

## Hybrids FAQ:

- 1. As of January 1, 2009, new reporting guidelines require all hybrid securities be reported on Schedule D Part 1 as bonds. What universe of securities is impacted by this change in reporting? Is it all securities that meet the NAIC's hybrid definition (adopted in 2006) or only those hybrids formerly reported on Schedule D Part 1 prior to 2006?**

Companies need to report on Schedule D Part 1 any Hybrid security that meets the definition of hybrids for NAIC reporting which was adopted under Blanks Proposal 2008-06BWG at the 2008 Summer National Meeting, and is as follows:

### Hybrid Securities:

Securities whose proceeds are accorded some degree of equity treatment by one or more of the nationally recognized statistical rating organizations and/or which are recognized as regulatory capital by the issuer's primary regulatory authority. Hybrid securities are designed with characteristics of debt and of equity and are intended to provide protection to the issuer's senior note holders. Hybrid securities products are sometimes referred to as capital securities. Examples of hybrid securities include Trust Preferreds, Yankee Tier 1s (with and without coupon step ups) and debt-equity hybrids (with and without mandatory triggers).

What appears to be missing is the following language, which NAIC Staff has been instructed to include as an editorial change to be considered by the Blanks Working Group at the 2009 Summer National Meeting.

This specifically excludes surplus notes, which are reported in Schedule BA, subordinated debt issues which have no coupon deferral features, and "Traditional" preferred stocks, which are reported in Schedule D Part 2 Section 1. With respect to preferred stock, traditional preferred stocks include, but are not limited to a) those that for U.S. issuers do not allow tax deductibility for dividends; and b) those issued as preferred stock of the entity or an operating subsidiary, and not through a trust or a special purpose vehicle.

- 2. How should a company report a hybrid which the SVO has classified as preferred or common stock?**

Assuming the structure of these investments meets the definition of traditional preferred stock in #1, there does not appear to be a need to make any changes. However, to the extent the reporting entity determines that the security meets the definition of a hybrid security; it should be reported with an equivalent bond designation.

- 3. Under the Long Term solution, are companies still required to notch down 1 designation those securities classified as common stock by the SVO or those issued after 08/15/05?**

No notching is required for Hybrid securities as of 01/01/09. On June 2, 2008, the Financial Condition (E) Committee adopted a report from the Hybrid RBC Working Group which adopted a report from the American Academy of Actuaries, but deferred reversal of the short-term notching solution until Jan. 1, 2009.

- 4. In reporting these securities as debt on Schedule D, will there exist a difference between STAT & GAAP treatment?**

This does not appear to be an NAIC-related issue unless the industry is willing to sponsor a Form A submitted to the Statutory Accounting Principles Working Group which would modify the current statutory guidance to adopt the US GAAP treatment.

- 5. Are there any future plans to create a new RBC charge specifically for those securities reported in the Hybrids Subgroup?**

Not at this time. However, in data capturing these securities in Schedule D, to the extent the NAIC (most likely the Capital Adequacy Task Force) accumulated data on these type of securities which indicated a different default experience than other instruments, it's possible that the NAIC could take on a project to modify the charge.

- 6. Are there any future plans to create a new AVR category specifically for those securities reported in the Hybrids Subgroup?**

Not at this time. See response to question 5, as if such a change were made for RBC, its possible a similar change would also be made for AVR.