NAIC NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

As of December
2023

Purposes & Procedures Manual of the NAIC Investment Analysis Office

NAIC Securities Valuation Office
NAIC Structured Securities Group

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NAIC NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

The NAIC is the authoritative source for insurance industry information. Our expert solutions support the efforts of regulators, insurers and researchers by providing detailed and comprehensive insurance information. The NAIC offers a wide range of publications in the following categories:

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Information about statutory accounting principles and the procedures necessary for filing financial annual statements and conducting risk-based capital calculations.

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Important answers to common questions about auto, home, health and life insurance — as well as buyer's guides on annuities, long-term care insurance and Medicare supplement plans.

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Useful handbooks, compliance guides and reports on financial analysis, company licensing, state audit requirements and receiverships.

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PURPOSES AND PROCEDURES MANUAL
OF THE NAIC INVESTMENT ANALYSIS OFFICE

Policies of the Valuation of Securities (E) Task Force

Operational/Administrative Instructions and Methodologies of the NAIC Securities Valuation Office and the NAIC Structured Securities Group

Effective December 31, 2023

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SPECIAL NOTICE

This publication of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) is published once a year as of December 31 of the given year and reflects any amendments adopted by the VOS/TF in 2023.

HOW TO CITE TO THE PURPOSES AND PROCEDURES MANUAL OF THE NAIC INVESTMENT ANALYSIS OFFICE

Cite a section by Part and paragraph number; e.g., Part One, paragraph 24.

NOTE: This section identifies amendments to the Manual adopted by the Valuation of Securities (E) Task Force in 2021. The amendments are presented in the chronological order in which they were adopted by the VOS/TF. The guidance in amendments adopted by the Task Force in any given year are applicable for the reporting period that year-end. The date on which an amendment was adopted is shown to facilitate research in the NAIC *Proceedings* on the topic or issues which the amendment touched on. The NAIC *Proceedings* contain the minutes (which document action taken) and the reports or other documents (that present the technical issues) considered during the policy deliberations of NAIC Committees, Task Forces and Working Groups. Amendments to this Manual are published within days of their adoption on this SVO website maintained for the Task Force (*www.naic.org/cmte_e_vos.htm)* and are retained on that website until they are incorporated into and published (as of December 31 of the given year) for use during the year-end reporting process.

- **Adopted updates to clarify the meaning of Repurchase Agreement in the Derivatives Transaction definition for Funds in Part Three –** According to the SEC definition in the Rule 18f-4 adopting release, "In a reverse repurchase agreement, a fund transfers a security to another party in return for a percentage of the value of the security. At an agreed-upon future date, the fund repurchases the transferred security by paying an amount equal to the proceeds of the initial sale transaction plus interest." However, according to SSAP No. 103R - Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, "Reverse repurchase agreements are defined as agreements under which a reporting entity purchases securities and simultaneously agrees to resell the same or substantially the same securities at a stated price on a specified date." The SSAP No. 103R reverse repurchase agreement definition is the opposite of the SEC definition in the Rule 18f-4 adopting release. According to SSAP No. 103, "Repurchase agreements are defined as agreements under which a reporting entity sells securities and simultaneously agrees to repurchase the same or substantially the same securities at a stated price on a specified date." The SAPP No. 103R definition of repurchase agreement matches the SEC definition of reverse repurchase agreement, in which the fund is obligated to make a repurchase payment at a later date. To maintain consistency between this Manual and SSAP No. 103R and eliminate any misconception that a fund cannot be the purchaser of securities/lender of cash, the SVO update the definition for a reverse repurchase agreement the NAIC Fund Lists section of the Manual.

  The Valuation of Securities (E) Task Force adopted this amendment on Jul. 13, 2023

Recent Changes to the P&P Manual

- **Adopted update Notice of Credit Deterioration for the List of Qualified U.S. Financial Institutions –** The SVO maintains the List of Qualified U.S. Financial Institutions ("QUSFI") which indicates the financial institutions eligible to issue letters of credit ("LOCs") which, pursuant to Section 3 of the Credit for Reinsurance Model Law ("Model #785"), can be used to reduce an insurers liability when ceding reinsurance to certain assuming insurers. To qualify as a QUSFI the LOC issuing financial institution needs to meet the criteria listed in Section 4 of Model #785, which includes a requirement that the financial institution "Has been determined by either the commissioner or the Securities Valuation Office of the National Association of Insurance Commissioners to meet such standards of financial condition and standing as are considered necessary and appropriate to regulate the quality of financial institutions whose letters of credit will be acceptable to the commissioner." The SVO has encountered situations in which a financial institution on the QUSFI list was not downgraded below the minimum permitted ratings of BBB-/Baa3 in the QUSFI guidelines in Part Two of the Purposes and Procedures Manual prior to regulatory action being taken by their primary regulator(s), such as closure of the bank by the relevant state regulator and appointment of the Federal Deposit Insurance Corp. as receiver. The amendment authorizes the SVO to remove a financial institution from the List of Qualified U.S. Financial Institutions if actions are either announced or taken by their primary regulator(s).

  The Valuation of Securities (E) Task Force adopted this amendment via e-mail vote on Apr. 19, 2023

- **Adopted a non-substantive technical amendment clarifying the corresponding NAIC Designation Category for NAIC 5GI –** At the 2021 Fall National Meeting the Task Force adopted a non-substantive technical amendment to the PL Securities section in Part Three of this Manual which clarified that an NAIC 5GI Designation is the equivalent of an NAIC 5.B Designation Category. The SVO identified other places in the Manual where the 5.B GI Designation Category is not currently specified that were corrected by this non-substantive technical amendment.

  The Valuation of Securities (E) Task Force adopted this amendment on Feb. 21, 2023

The following amendments were adopted by the VOS/TF in 2023 to be effective for 2024.

- **Adopted an amendment including Collateralized Loan Obligations (CLO) as a Financially Model Security in Part Four –** A collateralized loan obligation (CLO) is type of structured security backed by a pool of debt, typically corporate loans with low credit ratings. An insurer that purchases every tranche of a CLO holds the exact same investment risk as if it had directly purchased the entire pool of loans backing the CLO. The aggregate risk-based capital (RBC) factor for owning all of the CLO tranches should be the same as that required for owning all of the underlying loan collateral. If it is less, it means there is risk-based capital (RBC) arbitrage. As noted in the Investment Analysis Office's (IAO) memo of May 25, 2022, "Risk Assessment of Structured Securities – CLOs", it is currently possible to materially (and artificially) reduce C1 capital requirements just by securitizing a pool of assets. The Task Force assigned the Structured Securities Group (SSG) the responsibility of financially modeling CLO investments and evaluating all tranche level losses across all debt and equity tranches under a series of calibrated and weighted collateral stress scenarios to assign NAIC Designations that create equivalency between securitization and direct holdings, thereby eliminating RBC arbitrage. This amendment is effective beginning with year-end 2024.

The Valuation of Securities (E) Task Force adopted this amendment on Feb. 21, 2023

DISCLOSURE STATEMENT

An NAIC designation for quality (NAIC Designation) of a security is produced solely for NAIC members who should interpret the designation for quality, in the context of the NAIC Financial Regulation Standards and Accreditation Program, a member's state insurance laws and regulations, and the regulatory or financial solvency profile of a specific insurance company.

While NAIC members are the officials responsible for state insurance regulation, and while the NAIC as an association works to express regulatory consensus on issues pertaining to insurance regulation, the NAIC SVO staff has no statutory or regulatory authority.

Because an NAIC Designation, is not produced to aid the investment decision-making process, NAIC Designations are not deemed to be suitable for use by anyone but NAIC members.

NAIC Designations are not intended to be and should not be used as if they were the functional equivalent of the credit ratings of nationally recognized statistical rating organizations or other rating organizations whose ratings are intended to be used by investors as predictive opinions of default risk.

The use or adoption of NAIC Designations by anyone other than NAIC members is improper and is not authorized by the NAIC.

PART ONE
POLICIES OF THE NAIC VALUATION OF SECURITIES (E) TASK FORCE

ABOUT THE NAIC, THE VALUATION OF SECURITIES (E) TASK FORCE AND THE SVO

The NAIC

1. The National Association of Insurance Commissioners ("NAIC" or "Association") was founded in 1871. The NAIC is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators of the 50 states, the District of Columbia and five U.S. territories. Through the NAIC, NAIC Members, in their capacity as state insurance regulators, establish standards and best practices, conduct peer review, and coordinate regulatory oversight. NAIC staff supports these efforts, representing the collective views of state regulators domestically and internationally. NAIC members, together with the central resources of the NAIC, form the national system of state-based insurance regulation in the U.S. The NAIC is not itself a regulatory entity.
2. The 56 members of the Association are supported by the Executive Headquarters, which maintains offices in Washington, D.C., Kansas City, Mo., and New York, N.Y.
3. Committees composed of NAIC members conduct the work of the Association. Prior to regularly scheduled tri-annual meetings, regulatory and administrative issues are assigned to expert groups of NAIC members for consideration and recommendation. Progress on assigned work is reported to the next level of the committee system at the tri-annual meetings until the matter is disposed of without action or sent to the plenary session for consideration by the entire membership. If adopted by the Plenary, the recommendation becomes Association policy, reflecting national regulatory consensus and serving as guidance to state insurance departments and state legislatures.

The VOS/TF and the SVO Staff

4. The NAIC has determined that credit quality of insurance company investments provide a sound empirical anchor for certain regulatory functions related to financial solvency regulation. The VOS/TF formulates and implements NAIC's credit assessment and related policies. The SVO is the professional staff assigned to support the VOS/TF. The SVO conducts credit quality assessments of securities owned by state-regulated insurance companies and performs such other duties specified by VOS/TF in this Manual or assigned by other NAIC regulator groups, from time to time.

ABOUT THIS MANUAL

Purpose

5. This Manual collects the cumulative policies of the VOS/TF, identifies the procedures and methodologies adopted by the VOS/TF for credit assessment of insurer-owned investment securities and provides information on the operational and administrative procedures conducted by the NAIC, the SVO and the SSG to support the VOS/TF. This Manual is authoritative on these topics over other NAIC publications. The policies, procedures, methodologies or language of this Manual are subject to modification or amendment in accordance with the NAIC Standard procedure specified below which provides that proposed modifications and/or amendments be presented to and adopted by the VOS/TF in accordance with that procedure and with the NAIC Constitution and By-Laws.

Expression of NAIC Standards in State Law and Regulatory Processes

6. NAIC Designations and other SVO and SSG products are standards identified in the NAIC Policy Statement and Financial Regulation Standards (SFRS) that have been incorporated into state law by the States as participants in the Accreditation Program administered by the Financial Regulation Standards and Accreditation (F) Committee. Information about the F Committee and the Accreditation Program can be accessed here: *www.naic.org/cmte_f.htm*.
7. Part A of the SFRS identifies laws and regulations deemed necessary to financial solvency regulation. Analytical products of the SVO and SSG [sometimes collectively called the Investment Analysis Office (IAO)] are directly or indirectly incorporated into SFRS Part A standards.
   - Standard 5 requires that insurer-owned securities be assessed in accordance with the standards promulgated by the NAIC IAO.
   - Standard 2 refers to the NAIC *Risk-Based Capital (RBC) for Insurers Model Act* (#312 which assigns RBC factors for securities based on their credit risk as quantified by NAIC Designations.
   - Standard 3 refers to the NAIC *Accounting Practices and Procedures Manual*, which uses NAIC Designations produced by the SVO and/or Price Grids produced by the SSG for statutory accounting purposes including to identify the valuation rules that apply to an investment.
   - Standard 8 refers to state investment regulations which often incorporate NAIC model law provisions that relate asset allocations to credit quality or credit risk quantified by NAIC Designations.

- Standard 10 refers to the NAIC *Credit for Reinsurance Model Law* (#785), which refers to insurer-owned securities compiled by the SVO and identified on the List of Investment Securities, and in a separate provision, letters of credits issued by the banks and non-bank financial institutions whose name is placed on the NAIC List of Qualified U.S. Financial Institutions administered by the SVO, as eligible for use as collateral in reinsurance transactions.

8. NAIC Designations and other analytical products of the SVO and 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 as described above. To ensure NAIC members have a central source from which to obtain information about insurer-owned securities (including their NAIC Designations) the VOS/TF has identified the AVS+ Products as the depository for information compiled by the SVO in the SVO List of Investment Securities.

Procedures to Amend This Manual

9. The VOS/TF establishes the following procedure to ensure that any person interested in the work of the VOS/TF who wishes to recommend a change, amendment or modification (Change) to this Manual understands the process for doing so. The VOS/TF will consider proposals to Change this Manual (a "proposal") consistent with the manner indicated in this procedure. A proposal may be considered at any time of the year at any scheduled conference call, interim meeting or national meeting ("meeting") of the VOS/TF.

10. A person making a proposal presents the proposal to the SVO in a written letter or memorandum (a "letter") addressed to the Chair of the VOS/TF and to the Director of the SVO. The letter or memorandum must identify the person presenting the proposal; any affiliation or representative relationship between that person and any others interested in the outcome; must provide a concise statement of the issue to be addressed by the proposal and, if possible, recommend the desired outcome. A proposal should be submitted to the SVO expeditiously with any explanatory or supporting material, information or data necessary to understand the issues presented.

11. Upon receipt of the letter, the SVO acknowledges its receipt and consults with the Chair of the VOS/TF as to its disposition. When considering when to schedule the proposal for discussion before the VOS/TF, the Chair may consider the technical difficulty associated with the proposal, the time needed by the SVO to research issues, develop recommendations and prepare a memorandum. In rare instances, or where urgent or emergency action may be required, upon a two-thirds majority approval vote of the VOS/TF members present, the Chair may direct that a proposal be considered as an exception to this procedure and timeline. SVO staff support will inform the person making the proposal of the decision of the Chair of the VOS/TF with respect to scheduling public discussion of the proposal.
12. Subject to the discretion and direction of the Chair of the VOS/TF, the SVO will place any proposal that is ready to be presented to the VOS/TF on the Agenda for the next scheduled VOS/TF meeting. A matter is deemed to be ready to be discussed by the VOS/TF when the Chair has deemed it appropriate. The Chair may charge the SVO to research the proposed amendment, the issues presented and to develop recommendations, in which case it will prepare a report for the VOS/TF. However, the SVO may advise the Chair if it determines that it cannot make recommendations at that time. The SVO will prepare and present the proposed Agenda, including the amendment and proposal and report, to the Chair of the VOS/TF for approval before it is released. When approved by the Chair of the VOS/TF the SVO will finalize the Agenda, prepare the document package and distribute it for the next scheduled meeting.
13. Any newly received proposal for a substantive (i.e., material) or technical amendment to the Manual and the SVO memorandum should be distributed to members of the VOS/TF (or to the subgroup formed by the Task Force to study the matter, if any) no less than two weeks prior to any meeting at which it is intended to be discussed.
14. Any proposal previously discussed and placed on an Agenda for further discussion should be distributed to members of the VOS/TF (or to the subgroup formed by the Task Force then studying the matter, if any) by the SVO no later than two weeks prior to a scheduled meeting where it is to be discussed.
15. A substantive amendment is one that introduces a policy issue or a regulatory issue not currently addressed in the Manual. A technical amendment is one modifying an existing process without a policy change that relates to the maintenance of existing processes; i.e., a proposal that seeks modification of an established procedure to interpret an existing process, reflect changes in the market or regulatory environment that suggest a need to modify an existing process or for similar purposes.

16. The content of the SVO memorandum prepared for the VOS/TF would reflect the nature of the issues presented, their technical or political complexity, whether reliable public information is available on the subject, whether confidentiality considerations exist or whether the issues are permitted or required to be discussed in a regulator to regulator session under the NAIC's Open Meeting Policy and other similar considerations. As a general matter and subject to the limitations inherent in the considerations identified in the preceding sentence, the SVO should address, the following matters:

    - Identification of the party proposing the Change and any other interested persons represented by the party.
    - Whether the proposal is considered to be a substantive amendment or a technical amendment.
    - A concise statement of the issue to be addressed by the Change.
    - An evaluation of potential or actual impact on operations of the VOS/TF, the Investment Analysis Office or state insurance regulation.
    - Suggested approaches or recommendation to resolve the issues presented by the proposal.
    - Whether it appears, upon consultation with other NAIC staff, that the proposal or any aspect of it should be considered alongside or against other existing NAIC guidance related to that of the VOS/TF, typically the *Accounting Practices and Procedures Manual*, Annual Statement Instructions or the risk-based capital (RBC) framework or against the charges of other NAIC regulator groups and if whether it is the sense of the NAIC staff that the proposal be referred to such other NAIC regulator group.
    - A survey of NAIC activity to evaluate whether any other NAIC groups is already reviewing a similar or related item, their position on the issues and the implication of that work for the proposal made to the VOS/TF.
    - Text responsive to the issues or concerns expressed or an outline of the concepts that are relevant in drafting such text and an explanation of why the recommended text will resolve the issue identified by the proposal. If the text is presented in the form of an actual amendment to existing language such proposed text should be in redline format; show how it would be incorporated into the Manual, including where in the Manual it should be placed and any other text that may need to be modified.
    - A summary of interested party positions on the proposed text and the regulatory pros and cons of such positions.

- An explanation of how the Change would affect other sections of the Manual, other NAIC groups, NAIC publications, handbooks or manuals or state insurance regulation.

17. Upon receipt and consideration of the proposal and the SVO memorandum the VOS/TF may:
    - Expose the proposal and SVO memorandum for such period of time as the complexity of the issue may require. This is done by placing the proposal on the VOS/TF – SVO websites and distributing the material to the persons enrolled on the VOS/TF Distribution List.
    - Instruct NAIC staff, the person who made the proposal or other interested parties to conduct further research and/or study and report back to the VOS/TF or other impacted groups; or
    - Refer the proposal or recommended resolution to another NAIC group for consideration or resolution; or
    - Decide to table the matter for a later date; or
    - Take a vote to approve, reject or modify the proposed language followed by a vote of the parent committee.
18. Following a public comment period, the VOS/TF will consider any comments received on the proposal at its next scheduled meeting. At the direction of the Chair, the SVO shall supplement the SVO memorandum with additional research or analysis as necessary to address additional issues presented in the comments or to discuss the recommendations made in such comment letters. The SVO shall also prepare a summary of interested party positions expressed in the comments and the regulatory pros and cons of such positions.
19. The final proposal for a technical amendment is effective when adopted by the VOS/TF. The final proposal for a substantive amendment is effective when adopted by the VOS/TF and by the Financial Condition (E) Committee. The nature of the proposal is identified in the SVO memorandum.
20. Proposals adopted by the VOS/TF are published to the VOS/TF webpage. Proposals adopted by the VOS/TF but requiring approval of the Financial Condition (E) Committee are published to the VOS/TF webpage when adopted by the Financial Condition (E) Committee.

21. Adopted proposals are incorporated in the next scheduled publication of the Manual and identified in the Recent Changes section of the Manual where the proposal is summarized and the date when the Task Force and/or the Financial Condition (E) Committee adopted it is given. The date of adoption is published so that interested persons can access the minutes and related materials in the NAIC Proceedings reflecting the deliberations held and the rationale for the position adopted by the VOS/TF.

22. The Manual is currently published once a year in accordance with requirements set by NAIC Publications. The instructions and guidance in the newly published Manual is effective for insurance companies for the year end reporting cycle in the year the Manual is published; i.e., December 31, through April 31 of the following year.

23. If subsequent to the publication of the Manual in a given year, errors are discovered, the SVO shall identify such errors in Errata which it will publish on its website. The Errata explains the error and provides corrected information. Corrections will be reflected in the next published Manual.

Prohibition on Use of NAIC Designation in a Covenant

24. An insurance company shall not use:

    - An NAIC Designation assigned by the SVO; or
    - An upgrade or downgrade of an NAIC Designation previously assigned by the SVO; or
    - A change in any aspect of how a security is regulated that is the direct or indirect result of an upgrade or downgrade of an NAIC Designation assigned by the SVO, as the basis for an agreement to modify the terms of a transaction (the "Prohibition").

25. The Prohibition shall apply only to transactions issued on or after September 1, 2010 and to transactions to which the prohibited clause is added after September 1, 2010. Effective September 1, 2010, insurance companies shall certify to the SVO that the submitted transaction does not contain a prohibited clause or agreement as a condition to filing with the SVO. The SVO is prohibited from processing any transaction it knows or has reason to believe contains a prohibited agreement or clause.

26. The Prohibition reflects:

    - The conclusion of the VOS/TF, as the initial and primary NAIC regulatory group responsible for implementing NAIC policy on risk assessment of insurer-owned securities, that the use of NAIC Designations as indicated in the Prohibition to modify the terms of a security or any other transaction is inconsistent with regulatory objectives; and

- The decision of the NAIC Executive (EX) Committee, as the body charged with directing NAIC corporate activities, that the use of NAIC Designations as indicated in the Prohibition to modify the terms of a security is inconsistent with the corporate objectives of the NAIC.

27. Insurance companies are, therefore, advised that the NAIC disclaims any and all responsibility whatsoever for surveillance of insurance company investments for purposes of identifying when a deterioration of the borrower's credit quality or other risk attribute suggests that the insurance company should adjust the financial terms of the original transaction to obtain a different overall investment return or compensation for the risks involved.

28. It is the sense of the NAIC that these decisions are private and the proper and exclusive concern of insurance company management. NAIC Designations are not published as investment advice to insurance companies and might lack necessary attributes that would make them suitable for use as investment advice.

29. The NAIC, therefore, rejects the view that insurance company representatives may reasonably rely on SVO credit assessments or on any other NAIC analytical process as a guide to adjusting the terms of their private investment arrangements with borrowers.

POLICIES PERTAINING TO SVO AND SSG OPERATIONS

Policy Objective

30. The policies adopted by the VOS/TF and the operations and administrative procedures developed by or for the SVO and/or the SSG to implement them reflect a decision of NAIC 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 developed regulatory guidance embodied in state law.

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

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

NAIC Designations Do Not Communicate Statutory Accounting or Reporting

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

Sources and Application of Statutory Accounting Guidance

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

Impact on SVO Operations

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

Communication and Coordination Between the SVO and Statutory Accounting Principles (E) Working Group Staff

35. The following processes are intended to assist optimum communication and coordination between the SVO and Statutory Accounting Principles (E) Working Group support staff functions:

    - Maintain ongoing dialogue regarding investments, investment related SSAPs and relevant developments in the areas assigned to support staff of both groups.
    - Maintain an ongoing dialogue relative to obligations and assets filed with the SVO, including communications about new types of obligations or assets filed with the SVO and their likely treatment under existing investment related SSAPs.
    - Maintain an ongoing dialogue relative to new obligations or assets, in which no statutory accounting guidance exists, or uncertainty exists about how current statutory accounting guidance applies to features or characteristics of the obligation or asset.

- Investment Analysis Office (IAO) and Financial Regulatory Services (FRS) staff shall provide notice to, and consult with, each other when either staff determine that existing technical guidance or procedures administered by the staff are no longer adequate to secure the original regulatory objective for which it was designed. Upon receipt of such notice, both staff will formulate a statement of the issues and, if possible, recommendations, and thereafter coordinate discussion between the Working Group and the VOS/TF consistent with the NAIC procedures and policies that apply to the situation. Such proposed recommendations shall be discussed consistent with the NAIC open meetings policy, and any revisions to the authoritative guidance will be exposed for comment for a period of time commensurate with the significance of the change, to provide a formal forum for interested parties and regulators to provide input and allow for adequate due process.
- In situations in which NAIC staff (SVO or FRS) are contacted directly with questions on statutory accounting application, it shall be noted that opinions of NAIC staff are not authoritative and are based on the information provided and existing authoritative statutory accounting guidance. Information and issues can be submitted to the Statutory Accounting Principles (E) Working Group for consideration, as detailed in the NAIC Policy Statement on Statutory Accounting Principles Maintenance Agenda Process.

SECURITIES VALUATION OFFICE (SVO)

Ongoing SVO Operations

36. The SVO shall conduct the following ongoing operations:

- Analysis of credit risk for purposes of assigning an NAIC Designation.
- Identification and analysis of securities that contain other non-payment risk and communication of this information by assignment of the NAIC Designation subscript to such securities.
- Other analytical assignments requested by the VOS/TF or members of the regulatory community; in accordance with the directives, procedures and general methodologies described in this Manual.
- Compile and publish the AVS+ Products in accordance with instructions in this Manual.
- Administer the filing exemption for insurer-owned securities that are assigned publicly available credit ratings and the verification procedure for securities whose credit rating is communicated to the issuer in a private rating letter.

NAIC Designations

37. The SVO's analysis of credit risk (hereafter defined), is expressed as an opinion of credit quality by assignment of an NAIC Designation that is notched to reflect the position of the specific liability in the issuer's capital structure. Collectively, NAIC Designations as defined in this Manual describe a credit quality-risk gradation range from highest quality (least risk) to lowest quality (greatest risk). NAIC Designations express opinions about credit risk except when accompanied by the NAIC Designation subscript, described below.

    - Credit risk is defined as the relative financial capability of an obligor to make the payments contractually promised to a lender. Credit analysis is performed solely for the purpose of designating the quality of an investment made by an insurance company so that the NAIC member's department of insurance can better identify regulatory treatment.
    - Credit risk is assessed by analyzing the information and documentation provided to the SVO by the reporting insurance company and its advisors. The SVO does not audit the information submitted and assumes the information to be timely, accurate and reliable.
    - The ability of an insurance company to realize payment on a financial obligation can be affected by factors not related to credit risk or by the manner in which the repayment promise has been structured.
    - NAIC Designations do not measure other risks or factors that may affect repayment, such as volatility/interest rate, prepayment, extension or liquidity risk.
    - An NAIC Designation must be interpreted by the NAIC member in context of the NAIC Financial Regulation Standards and Accreditation Program, other characteristics of the investment, and the specific financial and regulatory status of the insurance company.

38. The result of the SVO's credit analysis, expressed as an opinion of credit quality by assignment of an NAIC Designation shall be further expanded into NAIC Designation Categories as, and for the purposes, discussed in this Manual.

    NOTE: See "Production of NAIC Designations" in Part Two.

Other Non-Payment Risk in Securities

39. The result of the SVO's analysis of securities for other non-payment risk is expressed by the assignment of an NAIC Designation Subscript S and the application of the notching procedures described below.

NOTE: See "NAIC Designation Subscript S" and "SVO Notching Guidelines" in Part Two.

Authority on Reporting

40. The SVO is assigned to assess investment securities reported by insurers to state regulators on Schedule D and Schedule BA. For the avoidance of doubt, the SVO's opinion that an investment is ineligible for reporting on Schedule D or Schedule BA shall not prevent the SVO from assigning an NAIC Designation to that investment. The SVO may, but is not obligated to, notify appropriate state regulators of an insurer's investment which, in its opinion, would not or might not be eligible for reporting on Schedule D or Schedule BA, regardless of the investment's NAIC Designation status. The SVO shall give its statutory accounting and reporting opinion, if requested to do so, as part of its Regulatory Treatment Analysis Service, it being understood that such opinion is not authoritative and may not reflect the opinion of the relevant state regulator.

Use of Generally Accepted Techniques or Methodologies

41. The SVO may use any analytical technique or financial modeling approach taught in undergraduate and graduate business school financial analysis curriculum; any analytical technique otherwise widely or commonly used by lending officers, securities professionals, credit rating analysts, valuation professionals, statisticians or members of other similar professions and any special technique of modeling approach that may be appropriate in a special situation that provides a reasonable assessment of risk or valuation for regulatory purposes, despite the lack of an express authorization to use any technique or modeling approach in this Manual.

STRUCTURED SECURITIES GROUP (SSG)

42. The NAIC has determined that it is necessary to establish a staff function to provide NAIC members with an internal analytical capability to assess risks associated with insurer-owned securitizations and other complex financially engineered securities. The SSG is established as the staff function assigned to assess credit and other investment risks in securitizations and other complex financially engineered securities owned by state-regulated insurance companies.

NOTE: See Part Four for guidance on topics pertaining to the SSG.

Ongoing SSG Operations

43. The SSG shall conduct the following ongoing operations: