguish when the SVO valued securities and when it began assessing risk. The SVO valued securities and published a book of association values. In 1951, there was a mandatory securities valuation reserve (MSVR), which some may remember when credit became

an element. With the adoption of risk-based capital (RBC) in the early 90's, the role of the SVO transitioned and is now credit focused and not the valuation office that it used to be. The takeaway is that risk metrics like MSVR and RBC were important drivers of the history of the SVO.

3. Received a Referral from the Statutory Accounting Principles (E) Working Group on Changes Proposed for Schedule BA Investments and a Recommendation From the SVO on Those Changes

Mears said the next agenda item was to receive a referral from the Statutory Accounting Principles (E) Working Group on its proposal to report debt securities that do not qualify as bonds on Schedule BA. A key component of the notice was to highlight that the proposal uses existing Schedule BA reporting provisions for SVO-assigned NAIC Designations in determining RBC. This referral was sent to the Task Force and the Capital Adequacy (E) Task Force. The SVO staff prepared a recommendation, and Charles Therriault (NAIC) provided a summary of that recommendation. The Task Force could then consider how it would like to respond to the Working Group and Capital Adequacy (E) Task Force on this matter.

Therriault said the Task Force has an existing policy in the P&P Manual in Part One, paragraphs 40 and 99, and instructions to the SVO in Part Two, paragraphs 209–212, that permit the SVO to assign NAIC Designations to Schedule BA assets.

SVO staff strongly recommend the continuation of the long-standing existing policy of only allowing the bond RBC factors associated with NAIC Designations assigned by the SVO to investments appropriately reported by insurers on Schedule BA. The nature of the investments on this schedule can vary widely and are often highly bespoke, which demands a higher level of regulatory scrutiny before being granted this favorable treatment. The adopted revisions to the definition of a bond following the principles-based bond project likely means that more unusual investments will be moving to Schedule BA. Keeping the process as-is will also align with the Task Force's efforts to reduce blind reliance on rating agency ratings. The SVO would also recommend the recognition and treatment of SVO-assigned NAIC Designations to investments on Schedule BA be made consistent and uniform across all statement types, as only life and fraternal insurers benefit today.

Mears, hearing no objections or concerns from the Task Force on the SVO's recommendation, said the recommendation would be communicated to the Capital Adequacy (E) Task Force and eventually the Risk-Based Capital Investment Risk and Evaluation (E) Working Group.

4. Exposed a Proposed P&P Manual Amendment to Update the Definition of an NAIC Designation

Mears said the next agenda item was to receive, discuss, and consider for exposure a revision to the proposed P&P Manual amendment to update the definition of an NAIC designation. After the Summer National Meeting, the SVO was directed to consider the actionable comments from industry and to work with industry on further updating and simplifying the definition. Perlman provided an update on these changes.

Perlman said, as mentioned at previous meetings, NAIC designations are currently explained and defined in both Parts One and Two of the P&P Manual. The SVO has proposed consolidating the explanations and definitions into Part One because what constitutes an NAIC Designation is a fundamental policy of the Task Force. In the amendment, the NAIC tried to clarify the meaning of an NAIC Designation, including their use, purpose, and the risks addressed. At the Summer National Meeting, the Task Force and interested parties discussed and provided comments and feedback on that initial draft of the proposal, and the Task Force directed the SVO staff to consider that feedback in a revised version of the amendment. Several of the

actionable comments received were incorporated into the amendment being considered for exposure. First, a more concise definition of an NAIC designation that reflects credit quality was created, which also reflects (i) any inconsistencies with the existing regulatory assumption that a fixed-income instrument pays scheduled interest and full repayment of principal on a date certain. This could result in diminution of payment and (ii) where appropriate, loss given default and/or “tail” risk. These last components would likely only be appropriate for certain structured asset classes. Additionally, all references to Subscript S and its application to securities for other non-payment risks was removed.

Mears directed the SVO to expose the updated definition of an NAIC designation for a 53-day public comment period ending Jan. 26, 2024.

5. Exposed a Revised Proposed P&P Manual Amendment Authorizing the Procedures for the SVO’s Discretion Over NAIC Designations Assigned Through the FE Process

Mears said the next agenda item was to receive, discuss, and consider for exposure a revised proposed P&P Manual amendment that would authorize the procedures for the SVO’s discretion over NAIC Designations assigned through the FE process. As mentioned during the Summer National Meeting and during the Task Force’s the May 15 meeting, the proposal stems from the Financial Condition (E) Committee’s charge to the Task Force to: Establish criteria to permit staff’s discretion over the assignment of NAIC designations for securities subject to the FE process to ensure greater consistency, uniformity, and appropriateness to achieve the NAIC’s financial solvency objectives.

The Task Force received many comments on the initial proposal put forth by the SVO. SVO staff took those recommendations to heart and worked with state insurance regulators to incorporate many of them into this revised proposal. Overall, this was a very deliberative process that state insurance regulators feel is both fair and reasonable, with appropriate levels of feedback and oversight.

It is incredibly important to remember that NAIC designations ultimately fall under the purview of state insurance regulators and are used solely within the insurance regulatory framework. Credit rating providers (CRPs) provide an invaluable service given the number of securities and efficiencies gained by the NAIC. This was demonstrated in the presentation from Perlman and there is no intention of displacing or competing with them. However, because of how the NAIC uses CRP ratings in its processes, this is not an unconditional usage. This proposal is specific to how state insurance regulators, as responsible consumers of CRP ratings for regulatory purposes, choose to use them in that regulatory process. It also empowers the SVO staff to act through a well-defined process, when necessary, in supporting state insurance regulators in this responsibility.

Therriault said the revised amendment incorporates the following process steps, many of which were requested by interested parties:

- 1) The process starts when an SVO analyst or NAIC regulator identifies as FE security with an NAIC designation assigned by a rating that appears to be an unreasonable assessment of risk.
- 2) The SVO would then convene the Senior Credit Committee (SCC), composed of the SVO director, the managing investment council, the two credit managers, and four credit supervisors, to meet with the analyst and determine if it agrees that the rating appears to possibly be an unreasonable assessment of risk and, if so, place the security “Under Review.”

- 3) If the SVO SCC votes to put the security “Under Review,” an information request will be sent through NAIC systems, such as VISION, to the insurers that hold that security that the SVO needs information on it. If the information request is not responded to, the SVO may reach out to the domiciliary chief financial examiner.
- 4) Upon receipt of all necessary documentation through the information request, the SVO will then perform a full analysis of the security and coordinate during its analysis with interested insurer(s) on any questions or issues the SVO may have about the security or questions that the insurers may have for the SVO. Insurers are invited to have discussions with the SVO during its analysis to better understand the SVO’s analytical concerns and methodology and are able to share their own analytical perspective and methodology.
- 5) When that analysis is completed, the SVO SCC reconvenes and determines, based on its full analysis of all necessary information, whether the FE NAIC designation is three or more notches different from the SCC’s opinion.
- 6) If the SVO SCC opinion differs from the FE-produced NAIC designation category by a material three or more notches, the specific CRP rating(s) for that security will be identified for removal from FE and the SVO SCC will present its analysis to a subgroup of the Task Force to provide oversight over the FE removal process and enable the Task Force to provide feedback to the SVO.
- 7) If there are no alternative CRP ratings, the SVO SCC’s assessment will be entered into VISION. If an alternative CRP rating is subsequently received, it will be incorporated into the FE process, if applicable.
- 8) If the SVO SCC assesses the issue is part of a recurring pattern, the SVO director will inform the chair and decide if an issue paper, referral, amendment, or other action is needed.
- 9) An anonymized summary of each unique issue or situation will be published on the SVO web page or some other insurer-accessible location for transparency.
- 10) An insurer may appeal to the Task Force chair if it believes the SVO did not follow the procedures outlined in the P&P Manual. This is an existing instruction that insurers can always avail themselves of.
- 11) If an insurer(s) wishes to appeal the SVO SCC’s analytical assessment, it may request the NAIC’s Investment Analysis Office (IAO) to contract, at the insurer’s expense, with an independent third-party acceptable to the NAIC IAO to perform a blind review of the security (e.g., without knowledge of the SCC’s, insurers’, or CRP’s assessment) with the information provided through the information request. If the independent third-party review results in an NAIC designation category that is one or less notches different from the FE-produced NAIC designation category, then the SVO SCC’s opinion will be overridden by the reinstatement of the CRP rating(s). If the independent third-party review results in an NAIC designation category that is more than one notch different from the FE-produced NAIC designation category, then the SVO SCC’s opinion will remain.
- 12) The SVO will identify through SVO administrative symbols when a CRP rating(s) has been removed from the FE process for a security through its application of discretion.
- 13) At the Spring National Meeting, the SVO director will summarize FE discretion actions taken for the preceding year.

As a whole, the process outlined reflects many of the recommendations made by Task Force members and interested parties. Specifically, the SVO will have complete information before making an assessment, the Task Force will be involved and informed, the application of discretion only targets a CRP’s rating thereby permitting an alternate CRP rating to be used, insurers are invited to have discussions with the SVO during its analysis to better understand the SVO’s analytical concerns and methodology and are able to share their own analytical perspective and methodology, there is the ability for insurers to appeal the SVO’s analytical opinion to an independent third-party, and the SVO will publish an anonymized summary of issues encountered.



The SVO agrees that credit analysis is both an art and a science; therefore, differences of professional opinion are unavoidable. This proposal focuses on only material differences of opinion. There are additional checks and balances in this proposal that should provide the Task Force and industry comfort that the investment risk assessments are reasonable. Unless otherwise directed to do so by the Executive (EX) Committee and Internal Administration (EX1) Subcommittee, which have the ultimate responsibility for all NAIC fees, the SVO is not planning to propose any fees associated with the discretion analysis other than the potential expense already noted if there is an analytical appeal by insurers to an independent third-party.

Anderson asked how the SVO can determine that something is three notches off where it should be. He also stated that the tests specified presently are unproven in three instances and vague in the fourth instance, noting that the SVO has the authority under the proposal to declare if something is off three notches for any reason that it feels appropriate. He stated that he does not see in the memorandum from Nov. 3 description of the kind of interaction and information available to insurers called into question. Anderson said if that can be documented with the information available to insurers, it would be very helpful. Anderson's third point was in regard to the appeal process that is new. He said he appreciates the fact that it is being considered and incorporated into this proposal. However, as it is written, it is fraught with problems. First, an appeal can only be mounted if an insurer feels that the SVO has not followed the P&P Manual. Anderson said what is being discussed is whether a rating agency has done a creditable job in rating a security, and the SVO does not necessarily do what rating agencies do.

Mears said there are two different components to making an appeal to the chair or Task Force if any party feels a policy was not followed. Separately, insurers can use the third-party appeal if they do not agree with the analytical assessment, which does not have to be a process-driven appeal.

Anderson said what he was addressing was the third party. The issues with the third party regard confidentiality. He stated that lot of these issues are intended to be private placements. In private placements, the banker, rating agency, and others form deal teams and have confidential information/insiders. Anderson asked how you can find a third party that is eligible and entitled to receive material nonpublic information. A larger problem is that the third party is supposed to act blindly and cannot have access to the other information. Specifically, it cannot have access to the rating agency materials that detail what the rating agency has done. The rational can run from 20–30 pages, and the rating agency is required by the SEC to disclose which of its private methodologies it uses. The third party cannot have access under this proposal. The SVO would have performed its own credit that the third party would not have access to. Under this proposal, the third party will essentially get a stack of virtual documents and will have to figure out the deal all by itself. The SVO will have the benefit of looking at rating agency work but will be coming up with a rating from scratch. Anderson stated that there is a better way of doing this and he hopes the Task Force will consider it. Instead of trying to do a rating from scratch, which would have been done by the rating agency and SVO with guidance from other sources, the third party could evaluate the work of the rating agency, if the confidentiality concerns can be overcome, compare it to the work of the SVO looking at the credit files correspondence, and decide. That would be more likely possible than the idea of coming up with a full-blown rating that will require tremendous research.

John Garrison (Lease-Backed Securities Working Group) said one thing missing from the memorandum is that nothing requires the SVO to produce a report explaining its analytical process to the investor like what is done by rating agencies. Without that, is hard to see how any appeal could be effective without knowing the steps of the analysis. A comment letter addressing that issue will be prepared.

Mears said that has come up in some discussions and that Garrison should absolutely put that in his letter. To provide some initial feedback, Mears said she was initially neutral on the request to have the SVO publish its analysis. However, hearing more about how there was an expectation that insurers would want to use it to distribute amongst themselves made Mears think it would be incredibly problematic to have a written report out there when the NAIC does not have the same engagement letter and provisions that exist for those insurers to demand confidentiality of the process, especially when there are multiple insurers that are invested in a deal and one chooses to reveal that information when others choose not to. That is not a responsibility that the SVO (via the Task Force) can take on, it would end up being problematic.

Therriault said confidentiality is something that the SVO is very concerned about and putting this out in written form to be distributed would be something the SVO is very reluctant to do and would recommend against. Having an open discussion with insurers invested in the transaction is welcomed, and the SVO regularly invites them to have an open dialogue.

Mears said there should be no expectation that the insurer will not have full visibility into the analysis that has been done or the methodologies used, and should have a full conversation with the SVO. There is absolute transparency in that process built into this proposal.

Mears, with the permission of the Task Force, directed the SVO to expose the updated amendment authorizing the procedure for the SVO's discretion over NAIC designations assigned through the FE process for a 53-day public comment period ending Jan. 26, 2024.

6. Exposed a Proposed P&P Manual Amendment to Add Practical Expedient to Determine the Issue Date for PLR Filings

Mears said the next item on the agenda was to hear about a proposed P&P Manual amendment to add a practical expedient to determine the issue date of private letter rating (PLR) filings.

Therriault said the SVO has been unable to independently source the date attribute "issue date" (e.g. date of legal closing), a necessary input to determine the requirement to provide a PLR rationale report. The SVO proposes permitting it to apply a practical expedient by assuming that any security subject to PLR guidance that was acquired on or after Jan. 1, 2022, was issued on or after Jan. 1, 2022, unless documentation showing an earlier issue date is provided. This is to fill in the gap that exists in the current data.

Michael Reis (Northwestern Mutual, representing the American Council of Life Insurers [ACLI], the Private Placement Investors Association [PPiA], and the North American Securities Valuation Association [NASVA]), said there has been a back and forth with PPiA, NASVA, and ACLI companies that may relate to the same root cause of what the exposure is about or even an ancillary issue related to it. The groups are fine with the exposure date but would like to meet with the SVO to talk about some the concerns.

Therriault said the SVO is always happy to meet with industry, work through any operational details, and propose modifications if something is needed to clarify an issue.

Mears said if there are any operational questions or needed guidance on how to interpret something, it can be posted on the SVO or Task Force web page.

Mears, with permission of the Task Force, directed the SVO to expose the proposed amendment to add a practical expedient to determine the issue date of PLR filings for a 53-day public comment period ending Jan. 26, 2024.

7. Received a Staff Report on Updates on the Proposed CLO Modeling Methodology Ad Hoc Group

Mears said the next agenda item was to hear updates on the proposed CLO Modeling Methodology Ad Hoc Group.

Eric Kolchinsky (NAIC) said the CLO project is proceeding apace. Recently, the SSG proposed 10 scenarios, including a number in the tail of the probability distribution. The detail was posted for default rates and recoveries for each scenario on the CLO web page.

The SSG also posted cash flow results for each proxy deal. The next step is to set probabilities for each of the 10 scenarios based on these cash flows. The SSG is looking for industry feedback on these probabilities.

Kolchinsky also said based on the Risk-Based Capital Investment Risk and Evaluation (E) Working Group's work, the SSG views the current approach to be consistent with the American Academy of Actuaries (Academy) principles that were discussed. The SSG offers assistance to the Working Group or Academy on any work that may be required on CLOs or any other structured product.

Kolchinsky then said he would like to address two operational issues that have come up. First is the starting date for the project, which is 2024. To clarify, nothing operational happens Jan. 1. The first impact will occur at year-end 2024 when the results are released. Second, just in case this work gets slowed down, there is an option to extend the effective date to 2025. This possibility was anticipated at the start of the project. If the extension is required, the Task Force will be informed at the Spring National Meeting, and an amendment to the P&P Manual to replace 2024 with 2025 can be submitted for the Task Force's consideration at the Summer National Meeting.

8. Received a Staff Report on the Projects of the Statutory Accounting Principles (E) Working Group

Mears said the next item on the agenda was to hear updates on the projects of the Statutory Accounting Principles (E) Working Group.

Julie Gann (NAIC) said this is an update in accordance with the coordination initiative with the Statutory Accounting Principles (E) Working Group. The Working Group met Dec. 1, 2023. Gann said that for all actions, please refer to the full summary and the minutes, as this will just be a high-level subset of investment-related items that may be of interest to the Task Force. The Working Group adopted three items. First, regarding residual interests, in the interim, there were adopted revisions to *SSAP No. 43R—Loan-Backed and Structured Securities*, *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, and the annual statement instructions to make it clear that all in-substance residuals shall be reported on Schedule BA. At this national meeting, the Working Group incorporated revisions to *SSAP No. 30R—Unaffiliated Common Stock* and *SSAP No. 32R—Preferred Stock* to make it clear that all in-substance residuals should be recorded on Schedule BA. That is effective immediately for year-end 2023. Hopefully, it is very clear that if an investment is an in-substance residual, it needs to be on the Schedule BA reporting line as a residual.

Second, the Working Group adopted revisions to *SSAP No. 2R—Cash, Cash Equivalent, Drafts and Short-Term Investments* to further restrict the investments that are permitted for cash equivalent and short-term reporting, with an effective date of Jan. 1, 2025. As a reminder under the bond project, the Working Group adopted revisions to remove all ABS from that short-term schedule. With ABS, the items that were just restricted include mortgage loans and all Schedule BA items, including collateral loans.

Third, the Working Group adopted revisions to the annual statement instructions to address specific elements related to interest maintenance reserve (IMR) that will allow non-interest-related impacts to go to IMR instead of asset valuation reserve (AVR), with an effective date of Jan. 1, 2024. Those focus mostly on mortgage loans and debt securities with known credit events that have occurred, but the rating or designation has yet to be updated before it is sold by a company.

There are six exposures to be addressed. First is the exposed revisions to *SSAP No. 21R—Other Admitted Assets* to incorporate a new measurement method for residuals. This included comments received from industry on the incorporation of the “effective yield with a cap” method but also has a practical expedient to allow the “cost recovery” method, which was the approach exposed previously by the Working Group. This exposure also includes the guidance for non-bond debt securities and is part of the bond project exposures. However, there were no comments on that section from the last exposure so there are no revisions to it. This is exposed until Jan. 22, 2024, and will hopefully be adopted in early February so the Schedule BA revisions can be adopted in February. That will conclude all the revisions for the bond project. They are posted publicly on the Working Group web page.

The Working Group exposed reporting revisions for collateral loans on Schedule BA. There had been a lot of conversations with regard to collateral loans earlier this year clarifying the guidance for admittance. The reporting was not sufficient to identify the underline collateral for collateral loans, so that is reflected in exposure with the Jan. 22, 2024, deadline to include several more reporting lines to bucket collateral loans. It also requests comments regarding possibly consolidating some of those lines.

Also exposed were reporting revisions to Schedule BA to further expand the description of the different types of underline components for the *SSAP No. 48* items, such as fixed-income instruments, common stock, and real estate, to make sure everyone did the same descriptions for which investments were reported in each category for the Jan. 22 deadline.

There is a proposal to reject the “current expected credit loss” U.S. generally accepted accounting principles (GAAP) standard, otherwise known as current expected credit losses (CECL). The current exposure is for a full rejection of the CECL guidance.

The Working Group exposed revisions to IMR related to perpetual preferred stock reported at fair value. That measurement change was incorporated in 2021. The Working Group has not updated the current IMR guidance that refers to perpetual preferred stock. These revisions serve to correct the current disconnect in the guidance.

Lastly, the Working Group exposed significant *SSAP* revisions to *SSAP No. 93—Low-Income Housing Tax Credit Property Investments* and *SSAP No. 94—Transferable and Non-Transferable State Tax Credits* pertaining to investments that generate tax credits and acquired tax credits. This exposure expands that guidance and specifically asks for comments on impacts that should be considered for the Schedule BA reporting lines beyond the current Low-Income Housing Tax Credit (LIHTC) guidance.

9. Received Notification from the SVO that it Will Defer the Deactivation of PLR that Missed a Required PR Rational Report Until Year-End 2024 and Requested Insurers to Submit Their Reports

Mears said she believed that Therriault had one other matter related to the deactivation of private ratings that are missing a required rationale report for year-end.

Therriault said it is taking the NAIC longer than expected to make the necessary updates to associate PLRs to the private rating rationale reports. Additional testing is still needed, and the SVO will be deferring the deactivation of PLRs that do not have a required rationale report until year-end 2024. The SVO wants to be certain this process is working accurately and does not want to unnecessarily penalize any insurer by deactivating a private rating at year-end. If the SVO has received a private rating letter in 2023, it will be reflected in the AVS+ application for year-end. Insurers should continue to submit rationale reports to the SVO. While private ratings will not be deactivated, insurers should not use this as an opportunity to avoid filing the rationale report with the SVO. The initial assessment is that private ratings have significantly increased for 2023. Through Nov. 30, there are approximately 7,327 private ratings that translate into an NAIC Designation, which may include some 2022 PLRs. There are some 2,430-private rating rationale reports missing, and the related private rating would have been deactivated if the SVO was not deferring the deactivation process for year-end 2023. That number of missing rationale reports excludes securities that are missing an issue date, the problem discussed earlier, or those issued prior to 2018. Again, the SVO requests insurers submit complete information, including the required private rating rationale reports. The SVO will continue to test NAIC systems in 2024.

Having no further business, the Valuation of Securities (E) Task Force adjourned.