



November 30, 2009

SSAP No. 43 Revised – Loan-Backed and Structured Securities (SSAP 43R) / RMBS Ratings Proposal

The NAIC has proposed a modification to SSAP No. 43R that will change the method in which non-agency residential mortgage-backed securities are assigned NAIC designations. This change was deemed necessary as the Acceptable Rating Organization (ARO) ratings do not distinguish between RMBS securities with different forecasted recovery values.

The NAIC has contracted with an independent vendor, PIMCO, for the fourth quarter of 2009, for the purpose of forecasting losses for 18,000+ non-agency RMBS cusips held by insurance companies. PIMCO will utilize forecast assumptions related to economic conditions and loan level details to calculate an expected loss and corresponding intrinsic price (100 – expected loss) for each modeled security. Once an intrinsic price is derived, the model will provide carrying value ranges associated with the six NAIC rating designations for each security. A set of ranges will be provided for life companies and another set of ranges provided for P&C companies for each CUSIP. Insurers are to use these ranges in a multi-step process to (1) determine the securities’ carrying value (amortized cost or fair value), (2) determine the RBC charge associated with each RMBS, and (3) determine the NAIC rating to be reported in the Annual Statement.

The NAIC provided a security as an example of how the new methodology will work. In this example, the intrinsic price is \$76, indicating a modeled loss of \$24. For this example, as will be the case with each modeled non-agency RMBS, the NAIC also provided a grid to guide insurance companies through the process of determining carrying value and RBC treatment for year-end reporting.

NAIC Designation	Price	Expected % Loss (RBC midpoint)	RBC Charge P&C and Health
1	≤76.50	≤0.65%	0.3%
2	76.51-77.16	1.50%	1.0%
3	77.17-78.15	3.25%	2.0%
4	78.16-81.94	7.25%	4.5%
5	81.95-95.00	20.00%	10.0%
6	>95.01	>20.00%	30.0%

The lower of cost or fair market value rules will not change as a result of the revised SSAP 43R guidance. An RMBS that is rated NAIC 3-6 and held by a P&C company or one that is rated NAIC 6 and held by a Life company is still carried at the lower of amortized cost or market (LCOM). However, the method to determine the rating has changed.

The first step of the RMBS ratings process involves identifying the NAIC designation for the purpose of determining the security’s carrying value (amortized cost or fair value). An insurer does this by applying a security’s amortized cost to the above grid to determine its corresponding

rating. This rating is then applied to the P&C or Life LCOM rules to determine if the security shall be carried at amortized cost or market. In the example above, a P&C company with an amortized cost of \$80 for the sample security will carry the position at LCOM due to the corresponding NAIC 4 rating.

The second step of the RMBS ratings process involves the determination of the security's RBC charge and the NAIC rating that will be reported in the Annual Statement. In the example above, if fair market value for the sample security is \$65, the P&C company will carry the position at \$65 (LCOM), hold the item as an NAIC 1 for Annual Statement reporting purposes, and incur a 0.3% RBC factor in the asset risk calculation. An unrealized loss of \$15 will affect capital & surplus on the balance sheet.

Example:

P&C Company

Amortized cost = \$80

Fair value = \$65

Step 1: Amortized cost of \$80 translates to a NAIC 4, which triggers LCOM. Security is carried at fair value \$65.

Step 2: Carrying value of \$65 translates to a NAIC 1, which is the rating reported in the Annual Statement. Security has an RBC charge of 0.3%.

The assessment of market activity and market pricing to determine abnormal or inactive markets as described in SSAP Interpretation 09-04: *Application of the Fair Value Definition* (INT 09-04) is not affected by the proposed guidance. Under INT 09-04, assets that trade in active markets are valued using a market approach given the availability of observable inputs to arrive at fair value. INT 09-04 also provides guidance in identifying the assets for which a model price can be selected over a quoted market price for determining fair value in an inactive market.

The Valuation of Securities Task Force held a conference call on November 30th for the purpose of discussing the modeler's assumptions. It remains unclear how assumptions related to home price depreciation will translate to collateral/deal specific forecasted default rates and loss severities. We'll be closely following the details of the model assumptions to assess how they may differ from AAM's quarterly modeling assumptions and will coordinate with clients as more information becomes available.

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