

July 26, 2023

The National Association of Insurance Commissioners (NAIC) is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators of the 50 states, the District of Columbia and five U.S. territories. Through the NAIC, NAIC Members, in their capacity as state insurance regulators, establish standards and best practices, conduct peer review, and coordinate regulatory oversight. NAIC staff supports these efforts, representing 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.

Committees composed of NAIC members conduct the work of the Association. 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 Valuation of Securities (E) Task Force (VOS/TF) reports to the Financial Condition (E) Committee and formulates and implements NAIC's credit assessment and related policies. The Securities Valuation Office (SVO) are the professional staff assigned to support the VOS/TF. The SVO conducts credit quality assessments of securities owned by state-regulated insurance companies and performs such other duties specified by VOS/TF in the Purposes and Procedures Manual of the NAIC Investment Analysis Office (P&P Manual) or assigned by other NAIC regulator groups, from time to time.

The P&P 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 procedures conducted by the NAIC, the SVO and the Structured Securities Group (SSG) to support the VOS/TF. The P&P Manual is authoritative on these topics over other NAIC publications. The P&P Manual describes the NAIC's use of credit ratings of rating organizations that have been designated a Nationally Recognized Statistical Rating Organization (NRSRO) by the U.S. Securities and Exchange Commission (SEC). The core policies covering the use of credit ratings are in P&P Manual, Part One, paragraphs 58-62, and Part Two, paragraphs 155-163 which is listed below along with a link to the full manual that contains additional references and instructions beyond these core policies related to the use of credit ratings.

To better support the credit assessment processes dependent upon credit ratings, the VOST/TF has compiled the following series of questions that it requests you to respond to in writing and submit back the SVO staff within 30-days. After your responses have been received, the SVO staff will follow up with you to schedule a private meeting with the VOS/TF members and NAIC staff to discuss your comments and answer any additional questions from the VOS/TF members, NAIC staff or yourselves.

Thank you in advance for responding to our questions.



NAIC Questions for Credit Rating Providers (CRP):

Regulation

1. Please describe what role, if any, credit ratings have or should have in relation to insurer financial solvency regulation, both now and in the future.
2. Do you consider the implications of regulatory capital under your ratings methodology; specifically, insurance regulatory capital?

Ratings Meaning and Performance

3. How do you define your ratings?
4. What are your ratings based/anchored on?
5. What, if any, performance expectations do you have for each rating category?
6. Do you have idealized expected loss given default percentages for each rating? Does it differ across methodology or asset class? Over what time period are they calculated? Do you publish them and/or publish a comparison of actual experience to them?
7. How do your ratings measure statistical tail-risk?
8. Under what circumstances or situations would you decline to rate a security?
9. Under what circumstances or situations would you withdraw a security's rating?
10. Describe if and how you use market data (e.g. credit default swaps pricing, bond market yield spread to USTs or some other observable metric) within your ratings process.
11. Describe the differences between your solicited and unsolicited ratings.
12. What percentage of your ratings are point in time versus continuously monitored?
13. Please describe the differences between your public and privately issued ratings.
14. What is your percentage distribution of ratings by assets class and security type (as described in your methodologies)?
 - Public vs. privately issued
 - Solicited vs. unsolicited
 - Withdrawn
15. Do you have the ability to provide the ratings performance by asset class over specific time periods, to the extent available?
16. How do you assess the quality and performance of your ratings?
17. How do you rate the following types of securities?
 - Feeder fund / rated notes
 - Closed end funds
 - Structures securities
 - Nested or compound securities (e.g. CLO Combo Notes, an SPV that invests in funds that issues notes)
 - Securities that do not have events of default or payment expectations (no scheduled principal or interest payments)
 - Securities that can defer interest more than 24-months.



Ratings Procedures and Processes

18. Which committees, persons/roles or entities can challenge an analyst rating and who is involved in this process? What level is this in the organization and is this a formal process?
19. How do you report withdrawn ratings on your Form NRSRO transitions and cumulative default statistics?
20. What would cause you to change a methodology? And how is the credit committee involved with setting methodologies?
21. Describe the main steps of your ratings assignment process?
22. What Is your process for developing / changing a rating methodology?

Internal Controls

23. Has your firm or an employee been fined or otherwise penalized by the SEC's Division of Enforcement in the past 10-years? If so, please describe each situation, the penalties and any remediation measures required and/or taken.
24. Describe your firm's governance policies and control structure. What are the key elements of your process that safeguard the independence of your ratings/ratings process, and prevent prohibited conflicts of interest?
25. Are your governance/oversight practices consistent for every asset class and type of rating? If not, explain the differences.
26. How many insurance industry related clients (e.g. insurance companies, group or entities that own/manage insurance companies, insurance company investment portfolios, or issue securities primarily for insurance companies) do you have whose fees exceed 1% of your total revenues?
 - What percentage of total revenues are they?
 - List those clients, if applicable.



PURPOSES AND PROCEDURES MANUAL OF THE NAIC INVESTMENT ANALYSIS OFFICE ([P&P MANUAL](#))

PART ONE: POLICIES OF THE VALUATION OF SECURITIES (E) TASK FORCE

THE USE OF CREDIT RATINGS OF NRSROs IN NAIC PROCESSES

NOTE: See “Policies Applicable to the Filing Exemption (FE) Process” below; “NAIC Policy on the Use of Credit Ratings of NRSROs” (especially “Definition – Credit Ratings Eligible for Translation to NAIC Designations”) in Part Two (the definition of “Eligible NAIC CRP Credit Ratings” excludes the use of any credit rating assigned to a security type *where the NAIC has determined that the security type is not eligible to be reported on Schedule D or that it is not appropriate for NRSRO credit ratings to be used to determine the regulatory treatment of the security or asset*); and “Procedure Applicable to Filing Exempt (FE) Securities and Private Letter (PL) Rating Securities” in Part Three.

Providing Credit Rating Services to the NAIC

58. 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 U.S. Securities and Exchange Commission (SEC) and which continues to be subject to federal regulation, may apply to provide Credit Rating Services¹ to the NAIC.

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

59. 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.
60. 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; e.g., 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.

¹ **Credit Rating Services** is defined as: (a) 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; (b) other analytical services or products, in English, provided to other customers; and (c) access to the NRSRO’s rating analysts by SVO staff.



No Waiver/Express Reservation of Authority

61. 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.
62. 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.



PART TWO: OPERATIONAL AND ADMINISTRATIVE INSTRUCTIONS APPLICABLE TO THE SVO

NAIC POLICY ON THE USE OF CREDIT RATINGS OF NRSROs

NOTE: See “Coordination Between the Statutory Accounting Principles Working Group and the Valuation of Securities Task Force, “Use of Credit Ratings of NRSROs in NAIC Processes” and “Policies Applicable to the Filing Exemption (FE) Process” in Part One; “Definition – Credit Ratings Eligible for Translation to NAIC Designations in this “NAIC Policy on the Use of Credit Ratings of NRSROs”; “Procedure Applicable to Filing Exempt (FE) Securities and Private Letter (PL) Rating Securities” in Part Three; and “Filing Exemption Status of RMBS and CMBS” in Part Four, which excludes RMBS and CMBS from the use of NRRO credit ratings for NAIC regulatory processes.

Procedure to Become an NAIC Credit Rating Provider

155. 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.
 - 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 its 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 months 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.
156. Adding the NRSRO to the NAIC Credit Rating Provider List 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

157. 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.

Definition – Credit Ratings Eligible for Translation to NAIC Designations

158. As disclosed below, the NAIC may determine that the rated security or investment is of a type that is not eligible to be reported on Schedule D 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, as specified in this manual.

159. The credit rating of the CRP to which this section and the NAIC Credit Rating Provider List refers is the (a) credit rating assigned by the NAIC CRP; (b) by application of its long-term obligation ratings scale and methodology; to (c) securities.

160. 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;
 - 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
 - Are 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”).



161. The NAIC may determine that the rated security or investment is of a type that is not eligible to be reported on Schedule D 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, as specified in this manual.

Special Rating Systems

162. 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

163. 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 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.