



MEMORANDUM

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

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DATE: October 6, 2017

RE: Rules Modernization Proposals: Modernize the Z Rule; Devise an Alternative Year-End Carryover Process

1. Introduction – On Aug. 1, 2017, the Task Force transferred the 5*/6* certification procedures to an Interrogatory and agreed to hold further discussion about the future use of the Z symbol.¹ At the time, the SVO had opined that insurers should continue to self-designate newly purchased securities under the Z process but that the use of Z for the “carryover population” (defined below) should be discontinued in favor of a new SVO administered procedure. ACLI and NASVA expressed support for the carryover population proposal but requested greater detail. ACLI and NASVA also identified a number of circumstances in which insurers need to use the Z symbol in support of their position that the use of Z be retained. The Task Force asked that the SVO, NASVA and ACLI to develop proposals to address the two issues.

2. Conclusions

a. The Z symbol – In their joint comment letter, ACLI and NASVA identified situations where securities transition from one reporting or filing status to another. For example, a filing exempt security may transition to a security eligible to be filed with the SVO if NAIC CRPs withdraw assigned credit ratings. A filing with the SVO in that circumstance may take time and the insurer and regulators would want to identify and track securities in transition until they are designated. The Z mechanism was initially concerned with the transition of a newly purchased security into the reporting environment with the insurer given 120 days to file the security with the SVO. The issue is that the Z mechanism has not been updated to acknowledge other transitions, as follows:

¹ Under the SVO administered process, the Z symbol was used by an insurer: 1) to self-designate a security until the SVO assigned an NAIC Designation but to file it with the SVO not later than 120 days after purchase. SVO said this use should be retained as clearly associated with Task Force operations; 2) Obtain an SVO assigned NAIC Designation or an NAIC 5* or 6* in year 2. The transfer of the certifications to the Interrogatory eliminates this process; 3) to use the Z symbol in year two instead of 5*/6* Designations if the insurer filed all required documents with the SVO and SVO did not complete an analysis by year-end.

1. New purchase where the insurer is awaiting required documentation to provide to SVO. This is the initial concept for the use of Z for which the P&P Manual provides a 120 day filing period. A security not reported in that time period should be reported as 5*GI or 6* as reflected in the flow chart.
2. The security has been properly filed with the SVO but the insurer has not yet received an NAIC Designation from the SVO. This situation is not reflected in the existing statement of the Z mechanism.
3. A previously filing exempt security that is no longer rated by any NAIC CRP. The P&P Manual requires the insurer to file the security with the SVO within 120 days. A security not filed in the allotted time period should be reported as 5*GI or 6*.
4. A previously SVO designated security has been dropped from AVS+. A security may have been dropped from AVS Plus+ because no insurer filed it for an annual review. If any insurer owned the security since the prior filing year and for more than 120-days, it would be incumbent upon them to have monitored the security and made the necessary filing with the SVO so the Z process would not apply. If no insurer continues to hold the security from the prior year into the current filing year or has only held the security for less than 120-days then this is a new purchase falling under the New Purchase Z process.
5. If the security was dropped from AVS Plus+ because the staff determines existing rules or analytical processes no longer permit the security to be designated and staff is formally seeking guidance from the Task Force the insurer should be permitted to use the Z process until the issue is resolved by the Task Force.

These considerations have led the SVO, ACLI and NASVA to recommend that the manner in which Z is used be modernized to serve the broader function of identifying all situations where a security can transition from one reporting/filing status to another. Attachment A is a flow chart that maps the operational logic that can lead to transitions given current rules and processes.

b. The Carryover Population Proposal – Under the SVO administered 5*/6* process, insurers could self-designate securities if the SVO was unable to assign an NAIC Designation to a properly filed and documented security by year-end (the “carryover population”). SVO, ACLI and NASVA agree that securities in the carryover population submitted for an **annual update** are not in transition so that the Z process should not apply to them. Initial filings in the carryover population are in transition and should be self-designated but under a distinct self-designation process until they are designated by the SVO, as further discussed below. SVO, ACLI and NASVA are in agreement on the outline of a procedure to manage these two carryover populations although further discussion is needed to finalize some of the details discussed in this memorandum. The procedure that is developing is as follows:

- At a specific date near year-end the SVO would determine that it can identify properly filed securities that it will be unable to designate by year end.
- The SVO communicates this determination operationally; by assigning the symbol **YE** to all annual updates securities and the symbol **IF** to all properly filed initial filings.
- The SVO would extend the existing designation for annual update securities in the carryover population into the next year. The insurer would report initial filing securities to regulators with the symbol **IF** and self-assign an NAIC Designation. This procedure would distinguish securities that are awaiting filing with the SVO or undergoing some recognized transition (which is what the Z rule is designed to do) from properly filed securities in the SVO space but not yet designated by the SVO at year end. The SVO would compile a list of the entire carryover population for use in discussions with the Task Force to evaluate whether the percentage of carryover population indicates a need for additional resources.
- All securities identified with the new symbols **YE** and **IF** would be prioritized for analytical assessment in the new-year.²

² 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. Further discussion with the American Council of Life Insurers (ACLI), the Private Placement investors Association (PPiA) and North American Securities Valuation Association (NASVA), led the SVO to modify the proposal in a memorandum dated March 10, 2015, entitled “Outline of Rules and System Changes and Characteristics” to provide that 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

- When the SVO finalizes its review of a security in the carryover population it would remove the **YE** or **IF** symbol and publish the updated NAIC Designation in AVS Plus+.

SVO, NASVA and the ACLI anticipate continued discussions on how the procedure might be improved for initial filings but feel the procedure and preliminary text for the P&P Manual explaining can be usefully received and released for comments. The SVO also requests that the Task Force refer a request to the Blanks (E) Working Group that it consider whether the proposed use of Z and the transitions issue is relevant to statutory reporting guidance.

3. Proposed P&P Manual Amendments

a) **The Z Symbol** – An amendment is proposed to the definition of the Z symbol in Part One, Section 3 (b) (v) of the P&P Manual as follows:

Today:

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.

Proposed:

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.

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

- 1) it is newly purchased and has not yet been submitted to the SVO;
- 2) has been properly submitted to the SVO for assignment of an NAIC Designation which is still pending, whether at year-end or otherwise;
- 3) 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
- 4) an SVO assigned NAIC Designation for the security has been dropped from AVS Plus+ and the insurer has otherwise followed all other filing requirements.

(This text shall be amended as additional transition situations are identified.)

b) **The YE Symbol** – An amendment is proposed to add definitions for a new symbol in Part One, Section 3 (b) (v) of the P&P Manual as follows:

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.

Proposed:

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 Part One, Section 3 (f) (iii) of this Manual. When the SVO assigns the symbol **YE** it also assigns the NAIC Designation in effect for the previous reporting year.

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.

c) **Year End Process** - An amendment is proposed to add the year end procedure discussed in the memorandum as a new sub-section (iii) in Part One, Section 3 (f) of the P&P Manual, as follows:

Today: The P&P Manual does not contain a procedure governing the year-end issue of carryover.

Proposed:

(iii) Administrative Procedure for Carryover Population

(A) Acceptable Carryover Population Rate

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.

(B) Definition

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.

(C) Procedures

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, defined in Part Two, Section 11 of this Manual as a Subsequent Report, 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, as defined in Part Two, Section 10 of this Manual, 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+.
- 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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