

Q&A for Filers

Compiled from NASVA members over the last few years

Section 1: Filing Q & A

Q: Why have the SVO analysts issued info reqs for the compliance certificate on private placement securities where there does not appear to be a requirement for this in the P&P manual?

A: Throughout the P&P Manual, reference is made to the need for the SVO analysts to perform adequate due diligence and, in order to do that, they are encouraged to use their professional judgment in requesting additional documents for a particular credit. The overriding assumption is that providing this document ultimately benefits both regulators and industry. In this specific case, the compliance certificate is a useful monitoring tool for an officer of the company to certify compliance with all covenants, including financial covenants, with the Terms and Conditions of the original or amended Offering Memo.

Q: Why have the SVO analysts issued info reqs for copies of the filer's internal investment analysis for private placement annual updates, there does not appear to be a requirement for this in the P&P manual?

A: Throughout the P & P Manual, reference is made to the need for the SVO analysts to perform adequate due diligence and, in order to do that, they are encouraged to use their professional judgment in requesting additional documents for a particular credit. The overriding assumption is that providing this document ultimately benefits both regulators and industry.

Q: Is it critical for an investment committee memorandum to be submitted as part of the initial filing package? If so, and if one is not available do we have to submit a VIM form?

A: Yes, it is critical for this document to be submitted whenever it is available because it provides detailed information from the insurance company about the investment transaction and the issuer. If one is not available, the filer should make a notation to that effect in the comments section of the ATF form. This should prevent an Info Req from being generated. In the event a filer does receive an Info Req for this document a telephone conversation with the analyst should resolve the problem. If it does not resolve the problem then a phone conversations with that analyst's manager should resolve the issue.

A VIM form is not a good substitute for the investment committee memorandum as it is designed to duplicate the kind of information found in an offering memorandum or a private placement memorandum. Only if these two latter documents are not available, the insurer must submit a completed VIM form. See Part Five, Section 3 (a) (ii) of the P&P Manual.

Q: As a new filer, I would like the definition of “Code 99” and how/when it is used. Also, why is this topic excluded from the P&P Manual if this something the SVO regularly employs?

A: A “Code 99” is used in the VOS database to indicate that a security was reviewed and updated in the current year for the previous year. Code 99 securities are not viewable on the VOS database.

Code 99 is used to process:

(a) Annual update filings that are received too late in the current year and cannot be processed before year end

(b) Annual update filings received in the current year to update a security for the previous year

All Code 99 filings are processed only at the request of the filer of the security.

After the Addendum, the SVO posts all the possible Code 99 securities for the prior year on its website.

Q: Can the NAIC expand industry’s ability to delete ATFs that have already been received by the SVO? Companies have encountered problems in the past when the SVO analyst tries to delete a filing which has been received at the SVO and already scanned into the system. Oftentimes the filings do not get deleted from the Inquiry Service screen so they must be deleted by NAIC staff.

A: Currently, the filer of an ATF can delete that AFT at any time prior to either its being scanned into ISIS by the SVO or its 30 day expiration window.

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Once the ATF is scanned into ISIS, only an SVO staff member can delete it from the system. The SVO has not encountered any problems with this process. If ATF information is displaying in Inquiry, then the ATF has not yet been deleted by the analyst.

Q: Should long-term Certificates of Deposits be filed with the SVO? If so, which section of the P&P Manual addresses this type of filing? Which specific documents should be submitted with the filing? Are there any regulator considerations that industry should be aware of?

A: *SSAP No. 26 defines Certificates of Deposit that have a maturity in excess of one year as a Bond. The P&P Manual states that all Bonds should be filed with the SVO for Designation and Valuation unless they are subject to a filing exemption. The insurance company should submit the same kind of documents as for a bond – financial statements for the issuer and the document describing the transaction. We are not aware of any special regulatory considerations.*

Q: Is there a way to track the status of a Counterparty initial filing? Which types of filings can be tracked via the Inquiry Service? Which cannot?

A: *Corporate, Municipal, Government, Sovereign and Supranational and Structured Securities are the eligible Departments within the VOS database for display in both AVS and the VOS CD-ROM, therefore only filings under those departments can be tracked within Inquiry Service.*

Other departments, including Mutual Fund, Bank Letter of Credit, Surplus Notes, Counterparty and Subsidiaries cannot be tracked using the Inquiry Service.

Q: For securities with non-12/31 FYE, what is considered to be a current financial statement? Is it fair to say that 8/31 to 12/31/05 and 1/31 to 7/31/06 would be considered valid for the current year?

A: *January (of past year) – June (of past year) = past year designation
July (of past year) – December (of current year) = current year designation
January (of current year) – June (of current year) = current year designation*

We don't consider this a significant issue, as close to 95% of issuers have December, January, and March fiscal year ends. Our experience has been that the primary reason filings are not completed is the timing of the filing with the SVO rather than FYE issues.

Q: Does the SVO review initial filings to determine if they correctly identify the instrument as Schedule D or Schedule BA? Does it contact the filer if the type of initial filing is incorrect?

A: The SVO is responsible for determining whether an investment is Schedule D-eligible. In the case of Schedule BA, the SVO does not question whether the investment is eligible, but accepts the filing as is.

Yes, the analyst will contact the filer.

Q: How does the SVO determine the guarantor and populate it in ISIS? If a filer feels the auto-populated data on the annual update ATF form is incorrect, what should it do?

A: The guarantor information is determined from the documents submitted by the filer with the initial filing. SVO Analysts link guarantor to VOS issues by assigning the 6 digit Issuer Number of the particular Guarantor.

If a filer believes that the guarantor information in our database is not accurate, he/she should contact the SVO analyst responsible for that security.

Q: Insurers are becoming more active in the foreign bank loan market. Oftentimes the documentation available for these types of deals is not the same as with U.S. issued private placements. Such is the case with the Audited Financials since they are oftentimes published in something other than English. The insurer's Investment Analyst instead uses the Auditors Due Diligence Report, as it is a more complex accounting of the company's financial status than the typical audited financials. Would the SVO be willing to accept this document, (in lieu of audited financials) so that these instruments are not automatically limited to a NAIC- 5* ratings?

A: We do not have the option to decide what we will consider for purposes of an analysis. For corporate transactions the P&P Manual requires a financial analysis based on Audited Financial Statements in English. (That term includes the auditor's opinion, and all notes to the financial statement.) In the case of non-US securities, the SVO may also require reconciliation. The requirement aims at reliability. Its application to all securities where financial analysis is at least part of the methodology ensures all securities are being measured against the same yardstick.

It's not clear what an Auditor's Due Diligence Report is. The question is whether it fulfills the same purpose as an audited Financial Statement and whether it has the same degree of reliability and analytical usefulness. If we were to determine that it does and that it is a document that is widely in use, uniform and subject to ascertainable professional standards we could introduce an amendment to the P&P Manual to permit its use.

Q: Does the SVO follow a FIFO process in reviewing filings? If not, what type of process does it employ?

A: *The SVO makes its best efforts to complete filings in the FIFO manner.*

Q: What criteria does the SVO use when assigning a market indicator of "A"? Should all privately traded equities have this indicator? When is something assigned an "A" vs. "U"?

A: *All private equities should have an "A" market indicator. The administrative symbol "A" indicates that the unit price of the equity was determined by the SVO.*

"U" is used to indicate that the equity price is the price listed on any market or exchange, including a foreign exchange, other than NYSE, AMEX, or NASDAQ.

Q: A number of securities appear to have been reclassified from corporate bonds to structured securities over the past year or so. Many are lease-backed securities and other types of leveraged transactions. Historically these have been filed as corporate bonds as the analysis is based upon the corporate lessee/obligor. Why has the SVO reclassified these types of transactions to structured securities and which analyst is reviewing the filings?

A: *The SVO has reclassified certain security filings from "Corporate" to "Structured" because the initial classifications were inaccurate.*

"Corporate" bonds, and related filings, are typically defined as direct obligations of domestic and foreign corporations (see Part Seven, Section 2(a) of the P&P), whereas, "Structured" securities are typically not direct obligations of domestic and foreign corporations, notwithstanding the fact that some "Structured" securities may involve an underlying "Corporate" entity. Kevin Driscoll reviews structured securities.

Q: Will the SVO accept non-US GAAP financials? If so, under what conditions?

A: *Yes. However, they must be in English with an explanation of how the national accounting standards differ from US GAAP.*

Q: What type of information does the SVO require be filed for foreign public common stock which trades on a non-US exchange when no English language audited financial statements are available?

A: The Purposes and Procedures Manual of the NAIC-SVO requires GAAP audited financials in English for all filings.

Q: What consideration does the SVO give to a security where the issuer has declared bankruptcy and the bankruptcy judge has deemed the security has "adequate protection" (recognizes that the security will receive if not all, close to all of the interest and principal due) allowing the issuer to continue paying interest to the holders? If this security is still paying interest, and the expectation is that the principal will be repaid, and the security is trading at 98% is a NAIC-6 an appropriate designation?

A: Yes. When a debtor enters into bankruptcy, a legal entity called an estate is created by operation of law. All of the interests of the debtor to any interest in property to any legal rights whatsoever are transferred to the estate. At the same time, upon the filing of a case in bankruptcy, an automatic stay is imposed that precludes anyone from asserting any rights against the debtor and specifically against property of the debtor. A secured creditor is affected by this stay and therefore cannot by law enforce its rights to collateral without the court first lifting the stay. The argument the secured creditor will make is that it will be damaged (i.e., it will not have the ability to recover) if the stay is not lifted so it can enforce its rights in the property of the debtor. Oftentimes, the court has an interest in keeping the property in the estate so that debtor can use it to carry on its business as part of the reorganization. If the court is unwilling to lift the stay as it applies to the secured creditor it must, by law, ascertain that the secured creditor is adequately protected and if it finds that the secured party's interest in the debtor's property would be diminished by debtor's use of it, it must order the debtor to make payments to the secured party or provide other relief, such as giving the secured party a lien in other property to make up the loss in value of its collateral.

If a court actually lifts the stay and permits the secured party to exercise its rights in collateral, the security holder will cash out and should account for the transaction accordingly. If the court were to actually permit the debtor to continue to make payments of interest as an adequate protection remedy – that would be relevant to SVO valuation per Part Six, Section 3 (b) (iv).

Adequate protection, however, is not intended as a judgment by the court that the secured party will ultimately receive all or close to all of its interest or principal, only that its security interest is sufficient to permit the court to leave the automatic stay in place. An expectation that principal will be paid cannot flow from the court's judgment since all the judgment does as to repayment of principal is freeze the secured party in place. A judgment on the likelihood of repayment of principal can only flow from post reorganization performance of the issuer.

Q: How does the SVO define a distressed security? If a security has had a modification to its original payment terms (i.e. converted to PIK or extended maturity date) does this automatically mean it is distressed?

A: Although Part Six contains a definition of distressed, we prefer to use the material credit event standard. Any security where the creditor has had to renegotiate repayment terms, accept less coupon, extend the maturity date or forgive amounts due would constitute a material credit that should be reported and analyzed by us to see if it requires a change in credit quality, valuation or both. A conversion to PIK could certainly qualify under this standard. The concepts in SSAP No. 36 are both relevant and useful.

Q: Will the SVO use the same procedures as any other issue for Schedule BA Asset ATFs?

A: Established InfoReq procedures will be followed for Schedule BA Asset ATFs.

Q: If there are multiple issues under one issuer, and one issue is appealed, would the appealed rating (if changed, presumably up) be applied to all issues under that issuer? We did not think so, but one of our analysts was told by an SVO analyst that another issue for the same issuer were upgraded, they would upgrade all issues under that issuer. Is that true for all appeals? That one filed for one issue will blanket all of the other issues (even if no other appeal forms were submitted)?

A: See response to this question on the SVO Q & A on their website.

Q: Are Code 99's referenced anywhere in the P&P Manual?

A: The use of Code 99s is not referenced in the P&P Manual.

Q: How do you identify the correct CUSIPs for Bank Loans and Leverage Loans? If you can not identify a CUSIP what do you do with these and what is your filing process?

A: It is usually easy to identify which bank loan you hold from the Credit Agreement based on maturity date and date of issue. More often than not, these don't have available PPNs from S&P and you will have to request one. We are filing the bank loans that we cannot verify will have monitored ratings, but even those that qualify for FE treatment need to have a valid PPN.