

CIPR Webinar: The Impact of Rating Agencies on the Insurance Industry

Overview of the NAIC Securities Valuation Office

October 20, 2016

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Capital Markets & Investment Analysis Office

- There are three investment functions within the NAIC's New York office.
- Two of the functions, Securities Valuations Office (SVO) and Structured Securities Group (SSG), combine to form the Investment Analysis Office (IAO). They are the operational areas that evaluate the quality of individual investment securities under the purview of the Valuation of Securities Task Force, a subgroup of the Financial Condition (E) Committee. The IAO teams support the Valuation of Securities Task Force along with other NAIC groups and NAIC staff on investment related issues.
- The third function is the Capital Markets Bureau (CMB), its mission is to support state insurance departments and other NAIC staff on matters affecting the regulation of investment activities at state regulated insurance companies. Typically they looking at more macro or portfolio level investment issues.



Securities Valuation Office (SVO)

- The SVO is responsible for the day-to-day quality assessment and valuation of securities owned by state regulated insurance companies. Insurance companies report ownership of securities to the Investment Analysis Office when such securities are eligible for filing on Schedule D, DA or BA of the NAIC Financial Statement Blank.
- The SVO supports a number of regulatory groups but primarily works with the Valuation of Securities (E) Task Force that formulates the NAIC policies that govern how analytical tools - for example, credit assessment, valuation and classification of insurer-owned securities - are employed and how analytical insight into investment risk is applied for regulation.
- The SVO functions in accordance with instructions adopted by the Task Force and contained in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual)*.



Securities Valuation Office (SVO)

- The SVO staff conducts investment research on behalf of the Task Force and serve as the investment experts for State Insurance Regulators
- The *P&P Manual* instructs insurers to report either specific securities to the NAIC or those that are not rated by a Nationally Recognized Statistical Rating Organizations (NRSRO) that provides the NAIC with security level ratings, known as credit rating providers (CRP).
- There are currently nine CRPs: Moody's, Standard & Poor's, Fitch, DBRS, A.M. Best, Morningstar, Kroll, Egan Jones and HR Ratings de Mexico.



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NAIC's SVO Use of CRP Rating Information

- SVO analysts may utilize the research of one or more NRSRO in their analysis. As permitted in the *P&P Manual*, this may include issuer rating analysis, sector trends or industry/asset class methodologies.
- Securities that are not rated by an NAIC credit rating provider (CRP) and are not covered under other instructions in the *P&P Manual* must be filed for analysis by the SVO analysts to receive an NAIC Designation.
- Securities that are rated by an NAIC credit rating provider (CRP) and are not covered under other instructions in the *P&P Manual* can have their ratings translated into an NAIC Designation.



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NAIC's SVO Use of CRP Rating Information

- This translation of a CRP rating to an NAIC Designation is one of several exception processes called Filing Exempt (FE) that is defined in detail in the *P&P Manual*.
- All nine CRP feeds are required for any translation to an NAIC Designation. Generally, all eligible CRP ratings are ordered according to their translated NAIC equivalent, sequenced from highest-to-lowest, with the second to lowest translated rating used for conversion to an NAIC Designation.
- Special ratings systems are typically excluded as are non-monitored ratings and those not covering repayment of principal and interest or dividends.



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Credit Rating Providers (CRP) Rating Equivalents

Corporate, Government Counterparty and Municipal Ratings SVO

NAIC SVO	Moody's Investor's Service	Standard and Poor's	Fitch
1	Aaa; Aa1, Aa2, Aa3; A1, A2, A3	AAA, AA+, AA, AA-, A+, A, A-	AAA, AA+, AA, AA-, A+, A, A-
2	Baa1, Baa2, Baa3	BBB+, BBB, BBB-	BBB+, BBB, BBB-
3	Ba1, Ba2, Ba3	BB+, BB, BB-	BB+, BB, BB-
4	B1, B2, B3	B+, B, B-	B+, B, B-
5	Caa1, Caa2, Caa3	CCC+, CCC, CCC-	CCC
6	Ca, C	CC, C, D	CC, C, DDD, DD, D

Other approved Credit Rating Providers (CRP) include: Dominion Bond Rating Service, A.M. Best Company, Morningstar Credit Ratings, LLC, Kroll Bond Rating Agency, Egan Jones Rating Company and HR Ratings de Mexico. The full list of all CRP Rating Equivalents is documented in the **Purposes and Procedures Manual**.



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NAIC Designations versus a CRP rating

- 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 (NRSRO) or other rating organizations whose ratings are intended to be used by investors as predictive opinions of default risk.
- Designations have a regulatory post-purchase focus instead of the capital market pre-purchase focus of a rating.
- Designations have a limited state insurance financial solvency role and are intended for use only by NAIC members.
- The primary source of the information used in the Designation analysis by the SVO staff is provided by the insurer – including its own internal analysis.
- This internal analytical capability provides regulators with an independent and objective analysis of the risks associated with the securities owned by insurers from a perspective fully aligned with their regulatory mission.



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Summary of Methodologies used to Produce NAIC Designations

- The SVO and SSG use a number of methodologies to produce and NAIC Designation. These various methodologies are described in greater detail in the *P&P Manual*.
 - 1) Certain US Government and US Treasury securities are assigned NAIC-1 Designations pursuant to a policy decision specified in the *P&P Manual*.
 - 2) The SVO produces and assigns NAIC Designations to Investment Securities not rated by a CRP using credit assessment methodology.
 - 3) Certain Certificates of Deposit are assigned NAIC Designations pursuant to a formula specified in the *P&P Manual*.
 - 4) A Special Reporting Instruction assigns regulatory treatment equal to that for an NAIC-5 or NAIC-6 Designation to Investment Securities based on an insurer certification or as a required SVO response in certain analytical processes.
 - 5) Certified Capital Companies (CAPCOs) securities are assigned NAIC Designations by reference to analytical and statutory accounting criteria.
 - 6) Working Capital Finance Investments are subject to an analytical process that incorporates financial, structural, legal and statutory accounting criteria



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- 7) Credit Tenant Loans receive bond treatment only if they meet financial, structural and legal criteria specified in the *P&P Manual*.
 - 8) Intrinsic prices for of RMBS and CMBS generated by a financial modeling process conducted by the SSG pursuant to the *P&P Manual* are converted to NAIC Designations by insurers in accordance with statutory accounting instructions.
 - 9) Military Housing Bonds are assigned NAIC Designations based on a combined insurer certification and SVO analytical processes specified in *P&P Manual*.
 - 10) Transactions between an insurer and related parties are subject to special rules under the Statements Statutory of Accounting Principles (SSAP) No. 25, Affiliates and Other Related Parties and SSAP No. 97 Investments in Subsidiary, Controlled and Affiliated Entities of the NAIC Accounting Practices and Procedures Manual.
 - 11) Specific classes of securities are excluded from the filing exemption process and regulated on some other basis as specified in the *P&P Manual*.
 - 12) Some Capital and Surplus Debentures are assigned NAIC Designations based on CRP credit ratings as an exception to a statutory accounting based valuation methodology.



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 - 13) Special Instructions - there are a number of Special Instructions in the P&P Manual that require the SVO to assign either a specific NAIC Designation or require it to decline assigning one.
 - 14) The SVO may be required to identify a new investment security or financial product to the VOS/TF with a recommendation that the NAIC develop guidance before insurers can purchase it because of a feature that makes it a different quality under the NAIC Financial Conditions Framework despite the assigned NAIC CRP credit rating.
 - 15) The terms or characteristics of certain securities may require the SVO to notch down from the obligor's NRSRO assigned credit rating to reflect concerns with Other Non-Payment Risk in an Investment Security which are unique to the NAIC reporting framework.

Q&A

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Securities Valuation Office (SVO)

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