



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, NAIC Investment Analysis Office
Charles Therriault, Director, NAIC Securities Valuation Office

CC: Dan Daveline, Director, NAIC Financial Regulatory Service

DATE: March 15, 2017

RE: Status Report on the List of Qualified U.S. Financial Institutions

1. Report – The Task Force adopted an amendment to Part Six, Section 1 of the *Purposes and Procedures Manual of NAIC Investment Analysis Office* (P&P Manual) that implements a new approach to the NAIC Securities Valuation Office’s (SVO) Bank List function. The amendment was adopted June 16, 2016, with an effective date of Jan. 1, 2017. The effective date was subsequently postponed to July 1, 2017, because of the need to complete internal administrative processes. At the time of adoption, it was agreed that the SVO would present editorial changes to the adopted text once the SVO concluded its development of internal administrative processes. In the interim, recently hired managers have proposed different financial ratios be used by the SVO to monitor financial institutions. All modifications from the adopted text are by comment balloons in the attachment, whose import is summarized below. The SVO would initiate the new List of Qualified U.S. Financial Institutions effective July 1, 2017, and requests that the proposed changes be exposed for a 30-day public comment period to permit consideration of adoption prior to July 1.

2. Editorial Changes – The editorial changes to the adopted text are identified in the following comment balloons:

- RC1: The List of Nationally Recognized Statistical Rating Organizations (NRSROs) is added.
- RC2: A link will be inserted in the P&P Manual text to the SVO website where the application is to be posted.
- RC3: The highlighted text will be deleted when the adopted text is inserted into the P&P Manual.
- RC4: References to the NRSRO process list where changes to assigned ratings are identified was expanded.
- RC5: A reference to the SVO Watch List was added to the description of the SVO monitoring process.
- RC6: Different financial ratios are identified for use in independent SVO analysis.
- RC7: The conditions for restoring a financial institution on the SVO Watch List to the new List of Qualified U.S. Financial Institutions are identified.
- RC8: The existing Bank List format was expanded to apply to the new List of Qualified U.S. Financial Institutions.
- RC9: The SVO Watch List has been added.
- RC10: The NRSRO List (identifying the required methodology) has been added.

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Attachment One
Proposed Amendment to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*

Part Six – List of Qualified U.S. Financial Institutions
(Issuers of Letters of Credit as Collateral in Reinsurance Arrangements)

Section 1. Regulatory Purpose and Objectives

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).

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.

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.

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.

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.

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.

Section 2. Directive to Compile the List of Qualified U.S. Financial Institutions

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

Section 3. List of Nationally Recognized Statistical Rating Organizations

a. 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:

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

2) 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:

(i) 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.

(ii) Results in the expression of an opinion of the bank's or NBF's likelihood of default on an LOC obligation and or long-term debt obligation.

(iii) 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.

b. Procedure

(i) 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.

(ii) 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 NBFs 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.

c. 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 Valuation of Securities (E) Task Force 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.

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.

Section 4. List of Qualified U.S. Financial Institutions

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

(i) 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.)

b. Procedure

(i) Initial Application – An application is submitted to the SVO. 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.

(ii) 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.

(iii) 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.

Section 5. Eligibility Standards to Be Placed on the List of Qualified U.S. Financial Institutions

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

(i) 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.

(ii) A U.S. branch or agency of a foreign financial institution:

(A) Authorized to issue LOCs for reinsurance.

(B) 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.

(C) 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).

Section 6. SVO Monitoring of Movements in the Credit Quality of Financial Institution on the List of Qualified U.S. Financial Institutions

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

(i) 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.

(ii) 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.

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

(i) 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

(ii) Determine and evaluate the following five primary data points and ratios. (Annually, the NAIC SVO will review industry data to determine if these benchmarks should be adjusted to reflect changes in market conditions.)

- Total assets must remain at greater than \$55 billion.
- Total equity capital must remain at greater than \$5 billion.
- Annualized cash from operations must remain at greater than \$2 billion.
- Debt to capital ratio must remain below 55%.
- EBITDA to interest coverage ratio must remain at greater than 8.5 times.

c. 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.

(i) 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 standards specified above, the SVO will monitor the institution to determine if the NRSRO takes any rating action against the institution.

(ii) If the SVO determines that a financial institution on the List of Qualified U.S. Financial Institutions rated below “A-/A3” by an NRSRO no longer meets one or more of the financial standards 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. 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 the Watch List, signifying that the financial institution will not be allowed to renew participation on the financial institution list for the next year, and until the financial institution’s credit rating is restored to BBB/Baa or higher with a stable outlook

(iii) 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.

Section 6. LOC Requirements Under the Model Law

a. 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.

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

List of List of Qualified U.S. Financial Institutions

EXPLANATORY NOTE: State insurance regulators and insurance companies may use this list for any purpose of the purposes discussed above.

A specific financial institution must apply to be listed only once. This means that an insurance company may do business with: (i) a listed domestic parent bank entity, and any of its unlisted domestic branches; (ii) a listed domestic branch of a domestic parent bank entity, the unlisted domestic parent bank entity and any other unlisted domestic branches of the same domestic parent bank entity; and (iii) a listed U.S. branch of a foreign bank entity and any other unlisted U.S. branches of the same foreign parent bank entity and to the equivalent relationships when a financial institution other than a bank is an Applicant.* Notwithstanding the above, any entity related to a domestic listed entity (i.e. parent or branch) may apply to be listed independently. Any domestic parent bank entity, its domestic branches and U.S. branches of a foreign parent bank entity with no related entity on the list that wants to be listed must apply to the SVO.

** This policy only applies to financial institutions that share the same legal identity. Banking entities or other financial institutions that share the same or similar names but that are separately chartered, and bank subsidiaries, that want to be listed, must apply individually.*

NAME OF FINANCIAL INSTITUTION	BRANCH NAME OR LOCATION	ABA NUMBER	SOVEREIGN
		113011258	USA

**List of Qualified U.S. Financial Institutions
on Watch List**

Note: The name of a US Qualified Financial Institution is placed on this Watch List if an analysis conducted by the SVO indicates that the institution may fall below the threshold NRSRO assigned credit quality required to be placed on the List. The placement of the name of a US Qualified Financial Institution on the List indicates the institutions is not permitted to renew participation on the List unless the credit conditions that prompt its removal have been reversed. If the NRSRO removes the name of the financial institution from Negative Watch or Outlook, the SVO removes the name of the financial institution from the Watch List.

NAME OF FINANCIAL INSTITUTION	NAME OF NRSRO	DATE PLACED ON NEGATIVE WATCH BY NRSRO AND CREDIT RATING AT THAT DATE	DATE PLACED ON SVO WATCH LIST

List of Nationally Recognized Statistical Rating Organizations and Methodology and Criteria Used to Monitor Institutions on the NAIC List of Qualified U.S. Financial Institutions

NAME OF NRSRO	METHODOLOGY/CRITERIA	DATE	
Moody's Investors Service	Rating Methodology – Banks, Nonbank Financial Institutions Rating Methodology,	March 16, 2015	
Standard & Poor's Global Ratings Portal, Ratings Direct :	Credit Rating Methodology for Nonbank Financial Institutions and Nonbank Financial Services Company, Banks: Rating Methodology and Assumptions	Dec. 9, 2014; Dec. 9, 2014 Nov. 9, 2011	The criteria for Banks was originally published on Nov. 9, 2011, was republished after a review completed on Sept. 30, 2014. The review replaced or revised criteria for the application of sovereign ratings and assessment of bank branch creditworthiness published Oct. 14, 2013, and other articles identified in the Appendix.