



MEMORANDUM

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

FROM: Bob Carcano, Senior Counsel, Investment Analysis Office

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

DATE: May 30, 2017

RE: Staff (Cumulative) Report on the 5*/6* Process and Proposed Amendments to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual).

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

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

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

² “Other Permitted Uses”

Existing Uses

- (i) Corporate Bonds & Preferred Stock. *No Audited Financial Statements.*
- (ii) RMBS and (iii) CMBS not rated by an NAIC CRP. *No NAIC CRP credit rating.*
- (iv) Foreign Security issued in country not having an NAIC CRP sovereign rating. *No NAIC CRP credit rating.*
- (v) Parent-Subsidiary Situations. *No Audited Financial Statement.*
- (vi) Military Housing Bonds issued on/after Dec. 31, 2009. *No NAIC CRP credit rating*
- (vii) Catastrophe-Linked Bonds. *No NAIC CRP credit rating or prescribed methodology not used.*

Proposed Use

- (viii) PL Securities – *No NAIC CRP or No Audited Financial Statement.*

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the insurer could make the required certifications. The AFS and CR Certification only differ in the information that does not permit an independent assessment.

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

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

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

(i) The proposed amendment would transfer the reporting of the population of securities subject to AFS Certifications from the P&P Manual to the Interrogatory. The P&P Manual would house the policy framework permitting the use of the 5*/6* when Audited Financial Statements could not be obtained by the insurer. Because the AFS Certification in Sections 5 (f) and 5 (g) grew out of concerns with populations of “Z securities”; the removal of the AFS Certifications from the P&P Manual suggest that two of the three current uses of the administrative symbol **Z** are no longer needed.

- The Z symbol is used by an insurer to self-designate a security purchased too late during the year to obtain an NAIC Designation from the SVO for year-end reporting. This use should be retained.³
- The insurer uses the **Z** administrative symbol for the first year but must thereafter obtain an SVO assigned Designation or an NAIC 5* or 6*. Adoption of the amendment means the insurer now obtains the 5* by complying with the instructions associated with the Interrogatory.⁴
- A **Z** security filed with all required documents that was not designated by the SVO at year-end (presumably due to resource constraints) could be self-designated by the insurer in the subsequent year.⁵ In a separate project, the SVO has proposed that in this situation the SVO be permitted to extend the Designation for such securities into the new year and to assign those securities a priority status for designation in the new year.⁶

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

⁴ Part Two, Filing with the SVO Section 5 Special Reporting Instruction b) Use of the Administrative Symbol **Z** – An insurance company may report a security with a “Z” suffix on its Schedule D for up to a year after purchase. For the second year after purchase, and thereafter, the insurance company may not report a security with a “Z” suffix except as noted in Section 5(d) of this Part below. The insurer shall either file the security and appropriate documentation with the SVO to obtain an NAIC Designation, file a Principal and Interest Certification Form to obtain an NAIC 5* Designation or report the security with an NAIC 6* Designation on its Schedule D (collectively, the “5*/6* Rule”).

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

⁶ The concept is first discussed in the memorandum dated January 13, 2015, entitled “Discussion – Improvements to NAIC Systems and Rules Governing Insurer Filing of Securities with the SVO” presented to the Task Force for the 2015 Spring National Meeting. The relevant paragraph is as follows: “The **Z** symbol and process is intended for use at year-end by an insurer that has filed all necessary documentation within 120 days but not received a reply from the SVO by year-end. The **Z** symbol could instead be assigned by the SVO as part of its year-end process to identify securities the SVO has received in compliance with the filing policies but has not completed its analysis during the year-end process and which the SVO is committed to complete thereafter and disseminate in its Code 99 process.” After further discussion with the American Council of Life Insurers (ACLI), the Private Placement investors

b. Two Additional AFS Certifications Associated with Analytical Instructions (Discussed in the Feb. 27 memorandum from the SVO to the Task Force) Two additional AFS Certification were identified in analytical instructions and proposed for removal to the Interrogatory:

- Part Three, Section 1 (a) (ii) (B) permits the use of NAIC 5* on the basis of a certification when an insurer can only provide the SVO with unaudited financial statements. The SVO proposes deleting the text from the P&P Manual because unaudited financial statements are not sufficiently reliable for use in assigning an NAIC Designation and therefore trigger the policy expressed in the Interrogatory.
- Part Three, Section 1 (a) (ii) (B) permits the SVO to use the audited financial statement of a parent holding company to designate the quality of an issuing subsidiary without audited financial statements in two circumstances. If neither of these circumstances apply, the SVO is authorized to assign a 5* on the basis of a certification. The lack of an audited financial statement is the precise trigger for the AFS Certifications to be transferred to the Interrogatory.

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

d. Other Proposed Amendments Related to the 5*/6* Process - There are other references in the P&P Manual to the 5*/6* process, which we identify below. All proposed amendments to the P&P Manual are shown in Attachment A.

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Association (PPIA) and North American Securities Valuation Association (NASVA), the SVO presented a memorandum dated March 10, 2015, entitled “Outline of Rules and System Changes and Characteristics” in which the concept is presented in fuller terms as follows:

“3. Self-Designation and the Z Symbol – Whenever the SVO is unable to assign a NAIC designation to a security filed by the Sept. 1 deadline, the insurer may self-designate the security and report it with the symbol Z to identify the security was self-designated. Problem – The intent of the above rules was to require insurers to file securities with the SVO or take onerous 5* treatment for securities not so filed. The September deadline expresses an expectation that the SVO should be able to complete all assessment filed by this date by year end. The problem is that instead of being a deadline applicable only for the Z population, the Sept. 1 deadline has become the effective filing deadline for all securities. This creates an unnecessarily uneven workflow and concomitant workload imbalance for the SVO. Second, the expectation expressed by the Sept. 1 deadline is not linked to resource availability and is, therefore, unworkable. Original SVO Proposal – The SVO recommended that it be the only assignor of the Z symbol to those securities properly filed by insurers but not assigned NAIC designations by the SVO by year-end. Under its proposal, the SVO would extend the designation previously assigned until it can proceed to a current evaluation for these securities. Coupled with other proposed changes in filing rules and/or their allotted time period, the population to which this process would apply should be small. The SVO also proposes that potential resource constraints also be addressed. Under this aspect of the SVO proposal, the Task Force and the SVO director would set an acceptable annual carryover rate that is analyzed the following calendar year. If this rate is significantly exceeded and if the cause is traceable to resource constraints, under a proposed P&P Manual oversight procedure, the Task Force would have responsibility to discuss the need for additional staff with the NAIC Internal Administration (EX1) Subcommittee. This mechanism and approach would eliminate the need for all of the captioned rules, and the filing deadline would be set by reference to the purchase date in a reduced 120-day rule. Current Status of Issue – NASVA and the ACLI support the SVO proposal. However, NASVA and the ACLI request that the Z rule be kept for insurers because it continues to serve historical roles and that a new administrative symbol be created for the SVO. The Task Force has approved this document, permitting its use as a framework for the development of the VISION computer platform.

Attachment A - Proposed Amendment to the P&P Manual

Part Two – Filing With the SVO

Section 5. Special Reporting Instruction

a) NAIC Designations Related to the Special Reporting Instruction

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

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

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

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

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

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

The asterisk (*) after the quality indicator 5 or 6 distinguishes the NAIC 5* and NAIC 6* Designation from an NAIC 5 or NAIC 6 Designation.¹

Comment [RC1]: This is the new text proposed as part of the removal of the 5*/6* process from the SVO and its transfer to the Interrogatory. The existing text is included in the footnote for your convenience.

Part Three - Credit Assessment

Section 1. Corporate Bonds and Preferred Stock

(B) Unaudited Financial Statement

~~Assuming the presence of information sufficient to form a credit opinion, filings accompanied by unaudited financial statements, or those not accompanied by any financial statements, may be analyzed by the SVO, but the SVO's discretion shall be limited to assigning the transaction the NAIC Designation NAIC 5*, and such Designation shall only be assigned if the SVO has received a signed statement by a qualified officer of the reporting insurance company certifying that the issuer is current on its contracted interest and principal payments. If the SVO has issued an InfoReq letter for the transaction, but the~~

~~reporting insurance company has not submitted information responsive to the InfoReq in time for the SVO to conclude its analysis, a Designation will not appear in the VOS Process. This will obligate the insurance company to report the security in its annual statement with a "Z" suffix for that reporting year. Additionally, the reporting insurance company should correct the deficiency with the SVO as soon as possible. If the transaction is assigned an NAIC Designation, the reporting insurance company shall annually file with the SVO either Audited Financial Statements or an annual certification in the form discussed above. In the absence of such certification, the transaction shall be deleted from the VOS Process. This paragraph shall not apply to foreign securities held by a "Subparagraph D Company," as defined below.~~

...

(E) Parent-Subsidiary Situations

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

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

Part Three — Credit Assessment

Section 1. Corporate Bonds and Preferred Stock

a) Methodology for Independent Credit Quality Assessments

(ii) Financial Analysis

(D) Foreign Securities

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

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

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

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

~~(i) a copy of the most recent covenant compliance certificate detailing the issuer's compliance with various financial coverage ratios and other terms of the transaction;~~

~~(ii) a signed statement from a qualified officer of the reporting insurance company with regard to the insurer's expectation as to the issuer's ability to meet the established financial covenants during the next twelve months and~~

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

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

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

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

h) NAIC Designation Categories, Valuation Indicators and Administrative Symbols

~~(iii) NAIC Designations Related to Special Reporting Instructions~~

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

Part Four

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

k) Procedures for Compilation of the RSAT Index List

(ii) Eligibility Requirements

(C) Components Rated

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

Section 2. Catastrophe-Linked Bonds

a) Catastrophe-Linked Securities

(i) Definition

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

(A) Are specifically designed to transfer underwriting risk associated with the occurrence of a natural catastrophic event, such as a hurricane, an earthquake or a flood (a "Catastrophe Event"), from an originating insurer to the reporting insurance company investor and other security holders, and

(B) Are structured so that payment of interest or principal to the reporting insurance company depends on the occurrence of a Catastrophe Event of a defined magnitude or, that causes an aggregate insurance loss in excess of a stipulated amount, and

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

(ii) Filing Exemption Status

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

(iii) Procedure for Other Catastrophe-Linked Bonds

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

Section 5. Military Housing Bonds

c) Status of Other Military Housing Bonds

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

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

Part Seven The NAIC Structured Securities Group

Section 3. Policies Defining The NAIC Structured Securities Group

b) SSG Regulatory Products

(i) NAIC Designations

The SSG is authorized to assign NAIC Designations.

~~(ii) NAIC 5*/6* Designations~~

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

Section 6. Analytical Assignments

a) Annual Surveillance of RMBS and CMBS –

Modeled and Non-Modeled Securities - General Instructions

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

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

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

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

Part Two

Section 5. Special Reporting Instruction

a) NAIC Designations Related to the Special Reporting Instruction

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

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

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

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

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

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

c) Application of the 5*/6* Rule

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

d) Exemption from Application of the 5*/6* Rule

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

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

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

e) Documentation

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

f) Use of NAIC 5* Designation

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

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

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

An NAIC 5* Designation can only be assigned by the SVO. The SVO shall assign an NAIC 5* Designation upon a review of a fully completed and executed Principal and Interest Certification Form.

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

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

g) Use of NAIC 6* Designation

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

The insurer shall assign an NAIC 6* Designation to a security when:

- (i) The documentation necessary to permit a full credit analysis of a security does not exist;
- (ii) The insurer cannot certify that the issuer or obligor is current on all required interest and principal payments; and
- (iii) The insurer cannot certify that it expects ultimate payment of all interest and principal.

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

h) Unit Price of NAIC 6* Securities

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

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

- (i) Corporate Bonds and Preferred Stock with Unaudited Financial Statements
The Principal and Interest Certification Form and the NAIC 5* Designation may be used in connection with the designation of corporate securities with unaudited financial statements as specified in [Part Three, Section 1\(a\)\(ii\)\(B\) of this Manual](#).
- (ii) Residential Mortgage Backed Security (RMBS)
The Principal and Interest Certification Form and the NAIC 5* and 6* Designations may be used in connection with a RMBS that has never been rated by an NAIC CRP as specified in [Part Seven, Section 6\(a\)\(iv\)\(B\) of this Manual](#).

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- (iii) Commercial Mortgage Backed Securities (CMBS)
The Principal and Interest Certification Form and the NAIC 5* and 6* Designations may be used in connection with a CMBS that has never been rated by an NAIC CRP as specified in [Part Seven, Section 6\(a\)\(iv\)\(B\) of this Manual](#).
 - (iv) Foreign Securities of Issuers Domiciled with No NAIC CRP Sovereign Rating
The Principal and Interest Certification Form and the NAIC 5* and 6* Designations may be used in connection with reporting foreign securities issued in countries that have not been assigned a sovereign rating by an NAIC CRP as specified in [Part Three, Section 1\(a\)\(ii\)\(D\)\(2\) of this Manual](#).
 - (v) Parent-Subsidiary Situations
The Principal and Interest Certification Form and the NAIC 5* and 6* Designations may be used in connection with reporting parent-subsubsidiary situations as specified in [Part Three, Section 1\(a\)\(ii\)\(E\) of this Manual](#).
 - (vi) Military Housing Bonds or Securities Issued On or After Dec. 31, 2009 and Not Rated by an NAIC CRP
The Principal and Interest Certification Form and the NAIC 5* Designation may be used in connection with the designation of military housing bonds or securities that were issued on or after Dec. 31, 2009, and were not rated by an NAIC CRP pursuant to the policy determination expressed in [Part Four, Section 5\(c\) of this Manual](#).
 - (vii) Other Catastrophe-Linked Bonds
The Principal and Interest Certification Form may be used to report a Catastrophe-Linked Bond that has not been assigned a credit rating by an NAIC CRP and those that have been assigned a credit rating by an NAIC CRP on the basis of a methodology other than that specified in [Part Four, Section 4 \(a\) \(ii\) of this Manual](#).

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