PURPOSES AND PROCEDURES MANUAL OF THE NAIC INVESTMENT ANALYSIS OFFICE

POLICIES OF THE VALUATION OF SECURITIES TASK FORCE
OPERATIONAL/ADMINISTRATIVE INSTRUCTIONS AND METHODOLOGIES OF THE NAIC SECURITIES VALUATION OFFICE AND NAIC STRUCTURED SECURITIES GROUP

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

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

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- **Adoption of a Policy Statement to provide principles for NAIC staff on coordination of the work of the Statutory Accounting Principles Working Group (E) and the Valuation of Securities (E) Task Force** - The policy provides a framework to guide coordination between the valuation-credit assessment and statutory accounting-reporting frameworks and was added to this Manual and to the NAIC Accounting Practices and Procedures Manual. The Policy makes clear that the use of NAIC Designation (whether assigned by the SVO or derived by the SVO from credit ratings of NAIC CRPs) is limited to that, if any, specified in a Statement of Statutory Accounting Principles (SSAP) and cannot be derived or implied by language in this Manual. Obtaining an NAIC Designation or an NAIC credit rating for a security does not change the statutory accounting posture or status of the investment; or the annual or quarterly statement reporting schedule, or override other SSAP guidance required for the investment to be an admitted asset.

  The Valuation of Securities (E) Task Force adopted this amendment on February 8, 2018.

- **Simplifying Amendments** - In response to concerns that the P&P Manual was becoming unwieldly and unnecessarily complex, SVO initiated a project to simplify the format and organization of the Manual. The simplification amendments united filing instructions and documentation instructions, housed in separate segments, with applicable methodology so all guidance applicable to a security type would be found in one location. The second part of the project involved a complete reformatting of the content of the P&P Manual.

  The Valuation of Securities (E) Task Force adopted simplifying amendments for: Power Generation; Working Capital Finance Investments; Credit Tenant Loans; Structured Transactions; Post-Default Securities; Certified Capital Companies and Lottery Securities on March 25, 2018.

  The Valuation of Securities (E) Task Force adopted simplifying amendments for: Catastrophe-Linked Bonds; Sovereign and Supra-Nationals; Preferred Stock; U.S. Government Securities and Military Housing Securities on June 11, 2018.

  The Valuation of Securities (E) Task Force adopted a simplifying amendment for SCA Investments on July 12, 2018.

- **Modernize the Credit Assessment Procedure Applicable to SCA Investments** - The procedure to assess credit risk in transactions between related parties was modernized to align it with statutory accounting requirements. Under the revised procedure, SVO is required to determine whether an SCA debt or preferred stock transaction between affiliated persons has terms, structure complexity and purpose like those in transactions between unaffiliated parties. If so the SVO can confidently anticipate application of the credit risk assessment methodologies used for investments between unaffiliated parties. Under the adopted revised procedure the

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SVO would not assess the security or assign it an NAIC Designation if it concluded that the SCA investment was unlike those between unaffiliated persons.

The Valuation of Securities (E) Task Force adopted the amendment on March 25, 2018.

- **Modifications to the Definition of NAIC CRPs** - The definition of NAIC CRP was modified to reflect an increase in the categories of rating activity in which H.R. Ratings de Mexico has NRSRO status and to include in the definition of NAIC CRP the Affiliates of the named NRSRO identified on the NRSRO's Form NRSRO as NAIC CRPs.

  The Valuation of Securities (E) Task Force adopted the revision relative to H.R. Ratings de Mexico on March 25, 2018 and the amendment to identify NRSRO Affiliates as NAIC CRPs on June 11, 2018.

- **The Definition of an NAIC Designation was modified to include the NAIC Designation Category framework for use by the Capital Adequacy (E) Task Force in its administration of the NAIC Risk-Based-Capital framework -** The NAIC Capital Adequacy (E) Task Force intends to increase the number of risk-based capital (RBC) factors for bonds to 20 using credit rating default probabilities of NAIC CRPs. The NAIC Designation Category provides the framework for the assignment of NAIC Designations to correspond with the new RBC factors. The amendment adopted by the Task Force incorporate the NAIC Designation Category into the definition of NAIC Designations and provides for mapping of NAIC CRP credit ratings to the RBC factors. NAIC Designation Categories would only be used for RBC purposes. NAIC Designations (NAIC 1 through NAIC 6) would continue to be used for statutory accounting, investment laws and other purposes.

  The Valuation of Securities (E) Task Force adopted this amendment on June 11, 2018.

- **Compilation Instructions were expanded to better describe the relationship between the SVO List of Investment Securities and the reference to the List in NAIC Reinsurance Model Laws, Model Regulations and Standards -** NAIC reinsurance standards, including but not limited to the Credit for Reinsurance Model Law, refer to the SVO List of Investment Securities provides (under different formulations) for the use of securities on the List as collateral in reinsurance transactions. The proposed amendment clarifies that securities on the List are stand-alone investments; that the focus of the reinsurance guidance is the right the owner of such a security has to the cash flow owed to the insurer by the obligor; that a security on the List cannot be assumed or presumed to constitute collateral under NAIC Standards simply because it is on the List because the status of a security as reinsurance collateral is not determined by the VOS/TF or the SVO or SSG.

  The Valuation of Securities (E) Task Force adopted this amendment on July 12, 2018.

- **Adopted a policy framework for the Filing Exemption Procedure** - In 2017, the VOS/TF identified policy objectives for transferring the administration of the filing exemption process to the SVO in a memorandum which was adopted and serves as the basis for subsequent decisions. This amendment incorporates such policies in the Manual.

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The Valuation of Securities (E) Task Force adopted this amendment on June 11, 2018.

- **The Valuation Instructions (and the SVO's Valuation Function) was eliminated**. - Changes to the valuation rules adopted by the VOS/TF in 2008, and to the statutory accounting guidance in 2010 (which established a framework for determining fair value) provide for the regulatory needs that led to the creation of the SVO valuation function. SVO recommended that the valuation instructions be removed from the Manual. The SVO will continue to assign values to securities for use in the AVS+ product when a price is not reported by the insurer.

  The Valuation of Securities (E) Task Force adopted this amendment on August 5, 2018.

- **The List of Broker-Dealers Eligible to Act as Custodians of Insurance Company Assets was deleted.** - The List of Broker-Dealers Eligible to Act as Custodian for Insurance Company Assets was deleted from the Manual. The List, placed in the Manual effective Dec. 31, 2005, permitted broker-dealers that met minimum criteria identified in the NAIC Model Act on Custodial Agreements and the Use of Clearing Corporations (#295) and the Model Regulation on Custodial Agreements and the Use of Clearing Corporations (#298) to apply to have their names added to the List after the SVO confirmed their eligibility. No broker-dealer ever filed to be added. NAIC staff indicated that the List is not necessary because the Models and the Exam Handbook provide the necessary guidance to state insurance departments.

  The Valuation of Securities (E) Task Force adopted this amendment on July 12, 2018.

- **The procedures that govern how changes are made to this Manual were revised -** The NAIC Governance Review (EX) Task Force had recommended that all groups with responsibility for maintaining NAIC work product that is incorporated by reference into state law prepare a written procedures document and post them to their respective NAIC websites. To ensure uniformity across NAIC regulator groups the SVO worked with the NAIC Legal Department to develop new procedures based on the template developed by the Governance Review (EX) Task Force.

  The Valuation of Securities (E) Task Force adopted this amendment on July 12, 2018.

- **The Large Company Standard of Swiss GAAP FER was added as a National Financial Presentation Standard** - The Large Company Standard of Swiss GAAP FER was added to the NAIC List of Countries and Associated National Financial Presentation Standard. This means an insurer may file a security with the SVO with audited financial statements prepared in accordance with The Large Company Standard of Swiss GAAP FER. Please see the Manual for information to be filed as part of the Audited Financial Statement.

  The Valuation of Securities (E) Task Force adopted this amendment on August 5, 2018.

DISCLOSURE STATEMENT

An NAIC designation for quality (NAIC Designation), or a classification of a security, is produced solely for NAIC members who should interpret the designation for quality or the classification decision in the context of the NAIC Financial Conditions Framework, 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 or a classification is not produced to aid the investment decision-making process, they 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 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.

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PART ONE
POLICIES OF THE NAIC VALUATION OF SECURITIES TASK FORCE

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ABOUT THE NAIC, THE VALUATION OF SECURITIES TASK FORCE AND THE SVO

The NAIC

1. The National Association of Insurance Commissioners ("NAIC" or "Association") traces its origin to 1871. The NAIC is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia and five US territories. Through the NAIC, NAIC Members, in their capacity as state insurance regulators, establish standards and best practices, conduct peer review, and coordinate their regulatory oversight. NAIC staff supports these efforts and represents 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, classification and securities valuation policy. The SVO is the professional staff of the VOS/TF responsible for day-to-day credit quality assessment and valuation of securities owned by state-regulated insurance companies. The SVO also performs such other duties as are specified by VOS/TF or other NAIC regulator groups.

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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 processes conducted by the NAIC, the SVO and the SSG on behalf of 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 procedure specified below which provides that proposed modifications and or amendments be presented to and adopted by the VOS/TF in accordance with the NAIC Constitution and Bylaws.

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 on 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 Program. Information about the F Committee and the Accreditation Program can be accessed here: http://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 SFRF 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 measured 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 risk expressed in the form of NAIC Designations. Standard 10 refers to the Credit for Reinsurance Model Act (#785) which identifies insurer owned securities compiled by the SVO into a List of Investment Securities, and in a separate provision letters of credits issued by the banks and non-bank financial institutions on the NAIC List of Qualified U.S. Financial Institutions administered by the SVO, as eligible for use as collateral in reinsurance transactions. 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

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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

8. 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 understand the process for doing so.

   - The VOS/TF will consider proposals to Change this Manual (a "proposal") in the manner indicated in this procedure.
   - A proposal will be considered at any time of the year at any scheduled conference call, interim meeting or national meeting ("meeting") of the VOS/TF.
   - SVO staff is responsible for preparing the Agenda for any meeting of the VOS/TF and for preparing and distributing the materials for that meeting. A proposal is placed on an Agenda only when the SVO has conducted the necessary research and developed recommendations for the VOS/TF. 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; 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 SVO expeditiously with any explanatory or supporting material, information or data feels necessary to understand the issues presented.
   - 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, the urgency of the issues presented in the letter and the workload of the VOS/TF and of the SVO at that time. 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.
   - Subject to the discretion and direction of the Chair of the VOS/TF, the SVO will place any matter that is ready to be presented to the VOS/TF on the Agenda for the next

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scheduled VOS/TF meeting. A matter is deemed to be ready to be presented to the VOS/TF when the SVO has researched the issues presented, developed recommendations or determined that it cannot make recommendations at that time and prepared a written report for the VOS/TF (SVO memorandum). The SVO prepares and presents the proposed Agenda to the Chair of the VOS/TF for approval before it is released. When approved by the Chair of the VOS/TF the SVO finalizes the Agenda, prepares the document package and distributes it for the next scheduled meeting.

- Any newly received proposal for a substantive (i.er., material) amendment to the Manual and the SVO memorandum should be distributed to members of the VOS/TF (or to the sub-group formed by the Task Force to study matter, if any) by the SVO three weeks prior to any meeting at which it is intended to be discussed.
- Any proposal previously discussed and placed on an Agenda for further discussion should be distributed to members of the VOS/TF (or to the sub-group formed by the Task Force then studying the matter, if any) by the SVO two weeks prior to a scheduled meeting where it is to be discussed.
- Any newly received proposal for a technical amendment to the Manual and the SVO memorandum should be distributed to members of the VOS/TF (or to the sub-group formed by the Task Force to study matter, if any) by the SVO not less than two weeks prior to any meeting at which it is intended to be discussed.
- 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 that relates to the maintenance of existing processes with no new policy content: i.e., a proposal that seeks modification of an established procedure to improve the process, reflect changes in the market or regulatory environment that suggest a need to modify an existing process or for similar purposes.
- 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 contractual or other legal or regulatory considerations impose confidentiality requirements that limit the ability to properly discuss, in public, important aspects of the proposal or its impact, 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 would endeavor to address, as may be relevant in a given proposal, the following matters:
    - Identification of the party proposing the change and any other interested persons represented by the party.

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- 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.

9. 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 web-sites 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

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- 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.

10. Following a public comment period, the VOS/TF will consider any comments received on the proposal at its next scheduled meeting. 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.

11. 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.

12. 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.

13. 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.

14. 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.

15. 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 web-site. 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

16. An insurance company shall not use:

- An NAIC Designation assigned by the SVO, or

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- 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").

17. 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.

18. 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.

19. 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.

20. 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.

21. 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.

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POLICIES PERTAINING TO SVO & SSG OPERATIONS

Policy Objective

22. 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.

Coordination Between the Statutory Accounting Principles Working Group and the Valuation of Securities Task Force

23. 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

24. 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 an 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. As stated in the Statutory Hierarchy, Section V of the Preamble, the AP&P Manual is the highest level of authoritative guidance.

Sources and Application of Statutory Accounting Guidance

25. 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

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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

26. 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 SVO and Statutory Accounting Principles (E) Working Group Staff

27. 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.

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- 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 SAPWG for consideration, as detailed in the NAIC Policy Statement on Statutory Accounting Principles Maintenance Agenda Process.

Ongoing SVO Operations

28. 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

29. 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.

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- 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.

30. The result of 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.

Other Non-Payment Risk in Securities

31. The result of 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.

Authority to Direct Insurers on Reporting

32. The SVO is assigned to assess investment securities reported to state regulators on Schedule D and Schedule BA of the Annual Statement Blank. To fulfill its function SVO must be able to communicate to an insurer that has filed a financial instrument or security that the financial instruments or security is not an investment security eligible for reporting on Schedule D and Schedule BA. SVO may be required to communicate to an insurer that it must refile a financial instrument or security to another schedule. SVO may also have to communicate to an insurer that an instrument the insurer has filed does not meet the definition of an Investment Security in this Manual and is therefore not eligible to be assessed or that the financial transaction or security is a Regulatory Transaction that can only be assessed by the SVO if requested by a state insurance department. When situations occur that require the SVO to communicate reporting or related statutory guidance to an insurer, SVO consults with Financial Regulatory Services Division staff to ensure the communication to the insurer is accurate.

Use of Generally Accepted Techniques or Methodologies

33. 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

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purposes, despite the lack of an express authorization to use any technique or modeling approach in this Manual.

Structured Securities Group (SSG)

34. 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.

Ongoing SSG Operations

35. The SSG shall conduct the following ongoing operations:

- Develop and maintain expertise related to securitizations, including, but not limited to, knowledge of: market developments; issues and concerns related to applicable law; accounting regimes; structures, including waterfall arrangements, governing the cash flows and performance characteristics of different types of collateral; and the financial modeling and other technology relevant to assessing their valuation and risk assessment;
- Collaboration with the SVO to assess credit and other risks in non-securitizations including for the purpose of assigning NAIC Designations;
- Collaboration with other NAIC staff functions to facilitate related regulatory objectives;
- Such other analytical assignments assigned or requested by the VOSTF or other NAIC Regulator Group;

pursuant to and in accordance with, the directives, procedures and instructions described in this Manual and those generally applicable to other NAIC staff under applicable NAIC rules and procedures.

36. SSG Regulatory Products

- NAIC Designations - The SSG is authorized to assign NAIC Designations.
- Price Grids - The SSG shall generate Price Grids as required for the annual surveillance of financially modelled RMBS and CMBS; in the exercise of its responsibilities under the Regulatory Treatment Analysis Service (RTAS) or as otherwise necessary in fulfillment of an assigned responsibility.
- Other Applicable Policies - The policies and instructions related to the application of analytical instructions, responsibility for analysis of new financial products and the procedures for placing securities under regulatory review applicable to the SVO also apply to the SSG, allowing for differences in structured securities, the different analytical assignment given to the SSG and the different methodologies

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Policy on Documentation and Data

37. Any transaction filed with the SSG for an analytical assessment, including, but not limited to, a Price Grid or for assignment of an NAIC Designation. Any filing with the SSG is deemed to be incomplete unless the insurer has provided the information, documentation, and data in quantity and quality sufficient to permit the SSG to conduct an analysis of the creditworthiness of the issuer and the terms of the security to determine the requested analytical value. It is the obligation of the reporting insurance company to provide the SSG with all necessary information. It is the responsibility of the SSG to determine whether the information provided is sufficient and reliable for its purposes and to communicate informational deficiencies to the reporting insurance company.

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FILING SECURITIES WITH THE SVO

Obligation to File Securities with the SVO

38. Insurance companies domiciled in any state of the United States, or any of its territories or possessions, that have adopted laws incorporating the standards in the NAIC Financial Regulation Standards and Accreditation Program that require the use of NAIC Designations or other analytical products for Investment Securities are required by those laws to file purchases of Investment Securities with the SVO as indicated in this Manual to obtain the NAIC Designation or other analytical product required by state law.

39. Investment Security means an instrument that documents a lending transaction between an insurance company as lender and a non-affiliated borrower, where the borrower's sole motivation is to borrow money and the insurance company's sole motivation is to make a profit on the loan that the state of domicile regulates by reference to the NAIC Financial Regulation Standards and Accreditation Program.

40. The SVO shall have no authority to issue NAIC Designations or any other NAIC analytical product to an insurance company for a Regulatory Transaction.

Who Must File

41. Filing a security with the SVO is the responsibility of the insurance company within 120-days after settlement of the investment. The expectation is that the filing of a security with the SVO is the responsibility of the insurance company lender with the largest dollar investment in the individual security (i.e. CUSIP or issue specific); however, all insurers are responsible to comply with all filing requirements in this Manual.

States May Require a Filing of Exempt or Other Transactions

42. Any provision in this Manual that exempts a transaction, security, financial asset or investment from being filed with the SVO does not prohibit a state insurance regulator from requiring its domiciled insurance company to file the transaction, security, financial asset or investment with the SVO for analysis and or assignment of an NAIC Designation. Also, nothing in this Manual prohibits a state insurance regulator from asking for SVO or SSG analytical assistance with respect to any investment related activity, or in connection with assessment of investment-related aspects of a Regulatory Transaction, and directing an insurance company to file relevant information with the SVO or the SSG for that purpose.

Filing Requirements

43. **Initial** - Insurers that file a security must provide the SVO with the information necessary to evaluate the credit risk for the security.

44. **Annual** - Insurers that file a security are also required to provide the SVO with the information necessary to evaluate the credit risk for the security on an annual basis.

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45. **Material Credit Events Filing** - It is the responsibility of the insurance company to file all information that indicates a change in the credit characteristics of the issuer or a material change in the terms of the agreement. A material change is an event that affects or is substantially likely to affect the issuer's ability to pay the insurer the obligation due to it in accordance with the original terms of the transaction. If an insurer determines that a bond is impaired under the statutory accounting procedures in *SSAP No. 26R—Bonds* then the impairment should also be considered to be a material change. Material changes should be reported to the SVO on the Material Change/Additional Information ATF.

46. **Information and Documentation Requirements –** This can be found in Part Three as part of the description of the methodology that applies to specific types of securities or investments and the instructions on how to submit through VISION is on the NAIC website: XYZ.

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THE USE OF CREDIT RATINGS OF NRSROS IN NAIC PROCESSES

Providing Credit Rating Services to the NAIC

47. The NAIC uses credit ratings for a number of regulatory purposes, including, to administer the filing exempt rule. Any rating organization that has been designated a Nationally Recognized Statistical Rating Organization (NRSRO) by the Securities and Exchange Commission of the United States of America (SEC) and which continues to be subject to federal regulation, may apply to provide Credit Rating Services[1] to the NAIC.

Policy and Legal Disclosure Pertaining to the NAIC Credit Rating Provider (CRP) List

48. The NAIC uses publicly available credit ratings, when available, as one component of the services it provides to state insurance regulators concerned with financial solvency monitoring of insurance company investments.

49. In adopting or in implementing the procedure described in this Section, the NAIC acts solely as a private consumer of publicly available credit ratings. The sole NAIC objective in obtaining and using publicly available credit ratings is to conserve limited regulatory resources, for example, the resources of the SVO. The VOS/TF has established the procedure specified in this section solely to ensure that the NAIC can avail itself of publicly available credit rating opinions.

50. The NAIC is not selecting, approving or certifying NRSROs or other rating organizations or distinguishing among them for any public or policy purpose whatsoever. Nor is the NAIC endorsing the credit rating or analytical product of any CRP or rating organization or distinguishing between CRPs or rating organizations for any specific public purpose. The NAIC disclaims any authority to regulate CRPs or rating organizations.

No Waiver/Express Reservation of Authority

51. Nothing in this Section should be interpreted or construed as a waiver of the authority of the VOS/TF, in its sole and absolute discretion, to modify or change, in any manner whatsoever, the NAIC Policy on the Use of Credit Ratings of NRSROs, including but not limited to: directing the removal of one or more NRSROs from the NAIC Credit Rating Provider List (subject only to the adjustment of any existing contractual obligations); directing the SVO to study any issue related to NRSRO operations in furtherance of state insurance regulatory policy; eliminating the NAIC Credit Rating Provider List or directing any other action or activity the VOS/TF may deem to be useful or necessary to the creation, maintenance or discharge of state based regulatory policy.

[1] **Credit Rating Services** is defined ^ as: 1) Electronic data feed transmissions of credit ratings assigned by the NRSRO with their corresponding CUSIP number and other pertinent security specific information in English, updated as frequently as provided to other customers; Other analytical services or products, in English, provided to other customers; and Access to the NRSRO's rating analysts by SVO staff.

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FILING EXEMPTIONS

Certain Separate Accounts

52. Insurance companies need not file securities or other relevant transactions with the SVO that are held in a separate account not subject to either the Asset Valuation Reserve or Risk-Based Capital charges. All other securities and relevant transactions held in a separate account must be filed with the SVO unless they are filing exempt.

Filing Exemption for Public Common Stock

53. Insurers must report values for all securities on their NAIC Financial Statement Blank including for FE securities.

Filing Exemption for Certificates of Deposit Reported as Bonds under *SSAP No. 26R*

54. A Certificate of Deposit that meets the definition of a bond in *SSAP No. 26R—Bonds* is exempt from filing with the SVO if it is issued by a bank whose deposits are fully insured by the FDIC and is for an amount:

- Equal to or less than the maximum FDIC deposit insurance, provided however, that the insurer's aggregate deposits with the bank are equal to or less than the maximum FDIC insurance limit or,
- Greater than the maximum FDIC deposit insurance provided the issuing bank is rated and monitored by an NAIC CRP,

55. The NAIC Designation for Certificates of Deposit described above shall be **NAIC 1**. The NAIC Designation for Certificates of Deposit described above shall be derived by application of the filing exempt conversion process.

NOTE: Please refer to the *NAIC Accounting Practices and Procedures Manual* for the text of *SSAP No. 26R—Bonds* as it applies to Certificates of Deposit.

FILING EXEMPTION FOR U.S. GOVERNMENT SECURITIES

Initial Filing Conventions and Documentation

56. **U.S. Government Securities required to be filed with the SVO** - U.S. Government debt that is not issued by, or guaranteed or insured by those entities listed in below are subject to the filing exemption when rated by an NAIC CRP, otherwise, they must be filed with the SVO.

SVO Publishing Conventions for Filing Exempt U.S. Government Securities

57. **U.S. Treasury Obligations** - U.S. Treasury Obligations are added to the VOS Process automatically, and they appear in the VOS Product. The NAIC Designation is **NAIC 1**.

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Other Filing Exempt U.S. Government Securities

58. A single entry is in the AVS+ Products in its normal CUSIP sequence, followed by the description "All Issues" for the securities listed below.

59. Because these securities are Filing Exempt, CUSIP numbers are not published in the AVS+ Products. The securities should, however, be reported with a CUSIP in the appropriate section of Schedule D. The NAIC designation is **NAIC 1**.

Filing Requirements for U.S. Government Securities

60. No filing is required for the securities deemed exempt from filing below unless a state insurance department has specifically requested the SVO to evaluate an exempt security.

61. For U.S. Government Securities required to be filed with the SVO, the reporting insurance company shall submit:

- A completed SAR, and (b) a prospectus of the security that includes a description of the U.S. government program under which it is issued, and appropriate evidence that the security or other obligation is backed by the U.S. government, an agency of the U.S. government or a U.S. government sponsored enterprise.
- A variety of documents are acceptable as evidence that the issuer in question has some degree of support from the U.S. government. A copy of the legislation that created the entity or the program is acceptable as evidence of government support. Additionally, a copy of the guaranty or insurance policy for the transaction is also good evidence of government support. Another acceptable form of evidence is evidence of an NAIC CRP rating with a copy of the rating rationale memorandum discussing the role of U.S. government support. Oftentimes, the prospectus for the security describes in sufficient detail the relationship of the entity to the U.S. government, its agency or its government-sponsored enterprise.

62. It is not enough to merely establish a relationship between the U.S. government and the entity. It is necessary to provide materials that specifically describe all of the financial terms of the obligation and the manner in which the U.S. government will pay the obligation.

U.S. Government Securities - Subsequent Reporting

63. **Subsequent Filing** - No subsequent report (i.e., an annual update filing) is required for non-exempt U.S. government securities. However, a material credit events filing is required for non-exempt U.S. government securities, if:

- The legislation authorizing the program has been rescinded;
- The transaction terms and/or the transaction documents have been waived, amended or modified; or
- If the legal commitment of the U.S. government, U.S. government agency or U.S. government sponsored entity has been allowed to lapse or has been withdrawn.

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Filing Exemption

64. This section defines what the NAIC deems to be U.S. Government Obligations. They are not required to be filed with the SVO.

NOTE: *Because these filing exemption provisions are set forth without any compliance mechanism, the SVO will not be able to verify whether insurers have filed all securities that are required to be filed with the SVO. State insurance department regulators may wish to create their own compliance mechanisms to protect any interests they may have relative to their domiciliary insurers.*

65. The SVO does not have responsibility for determining whether specific securities should be filing exempt. An insurer who is uncertain whether a specific security qualifies for exemption should not contact the SVO for guidance, but should either file the security with the SVO or use the RTAS – Emerging Investment Vehicle Service process and obtain an opinion on exemption for that security.

66. **Filing Exemption for Direct Claims on, or Backed Full Faith and Credit of, the United States U.S. Government Obligations** means all direct claims (including securities, loans, and leases) on, and the portions of claims that are directly and unconditionally issued, guaranteed or insured by the United States Government or its agencies.

67. **U.S. Government agency** means an instrumentality of the U.S. Government the debt Obligations of which are fully guaranteed or insured as to the timely payment of principal and interest by the full faith and credit of the U.S. Government. This category includes in addition to direct claims on, and the portions of claims that are directly and unconditionally guaranteed by, the United States Government agencies listed below, claims collateralized by securities issued or guaranteed by the U.S. government agencies listed below for which a positive margin of collateral is maintained on a daily basis, fully taking into account any change in the insurance company's exposure to the obligor or counterparty under a claim in relation to the market value of the collateral held in support of that claim.

U.S. Government Full Faith and Credit – Filing Exempt
Agency for International Development (AID)
Army and Air Force Exchange Services (AAFS)
Commodity Credit Corporation (CCC)
Export – Import Bank of the United States (Exim Bank)
Farmers Home Administration (FmHA) Certificates of Beneficial Ownership
Federal Deposit Insurance Corporation (FDIC)
Federal Housing Administration (FHA)
General Services Administration (GSA
Government National Mortgage Association (GNMA)
Health and Human Services (HHS)
Housing and Urban Development (HUD)
Maritime Administration (MARAD)
National Credit Union Administration (NCUA)
Overseas Private Investment Corp (OPIC)
Small Business Administration (SBA)
United States Department of Agriculture (USDA)
United States Treasury

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Veterans Administration (VA)
Washington Metropolitan Area Transit Authority

Filing Exemption for other U.S. Government Obligations

68. Obligations issued and either guaranteed or insured, as to the timely payment of principal and interest, by the government agencies or government-sponsored enterprises listed below are filing exempt. They are not backed by the full faith and credit of the U.S. Government. The filing exemption here is based on an analytical judgment that the combined creditworthiness of the entity itself and U.S. government support for that entity provides confidence that the issuer will be able to pay its obligation on a full and timely basis at the level of an **NAIC 1** quality designation. For the avoidance of doubt, preferred stock or similar securities of the government agencies or government-sponsored enterprises listed below are not considered guaranteed or insured and hence are not subject of this section (ii).

Filing Exempt Other U.S. Government Obligations if issued and either fully guaranteed or insured by:
Federal Agricultural Mortgage Corporation (Farmer Mac)
Federal Farm Credit Banks (FFCB)
Federal Financing Bank (FFB)
Federal Home Loan Banks (FHLB)
Federal Home Loan Mortgage Corporation (Freddie Mac)
Federal National Mortgage Association (Fannie Mae)
Financing Corporation (FICO)
Resolution Funding Corporation (REFCorp)
Tennessee Valley Authority (TVA)

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POLICIES APPLICABLE TO THE FILING EXEMPTION (FE) PROCESS

69. **Determinations** - The VOS/TF is resolved that the benefit obtained from the use credit rating in state regulation of insurance must be balanced against the risk blind reliance on credit ratings. To ensure the Task Force properly understands the composition and risk of the filing exempt securities population; promote uniformity in the production of NAIC Designations, reduce reporting exceptions for filing exempt securities and increase the efficiency of this NAIC process, the SVO and SSG (hereafter the IAO) is charged with administration of the filing exempt process defined in Part Three, Section 1 (b) of this Manual.

70. **Directives** - The IAO shall:

- Recommend improvements to the production of NAIC Designations based on NRSRO credit ratings;
- Identify monitoring and communication procedures that enhance the possibility of regulatory intervention by the VOS/TF to respond to risks to insurer solvency posed by securities in the filing exempt population;
- Identify and develop correctives to the administrative, operational and system based causes of reporting exemptions in the filing exempt process.
- Change the NAIC Designation equivalent calculated for filing exempt securities when necessary to correct errors or other anomaly that occur in the automated filing exempt process.
- Develop a staff administered reporting exceptions resolution process that incorporates state insurance regulator and insurance companies participation;

POLICIES APPLICABLE TO FILING EXEMPT (FE) SECURITIES AND TO PRIVATE LETTER (PL) RATING SECURITIES

Filing Exemption

71. Bonds, (excluding RMBS and CMBS) and Preferred Stock that have been assigned an Eligible NAIC CRP Rating, are exempt from filing with the SVO (FE securities).

Policy Considerations

72. In connection with the implementation of the verification procedure for PL securities, the Task Force acknowledges that the practices adopted by NAIC CRPs in relation to the distribution of private rating letters for what the NAIC refers to as PL securities, including their confidentiality procedures and agreements, are integral to the business models of private for profit entities that the NAIC does not regulate and which the NAIC stands in the relation of a customer of rating services. Accordingly, the SVO, as NAIC staff, shall not be

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responsible for negotiating with NAIC CRPs to modify their confidentiality practices or provide data-feeds to the SVO. However, if an NAIC CRP shall determine that it is willing to modify its confidentiality provisions or provide such data-feed or an alternative process so that the SVO can obtain electronically, copies of private rating letters for PL securities issued by that NAIC CRP instead of by requiring insurers to provide PDF files, then the SVO is authorized to work with the NAIC CRP to obtain and integrate the private rating letters or the data-feeds into NAIC systems to create electronic processes that will permit electronic verification that the insurer owned PL security have been assigned an NAIC CRP Eligible Credit Rating. Individual insurers and or representatives of the insurance industry are encouraged to find ways to resolve confidentiality restrictions imposed by NAIC CRPs on the private rating letter or to influence the process as investors to encourage NAIC CRPs to provide the data-feeds to the SVO or alternative methods to permit the SVO to obtain NAIC CRP credit ratings for PL securities to be used to administer the PL securities verification procedure specified in this section.

Application of the FE Procedure to Specific Populations

73. The filing exemption procedure does not apply to subsidiary, controlled and affiliated (SAC) company investments. Catastrophe-Linked Bonds are filing exempt if the credit rating assigned to them by an NAIC CRP was derived using a stochastic methodology. Please refer to the methodology for Catastrophe-Linked Bonds.

Securities no longer assigned an Eligible NAIC CRP Credit Rating

74. Any Bond or Preferred Stock that at one time was assigned an Eligible NAIC CRP Credit Rating by any NAIC CRP but is no longer assigned a credit rating by any NAIC CRP must be filed with the SVO within 120 days of the date the NAIC CRP withdrew the credit rating.

LIMITATIONS ON USE OF NAIC CRP RATINGS

75. **NAIC Designation Is Capped To Highest NAIC CRP Rating** - The SVO shall not assign an NAIC Designation for a security that has a credit rating assigned by an NAIC CRP when the NAIC Designation would express an opinion of credit quality higher than that indicated by the rating assigned by the NAIC CRP, except that the SVO may assign the NAIC Designation it deems appropriate to Municipal bonds and Military housing bonds or securities.

76. **Split Ratings** - For filing exempt securities the NAIC Designation assigned will be the NAIC Designation equivalent that results from the application of the filing exemption conversion process. This rule will also apply to replication transactions and other instances where NAIC CRP ratings are used by the SVO.

77. **Unrated Transaction of Issuer with NAIC CRP Rated Debt** - When an insurer files an unrated security of an issuer that has another issue rated by an NAIC CRP, SVO may consider the rated issue and its position in the capital structure of the issuer to arrive at an

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NAIC Designation for the unrated security, provided staff first consults with the rating agency and independently consider the terms of the unrated security and its impact on credit or other non-payment risk.

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NAIC DESIGNATION

78. **NAIC Designation means** any one of the gradations of credit quality and credit risk identified by the **NAIC 1** through **NAIC 6** symbols **further discussed and** defined in this Manual and may reflect notching pursuant to one or both of the notching procedures discussed in this Manual. NAIC Designations are proprietary symbols of the NAIC to be used by the SVO and SSG or under certain circumstances by an insurer to denote a category or band of credit risk.

79. **NAIC Designation Category means** and refers to 20 more granular delineations of credit risk in the **NAIC 1** through **NAIC 6** credit risk scale used by the VOS/TF to relate credit risk in insurer owned securities to a risk based capital factor assigned by the NAIC Capital Adequacy (E) Task Force. Each delineation of credit risk is represented by a letter (a Modifier) which modifies the NAIC Designation grade to indicate a more granular measure of credit risk within the NAIC Designation grade. The more granular delineations of credit risk are distributed as follows: 7 for the **NAIC 1** Designation grade indicated by the letters A through G; 3 delineations each for each of the NAIC Designation grades **NAIC 2**, **NAIC 3**, **NAIC 4** and **NAIC 5** indicated by the letters A, B and C and 1 delineation for NAIC Designation grade **NAIC 6**. The NAIC Designation Category framework is shown in this Manual. All Modifiers roll up into the respective NAIC Designation grade as they are a subset of them.

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NAIC DESIGNATION SUBSCRIPT S

80. An objective of the VOS/TF is to assess the financial ability of an insurer to pay claims. For example, the regulatory assumption is that a fixed income instrument called debt by its originator or issuer requires that the issuer make scheduled payments of interest and fully repay the principal amount to the insurer on a date certain. A contractual modification that is inconsistent with assumption creates a rebuttable inference that the security or instrument contains an additional or other non-payment risk created by the contract - that may result in the insurer not being paid in accordance with the underlying regulatory assumption. The SVO is required to identify securities that contain such contractual modifications and quantify the possibility that such contracts will result in a diminution in payment to the insurer so this can be reflected in the NAIC Designation assigned to the security through the application of the notching process.

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NAIC GENERAL INTERROGATORY

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

82. **NAIC PLGI …. (text to follow)**

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MONITORING OF SVO DESIGNATED SECURITIES

83. The SVO shall monitor, on an ongoing basis, improvements and deterioration of credit quality of securities that are not filing exempt.

AUDITED FINANCIAL STATEMENT

General Rule on Presentation of Financial Results

84. Any security owned or eligible for purchase by an insurance company that is issued or is otherwise the obligation of a non US obligor, must be accompanied by an Audited Financial Statement prepared in accordance with a Global Financial Presentation Standard or a Reconciled Financial Presentation Standard unless the SVO has been specifically authorized to use a National Financial Presentation Standard for issuers using the accounting standards of that country.

85. Audited Financial Statement means, collectively, for any given year, the auditor's Opinion, the issuer's income statement, balance sheet, the statement of cash flows, all notes to the financial statements, and any supplementary information thereto typically created, generated or otherwise provided to investors, in English, and prepared by a certified public accountant or the international equivalent thereto, showing financial results for the reported year together with the prior year prepared and presented in accordance with a Global Financial Presentation Standard, a Reconciled Financial Presentation Standard or a National Financial Presentation Standard. For purposes of this definition:

Global Financial Presentation Standard means:

- U.S. Generally Accepted Accounting Principles (US GAAP); or
- International Financial Reporting Standards (IFRS) as published by the International Accounting Standards Board (IASB).
- Reconciled Financial Presentation Standard means:
- A standard other than Global Financial Presentation Standard or National Financial Presentation Standard with a reconciliation to US GAAP or IASB IFRS; or
- National IFRS with such additional information as required by IASB standards to make National IFRS comparable to IASB IFRS.

National Financial Presentation Standard means:

- National GAAP or National IFRS, without a reconciliation to US GAAP or IASB IFRS, authorized to be used for filing a transaction with the SVO pursuant to the procedure specified below.
- In this definition, National GAAP refers to the generally accepted accounting policies as required by a country's national accounting standards board and National IFRS refers to the international financial reporting standards required by the country's national accounting standards board.

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- Please refer to the List of Countries and Associated National Financial Presentation Standard.
- Foreign issuers not using the accounting standards of a country on the List of Countries and Associated National Financial Presentation Standard must provide the SVO with an Audited Financial Statement prepared in accordance with a Global Financial Presentation Standard or a Reconciled Financial Presentation Standard.

86. For insurance companies, an Audited Financial Statement will be prepared in accordance with SAP.

87. For municipal and U.S. Government securities, an Audited Financial Statement will be prepared in accordance with generally accepted auditing standards and government auditing standards issued by the Comptroller General of the United States. For municipal securities only, the statements will be accepted if they have been submitted to, reviewed and certified by a state comptroller's office.

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POLICIES APPLICABLE TO SPECIFIC ASSET CLASSES

SCHEDULE BA ASSETS

88. Insurers may file a Schedule BA asset with the SVO if they can represent that the asset has underlying characteristic of a bond or other fixed income instrument. When an insurer files a Schedule BA asset the SVO assesses the insurer's fixed income determination and it if agrees that the asset has fixed income characteristics, conducts a credit assessment and a valuation of the asset. Upon conclusion of its analysis, the SVO provides the insurer a response setting forth its determination as to the NAIC Designation and asset classification assigned to the asset. Upon receipt of the SVO response, the insurer reports the aforementioned analytical values obtained from the SVO for the asset on the NAIC Financial Statement Blank.

CREDIT TENANT LOANS

CTL Categories

89. Mortgage loans that are made primarily in reliance on the credit standing of a major tenant, structured with an assignment of the rental payments to the lender with real property pledged as collateral in the form of a first lien, are referred to as a Credit Tenant Loan. Four categories of CTLs are recognized as eligible for reporting on Schedule D: Bond Lease Based CTLs, Credit Lease Based CTLs, Acceptable CTL Variants (ACVs) and Multiple Property Transactions (MPTs).

Intent

90. The categories segregate CTL transactions in accordance with two principles: (i) the degree to which the credit tenant is obligated to the lender for payments and real estate-related risks and (ii) the degree of complexity in the legal or structural components of the transaction. The Bond Lease Based CTL category is intended to capture those transactions that reflect the criteria discussed below and contains no legal or structural variation from one transaction to another. The Credit Lease Based CTL category is intended to capture those transactions that differ from Bond Lease Based transactions primarily because the lessor is to perform specified obligations, requiring analysis of how lessor risk is mitigated. The ACV category is intended to reflect substantially all of the standards described for the Bond Lease Based or Credit Lease Based CTL categories. Transactions in the ACV category are those that do not perfectly reflect all of such required characteristics, but which contain the deviations highlighted in the ACV list; provided such deviations do not in number or otherwise alter the character of the transaction as a Bond Lease Based or Credit Lease Based CTL. The ACV category will be interpreted so as to maintain the regulatory expectation that all submitted transactions meet the criteria set out for the Bond Leased Based or Credit Lease Based CTL, with only slight deviations from criteria permitted. The MPT category is intended to facilitate the SVO's analysis of Bond Lease Based or Credit Lease Based CTL

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Transactions where more than one site or property exists in the transaction structure. The MPT category provides an economy and efficiency of transaction cost and resources. It allows for the use of essentially uniform documentation for the transaction for one credit tenant or one credit tenant group.

Presumption of Eligibility

91. Transactions that meet the definition and legal and structural characteristics for one of the four CTL categories shall be submitted to the SVO for evaluation on the appropriate CTL Evaluation Form. From the perspective of an insurance company lender, a transaction that on its face meets the criteria of a particular CTL category is entitled to a presumption of Schedule D eligibility, subject to a determination by the SVO that the transaction is not appropriate for Schedule D reporting.

SUBSIDIARY, CONTROLLED AND AFFILIATED INVESTMENTS

92. SCA investments in the form of a debt instrument purchased (or otherwise acquired) from an insurance or non-insurance entity (SCA debt) and preferred stock issued by an insurance or non-insurance entity (SCA preferred stock) may be assessed by the SVO to determine eligibility for reporting as an Investment Security as defined in this Manual. The SVO is required to determine that a filed SCA investment has terms, structure, complexity and purpose like those in transactions between unaffiliated parties so that credit risk assessment methodologies applied to transactions between unaffiliated parties can be meaningfully applied to transactions between affiliated parties; as a condition to assigning an NAIC Designation to the investment.

INVESTMENTS IN FUNDS

REGULATORY TRANSACTIONS

Defined

93. Regulatory Transaction means a security or other instrument in a transaction submitted to one or more state insurance departments for review and approval under the regulatory framework of the state or states.

Intent

94. This Section provides guidance to the SVO and the SSG on how to manage requests for assistance made by a state insurance department made as permitted in this Manual.

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REVIEW OF SVO DETERMINATIONS

Condition to Filing of an Appeal

95. Any insurer that owns a security for which the SVO has performed a credit assessment, or another analysis, may appeal the SVO decision provided the appeal is filed within 120 days of the SVO decision. An insurer can ascertain the date of the original SVO decision by accessing VISION and noting the Review Date shown there. The Review Date is the date of the original decision.

Status of NAIC Designation During Appeal

96. Until such time as the SVO credit committee determines that a previous SVO decision should be changed, the previous decision of the SVO remains in full force and effect.

Task Force Review for Alleged Violations of Procedures

97. Request for Review - Any insurer that has filed a security for an NAIC Designation, a classification or other analysis, and is concerned that a decision relative to the security was not made in accordance with the procedures in this Manual, may request consideration of this concern by the VOS/TF.

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SPECIAL INSTRUCTIONS

Short-Term Investments

98. A short-term investment is defined as an investment that has one year or less to maturity. Investments that have one year or less to maturity when issued are not reported to the SVO. Investments which when acquired by an insurance company have one year or less to maturity, but which when issued had greater than one year to maturity, need only be reported to the SVO if they do not have an NAIC CRP rating or an NAIC Designation for the issuer.

Circular Transaction

99. For purposes of this paragraph a circular transaction shall be deemed to exist whenever the SVO shall find that the essential financial characteristic of a reported security is that the obligor depends on funds advanced by an insurance company to make debt service payments to the same insurance company and that the interdependency of the entities involved in this or related transactions and the lack of any arm's-length economic dealings renders the application of the credit assessment or valuation techniques provided for in this Manual analytically meaningless and therefore misleading to NAIC members. The SVO is instructed to assign a **NAIC 6** Designation to circular transactions and to provide written confirmation of this action to the department of insurance of the reporting insurance company's state of domicile. The department of insurance may appeal the SVO decision to an appropriate working group of the VOS/TF.

Mandatorily Convertible Securities

100. Mandatorily convertible securities are defined as a type of convertible bond or convertible preferred stock that has a required conversion or redemption feature. Either on or before a contractual conversion date, the holder must convert the mandatory convertible bond or preferred stock into the underlying common stock. Mandatorily convertible securities are not assigned NAIC Designations or Unit Prices by the SVO. Prior to conversion, insurers shall report mandatory convertible securities in accordance with the SSAP of the current nature of the investment (e.g., *SSAP No. 26R—Bonds* or *SSAP No. 32—Preferred Stock*). Insurers should also report an NAIC Designation in Schedule D which they can self-assign or determine in accordance with the filing exempt rule. Please refer to paragraphs 2, 10 and 20 of *SSAP No. 26R* for further guidance.

Unrated Hybrid Securities

101. An unrated hybrid security is filed with the SVO for an NAIC Designation but the insurance company reports the hybrid security as a bond pursuant to NAIC Annual Statement Instructions using the NAIC Designation assigned by the SVO. Please refer to the Annual

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Statement Instruction, Investment Schedules, General Instructions for guidance on the securities that fall within the definition of hybrid securities.

Sub-paragraph D Company

102. The insurance company must file all foreign securities for which the information required by this Manual is available. For those foreign securities held by a "Sub-paragraph D Company" as defined below, where the required information is not available for the SVO to value the security, the NAIC Designation may be determined by the reporting insurance company. This determination shall carry an **F** suffix. In no case shall the NAIC Designation exceed the sovereign rating of the issuer's country of origin. The company shall provide its domestic regulator with a description of the procedure it used to evaluate and assign ratings to these foreign securities. In addition, the company shall retain the documentation supporting each designation assigned by it until the next domestic insurance department examination.

103. "Sub-paragraph D Company" is defined as a domestic insurer which is holding foreign securities in support of its foreign liabilities and where the U.S. gross premiums of the company are no more than 20 % of its gross worldwide premiums or the amount of the company's gross reserves and other liabilities under contracts of insurance (for life insurers gross reserves and other liabilities shall be actuarial reserves and policyholder liabilities currently reported on page 3, lines 1 - 11 of the NAIC Financial Statement Blank, grossed up for reinsurance ceded; for property and casualty insurers gross reserves and other liabilities shall be loss reserves, loss adjustment expense reserves and unearned premium reserves reported on page 3, lines 1, 2 and 9 of the NAIC Financial Statement Blank, grossed up for reinsurance ceded) on lives or risks resident or located in the U.S. are no more than 20 % of its total gross reserves and other liabilities under contracts of insurance as reported on the company's last NAIC Financial Statement Blank.

104. The insurer must also maintain a trust fund in a qualified U.S. financial institution for the payment of the valid claims of its U.S. policyholders, their assigns and successors in interest. The trust shall consist of a trusteed account representing 103% of the company's gross reserves and other liabilities under contracts of insurance on lives or risks resident or located in the U.S. The assets of the trust shall maintain an NAIC Designation as assigned by the SVO and be valued at admitted values carried in the insurer's NAIC Financial Statement Blank. Such trust shall be established in a form approved by the insurer's domestic commissioner of insurance. The trust instrument shall provide that contested claims shall be valid and enforceable upon the final order of any court of competent jurisdiction in the U.S. and shall allow the right of substitution without diminution. The trust shall be subject to examination as determined by the insurer's domestic commissioner and the assets of the trust shall be reported in the insurer's NAIC Financial Statement Blank special deposit schedule. The trust shall remain in effect for as long as the insurer shall qualify as a "Sub-paragraph D Company" and have outstanding obligations under contracts of insurance on lives or risks resident or located in the U.S.

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105. If a Company which previously qualified as a "Sub-paragraph D Company" no longer qualifies, any foreign securities held by such company which are not assigned an NAIC Designation by the SVO shall be assigned an NAIC Designation in accordance with the procedure set forth in sub-paragraph (B) above, Unaudited Financial Statements. These securities shall be reported by the company with a **"Z"** suffix for the reporting year and shall comply with the provisions of sub-paragraph (B) for subsequent reporting years.

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PART TWO
OPERATIONAL AND ADMINISTRATIVE INSTRUCTIONS APPLICABLE TO THE SVO

OPERATIONS

ORGANIZATION

IAO Departments

106. The SVO and the SSG shall establish such procedures or guidelines as are necessary to perform the functions assigned to them.

Credit Committee

107. The SVO and the SSG shall establish a credit committee composed of its senior staff, non-senior analytical staff or both, possessing expertise relevant to the issues entrusted to the credit committee. The credit committee shall provide SVO's and the SSG's professional staff with such direction or guidance necessary on analytical or internal analytical policy issues as may be assigned to it.

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COMPILATION OF THE SVO LIST OF INVESTMENT SECURITIES

Directive

108. On a quarterly basis, the SVO shall:

- Compile a list of Investment Securities from each of the data files defined as VOS Process, Filing Exempt Securities Process, RMBS/CMBS Modeled Securities Process, U.S. Treasury Process and the Exempt U.S. Government Securities Process (each an SVO Sub-List bearing the name of the corresponding Process).
- Aggregate the content of each SVO Sub-List into a single SVO List of Investment Securities (hereafter, the SVO List of Investment Securities) identifying each Investment Security by name and other pertinent information and showing the NAIC Designation assigned to them by the SVO or pursuant to such other methodology or procedure specified in this Manual.
- Compile, or cause to be compiled, sub-lists from the informational content of the Derivative Counterparties Process, Exchange Rates Process, Ex-Dividend Process, Letter of Credit Process, Money Market and Exchange Traded Fund Process and Surplus Notes Processes (each an SVO Sub-List bearing the name of the corresponding Process and collectively the "Other Information").
- Publish, or cause the SVO List of Securities and the Other Information to be published, by being incorporated into the NAIC's AVS+ Product.

VOS Process

109. The VOS Process (data file) is used to store NAIC Designation or other determinations assigned by the SVO to Investment Securities. The SVO shall not add a Regulatory Transaction to the VOS Process.

Filing Exempt Securities Process

110. The Filing Exempt Securities Process (data file) is used to store NAIC Designations, Unit Prices or other determinations assigned by the SVO though an automated process for filing exempt (FE) securities that are an Investment Security. Insurance companies derive NAIC Designations for FE securities by applying the conversion instructions. The insurance company then reports the NAIC Designations assigned to FE securities through NAIC systems. The SVO subsequently adds the security to the Filing Exempt Securities Process. The SVO shall not add a Regulatory Transaction to the Filing Exempt Securities Process.

RMBS/CMBS Modeled Securities Process

111. A residential mortgage-backed securities (RMBS) or commercial mortgage-backed securities (CMBS) is an Investment Security, reported by an insurance company to the NAIC and subsequently added by NAIC staff to the RMBS/CMBS Modeled Securities Process, where

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on an annual basis and for purposes of the annual surveillance they are evaluated for eligibility to be financially modeled.

112. RMBS and CMBS that are deemed to be subject to financial modeling are retained in the RMBS/CMBS Modeled Process. RMBS and CMBS that are deemed ineligible for financial modeling but that have been assigned credit ratings by NAIC CRPs migrate to the Filing Exempt Securities Process. RMBS and CMBS that are deemed ineligible for financial modeling and that have also not been assigned credit ratings by NAIC CRPs may be reported by the insurer on the **5GI**.

113. Insurance companies shall not file Regulatory Transactions as eligible for the RMBS/CMBS Modeled Securities Process, and the NAIC staff shall not add a Regulatory Transaction to the RMBS/CMBS Modeled Securities Process.

U.S. Treasury Securities Process

114. U.S. Treasury Securities are an Investment Security added to the U.S. Treasury Securities Process automatically by electronic processes administered by the SVO and assigned an **NAIC 1** Designation by a policy-based convention. Insurance companies shall not report Regulatory Transactions as U.S. Treasury Securities and the NAIC staff shall not add a Regulatory Transaction to the U.S. Treasury Securities Process.

Exempt U.S. Government Securities Process

115. Exempt U.S. Government Securities are an Investment Security reported by the insurance company to the NAIC, subsequently added by NAIC staff to the Exempt U.S. Government Securities Process and assigned **NAIC 1** Designation pursuant to a policy based convention. Insurance companies shall not report Regulatory Transactions as exempt U.S. Government Securities, and the NAIC staff shall not add a Regulatory Transaction to the Exempt U.S. Government Securities Process.

Reference to SVO List of Securities

116. The NAIC, acting by and through its VOS/TF and its Reinsurance (E) Task Force, acknowledges that the phrase "Securities Listed by the SVO," used in Section 3 B. of the NAIC *Credit for Reinsurance Model Law* (#785) and Section 10 A. (2) of the *Credit for Reinsurance Model Regulation* (#786) refers to the SVO List of Securities as defined above provided that for purposes of the Model Law, the phrase Securities Listed by the SVO also includes:

- All US Treasury Securities whether or not on the US Treasury Securities Process Sub-List of the SVO List of Securities as owned by an insurance company;
- Any is a US Government Exempt security not owned by an insurance company and therefore not on the SVO Exempt US Government Securities Process Sub-List of the SVO List of Securities; and

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- Such other or additional type or class of securities as the Reinsurance (E) Task Force shall from time to time determine are suitable for use as collateral in reinsurance transactions and are added to this definition by the VOS/TF at its request.

117. To avoid confusion, and for purposes of this acknowledgment, the Filing Exempt Securities Process included in the definition of SVO List of Securities includes the SVO listed securities referred to as those "deemed exempt from filing" in the cited sections of the Model Law and Model Regulation.

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PRODUCTION OF NAIC DESIGNATIONS

NAIC DESIGNATIONS

118. NAIC Designations are proprietary symbols of the NAIC. The SVO and sometimes the SSG produce NAIC Designations for insurer owned securities using the policies, procedures or methodologies adopted by the VOS/TF in this Manual. NAIC Designations identify a category or band of credit risk. NAIC Designations are produced for statutory accounting, reporting, state investment laws and other purposes identified in the NAIC Financial Regulation Standards and Accreditation Program and or other NAIC developed regulatory guidance embodied in state law. NAIC Designations are adjusted in accordance with the notching procedures described below so that an NAIC Designation for a given security reflects the position of that specific security in the issuer's capital structure. NAIC Designations may also be adjusted by notching to reflect the existence of other non-payment risk in the specific security in accordance with the procedures described below.

119. **NAIC 1** is assigned to obligations exhibiting the highest quality. Credit risk is at its lowest and the issuer's credit profile is stable. This means that interest, principal or both will be paid in accordance with the contractual agreement and that repayment of principal is well protected. An **NAIC 1** obligation should be eligible for the most favorable treatment provided under the NAIC Financial Regulation Standards and Accreditation Program.

120. **NAIC 2** is assigned to obligations of high quality. Credit risk is low but may increase in the intermediate future and the issuer's credit profile is reasonably stable. This means that for the present, the obligation's protective elements suggest a high likelihood that interest, principal or both will be paid in accordance with the contractual agreement, but there are suggestions that an adverse change in circumstances or economic, financial or business conditions will affect the degree of protection and lead to a weakened capacity to pay. An **NAIC 2** obligation should be eligible for relatively favorable treatment under the NAIC Financial Regulation Standards and Accreditation Program.

121. **NAIC 3** is assigned to obligations of medium quality. Credit risk is intermediate and the issuer's credit profile has elements of instability. These obligations exhibit speculative elements. This means that the likelihood that interest, principal or both will be paid in accordance with the contractual agreement is reasonable for the present, but an exposure to an adverse change in circumstances or economic, financial or business conditions would create an uncertainty about the issuer's capacity to make timely payments. An **NAIC 3** obligation should be eligible for less favorable treatment under the NAIC Financial Regulation Standards and Accreditation Program.

122. **NAIC 4** is assigned to obligations of low quality. Credit risk is high and the issuer's credit profile is volatile. These obligations are highly speculative, but currently the issuer has the

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capacity to meet its obligations. This means that the likelihood that interest, principal or both will be paid in accordance with the contractual agreement is low and that an adverse change in circumstances or business, financial or economic conditions would accelerate credit risk, leading to a significant impairment in the issuer's capacity to make timely payments. An **NAIC 4** obligation should be accorded stringent treatment under the NAIC Financial Regulation Standards and Accreditation Program.

123. **NAIC 5** is assigned to obligations of the lowest credit quality, which are not in or near default. Credit risk is at its highest and the issuer's credit profile is highly volatile, but currently the issuer has the capacity to meet its obligations. This means that the likelihood that interest, principal or both will be paid in accordance with the contractual agreement is significantly impaired given any adverse business, financial or economic conditions. An **NAIC 5** Designation suggests a very high probability of default. An **NAIC 5** obligation should incur more stringent treatment under the NAIC Financial Regulation Standards and Accreditation Program.

124. **NAIC 6** is assigned to obligations that are in or near default. This means that payment of interest, principal or both is not being made, or will not be made, in accordance with the contractual agreement. An **NAIC 6** obligation should incur the most severe treatment under the NAIC Financial Regulation Standards and Accreditation Program.

NAIC DESIGNATION CATEGORIES

125. Upon the determination of an NAIC Designation, the SVO produces NAIC Designation Categories, as described and defined in Part Two, Section 1 of this Manual below.

126. NAIC Designation Categories are a subset of NAIC Designations and are used by the VOS/TF to link the NAIC risk-based-capital (RBC) framework adopted by the NAIC Capital Adequacy (E) Task Force to the VOS/TF's credit assessment process. The NAIC Capital Adequacy (E)

127. Task Force assigns RBC factors to each NAIC Designation Category as shown below.

NAIC Designation	+	NAIC Designation Modifier	=	NAIC Designation Category
1		A		1.A
1		B		1.B
1		C		1.C
1		D		1.D
1		E		1.E
1		F		1.F
1		G		1.G
2		A		2.A
2		B		2.B
2		C		2.C
3		A		3.A
3		B		3.B
3		C		3.C
4		A		4.A
4		B		4.B
4		C		4.C
5		A		5.A
5		B		5.B
5		C		5.C
6				6

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NAIC DESIGNATION SUBSCRIPT S

Description of Other Non-Payment Risk

128. It may not be practical, desirable or possible to specifically define other non-payment risk given the assumption that it originates as a result of a contractual agreement or the presence of a structural element of a transaction that is agreed upon between the issuer and the insurer. Accordingly, what follows is intended as general guidance to insurers and others.

129. Most typically, other non-payment risk has been associated with contractual agreements between the insurer and the issuer in which the issuer is given some measure of financial flexibility not to make payments that otherwise would be assumed to be scheduled, given how the instrument has been denominated, or the insurer agrees to be exposed to a participatory risk.

130. Other non-payment risk differs from the type of issues encountered in credit risk. This is because typically, credit assessment is concerned with securities in which the parties create subordination by modifying the lender's priority of payment (for example, senior unsecured versus junior subordinated) but in a context where the contract otherwise specifies that the failure to make payments on a schedules basis (defined in the contract) is an event of default (in the case of a bond) or triggers some other specific and identifiable lender remedy (in the case of other fixed income securities).

131. Using the broad concepts identified above, non-payment risk may be present when:

- A reporting insurance company takes on a participatory risk in the transaction;

  Illustration *– The contract promised payment of a dollar denominated obligation in non-US currency but does not require an exchange rate that would yield foreign currency sufficient to buy a defined principal amount of US dollars. The other non-payment risk in this illustration consists of the reporting insurance company's acceptance of currency risk which may diminish the principal amount of the investment. Currency risk here is not related to the issuer's ability or willingness to pay and therefore is not appropriately reflected in the NAIC Designation of the issuer or captured by notching for credit risk.*

- The contract governing the loan provides for a degree of permanence in the borrower's capital structure that is incompatible with notions of a loan that is expected to be repaid;

  Illustration *– A loan stated to be perpetual and giving the issuer the right to miss interest or dividend payments otherwise said to be scheduled where the missed payments are not required to be paid on a subsequent date.*

  Illustration *– An instrument denominated as a bond but lacking a maturity date, a mechanism to determine a maturity dates (for example a mandatory redemption) or that states a maturity equal to or exceeding 40 years.*

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132. Agrees to an exposure that has the potential to result in a significant delay in payment of contractually promised interest and or a return of principal in an amount less than the original investment.

Meaning of the Subscript Symbol

133. An SVO determination that a specific security contains other non-payment risk is communicated by assigning the NAIC Designation subscript S to the specific CUSIP and applying the notching procedure described below. The subscript follows the NAIC Designation as follows: **NAIC 2 S**.

134. The SVO shall assess securities for other non-payment risk:

- Routinely, for any security or financial product filed with the SVO;
- As part of the analysis of a security or financial product submitted to the SVO under the RTAS – Emerging Investment Vehicle process discussed in of this Manual;
- When requested to do so by any state insurance regulator acting pursuant to this Manual; and
  - When requested by the Task Force, including in support of the IAWG; or
  - In support of any other NAIC group engaged in the analysis of investment risks in new securities.

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SVO NOTCHING GUIDELINES

Definition and Purpose

135. Notching is defined as the process used to make distinctions between different liabilities in an issuer capital structure to reflect differences in credit or other non-payment risk smaller than a whole grade. Notching expresses differences in expected loss (i.e., severity) of an issuer's liabilities by their relative priority of claim in bankruptcy.

Notching NAIC Designations (to Reflect Credit Risk)

136. **Illustration** - The distinctions in credit risk made in the notching process involve (conceptually) the issuer's actual capital structure. The hypothetical capital structure below is shown to illustrate and explain notching:

Senior secured	Notch up from the benchmark
Senior unsecured	The benchmark designation
Senior subordinated	Notch down from the benchmark
Junior subordinated	Notch down from benchmark
Preferred stock	Notch down from benchmark

Methodology

137. The SVO determines the benchmark designation for the senior unsecured obligation of the issuer or its equivalent. The SVO adjusts the benchmark designation up or down to reflect the difference in risk between the benchmark security and the specific liability under review by the SVO.

Definition of SVO Notches

138. The NAIC has not adopted pluses (+) and minus (-) symbols to express incremental gradations of credit risk of less than a full NAIC category. However, the SVO uses plus and minus symbols internally to enable more accurate monitoring of issuers and transactions and facilitate upgrades and downgrades of NAIC Designations. Accordingly, for purposes of this paragraph, a notch is defined as a movement in the NAIC Designation of less than a full grade. The following table shows all possible notching possibilities:

NAIC 1;	NAIC 1 (-);	
NAIC 2 (+);	NAIC 2;	NAIC 2 (-);
NAIC 3 (+) ;	NAIC 3;	NAIC 3 (-);
NAIC 4 (+);	NAIC 4;	NAIC 4 (-);
NAIC 5 (+);	NAIC 5;	NAIC 5 –;
NAIC 6.		

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139. In the table above, a movement from **NAIC 1** to **NAIC 2** is a movement of a full grade while a movement from **NAIC 1** to **NAIC 2** (+) is a movement of two notches.

SVO Guidelines for Notching

140. The SVO shall notch an NAIC Designation for an issuer up or down to reflect the position of a specific liability in the issuer's capital structure.

141. Notching upward from a benchmark NAIC Designation is almost exclusively associated with transactions in which the SVO determines that covenants or collateral act to further reduce the probability of default from that implied by the issuer's senior unsecured NAIC Designation.

142. In determining the number of notches that should be applied to a security, the SVO shall apply the following guidelines:

Notching Investment Grade Issuers:

143. The capital structure of an issuer whose current senior unsecured NAIC Designation is **NAIC 1** or **NAIC 2** is not considered indicative of what the issuer's capital structure is likely to be at default. Notching for issuer's whose senior unsecured NAIC Designation is **NAIC 1** and **NAIC 2** is therefore based on the following general guidelines:

- *Secured debt* is generally rated one notch above the senior unsecured issuer designation.
- *Subordinated debt* (including junior and senior subordinated) are generally designated one notch below the senior unsecured rating.
- *Preferred* will generally be designated one notch below subordinated debt (two below senior unsecured or senior implied).
- *Holding company debt* is generally designated at or below the lowest rated debt security that would be assigned at the principal operating company.

Notching for Non-Investment Grade Issuers

144. The capital structure of an issuer whose current senior unsecured NAIC Designation is **NAIC 3**, **NAIC 4** or **NAIC 5** is considered to be more indicative of what the issuer's capital structure is likely to be at default.

145. A greater presumption that the current capital structure is the one with which the issuer will default attaches as the issuer's senior unsecured NAIC Designation decreases.

146. Notching for issuer's whose senior unsecured NAIC Designation is **NAIC 3**, **NAIC 4** and **NAIC 5** therefore requires grater professional judgment and discretion.

147. Notching differentials for issuers with **NAIC 3**, **NAIC 4** and **NAIC 5** Designations are wider than for issuer's whose senior unsecured NAIC Designation is **NAIC 1** or **NAIC 2**.

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Notching for NAIC Designation Subscript (to Reflect Non-Payment Risk Unrelated to Credit Risk)

148. **Grant of Significant Discretion** - The SVO is granted significant discretion to determine the number of notches it will assign to a security to reflect other non-payment risk. This discretion is to be exercised in the context of the regulatory objective and purpose of this procedure. SVO determinations made under this subparagraph are subject to review in accordance with the procedures described of this Part, above.

149. **Relevant Considerations** - The name given to the security is not relevant to a determination whether this subparagraph should be applied. The relevant criterion is whether the risks in the security are clearly credit risks or whether they are not clearly credit risks.

150. Factors the SVO may deem relevant to the question of notching for other non-payment risk may include:

- Any security or financial instrument denominated with a term associated with fixed income investments must contain a clearly stated obligation to pay a return and to repay the amount of the principal repayment. Otherwise it is not rational or possible to assign an NAIC Designation.
- Any security or financial instrument denominated as fixed income that does not contain a legally binding obligation to pay shall not be assigned an NAIC Designation and instead will be reported to the Task Force and the Chief examiner of the State of Domicile.
- Any security or financial instrument that is denominated as fixed income and that contains a promise to pay that is otherwise conditional may be notched either under this subparagraph to reflect other non-payment risks or under the notching procedure for credit risk to reflect the expected loss of that obligation in the issuer's specific capital structure, depending on which approach seems more appropriate to the SVO.

151. The widest degree of notching for a security or financial instrument is likely to be for a security that is denominated as fixed income but which is deemed to be a perpetual investment and to not require payment of dividends.

152. In contracts that permit the issuer flexibility to not make payments, the SVO would focus on the degree of financial discretion afforded the issuer to not make payments and the circumstances under which that financial flexibility will be exercised;

153. In contracts where the insurer agrees to accept a risk or participate in an activity that may reduce either the interest or dividend otherwise agreed on or the amount to be repaid to less than the original principal investment, the SVO would consider whether the risk of a loss is structurally or otherwise mitigated;

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154. Notching differentials are expected to be wider for NAIC 3, NAIC 4 and NAIC 5 issuers because the issuer's credit risk is deemed to increase the likelihood that the issuer will avail itself of contractually provided flexibility to not pay or increase the likelihood of a loss as a result of the insurer's participatory activity.

155. Deferral of dividends in a security denominated preferred stock is presumed to be subject to notching for credit risk subject to an SVO determination that the denomination is not truly reflective of the terms of the agreement in which case it may be more appropriately notched for other than credit risk.

156. In a given capital structure, the priority of payment due to an investor may be so subordinated as to require treatment under these guidelines for other non-payment risk. This is especially true where deep subordination is combined with a right to defer interest.

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SVO RESPONSIBILITY FOR INVESTMENT RISK ANALYSIS OF NEW FINANCIAL PRODUCTS

157. The SVO has responsibility for assisting NAIC members and individual states to assess investment risk in new securities and financial products. The SVO exercises this responsibility:

- When requested to do by the VOS/TF, any of its working groups, any other NAIC task force or working group or any individual state insurance department.
- Through the RTAS – Emerging Investment Vehicle Service process.
- Through ongoing research and analysis activity aimed at identifying both broad developments in the capital markets and the introduction of specific new classes of securities that insurance companies may purchase.
- By providing biannual or more frequent reports to the VOS/TF on innovative structures filed by insurance companies and the risks they contain.
- By sharing information obtained through interaction with market participants with the VOS/TF.

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REPLICATION AND (SYNTHETIC ASSET) TRANSACTION

Definitions

158. The following terms shall have the meaning ascribed in this section. The definitions of derivative instruments set forth in *SSAP No. 86—Derivatives* of the NAIC Accounting Practices and Procedures Manual are incorporated by reference.

Approved RSAT

159. *Safe Harbor - Defined RSATs* - Any transaction that meets either of the following conditions:

Any transaction structured according to the following defined transaction types shall be presumed to be an Approved RSAT and should be submitted to the SVO pursuant to this paragraph. Transactions that are structured to contain elements of risk other than those normally associated with the Defined RSAT descriptions below, and transactions involving assets that would not normally qualify for an NAIC Designation, are not eligible for safe harbor treatment and must be submitted to the SVO pursuant to the paragraph titled Transactions Subject to RSAT Approval Review below. If the SVO receives a transaction that does not qualify for an NAIC Designation but would otherwise qualify as an Approved RSAT, the SVO will bring the transaction to the attention of the VOS/TF and await instructions on how to proceed with it.

- **Bond with Interest Rate Swap**—In this RSAT, the insurer enters into a swap agreement to exchange a floating interest rate for a fixed interest rate, or vice versa.
- **Bond with Credit Default Risk Swap**—In this RSAT, the insurer enters into a credit default swap to exchange the credit default risk of a bond for that of another bond.
- **Bond with Total Return Swap**—In this RSAT, the insurer enters into a total return swap to exchange the return of one Basket or Index of bonds for the return of another Basket or Index of bonds.
- **Bond with Foreign Currency Swap**—In this RSAT, the insurer enters into a currency swap to exchange the right to receive principal and/or interest in the currency of one country for that of another. A foreign currency swap can be structured on a fixed or floating rate bond. The swap can involve any currency.
- **Bond with Equity Option**—In this RSAT, the insurer holds a bond and enters into a call option to purchase common stock or a call on an equity index
- **Convertible Bond with Sale of Equity Option**—In this RSAT, the insurer holds a convertible bond and enters into an agreement to sell the equity conversion rights connected with the bond to another party.

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- **Bond with Index Amortizing Interest Rate Swap**—In this RSAT, the insurer enters into an agreement to exchange fixed interest rate payments for floating interest rate payments or vice versa. The notional amount of the swap, and therefore the size of the interest rate swap, amortizes by reference to an index, usually also tied to interest rates.
- **Bond with Interest Rate Swap and Swaption Agreement**—In this RSAT, the insurer enters into two agreements. The first agreement is to exchange a fixed interest rate for a floating interest rate or vice versa. In the second agreement, the insurer enters into a swaption agreement by which it allows itself the option of transferring its obligations under the swap agreement.
- **Bond with Interest Rate Swap and Interest Rate Cap/Floor**—In this RSAT, the insurer enters into two agreements. The first agreement is to exchange a fixed interest rate for a floating interest rate or vice versa. In the second agreement, the insurer limits its exposure above or below a certain interest rate level by entering into a cap or floor agreement.

Transactions Subject to RSAT Approval Review

160. Transactions that are not structured according to one of the transaction types defined above must be submitted to the SVO for a determination of whether or not the transaction is an Approved RSAT. This determination shall be made through a review of the submitted documents that describe the characteristics of the derivative and cash components of the transaction. The description submitted shall include the following:

- An identification of the cash flows in the transaction; both from the insurer to other parties and from other parties to the insurer.
- An identification of the resulting synthetic asset.
- A demonstration of how the cash flows serve to produce the synthetic asset.

161. The documentation should demonstrate that the combined cash flows will achieve the economic performance sought to be produced by the insurer and, therefore, qualify the transaction as an Approved RSAT. If the SVO receives a transaction that does not qualify for an NAIC Designation but would otherwise qualify as an Approved RSAT, the SVO will bring the transaction to the attention of the VOS/TF and await instructions on how to proceed with it.

- Basket means composite of specific financial instruments that are determined by agreement between two parties to be used as a statistical benchmark.

(ii) Cash Component
means the instrument, or portfolio of instruments, owned by the insurance company that is identified by the insurer as the cash instrument component of the RSAT. In

an RSAT, the credit quality of the Cash Component may differ from the credit quality of the reference securities.

(ii) Change in Credit Profile

means an RSAT where the credit risk denoted by NAIC Designation and/or NAIC CRP rating, of the Cash Component is different from the credit risk of the replicated (synthetic) asset. Examples of transactions that constitute a change in credit profile may include:

(a) **A Bond with Credit Default Risk Swap** where the risk of loss of principal results from the potential of default by an obligor different from the Cash Component obligor. This RSAT can also be structured to use the same obligor for the Cash Component and the replicated (synthetic) asset, but where the replicated (synthetic) asset is in a different position in the capital structure of the obligor. For example, the swap may result in a change from senior creditor's status to one of a subordinated debt holder.

(b) **A Bond with Total Return Swap** where the obligors in the Cash Component portfolio are different from those in the derivative instrument component.

Examples of transactions that do not, on their own, constitute a change in credit profile include:

(1) A Bond with Interest Rate Swap.

(2) A Bond with Foreign Currency Swap.

(iv) Effective RSAT

means a reported transaction that meets the following conditions:

(a) The transaction is determined to be an Approved RSAT; and

(b) The replicated (synthetic) asset is an otherwise permissible investment; and

(c) At the time the RSAT is entered into, the insurer's investment in the cash and derivative components have a market value that is not materially different from the market value ascribed to the RSAT; and

(d) The insurer's maximum potential loss in the Replicated (Synthetic) Asset does not exceed the sum of the book/adjusted carrying value of the Cash Component, and the derivative component; and

(e) The RSAT consists of a fixed income Cash Component and a derivative component and the term of the derivative component does not exceed the term to maturity of the Cash Component; and

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(f) At no time is there exposure to a derivative transaction without a corresponding Cash Component assigned exclusively to the Replicated (Synthetic) Asset.

(v) Identical RSAT

means an RSAT entered into by multiple, yet legally separate and distinct, insurance companies of the same insurance company group through separate derivative contracts, but utilizing the same type of derivative transaction, Cash Component, counterparty, transaction effective date, scheduled termination date and assigned a single CUSIP Identifier.

(vi) Index

means a composite of financial instruments whose composition is determined by application of objective, pre-defined rules to be used as a statistical benchmark. Financial instruments may be added to or deleted from the index universe.

(vii) Reference Security

means a financial instrument or instruments whose creditworthiness is referenced in a derivative agreement (typically, a credit default risk swap) and that serves as the instrument by which a credit event is determined or triggered.

(viii) RSAT

stands for Replication (Synthetic Asset) Transaction and means a derivative transaction entered into in conjunction with other investments in order to reproduce the investment characteristics of otherwise permissible investments. Notwithstanding the exemption of short-term investments from filing with the SVO, the term RSAT includes long-term transactions (i.e., those with a when - issued maturity of a year or more) and short term transactions (i.e., those with a when issued maturity of a year or less). Although transactions structured with a futures or forward equity contract may not exactly reproduce a specific asset, these transactions are permitted to the extent such RSATs are permissible investments according to the insurer's state of domicile. A derivative transaction entered into by an insurer as a hedging or income generation transaction shall not be considered to be a replication (synthetic asset) transaction. The insurer shall be responsible for determining that a derivative transaction is considered to be either a hedging, income generation or replication (synthetic asset) transaction prior to filing the transaction with the SVO. For a definition of hedging and income generation, see *SSAP No. 86—Derivatives*.

(ix) RSAT Form

refers to the Replication (Synthetic Asset) Transaction Form used to report the RSATs.

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(x) RSAT-CCA Form
refers to the Replication (Synthetic Asset) Transaction - Credit Change Annex Form used to report transactions where the RSAT results in a Change in Credit Profile from that of the Cash Component.

(xi) RSAT Basket Form
refers to the Replication (Synthetic Asset) Transaction Form used to Report RSATs using Baskets.

(xii) RSAT Fixed Income Index Form
refers to the Replication (Synthetic Asset) Transaction Form used to report RSATs using Indices discussed and defined in this Section 2.

(xiii) RSAT Index List Application
refers to the form used to apply for inclusion on the NAIC Approved RSAT Index List.

Instruction to Report Replication (Synthetic Asset) Transactions

162. **Instruction** - Insurance companies shall report all RSAT transactions, including RSAT transactions of duration less than 365 days, to the SVO and the SVO shall apply the instructions in this Section to all reported RSATs including Baskets and Indices.

163. **Special Instruction Regarding Identical RSATs** - Only one insurance company that is a member of an insurance company group that has engaged in an Identical RSAT is required to file the RSAT with the SVO. All of the rules and procedures specified in this Section shall be applicable to that filing.

164. Notwithstanding this special instruction, all of the members of the insurance company group that have entered into an Identical RSAT shall nevertheless fully report their holdings as required by annual statement instructions for Schedule DB Part C.

165. Any state insurance regulator who questions whether the RSAT entered into by members of an insurance company group meets the definition of an Identical RSAT may require the members of the group to file relevant information with the SVO so that the SVO may verify whether transactions claimed to be identical are identical within the meaning of the definition and/or whether the insurance companies have otherwise appropriately reported the RSAT transaction.

166. The SVO shall have authority to make inquiries of insurance companies and to request insurance companies to file relevant information with it so it may verify whether transactions claimed to be identical are identical within the meaning of the definition and/or whether the insurance companies have otherwise appropriately reported the RSAT transaction.

167. **Counterparty Risk-Based Capital** - The NAIC Designation assigned to a RSAT does not capture any counterparty risk associated with any derivative component of the RSAT. The

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credit risk of any particular counterparty is captured in the risk-based capital charge of the counterparty reported in Schedule DB - Part D - Section 1.

Initial Reporting of Replication (Synthetic Asset) Transactions

168. **Informational Requirements – General** - Each reporting insurance company is required to file the information listed below for every RSAT filing. Additionally, for those RSATs exhibiting a Change in Credit Profile, the reporting insurance company shall be required to file the information listed under the subparagraph titled Additional Instructions for RSATs with a Change in Credit Profile below.

General Filing Instructions

- RSAT Form
- If any Cash Component is required to be filed with the SVO and is not on the VOS Process with a current year Designation, the reporting insurance company is required to follow the reporting conventions and file the required documents.
- The reporting insurance company is required to file the prospectus, offering circular, detailed term sheet, trade confirmation, swap agreement, call option agreement, foreign currency agreement or other agreement or document, as appropriate to the transaction, corresponding to each derivative component of the reported Approved RSAT.
- If the derivative component of the Approved RSAT relies on a counterparty that is not on the List of Counterparties Designated by the SVO refer to that section for a description of analytical procedures and informational requirements.

Additional Instructions for RSATs with a Change in Credit Profile

- RSAT-CCA Form.
- If the transaction is one that involves securities, including Reference Securities that require an NAIC Designation, the reporting insurance company is required to follow the reporting conventions and file the required documents for such securities.

Procedures Applied to Initial Reports of Replication (Synthetic Asset) Transactions

169. **Effective RSAT** - The SVO shall verify that the reported RSAT meets those standards of effectiveness set forth in subsections (A), (D), (E), and (F) of Section (v) above. The reporting insurance company shall have responsibility for ensuring that the standards of effectiveness set forth in subsections (B) and (C) of the section titled Effective RSAT in (v) above have been met.

170. **Credit Assessment** - The SVO shall apply the procedures listed under subsection General Procedures below for every filing. Additionally, for those RSATs exhibiting a Change in Credit Profile, the SVO shall apply the procedures set forth in the subsection titled Additional Procedures for RSATs with a Change in Credit Profile below.

171. **General Procedures**

- If the Cash Component is of a type that is required to be filed with the SVO and is not on the VOS Process with a current year designation, the SVO shall apply the methodologies set forth in this Manual.
- If any counterparty involved in the RSAT is not currently listed on the SVO's List of Counterparties Designated by the SVO, the SVO shall apply the procedures set forth in this Manual.
- The SVO shall review the documents corresponding to each derivative component of the reported Approved RSAT to verify that the relationships and identities of the parties to the agreement(s) are as reported on the RSAT Form.
- If the SVO determines that the documentation provided comports with the reported RSAT, then the analyst shall assign the NAIC Designation of the Cash Component to the RSAT.

172. **Additional Procedures for RSATs with a Change in Credit Profile**

- If the transaction involves securities, including Reference Securities, which are on the VOS Process with a current year designation, the SVO shall assign that Designation associated with the Reference Securities to the RSAT.
- If the transaction involves securities, including Reference Securities that are not on the VOS Process with a current year designation, the SVO shall apply the methodologies in this Manual to the securities. Upon determination of an NAIC Designation for such securities, the SVO shall apply that Designation associated with the Reference Securities to the RSAT.

Subsequent Reporting of Replication (Synthetic Asset) Transactions

173. **Informational Requirements – General -** Each reporting insurance company is required to file the information listed below for every RSAT filing. Additionally, for those RSATs exhibiting a Change in Credit Profile, the reporting insurance company shall be required to file the information listed under the subsection titled Additional Instructions for RSATs with a Change in Credit Profile below.

General Filing Instructions

174. For the Cash Component, file the required documentation.

There are no additional subsequent reporting requirements if there are no changes in any of the components of the RSAT. Any sale, termination or modification of the component pieces of an Approved RSAT must be reported to the SVO within 30 days. This can be done by submitting to the SVO either a Material Change ATF Form or a Renumbering Request for the affected RSAT. Any such sale, termination or modification that results in the RSAT ceasing to be effective pursuant

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to the section titled Effective RSAT in (v) above above will immediately terminate the replication (synthetic asset) transaction.

Additional Instructions for RSATs with a Change in Credit Profile

175. File the required documentation required this Manual for securities, including Reference Securities, on the VOS Process. If a security is no longer listed on the VOS Process, file the documentation by this Manual.

Procedures Applied to Subsequent Reports of Replication (Synthetic Asset) Transactions

176. **Credit Assessment** - The SVO shall apply the procedures listed below for every filing. Additionally, for those RSATs exhibiting a Change in Credit Profile, the SVO shall apply the procedures set forth in the subsection titled Additional Instructions for RSATs with a Change in Credit Profile below.

177. General Procedure

- The SVO shall monitor the NAIC Designation assigned to the Cash Component.
- The SVO shall monitor the NAIC Designation assigned to the counterparties to the derivative component of the RSAT.

The reporting insurance company must report a change in the documentation relating to any derivative component to the SVO. The SVO shall assess the significance of such change.

178. Additional Procedures for RSATs with a Change in Credit Profile - The SVO shall monitor the NAIC Designation assigned to any security, including Reference Securities, involved in the RSAT.

ADDITIONAL PROCEDURES FOR RSATS USING BASKETS

Initial Reporting

179. **Informational Requirements** - Reporting insurance companies are required to file the information listed below for each replication they enter into using a Basket.

- RSAT Basket Form
- If any of the component instruments in a Basket are not on the VOS Process with a current year Designation, the reporting insurance company is required to follow the reporting conventions and file the required documents set forth in this Manual.
- If the derivative component of the RSAT relies on a counterparty that is not on the List of Counterparties Designated by the SVO the informational requirements identified above apply.

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Procedures Applied to Initial Reports of Baskets

180. **Effectiveness Testing** - The SVO shall verify that the reported RSAT meets those standards of effectiveness set forth in subsections (A), (D), (E),and (F) of the section titled Effective RSAT in (v) above. The reporting insurance company shall have responsibility for ensuring that the standards of effectiveness set forth in subsections (B) and (C) of the section titled Effective RSAT in v) above have been met.

181. **Credit Assessment** - If any component instrument of a Basket is not on the VOS Process with a current year Designation, the SVO shall apply the methodologies in Part Three of this Manual.

182. **Counterparty** - If any counterparty named in the RSAT is not currently listed on the SVO's List of Counterparties Designated by the SVO, the SVO shall the corresponding procedures in this Manual.

Subsequent Reporting

183. **Informational Requirements** - Reporting insurance companies are required to file the information listed below for each replication they enter into using a Basket on an annual basis.

- If there are additions or deletions to the component instruments in a Basket, the SVO should be notified within 30 days. If any new component instrument in a basket is not on the VOS Process, the reporting insurance company is required to follow the reporting conventions and file the required documents for each of those instruments.
- If any of the existing or new component instruments in a Basket are on the VOS Process, but do not have a current year Designation, the reporting insurance company is required to follow the reporting conventions and file the required documents for each of those instruments.

184. **Procedures Applied to Subsequent Reports of Baskets**

- The SVO shall monitor the NAIC Designation of those Basket components with NAIC Designations.
- The SVO shall monitor the NAIC Designation assigned to the counterparty to the derivative component of the RSAT.

ADDITIONAL PROCEDURES FOR RSATS USING INDICES

Initial Reporting

185. **Informational Requirements** - Reporting insurance companies are required to file an RSAT Fixed Income Index Form with the SVO for each replication they enter into using an equity or fixed income Index. An insurance company may only enter into an RSAT using a fixed income Index if the Index is listed on the SVO's RSAT Index List Equity Indices are

not required to be on the SVO's RSAT Index List as no credit quality evaluation is performed on equity investments.

186. **Procedures Applied to Initial Reports of Indices**

- *Effectiveness Testing* - The SVO shall verify that the reported RSAT meets those standards of effectiveness set forth in subsections (A), (D), (E), and (F) of the section titled Effective RSAT in (v) above. The reporting insurance company shall have responsibility for ensuring that the standards of effectiveness set forth in subsections (B) and (C) of the section titled Effective RSAT in (v) above have been met.
- *Counterparty* - If any counterparty named in the RSAT Form is not currently listed on the SVO's List of Counterparties Designated by the SVO, the SVO shall apply the corresponding procedures.
- *Verification* - The SVO will verify that any fixed income Index named in the RSAT Form is on the SVO's current RSAT Index List.

Subsequent Reporting

187. Informational Requirements

- Reporting insurance companies are not required to file any annual information with the SVO for RSATs using an Index as long as the Index, if it is a fixed income Index, remains on the SVO's RSAT Index List. If a fixed Income index is removed from the list, any RSAT utilizing such Index will no longer qualify as an Approved RSAT.
- The SVO shall monitor the NAIC Designation assigned to the counterparty to the derivative component of the RSAT.

Procedures for Compilation of the RSAT Index List

188. **Compilation of List** - The staff is instructed to compile and maintain a list of fixed income indices that meet the standards identified in subsection (ii) below (RSAT Index List). The RSAT Index List may be used by reporting insurance companies when filing fixed income Index RSATs with the SVO. If the SVO determines that an Index does not meet the eligibility requirements set forth below, the Index will not be included on the list. Publication of an Index on the RSAT Index List does not imply an opinion of the quality of such Index or of the Index vendor.

189. **Eligibility Requirements** - A fixed income Index may be eligible for listing on the RSAT Index List if the Index meets the following requirements:

- *Rule-Based* - The Index is composed and valued based on the application of objective, pre-defined criteria. Additions to or deletions from the list must be made based on the application of such criteria.

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- *Information Available* - Rating information about the components is, or can be made available, to the SVO.
- *Components Rated* - All, or substantially all, of the Index components are rated, or have obligors that are rated, by an NAIC CRP or have received a current year NAIC Designation from the SVO. In the event that not all of the Index components are NAIC CRP rated or have a current year NAIC Designation, the reporting insurance company may either (1) file the component with the SVO to obtain a Designation or (2) assign an **NAIC 5*** Designation to the unrated instrument, as long as it is current on principal and interest or an **NAIC 6*** Designation if it is not or if the status is not determinable. Instruments assigned an **NAIC 5*** Designation or **NAIC 6*** Designation, on a combined basis, can represent no more than 5% of the Index's total value.
- *Independent* - The Index is predominantly composed of instruments whose issuers are unaffiliated with the Index vendor.

Initial Reporting

190. In order to apply for listing of a fixed income Index on the RSAT Index List, a reporting insurance company should submit the following to the SVO:

- A listing of all Index components.
- The ratings of all NAIC CRP-rated Index components from all NAIC CRPs that have rated the component.
- The actual NAIC Designation for each Index component with an NAIC Designation or an equivalent NAIC Designation for each component rated by an NAIC CRP using the conversion instructions and the rating equivalents, if rated and monitored by one NAIC CRP, the equivalent NAIC Designation; if rated and monitored by two NAIC CRPs, then the lowest rating and if rated and monitored by three or more NAIC CRPs, then the second lowest rating. In the case of a security rated and monitored by three or more NAIC CRPs, the NAIC CRP ratings for a security are ordered according to their NAIC Designation equivalents and the rating that is second lowest will be selected, even if that rating is equal to that of the first lowest.
- A demonstration and certification by the insurance company, as evidenced by an executed certificate by an officer of the insurance company, that the eligibility requirements set forth in subsection Eligibility Requirements in the Procedures for Compilation of the RSAT Index List above have been met.

Subsequent Reporting

191. The reporting insurance company shall annually submit to the SVO the items listed in the Initial Reporting subsection of the Eligibility Requirements in the Procedures for Compilation of the RSAT Index List above for each fixed income Index it desires to

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maintain on the RSAT Index List. Any Index on the RSAT Index List for which the required documents are not submitted, or any Index that no longer meets the eligibility requirements set forth in section above, shall be deleted from the RSAT Index List.

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THE REGULATORY TREATMENT ANALYSIS SERVICE – EMERGING INVESTMENT VEHICLE

Emerging Investment Vehicle

192. **Finding** - The VOS/TF finds that the pace of financial innovation and extent of financial engineering requires close cooperation between regulated insurance companies, investment banks and other financial market participants and the regulators who must assess the solvency implications of financial innovation and engineering. This sub-section establishes the mechanism for an insurance company or another market participant ("Applicant") to apply to the SVO for the purpose of determining the probable regulatory treatment to be accorded to an Emerging Investment Vehicle ("EIV") before it is sold to an insurance company, or for any other security.

193. **Definition of Probable Regulatory Treatment** - For purposes of this sub-section, probable regulatory treatment means the professional opinion of the SVO as to the credit quality designation; and or asset classification for statutory reporting purposes; and or the valuation that would be accorded to the EIV under this Manual if it were purchased by an insurance company and reported to the SVO.

194. Probable regulatory treatment includes a statement by the SVO that in its opinion: (1) the existing regulatory framework already captures the risks posed by the security either through the mechanism of credit ratings, valuation policy or classification methodology, (2) that the existing regulatory framework does not capture the risks posed by the security and that it is necessary to apply to the VOS/TF to develop an appropriate regulatory accommodation for the instrument or (3) that the SVO lacks an approved methodology that could be used to assess the risks contained in the EIV and that it is necessary to apply to the VOS/TF to develop an appropriate methodology.

195. **Definition of EIV** - For purposes of this sub-section, an EIV is an investment security or other financial product that is newly offered and that contains characteristics or features not previously reviewed by the VOS/TF or the SVO for a determination of the probable regulatory treatment to be accorded to the EIV. An EIV may be "newly offered" in the sense that the security or financial product has not previously been known (and hence none of its characteristics or features are known) or in the sense that a security or financial product whose primary characteristics or features are understood has evolved to incorporate substantially different features or to contain significant innovation such that it should be considered as never having been reviewed by the VOS/TF or the SVO.

196. **Who May Request an Analysis Under This Section** - An EIV may be filed: by an insurance company or by another market participant (without the requirement of insurance company sponsorship); or by a state insurance regulator for any security owned by an insurance company under the authority and for purposes discussed in this Section 3(a)

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above, subject only to the conditions imposed in this sub-section and in other referenced sections.

197. The SVO is not authorized to require anyone to file a transaction as an EIV. However, nothing in this sub-section limits the obligation or the authority of the SVO to report to the VOS/TF any transaction, whether or not filed with the SVO, that presents issues or contains features that require guidance from the VOS/TF.

198. **Submission Procedure** -To request an analysis of probable regulatory treatment of an EIV, the Applicant submits an original completed Application for Regulatory Treatment Analysis Service ("Application") to the Director, SVO (the "Director"), or the Director's designated representative. An Application shall be accompanied by written and substantially finalized documentation showing all material terms with the same specificity and clarity as the SVO requires to complete a purchased transaction. A copy of the prospectus or private placement memorandum will not be required if it is unavailable at the time of the filing of the Application, however, it may be required before a determination on the EIV in question can be made by the SVO.

199. **Requirement of a Substantially Finalized Transaction** - Analysis of probable regulatory treatment will be provided only for securities and financial products that have been substantially finalized in all material respects. The SVO is not authorized to assist the Applicant to structure a transaction to attain specific regulatory objectives. The SVO shall have full discretion to determine that the terms of a security or financial product as reflected in the documentation submitted with the Application indicate that the security or financial product is not substantially finalized.

200. **Discretion** - The Director shall have full discretion to reject an Application if, in the Director's sole discretion, acceptance of the Application would not meet the objectives of the NAIC Financial Conditions Framework. The Director will communicate any such rejection to the Applicant and will return the Application fee and may communicate such rejection to the VOS/TF for informational purposes.

201. **Communication of Determination** - At the conclusion of the processing of the EIV, the SVO will provide a letter to the EIV Applicant setting forth its conclusions with respect to the issue(s) raised by the EIV.

202. If the SVO concludes that this Manual does not provide sufficient guidance to determine an NAIC Designation, valuation or classification for the EIV, or that in its opinion the NAIC Financial Conditions Framework does not clearly specify standards or criteria for responding to the issue(s) raised by the Applicant, it will so inform the Applicant and the VOS/TF.

203. **Information provided as part of the RTAS** – Emerging Investment Vehicle Application shall be treated as confidential by the SVO. The Applicant may communicate the content of the letter to anyone provided the Applicant also communicates that the purpose of the

analysis reflected in the letter is regulatory. The Applicant may also provide copies of the SVO letter to anyone provided a complete copy of the SVO letter must be given.

204. If, after the SVO has communicated its decision to the Applicant, an insurance company purchases the EIV and reports it to the SVO, either on its own initiative or at the direction of an insurance regulator, the SVO may be required to enter its determination into NAIC systems, including systems accessible to the market participants for regulatory purposes. This shall not be considered a breach of the agreement to hold our determination confidential.

205. The regulatory expectation is that Applicants who advise insurance companies will make full disclosure of the SVO determination to any insurance company that requests such information, even if the conclusion is contrary to the Applicant's initial expectations.

206. **Standing of EIV Application in the NAIC Financial Condition Framework -**The activity authorized by this subsection is intended solely to facilitate the business and regulatory objectives of the NAIC and the financial solvency function of the VOS/TF. The SVO's acceptance of an Application does not convey any regulatory status or recognition to the EIV.

207. A preliminary NAIC Designation assigned under the procedure specified in this sub-section is only valid for the day issued as such designation reflects the preliminary draft of documents and other information that have been presented to the SVO.

208. A preliminary NAIC Designation will not be published in the Database or the AVS+ Products and, therefore, cannot be used to report the credit quality of the security to the NAIC or any state insurance department. Only NAIC Designations published in the AVS+ Products may be used to report an investment to an NAIC member's state insurance department.

209. If an insurance company subsequently purchases the security, the purchasing company must file an Initial Report or, if the security is filing exempt, report the security in accordance with that procedure. The SVO shall apply its usual procedure for initially reported securities before assigning an NAIC Designation and publishing such NAIC Designation in the AVS+ Products.

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LIST OF QUALIFIED U.S. FINANCIAL INSTITUTIONS

Regulatory Purpose and Objectives

210. The List of Qualified U.S. Financial Institutions established in this Part Six implements Section 3 C. (1) and Section 4 A. of the NAIC *Credit for Reinsurance Model Law* (#785) (Model Law).

211. Section 3 C. (1) of the Model Law permits an asset or a reduction from liability for reinsurance ceded by a domestic insurer to an assuming insurer. The asset or reduction may be in an amount held by or on behalf of the ceding insurer, including security in the form of a LOC issued or confirmed by a qualified U.S. financial institution. Section 4A of the Model Law defines the term "qualified U.S. financial institution," which is hereby incorporated by reference.

212. The List of Qualified U.S. Financial Institutions is a compilation of the names of banks and nondepository lenders (financial institutions) that have applied to the NAIC to be identified as issuers of LOCs in support of reinsurance arrangements under the Model Law or state law provisions based on the Model Law.

213. The placement of the name of a financial institution on the List of Qualified U.S. Financial Institutions indicates that the SVO has verified that the applicant meets the financial and other eligibility standards specified in this part and that the financial institution has agreed to provide the SVO with any information necessary to permit the SVO to evaluate whether the financial institution continued to meet the eligibility standards specified in this Part.

214. The List of Qualified U.S. Financial Institutions is maintained for the use of state insurance regulators administering credit for reinsurance provisions in state law based on the Model Law and may also be used by insurance companies to identify financial institutions willing to support reinsurance arrangements as identified in Section 3 C. (1) and Section 4A of the Model Law.

215. The List of Qualified U.S. Financial Institutions implemented under this Part is not intended to be used for any other purpose or by any other person or entities. The placement of the name of a financial institution on the List of Qualified U.S. Financial Institutions is not an opinion as to any aspect of the financial institution's operations, the appropriateness of doing business with the financial institution or the suitability or unsuitability of any financial institution on the list to serve as a provider of credit enhancement for securities transactions.

Directive to Compile the List of Qualified U.S. Financial Institutions

216. The SVO shall compile the List of Qualified U.S. Financial Institutions in accordance with the procedures and instructions provided in this Section.

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List of Nationally Recognized Statistical Rating Organizations

217. Establish a List of Nationally Recognized Statistical Rating Organizations - The SVO shall establish a List of Nationally Recognized Statistical Rating Organizations (NRSROs), as specified in this Section, to be used to administer the List of Qualified U.S. Financial Institutions. The SVO shall place on the List of NRSROs any credit rating organization that:

A) Is registered with the U.S. Securities and Exchange Commission (SEC) as an NRSRO, as that term is defined in the applicable federal statute.

B) Has criteria and methodology for assigning credit ratings to banks and nondepository lenders—sometimes hereafter referred to as nonbank financial institutions (NBFIs)—that the SVO has confirmed is consistent with the needs of the NAIC for purposes of the Model Law and which at a minimum:

218. Utilizes an analytical framework that assesses the incremental risk of banks and NBFIs (i.e., nondepository lenders) relative to each other and incorporates as criteria in its bank and NBFI methodology the nature and robustness of regulation, access to the central bank for contingent liquidity and the stability of funding.

219. Results in the expression of an opinion of the bank's or NBFI's likelihood of default on an LOC obligation and or long-term debt obligation.

220. Results in the assignment of a stable credit rating, defined to mean that the NRSRO considers it unlikely that the assigned credit rating would be downgraded within one year under the moderate stress scenario specified in its credit rating criteria.

221. **Procedure** - The SVO may place an NRSRO on the List of NRSROs either on its own initiative or upon the application of the NRSRO, after confirming that as an analytical matter and in its sole discretion the NRSRO's criteria and methodology meets the minimum standards specified above and is otherwise consistent with the needs of the NAIC for the purposes of the Model Law. The SVO may delete the name of an NRSRO if, as an analytical matter and in its sole discretion, it determines that changes in the NRSRO criteria and or methodology no longer meet specified minimum standards or are otherwise no longer consistent with the needs of the NAIC for purposes of the Model Law.

222. The SVO shall place on the List of NRSROs the name of the NRSRO, the titles and dates of publication of the criteria, and methodology for banks and NBFIs that the SVO has determined will provide the NAIC a credit rating suitable for the administration of aspects of credit risk pertaining to reinsurance arrangements under the Model Law.

223. **Policy and Legal Disclosure Pertaining to the List of NRSROs** - The NAIC uses publicly available credit ratings, when available, as one component of the services it provides to state insurance regulators concerned with financial solvency monitoring of insurance company investments. In adopting or in implementing the procedure described in this part, the NAIC acts solely as a private consumer of publicly available credit ratings. The sole

NAIC objective in obtaining and using publicly available credit ratings is to conserve limited regulatory resources—for example, the resources of the SVO. The VOS/TF has established the procedure specified in this section solely to ensure that the NAIC can avail itself of publicly available credit rating opinions for the purposes identified in this part.

224. The NAIC is not selecting, approving or certifying NRSROs or other rating organizations or distinguishing among them for any public or policy purpose whatsoever. Nor is the NAIC endorsing the credit rating or analytical product of any NRSRO or distinguishing between NRSROs for any specific public purpose. The NAIC disclaims any authority to regulate NRSROs.

Application to be on the List of Qualified U.S. Financial Institutions

225. **Process** - A representative of a financial institution may apply to have the name of the financial institution added to the List of Qualified U.S. Financial Institutions by completing and submitting to the SVO the QUSFI application and paying the applicable fee. The QUSFI Application can be obtained at this Web address: **http://www.naic.org/documents/svo_qusfi_list_app.pdf** .

The QUSFI application requires that the applicant:

- Describe whether it is a bank or nondepository lender, as well as identify its federal and state regulators and corporate affiliations.
- Represent that it meets the definition of a qualified U.S. financial institution as specified in the Model Law (as printed in the Application).
- Describe its experience in the issuance of letters of credit.
- Provide evidence of a credit rating grade, assigned by an NRSRO on the List of NRSROs developed using the criteria and methodology specified in the List of NRSROs.
- Provide initially and agree to provide on a periodic basis the financial information identified in the application as the financial institution's profile and metrics to enable the SVO to monitor the financial institution's credit rating and financial profile. (The best method of data collection and the most appropriate data sources to be used for this information are still being determined and thus may change based upon availability and system modifications.)

Procedure

226. **Initial Application** - An application is submitted to the SVO. (The mechanics of the application process and of required information has not been finalized). Upon receipt, the SVO shall review the application and supporting documentation and communicate in a writing its determination whether the application has been approved and whether the name of the financial institution will be placed on the List of Qualified U.S. Financial Institutions.

227. **Annual Updates** - On an annual basis, the SVO shall contact all financial institutions whose names shall then appear on the List of Qualified U.S. Financial Institutions by mail, requesting each financial institution to indicate whether it requests to be maintained on the List of Qualified U.S. Financial Institutions by submitting the annual update portion of the application and renewal fee or drop off the list.

228. **Failure to Timely Respond** - The failure to submit a response to this inquiry and or to provide the required annual update application documents and or the renewal fee shall be interpreted as a request that the name of the financial institution be removed from the List of Qualified U.S. Financial Institutions. The SVO shall accordingly remove the name of the financial institution from the List of Qualified U.S. Financial Institutions without further communication or notice.

Eligibility Standards to Be Placed on the List of Qualified U.S. Financial Institutions

229. **Eligibility Standards**- The SVO shall place on the List of Qualified U.S. Financial Institutions the name of any financial institution that is:

- A domestic financial institution authorized to issue or confirm LOCs that have been assigned a credit rating from an NRSRO on the List of NRSROs generated pursuant to the criteria and methodology specified on the List of NRSROs for that NRSRO of "Baa/BBB" or better for its LOC or long-term debt obligation.
- A U.S. branch or agency of a foreign financial institution:
  - Authorized to issue LOCs for reinsurance.
  - That is a part of a foreign institution that (a) has attained a credit rating from an NRSRO on the List of NRSROs generated pursuant to the criteria and methodology specified in the List of NRSROs for that NRSRO of "Baa/BBB" or better for its LOC or long-term debt obligation.
  - Domiciled in a country with a sovereign debt rating of (a) "Aa/AA" for long-term debt and/or "P1/A1" for short-term debt by an NAIC credit rating provider (CRP).

SVO Monitoring of Movements in the Credit Quality of Financial Institution on the List of Qualified U.S. Financial Institutions

230. **SVO Monitoring** - The SVO shall monitor the credit quality of financial institutions on the List of Qualified U.S. Financial Institutions by:

- Monitoring NRSRO activity relative to the financial institution's assigned LOC or long-term debt obligation credit rating, including whether the NRSRO considers the rating to be stable or has indicated that the financial institution may be placed on Negative Outlook or Negative Watch.

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- Conducting independent analysis of the financial institution's profile and metrics. The objective of the independent analysis is to monitor the potential for and actual deterioration of the credit quality of a financial institution on the List of Qualified U.S. Financial Institutions in order to provide notice to the regulatory community and insurers including to determine whether the entity should be added to the SVO Watch List so the regulatory community and insurers may consider the implications of the noted credit deterioration for reinsurance arrangements with the financial institution, if any.

231. **Outline of Methodology** - On a quarterly (or semi-annual) basis, the SVO shall:

- Calculate the following financial ratios or items for each financial institution on the SVO Watch List or for those financial institutions on the List of Qualified U.S. Financial Institutions:
  - Net interest income to total income
  - Net Interest Margin
  - Efficiency Ratio
  - Charge-Offs / Allowance for Losses
  - Tier 1 Capital Ratio
  - Total Capital Ratio
  - Financial Leverage Ratio

232. The SVO will compare the results obtained for the metrics discussed above to the ranges published by nationally recognized statistical rating organizations (NRSROs) for the minimum NAIC credit rating requirement (Baa3/BBB-) as they pertain to: total assets; total equity capital; annualized cash from operations; debt to capital; and, EBITDA to interest coverage. This information will be used to estimate the likelihood that the financial institution will drop below the required minimum credit rating.

NOTE: The financial metrics (i.e., ratios and data points) for specific credit ratings are published by NRSROs and may be adjusted from year to year by the NRSROs to relate changes in market conditions to the financial profiles associated with their credit ratings.

233. **Notice of Credit Deterioration** - The SVO shall provide notice to the NAIC Reinsurance (E) Task Force and state insurance regulators more generally and to insurers about the credit quality of financial institutions on the List of Qualified U.S. Financial Institutions as described below.

- If a financial institution is rated by an NRSRO at "A-/A3" or better and the SVO determines that a financial institution no longer meets one or more of the financial

metrics specified above, the SVO will monitor the institution to assess the likelihood of the NRSRO to take a potential negative rating action against the institution.

- If the SVO determines that a financial institution on the List of Qualified U.S. Financial Institutions rated "BBB+/Baa1 or below but not lower than BBB-/Baa3" by an NRSRO no longer meets one or more of the financial metrics specified above or that it has been placed on Negative Outlook or Negative Watch by an NRSRO, the SVO shall perform a more detailed review of the financial condition of the institution.

234. If the SVO determines that the noted credit deterioration suggests that the financial institution may soon no longer meet the required minimum, the SVO will place the name of the financial institution on its Watch List. If the name of the financial institution is placed on the SVO Watch List, the financial institution will not be allowed to renew participation on the financial institution list for the next year.

235. If a financial institution on the List of Qualified U.S. Financial Institutions is downgraded below "BBB-/Baa3" by an NRSRO, the SVO shall remove the name of the financial institution from the List of Qualified U.S. Financial Institutions.

236. A financial institution whose name is deleted from the List of Qualified U.S. Financial Institutions because its NRSRO credit rating dropped below the minimum credit rating may renew participation on the financial institution list when the financial institution's credit rating is restored to BBB-/Baa3 or higher with a stable outlook.

LOC Requirements Under the Model Law

237. **Not an SVO Activity** - The SVO does not review individual LOCs, trust agreements or reinsurance arrangements. The placement of the name of a financial institution on the List of Qualified U.S. Financial Institutions does NOT imply that the Model Law requirements pertaining to LOCs, trust agreements or reinsurance arrangements have been met.

238. **Information -** For information about LOC requirements, see Sections 10 A. (3) and Section 12 of the NAIC *Credit for Reinsurance Model Regulation* (#786).

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COUNTERPARTY EXPOSURE; NETTING ELIGIBILITY

NAIC Designation

239. The SVO will convert the counterparty's or the guarantor's financial strength ratings as assigned by an NAIC CRP (e.g., S&P Financial Programs Ratings, Moody's Counterparty's Ratings or Fitch Counterparty Risk Ratings) into an equivalent NAIC Designation. In the absence of an NAIC CRP counterparty financial strength rating, the SVO may convert the counterparty's senior unsecured rating, as assigned by an NAIC CRP, into the equivalent NAIC Designation. In the absence of an NAIC CRP counterparty financial strength or senior unsecured rating, the SVO will conduct a review of the counterparty's financial statements to assign an NAIC Designation. For purposes of the application of this Section, all U.S. domiciled exchanges are assigned an **NAIC 1** Designation.

Netting Eligibility

240. The VOS/TF has determined that there is adequate legal certainty to permit netting of exposures for counterparties domiciled within the United States. Netting of exposures for a foreign (non-U.S.) counterparty will be permitted if its domiciliary jurisdiction has been approved for listing in the List of Jurisdictions Eligible For Netting. Other jurisdictions may be added to the List of Jurisdictions Eligible For Netting if, in the opinion of the SVO, after consultation with the VOS/TF, legal opinions or analyses provide adequate legal certainty that upon default of the counterparty, close-out netting would be enforceable.

COUNTERPARTIES DESIGNATED BY THE SVO FOR SCHEDULE DB-PART D-SECTION 1

Association Values

241. The value for derivative instruments, where such derivative instruments are permitted by law or regulation of an insurer's state of domicile, shall be equal to the Statement Value reported in Schedule DB, Parts A (Options, Caps and Floors Owned), B (Options, Caps and Floors Written), C (Collars, Swaps and Forwards) and D (Futures) that is calculated according to the procedures found in the NAIC Accounting Practices and Procedures Manuals for Life and Health, Fraternal, and Property & Casualty companies.

Accounting and Documentation Guidance

242. The NAIC Accounting Practices and Procedures Manual contains general accounting guidance, documentation guidance, and specific accounting procedures for derivative instruments.

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PROCEDURES FOR DETERMINING NAIC DESIGNATIONS AND NETTING ELIGIBILITY FOR DERIVATIVE INSTRUMENT COUNTERPARTIES

Purpose

243. The purpose of assigning NAIC Designations or quality ratings is to assign counterparties into SVO Rating Categories for Schedule DB — Part D—Section 1.

Administration

244. **Listing a Counterparty** - An insurance company that wants to have a counterparty listed on the List of Counterparties Rated by the SVO for Schedule DB--Part D—Section 1 shall submit to the SVO:

- A Counterparty Rating ATF Initial Filing Form.
- Form CRR 1.
- Evidence of an NAIC CRP counterparty rating, an NAIC CRP senior unsecured rating or a copy of the most recent Audited Financial Statement for the counterparty, or the counterparty's guarantor, so that the SVO can assess credit quality and assign an NAIC Designation.
- Upon receipt of the above documents, the SVO shall convert the NAIC CRP rating into its equivalent NAIC Designation or perform a financial analysis of the counterparty, or the counterparty's guarantor, in order to assign an NAIC Designation.

245. **Annual Update of Counterparties on the List -** In order to maintain a counterparty on the List, an insurance company must file the following information:

- A Counterparty Rating ATF Annual Update Filing Form;
- Evidence of an NAIC CRP counterparty rating, an NAIC CRP senior unsecured rating or a copy of the most recent Audited Financial Statement for the counterparty, or the counterparty's guarantor.

246. If an insurance company doesn't file an annual update by June 1, XXXX, the counterparty will be deleted from the List effective July 1, XXXX. If deleted, the insurance company will have to submit an initial filing in order for the counterparty to be placed on the List.

LIST OF FOREIGN (NON-U.S.) JURISDICTIONS ELIGIBLE FOR NETTING FOR PURPOSES OF DETERMINING EXPOSURES TO COUNTERPARTIES FOR SCHEDULE DB - PART D - SECTION 1

Procedures for Determining NAIC Designations and Netting Eligibility for Derivative Instrument Counterparties

247. **Netting Eligibility**: The purpose of identifying jurisdictions eligible for netting is to permit the calculation of credit risk exposures to counterparties in Schedule DB—Part D—Section

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1. The netting of offsetting liabilities with a counterparty will only be permitted in this Schedule if there exists a master agreement that provides for such netting and if there is adequate legal certainty that closeout netting would be enforced upon default of the counterparty.

248. **Legal Certainty for Netting Eligibility**: There is adequate legal certainty to permit netting of exposures for counterparties domiciled within the United States. Netting of exposures in Schedule DB—Part D—Section 1 will be permitted for a foreign (non U.S.) counterparty if its domiciliary jurisdiction appears on the list in this sub-paragraph (d). Jurisdictions will appear on the list if, in the opinion of the SVO, legal opinions and/or analyses provide adequate legal certainty that upon default of the counterparty, closeout netting would be enforced.

Jurisdiction:
Australia
Belgium
Canada
Cayman Island
England
France
Germany
Ireland
Japan
Scotland
Singapore
Switzerland

249.

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SECURITIES THAT ARE CONSIDERED "EXEMPT OBLIGATIONS" FOR PURPOSES OF DETERMINING THE ASSET VALUATION RESERVE AND THE RISK BASED CAPITAL CALCULATION

NOTE: This section is used to determine those securities that are included in the "exempt obligations" category for purposes of determining asset valuation reserve and the risk-based capital calculation.

250. The securities issued, guaranteed or insured by U.S. Government Exempt entities considered to be in the "exempt obligations" category for purposes of determining Asset Valuation Reserve and the Risk-Based Capital charge calculation.

251. Securities issued, guaranteed or insured by entities on the Filing Exempt Other U.S. Government list are not "exempt obligations", and shall be reported in the Special Revenue and Special Assessment Obligations category, not in the U.S. Government category.

252. The loan-backed and structured securities that are "exempt obligations" and are reported in the U.S. Government category are securities that have a full guarantee for their interest and principal payments by the United States Government. Examples are the pass through securities and Collateralized Mortgage Obligations guaranteed by the Government National Mortgage Association (GNMA) or the U.S. Department of Veterans Affairs (VA).

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SVO ADMINISTRATIVE PROCEDURES

ORGANIZATION

Internal Administration

253. The staff of the SVO is organized in the manner specified by the NAIC Internal Administration Subcommittee. The SVO Director implements internal administrative procedures, operational policies and guidelines as necessary or appropriate to conduct the functions assigned to the SVO. The organization and staffing of the SVO and its ability to perform the regulatory functions assigned to it are acknowledged as part of the oversight function of the VOS/TF.

Statement of Practice

254. The SVO routinely receives financial information, legal documents and other data from reporting insurance companies so that it may assess the reported investment for the NAIC. While the NAIC is not a guarantor of the confidentiality of information submitted to the SVO, the SVO does not redistribute documents obtained in the course of its work for other than regulatory purposes or as may be required by law. The NAIC does, however, respect copyright and will not reproduce or externally distribute copyrighted documents without permission.

SVO Administrative Symbols

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

SVO Analytical Department Symbols

256. All SVO analytical departments use the following administrative symbols:

257. **F** means that the NAIC Designation shown was determined by the reporting insurance company and not by the SVO. Unlike the administrative symbol **Z**, the **F** symbol is used by insurers that meet the definitional criteria for a "Sub-paragraph D Company" as defined in this Manual, to report ownership of a foreign security for which the company did not have the information necessary to permit the SVO to conduct an assessment or a valuation.

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

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259. **IF** means that the security is an initial filing that has been properly filed with the SVO but which the SVO has determined will not be assigned an NAIC Designation by the close of the year-end reporting cycle. The symbol **IF** is assigned by the SVO and communicates that the insurer should self-designate the security for year end and identify it with the symbol **IF**. **IF** therefore also communicates to the regulator that the NAIC Designation reported by the insurance company was not derived by or obtained from the SVO, but has been determined analytically by a reporting insurance company.

260. **NR** means Not Rated. The symbol is used in the AVS+ Products for bonds and communicates that the information required to arrive at an NAIC Designation is not available to the SVO or that such information was received too late to be processed and reflected in the most current AVS+ Products. Bonds assigned an **NR** symbol will be deleted from the VOS Process if any information deficiency is not rectified by the end of the first quarter following the previous year-end.

261. **NR*** indicates that the security so designated belongs to a class of securities currently under policy review by the NAIC.

262. **PL** stands for a private letter rating and refers to an insurer-owned security that has been assigned a private rating by an NAIC CRP which rating is not publicly disseminated but is instead published in a letter or report provided by the CRP to the issuer of the security and to the insurer as an investor and has been submitted to the SVO under the procedures specified in this Manual or provided to the SVO electronically by the NAIC CRP specifically identifying the issue as being privately rated. The administrative symbol **PL** is used with an **NAIC 1** through **6** Designation, and in the case of preferred stock, in combination with the **P** and **RP** Valuation Indicators, and must adhere to the eligibility and reporting requirements of an NAIC Designation with an **FE** symbol.

263. **UP** means unable to price. This symbol is used with common or preferred stock and indicates that a current market quotation was not obtainable or was not deemed reliable by the SVO.

264. **YE** means that the security is a properly filed annual update that the SVO has determined will not be assigned an NAIC Designation by the close of the year-end reporting cycle. The symbol **YE** is assigned by the SVO pursuant to the administrative procedure described in this Manual. When the SVO assigns the symbol YE it also assigns the NAIC Designation in effect for the previous reporting year.

265. **Z** means that the NAIC Designation reported by the insurance company was not derived by or obtained from the SVO, but has been determined analytically by a reporting insurance company. A security designated with a **Z** must be submitted to the SVO for valuation within 120 days of the date the security was acquired. The **Z** symbol should not be used for securities that are exempt from filing with the SVO pursuant to this Manual. The **Z** symbol

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is used to identify an insurer owned security that is in transition in reporting or filing status because:

- it is newly purchased and has not yet been submitted to the SVO;
- has been properly submitted to the SVO for assignment of an NAIC Designation which is still pending, whether at year-end or otherwise;
- is in transition from one reporting or filing status to another (for example, a previously filing exempt security is no longer rated by any NAIC CRP making it eligible for filing with the SVO but has not yet been filed) and
- an SVO assigned NAIC Designation for the security has been dropped from AVS+ and the insurer has otherwise followed all other filing requirements.
- (This text shall be amended as additional transition situations are identified.)

266. **Z*** follows an NAIC Designation and means that the class of securities cannot be rated by the SVO because the valuation procedure is under regulatory review.

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NAIC POLICY ON THE USE OF CREDIT RATINGS OF NRSROS

Procedure to Become an NAIC Credit Rating Provider

267. An NRSRO that wishes to provide Credit Rating Services to the NAIC may indicate its interest by sending a letter to the Chair of the VOS/TF with a copy to the Director of the SVO, in which it:

- Indicates an interest in providing Credit Rating Services to the NAIC;
- Confirms that it is currently an NRSRO subject to regulation by the SEC;
- Provides a chart relating its credit rating symbols to NAIC Designations; and
- Indicates that the NRSRO agrees to enter into a legally binding agreement under which the NRSRO will:
  - Provide Credit Rating Services to the NAIC at no cost;
  - Reimburse the NAIC for all costs associated with: integration of it data feed into NAIC systems, subsequent changes to NAIC systems to accommodate changes in the NRSRO's systems and changes to NAIC systems as a result of the termination of Credit Rating Services by the NRSRO;
  - Give written notice 6 month prior to terminating Credit Rating Services; and
  - Agree not to claim in marketing literature that the provision of Credit Rating Services indicates NAIC approval or endorsement of the NRSRO, its products or services.

Adding the NRSRO to the NAIC Credit Rating Provider List

268. When directed to do so by the VOS/TF, the SVO shall add the name of the NRSRO (hereafter described as a Credit Rating Provider (CRP)) to the NAIC Credit Rating Provider List in the publication of this Manual that follows the execution of an agreement between the NAIC and the NRSRO.

Regulatory Significance – Filing Exempt Rule

269. Adding the name of an NRSRO to the Credit Rating Provider List indicates that insurance companies must use the credit ratings assigned by that NRSRO, if any, when determining the NAIC Designation equivalent for a security to be reported under the filing exempt rule. Only those NAIC CRP ratings that meet the definition below may be translated into NAIC Designations under the filing exempt rule. Securities assigned ratings by NAIC CRPs that do not meet the definition below, shall be filed with the SVO. The translation of a NAIC CRP rating into an NAIC Designation is conducted in accordance with the procedures described in this Manual.

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Definition - Credit Ratings Eligible for Translation to NAIC Designations

270. The credit rating of the CRP to which this Section and the NAIC Credit Rating Provider List refers, is the 1) credit rating assigned by the NAIC CRP, 2) by application of its long term obligation ratings scale and methodology to 3) securities.

271. Credit ratings of a NAIC CRP that meet this definition are entitled to a presumption of convertibility to the equivalent NAIC Designation published in the NAIC Credit Rating Provider List except that the presumption of convertibility is subject to the following limitations:

- Those rating activities or markets in which the entity has NAIC CRP status;
- Securities with monitored NAIC CRP ratings that:
  - Are monitored at least annually by the CRP that issued the rating,
  - Are assigned to a specific issue that must be specifically identified,
  - Apply to securities where the issuer promises to repay principal and interest or dividends;
  - (X) Convey an opinion as to the likelihood of payment of both principal and interest/dividends due from the issuer to the holders of the security, or
  - (Y) those structured to pay only principal or only interest/dividends, if the monitored NAIC CRP rating addresses the likelihood of payment of either the principal, in the case of a security structured to pay only principal or the interest/dividends, in the case of security structured to pay only interest/dividends, (an "Eligible NAIC CRP Rating"); and
- The NAIC may determine that the rated security or investment is of a type that is not eligible to be reported on Schedule D of the NAIC Financial Statement Blank or that the NAIC determines is not appropriate for NRSRO credit ratings to be used to determine the regulatory treatment of a specific asset class.

Special Rating Systems

272. Unless otherwise specifically approved by the VOS/TF special rating systems of any CRP, rating agency or rating organization shall not be entitled to a presumption of convertibility. Nevertheless, an SVO analyst assessing a security that has been assigned such a rating by any rating organization, including a CRP, may consider the information imparted by that rating or a related research report as one factor in determining an NAIC Designation.

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

273. The presumption of convertibility accorded to a credit rating of a NAIC CRP should not be interpreted to indicate that NAIC Designations and NAIC CRP credit ratings are produced

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using identical methodologies or that they are intended to communicate the same information. SVO credit assessment is conducted for regulatory purposes and may therefore include considerations or address concerns unique to the regulatory community.

GENERAL FILING PROCEDURES

Filing

274. Information about the VISION platform, including general information, user guides and on-line demonstrations can be found at http://www.naic.org/svo_vision.htm and the application itself can be found at https://vision.naic.org.

Filing Logic

275. Insurer need only file a security that is not in the AVS+ or that is in the AVS+ without a recently assigned NAIC Designation/Unit Price, is in the AVS+ but without a current year review date or a symbol that is other than an **NR** or **UP** or has not been logged into VISION.

Use of a Filing Agent

276. Insurance companies may designate an agent to perform filings with the SVO by providing the SVO with written notification of the agent's appointment, on the insurance company's letterhead, identifying the agent, detailing the agent's authority, expiration date of the authority and an acknowledgment that the insurance company remains legally obligated to file all necessary information and to pay all appropriate fees.

Security Identification Numbers

277. No security may be filed with the SVO without a valid CUSIP, PPN or CINS Identifier. Only S&P CUSIP may assign CUSIP Identifiers, PPNs and CINS.

278. To obtain filing and fee information and a CUSIP Identifier, PPN or CINS number, reporting insurance companies must contact S&P CUSIP at: CUSIP Service Bureau, Standard & Poor's Corporation, Attention: Senior Copy Editor, 55 Water Street, 47th Floor, New York, N.Y. 10041, e-mail address is cusip_ppn@standardandpoors.com, Facsimile (212) 438-6572.

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FILING PROCESS AND REQUIRED DOCUMENTS

Initial Filing

279. An insurance company makes an initial filing by providing the SVO with the completed form(s) and the information, documents and data necessary for the SVO to conduct an analysis of the issuer's creditworthiness and the terms of the security.

Informational Deficiencies

280. When an insurance company submits an initial filing, the SVO logs the submission by date and time received and the filing is assigned to the appropriate staff analyst. If the staff analyst determines that there is an informational deficiency, he or she will advise the insurance company that submitted the filing.

281. If the SVO identifies an information deficiency, the transaction is held by the SVO without processing for a period not to exceed 45 days. If the insurance company has not filed the necessary information with the SVO at the completion of the 45 days, the SVO discards the filing and all documentation submitted with it and enters a note in VISION to reflect that the filing was discarded due to insufficient information.

282. On an exception basis, the SVO may grant an extension to the insurance company not to exceed 90-days in total with the time-period to begin on the date that the SVO issues an information request. If the SVO grants this extension, and if the insurance company fails to provide the information requested within the time provided, the SVO will discard the filing and all documentation submitted with it at the end of the 90-day period and Work Flow will reflect that the filing was discarded due to insufficient information.

283. If the SVO determines it requires additional information after it has received a response to its request for additional information, a new 45-day period begins, unless an extension is granted as indicated above, in which case a new 90-day period will begin.

Filing Procedures and Documentation Requirements

284. Filing procedures and documentation requirements can be accessed at this location: https://vision.naic.org/. See Part Three which contain filing procedures and documentation requirements for the asset classes identified there.

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PROCEDURE TO AUTHORIZE SVO USE OF A NATIONAL FINANCIAL PRESENTATION STANDARD

Procedure

285. A national insurance association (but not individual insurers or other persons) may, by written request, ask the SVO to study the feasibility of adding a country and the associated National GAAP or National IFRS. The SVO is authorized, but not required, to hold discussions with representatives of the national insurance association to evaluate whether the criteria specified below has been met and to formulate a recommendation to the VOS/TF. The SVO may not assign an NAIC Designation to or otherwise assess a security under the proposed national standard until the VOS/TF has, by amendment to this Manual, added the proposed country and the associated National GAAP or National IFRS.

Pre-Conditions to the Exercise of SVO Authority to Conduct a Requested Study

286. **Information Supporting the Request** – As part of its request the national insurance association shall:

- Demonstrate that the request to add a National GAAP or National IFRS standard reflects that the borrower population the industry would target is not required to use a Global Financial Presentation Standard or the Reconciled Financial Presentation Standard to obtain financing in its local market and otherwise lacks the economic or market incentive to use a Global Financial Presentation Standard or the Reconciled Financial Presentation Standard in the absence of a requirement.
- Provide evidence of both investment opportunity and industry interest to make investments in the country;
- Explain the relationship of the proposed National GAAP or National IFRS financial presentation standard within the larger context of the country's economic, financial, regulatory and legal traditions; and
- Explain how the proposed National GAAP or National IFRS financial presentation standard, viewed from the perspective of an investor and from that of the SVO as a risk assessor, is of a quality and of a transparency sufficient to enable the creation of NAIC Designations analogous to those prepared using a Global Financial Presentation Standard.

Parameters of the SVO Study

287. The objective of the SVO study is to assess whether the proposed national accounting standard result in similar or materially different presentation (i.e., consistently more conservative or aggressive presentation for significant transactions) of financial results and position from that under a Global Financial Presentation Standard or a Reconciled Financial

Presentation Standard. This reflects that the role of financial information in a credit risk assessment is to provide an adequate basis to make an assessment of the issuer's financial profile, both by itself and compared to other issuers. The SVO's primary focus will be on identifying the material differences between accounting methods for the income statement, balance sheet, and, to a lesser extent, the statement of cash flows. The agreed upon expectation is that similar presentation of financial results and position generally require no change in determination of credit risk while material differences in presentation could lead to a change in determination of credit risk. If local accounting standards lead to material differences, it will be necessary to determine which differences in accounting method apply to the company being analyzed and whether the differences are broadly observed (i.e., across industries).

288. Process

- The national insurance association will, as necessary, identify an accounting firm that is an expert in the national accounting system of the country proposed for inclusion on the List of Countries and associated National Financial Presentation Standard.
- The national insurance association will work with the SVO to create an educational session on those aspects of financial presentation relevant to the SVO for purposes of its credit risk assessment.
- The educational session will focus on the material differences between accounting methods for the income statement and balance sheet, and shall include such further or additional areas as the SVO shall deem necessary in view of the specific country and national accounting system proposed.
- At the conclusion of such educational session, the SVO shall assess whether the educational session provides a sufficient basis for it to make needed adjustments to the financial information presented under the national accounting standard.
- The SVO shall then assess whether the application of the adjustments in one or more transactions confirms that the use of the national accounting standard leads to the creation of NAIC Designations analogous (in the information they convey about credit risk) to those created by the use of a Global Financial Presentation Standard.

Information Requirements Associated with the Use of a National Financial Presentation Standard

289. Insurance companies who file securities whose issuers present financial information in accordance with a National Financial Presentation Standard shall:

- Where materially different from Global Financial Presentation Standards, identify how local accounting standards treat specific issues relevant to assessment of credit risk;

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- Provide written descriptions of the accounting difference the insurer considered, and of how it resolved concerns about the accounting differences during the investment decision making process;
- Be prepared to provide SVO with access to the issuer's management or to convey questions and retrieve information from the issuer's management.
- Include a consolidated statement of cash flows for the past three years. See the definition of Audited Financial Statement in Part Two, Section 1 and Part Three, Section 1 (a) (ii) (A) for additional guidance pertaining to this requirement.
- For filings presented on the basis of French generally accepted auditing standards GAAP, the following additional documentation is required:
  - Disclosure of finance lease obligations;
  - Disclosure of operating lease commitments in a manner similar to that required by IRFS or US GAAP;
  - Disclosure of pension assets and liabilities as well as any other post-employment plan obligations. Key is disclosure of any unfunded amount;.
  - Disclosure of the amount of treasury stock, if any, and how it is accounted for;
  - Segment reporting of sales, assets, income and depreciation.
- For filings presented on the basis of Italian GAAP, the following additional documentation is required:
  - A consolidated statement of cash flows for three years;
  - Disclosure of finance lease obligations;
  - Disclosure of operating lease commitments in a manner similar to that required by IRFS or U.S. GAAP;
  - Disclosure of pension assets and liabilities, as well as any other post-employment plan obligations, especially of any unfunded amounts;
  - Disclosure of the amount of Treasury stock, if any, and how it is accounted for.

Countries and Associated National Financial Presentation Standards

290. The SVO is authorized to accept Audited Financial Statements prepared in accordance with the following National Financial Presentation Standards:

- Canadian Accounting Standards for Private Enterprises but only for non-financial institutions.
- UK Financial Reporting Standard (FRS) 102 (which encompasses Irish companies reporting under FRS 102)

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- Australian GAAP
- German GAAP
- French GAAP but subject to the presentation of additional documentation as specified above and annually thereafter as specified below.
- Dutch (Netherlands) GAAP
- Italian GAAP but subject to the presentation of additional documentation as specified above and annually thereafter per as specified below.
- Belgium GAAP.

Annual Update Information

291. For corporate issuers whose Audited Financial Statements are presented in accordance with a National Financial Presentation Standard, the insurer shall also file with the SVO the items of information identified in D above.

APPEALS FROM SVO DETERMINATIONS

APPEALS OF SVO ANALYTICAL DECISIONS

Requests for Clarification of SVO Decisions

292. Any insurer that owns a security for which the SVO has provided an NAIC Designation, a classification or a valuation, may request a clarification of the decision from the SVO. The SVO analyst responds informally to informal requests for clarification and in writing within 10 days after receipt of the written request. Any reply from the SVO shall be a confidential communication between the SVO and the insurer.

Condition to Filing of an Appeal

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

Procedure for Filing an Appeal

294. Filing an appeal with the SVO is accomplished through a computer linkup with the VISION computer system of the SVO. This appeal procedure applies only to situations where the SVO has expressed an analytical conclusion in the exercise of its quality assessment, credit risk assessment, classification, or valuation functions. The stated procedure encompasses initial filings, annual updates and securities not rated by an NAIC CRP. Securities rated by an NAIC CRP may be appealed only if the SVO designates securities differently than the NAIC CRP and the SVO retains responsibility for review of NAIC CRP rated transactions.

SVO Review of the Appeal

295. The SVO analyst to whom the Appeal ATF is directed will alert the SVO credit committee that an appeal of an SVO decision has been made and provide it with copies of the correspondence, documents and information presented by the insurer as well as copies of the original analysis that lead to the conclusion appealed from.

296. The credit committee chair will then set a date, not to exceed 45 days from the date the insurer submits a complete file to the SVO, for the credit committee to meet to deliberate the issues presented. Prior to the meeting, the members of the credit committee will review the original decision and the correspondence, documents and information presented by the insurance company. The insurer shall be notified of the date of the meeting, and shall be given the opportunity to present its appeal in person to the credit committee.

297. The credit committee is composed of those senior staff members whose expertise may be necessary or desirable to the discussion of the issues presented, including, whenever

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possible, persons who did not previously participate in the formulation of the original decision. The original analyst is present during all deliberations of the credit committee and participates in its deliberations by providing information and responding to questions. However, the original analyst does not vote on nor decide the issues presented in the appeal.

298. After evaluation of the correspondence, documents and information presented by the insurance company, the credit committee will render a decision within 10 days of its meeting to consider the appeal. Once the credit committee renders a decision, a representative of the credit committee, which may be the original analyst, is chosen to communicate the decision to the insurance company or companies that filed the appeal. After it has communicated its decision to the insurer, the SVO will entertain such further reasonable discussions with the insurer as it shall deem reasonably necessary to ensure that the credit committee has considered and responded to all of the issues deemed relevant by the insurer.

299. Not later than 10 days after the verbal communication of its decision, the SVO will provide the insurer with a letter specifying whether the SVO has determined to modify or affirm its previous decision and addressing the issues posed by the insurer. The letter shall be issued directly to the insurer that filed the appeal as a confidential communication between the SVO and that insurer. At the request of any other insurer holding the same security, the SVO shall provide a copy of the letter to such other insurer.

Review Timeline

300. The SVO's goal is to complete all work on an appeal and communicate a decision to the insurer within 90 days of receipt of a complete file for the appeal. The time periods for action by the SVO identified in this section shall not be deemed to restrict the exercise of management discretion by the Director of the SVO as to the proper disposition of SVO resources in the fulfillment of SVO priorities and commitments. Any of the time periods in this section may be extended by mutual agreement of the insurer and the SVO or Task Force, respective to the stage of the appeal.

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REVIEW OF SVO DECISIONS BY THE VOS/TF

Task Force Review for Alleged Violations of Procedures

301. Any insurer that has filed a security for an NAIC Designation, a classification or a valuation, and is concerned that a decision relative to the security was not made in accordance with the procedures in this Manual, may request consideration of this concern by the VOS/TF.

Condition to Request; Exhaust SVO Remedies

302. Before making a request to the VOS/TF, the insurance company must submit a written statement to the Director of the SVO, or to the person then exercising the executive function of the SVO, whatever the title then used, with a copy to the Chair of the VOS/TF. The written statement must identify the specific procedure or procedures in this Manual that the insurance company believes have been ignored or improperly applied.

303. Upon receipt of the written statement, the Director will fully investigate the assertions and communicate its factual findings back to the insurance company with a copy forwarded to the Chair of the VOS/TF within 30 days. Should the result of the SVO investigation not resolve the factual issues expressed by the insurance company, a request for further consideration can be made to the Chair of the VOS/TF. The Chair of the VOS/TF may then choose to review the matter.

Basis of Review by the Task Force

304. If the VOS/TF chooses to review the matter further, its focus is on determining whether the SVO decision was made in a manner that is inconsistent with the applicable provisions of this Manual. If the VOS/TF finds that the SVO decision was made in a manner that is inconsistent with the applicable provisions of this Manual, it will provide the SVO with interpretive guidance respecting the meaning of the applicable language or procedures in the Manual and instruct the SVO to reformulate a decision.

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YEAR-END CARRYOVER PROCEDURE

Acceptable Carryover Population Rate

305. Effective with the adoption of this procedure, the SVO Director shall prepare a report for the VOS/TF, to be presented at the Spring National Meeting, identifying an acceptable annual rate of the carryover population for the year-end reporting period. Thereafter, at the beginning with the subsequent year of analytical operations, the SVO Director shall prepare a report for the VOS/TF, to be presented at the Spring National Meeting, identifying whether the acceptable annual carryover rate was significantly exceeded and if so, whether the cause is traceable to resource constraints. If so, the Task Force shall consult with NAIC senior staff and the NAIC Internal Administration (EX1) Subcommittee to determine whether and how to evaluate the need for additional SVO staff or other resources.

Definition

306. When used in this sub-section, the term carryover population means, collectively, all insurer owned securities filed with the SVO for an NAIC Designation and not yet assigned NAIC Designation by the SVO at the conclusion of the year-end reporting process.

Procedures

307. The following procedures apply to the carryover population.

- The SVO shall identify the carryover population by assigning each security the administrative symbol **YE** or **IF**.
- A security in the carryover population that is an annual update filing shall be assigned the NAIC Designation then in effect for the just concluded reporting period, for example: **2YE**, if the security was designated **2** in the just concluded year.
- A security in the carryover population that is an initial filing shall be self-designated by the insurer and reported with the insurer assigned NAIC Designation and the administrative symbol **IF** and shown by the SVO on its systems as **IF** but without an NAIC Designation.
- The SVO shall remove the **YE** symbol when it assigns an NAIC Designation to an annual update security in the carryover population for the current year and publishes the NAIC Designation in AVS+. The SVO shall remove the **IF** symbol when it assigns an NAIC Designation to an initial filing security in the carryover population for the current year and publishes the NAIC Designation in AVS+. The insurer maintains the NAIC Designation assigned by the SVO under **YE** or self-assigned under IF until the SVO has published an NAIC Designation in AVS+.

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- The SVO shall assign top priority to the assessment of the carryover population and the assignment of NAIC Designations to that population in the subsequent year of operation.

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PROCESS FOR PLACING SECURITIES UNDER REGULATORY REVIEW; WHEN ANALYTICAL INSTRUCTIONS ARE INSUFFICIENT OR INADEQUATE

Notice

308. The Director shall promptly inform the Chair of the VOS/TF of his or her conclusion that market or other developments; the aspects of a new or existing security, financial instrument or analytical situation, requires the NAIC to formulate new financial solvency policy or develop new or additional instructions and or methodologies for the SVO. The Director shall prepare a written report for the VOS/TF explaining the reasoning that led to the conclusion.

Deliberation

309. The Chair shall call a meeting of the VOS/TF to consider and discuss the SVO report and the issues it presents and to consider how to proceed. If the VOS/TF determines that the nature of the security and/or the issues raised by the SVO requires formulation of new policy or regulatory instructions or the development of new or additional instructions and/or methodologies, the VOS/TF shall consider whether to declare the security or financial product to be under regulatory review.

310. On its own initiative or at the direction of the NAIC Executive Committee, the Financial Conditions (E) Committee may instruct the VOS/TF to place a security under regulatory review. The VOS/TF may, on its own initiative place a security under regulatory review as discussed in this section.

Hearing and Declaration

311. If the VOS/TF is instructed or if it determines that a security should be formally declared to be under regulatory review, it shall hold a public hearing to discuss the issue and make a formal declaration of this decision. The staff shall cause notice of the determination to be published to interested persons and to other NAIC groups that have jurisdiction over reporting issues, have relevant expertise or would be affected by the activities of the VOS/TF.

Reporting Framework for Securities under Regulatory Review

312. Upon a public declaration that a security is under regulatory review, insurance companies that own the security shall report it on the NAIC Financial Statement Blank with the administrative symbol **NR*** if the security is under review for an assessment of regulatory policy for the investment or regulatory reporting instructions to implement applicable policy or with the administrative symbol **Z*** if the security is under regulatory review for development by the VOS/TF of the instructions or methodologies for application by the SVO in its risk assessment.

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313. In September of each year, the VOSTF will publicly identify which classes of securities, if any, are under regulatory review and therefore eligible to take the regulatory treatment prescribed for **NR*/Z*** in the Annual Statement Instructions for that year's year-end NAIC Financial Statement Blank.

Filing of Securities under Regulatory Review

314. Unless the VOS/TF shall provide other instructions to insurance companies, securities under regulatory review that are otherwise reportable to the SVO shall continue to be filed with the SVO during the period of regulatory review.

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MAINTENANCE AND MONITORING OF SVO DETERMINATIONS FOR SCHEDULE BA ASSETS

Maintaining and Publishing SVO Determinations

315. SVO analytical determinations for Schedule BA assets that have the underlying characteristic of a bond or other fixed income instrument are compiled in a separate database within the VOS Process and published as a part of the SVO List of Securities in the AVS+ Products under a separate heading to facilitate the work of NAIC members and their staff.

316. The SVO monitors improvement or deterioration of credit quality for Schedule BA assets entered into the VOS Process. On at least an annual basis, the SVO reviews the credit quality and value of the Schedule BA assets in the VOS Process.

317. The SVO will delete any Schedule BA asset from the VOS Process on if the investment has matured or if the investment is no longer owned by an insurance company.

318. The SVO will also delete a Schedule BA asset from the VOS Process if a reporting entity has failed to provide sufficient or timely information to permit the SVO to conduct the annual review assessment required above. Schedule BA assets assigned the administrative symbol NR are deleted from the VOS Process if an information deficiency is not addressed by the end of the first quarter following the previous year-end. However, a Schedule BA asset assigned the administrative symbol NR is not deleted if an ATF annual update filing has been filed and the SVO has received the information required to assign an NAIC Designation to the Schedule BA asset.

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PART THREE
SVO PROCEDURES AND METHODOLOGY FOR PRODUCTION OF NAIC DESIGNATIONS

INTRODUCTION

Parameters for Use of Instructions and Methodologies

1. The description of methodologies and the instructions pertaining to the application of those methodologies in this Part are general and mandatory instructions from the VOS/TF to the SVO. The SVO shall have reasonable professional latitude to interpret how the instructions and methodologies contained in this Part apply to specific securities, financial products or differing analytical situations. Factors that may affect how the SVO interprets instructions and methodologies include, but are not limited to, the terms of individual securities, unique features or characteristics of securities, legal or regulatory issues associated with structured transactions, the issuer's industry, the introduction of a new security type or asset class and NAIC regulatory objectives.

Updating Instructions and Methodologies

2. The SVO shall have ongoing professional responsibility to advise the VOS/TF of developments that may suggest the need for the NAIC to develop regulatory policy for new or existing investments or the need for the NAIC to amend or provide for additional instructions and or methodologies.

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PROCEDURE APPLICABLE TO FILING EXEMPT (FE) SECURITIES AND TO PRIVATE LETTER (PL) RATING SECURITIES

Filing Exemption

3. Bonds, (excluding RMBS and CMBS) and Preferred Stock that have been assigned an Eligible NAIC CRP Rating, as described in this Manual, are exempt from filing with the SVO (FE securities). Any Bond or Preferred Stock that at one time was assigned an Eligible NAIC CRP Credit Rating by an NAIC CRP but is no longer rated must be filed with the SVO within 120 days of the loss of the credit rating, as if the security had never been filing exempt.

Identification of FE Securities

4. The SVO identifies FE securities as part of its quarterly compilation of the SVO List of Securities. SVO staff then applies the procedures discussed below to the FE securities it has identified in the compilation process to produce the most accurate NAIC Designation equivalent. Per instructions of the VOS/TF, the SVO publishes the NAIC Designations it produces in the AVS+. The AVS+ contains the official NAIC Designations for any given security. Insurers use the information in AVS+ to identify and report the SVO assigned NAIC Designation for FE securities they own to the domiciliary state in the NAIC Financial Statement Blank.

Direction and Procedure

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

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

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

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PL SECURITIES

Effective Date of Verification Procedure for PL Securities

7. Effective July 1, 2018, insurance companies shall be responsible for providing the SVO copies of private rating letters for PL securities, where applicable, until such time as industry representatives and the SVO shall have established reliable procedures for obtaining the necessary information on credit ratings directly from the NAIC CRPs. For **PL** Securities issued prior to January 1, 2018, if an insurance company cannot provide a copy of the rating letter to the SVO due to confidentiality concerns and the rating is not included in a CRP credit rating feed (or other form of direct delivery from the NAIC CRP), the insurer shall report such securities on such securities' General Interrogatory to be developed for this purpose (i.e., a **PL GI** security). The rules for **PL** securities identified above do not and shall not apply to **PL** securities in scope of *SSAP 43R* for which a Modified Filing Exempt matrix is prescribed for purposes of determining capital requirements.

Definitions

8. For purposes of this paragraph, the phrase "private rating letter" means a letter or report issued by an NAIC CRP on its letterhead or its controlled website to an issuer or investor, obtained by an insurer in its capacity as an investor in the issuance or by following the confidentiality process established by the NAIC CRP. The phrase "privately rated security" means a security issued by an issuer wherein the issuer has solicited a credit rating for the issuance from an NAIC CRP and the NAIC CRP has agreed to issue a credit rating for the issuance to be communicated to the issuer and a specified group of investors only and not publicly released via the NAIC CRP's public data feed or website. The privately rated security is the subject of the private rating letter and is referred to herein as a private letter (PL) security.

Conditions to Filing Exemption for PL securities issued on or after January 1, 2018

9. **PL** securities are exempt from filing with the SVO for assignment of an analytically determined NAIC Designation if the security has been assigned an Eligible NAIC CRP Credit Rating and the insurer verifies the rated status of the **PL** security to the SVO. If the **PL** security is not rated by an NAIC CRP; or a credit rating is assigned that is not an Eligible NAIC CRP Credit Rating; or if the insurer cannot provide the SVO a private rating letter verifying that the assigned credit rating is an Eligible NAIC CRP Credit Rating; or the NAIC CRP cannot provide the Eligible NAIC CRP Credit Rating on the **PL** security to the NAIC through an electronic data feed approved by the SVO and that specifically identifies the **PL** securities rated by that NAIC CRP, the **PL** security is not filing exempt. An insurer that owns a **PL** security that is not filing exempt shall either: 1) file the security with the necessary documentation with the SVO for an analytically determined NAIC Designation; or 2) self-assign an **NAIC 5*GI** to the security and report using the Interrogatory procedure; in either case within 120 days of purchase.

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Conditions to Filing Exemption for PL securities issued prior to January 1, 2018

10. **PL** securities are exempt from filing with the SVO for assignment of an analytically determined NAIC Designation if the security has been assigned an Eligible NAIC CRP Credit Rating. If the **PL** security CRP rating is not included in the applicable CRP credit rating feed (or other form of direct delivery from the CRP) or the insurer cannot submit the private letter rating to the SVO because of confidentiality provisions, the security shall be designated **PLGI.** Insurers shall report on all such securities in a General Interrogatory with an attestation that all such securities have an Eligible CRP Credit and are reflected in the financial statements and risk-based capital calculation commensurate with that rating

Procedure

11. The NAIC shall create systems and develop and staff administrative and operational procedures to be administered by the SVO to identify insurer-owned **PL** securities; verify whether or not the assigned credit rating is an Eligible NAIC CRP Credit Rating and either translate that credit rating into its equivalent NAIC Designation and input the NAIC Designation for the security into the appropriate NAIC systems or notify the insurer that the security is not eligible for filing exemption.

SVO to Administer Verification Procedures

12. It shall be the responsibility of the NAIC to create and maintain for the SVO, electronic facilities to accept: 1) electronic data-feeds provided by NAIC CRPs containing and specifically identifying the **PL** securities rated by that NAIC CRP and the credit rating assigned to the **PL** securities; or 2) PDF files of private rating letters provided by insurers to the SVO containing the NAIC CRP credit rating for the **PL** security.

The PL Process

13. It shall be the responsibility of the SVO to identify **PL** securities in the AVS+ system for insurance companies to use when reporting **PL** securities to the NAIC as part of the NAIC's Financial Statement Blank reporting process. The SVO identifies PL securities when it conducts the quarterly compilation of the SVO List of Securities.

Producing NAIC Designations for PL Securities

14. The SVO shall produce NAIC Designations for securities subject to private letter ratings as follows:

    - The insurance company shall file a copy of the private rating letter with the SVO if not included in the applicable NAIC CRP Rating feed(s) (or other form of direct delivery from the CRP) noted above in Conditions to Filing Exemption for PL Securities. In instances where the **PL** security is included in the applicable NAIC CRP Rating feed(s), the SVO shall follow the procedure for Filing Exempt (FE) securities.
    - In instances where a private letter is filed, the SVO shall evaluate the private letter to determine whether the security has been assigned an Eligible NAIC CRP Rating. Similar

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to public securities where rating is received directly from the CRP via electronic feeds that meets the definition of an Eligible NAIC CRP Rating as a normal part of the CRP rating process, absent evidence to the contrary in the rating letter (e.g., evidence that the rating applies only to principal or interest, in a deviation from the normal CRP rating process).

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

15. If the SVO verifies that the security:

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

16. The SVO shall notify the insurer that the security is not eligible for filing exemption. The insurance company shall then either file that security and necessary documentation with the SVO for an independent credit assessment or assign an **NAIC 5* GI** Regulatory Designation to the security in the related Interrogatory.

17. An **NAIC 5*** designation may also be used in connection with the designation of **PL** securities rated by an NAIC CRP (i.e., for private letter ratings issued on or after January 1, 2018) when the documentation is not available for the SVO to assign an NAIC Designation. For purposes of this section, the documentation is not available for the SVO to assign an NAIC Designation if the NAIC CRP credit rating is not included in the applicable CRP credit rating feed (or other form of direct delivery from the NAIC CRP) and the insurer is unable to provide a copy of the private letter rating documentation necessary for the SVO to assign an NAIC Designation.

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LIST OF NAIC CRPS

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

- Moody's Investor's Service, for credit ratings issued to financial institutions, brokers, or dealers; insurance companies; corporate issuers; issuers of asset-backed securities and issuers of government securities, municipal securities, or securities issued by a foreign government.
- Standard and Poor's, for credit ratings issued to financial institutions, brokers, or dealers; insurance companies; corporate issuers; issuers of asset-backed securities and issuers of government securities, municipal securities, or securities issued by a foreign government.
- Fitch Ratings, for credit ratings issued to financial institutions, brokers, or dealers; insurance companies; corporate issuers; issuers of asset-backed securities and issuers of government securities, municipal securities, or securities issued by a foreign government.
- Dominion Bond Rating Service (DBRS), for credit ratings issued to financial institutions, brokers, or dealers; insurance companies; corporate issuers; issuers of asset-backed securities and issuers of government securities, municipal securities, or securities issued by a foreign government.
- A.M. Best Company (A.M. Best) for credit ratings issued to insurance companies; corporate issuers and issuers of asset-backed securities.
- Morningstar Credit Ratings, LLC for credit ratings issued to financial institutions, brokers, or dealers; corporate issuers and issuers of asset-backed securities.
- Kroll Bond Rating Agency for credit ratings issued to financial institutions, brokers, or dealers; insurance companies; corporate issuers; issuers of asset-backed securities and issuers of government securities, municipal securities, or securities issued by a foreign government.
- Egan Jones Rating Company for credit ratings issued to financial institutions, brokers, or dealers; insurance companies and corporate issuers.
- HR Ratings de Mexico, S.A. de C.V. for credit ratings issued to financial institutions, brokers, or dealers; corporate issuers and issuers of government securities, municipal securities, or securities issued by a foreign government.

Note 1*: The information shown above for each NRSRO was obtained from the U.S. SEC's web-site: www. Sec.gov/ocr on October 14, 2016 and confirmed against each NRSROs annual FORM NRSRO certification with the exception of the information for HR Ratings de Mexico, S.A. de C.V., which was revised on February 15, 2018, on the basis of the Order Granting Registration … for Two Additional Classes of Credit Ratings issued November 23, 2016.*

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Note 2: *The credit rating providers identified above include those of its affiliates that the credit rating provider identified to the U.S. Securities and Exchange Commission (the "SEC") as part of its Form NRSRO Application as a separate legal entity or a separately identifiable department or division of the credit rating provider that determines credit ratings that are credit ratings of the credit rating provider and which the SEC treats as a credit rating issued by the credit rating provider for purposes of section 15E of the Exchange Act and the Commission's rules thereunder.*

CRP Credit Rating Equivalent to NAIC Designations and NAIC Designation Categories

19. Please note that the existence of a rating does not eliminate the requirement to file on SAR on any insurer owned security not currently listed in the VOS manual unless exempted from filing.

			Credit Rating Providers (Pursuant to the terms of of Section 4 of Part One and as specifically noted in Part Three, Section One, (vi) List of NAIC CRPs.)								
NAIC Designation	**NAIC Designation Modifier**	**NAIC Designation Category**	**Moody's Investor's Service**	**Standard and Poor's**	**Fitch Ratings**	**Dominion Bond Rating Service**	**A.M. Best Company**	**Morningstar Credit Ratings, LLC**	**Kroll Bond Rating Agency**	**Egan Jones Rating Company**	**HR Ratings de Mexico, S.A. de C.V.**
1	**A**	**1.A**	Aaa	AAA	AAApre, AAA	AAA, Pfd-1 (high)	aaa	AAA	AAA	AAA	HR AAA (G)
1	**B**	**1.B**	Aa1	AA+	AA+	AA (high), Pfd-1	aa+	AA+	AA+	AA+	HR AA+ (G)
1	**C**	**1.C**	Aa2	AA	AA	AA, Pfd-1 (low)	aa	AA	AA	AA	HR AA (G)
1	**D**	**1.D**	Aa3	AA-	AA-	AA (low), Pfd-1	aa-	AA-	AA-	AA-	HR AA- (G)
1	**E**	**1.E**	A1	A+	A+	A (high)	a+	A+	A+	A+	HR A+ (G)
1	**F**	**1.F**	A2	A	A	A	a	A	A	A	HR A (G)
1	**G**	**1.G**	A3	A-	A-	A (low)	a-	A-	A-	A-	HR A- (G)
2	**A**	**2.A**	Baa1	BBB+	BBB+	BBB (high), Pfd-2 (high)	bbb+	BBB+	BBB+	BBB+	HR BBB+ (G)
2	**B**	**2.B**	Baa2	BBB	BBB	BBB, Pfd-2	bbb+	BBB	BBB	BBB	HR BBB (G)
2	**C**	**2.C**	Baa3	BBB-	BBB-	BBB (low), Pfd-2 (low)	bbb-	BBB-	BBB-	BBB-	HR BBB- (G)
3	**A**	**3.A**	Ba1	BB+	BB+	BB (high), Pfd-3 (high)	bb+	BB+	BB+	BB+	HR BB+ (G)
3	**B**	**3.B**	Ba2	BB	BB	BB, Pfd-3	bb	BB	BB	BB	HR BB (G)
3	**C**	**3.C**	Ba3	BB-	BB-	BB (low), Pfd-3 (low)	bb-	BB-	BB-	BB-	HR BB- (G)
4	**A**	**4.A**	B1	B+	B+	B (high), Pfd-4 (high)	b+	B+	B+	B+	HR B+ (G)
4	**B**	**4.B**	B2	B	B	B, Pfd-4	b	B	B	B	HR B (G)
4	**C**	**4.C**	B3	B-	B-	B (low), Pfd-4 (low)	b-	B-	B-	B-	HR B- (G)
5	**A**	**5.A**	Caa1	CCC+	CCC+	CCC (high), Pfd-5 (high)	ccc+	CCC+	CCC+	CCC+	HR C+ (G)
5	**B**	**5.B**	Caa2	CCC	CCC	CCC, Pfd-5	ccc	CCC	CCC	CCC	HR C (G)
5	**C**	**5.C**	Caa3	CCC-	CCC-	CCC (low), Pfd-5 (low)	ccc-	CCC-	CCC-	CCC-	HR C- (G)
6		**6**	Ca	CC	CC	CC (high)	cc	D	CC	CC	HR D (G)
6		**6**	C	C	C	CC	c		C	C	
6		**6**		D	DDD	CC (low)	d		D	D	
6		**6**			DD	C (high)					
6		**6**			D	C					
6		**6**				C (low)					
6		**6**				D					

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LIMITATIONS ON USE OF NAIC CRP RATINGS

Application of the FE Procedure to Specific Populations

20. The filing exemption procedure does not apply to SCA Investments.

21. Catastrophe-Linked Bonds are filing exempt provided the credit rating assigned to them by a CRP was derived using a stochastic methodology.

NAIC Designation Is Capped To Highest NAIC CRP Rating

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

    - Municipal bonds and;
    - Military housing bonds or securities.

Split Ratings

23. For filing exempt securities the NAIC Designation assigned will be the NAIC Designation equivalent that results from the application of the filing exemption process. This rule will also apply to replication transactions defined in and other instances where NAIC CRP ratings are used by the SVO.

Unrated Transaction of Issuer with NAIC CRP Rated Debt

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

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GENERAL CORPORATE AND MUNICIPAL METHODOLOGY FOR INDEPENDENT CREDIT QUALITY ASSESSMENT

25. Corporate bonds defined as the Obligations[2] of domestic and foreign corporations, and preferred stock shall be distinguished on the basis of the categories discussed below. The creditworthiness of the issuer of any particular category of Obligation shall be assessed by reference to the general, and any special, rating methodology discussed in this Part, unless the context of the analysis requires a different approach.

INDEPENDENT ASSESSMENT

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

INFORMATION REQUIREMENTS

27. Information required to assess credit risk for an unrated issue will vary based on the structure of the transaction and nature of the business or industry in which the issuing entity operates. The minimum requirements are outlined below; however, the SVO will contact the reporting insurance company if additional information is required to be able to complete the analysis of a specific issue.

28. Minimum requirements for an initial filing:

- Information regarding the issuer's business and the transaction. This may be provided in the form of a: i) public offering statement or private placement memorandum, as the case may be; ii) the insurance company's internal credit committee memorandum; iii) management presentations; and/or iv) completion and submission of the SVO's VIM form.
- Audited Financial Statements (see below) or, in the case of a municipal transaction, continuing disclosure information.
- Legal documentation such as a credit agreement (note purchase agreement, indenture, promissory note, guaranty, etc.).

29. Minimum requirement for an annual review of an issue with a current NAIC designation:

[2] **Obligation** means bonds, notes, debentures, certificates, including equipment trust certificates, production payments, bank certificates of deposit, bankers' acceptances, credit tenant loans, loans secured by financing net leases and other evidences of indebtedness for the payment of money (or a participation, certificates or other evidences of an interest in any of the foregoing), whether constituting general obligations of the issuer or payable only out of certain revenues or certain funds pledged or otherwise dedicated for payment.

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- Audited Financial Statements (see below) or, in the case of a municipal transaction, continuing disclosure information.

Audited Financial Statement

30. As a first step in the independent assessment, the analyst shall conduct an independent financial analysis of the issuer based on the financial information presented in the Audited Financial Statement, as defined in this Manual.

31. The SVO shall base its financial analysis on at least three years of historical audited financial information and projected financial information (if available) when the issuer has an operating history of three years or more.

32. However, the SVO may assign an NAIC Designation based on less than three years of financial information in circumstances where the issue's operating history is less than three years or because the issuer's legal identity has been subsumed as a result of a merger into a new entity or due to other documentable business circumstances.

33. Where three years of financial information is not available, the analyst shall review such information as is available, and shall determine if the time period for which information is available is sufficient to produce a professionally sound opinion.

34. **Parent-Subsidiary Situations**: In the case of transactions involving a parent holding company with an Audited Financial Statement and an issuing subsidiary without a separate Audited Financial Statement, the SVO may use the financial statements of the parent holding company as if they were prepared for the issuing subsidiary when the consolidating work papers relating to the issuing subsidiary are provided or when the operations of the parent: (i) are limited solely to owning the issuing subsidiary, and; (ii) the issuing subsidiary constitutes at least 97% of the parent's pre-tax income and assets on a consolidated basis.

Other Information Commonly Requested

35. Other information or documents that may be requested include a legal organizational chart, covenant compliance certificate, management discussion and analysis (MD&A), security agreement, intercreditor agreement, asset appraisals or any other document or information deemed necessary by the analyst to produce a professionally sound opinion.

CREDIT ANALYSIS

36. In our assessment of credit risk, we evaluate both qualitative and financial factors for the issuing entity. This approach is applied to: i) both domestic and foreign entities; ii) not-for-profit entities, and; iii) real estate operating companies or entities that have elected to be structured as REITs.

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Qualitative Analysis—Assessment of Industry and Business Risk

37. Assessment of the qualitative factors for an issuing company informs the ability of the entity to generate future cash flows and drive financial results. Specific business risk factors assessed will vary depending on the business and/or industry sector in which the issuing entity operates.

    - The industry analysis shall reflect issuer and industry response to factors such as competitive and general economic developments, including industry and issuer growth trends, competitive environment and regulatory considerations.
    - We also consider the issuer's market or competitive position, diversification, profitability, quality of management and operating strategy.

Financial Analysis—Calculation of Ratios

38. Financial analysis shall culminate in the calculation of such financial ratios as the analyst feels highlight appropriate aspects of the financial performance of the issuer that bear on its ability to meet the obligation owed to the insurance company.

39. The financial analysis will also consider adequacy of near term liquidity and compliance with financial covenants as well as the company's financial policy based on historical practice and future expectations.

40. Relevance of special accounting practices applicable to the industry and any other factor that may bear on an assessment of the level of risk associated with the issuer's ability to meet its obligation to the reporting insurance company.

Unsecured Benchmark and Final Designation

41. This qualitative and financial analysis shall culminate in a preliminary determination of the issuer's senior unsecured "benchmark" credit quality.

42. Before determining a final NAIC Designation, the analyst shall consider: (i) the position of the security in the issuer's capital structure (the NAIC Designation may be scaled up or down based on the security's relationship to the issuer's senior unsecured debt in the capital structure); (ii) the sufficiency of the legal documentation; and (iii) the terms of the security such as:

    - Covenants;
    - Structure;
    - Collateral;
    - Third-party financial support, or other credit enhancements, and;
    - Any other credit-related factor specific to the security under review.

Foreign Securities

43. Where a reporting insurance company has filed a foreign security accompanied by an Audited Financial Statement, in English, the SVO will assess the security in accordance with

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the applicable corporate methodology, but the NAIC Designation it may assign shall be limited by the sovereign rating of the issuer's country of origin. This section should not be read as prohibiting the presentation of transactions structured to eliminate foreign sovereign risk.

STRUCTURED SECURITIES OR TRANSACTIONS BACKED BY CREDIT ENHANCEMENT

STRUCTURED SECURITIES FULLY GUARANTEED BY AN NAIC CRP-RATED ENTITY OR U.S. GOVERNMENT ENTITY

44. **Initial Filing Requirements** - A structured security filed under this subsection must be filed with a completed SAR, evidence that the guarantor is rated by an NAIC CRP and a prospectus, private placement memoranda or other similar document describing the pool, the credit and structural components of the transaction and how the guaranty is called upon together with a copy of the final executed guaranty.

45. **Subsequent Reporting Requirement** - A structured security filed under this subsection must be filed together with evidence of the current NAIC CRP rating for the guarantor.

46. **Analytical Procedure** - The analytical procedures in this subparagraph apply to non-NAIC CRP-rated asset-backed securities and residential mortgage-backed securities fully, unconditionally and irrevocably guaranteed by a U.S. government entity or an entity with an NAIC CRP-rated senior unsecured obligation or claims paying ability. This procedure shall only apply when the reporting insurance company intends that the NAIC designation assigned to the security will depend solely on the rating assigned by an NAIC CRP to the guarantor or implied rating of the U.S. government entity. As used in this subparagraph, an NAIC CRP-rated guaranty means an unconditional promise to pay all amounts due to the investor on a full and timely basis, which is effective for the life of the security, ranks as the guarantor's direct, unsubordinated, general obligation and is issued by an entity rated and monitored by an NAIC CRP. The guaranty may be in the form of a guaranty, financial guaranty insurance policy, letter of credit, or other similar credit enhancement instrument. The SVO shall assess any reported structured securities benefiting from NAIC CRP rated financial guarantee by applying the procedure described below. The SVO shall first confirm that the guaranty meets the definition set forth above. The SVO shall then review the terms of the reported security to determine whether any aspect of the credit and structural characteristics of the security compromises the benefit of the guaranty to the investor.

47. If the SVO is satisfied that the guarantor is fully obligated to pay the amounts due to investors, and that the structural characteristics of the security do not compromise the benefit of the guaranty to the investor, the SVO shall assign an NAIC Designation not higher than the NAIC Designation that corresponds to the NAIC CRP rating assigned to the guarantor.

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STRUCTURED SECURITIES BACKED BY NAIC CRP RATED FINANCIAL ASSETS

48. **Initial Filing Requirements** - A structured security filed under this subsection must be filed with a completed SAR, evidence of all NAIC CRP ratings assigned to the obligors in the pool and a prospectus, private placement memoranda or other similar document (which must include a detailed list of all of the obligors in the pool), describing the asset types in the pool and the credit and structural components of the transaction.

49. **Subsequent Reporting Requirement** - A structured security filed under this subsection must be filed together with evidence of the current NAIC CRP rating assigned to each pool obligor.

50. **Analytical Procedure** - This sub-paragraph applies to investment instruments backed by the scheduled payment stream from (i) NAIC CRP rated or NAIC Designated underlying obligations (ii) issued by NAIC CRP rated entities, or (iii) 100 percent unconditionally guaranteed by NAIC CRP rated entities even if none of the assets themselves are rated by an NAIC CRP.

51. As used in this sub-paragraph, an underlying obligation is any obligation of an NAIC CRP rated entity that gives the holder of the security a contractual right to receive benefits in the form of cash whether disbursed at a time certain or in scheduled payments of interest and principal. To be eligible for reporting under this subsection, the sum of the total cash obligations evidenced by the financial asset pool must be equal to or greater than the outstanding balance on the reported security. The SVO shall assess any reported structured securities backed by NAIC CRP rated underlying obligations by applying the procedure described below. The SVO shall confirm that the pool meets the criteria identified above. The SVO shall then assess the reported security to determine whether the credit and structural characteristics of the security compromise the expectation of predictable cash flows from the rated pool obligors. If the SVO is satisfied that the reported security meets the conditions of this sub-paragraph, and that the structural characteristics of the security do not compromise the expectation of predictable cash flow from the underlying obligations, the SVO shall assign an NAIC Designation not higher than the NAIC

52. Designation corresponding to the NAIC CRP rating for senior unsecured debt assigned to the lowest rated obligor in the pool, or, on a weighted-average basis, whichever is applicable.

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STRUCTURED SECURITIES FULLY BACKED BY FINANCIAL ASSETS INSURED BY NAIC CRP RATED INSURERS

53. **Initial Filing Requirement** - A reporting insurance company may file such a structured security with the SVO and the SVO may assign an NAIC Designation in reliance on the claims paying NAIC CRP rating assigned to the pool insurer per the informational requirements described in this Section and the analytical procedure described in this Manual.

54. A structured security filed under this subsection must be filed with a completed SAR, evidence that the pool insurer is rated by an NAIC CRP, a prospectus, private placement memoranda or other similar document describing the pool and a copy of the pool insurance policy including the proof of loss and claim form together with a description of the claims processing procedures employed by the pool insurance issuer.

55. **Subsequent Filing Requirement** - A structured security filed under this subsection must be filed together with evidence of the current NAIC CRP rating assigned to the pool insurer.

56. **Analytical Procedure** - This sub-paragraph applies to investment instruments backed by underlying financial assets that are insured against individual obligor defaults by a pool insurance policy underwritten by an insurer with an NAIC CRP claims paying ability rating. Such a pool insurance policy must have coverage in an amount equal to or greater than the outstanding balance of the pool's assets.

57. This procedure shall only apply when the reporting insurance company intends that the NAIC Designation assigned to the security will depend solely on the claims paying ability rating assigned to the issuer of the pool insurance policy by an NAIC CRP.

58. As used in this sub-paragraph, NAIC CRP rated pool insurance means an insurance policy that provides protection against individual obligor defaults, underwritten by an insurer rated and monitored by an NAIC CRP for claims paying ability. The insurance policy must: be in effect for the life of the security; provide for full and timely payment of all amounts due to the issuer; and rank as the direct, unsubordinated general obligation of the rated insurer.

59. The SVO will review the reported security to determine whether the reporting insurance company has provided evidence that there are no factors that might compromise the contractual or financial ability or willingness of the pool insurer to honor claims promptly. The SVO will then review the pool insurance policy to ascertain the terms of the policy and verify the information provided by the reporting insurance company.

60. If the SVO is satisfied that the pool insurer is fully obligated to pay amounts equal to obligor defaults and that such amounts will enable the issuer to meet its payment obligation to the investors, and that there are no factors which might compromise the contractual or financial ability or willingness of the insurer to honor claims promptly, the SVO shall assign an NAIC Designation not higher than the NAIC Designation corresponding to the NAIC CRP rating assigned to the pool insurer.

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VALUATION AND CREDIT ASSESSMENT OF DEFAULTED SECURITIES AND ANALYTICAL CONVENTIONS

GENERAL INSTRUCTIONS

61. Issuers of defaulted securities often emerge from reorganization or private restructuring and their pre-default liabilities may have been modified but remain viable as modified. When this is the case, and the insurance company can demonstrate that it has accounted for the loss of fair value consistently with *SSAP No. 36—Troubled Debt Restructuring*, the SVO will assign a credit quality designation to the defaulted security to reflect the issuer's post-default credit risk.

Procedure for Determining a Post-Default Fair Value for a Loan or a Security

62. Any insurance company that owns a previously defaulted security can file relevant information with the SVO to obtain a fair value for the security or loan, or in the alternative, may calculate a fair value for the loan consistent with *SSAP No. 36—Troubled Debt Restructuring* and report the fair value obtained and a copy of its work papers and other information about how the fair value was determined, to the SVO.

63. Where the insurance company has filed information with the SVO and requested that the SVO determine a fair value, the SVO shall calculate a fair value for the security or loan and communicate its determination to the insurance company in writing and enter the fair value in the VOS Process.

64. Where the insurance company has calculated or wishes to calculate the fair value, it may report its determination to the SVO with an explanation of the methodology used to arrive at the fair value. The SVO will consider the information provided and determine whether in its opinion, the fair value claimed by the insurance company is reasonable or unreasonable. The SVO determination will be entered into the VOS Process and will also be communicated to the insurance company and the domiciliary regulator in writing.

Procedure for Obtaining a Post-Default Credit Assessment

65. Contemporaneously with the filing contemplated above, the insurance company shall file current financial and other relevant issuer information so that the SVO can determine the issuer's financial condition and a current NAIC Designation for the security. The SVO will not assign an NAIC Designation unless the fair value for the loan or security has been calculated consistently with *SSAP No. 36—Troubled Debt Restructuring*.

Issuer Amends or Refinances an Existing Issue as a Non-Troubled Restructuring

66. Insurance companies who determine that a restructuring or workout of a transaction is not a troubled restructuring under *SSAP No. 36—Troubled Debt Restructuring* shall file information about the transaction and its determination to enable the SVO to express an opinion on the

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matter. The SVO shall provide its conclusions in writing to the insurance company and the domiciliary insurance department.

Required Documents for Credit Assessment and Valuation Analysis

67. For purposes of the valuation discussed above, the insurance company should submit the following documentation to the SVO within 120 days of closing: If a new issue, Sources and Uses of Funds Statement, including:

- Listing of new loan participants and allocations
- Listing of previous participants and associated payment disbursements
- Breakdown of previous issue repayment (and explanation of any write-off/ realized loss or waiver, by type) of:
- Principal balance
- Accrued interest
- Deferred financing fees and charges
- Unamortized premiums or discount
- Make-whole provision

68. If amended, then:

- Breakdown and explanation of any write-off, realized loss or waiver of:
- Principal balance
- Accrued interest
- Deferred financing fees and charges
- Unamortized premiums or discount
- Make-whole provision
- Covenants
- Breakdown and description of any amendment fees received
- Copy of the original, executed Note Agreement and Schedules and all Executed Amendments (including those to Inter-Creditor and Security Agreements) to date
- Pricing rationale, including basis for current credit risk assessment & Comps
- If secured, Collateral Loan Form, including:
- Most recent Compliance Certificate and financials from the company, including calculations and comparison to covenant levels in effect at period-end.

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ANALYTICAL CONVENTIONS

Issuer Liquidation

69. The SVO will maintain any non-liquidated assets of an issuer in liquidation at **NAIC 6** provided that the insurance company may file a request for a reassessment of credit quality of the loan where there is new underlying credit support for the obligation. As a general rule, in an issuer liquidation of a bankruptcy-remote entity, the SVO assumes the liabilities to be permanently impaired, in the absence of evidence to the contrary.

Reorganizations under Chapter 11 of the U.S. Bankruptcy Code

70. The SVO will maintain the NAIC Designation of any issuer liability subject to compromise (i.e., any liability of the issuer that has not emerged intact from the reorganization) at **NAIC 6**. Bankruptcy-remote liabilities may be other than temporarily impaired, but may be upgraded from **NAIC 6** to reflect the credit risk of the new obligor, provided the insurance company has recognized a loss as required by *SSAP No. 36—Troubled Debt Restructuring* in a prior year as discussed in sub-paragraph (c) above. New securities issued in lieu of the compromised liabilities on emergence from bankruptcy will be reevaluated in line with the credit of the post-bankruptcy entity.

Work-out or Restructurings Resulting in Modified Terms

71. The guidance in this sub-paragraph applies whether new securities are issued or not. Whenever an insurance company has agreed to discuss a modification of the terms of an existing obligation, *SSAP No. 36—Troubled Debt Restructuring* is implicated and the event is a material credit event. Reporting a work-out situation to the SVO as soon as practicable after the decision to restructure the transaction is taken, will enable the SVO to work with the insurer to estimate the fair value of the loan and the credit quality of the issuer.

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CREDIT TENANT LOANS

FILING INSTRUCTIONS

Initial Flings Requirements

72. For Bond Lease Based CTLs and Credit Lease Based CTLs, the reporting insurance company shall submit a completed SAR form, a completed Bond Lease Based or Credit Lease Based CTL Evaluation Form, as appropriate (in either case together with the documentation described in the Evaluation Form), and evidence of the lessee's rating or Audited Financial Statement.

73. In the case of Acceptable CTL Variants (ACVs), the reporting insurance company shall submit a completed SAR, an Audited Financial Statement, Credit Lease Based CTL Evaluation Form (including the documents described in the Evaluation Form) and a separate memorandum identifying and describing the ACV. Any documents that are unique to the transaction by virtue of its being an ACV should be included.

Subsequent Filing Requirements

74. For Bond Lease Based CTLs, Credit Lease based CTLs, Multiple Property Transactions (MPTs) and Acceptable CTL Variants, the reporting insurance company shall submit evidence of a current NAIC CRP rating for the lessee or the lessee's guarantor. For purposes of this subsection, a current rating is defined as one issued or reviewed within the past 12 calendar months. Evidence of a current rating may be submitted in the form of a Bloomberg screen or other similar screens acceptable to the NAIC from another information vendor. In the event the lessee, or lessee's guarantor, is not rated by an NAIC CRP, the reporting insurance company shall file the Audited Financial Statement of the lessee or the lessee's guarantor, as the case may require.

GENERAL

SVO Procedure

75. Upon receipt of an Evaluation Form, the SVO analyst shall first review the Evaluation Form and other documents submitted by an insurer to verify that the transaction reflects appropriate CTL criteria. If the information provided on the Evaluation Form suggests that the transaction is likely to reflect all appropriate CTL criteria, the analyst shall proceed to determine either that (i) the transaction reflects risk consistent with the definition and other criteria for the category or (ii) that the transaction contains risks different from those normally associated with Schedule D transactions.

76. Where, in the opinion of the analyst and where otherwise appropriate, the risk presented by the transaction is inconsistent with the definition and other criteria for the CTL category but is consistent with Schedule D reporting, the analyst may reflect the additional risk by

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adjusting the Designation for the transaction downward and away from the credit rating category assigned to the lessee. If the analyst concludes that the transaction contains risks different from those normally associated with Schedule D, the transaction shall be rejected as ineligible for Schedule D reporting.

General CTL Issues

77. The following are the types of general issues that may be relevant to SVO's CTL analysis. The list is not intended to be all inclusive and not all statements may be relevant to each CTL category. Where appropriate, analysts shall consider:

- The extent to which the transaction appears well insulated from the credit risk of the lessor.
- If a Phase I report, or the nature and prior use of the land, indicates a substantial likelihood of preexisting environmental contamination, the extent to which the risk is mitigated may be evidenced by a Phase I or II report, an assumption of that cost by the lessee or other acceptable solution.
- If the lessee's NAIC Designation is less than **NAIC 2**, insolvency risks associated with the lessee may be increased, and all other aspects of the transaction may play an important role in the SVO's analysis.
- A previously unrated lessee or guarantor is eligible for CTL consideration if it presents the information requested in the Evaluation Form.
- While the number of lenders is not limited, there must be equivalency in protection for all lenders.
- While lessor's ownership structure is not limited (i.e., special purpose entity is not required), the SVO may require additional information to assess whether the risks associated with the lessor's ownership structure are mitigated.
- While the transaction may involve a leasehold interest created by an agreement between the owner of the fee interest, the ground lessee, the ground lessor and the remainder man, if any (specifically whether or not the ground lease or estate for years is terminated pursuant to a foreclosure of the note(s) or whether all of the ground lease obligations materially match all of the lessee's obligations under the lease).
- Where casualty insurance for full replacement value is required, it shall be provided by an insurer having a claims paying rating ability at least equivalent to an **NAIC 2** Designation, or if the lessee shall be rated at least the equivalent of an **NAIC 2** Designation and lessee's GAAP net worth is at least $100 million at the time of origination, by self-insurance. If the credit rating of a lessee self-insuring falls below an **NAIC 2** Designation equivalent, then the lessee shall obtain adequate casualty insurance from an insurer having a claims paying ability rating at least equivalent to an **NAIC 2**

Designation. Within 90 days of a rating downgrade, insurer shall provide evidence to the SVO that the required insurance coverage has been obtained.

- If the lessee is not assigned an **NAIC 2** Designation or better, and the SVO shall consider it necessary to conclude its analysis, the insurer shall collect and send such additional information explaining the strategic importance of the premises to the lessee's business operations (whatever the nature of the leased premises—e.g., retail, office, warehouse, manufacturing plant).

EVALUATION FORM

78. The CTL Evaluation Form shall be deemed to be a part of the documentation submitted by the insurer subject to all pertinent rules of the NAIC and of state insurance departments regarding truthfulness, accuracy and completeness. However, the Evaluation Form is not intended to be a statement of criteria to assist structuring of CTLs. Acceptance of an Evaluation Form by the SVO does not imply that the transaction will be accorded Schedule D treatment. The SVO shall have discretion to vary the terms of the Evaluation Form as experience and prudent analytical judgment may suggest.

BOND LEASE BASED CTL

Definition

79. A Bond Lease Based CTL is a transaction structured around the terms of a Bond Lease. A Bond Lease is a lease between a lessor and a lessee for a specified period of time with specified rent payments that are at least sufficient to repay the related note(s). The Bond Lease requires the lessee to perform all the obligations related to the leased premises. The investment community has historically defined a Bond Lease as a "hell or high water lease," the general concept being that regardless of what occurs as to the leased premises, the lessee is obligated to continue to pay its rent. Therefore, the focus is on the credit of the lessee (or of the guarantor of lessee's obligations) under the Bond Lease, not the real property characteristics related to the premises.

Legal Characteristics of Bond Leases

80. A Bond Lease reflects the following legal characteristics:

- The lessee is responsible for every obligation related to the leased premises, such as payment of all taxes and utilities, the performance of maintenance, environmental and ground lease obligations (if any) and the obligation that the lessee must indemnify the lessor against losses and claims relating to the leased premises. The lessor's only obligation may be to provide quiet enjoyment of the premises by the lessee.
- The lessor makes no representations or warranties regarding the condition of the leased premises and the lessee accepts the premises "as is."

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- The lessee has no right to offset or abate rent or to terminate the Bond Lease upon the occurrence of obsolescence, condemnation, casualty or for any other reasons, except that the lessee may terminate the Bond Lease (i) at any time, if the termination coincides with the lessee's purchase of the leased premises, for an amount at least sufficient to pay the outstanding principal balance and accrued interest or (ii) during a period no longer than the last three years of the lease term without such purchase, in the event of a condemnation and casualty, if the insurance proceeds (or self-insurance proceeds) and condemnation awards are payable to the lender/trustee and are in amounts sufficient to pay the loan in full.
- The lessee is not required to occupy the leased premises if the occupant is a subsidiary or affiliate of the credit tenant. In these cases, the SVO may require additional information regarding the strategic importance of the leased premises.
- The lessee may assign and sublease if the lessee remains unconditionally liable for the performance of all lessee obligations.
- The Bond Lease cannot be amended without the lender's consent.
- The Bond Lease or other relevant document(s) must specifically prohibit a merger of estates.

Structural Characteristics of Bond Lease Based Transactions

81. A Bond Lease and related documentation reflect the following structural characteristics:

- Payments under the note, including a balloon payment, correspond to a lease payment due from the lessee pursuant to the Bond Lease that is equal or greater than the note payment. The term "balloon" in the definition is intended to imply only a payment larger than previous payments and does not contemplate permitting transactions with refinance risk.
- Neither the lease payments nor the debt payments need be level.
- The lessee is required to pay for all expense items.
- The lessee leases 100% of the real property securing the note.
- There is a valid first lien on the real property or the leasehold estate in favor of the lender/trustee.
- There must be in effect a fully executed irrevocable and perfected assignment of lease payments in favor of the lender/trustee and the lender/trustee must be directly collecting lease payments sufficient to fully pay each and every installment of debt service.
- To the extent the credit to be relied upon is that of a guarantor, the guarantee of the lessee's obligations must be irrevocable and unconditional, and must guarantee

performance of all obligations of the lessee under the Bond Lease. The term "guarantor" excludes third party guarantees for purposes of credit enhancement but is intended to include support arrangements, which in the opinion of the SVO, are entered into as a regular part of the business of the lessee or the group of entities of which the lessee is a part.

- Loan to value is not relevant and therefore not limited.

CREDIT LEASE BASED CTL

Definition

82. A Credit Lease Based CTL transaction is one structured around a Credit Lease. A Credit Lease is a lease between a lessor and a lessee for a specified period of time with specified rent payments at least sufficient to repay the related note(s). The Credit Lease requires the lessee to perform most of the obligations related to the leased premises. A Credit Lease transaction is a corporate bond/commercial mortgage transaction whose primary risk/return characteristics are derived from the creditworthiness of the lessee rather than from the traits of the mortgaged property. The principal difference between a Bond Lease and a Credit Lease is the small set of landlord obligations or real estate risks that must be explicitly addressed through well-recognized mitigation methods discussed in paragraph D below.

Legal Characteristics of Credit Leases

83. A Credit Lease reflects the following legal characteristics:

- The lessee is responsible for most of the obligations related to the leased premises, such as the payment of taxes and utilities, the performance of maintenance, environmental matters caused by its occupancy and ground lease obligations (if any) and must indemnify the lessor against most losses and claims relating to the leased premises. Any exceptions or other obligations must be addressed through insurance, adjusted debt service coverage ratios or other acceptable mitigants.
- The lessee accepts the leased premises, as evidenced by an estoppel certificate.
- The lessee has limited rights to offset or abate rent related to casualty or condemnation or the failure to perform roof, structural or parking obligations.
- The lessee is not required to occupy the leased premises if the occupant is a subsidiary or affiliate of the credit tenant. In these cases, the SVO may require additional information regarding the strategic importance of the leased premises.
- The lessee may assign and sublease if the lessee remains unconditionally liable for the performance of all lessee obligations.
- The Credit Lease cannot be amended without the lender's consent.

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- The Credit Lease or other relevant document(s) must specifically prohibit a merger of estates.

Structural Characteristics of Credit Lease Based Transactions

84. A Credit Lease Based transaction reflects the following structural characteristics:

- Payments under the note, including a balloon payment, correspond to a lease payment due from the lessee pursuant to the credit lease, except that the loan term may exceed the lease term by not more than six months, and the outstanding principal balance at the end of the lease term shall not exceed 5% of the original loan balance.
- Neither the rent payments nor the debt payments need be level.
- The lessee is required to either directly pay or to reimburse the lessor for primary expense items (e.g., taxes, utilities, maintenance and other operating expenses).
- The lessee leases 100 percent of the real property securing the note.
- There is a valid first lien on the real property or the leasehold estate in favor of the lender/trustee.
- There must be in effect a fully executed irrevocable and perfected assignment of lease payments in favor of the lender/trustee and the lender/trustee must be directly collecting lease payments sufficient to pay the debt service fully.
- To the extent the credit to be relied upon is that of a guarantor, the guarantee of the lessee's obligations must be irrevocable and unconditional, and must guarantee performance of all obligations of the lessee under the Credit Lease. The term guarantor excludes third party guarantees for purposes of credit enhancement, but is intended to include support arrangements that in the opinion of the SVO are entered into as a regular part of the business of the lessee or the group of entities of which the lessee is a part.
- Loan balance shall not exceed initial appraised value of the property. An appraisal must be done in accordance with Member of the Appraisal Institute (MAI) standards. The value reported in the appraisal report must proceed from a comparison of each of the (i) cost, (ii) comparative and (iii) income approaches.

Risks and Acceptable Mitigants in Credit Lease Based Transactions

85. The following are acceptable forms of mitigation against landlord-retained obligations:

Situation/ Mitigant:

- *Roof, structural and parking expenses not explicitly covered by Credit Lease*: (a) Deduct all appropriate costs in calculating an adjusted debt service coverage (DSC) ratio of at least 1.05x; and, (b) Provide that funds shall be escrowed in amounts estimated to be

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accumulated, on a substantially level basis, to a level sufficient to allow for payment of the named costs at the time they are expected to occur.

- *Loan term exceeds initial lease term*: (a) Difference shall not exceed six months; and (b) Remaining principal shall not exceed 5% of original loan balance.
- *Casualty*: (a) Rent loss insurance (or an obligation to pay rent regardless of a casualty) is required from an insurer having a claims paying ability rating equivalent to an **NAIC 2** Designation, or self-insurance by a tenant having a credit rating equivalent to an **NAIC 2** Designation, and whose GAAP net worth is at least $100 million, at the time of the origination; (b) If the casualty does not result in termination of the Credit Lease, proceeds must be used to repair and restore premises; and (c) If the casualty results in the termination of the Credit Lease, awards go to the lender to the extent of the outstanding principal and interest. Termination is only allowed in the last three years of the lease term, unless the lessee is required to make a termination payment at least equal to the outstanding principal and accrued interest.
- *Ground lease obligations not explicitly addressed in credit lease*: (a) Credit Lease payments must be sufficient to pay ground rent, with DSC adjusted accordingly; and (b) Attornment (non-disturbance) or other agreement between fee owner and lender is required, obligating ground lessor to notify lender of any default by ground lessee and permitting lender an opportunity to cure the default.
- *Condemnation*: (a) Where condemnation results in the termination of the Credit Lease, all awards go to the lender to the extent of the outstanding principal and interest; and (b) Where condemnation does not result in the termination of the Credit Lease, the premises must be repaired and restored.
- *Environmental*: Phase I environmental report showing no environmental problems or, if the Phase I report shows a problem or the nature and prior use of the land indicates a substantial likelihood of preexisting environmental contamination, a Phase II report and an assumption of that cost by the lessee or other acceptable solution.

ACCEPTABLE CTL VARIANTS

86. An ACV CTL is a transaction that meets substantially all of the standards for a Bond Lease Based or Credit Lease Based CTL but that contains one or more of the variants described in the Guidelines for Acceptable CTL Variants as set forth in subsection (v) below. An insurance company may report an ACV to the SVO by submitting the Bond Lease Based or Credit Lease Based Evaluation Form, whichever is appropriate, specifically identifying the items in the Bond Lease Based or Credit Lease Based CTL standards not present in the submitted transaction, explaining the differing language, device or mitigant put in place to substitute for the missing criteria and providing documentation to substantiate the different approach employed in the transaction.

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GUIDELINES FOR ACCEPTABLE CTL VARIANTS

Acceptable CTL Variants

87. Transactions that exhibit the following variations from the definitions of Bond Lease or Credit Lease Based CTL contained above will nevertheless be eligible for Schedule D treatment in accordance with these guidelines and the definitions if the following standards are met:

- Transactions where lease payments are insufficient to cover required debt service. The shortfall would be covered fully by credit enhancement, cash escrow or excess rent set-asides.
- Transactions with balloon payments in excess of 5% for Credit Lease Based CTLs if lease payments or credit enhancement fund the balloon. The SVO will assess the extent to which the payment stream, whether provided by the lease or credit enhancement, covers the balloon payment.
- Transactions where loan term exceeds lease by more than 6 months. The lessee is obligated either to renew the lease, purchase the property or terminate the lease and pay an amount equal to the outstanding debt. If the tenant renews the lease, the renewal term would have to be for the balance of the loan term. If the tenant purchased the property, the sale and settlement of the landlord's loan obligation must occur not later than the date prior to which lease payments would cease and there must be a simultaneous payment to the lender.
- Transactions that have been purchased by the reporting insurance company from another institution via an assignment. If Bond Lease or Credit Lease criteria are met, the fact that the transaction was acquired through an assignment does not jeopardize CTL treatment.
- Transactions in which the tenant occupies less than 100% of the premises. The reporting insurance company shall identify the credit tenant and the credit tenant's lease payments shall be sufficient to cover the necessary escrow, common area maintenance and other relevant costs.
- Transactions where the user of the property is not affiliated with credit tenant or guarantor. If (i) the credit tenant or a guarantor is liable for and agrees to make the required lease payments and (ii) despite lack of affiliation between the parties, there is a substantial community of interests between the parties, for example the relationship that might exist between an auto manufacturer and an auto supplier.
- Transactions where the tenant may terminate the lease despite the fact that the amount due under the lease is greater than 5% of the original loan amount. The tenant shall not

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terminate the lease without first paying off the loan or extending the term of the lease to a term sufficient to amortize the remaining balance of debt.

- Transactions in which the landlord has obligations other than those specified in the definition for Credit Lease Based CTLs. The SVO shall have sole discretion to determine whether the level of risk associated with the retained landlord obligation is consistent with the mitigant used. The SVO anticipates that the reporting insurance company will provide a structure that protects the cash flow. Devices like cash escrow or excess rent set asides may be appropriate mitigants.
- Transactions in which the landlord retains obligations but where the lease requires the tenant to continue to make payments regardless of landlord's breach of these obligations, with tenant's only remedy to pursue legal remedies for damages against the landlord. These transactions would be treated as Credit Lease Based CTLs, irrespective of the fact that the stated variation may be the only difference between the submitted transaction and a Bond Lease Based CTL.
- Transactions that permit lease termination for casualty to all or substantially all of the property prior to the final three years of the lease term. The reporting insurance company must demonstrate that insurance by a third party acceptable to the SVO is in place and fully covers principal and interest in the event of lease termination. A key consideration in this variation is that it be clear that the insurance company lender would always "walk away whole."
- Transactions that permit the lease to be canceled if the property is not restored within a specified time period after a casualty. The transaction shall incorporate a mechanism to assure that the casualty could be repaired within the term of the insurance policy then in force and the mortgagee would have to permit application of insurance proceeds to pay off the debt.
- Transactions in which the tenant has a right to abate rent during a casualty, condemnation, repair or restoration event. The reporting insurance company shall provide (i) evidence of rent insurance of a duration of at least 1 year from a company rated the equivalent of an **NAIC 1** and (ii) evidence that the tenant is obligated to resume paying rent after the end of the insurance policy payments, regardless of the status of the casualty, condemnation, repair or restoration event.
- Transactions that provide a right to terminate the lease and substitute property on substantial casualty or condemnation. The tenant shall substitute equivalent leased property.
- Transactions where tenant has a right to condemnation award for value of leasehold estate or tenant improvements. If the tenant has a leasehold interest in the premises because it has advanced funds for improvements, CTL eligibility is not affected because the agreement would permit the tenant to receive proceeds of the condemnation award,

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provided the tenant continues to be obligated to make the payments called for under the lease and those payments are sufficient to pay the loan in full, or the loan is repaid.

- Transactions with an unsatisfactory Phase I or II report. Section 1(a)(i)(E)(2) of this Part above is intended to provide the industry with a device through which it can communicate environmental issues to the SVO. Generally, the SVO anticipates that all CTL transactions will have a Phase I report. If the Phase I report sets forth an unfavorable matter, a Phase II report shall provide more detailed study of the issue. If the reporting insurance company wants to pursue the transaction it may present the Phase II and other material information to the SVO, detailing the manner in which it would mitigate the risk. The SVO would then determine whether the proposed solution serves as an adequate mitigant for the risk.
- Transactions with a stale environmental audit. These transactions may be permitted if the tenant has been in the property since the date of the initial audit, the initial audit is available and acceptable to the SVO and the tenant's use of property is not environmentally sensitive. The documents shall include reliance on a strong net lease paragraph to establish that all environmental obligations are tenant obligations and not landlord obligations.
- Transactions with appraisals submitting only one appraisal method. A transaction may be submitted with an appraisal that lacks all three-valuation methods (cost, comparative and income approaches) if the appraisal is in accordance with MAI standards and makes clear that the other two methods were not applicable and this is stated in the MAI opinion.
- Transactions with second mortgages. Rent must exceed aggregate debt service on all debt up to required Credit Lease Based coverage standards and the second mortgagee could not put lender into default.
- Transactions where the lender is the second mortgagee. Rent must exceed aggregate debt service on all debt up to required Credit Lease Based coverage standards and the lender shall have a right to cure first mortgage defaults.
- Transactions with minor lessor representations, warranties or covenants. Staff shall have sole discretion to assess the nature of the landlord obligation and the extent to which the mitigant is appropriate. However, these transactions may be permitted if the tenant is estopped from asserting these lessor obligations to abate or cease payment of rent, or if there is credit enhancement or other collateral available to protect against tenant non-payment.
- Use of collateral trustee and issuance of trust certificates. The use of a collateral trustee, or trust certificates, has no impact on eligibility for CTL treatment. Staff will, of course, review appropriate documentation associated with the arrangement.

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- Transactions involving a "Dark Store." The SVO will raise no objection to CTL eligibility for a transaction in which the original lessee "darkens" the leased premises if the lessee remains unconditionally liable for the performance of all lessee obligations.

MULTIPLE PROPERTY TRANSACTIONS (MPTS)

Definition

88. An MPT transaction is a series of single property Bond Lease Based CTLs or Credit Lease Based CTLs (but not both) combined in one transaction. The MPT category does not alter the fundamental structure or principles of either the Bond Lease Based or the Credit Lease Based CTL. To qualify as an MPT CTL, each site or property must satisfy the existing Bond Lease Based or Credit Lease Based CTL definition, on a stand-alone basis.

General Legal Characteristics of MPTs

89. An MPT transaction reflects the following legal characteristics:

- Each property or site qualifies as (i) a Bond Lease Based CTL or (ii) a Credit Leased Based MPT CTL, as defined below.
- Either (a) a single credit tenant or (b) "affiliated" credit tenants with a guarantee by the parent.
- Differences in the documents are identified and limited to dollar amount of rent or debt and state/local law differences.
- Local counsel opinion(s) and a special counsel opinion regarding enforceability of documents, perfection of security interests in the collateral and consequently, the recordation of security documents, are provided to the SVO.
- For Credit Lease Based MPT CTLs, each property has a satisfactory Phase I environmental report and an Appraisal indicating the appraised value of the property and containing the appraiser's name and certifications done in accordance with MAI standards.
- Existing cross default and/or cross collateralization provisions are identified.
- Any variance must be consistent among all the properties or sites in the transaction.

Legal and Structural Characteristics of Credit Lease Based MPT CTLs

90. The legal and structural characteristics of a Credit Lease Based MPT CTL shall be the same as the existing Credit Lease Based CTL definition, with the following modifications:

- There must be a single lessor.
- Either a single credit tenant or affiliated credit tenants with a guarantee by the parent; however, in all cases the lessee must occupy the leased premises.

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- Any guarantee of a lessee's obligation must be with respect to all properties in the transaction.
- All risks and acceptable mitigants, as currently described in the existing Credit Lease Based CTL definition, must be uniform for each property.

Acceptable CTL Variants Eligible for MPT Treatment

91. The following Acceptable CTL Variants will be acceptable for Credit Lease Based MPT CTLs:

- Transactions that have been purchased by the reporting insurance company from another institution via an assignment. If Bond Lease or Credit Lease criteria are met, the fact that the transaction was acquired through an assignment does not jeopardize CTL treatment.
- Transactions where the tenant may terminate the lease, despite the fact that the amount due under the lease is greater than 5% of the original loan amount. The tenant may not terminate the lease without first paying off the loan or extending the term of the lease to a term sufficient to amortize the remaining balance of debt.
- Transactions that permit lease termination for casualty to all or substantially all of the property prior to the final three years of the lease term. The reporting insurance company must demonstrate that insurance by a third party acceptable to the SVO is in place and fully covers principal and interest in the event of lease termination. A key consideration in this variation is that it be clear that the insurance company lender would always "walk away whole."
- Transactions that provide a right to terminate the lease and substitute property on substantial casualty, economic obsolescence or condemnation. The tenant would have to substitute equivalent leased property.
- Transactions with appraisals utilizing only one appraisal method (provided that the appraisal method is uniform for all properties). A transaction may be submitted with an appraisal that lacks all three valuation methods (cost, comparative and income approaches), provided the appraisal is in accordance with MAI standards and makes clear that the other two methods were not applicable and this is stated in the MAI opinion.

Variants Requiring an NAIC CRP Rating

92. An NAIC CRP rating is required for CTL transactions:

- With two credit tenants in the transaction.
- If lease payments do not commence until completion of construction, but cash escrow or credit enhancement is available during construction sufficient to negate risks.

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- If additional credit enhancement would upgrade the rating of the transaction above the credit rating of the tenant.
- Where self-insured tenants with a Designation below **NAIC 2** are required to maintain a specified minimum net worth or to immediately obtain insurance.
- Where environmental issues are not addressed, but there is a strong net lease paragraph, indemnification, compliance with laws or maintenance covenants.
- With unaddressed and preexisting environmental issues, if there is credit enhancement or other collateral to support the risk.
- Where there is no appraisal or MAI equivalent. Where landlord makes construction warranties or credit tenant has limited rights to offset rent for construction, if estopped agreements are in place or there is agreement from credit tenant that set-offs are nonbinding against lender because the risk is fully mitigated.

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WORKING CAPITAL FINANCE INVESTMENTS

FILING REQUIREMENTS

Initial Filing Requirements

93. An insurance company requesting an analysis of a proposed Working Capital Finance Program shall provide the SVO with the documentation described in this subparagraph.

- An RTAS Application;
- The Obligor's Audited Financial Statements, if the Obligor is not rated for credit risk by a NAIC CRP;
- The insurance company's Investment Committee Memorandum for the proposed Working Capital Finance Program;
- The audited consolidated financial statements of the group of which the Finance Agent for the Working Capital Finance Program is a part, and one of the following:
  - An annual independent report according to Statement on Standards for Attestation Engagements (SSAE) No. 16, reporting on controls at a service organization related to the administration of the investment; or
  - An annual audit of the internal controls of the consolidated group of which the Finance Agent is part, which does not note any material weakness related to servicing.
  - A Certification from the insurance company's Chief Investment Office that the insurance company, in its capacity as an Investor, is not affiliated with the Obligor or with any Supplier in the Working Capital Finance Program, and that the Working Capital Finance Program does not include any insurance or insurance related assets.
  - A Certification from the insurance company's Legal Counsel:

- **In the case of a participation**, that it has a commercially reasonable belief that its participation interest meets the Uniform Commercial Code's standards for creating and preserving first priority security interests in the payments due and in the Confirmed Supplier Receivables.
- **In the case of a certificate**, note or other manifestation, representing a right to payment from a trust, other special purpose entity, or special purpose pool holding confirmed supplier receivables, that it has a commercially reasonable belief that the documents establishing and governing the Working Capital Finance Program create and preserve interests in the Confirmed Supplier Receivables capable of being enforced by the trustee or other entity holding Confirmed Supplier Receivables as first priority perfected security interests under the Uniform Commercial Code.

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Please refer to SSAP No. 105—Working Capital Finance Investments for the definition of a commercially reasonable belief.

94. A copy of:

- The document(s) that create the Working Capital Finance Investments (i.e., the short-term receivables) that is the subject of the RTAS – Emerging Investment Vehicle Service Application, and establishes the obligations of the Obligor to, and the protection afforded owners of, Working Capital Finance Investments (including the Investors). This agreement is sometimes referred to as the Invoice Payment Terms Acknowledgement, the Payable Services Agreement or the Paying Services Agreement.

Please refer to the guidance for filing an RTAS Application with the SVO.

- The agreement(s) between the Obligor and the Finance Agent governing the administration of the Working Capital Finance Program and the Working Capital Finance Investments issued thereunder. These agreements may be included in the documents mentioned above or may be a standalone agreement which are sometimes referred to as the Settlement Services Agreement or the Invoice—Related Electronic Services Agreement.
- The agreement governing the sale of the Working Capital Finance Investments from the Supplier to the Finance Agent. This agreement is sometimes referred to as the Receivables Purchase Agreement or the Supplier Agreement. The agreement governing the ongoing purchase of Working Capital Finance Investments or an interest in Working Capital Finance Investments by the Investor from the Finance Agent. This agreement is sometimes referred to as the Agency Agreement, the Participation Agreement or the Program Trust Agreement.

Subsequent Filing Requirements

- Copies of any of the documents originally submitted with the RTAS Application subsequently amended.
- The audited consolidated financial statements of the group of which the Finance Agent for the Working Capital Finance Program is a part, and one of the following:
  - An annual independent report according to Statement on Standards for Attestation Engagements;
  - (SSAE) No. 16, reporting on controls at a service organization related to the administration of the investment; or
  - An annual audit of the internal controls of the consolidated group of which the Finance Agent is part, which does not note any material weakness related to servicing.

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DEFINITIONS IN *SSAP NO. 105*—WORKING CAPITAL FINANCE INVESTMENTS

95. Please refer to *SSAP No. 105—Working Capital Finance* Investments, for the definitions and associated definitional guidance insurance companies must understand and comply with before applying for an NAIC Designation for Working Capital Finance Programs that would permit them to purchase Working Capital Finance Investments.

96. With the exception of the definitions for Dilution Risk and Operational Risk below, the definitions shown below are summaries of those contained in *SSAP No. 105—Working Capital Finance* Investments intended only to facilitate a discussion and in all cases subordinate to the definitions in *SSAP No. 105*.

SUMMARY OF KEY DEFINITIONS

97. **Confirmed Supplier Receivable** - A receivable sold by a Supplier to a Finance Agent or Investor (or by a Finance Agent to an Investor) under a Working Capital Finance Program designated by the SVO that requires the Obligor to confirm to the Finance Agent or Investor, prior to the sale of the receivable from the Supplier to the Finance Agent or Investor, that it has no defenses to payment of the monetary obligation represented by the receivable against the Supplier and, therefore, no defenses to payment of the same monetary obligation to the Finance Agent and/or Investor after such sale. The confirmation by the Obligor that it has no defenses to payment includes confirmation that the Obligor does not have a right to refuse payment that it may have acquired with respect to underlying commercial trade transaction and that, if it has such a right, it will not assert such defenses against the Finance Agent or Investor.

98. **Dilution Risk** - With respect to any Working Capital Finance Program, dilution risk refers to disputes or contractual provisions that may reduce the amount of the obligation owed by the Obligor to the Supplier under the original receivable or the obligation owed by the Obligor to the Finance Agent and/or Investor under the Confirmed Supplier Receivable. Examples of dilution risk are credit for returns of defective goods or an allegation of fraud, such as that the invoice is not legitimate or is a duplicate invoice.

99. **Finance Agent** -- A bank, financial institution, financial intermediary or service provider that facilitates the Working Capital Finance Program that arranges the sale, assignment or transfer of the Confirmed Supplier Receivable to the Investor and administers payment.

100. **Investor** - The insurance company that files the RTAS Application with the SVO in order to obtain an NAIC Designation for a proposed Working Capital Finance Program.

101. **Obligor** - An entity that purchases the goods or services from the Supplier and thereby generates the original supplier receivable — and which Obligor has, or can be designated, **NAIC 1** or **NAIC 2** by the SVO or has been assigned an equivalent credit rating by a NAIC CRP.

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102. **Operational Risk** - With respect to any Working Capital Finance Program, operational risk refer to the combined effect of the procedures and parties employed to implement the program and their responsibility under the documents and to the determination by the SVO of whether these procedures and parties will ensure full and timely performance by the Obligor of the payment obligation to the Investor. An example of an operational risk is the confirmation process employed to verify that the Obligor has no defenses to payment.

103. **Supplier** - The entity that sells the goods or services to the Obligor, obtains a receivable from the Obligor in exchange and subsequently chooses to sell the right to receive the payment associated with the receivable to the Finance Agent or Investor under the terms of a Working Capital Finance Program designated **NAIC 1** or **NAIC 2** by the SVO.

104. **Working Capital Finance Program** - The program created for the Obligor and its Suppliers by a Finance Agent the terms of which permits Suppliers to the Obligor to negotiate the sale of a right to receive payment from the Obligor (which is associated with and evidenced by a receivable) to the Finance Agent or an Investor.

105. **Working Capital Finance Investment** - The right to receive the payment associated with a Confirmed Supplier Receivable purchased by an Investor under a Working Capital Finance Program designated **NAIC 1** or **NAIC 2** by the SVO and is the subject of *SSAP No. 105—Working Capital Finance Investments*.

NOTE: *SSAP No. 105—Working Capital Finance Investments* imposes reporting and statutory accounting requirements on insurance company investments in Working Capital Finance Investments and specifies analytical procedures to be applied or analytical controls to be verified by the SVO that are not detailed above. Insurance companies are strongly advised to become familiar with *SSAP No. 105* before filing an RTAS Application with the SVO.

DIRECTION AND PROGRAM PARAMETERS

Direction

106. The SVO may assign an NAIC Designation to a Working Capital Finance Program that would generate Working Capital Finance Investment that meet the criterion and standards identified in this Section 6.

Program Parameters

RTAS Submission Required

107. A request that the SVO assign an NAIC Designation to a Working Capital Finance Program is made by filing an RTAS Application. The RTAS Application is available at: http://www.naic.org/documents/svo_rtas_app.pdf.

108. Upon completion of its risk assessment, the SVO will issue an RTAS Letter indicating a preliminary NAIC Designation; i.e., the NAIC Designation that would be assigned if the Investor enters into a Working Capital Finance Program with a Finance Agent and sought to

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report it to the SVO. Note: A preliminary NAIC Designation cannot be used for statutory reporting purposes. The SVO shall issue a final NAIC Designation to the Investor for the Working Capital Finance Program and the

109. Working Capital Finance Investments generated thereunder upon receipt of fully executed final copies of the required documentation.

Variations in Structure

110. Working Capital Finance Programs may differ in structure and in the protection afforded the Investor. Structural strength and weaknesses of various structures in such programs will be reflected in the NAIC Designation assigned by the SVO.

Program Quality

111. The SVO shall only assign an NAIC Designation to Working Capital Finance Programs that can be designated **NAIC 1** or **NAIC 2**. Credit quality is measured by reference to a NAIC CRP credit rating or an NAIC Designation assigned by the SVO. The SVO shall withdraw the NAIC Designation assigned to a Working Capital Finance Program on the date the Obligor's NAIC CRP credit rating or NAIC Designation is downgraded to **NAIC 3** or its NAIC CRP equivalent.

NOTE: *SSAP No. 105—Working Capital Finance Investments* provides that Working Capital Finance Investments generated under a Working Capital Finance Program of an Obligor that falls below the equivalent of **NAIC 1** or **NAIC 2** becomes nonadmitted.

PROCESS AND METHODOLOGY

112. An NAIC Designation shall be assigned to a Working Capital Finance Program on the basis of a thorough assessment of credit, dilution, operational and other risks, an assessment of protections provided by operative documents to the Investor and the quality of transaction participants.

RISK-ASSESSMENT PROCESS

Credit Risk

113. The NAIC Designation for a Working Capital Finance Program shall be linked to the credit quality of the Obligor, which may be determined by reference to a credit rating assigned by a NAIC CRP or by an NAIC Designation assigned by the SVO. Credit risk is assessed by the SVO analyst in accordance with any permitted methodology set forth in this Manual for corporate obligors.

Dilution Risk

114. To achieve an **NAIC 1** or **NAIC 2** Designation, the Working Capital Finance Program must eliminate dilution risk in the Working Capital Finance Investment proposed to be eligible for

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purchase by the Investor. The terms governing the Investor's Working Capital Finance Investment must eliminate Obligor recourse to its Supplier as a condition to payment of the obligation to the Investor so as to result in an unconditional right to receive payment on a full and timely basis.

Operational Risk

115. To achieve an **NAIC 1** or **NAIC 2** Designation, all operational risks shall be identified and assessed. Key participants shall have a NAIC CRP credit rating or an NAIC Designation assigned by the SVO at a level at least that of the Obligor.

LEGAL, STRUCTURAL AND REGULATORY CONSIDERATIONS

116. Events of default remedies should provide the Investor at least those rights and privileges, unimpaired, of a trade creditor upon default with no Obligor defenses that could cause dilution of principal.

117. The Finance Agent must be an entity regulated or supervised by a financial regulator in one of the countries in the List of Foreign (non-US) Jurisdictions Eligible for Netting for Purposes of Determining Exposures to Counterparties for Schedule DB, Part D, Section 1 and that the regulator is the functional equivalent of the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency (OCC) or the Federal Deposit Insurance Corporation (FDIC). In the alternative, the SVO shall verify that payments due the Investor are made directly by the Obligor with no commingling of funds or assets with those of the Obligor, Supplier, Servicer or Trust Administrator or other Investors.

118. The SVO will verify that the Certification from the insurance company's Chief Investment Office confirms that the Investor is not affiliated with Obligor and that Working Capital Finance Investment excludes insurance or insurance-related assets.

119. The SVO will verify that the Certification from the insurance company's Legal Counsel confirms the existence of a commercially reasonable belief that the documents establishing and governing the Working Capital Finance Program establishes the rights and UCC code standard for preserving first priority perfected interest in Confirmed Supplier Receivables.

120. The remedies available to the participants in the Working Capital Finance Program should be expressly identified in the documentation for the Working Capital Finance Investment.

121. Characteristics that shall be present in a proposed Working Capital Finance Investment include, but are not limited to, the following, or a substantial equivalent:

122. The Obligor makes payments directly to (i) the Investor; (ii) Finance Agent; or (iii) the servicer for the Working Capital Finance Program.

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123. The Investor must have the option, and not an obligation, to purchase subsequent Working Capital Finance Investment so as to ensure the Investor can exit the Working Capital Finance Investment by permitting existing investments to mature.

124. *SSAP No. 105—Working Capital Finance Investments* provides that the documentation governing Working Capital Finance Programs must provide that disputes arising under the agreements shall be submitted to a court of competent jurisdiction in the U.S. or be subject to an alternative dispute resolution process sanctioned by state law. Given the nature of Working Capital Finance Programs, the SVO anticipates that documentation governing Working Capital Finance Investments will be subject to the laws and jurisdiction of the courts of California, Delaware or New York, or a similar legal jurisdiction with significant exposure to sophisticated institutional financial transactions.

125. Events of default must be clearly defined, and provide a mechanism that gives the Investor the ability to pursue collection unfettered by actions taken or not taken by participants such as the Servicer or Trustee, or other named persons performing similar functions.

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INVESTMENTS IN CERTIFIED CAPITAL COMPANIES

DEFINITION

126. A certified capital company (CAPCO) is a state legislated venture capital firm that can be a partnership, corporation, trust or limited liability company, profit or not-for-profit and which may capitalize itself in a variety of ways. Investors who acquire an equity interest or qualified debt instrument from a CAPCO receive state premium or income tax credit.

Statutory Accounting Guidance

127. Guidance on the accounting for investments in Certified Capital Companies ("CAPCO") is in "INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO)" (INT 06-02) located in Appendix B of the Accounting Practices and Procedures Manual.

128. Before a CAPCO security can be filed with the SVO, the reporting insurance company must apply INT 06-02 to the facts of the specific security. It is the insurance company's responsibility to apply Statutory Accounting Guidance for CAPCO Transactions.

129. INT 06-02 requires reporting entities to account and report for investments in CAPCOs consistent with the security or other interest they acquire except for specific guidance on the tax credits. For example, an investor who acquired a bond issued by a CAPCO would follow the accounting guidance for bonds found in *SSAP No. 26R—Bonds* and report the details about the transaction on Schedule D in accordance with the NAIC Quarterly and Annual Statement Instructions. Such securities are assessed using the procedures referenced in Part Three of this Manual.

130. For an investor who acquired a limited liability partnership interest, the interest would be valued in accordance with the guidance for limited liability partnerships contained in *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* and reported on Schedule BA in accordance with the NAIC Quarterly and Annual Statement Instructions within the appropriate Joint Venture, Partnership or Limited Liability Company subcategory.

131. Both of the examples cited immediately above would also follow the specific reporting on tax credits found in INT 06-02.

NOTE: Nothing in this Manual is intended to modify or interpret INT 06-02: Accounting and Reporting for Investments in a Certified Capital Company (CAPCO) (INT 06-02); *SSAP No. 26R—Bonds* or *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*.

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PROCEDURE FOR REPORTING AND FILING WITH THE SVO

132. The insurance company should first determine the reporting for CAPCOs indicated by the statutory accounting guidance. This is done by establishing the character of the investment and then applying the appropriate accounting and reporting guidance and to the extent necessary the related procedures in this Manual for Schedule D or BA assets. If the CAPCO investment is subject to the SVO filing process and does not meet the filing exempt requirements, it should be filed with the SVO. If the SVO disagrees with the insurance company characterization of the investment, it will so inform the insurance company and provide rationale why the SVO believes the company has misapplied or misinterpreted the guidance of INT 06-02 and request a re-filing if necessary.

REQUIRED DOCUMENTATION

133. **Unrated —** In the case of a CAPCO issue that is not rated by an NAIC CRP:

Initial Filings

134. The reporting insurance company completes an SAR and attaches the issuer's public offering statement or private placement memorandum, as the case may be, the insurance company's internal credit committee memorandum and the Audited Financial Statement of the issuer for the last three consecutive years. If an issue is rated by a rating organization other than an NAIC CRP, submit evidence of such rating. If none of these documents are available, the reporting insurance company must obtain and complete the SVO's VIM form and submit it with the required documents and attachments.

Subsequent Filings

135. For CAPCO issues that are not filing exempt follow the procedures that apply to Corporate Issues not Filing Exempt to file an annual update with the SVO. The reporting insurance company shall annually file an updated Audited Financial Statement.

Applicable Methodology

136. The SVO shall have discretion to apply any credit assessment methodology or any combination of credit assessment methodologies to assess the credit quality or assess asset classification of a CAPCO security.

137. The SVO shall have discretion to apply any credit assessment methodology or combination of methodologies and shall consider whether the procedure applicable to securities that contain other non-payment risk should be applied.

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LOTTERY SECURITIES

Definition

138. Lottery Securities are financial arrangements in which an insurer purchases the right to receive lottery prize money owed by a state lottery authority to the winner of a lottery or a subsequent assignee. The transfer may be expressed as the purchase of a receivable, the execution of an assignment of rights or in some other legally effective manner. A significant component of SVO's analysis of lottery securities focuses on the enforceability of the rights obtained by the reporting insurance company. The issue raised is whether state law requires the observation of a special procedure before a transfer of lottery prize money may be effected.

Documentation Requirements

139. An insurer filing a lottery security must file the following documents:

Direct Transfer

- Documentation of the transfer such as assignment agreement or receivable purchase agreement,
- A certified copy of a court order if one is required,
- A written statement of the lottery authority that it has received the court order and will make payment to the insurer as directed in the court order,
- Evidence, in the form of a letter from the lottery authority, that the withholding of federal and state income tax attributable to the lottery prize money will be credited to the insurer.

Indirect Transfer

140. In addition to the documents required above, the insurer shall submit:

- A trust agreement,
- Legal opinions.

No Court Order Required

141. If the state lottery law governing the transfer does not require a court order, the reporting insurance company shall submit an opinion of counsel acceptable to the SVO, certifying that no approval, consent or authorization of a governmental or administrative authority is required in connection with the transfer.

Court Order Required

142. **Direct Transfer**- A direct transfer structure is a lottery security arrangement in which the reporting insurance company purchases or otherwise acquires the right to the lottery prize

money directly from the winner of a lottery or from a subsequent assignee. The reporting insurance company shall submit the following documents:

- A certified copy of the court order that authorizes the transfer of the lottery prize money to the insurer, and
- A written acknowledgement by the state lottery authority that it has received a copy of the court order and that it will cause the lottery prize money to be paid (and, if applicable, that it will instruct and require the issuer of the annuity responsible for making the lottery prize money payments to pay and deliver the lottery prize money) directly to the insurer, in accordance with the court order.

Indirect Transfer

143. An indirect transfer structure is a lottery security in which the reporting insurance company has obtained the right to the lottery prize money by acquiring the beneficial interest in a trust, or through some other similar manner. If more than one lottery prize is transferred to a trust (or similar entity) an additional issue is raised: i.e., would the indirect transfer be considered a transfer of the lottery prize money that must be ordered by a court. To address this issue, the insurer shall submit the documents required by one of the following options.

- A certified copy of the court order that authorizes the transfer of the lottery prize money from the trust to the insurer, and a written acknowledgement by the state lottery authority that it has received a copy of the court order and that it will cause the lottery prize money to be paid (and, if applicable, that it will instruct and require the issuer of the annuity responsible for making the lottery prize money payments to pay and deliver the lottery prize money) directly to the trust, in accordance with the court order; or
- An unqualified opinion of counsel to the effect that although state lottery law requires a court order to effect a transfer of the right to receive lottery prize money, the transfer of a beneficial interest in a trust is not the transfer of the lottery prize money under state lottery law and thus no approval, consent or authorization of a governmental or administrative authority is required in connection with the transfer of the beneficial interest in the trust; or
    - An opinion of counsel expressing a qualified opinion that the transfer of the beneficial interest in a trust should not be construed as a transfer of lottery prize money requiring a court order which may be qualified with respect to the lack of case law or legislative history to support this view or by the observation that counsel is unaware that the state lottery authority would concur with this reasoning; and
    - A written acknowledgement by the state lottery authority to the effect that the indirect transfer (for example, via a transfer of the beneficial interest in a trust) is not the transfer of the lottery prize and does not require a court order; or

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- A copy of the state lottery authority's policy statement that it will irrevocably cause the lottery prize money to be paid (and, if applicable, that it will instruct and require the issuer of the annuity responsible for making the lottery prize money payments to pay and deliver the lottery prize money) to the trust despite the lack of court order.

Limited Discretion for Certain Indirect Transfers

144. An insurer reporting an indirect transfer lottery security arrangement that cannot obtain the documents set forth in (b)(i), (ii), (iii) or (iv), may submit the transaction to the SVO with a qualified opinion of counsel, as set forth in (b)(iii)(a) above. In that case, the SVO may process the transaction but it shall be limited in its discretion to assigning an NAIC Designation one category lower than the Designation the transaction would have received based on the credit strength of the state or of the lottery authority.

Structured Lottery Securities

145. If more than one lottery prize is transferred to a trust (or similar entity), the security created thereby is considered to be a structured lottery security. The issues and criteria described above are applicable to structured lottery securities. However securitizations introduce other structural considerations. The insurer is urged to contact the SVO.

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POWER GENERATION PROJECTS

146. Documentation Requirements

- **Independent Engineer Report** - A typical report format identifies the contractor who will construct the Project, experience, and the contract type: i.e. fixed cost turnkey. Describes the equipment to be used to construct the Project, provides an assessment of its expected life and identifies and explains applicable warranties. Discusses anticipated completion date and contingencies or ramifications if the completion date is not met. Projects financed after construction is completed will not need to include such construction discussions in the Independent Engineer Report. The report should identify uses of construction funds and any construction budget contingency available. Provides data and a study of Resource Risk including where the geography and time period over which the information was obtained. Often provides an analysis of the Off-Take Arrangement. Provides an analysis of projected cash flows based on Resource Risk and any applicable degradation or curtailment projections.
- **Off-Take Arrangement or Power Purchase Agreement** – Identifies the Buyer and the terms under which the Project's dedicated capacity, generated electricity, ancillary services, and/or environmental attributes will be sold; identifies pricing (including escalation clauses); permitted degradation; allowances for scheduled and unscheduled outages; financial penalties imposed under the contract for generation below required levels and identifies required reserves and the amount of such reserves.
    - *Please refer to the Audited Financial Statement standards applicable to an off-taker not rated by an NAIC CRP.*
- **Information Memorandum** – This can be in the form of a Private Placement Memorandum, a Confidential Information Memorandum or a Detailed Internal Report. The Information Memorandum should include: a Project description (site), parties and background information on the equipment supplier(s) and contractor, the transaction and the economic rationale of the Project; a description of the sources and uses of funds; cash flow projections covering the term of the debt, including base case and stress case scenarios; a discussion of available reserve accounts such as debt service, operating and maintenance and decommissioning, as applicable; a description of the legal agreements including security and covenants and a description of the Off-Take Arrangement.
- **Legal Agreements** – The package of legal agreements identifies the terms of the security and collateral package; and provides an opinion whether investors have a perfected security interest and lien on the collateral; indicates the maturity date of the debt incurred in the Project Financing and includes sufficiently detailed Scheduled and Targeted Amortization schedules as well as the requirement for any Cash Sweep (as applicable); identifies the reserves that have been established and confirms that such

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reserves are pledged as part of the collateral package to bondholders; provides for a cash flow Waterfall to ensure items of cash flow such as revenue, expenses, tax, debt service and distributions occur in the specified priority; and includes the affirmative and negative covenants (such as restricted payments tests and limitations on the incurrence of additional indebtedness) applicable to the Project; identifies events of default, cross-default to the issuer's other debt, if applicable, and remedies upon the occurrence of an event of default.

- **Depositary Agreement** – The contractual agreement between the Project company, the lenders, and a third-party trustee, which governs the collection and application of cash flow proceeds from the Project.

147. **Definitions**

- **Cash Flow Available for Debt Service (CFADS)** is defined as cash flow from operations in any given period (cash revenue minus cash operating expenses) less major maintenance capital expenditures. Major maintenance expenditures are those the Project needs to make to operate the plant in good order for the life of the transaction, including expenditures related to a Forced Outage. Excluded from major maintenance capital expenditures are any extraordinary or discretionary capital expenditures that are not required to keep the plant in good working order.

- **Cash Sweep** refers to principal amortization that occurs at specified intervals based on excess cash (or a portion thereof) after completing certain steps in the Project's Depositary Agreement Waterfall. Cash Sweep mechanisms are often utilized in order to reduce leverage with excess cash available, and can be utilized to reduce refinancing risk in certain Financing Structures. Failure to make a Cash Sweep payment does not typically trigger a payment default, but might result in a prohibition on distributions to the parent or sponsor.

- **Depositary Agreement** refers to the contractual agreement between the Project company, the lenders, and a third-party trustee, which governs the collection and application of cash flow proceeds from the Project. The Depositary Agreement includes provisions for reserve accounts that support specific Project liquidity needs, certain future Project liabilities, and/or backstop debt service.

- **DSCR** stands for debt service coverage ratio and is defined as Cash Flow Available for Debt Service (CFADS), divided by the scheduled interest and principal payments as measured during any given period (measured on a twelve month rolling basis) and seeks to show the cash flow cushion available to meet the Project's ongoing debt amortization obligations given the intrinsic cash flow generation ability of the Project. The scheduled interest and principal payments are defined in the project's bond indenture or loan agreement during a specified period.

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- **EPC** means Engineering, Procurement and Construction and refers to a contract under which a contractor agrees to design and construct a project on a specified timeline and in accordance with specified performance requirements.
- **Financing Structure** means the specific form of the financing plan describing the type(s) of debt used to capitalize the Project entity, the position of the debt relative to the asset and other participants in the capital structure, terms of repayment, contractual obligations, and protections incorporated in the financing (such as guarantees, security, pledges, reserve accounts, restrictive covenants, etc.).
- **Fully Amortizing** means that the Project's debt is fully repaid during the term of such debt through cash flow from operations.
- **Fully Contracted** means that the Project (as Seller) has entered into an agreement with a utility or other purchaser of electricity (as Buyer) to sell all of the electricity it will produce in an Off-Take Arrangement or PPA pursuant to which the Buyer agrees to buy the capacity, electricity, ancillary services, tax credits, and or environmental attributes/credits generated by the Project.
- **Forced Outage** means the net capability of the Project's main electricity generating units that are unavailable for load for emergency reasons.
- **Generation** means the process of producing electric energy by transforming other forms of energy; also, the amount of electric energy produced, expressed in kilowatt hours.
- **Heat Content** means the amount of heat energy available to be released by the transformation or use of a specified physical unit of an energy form (e.g., a ton of coal, a barrel of oil, a kilowatt-hour of electricity, a cubic foot of natural gas, or a pound of steam). The amount of heat energy is commonly expressed in British thermal units (Btu). Note: Heat content of combustible energy forms can be expressed in terms of either gross heat content (higher or upper heating value) or net heat content (lower heating value), depending upon whether or not the available heat energy includes or excludes the energy used to vaporize water (contained in the original energy form or created during the combustion process). The Energy Information Administration typically uses gross heat content values.
- **Hedging Contracts** - Contracts where a counterparty agrees to purchase a specified quantity of future electric generation (or ancillary services) at fixed prices independent of the real-time spot market prices. These contracts are typically financially settled with the power plant selling its generation into the spot market and paying/receiving the difference between the hedged price and the actual spot market price to/from the counterparty. In the electric power market, these hedges are typically structured as a heat rate call option or revenue put. Interest rate hedges provide for the conversion of floating interest rates to fixed rates. Derivatives may be used for this purpose.

- **Implied Heat Rate** - A calculation of the day-ahead electric price divided by the day-ahead natural gas price. Implied heat rate is also known as the 'break-even natural gas market heat rate,' because only a natural gas generator with an operating heat rate (measure of unit efficiency) below the implied heat rate value can make money by burning natural gas to generate power. Natural gas plants with a higher operating heat rate cannot make money at the prevailing electricity and natural gas prices.
- **Merchant Pricing** means the price of electricity agreed to between a buyer and seller set in an open market on the basis of supply and demand.
- **Off-Taker** means the purchaser of the Project company's electricity under an Off-Take Arrangement or a PPA.
- **Off-Take Arrangement** means an agreement under which the Project company enters into an agreement with the Off-Taker to provide a specified quantity of electric generation, available capacity, ancillary services and or environmental attributes and the Off-Taker is typically obligated to pay for that product whether or not it accepts the product; provided the Project company has the current capacity to produce it.
- **O&M** means operation and maintenance expenses and refers to the costs related to the normal operating, maintenance and administrative activities of the Project.
- **Partially Amortizing** – A debt amortization profile that includes a balloon payment at the end of the debt term. This structure typically relies on refinancing or an equity contribution to repay the balloon amount.
- **Partially Contracted** – A Project that has entered into a PPA or Off-Take Arrangement for less than the plant's full generating capacity.
- **Power Generation Project** (Project) refers to a power plant that generates and sells electricity within a special purpose entity, using a specified Technology and Fuel Source.
- **Power Purchaser** means the buyer of electric generation, capacity, ancillary services, and/or environmental attributes from the Project company.
- **Power Purchase Agreement** (PPA) means an agreement in which the Power Purchaser agrees to purchase all or up to a specified quantity of electric generation, capacity, ancillary services, and/or environmental attributes produced by the Project company.
- **Project Financing** means the issuance of debt by a special purpose entity on a non-recourse basis – whereby the debt incurred to construct or acquire the Project is repaid from the cash flow from operations of the Project company, typically pursuant to an Off Take Arrangement or in a PPA, rather than relying on the equity Sponsor.
- **Renewable Energy Power Generation Project** means a Project Generation Project whose Technology is based on the capture of energy from on-going natural processes,

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such as sunshine, wind, wave power, flowing water, biological processes such as anaerobic digestion and geothermal heat flow.

- **Resource Risk** refers to the inherent variability and uncertainty in projected solar irradiation and wind speeds using data gathered from the project site that is then correlated to a longer historical meteorological data set to produce a long-term resource projection for the Project.
- **Scheduled Outage** refers to planned downtime during which a plant is unavailable to operate. Scheduled Outages are typically planned in advance and communicated with the RTO/ISO and/or the Off Taker.
- **Scheduled Principal** payments are the principal amortization amounts required to be paid, pursuant to a schedule included either in the Note Purchase Agreement, Credit Agreement, or the form of Note. Scheduled Principal is distinguished from Targeted Principal payments and Cash Sweep principal payments by the fact that failure to make a Scheduled Principal payment would result in a payment default.
- **Solar Power Generation Project** is a Renewable Energy Power Generation Project based on a technology that converts heat energy into electricity using mechanical processes (solar thermal) for example, by concentrating solar radiation to create steam or that converts sun light directly into electricity based on semiconductor technology (photovoltaic or PV solar).
- **Targeted Principal** payments are principal amortization amounts that are paid if and to the extent that cash is available at that point of the Waterfall according to the priority of payments in the Depositary Agreement. Failure to make a Targeted Principal payment does not result in a payment default. Satisfaction of Targeted Principal payments may be a condition to permitting distributions to the parent or sponsor. Financing Structures with debt tranches that utilize Targeted Principal payments are often intended to address the inherent period to period variability in renewable resources (such as solar or wind) by allowing the Project to amortize principal during periods of strong resource without penalizing or straining Project cash flow during periods of weaker resource.
- **Technology and Fuel Sources** refers to the technology on which a power plant will be based and the mechanical process or fuel to be used to generate electricity – which may involve any one of the following: gas-fired, coal, hydroelectric, nuclear, bio-mass, renewable or other.
- **Waterfall** describes the order and priority of payments that may (or must) be made according to the Depositary Agreement or other Project document.
- **Wind Power Generation Project** is a Renewable Energy Power Generation Project that utilizes one or more wind turbine generators (WTGs) that harness the energy generated by wind and convert it to electricity.

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Economic Dynamic of Power Generation Projects

148. The methodology discussed in Section 7 and more particularly in sub-section (c) below, applies to non-recourse power generation projects. A typical non-recourse power generation project relies on one or a small number of assets to generate all of the project's revenue and operating margin over the life of the asset(s). In some instances, the project's collateral may consist of only a single asset and an assignment of rights under an offtake agreement. In order to properly assess the credit quality of these Project Financings, a number of factors must be considered, with the strengths and relative weaknesses weighed against one another in an organized and holistic manner.

General Methodology for Power Generation Project Finance Transactions

149. Assessment of a project incorporates an evaluation of the analytical constructs described in this sub-section (c). The conclusions drawn from each analytical constructs are then organized by reference to the factors shown in the Credit Factor Chart in sub-section (d) below applied in conjunction with the Principles Guiding the Use of the Credit Factor Chart to reflect the unique structural elements in each transaction.

- Cash Flows – Analysis of the Project's cash flow during the debt term (and beyond, as applicable) to assess its composition and predictability.
- Competitive Position of the Project Asset and its PPA/Off-take Arrangement – An assessment of the Project asset within the context of the marketplace and regulatory environment and an analysis of the PPA or Off-take Arrangement relative to the power market in its region and regulatory considerations.
- Operating and Technical Risks –Assessment of the Project's technology and operating risks.
- Financial Metrics – Analysis of the Project's key financial metrics The primary metric for a Project Financing Structure that is fully contracted and fully amortizing is DSCR. Financial metrics are evaluated against peers with similar characteristics, debt service obligations and leverage. The NPV of projected cash flow compared to total debt is another key metric used in this analysis. Additional considerations that could strengthen or weaken the above core analysis include:
  - Liquidity/Reserve Accounts
  - Structure
  - Refinancing Risk
  - Structural Subordination
  - Construction Exposure

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TOOLS AND CONCEPTS USED IN THE APPLICATION OF THE GENERAL METHODOLOGY FOR POWER GENERATION PROJECT

Credit Factor Chart

150. The following Credit Factor Chart is intended as a tool to organize the primary analytical considerations derived from the application of the methodology discussed in sub-section (c) above to the most important factors in determining the credit quality of a transaction. Given the highly specialized nature of this asset class, the baseline assumption is that there will be unique structural elements in each transaction that reflect the specific facts and circumstances of that credit. Accordingly, judgment is required in the application of the Credit Factor Chart to specific transactions. For each Credit Factor there is a recommended range for weighting to reflect that risk can vary significantly among projects.

Credit Factor	Subcategory	Weight Range	Project Risk Score Descriptions		
			Weak	Average	Strong
Construction	Construction	0%-40%	Contractor with little relevant experience or weak reputation; floating contract; aggressive budget and schedule; difficult construction process and/or complexity	Contractor with some relevant experience; fixed rate contract; reasonable budget and schedule; reasonable construction complexity	Contractor with significant experience and strong financial position; fixed rate contract with financial incentives and penalties; reasonable budget and schedule; simple construction
Operations & Technology	Operator	5%-10%	Operator with little relevant experience; irreplaceable operator; compensation is not performance based	Operator with some relevant experience; operator can be replaced; compensation is based on performance	Operator with significant experience; operator can be replaced; compensation is based on results with LDs for underperformance
	Technology	10%-20%	Unproven technology with limited performance history	Proven technology with some performance history, or newer technology with appropriate equipment warranties backstopping performance guarantees	Proven technology with significant performance history
	Operations & Maintenance (O&M)	10%-15%	O&M is managed by the project and funded from cash flow from operations	O&M is managed by the project or third party and expenses are smoothed/backstopped by reserve accounts and/or equipment warranties. Adequate sensitivity modeling for higher than projected O&M expenses.	O&M is managed by a reputable third party through a long-term service agreement with fixed pricing
	Resource/Fuel Assessment	5%-20%	Fuel is purchased on the open market; resource assessment lacks on-site historical reference data	Firm fuel transportation and supply; resource assessment is acceptable and based on some on-site historical data, correlated to a reference station with a longer data set	Fuel is purchased through a long-term agreement with fixed pricing and firm transportation or is subject to a tolling agreement with the power purchaser; resource assessment is high-quality and based on significant historical data or meaningful historical operating data is present in lieu of a new resource assessment
Counterparty Credit Profile & Competitive Position	Creditworthiness of Counterparty	10 - 25%	Weak counterparties; aggressive contractual terms, high probability of default or termination	Creditworthy counterparties; reasonable contractual terms, and achievable performance standards	Counterparties whose creditworthiness is rated above the project's; favorable contractual terms
	Competitive	5%-	All of the Project's generation will be	Partial merchant exposure with some hedging or	Generation is sold under a long term power purchase agreement

Credit Factor	Subcategory	Weight	Project Risk Score Descriptions		
	Position	15%	sold into merchant market	some PPA offtake to mitigate price fluctuations	or hedge arrangement
Transaction Structure	Transaction Structure	10% - 20%	Acceptable legal structure/separation provisions; no distribution tests; refinancing risk; cross-default provisions with other debt; weak depositary terms/cash control/liquidity	Strong bankruptcy remoteness and legal separation provisions; limited refinancing risk; historical look-back distribution tests; appropriate depositary arrangement and average reserve account/liquidity protection	Strong bankruptcy remoteness and legal separation provisions; strong look-back and look-forward distribution tests; no refinancing risk; strong depositary terms, excellent liquidity protection with appropriate reserve accounts

PRINCIPLES GUIDING THE USE OF THE CREDIT FACTOR CHART

Credit Factors:

152. Construction: Projects are often financed for a long-term period, with the private placement debt coming in before, during, or after construction. Accordingly, if the debt is funding before or during construction, an analysis of the construction exposure and its potential impact on the financing must be completed. The assessment of construction risk is intended to facilitate the assignment of a long-term rating for the project from the first date of the financing, assuming steady state operations, that is unaffected by the presence of a typical construction scenario with a properly structured Engineering, Procurement and Construction (EPC) arrangement. Accordingly, the analysis of construction risk exposure is meant to capture outsized risk exposures that have a high probability of causing a meaningful delay in achievement of commercial operations, materially increasing costs, or delaying/impairing the project's ability to service debt.

This analysis should address the likelihood of the project's construction being completed on time, on budget (or within contingency), and within the expected operating performance parameters. In addition to the likelihood of a smooth construction process, the contractual structure of the EPC arrangement should be assessed to determine the adequacy of remedies and mechanisms in the EPC Agreement to address potential delays, disputes, cost overruns, and operational deficiencies. A fixed-price EPC Contract with a reputable construction company that includes mechanisms (such as bonuses and liquidated damages) to align the parties' incentives to complete the Project on time, within operational specifications, and within budget would be expected to score as a Strong in the risk factor scoring for this category. Unqualified contractors, unrealistic construction budgets, or unachievable timelines (if not addressed by structural enhancements to the EPC Contract) could merit a Weak score. Escrow accounts and letters of credit may be used to help ensure performance under the EPC Contract where a guarantee from the construction company's parent is deemed insufficient/lacking creditworthiness to backstop the contractor's obligations. An

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independent engineer would typically assess the quality of the contract, the pricing, adequacy of contingency, and the ability of the contractor to complete the scope of work in the timeline expected.

Special considerations unique to renewable projects: Wind and solar projects are generally considered to have lower risk construction processes than conventional power plants due to the modular nature of the equipment involved and the shorter timeline required to complete construction and commissioning activities. Both solar and wind projects are typically commissioned in stages, allowing the project to begin earning revenue prior to Commercial Operation Date (COD), which can help to offset exposure to construction delays if they arise in the final stages of commissioning. The level of complexity in the construction activities for a photovoltaic (PV) solar project is typically considered to be low due to minimal moving parts and the modular nature of the plant assembly.

153. Operational & Technology: Assessment of a project's Operational & Technology profile is intended to determine the level of exposure to these challenges that could impact both revenue and expenses. These risks are assessed through four primary sub-categories: operator, technology, O&M expense profile, and resource/fuel assessment. Typical investment grade projects will utilize commercially proven technology, a sophisticated operator, a carefully planned operating and capital expense projection, and an appropriate fuel arrangement that avoids financial penalties for fuel supply/transportation constraints and exposure to fuel costs that aren't passed through to the Off-taker. Comprehensive property damage and liability insurance is expected to be in place, with business interruption coverage that compensates that project for force majeure disruptions in operations.

Special considerations unique to renewable projects: For renewable projects, a professional resource assessment by an experienced third party engineering firm will typically be completed prior to construction of a Project, with appropriate sensitivities and adjustments for the particular geography, climate, and details of the project site and equipment being used. Wind speeds or solar insolation data gathered on site for a meaningful period of time in advance of the start of construction is preferable. The debt sizing should account for downside resource scenarios as well as the mean projected resource. Operational projects that have meaningful resource and generation data from historical operations may rely on actual historical data points in base and stress cases if the actual operating history is determined to be a better predictor for future performance than the original resource assessment.

Counterparty Exposure and Competitive Position

154. Counterparty Exposure - In instances where the project's cash flow stream is dependent upon payment or other performance by a counterparty, the credit quality of that entity should be assessed. The primary counterparty of concern in a typical power project financing is the Off-taker or hedge counterparty for the sale of the project's generated power. The credit rating of the Off-taker/hedge counterparty typically serves as the ceiling for the

project's credit quality due to reliance on the counterparty for cash flow to service the debt financing. The power purchase agreement or hedge does not need to cover all of a power project's generation in order for the project to qualify for an investment grade quality conclusion or a strong assessment in this category, but the debt sizing should be appropriate for the level of contracted cash flows under the Offtake arrangement, with limited or no reliance on the merchant cash flow to service debt. Please refer to for Audited Financial Statement standards applicable to an off-taker not rated by an NAIC CRP.

Letters of credit, guarantees, and other security posted in support of a lower credit quality counterparty's obligations should be taken into account, as the security could be sufficient to ensure performance throughout the contract. If the project must provide a pari passu lien to the hedge provider to secure the project's obligations under the hedge, the potential detriment to the senior lenders caused by sharing this security interest should be evaluated relative to the debt amount and value of the project's long term cash flows under scenarios where the hedge is out of the money. Capped liens in such situations are typically preferred.

Off-take agreements should be assessed to identify risks to the project's cash flow due to the project failing to meet specified performance standards, uncompensated curtailment, and any clauses that could allow the Off-taker to reduce payments or terminate the agreement due to future regulatory/market changes. In some instances, the market alternatives to a counterparty, and the ease with which such counterparty could be replaced, should be evaluated.

155. Competitive Position - Fully contracted projects with power purchase agreements or hedge arrangements under market terms should generally be considered to have a strong competitive position. In situations where the contractual price of the power being sold under the offtake agreement materially exceeds prevailing spot and forward market prices in the region, the Offtaker's motivation for entering into the agreement (and ability to pass the cost of such agreement on to its ratepayers/customers) should be considered. State renewable portfolio standards, federal environmental legislation, the current political climate, federal/state energy policy and regulations, and regional supply/demand fundamentals may support the viability/defensibility of above market offtake agreements. If the viability of an off-take arrangement is in question, it might be appropriate to consider the project's ability to service debt if it were to sell power (and any applicable ancillary services) under current and forward market rates.

Projects that are fully exposed to merchant pricing are likely to be considered to have a weak competitive position unless a particular heat rate or cost advantage that results in superior cash flow relative to other market participants can be proven.

156. Structure - A typical power project financing is structured as a non-recourse, standalone entity that is neither reliant on its parent, nor impacted by its parent's credit profile. While

the ultimate structure of the transaction can take different forms (including leases), several components are needed in order for the project to be considered separate from its parent(s):

- The project entity is a limited or special-purpose entity (solely engaged in the generation, distribution, voltage regulation, and/or transmission of electricity).
- The debt investors have a security interest in the assets, accounts, and equity of the project. The debt investors have an assignment of key contracts/agreements.
- The project is contractually entitled to the cash flow stream that services the debt.

Additionally, a typical project structure includes the following:

- The Project's funds are segregated from the parent/sponsor, and a third-party trustee administers the movement of cash flow, in accordance with a Waterfall.
- Distributions to the parent/sponsor are allowed only when certain criteria and DSCRs are met.
- Standard affirmative and negative covenants requiring regular operational and financial reporting, restricting the sale of assets, prohibiting/restricting the incurrence of additional liens/indebtedness, limiting modifications to and cancellation of material project agreements, restricting acquisitions or changes in line of business, and other standard project finance covenants.

157. The assessment of strong, average, or weak for the Project's structure is dependent upon the strength of the above terms, and how they have been crafted to address the Project's specific attributes/risk profile.

158. Financial structures that should be evaluated further to determine whether their structure merits a designation of average or weak include:

- Refinancing Risk – Projects with partial or a back-ended amortization during the debt term should present downside scenarios to show the most likely level of debt outstanding at maturity that will be refinanced, and the likelihood that a refinancing would be accepted by the marketplace based on the cash flow post-maturity, contract structure post-maturity, and the expected asset value at the time of refinancing. The life of the asset (compared to its expected useful life), debt/kW of capacity, and current mergers & acquisitions (M&A) values for similar assets on a transaction price per kW basis should be used to evaluate the viability of a refinancing. A Project with a fully amortizing structure (with otherwise strong structural elements) will be considered stronger than a partially amortizing structure.
- Structural Subordination – In Projects where the debt is at a holding company and there is a significant degree of project or subsidiary level debt (or tax equity) that needs to be serviced prior to cash being available to service the debt of the rated issuer.

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159. The ability of the Project to withstand revenue disruptions due to unscheduled Forced Outages and other events is assessed. The assessment factors include the existence and amounts of debt service reserves, major maintenance reserves, operating reserves, property damage and business interruption insurance, and committed working capital facilities. A debt service reserve of six-month is standard. The need for a major maintenance reserve may be mitigated by a long-term service agreement.

Overall Financial Risk Profile

160. After evaluating the Project's credit factors, the average debt service coverage ratio (DSCR) profile necessary to support a quality conclusion will be determined. DSCR is not the only metric used to determine the appropriate quality conclusion—in structures with multiple tranches, Cash Sweeps, Targeted Amortization, and refinancing risk, the net present value (NPV) of the remaining projected cash flow divided by the total debt amount ("NPV Ratio") is an appropriate measure of the Project's ability to service debt over the term of the financing (or post-financing, when evaluating refinancing risk). The calculation of the NPV Ratio typically uses the coupon (or weighted average interest rate) as the discount rate for the calculation. In evaluating a refinancing scenario post-maturity of the current financing, market rates (accounting for the current forward interest rate environment) can be used to approximate the appropriate coupon/discount rate.

161. Projects exhibiting an overall credit factor assessment of "weak" are not expected to fall within the highest or high quality categories due to their inherent weaknesses. Projects with unique situations that give rise to higher variability or uncertainty in cash flow, may require higher debt service coverage ratios to achieve the same quality conclusion as a comparable project without such volatility. The following table provides guidance for what ranges of DSCRs or NPV Ratios would generally indicate higher versus lower quality conclusions given different overall risk assessments from the Credit Factor Chart.

Average Debt Service Coverage or NPV of Cash Flow to Total Debt					
Overall Credit Factor Chart Risk Assessment	**Quality Conclusion**				
	Investment Grade		**Speculative Grade**		
	Highest	**High**	**Medium**	**Low**	**Lowest**
Weak	N/A	N/A	1.30-2.00x	1.20-1.50x	1.10-1.35x
Average	1.75-3.25x	1.30-2.00x	1.20-1.50x	1.10-1.35x	1.00-1.25x
Strong	1.50-3.00x	1.20-1.75x	1.10-1.35x	1.00-1.25x	1.00-1.15x

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ADDITIONAL METHODOLOGICAL CONSIDERATIONS FOR RENEWABLE ENERGY PROJECTS

Additional Considerations Applicable to Solar Power Generation Projects

162. Assessment of Solar Power Generation Projects is conducted on the basis of the general methodology described above but is subject to the additional considerations that follow.

- Regulatory Incentives – The electrical output of Solar Power Generation utilizing photovoltaic technology can be expensive relative to the cost of the output of thermal combined cycle gas turbines or coal-fired plants depending on the regional market that the project is operating in and time of day that the power is being delivered. This often means the viability of individual projects depends on regulatory incentive, subsidy or support. When such support exists, the form of the support; its predictability; the general level of political support for renewable energy and the fit with the energy policy and framework are evaluated.
- Structural Risk – If the form of incentive, subsidy or support imposes time lines for project completion as a condition, the ability to meet the timelines and the potential loss of the incentive, subsidy or support on the viability of the Project should be considered.
- Technology Risk - Technology risk is defined by reference to the potential for serial defects that can cause panel yields to be below specification or make yields degrade more quickly than originally assumed. The presence of warranties and insurance products supporting the Project's panel technology, as well as decreasing future panel replacement costs should be considered as potential risk mitigants.
- Resource Risk - The volume of electricity produced by a PV solar power plant depends on the period to period variability of solar irradiation. The expected volume of irradiation over a given time is contained in forecasts provided by reputable and experienced consultants prior to the commencement of commercial operations, expressed as a probability distribution function. The project's ongoing ability to service debt is assessed by using both the P50 and the P90 forecast to calculate base case and downside financial ratio scenarios. Operational projects that have meaningful insolation and generation data from historical operations may rely on actual historical data points in base and stress cases if the actual operating history is determined to be a better predictor for future performance than the original resource assessment.

Additional Considerations Applicable to Wind Power Generation Projects

163. Assessment of Wind Power Generation Projects is conducted on the basis of the general methodology described in Section 7 (b) of this Section above, but is subject to the additional considerations that follow.

- Regulatory Incentives – The cost of electrical output from Wind Power Generation is typically competitive with the cost of the output of thermal combined cycle gas turbines or coal-fired plants depending on the regional market that the project is operating in and

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time of day that the power is being delivered. Some projects, however, rely on a regulatory incentive, subsidy or support. When such support exists, the form of the support; its predictability; the general level of political support for renewable energy and the fit with the energy policy and framework are evaluated.

- Structural Risk – If the form of incentive, subsidy or support imposes time lines for project completion as a condition, the ability to meet the timelines and the potential loss of the incentive, subsidy or support on the viability of the Project should be considered.
- Technology Risk - Technology risk is defined by reference to the potential for serial defects that can cause lower than projected availability and/or higher than projected operating expenses. The presence of warranties and insurance products supporting the Project's turbine technology, carefully considered O&M projections, as well as the level of deployment of the turbine model/similar technology, and availability of spare parts (OEM and/or aftermarket) are factors that can balance this risk.
- Resource Risk - The volume of electricity produced by a wind power plant is impacted by the period to period variability of the wind resource. The wind resource forecast is provided by reputable and experienced consultants prior to the commencement of commercial operations, expressed as in a probability distribution function. The project's ongoing ability to service debt is typically assessed by using both the P75 and the P90 forecast to calculate base case and downside financial ratio scenarios. (Different base or downside scenarios may be used in certain instances if the circumstances of a project or the presence of a unique risk exposure merits a different projection scenario.) Projects that have meaningful wind speed and generation data from historical operations may rely on actual historical data points in base and stress cases if the actual operating history is determined to be a better predictor for future performance than the original resource assessment.

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PRINCIPLES GUIDING THE USE OF THE CREDIT FACTOR CHART - SPECIAL CONSIDERATIONS UNIQUE TO RENEWABLE PROJECTS

Credit Factors

164. Construction: Wind and solar projects are considered to have lower risk construction processes than conventional power plants due to the modular nature of the equipment involved and the shorter timeline required to complete construction and commissioning activities. Both solar and wind projects are typically commissioned in stages, allowing the project to begin earning revenue prior to Commercial Operation Date (COD), which can help to offset exposure to construction delays if they arise in the final stages of commissioning. The level of complexity in the construction activities for a photovoltaic (PV) solar project is typically considered to be low due to minimal moving parts and the modular nature of the plant assembly.

165. Operational & Technology*: Assessment* - For renewable projects, a professional resource assessment by an experienced third party engineering firm will typically be completed prior to construction of a Project, with appropriate sensitivities and adjustments for the particular geography, climate, and details of the project site and equipment being used. Wind speeds or solar insolation data gathered on site for a meaningful period of time in advance of the start of construction is preferable. The debt sizing should account for downside resource scenarios as well as the mean projected resource. Projects that have meaningful resource and operational data from historical operations may rely on actual historical data points in projection scenarios if the actual operating history is determined to be a better predictor for future performance than the original resource assessment.

166. Special Considerations for Renewable Projects: Projects should be evaluated using both the financing case (typically P75 for wind or P50 for solar, unless pre-financing actual results differ materially and necessitate the usage of a different probability of exceedance as the baseline projection) and a stress case (typically P90 unless unique circumstances of a Project's risk profile or its historical performance merit the use of a different scenario) to determine which designation is most appropriate.

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CATASTROPHE-LINKED SECURITIES

Definition

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

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

Filing Exemption Status

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

Procedure for Other Catastrophe-Linked Bonds

169. Catastrophe-Linked Bonds that have not been assigned a credit rating by an NAIC CRP and those that have been assigned a credit rating by an NAIC CRP based on the use of a methodology other than that specified above are subject to the Special Reporting Instructions.

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FOREIGN SOVEREIGN GOVERNMENT AND SUPRANATIONAL ENTITIES

170. A reporting insurance company that owns a security issued by a foreign sovereign government, an agency or political subdivision of a foreign sovereign government or a supranational entity (entities with more than one sovereign government as a member), or that is guaranteed directly or indirectly by such an entity, must file such security with the SVO accompanied by a prospectus, investment committee memorandum and proof of rating from an NAIC CRP unless it is filing exempt.

171. Insurance companies shall not file issues with the SVO if the issuer does not have a sovereign rating from an NAIC CRP. If the issuer is not rated by an NAIC CRP, proof of a guarantee from an NAIC CRP-rated foreign sovereign government may be submitted. Where a reporting insurance company has filed a foreign security accompanied by an Audited Financial Statement, in English, the SVO will assess the security in accordance with the applicable corporate methodology, but the NAIC Designation it may assign shall be limited by the sovereign rating of the issuer's country of origin. This section should not be read as prohibiting the presentation of transactions structured to eliminate foreign sovereign risk.

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MILITARY HOUSING BONDS OR SECURITIES

INITIAL FILING REQUIREMENTS

172. Military housing bonds or Securities are defined below. The reader is urged to familiarize himself with that Section before filing a security with the SVO. An insurance company requesting an analysis of a military housing bond or security shall provide the SVO with the documentation described in this subparagraph.

Analytical Memorandum

173. A detailed analytical memorandum containing a complete analysis of the transaction in the following form:

- Name of Project
- Identification of risk assessment on key issues
- Transaction Summary and Structure Overview
- Project Summary
- Debt Issuance
- Participants and Issuance Details
- Bonds Outstanding and Sources and Uses at Close
- Scope Plan
- Any Modifications including New Sources and Uses Based on Modified Scope Plan
- Other Deal Provisions
- Accounts and Reserves
- Key Waterfall Provisions
- Base Overview
- Developer Overview
- Basic Allowance for Housing (BAH) and DSCR Performance
- BAH Rates and BAH Rate Growth
- Occupancy Rates
- Cumulative New and Renovated Military Housing Units
- Debt Service Coverage Ratio for last several years
- Occupancy and Construction History

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174. At a minimum the memorandum shall include a detailed analysis of the following key risk factors:

- Stabilized/Permanent Debt Service Coverage
- Stabilized/Permanent Occupancy
- Developer Opinion
- Political (BRAC) Opinion
- Expense Ratio (if applicable)
- Overall Credit Opinion

Certification from Insurer Investment Officer

175. The insurance company shall also file with the SVO a certification in such form as the SVO shall determine and provide. The certification form shall require an investment officer of the insurance company to attest to the truth and accuracy of the facts and conclusions reached in the memorandum.

Prospectus

176. A final and current prospectus or offering memorandum for project and bonds or securities.

Audited Financial Statements

177. The most recent audited financial statements for the project or issuer.

SUBSEQUENT FILING REQUIREMENTS

Analytical Memorandum

178. A detailed revised or updated analytical memorandum containing a complete analysis of the transaction discussing, at a minimum, the following key risk factors:

- Stabilized/Permanent Debt Service Coverage
- Stabilized/Permanent Occupancy
- Developer Opinion
- Political (BRAC) Opinion
- Expense Ratio (if applicable)
- Overall Credit Opinion

Certification from Insurer Investment Officer

179. An updated certification.

Audited Financial Statements

180. The most recent Audited Financial Statements for the issuer.

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PREFERRED STOCK

DIRECTIVE - VALUATION INDICATORS

181. Insurance companies classify preferred stock as either perpetual or redeemable. A preferred stock is perpetual when the issuer of the preferred stock is not obligated to redeem the issue, the holder of the preferred stock does not have a right to put the preferred stock to the issuer or that there is no other equivalent right. A preferred stock is redeemable when the issuer of the preferred stock is obligated to redeem the issue, the holder of the preferred stock has a right to put the preferred stock to the issuer or that there is some other equivalent right.

Please see *SSAP No. 32—Preferred Stock*.

General Procedure for Credit Assessment and Classification of Preferred Stock

182. The following provisions apply to all preferred stock subject to notching to reflect its position in the issuer's capital structure.

PREFERRED STOCK NOT RATED BY AN NAIC CRP

Determining an NAIC Designation

183. The analyst shall first ascertain the senior unsecured debt rating of the issuer by applying the general credit assessment procedure for corporate bonds specified. Once the issuer's senior unsecured NAIC Designation has been established, the analyst will adjust the associated NAIC Designation to reflect:

- The position of the preferred stock in the capital structure of the issuer;
- A determination that the debt level in the issuer's capital structure would, or would not impede the ability of the issuer to pay interest or dividends to the preferred stock holder, and whether earnings are likely to be sufficient to pay such interest or dividends (whether or not the issuer is contractually obligated to make such payments); and
- Whether all preferred dividends have been paid or sinking fund requirements have been met for the last three years. If not, the analyst shall not assign an **NAIC 1, 2** or **3** Designation to the preferred stock.

184. Once these adjustments have been considered, the analyst shall then determine and assign the most appropriate NAIC Designation to the preferred stock.

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PREFERRED STOCK RATED BY AN NAIC CRP

Determining an NAIC Designation

185. **Rated Preferred Issue** - If the preferred stock is rated by an NAIC CRP, the SVO shall note the equivalent NAIC Designation for the issue and then apply the instructions outlined above. If necessary, the analyst shall adjust the NAIC Designation equivalent to the NAIC CRP rating as is appropriate. If no adjustment is deemed necessary to the NAIC Designation equivalent to the NAIC CRP rating, the analyst shall assign the NAIC Designation equivalent to the NAIC CRP rating to the preferred stock.

186. **Issuer Rated, Preferred Issue Not Rated** - The analyst may determine the issuer's senior unsecured designation by converting the rating assigned by the NAIC CRP to the issuer's outstanding debt into an equivalent NAIC Designation. Once the senior unsecured designation level has been established, the analyst may adjust the NAIC Designation associated with the issuer's senior unsecured designation level to the unrated preferred stock. The analyst then determines the most appropriate NAIC Designation and applies the NAIC Designation to the preferred stock.

187. Issuer Rated, With Other Preferred Stock Rated - The analyst may determine an NAIC Designation for an unrated preferred by comparing the unrated preferred stock with the outstanding rated preferred stock. The analyst will make such adjustments as are necessary to account for dissimilar features in the two securities. The analyst shall then determine the most appropriate NAIC Designation and apply the NAIC Designation to the preferred stock.

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SUBSIDIARY CONTROLLED AND AFFILIATED (SCA) DEBT OR PREFERRED STOCK INVESTMENTS

Filing Instructions

188. **Common Stock** - An investment in the form of common stock issued by an insurance or non-insurance subsidiary, controlled or affiliated (SCA) entity of the reporting insurance company or an investment in the form of a preferred stock issued by an insurance subsidiary, controlled or affiliated company of the reporting insurance company is required to be filed with the NAIC Financial Regulatory Services Division in the manner and form and with the documentation provided for in the Appendix to *Statement of Statutory Accounting Principles (SSAP) No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*.

189. **Bonds** - An investment in the form of a bond issued by an insurance or noninsurance SCA entity of the reporting insurance company is filed with the SVO. To file an SCA bond investment, the reporting insurance company files a completed SAR, an Audited Financial Statement for the subsidiary, a copy of the corporate resolution authorizing the issuance of the debt, written evidence that the transaction has been approved by the state of domicile or that no such approval is necessary and, if the subsidiary is an insurance company, the subsidiary's most recent NAIC Financial Statement Blank, together with the reporting insurance company's NAIC Financial Statement Blank, internal investment committee memorandum for the investment and loan documentation appropriate to the transaction.

190. **Preferred Stock** - An investment in the form of a preferred stock issued by a noninsurance SCA entity of the reporting insurance company is filed with the SVO. To file an SCA preferred stock issued by a non-insurer, the reporting insurance company files an Audited Financial Statement for the issuer of the preferred stock, a copy of the corporate resolution authorizing the issuance of the preferred stock, written evidence that the transaction has been approved by the state of domicile or that no such approval is necessary, together with details of the terms of the preferred stock, as well as the NAIC Financial Statement Blank for the reporting insurance company.

Please see the section on preferred stock in this Part for additional analytical procedures applicable to that asset class.

Purpose

191. This section applies to credit assessment of any SCA investment in the form of a debt instrument purchased (or otherwise acquired) from an insurance or non-insurance entity (SCA debt) and preferred stock issued by an insurance or non-insurance entity (SCA preferred stock). This procedure is used to determine whether an SCA debt or SCA preferred transaction is eligible for reporting as an Investment Security pursuant to this Manual. The determination of "Investment Security" and credit assessment provided by the SVO shall not be construed to reflect assessments specific to affiliated transactions

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contained in SSAP No. 25—Affiliates and Other Related Parties. As such, an SVO assigned NAIC Designation for affiliated transactions:

- Does not reflect collectability based on independent payment ability of a parent reporting entity.
- Does not reflect whether the transaction was conducted at arm's-length.
- Does not reflect whether the transaction is considered "economic" under SSAP No. 25.

Notification Procedure

192. Prior to applying the procedures required below, the SVO shall:

- Confirm that the SCA relationship has been reported to the NAIC Financial Reporting Services Division, if required.
- If the SCA common preferred stock transaction was reported (or if not required to be reported), the SVO shall:
  - Inform the state insurance department of the reporting insurance company's state of domicile that the SCA debt or SCA preferred stock has been filed with the SVO.
  - Evaluate whether the SCA debt or SCA preferred stock transaction is circular within the meaning of that phrase as discussed in this Manual.
  - In the case of SCA preferred stock, determine the SCA preferred stock issuer's senior unsecured debt designation and obtain the appropriate designation level for the preferred stock by applying the methodology specified in this Manual.

193. Although an NAIC Designation does not provide assurances regarding arms-length or economic, if the SVO becomes aware of any information that indicates further review is warranted, the SVO shall contact the reporting entity to discuss, with subsequent notification (by the reporting entity or SVO) to the domiciliary state regulator, as needed. Pursuant to SSAP No. 25, affiliate transactions that are not arm's-length and/or economic are subject to additional accounting and reporting guidelines and each reporting entity is required to be knowledgeable about its domiciliary state regulatory requirements for approval of these transactions.

194. The following definitions / concepts are from SSAP No. 25:

- *Arm's-Length*: An arm's-length transaction is defined as a transaction in which willing parties, each being reasonably aware of all relevant facts and neither under compulsion to buy, sell, or loan, would be willing to participate.
- *Economic*: An economic transaction is defined as an arm's-length transaction which results in the transfer of the risks and rewards of ownership and represents a consummated act thereof, i.e., "permanence." The appearance of permanence is also an important criterion in assessing the economic substance of a transaction. In order for a

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transaction to have economic substance and thus warrant revenue (loss) recognition, it must appear unlikely to be reversed. An economic transaction must represent a bonafide business purpose demonstrable in measurable terms. A transaction which results in the mere inflation of surplus without any other demonstrable and measurable betterment is not an economic transaction. The statutory accounting shall follow the substance, not the form of the transaction.

Procedure for Credit Assessment of Filed SCA Transaction

195. The procedure specified in this sub-section applies to bonds and preferred stock whose terms, structure, complexity and purpose are like those in transactions between unaffiliated parties filed with the SVO so that credit risk assessment methodologies applied to transactions between unaffiliated parties can be meaningfully applied to transactions between affiliated parties.

196. A determination that a bond or a preferred stock submitted for an assessment under this Section is not like a transaction between unaffiliated parties and or that analytical methodologies applied to transactions between unaffiliated parties cannot be meaningfully applied to the filed transaction shall be in the sole discretion of the SVO.

197. An insurer apprised of the SVO's determination may request a conference call with the SVO to evaluate whether focused disclosure and documentation pertaining to the terms, structure, complexity and purpose of the transaction may enable the SVO to develop a credit assessment methodology specific to the transaction. If the insurer and the SVO agree that a transaction specific credit assessment approach can be developed, administrative details pertaining to the conduct of the assessment shall be as negotiated between the SVO and the insurer.

198. Instead of filing a transaction under this section, an insurer may choose to file an RTAS submission (discussed in this Manual) to solicit an opinion and rationale from the SVO whether or not an SCA transaction would be considered to be like those between unaffiliated entities or ask its domiciliary state regulator to consider requesting that the SVO assist the department in the determination of an NAIC Designation for the transaction under the Regulatory Transactions procedure discussed in this Manual.

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INVESTMENTS IN FUNDS

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BANK LOANS

CREDIT ENHANCED TRANSACTIONS

199. A credit enhanced transaction is one in which the application for an NAIC Designation is based on the substitution of the credit rating of another party for that of a lesser rated obligor. The credit substitution is effected through the use of contractual arrangements that bind the other party to make full and timely payment directly or indirectly to noteholders, to make such payments upon obligor default or to purchase the obligation. The promise of the obligor to make the required payments shall be represented by a guarantee, a revolving credit agreement, financial insurance policy or other credit enhancement device.

200. The staff shall focus on the extent to which the legal documents ensure that the credit strength of the support entity flows through unimpeded to the security holder. The SVO shall examine the degree to which the payment obligation of the other party assures full and timely payment of all amounts due to security holders. Factors relevant to this analysis include: irrevocability of the supporting party's obligation to pay, the effect of debtor insolvency on payments made by the debtor and/or the other party to the insurance company lender and the other party's credit rating. The analyst may review corporate resolutions of the issuer, the guarantee or other agreements binding the other party to pay for the debt of the debtor, the indenture or other similar document governing the remedies, opinions of counsel regarding enforceability of the obligation of the other party, the payment stream under applicable insolvency laws or other regulatory regime, or any other documentation that may be considered necessary.

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REGULATORY TRANSACTIONS

DEFINED

201. Regulatory Transaction means a security or other instrument in a transaction submitted to one or more state insurance departments for review and approval under the regulatory framework of the state or states.

Intent

202. This Section provides guidance to the SVO and the SSG on how to manage requests for assistance made by a state insurance department.

Guidelines

203. The SVO or SSG is authorized to conduct an analytical assessment on behalf of any state insurance department that requests such assistance.

204. If an insurance company files a Regulatory Transaction with the SVO via the ATF process or under the Regulatory Treatment Analysis Service (RTAS) process, the SVO shall first contact the state insurance department of the insurance company's state of domicile to disclose that a Regulatory Transaction has been submitted and inquire whether the state insurance department wants SVO analytical assistance.

205. If the state insurance department of the insurer's state of domicile requests such assistance, the SVO shall engage in the requested analytical assessments of the Regulatory Transaction. SVO determinations may include and refer to NAIC analytical benchmarks, such as NAIC Designations, valuation or classification assessments, and such determinations may be given by the SVO or SSG to the state insurance department.

206. SVO or SSG determinations given in connection with the assessment of a Regulatory Transaction may be given to and adopted by the state insurance department as part of that state's internal determination of the regulatory issues presented by the Regulatory Transaction. However, SVO assessments for a Regulatory Transaction will not be entered into NAIC computer systems reserved for Investment Securities or added to the SVO List of Securities.

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STRUCTURED NOTES

207. A Structured Note's is a direct debt issuance by a corporation, municipality, or government entity, ranking pari-passu with the issuer's other debt issuance of equal seniority where either:

- The coupon and/or principal payments are linked, in whole or in part, to prices of, payment streams from, index or indices, or assets deriving their value from other than the issuer's credit quality, or
- The coupon and/or principal payments are leveraged by a formula that is different from either a fixed coupon, or a non-leveraged floating rate coupon linked to an interest rate index including by not limited to LIBOR or prime rate.

208. Analytically, a Structured Note can be divided into the issuer's debt issue and an embedded derivative. Securities with certain embedded securities are not considered Structured Notes, including but not limited to bonds with standard call or put options. When the issuer is a trust, the source of payments on the security is the assets in the trust, and investors' recourse is limited to the assets in that trust, the security is not a Structured Note.

209. Please refer to Part Four for related guidance pertaining to a Structured Note defined as a Mortgage Referenced Security.

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MUNICIPAL BONDS

General Obligation Bond

210. In the case of a general obligation bond, the SVO shall determine whether the issuer has taxing authority and the precise limitations on that authority, arrive at a determination of all current indebtedness that relies on the issuer's taxing authority and assess the taxpayer's ability to support the existing and proposed levels of debt. In the conduct of this analysis, the SVO shall consider all factors relevant to general obligation bond analysis, such as issuer's debt obligation for unfunded pension liabilities and other similar obligations. In assessing the taxpayer's ability to support the level of debt, the SVO shall assess the trend of the issuer's economy, employment distribution and composition, population growth, real estate property valuation, personal income trends and other local economic traits that are relevant to its assessment.

Revenue Bond

211. In the case of a new issue revenue bond, the reporting insurance company shall provide the SVO with a feasibility study of the project in order to assess the level of demand and all probable alternatives to the services or project. In all other cases, the SVO may request the submission of the feasibility study. The SVO shall assess sources of revenue, revenue assumptions, project costs and expenses and other relevant factors. The analyst may consider any aspect of the project that may be relevant to determining an appropriate NAIC Designation.

Industrial Development Revenue Bonds; Pollution Control Bonds

212. In the case of an industrial development revenue bond or a pollution control bond, the methodology applied by the SVO to assess credit risk may derive from any appropriate corporate methodology or from a municipal methodology, whether associated with the revenue or the general obligation approach.

Escrowed And Pre-refunded Bonds

213. The SVO may make its credit assessment on the basis of an executed Letter of Defeasance, an Escrow Agreement or a Pre-refunding Agreement.

Credit Enhanced Municipal Transactions

214. A credit enhanced municipal transaction is one in which the application for an NAIC Designation is to be based on one of the following (i) the credit rating of a nationally recognized municipal bond insurer that has issued a financial guarantee or otherwise insured the bond, (ii) on a financial guarantee issued by an insurance company, (iii) on a Letter of Credit issued by a bank, or (iv) on another acceptable form of credit enhancement. In determining an NAIC Designation for the transaction, the SVO shall ascertain the extent to

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which the legal documents ensure that the credit strength of the insurer or bank flows through unimpeded to the security holder. The SVO shall examine whether the payment obligation of the insurer or bank assures full and timely payment of all amounts due to the reporting insurance company. Factors relevant to this analysis include irrevocability of the insurer's or bank's obligation to pay the effect of debtor insolvency on payments made by the debtor and/or the third party to the insurance company lender and the third party's credit rating. The analyst may review corporate resolutions of the issuer the guarantee or other agreements binding the third party to pay for the debt of the debtor, the indenture or other similar document governing the remedies, opinions of counsel regarding enforceability of the obligation of the third party, the payment stream under applicable insolvency laws or other regulatory regime, or any other documentation that may be considered necessary.

Special Situations

215. The reporting insurance company shall contact the SVO on a case-by-case basis in order that the SVO may determine what information is necessary to conduct an analysis of Annual Appropriation Bonds, Special Assessment Bonds and Municipal Bonds Supported by the U.S. Government.

QUANTITATIVE ANALYSIS

216. The analyst shall make an independent financial analysis of the issuer. Wherever possible, the analysis shall be based on historical and projected tax or revenue data. It shall be the responsibility of the insurance company investor reporting the investment to obtain and provide this information to the SVO. The analysis shall incorporate the Audited Financial Statement, as well as additional information the analyst may deem necessary. Upon receipt of this information, an analyst shall perform financial analysis necessary or appropriate for the transaction under consideration. Interpretation of the financial information and data obtained will be conducted in the context of the particular facts of the issuer and the project to be financed. The analysis shall reflect the issuer's political and economic circumstances and other criteria unique to municipal bond issuance.

Use of Unaudited Financial Statements

217. For general obligation bonds not rated by an NAIC CRP, the SVO will assess the transaction one grade lower than would otherwise be justified by the issuer's credit rating, if the reporting insurance company cannot provide the SVO with a copy of the Audited Financial Statement. However, the SVO shall accept the unaudited financial statement of an issuer without grade reduction, if such unaudited financial statement has been submitted to and is certified by the appropriate state controller's office. Revenue Bonds will be subject to the same rules applicable to corporate debt.

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Terms of the Security; Final Designation

218. Before determining a final NAIC Designation, the analyst shall consider (i) the sufficiency of the legal documentation and (ii) the terms of the security such as:

- Collateral.
- Legality of the exercise of taxing authority in general bond obligations, or legal validity and enforceability of the pledge of cash flow.
- Economic feasibility, including demand for the services for which the issuance is made or project is being built.
- Project risks and risk mitigation.
- Priority and legal position of the lender's right to payment of the issuer's general fund (for general obligations bonds) or reserve or trust fund accounts (for revenue bonds).

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PART FOUR
THE NAIC STRUCTURED SECURITIES GROUP

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DEFINITIONS

1. The following terms used in this Part Four have the meaning ascribed to them below.

   - **ABS** stands for asset-backed securities and means structured securities backed by consumer obligations originated in the United States.
   - **CMBS** stands for commercial mortgage-backed securities and means structured securities backed by commercial real estate mortgage loans originated in the United States. The definition of CMBS may refer to securitizations backed by commercial mortgages, respectively, originated outside of the Unites States if and to the extent that the vendor selected by the NAIC to conduct the financial modeling: 1) has the necessary information about the commercial mortgage and commercial mortgage loans originated outside of the United States to fully model the resulting securities; and, 2) can adapt the modeling process to account for any structural peculiarities associated with the jurisdiction in which the mortgage was originated.
   - **Initial Information** means the documentation required to be filed with an Initial Filing of an RMBS or a CMBS CUSIP, pursuant to the section below and pertaining to Loan Information, Reps and Warranty Information and Structure and Formation Information for the transaction, where:
     - *Loan Information* means a review of the loan files by a third party to assess the sufficiency of legal title and other related issues;
     - *Reps and Warranty Information* means the actual representation and warranties in effect for the securitization given by the mortgage originator(s) to the Trust pertaining to loan origination processes and standards, compliance with applicable law, loan documentation and the process governing put backs of defective mortgages back to the originator(s); and
     - *Structure and Formation Information* means the waterfall, as described in the definition of Ongoing Information, information and documentation in the form of legal opinions and documentation governing the formation of the securitization and its entities relative to issues such as bankruptcy remoteness, true sale characterization, the legal standards and procedures governing the securitization and other similar issues.
   - **Legacy Security**, for the purposes of this section shall mean any RMBS and any CMBS that closed prior to Jan. 1, 2013.
   - **Ongoing Information** consists of: a) tranche level data; such as principal balance, factors, principal and interest due and paid, interest shortfalls, allocated realized losses, appraisal reductions and other similar information for the specific tranche; b) trust level data, such as aggregate interest and principal and other payments received, balances and payments to non-trance accounts, aggregate pool performance data and other similar

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information; c) loan level performance information; and (d) a computerized model of rules that govern the order and priority of the distribution of cash from the collateral pool ("i.e., the waterfall") to the holders of the certificates/securities—provided in the format and modeling package used by the NAIC financial modeling vendor.

- **Original Source**, with respect to a specific set of data, means the Trustee, Servicer or similar entity that is contractually obligated under the agreement governing the RMBS or CMBS to generate and maintain the relevant data and information in accordance with standards specified in applicable agreements or an authorized re-distributor of the same.
- **Re-REMIC** is a securitization backed by: (i) otherwise eligible RMBS from one or two transactions; or (ii) otherwise eligible CMBS from one or two transactions at closing. Re-REMICs cannot acquire any Underlying Securities after closing.
- **RMBS** stands for residential mortgage-backed securities and means structured securities backed by non-agency residential mortgages originated in the United States, where the collateral consists of loans pertaining to non-multi-family homes. That includes prime, subprime and Alt-A mortgages, as well as home-equity loans, home-equity lines of credit and Re-REMICs of the above. Excluded from this definition is agency RMBS, where the mortgages are guaranteed by federal and federally sponsored agencies such as the Government National Mortgage Association (GNMA), Federal National Mortgage Association (FNMA) or Federal Home Loan Mortgage Corporation (FHLMC) and loans against manufactured or mobile homes or collateralized debt obligations backed by RMBS. The exclusion covers bonds issued and guaranteed by, or only guaranteed by, the respective agency. Also not included are loans guaranteed by the U.S. Department of Veteran Affairs or the U.S. Department of Agriculture's Rural Development Housing and Community Facilities Programs. The definition of RMBS may refer to securitizations backed by residential mortgages, respectively, originated outside of the Unites States if and to the extent that the vendor selected by the NAIC to conduct the financial modeling: 1) has the necessary information about the residential mortgage and residential mortgage loans originated outside of the United States to fully model the resulting securities; and 2) can adapt the modeling process to account for any structural peculiarities associated with the jurisdiction in which the mortgage was originated.
- **Underlying Security** means the RMBS or CMBS backing a Re-REMIC. A Re-REMIC cannot be an Underlying Security.

  NOTE: The definitions of RMBS and CMBS reflect limitations associated with the financial modeling process, NAIC credit rating provider (CRP) internal naming conventions and SSG processes, as more fully discussed below and may, therefore, be subject to a narrower or a broader reading in any reporting period. Please call the SSG with any concerns or questions about the scope of the definitions for a given reporting period.

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- It is possible that the scope of the RMBS and CMBS definitions may be broadened because the financial modeling vendors indicate other collateral or waterfall structures can be modeled.
- NAIC CRPs may adopt different internal conventions with respect to what market or asset segments are within their rated populations of RMBS, CMBS or ABS. This could affect the application of the adopted NAIC methodology or require the NAIC to select which naming process it wishes to adopt.
- It is possible that the SSG will acquire analytical assessment capabilities that permit the assessment of existing, additional or different structured securities that cannot now be modeled or that are not currently rated.
- **Price Grids** means and refers to CUSIP-specific price matrices containing six price breakpoints; i.e., each price corresponding to a specific NAIC Designation category. Each breakpoint on a Price Grid is the price point that tips the NAIC Designation for the RMBS CUSIP into the next NAIC Designation (credit quality/credit risk) category. The plural is used because two Price Grids are generated for any CUSIP. This reflects the difference in RBC for those insurance companies that maintain an asset valuation reserve and for those insurance companies that do not.
- **Official Price Grids** means and refers to those generated by the SSG and provided to an insurance company or insurance companies that own the security for regulatory reporting purposes.

ADMINISTRATIVE AND OPERATIONAL MATTERS

Certain Administrative Symbols

2. The following administrative symbols are used in the Valuation of Securities (VOS) Products to identify RMBS and CMBS that the NAIC vendor has confirmed will be subject to the financial modeling methodology described in this Part.

   - **FMR** indicates that the specific CUSIP identifies an RMBS that is subject to the financial modeling methodology.
   - **FMC** indicates that the specific CUSIP identifies a CMBS that is subject to the financial modeling methodology.

   The use of these administrative symbols in the VOS Product means the insurer should not use the filing exempt process for the security so identified.

   NOTE: The administrative symbols **FMR** and **FMC** are related to symbols that insurers are required to use in the financial statement reporting process. Under applicable financial statement reporting rules, an insurer uses the symbol:

   - **FM** – as a suffix to identify modeled RMBS and CMBS CUSIPs;

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- **AM** – as a suffix to identify CUSIPs not modeled and not designated by the SSG but for which CRP ratings were used to derive the NAIC Designation.

The symbols **FM** and **AM** are inserted by the insurer in the financial statement as a suffix in front of the NAIC Designation category—i.e., **2FM**.

Quarterly Reporting of RMBS and CMBS

3. To determine the NAIC Designation to be used for quarterly financial statement reporting for an RMBS or CMBS purchased subsequent to the annual surveillance described in this Part, the insurer uses the prior year-end modeling data for that CUSIP (which can be obtained from the NAIC) and follows the instructions in contained under the heading "Use of Net Present Value and Carrying Value for Financially Modelled RMBS and CMBS" below or follows the instructions in "Publication of Final Results" below, subject to, and in accordance with, *SSAP No. 43R—Loan -Backed and Structured Securities.*

FILING EXEMPTIONS

Limited Filing Exemption for RMBS and CMBS

4. **RMBS and CMBS that can be Financially Modeled** - RMBS and CMBS that can be financially modeled are exempt from filing with the SVO. NAIC Designations for RMBS and CMBS that can be financially modeled are determined by application of the methodology discussed in this Part, not by the use of credit ratings of CRPs.

5. **RMBS and CMBS securities that cannot be Financially Modeled**

   - ***But are rated by a CRP*** - RMBS and CMBS that cannot be financially modeled but that are rated by a CRP are exempt from filing with the SSG. The NAIC Designations for these RMBS and CMBS are determined by application of the modified filing exemption discussed in this Part.

   - ***But are not rated by an CRP*** - RMBS and CMBS that cannot be financially modeled and that are not rated by a CRP are not filing exempt and must be filed with the SSG as discussed below in this Part.

Filing Exemption for ABS

6. ABS rated by a CRP are exempt from filing with the SSG.

Review of Decisions of the SSG

7. Analytical decisions made through the application of financial modeling are not subject to the appeal process. In the absence of an appeal, the SSG shall provide whatever clarification as to the results of financial modeling is possible to any insurer who requests it and owns the security, provided that it is not unduly burdensome for the SSG to do so. Any decision made by the SSG that results in the assignment of an NAIC Designation and does not involve financial modeling methodology, whether developed by the SSG on its own or in collaboration with the SVO, is subject to the appeal process.

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REQUIRED DATA AND DOCUMENTS FOR TRANSACTIONS SUBMITTED TO THE SSG

8. The policy statement set forth in this section shall be applicable generally to any transaction filed with the SSG for an analytical assessment, including, but not limited to, a Price Grid or for assignment of an NAIC. Any filing with the SSG is deemed to be incomplete unless the insurer has provided the information, documentation, and data in quantity and quality sufficient to permit the SSG to conduct an analysis of the creditworthiness of the issuer and the terms of the security to determine the requested analytical value. It is the obligation of the reporting insurance company to provide the SSG with all necessary information. It is the responsibility of the SSG to determine whether the information provided is sufficient and reliable for its purposes and to communicate informational deficiencies to the reporting insurance company.

Documentation Standards

9. In order for an insurer-owned RMBS or CMBS to be eligible for the year-end modeling process, conducted pursuant to this section below, the analysis must be based on information, documentation and data of the utmost integrity. A Legacy Security must meet the Ongoing Information requirements. An RMBS, CMBS or Re-REMIC that is not a Legacy Security must meet the Initial Information and Ongoing Information requirements. For the purposes of determining a Re-REMIC's status as a Legacy Security, the closing date of the Re-REMIC (not the Underlying Security) shall be used. The SSG may, in its sole discretion, determine that the Initial Information and/or Ongoing Information is not sufficient and/or not reliable to permit the RMBS or CMBS CUSIP to be eligible for financial modeling. If the SSG determines that the Initial Information and/or Ongoing Information is not sufficient and/or not reliable to permit the RMBS or CMBS CUSIP to be eligible for financial modeling, it will communicate this decision to the insurer and invite a dialogue to ascertain whether alternative information is available that would be deemed sufficient and/or reliable by the SSG.

Initial Information Requirements

10. An RMBS or CMBS meets the Initial Information Requirements if the security meets one of the following three conditions:

- **RTAS**. The RMBS or CMBS was assigned a preliminary price grid or designation as described in this Part;
- **Initial Sufficiency Filing**. The RMBS or CMBS was reviewed by SSG through an Initial Sufficiency Filing; or
- **Safe Harbor**. The RMBS or CMBS meets the Safe Harbor requirements.

Initial Sufficiency Information Filing

11. An insurance company may file Initial Sufficiency Information with the SSG for the purpose of obtaining a determination that an RMBS or CMBS CUSIP is eligible for financial

modeling under the annual surveillance process discussed below. Initial Sufficiency Information is only filed once for any given RMBS or CMBS. Reporting insurance companies are solely responsible for providing the SSG with Initial Information. A determination by the SSG that a given RMBS or CMBS CUSIP is eligible for financial modeling after an Initial Sufficiency Filing assessment is subject to the further and continuing obligation that the SSG obtain or the insurer provide the SSG with updated Ongoing Information close to the date of the annual surveillance.

12. **Required Documents for Initial Sufficiency Filing** – An insurer that owns an RMBS or a CMBS for which Initial Information is not publicly available shall provide the SSG with the following documentation.

13. **RMBS** - Unless otherwise specified by the SSG in a Modeling Alert, as further described below, an Initial Filing for an RMBS consists of submission of Initial Information and Ongoing Information in the form of the following documentation:

- Pooling and Servicing Agreement or similar
- Prospectus, Offering Memorandum or similar; Accountant's comfort letter
- If applicable, ISDA Schedules and Confirmations or similar
- Legal opinions given in connection with the transaction
- Any other documents referenced by the above
- Third-Party Due diligence scope document and raw results. If less than 100% due diligence, detailed description of the loan selection process
- If applicable, loan purchase agreements or similar. Loan Tape

14. **CMBS** - Unless otherwise specified by the SSG in a Modeling Alert, as further described below, an Initial Filing for a CMBS consists of submission of Initial Information and Ongoing Information in the form of the following documentation:

- Pooling and Servicing Agreement or similar
- Prospectus, Offering Memorandum or similar; Accountant's comfort letter
- If applicable, ISDA Schedules and Confirmations or similar
- Legal opinion given in connection with the transaction
- Any other documents reference in the above
- Asset Summaries
- Loan Tape
- Loan documents, including reliable information about the terms of the transaction; including, but not limited to, financial covenants, events of default, legal remedies and

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other information about financial, contractual or legal aspects of the transaction in form and substance consistent with industry best practices for CMBS issuance.

- In certain cases, additional documents below will enable the SSG to verify and validate initial underwriting information of the property securing the CMBS. These documents may be required in form and substance consistent with best practices for typical CMBS issuance.
- Historical operating statements and borrower's budget
- Underwriter's analysis of stabilized cash flow with footnotes of assumptions used
- Property type specific, rent roll information
- Appraisals and other data from recognized industry market sources
- Independent engineering report (Property Condition Assessment)
- Environmental Site Assessment (ESA) – Phase I/Phase II
- Documentation related to seismic, flood and windstorm risks
- Franchise agreements and ground leases, if applicable
- Management agreements.

SSG Modeling Alerts

15. The SSG shall at all times have discretion to determine that differences in the structure, governing law, waterfall structure or any other aspect of a securitization or a class of securitization requires that insurance companies provide Initial Information and or Ongoing Information additional to or different from that identified in this Part. The SSG shall communicate such additional or different documentation requirements to insurers by publishing a Modeling Alert on the NAIC website and scheduling a meeting of the VOS/TF to ensure public dissemination of the decision.

Safe Harbor

16. Safe Harbor options serve as proxies for the Initial Sufficiency filing. The options reflect publicly available information that a third party has analyzed the Initial Information. Because the structured securities market is quite dynamic, the list of Safe Harbor options may change frequently, with notice and opportunity for comment, as described in this section. An RMBS or CMBS meets the Initial Information requirement if:

- At least two Section 17(g)-7 reports issued by different CRPs are publicly available; or
- A security that is publicly registered under the federal Securities Act of 1933.

Ongoing Information Requirements

17. An RMBS or CMBS meets the Ongoing Information Requirements if Ongoing Information is available to the SSG and the relevant third-party vendor from an Original Source. The

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SSG, in its sole discretion and in consultation with the relevant third-party vendor, may determine that the Ongoing Information is not sufficient or reliable to permit a given RMBS or CMBS CUSIP to be financially modeled. However, in making such a determination, the SSG shall take into account reasonable market practices and standards.

Special Rules for Certain Re-REMICs

18. Re-REMICs are generally simple restructurings of RMBS or CMBS. An Initial Sufficiency Filing for a Re-REMIC (a) which is not a Legacy Security itself but (b) where each Underlying Security is a Legacy Security shall not require submission of information regarding the Underlying Securities. In most cases, a prospectus for the Re-REMIC will be sufficient. If the SSG determines that additional information about the Re-REMIC structure or formation is required, it will communicate this decision to the insurer and invite a dialogue to ascertain whether additional information is available that would be deemed sufficient by the SSG.

ANALYTICAL ASSIGNMENTS

Annual Surveillance of RMBS and CMBS –Modeled and Non-Modeled Securities

19. **Scope** - This section explains the financial modeling methodology applicable to RMBS and CMBS (defined above) securitizations and the book/adjusted carrying value methodology applicable to modeled and non-modeled securities subject to *SSAP No. 43R—Loan-Backed and Structured Securities*. Please refer to *SSAP No. 43R—Loan-Backed and Structured Securities* for a description of securities subject to its provisions. The VOS/TF does not formulate policy or administrative procedures for statutory accounting guidance. Reporting insurance companies are responsible for determining whether a security is subject to *SSAP No. 43R—Loan-Backed and Structured Securities* and applying the appropriate guidance.

Important Limitation on the Definitions of RMBS and CMBS

20. The definitions of RMBS and CMBS above are intended solely to permit the SSG to communicate with financial modeling vendors, insurance company investors who own RMBS and CMBS subject to financial modeling and/or the book/adjusted carrying value methodology and their investment advisors to facilitate the performance by the SSG of the financial modeling methodology described below. The definitions contained in this Section are not intended for use and should not be used as accounting or statutory statement reporting instructions or guidance. Readers must refer to *SSAP No. 43R—Loan -Backed and Structured Securities* for applicable accounting guidance and reporting instructions.

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ANALYTICAL PROCEDURES APPLICABLE TO RMBS AND CMBS SECURITIZATIONS SUBJECT TO FINANCIAL MODELING METHODOLOGY

Filing Exemption Status of RMBS and CMBS

21. RMBS and CMBS are not eligible for the filing exemption because credit ratings of CRPs are no longer used to set risk-based capital (RBC) for RMBS or CMBS. However, RMBS and CMBS are not submitted to the SSG.

Use of Financial Modeling for Year-End Reporting for RMBS and CMBS

22. Beginning with year-end 2009 for RMBS and 2010 for CMBS, probability weighted net present values will be produced under NAIC staff supervision by an NAIC-selected vendor using its financial model with defined analytical inputs selected by the SSG. The vendor will provide the SSG with a range of net present values for each RMBS or CMBS corresponding to each NAIC designation category. The NAIC designation for a specific RMBS or CMBS is determined by the insurance company, based on book/adjusted carrying value ranges. Please refer to *SSAP No. 43R—Loan-Backed and Structured Securities* for guidance on all accounting and related reporting issues.

Analytical Procedures for RMBS and CMBS

23. The SSG shall develop and implement all necessary processes to coordinate the engagement by the NAIC of a vendor who will perform loan-level analysis of insurer-owned RMBS and CMBS using the vendor's proprietary models.

RMBS AND CMBS SUBJECT TO FINANCIAL MODELING

Setting Microeconomic Assumptions and Stress Scenarios

24. Not later than September of each year, the SSG shall begin working with the vendor to identify the assumptions, stress scenarios and probabilities (hereafter model criteria) the SSG intends to use at year-end to run the vendor's financial model.

The Financial Modeling Process

25. The SSG shall obtain loan-level analysis of RMBS and CMBS using the selected vendor's proprietary financial model. The financial model used by the SSG is expected to provide for each of the analytical steps that follow: a macroeconomic process, a mortgage loan credit process and a waterfall process. The macroeconomic process projects the future performance of macroeconomic variables. These variables and various scenarios to be employed in this step of the financial modeling process will have been determined through the meetings described above. The mortgage loan credit process projects loan performance based on the projected macroeconomic variables and loan characteristics. The loan characteristics employed may be broadly identified and discussed in the Final Model Criteria Document to the extent the VOS/TF deems it necessary to ensure attainment of regulatory objectives, but subject to legitimate commercial and proprietary interests of the financial

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model vendor. The results of the mortgage loan credit model provide the scenario inputs to produce a tranche level cash flow "waterfall." What follows is, therefore, intended as a general description of one such process.

LOAN-LEVEL ANALYSIS

RMBS

26. Loan-level analysis begins with historical loan performance. Loans are classified as performing or non-performing. Based on loan characteristics and macroeconomic variables, transition probabilities are calculated. Because the parameters of the model are path-dependent, Monte Carlo simulation is used. A random drawing against these calculated probabilities decides the performance group or exit group (prepayment or default) that the loan will be assigned to during the next month. The loan-level prediction is then aggregated into pool level projected curve. For purposes of loss severity, the same default probabilities are applied to maintain consistency. Additional components that contribute to the ultimate loss severity analysis include collateral deficiency (unpaid balance less REO sales price), lost interest (accrued as servicer advances), expenses (legal fees, property taxes and brokerage fees) and mortgage insurance considerations.

CMBS

27. The vendor will review raw loan level data sourced from servicers and trustees for inconsistencies and inaccuracies, correcting the data where applicable. Based upon SSG directions, the vendor will manually review and re-underwrite certain loans in each pool based upon size, credit history or other criteria at the discretion of the SSG. In addition to loan level performance, the vendor's analysis will reasonably take into account other factors known to bear on long-term property performance, such as age, size and locational characteristics. The vendor will then utilize market-derived income growth curves and capitalization rates to project the collateral performance of each loan in a given CMBS issue. Based on parameters and triggers such as debt service coverage levels, extension parameters and workout periods and costs, produce an outcome and loss estimate for each loan in the pool.

RMBS and CMBS

28. Once generated, pool cash flows are passed through the bond waterfall. The "waterfall" is a set of rules derived from the terms of the contract governing the RMBS or CMBS securitization that determine which bonds get paid principal and interest and how losses are distributed at a particular point in time. Waterfall models for individual RMBS and CMBS securitizations can be obtained from a reputable vendor (often referred to as a deal library).

29. The net present value for the insurer-owned RMBS or CMBS tranche is derived by applying a discount rate to the projected/probability weighted cash flow. In multiple scenario approaches, the mortgage credit model and waterfall model are used to calculate the present value of losses under each scenario.

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30. The final valuation is the par value minus the probability weighted present value of losses. The interest rate used to discount the bond cash flow will be the bond coupon.

Validation of Modeled Results

31. The NAIC and SSG staff shall ensure that the vendor has extensive internal quality-control processes in place. In addition, however, the SSG shall conduct its own quality-control checks of the vendor's valuation process.

Publication of Final Results

32. Upon delivery by the vendor of values for the RMBS and CMBS portfolio and subject to the final modeling process and completion of all SSG quality control and validation processes, the SSG shall cause the valuation file for the modeled insurer-owned portfolio to be delivered to other appropriate NAIC staff for dissemination to insurance companies.

Use of Net Present Value and Carrying Value for Financially Modeled RMBS and CMBS

33. For each modeled RMBS and CMBS, the financial model determines the net present value at which the expected loss equals the midpoint between the RBC charges for each NAIC designation; i.e., each price point, if exceeded, changes the NAIC designation. Net present value is the net present value of principal losses, discounted using the security's coupon rate (adjusted in case of original issue discount securities to book yield at original issue and in case of floating rate securities, discounted using LIBOR curve + Origination spread). Because of the difference in RBC charge, the deliverable is five values for each RMBS and CMBS security for companies required to maintain an asset valuation reserve (AVR) and five values for companies not required to maintain an AVR. This is illustrated in the chart below.

RBC charge / NAIC designation (pre-tax)

P&C	RBC	Midpoint
1	0.3%	0.65%
2	1.0%	1.50%
3	2.0%	3.25%
4	4.5%	7.25%
5	10.0%	20.00%
6	30.0%	
Life	**RBC**	**Midpoint**
1	0.4%	0.85%
2	1.3%	2.95%
3	4.6%	7.30%
4	10.0%	16.50%
5	23.0%	26.50%
6	30.0%	

34. The NAIC designation for a given modeled RMBS or CMBS CUSIP owned by a given insurance company depends on the insurer's book/adjusted carrying value of each RMBS or CMBS, whether that carrying value, in accordance with *SSAP No. 43R—Loan-Backed and Structured Securities*, paragraphs 25 through 26a, is the amortized cost or fair value, and where

the book/adjusted carrying value matches the price ranges provided in the model output for each NAIC designation; except that an RMBS or CMBS tranche that has no expected loss under any of the selected modeling scenarios and that would be equivalent to an **NAIC 1** Designation if the filing exempt process were used, would be assigned an **NAIC 1** Designation regardless of the insurer's book/adjusted carrying value. Please refer to the detailed instructions provided in *SSAP No. 43R—Loan-Backed and Structured Securities*.

ANALYTICAL PROCEDURES APPLICABLE TO SECURITIES NOT SUBJECT TO FINANCIAL MODELING METHODOLOGY

Securities Not Modeled but Rated by an NAIC CRP and Subject to Modified Filing Exempt Process

35. To obtain the NAIC designation for a CUSIP not modeled but rated by an NAIC CRP, please refer to the detailed instructions in *SSAP No. 43R—Loan-Backed and Structured Securities*, paragraph 26b. Securities assigned an NAIC CRP credit rating equivalent to an **NAIC 1** designation are assumed to have zero expected loss, and, therefore, the designation is not modified by the carrying value and remain **NAIC 1**. Securities assigned an NAIC CRP credit rating equivalent to an **NAIC 6** designation are not modified by the carrying value and remain **NAIC 6**. The Table below is used to implement the book/adjusted carrying value methodology for securities that are subject to modified filing exempt process *SSAP No. 43R—Loan-Backed and Structured Securities*, except Excluded Securities as defined below.

Table One
NAIC Designation Breakpoints for Loan-Backed and Structured Securities

Life	1>2	2>3	3>4	4>5	5>6
NAIC2	97.88	100.00	104.69	116.23	132.04
NAIC3	93.49	95.52	100.00	111.02	126.12
NAIC4	84.22	86.04	90.08	100.00	113.61
NAIC5	74.13	75.73	79.29	88.02	100.00
P&C & Health	**1>2**	**2>3**	**3>4**	**4>5**	**5>6**
NAIC2	99.14	100.00	101.81	106.20	123.13
NAIC3	97.38	98.22	100.00	104.31	120.94
NAIC4	93.36	94.16	95.87	100.00	115.94
NAIC5	80.52	81.22	82.69	86.25	100.00
Designation changes when book/adjusted carrying value exceeds the breakpoint					

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

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

EXCLUSION OF CERTAIN SECURITIES FROM APPLICATION OF BOOK/ADJUSTED CARRYING VALUE METHODOLOGY FOR NON-MODELED SECURITIES

Exclusion and Excluded Securities

37. The book/adjusted carrying value methodology described above, shall not apply (the Exclusion) to Credit Tenant Loans, Equipment Trust Certificates (whether rated by an NAIC CRP or designated for quality by the SVO) or to every other individual security to which the SVO has assigned an NAIC Designation, (collectively, "Excluded Securities"), effective with the 2011 year-end reporting cycle. Please refer to *SSAP No. 43R—Loan-Backed and Structured Securities*, paragraph 26c.

Deriving NAIC Designations for Excluded Securities

38. The NAIC Designation for Excluded Securities that are Credit Tenant Loans or Equipment Trust Certificates shall be the credit rating assigned by NAIC CRPs after application of the filing exemption procedure or the NAIC Designation assigned by the SVO. The NAIC Designation for Excluded Securities that are individual securities to which the SVO has assigned an NAIC Designation, shall be the NAIC Designation assigned by the SVO. Please refer to *SSAP No. 43R—Loan-Backed and Structured Securities*, paragraph 26c.

MORTGAGE REFERENCED SECURITY

Definition

39. Mortgage Referenced Security is a category of a Structured Note, as defined in Part Three of this Manual. In addition to the Structured Note definition, the following are characteristics of a Mortgage Referenced Security: A Mortgage Referenced Security's coupon and/or principal payments are linked, in whole or in part, to prices of, or payment streams from, real estate, index or indices related to real estate, or assets deriving their value from instruments related to real estate, including, but not limited to, mortgage loans.

Not Filing Exempt

40. A Mortgage Referenced Security is not eligible for the filing exemption but is subject to the filing requirement.

NAIC Risk Assessment

41. In determining the NAIC designation of a Mortgage Referenced Security, the SSG may use the financial modeling methodology discussed in this Part, adjusted to the specific reporting and accounting requirements applicable to Mortgage Referenced Securities.

THE RTAS – EMERGING INVESTMENT VEHICLE

Purpose

42. Price grids are generated for the exclusive use of insurance companies and the NAIC regulatory community. Insurance companies use official Prices Grids by following the instructions in *SSAP No. 43R—Loan-Backed and Structured Securities* to derive a final NAIC Designation for the RMBS or CMBS, which they use to derive the RBC applicable for the RMBS or CMBS. Please refer to *SSAP No. 43R* for a full explanation of the applicable procedure.

Extension of Authority

43. **The Regulatory Treatment Assessment Service** – Emerging Investment Vehicle procedure is extended to the SSG, and the SSG is authorized to determine probable regulatory treatment for RMBS and CMBS pursuant to this Part or for other securities, where, in the opinion of the SSG, financial modeling methodology would yield the necessary analytical insight to determine probable regulatory treatment or otherwise enable the SSG to make recommendations to the VOS/TF as to regulatory treatment for a security.

Interpretation

44. To facilitate this purpose, wherever in the Regulatory Treatment Assessment Service – Emerging Investment Vehicle procedure reference is made to the SVO, it shall be read to also refer to and apply to the SSG, adjusting for differences in the operational or methodological context. The Regulatory Treatment Assessment Service – Emerging Investment Vehicle procedure shall also be read as authority for collaboration between SVO and SSG staff functions so as to encompass RTAS assignments that require the use of SVO financial, corporate, municipal, legal, and structural analysis and related methodologies, as well as of financial modeling methodologies.

Translation of Preliminary into Official Price Grids

45. Price Grids generated by the SSG pursuant to an RTAS are preliminary within the meaning of that term as used in the Regulatory Treatment Assessment Service – Emerging Investment Vehicle procedure and accordingly cannot be used for official NAIC regulatory purposes. Preliminary NAIC Designations are translated into official NAIC Designations by the SVO when an insurance company purchases and files the security and the SVO conducts an official assessment. However, the Purposes and Procedures Manual does not require the filing of RMBS and CMBS subject to financial modeling methodology with the SSG. It is, therefore, necessary to specify a procedure for the translation of preliminary Price Grids into

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official Price Grids that can be used for NAIC regulatory purposes. Preliminary Price Grids generated by the SSG become an official Price Grid within the meaning of this Section when an insurance company has purchased the security for which the Price Grid was generated and reported that security for quarterly reporting purposes using the SSG generated Price Grid. A Price Grid for a security reported by an insurance company for quarterly reporting is effective until the SSG conducts the next annual surveillance pursuant to this Part at which the time the Price Grids generated by the SSG at year-end shall be the official Price Grid for that security.

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