

Issue Paper No. 147

Working Capital Finance Investments

STATUS

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Common Area

SUMMARY OF ISSUE

1. This issue paper establishes statutory accounting principles for working capital finance investments held by reporting entities. This issue paper amends *SSAP No. 20—Nonadmitted Assets* (SSAP No. 20) to allow working capital finance investments as admitted assets to the extent they conform to the requirements of this issue paper.

SUMMARY CONCLUSION

2. Working capital finance investments represent a confirmed short-term obligation¹ to pay a specified amount owed by one party (the obligor) to another (typically a supplier of goods), generated as a part of a working capital finance investment program currently designated by the NAIC Securities Valuation Office. Pursuant to the working capital finance investment program, this short-term obligation has been transferred by the entity entitled to payment (typically a supplier of goods) to a third party investor.

3. Working capital finance investments held by a reporting entity represent a right for the reporting entity to receive future payment. This issue paper provides accounting and reporting guidelines for the right to receive payment under working capital finance programs that meet particular criteria working capital finance program that meet particular criteria.

Working Capital Finance Program - Definitions and Conditions

4. A “working capital finance program” is an open account program under which an investor may purchase interests, or evidence thereof, in commercial non-insurance receivables. A working capital finance program is created for the benefit of a commercial investment-grade obligor and its suppliers of goods or services, and facilitated by a finance agent.

5. A working capital finance program transfers a right to payment to an investor from a short-term obligation and arises from transactions among:

- a. a buyer of goods or services that becomes an obligor to the supplier of goods or services,
- b. the supplier(s) of those goods or services,
- c. a finance agent, and
- d. an investor.

¹ All references to short-term obligations in this issue paper refer to obligations not exceeding one year.

6. A “working capital finance investment” is an interest in payment(s) from a confirmed supplier receivable issued pursuant to a working capital finance program. The payment (maturity) date must not exceed one year from the date of invoice from the supplier to the obligor. This investment is created when the investor purchases from a working capital finance program that is currently designated as NAIC “1” or “2” by the NAIC Securities Valuation Office, any of the following:

- a. One or more confirmed supplier receivables;
- b. in case of a participation, a participation interest in one or more confirmed supplier receivables issued by the finance agent or lead lender holding confirmed supplier receivables; or
- c. a certificate, note or other interest manifestation, documented in a way that is verifiable by regulators, representing a legally enforceable interest in a right to payment from a trust, other special purpose entity or pool holding confirmed supplier receivables.

7. “Obligor” is the party that purchases the goods or services that generates the original supplier receivable (and payable for the Obligor). The obligor must be a single entity, which has an NAIC designation of “1” or “2” or a Credit Rating Provider equivalent. The obligor must confirm the supplier receivable described in paragraph 11 as described in the confirmation process in paragraphs 12-14.

8. “Supplier” is the party that sells the goods or services to the obligor. The supplier sells the confirmed supplier receivables in accordance with the terms of the working capital finance program designated by the NAIC Securities Valuation Office at a price agreed to by the finance agent and/or investor.

9. “Investor” is the party purchasing a working capital finance investment in accordance with the terms of the working capital finance program designated by the NAIC Securities Valuation Office.

10. The “finance agent” is a bank, financial institution, other financial intermediary, or service provider that facilitates the working capital finance program, arranges the sale, assignment or transfer of the confirmed supplier receivable to the investor for a fee and administers the payment mechanism. In the case of participation, the finance agent must inform the reporting entity investor of a default or event of default as soon as it becomes aware of such default or event of default. For the working capital finance program to qualify under this SSAP, the finance agent must meet the requirements of either paragraph 10.a. or 10.b.:

- a. The finance agent is directly regulated by, or falls under the supervision of, a financial regulator of its domiciliary country provided that such country appears on the *Purposes and Procedures Manual of the NAIC Securities Valuation Office* List of Jurisdictions Eligible for Netting and that the Securities Valuation Office determines that the regulator is the functional equivalent of the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, or the Federal Deposit Insurance Corporation; or
- b. Payments from the obligor must 1) be paid directly to the reporting entity (investor) and cannot flow through the finance agent and 2) there can be no commingling of payments or assets with those of the obligor, supplier, servicer or trust administrator or other investors.

11. A “confirmed supplier receivable” is a first priority perfected security interest or right to payment a monetary obligation from the obligor arising from the sale of goods or services from the supplier to the obligor the payment of which has been confirmed by the obligor committing and stating that the obligations under the agreement and any payment shall not be affected by the invalidity, unenforceability,

existence, performance or non-performance of the underlying commercial trade transaction or any related contract or undertaking nor that it will not protest, delay, or deny, nor offer nor assert any defenses, personal or otherwise, against payment to the supplier or any party taking claims, interests, or rights to payments made by the supplier.

- a. The confirmed supplier receivable must be sold, assigned or otherwise transferred in a manner that results in an absolute, irrevocable and legally enforceable obligation that has been confirmed by the Obligor.
- b. In the case of a participation, the certificates or other evidence of participation provide an absolute, irrevocable, and legally enforceable obligation of the finance agent or holder of the confirmed supplier receivable to pay to the reporting entity investor all of the amounts due to it under the confirmed supplier receivable, without reduction or delay arising from any claims that the finance agent may have against the reporting entity investor. The reporting entity investor's ability to exercise its rights as creditor, or to direct the finance agent to exercise the rights of a creditor on its behalf, shall not be subject to the discretion of the finance agent or other lenders or investors. The reporting entity investor's ability to exercise its rights as creditor, or to direct the finance agent to exercise the rights of a creditor on its behalf, shall not be subject to, other than during a cure period not to exceed thirty days, the discretion of the finance agent or other lenders or investors.

Confirmation Process

12. In the case of a purchase, the investor shall verify, prior to the sale that the obligor has confirmed the respective amounts, payment dates and related invoice numbers' specified dates and has waived all defenses to payment. in the case of a participation, the finance agent must verify that the obligor has confirmed the respective amounts, payment dates and related invoice numbers' specified due dates, and has waived all defenses to payment in accordance with the confirmation process.

13. The obligor must commit and state that upon confirmation of a supplier receivable it is obligated to pay to the investor, the finance agent, or any third party acting as agent or trustee for the investor, a sum equal to the full amount of that confirmed supplier receivable(s) on a date certain stated in the confirmation and that it waives any right of setoff or other defenses to avoid or delay the full and timely payment of such confirmed supplier receivable. The documents establishing the working capital finance program or the confirmation must state and confirm that the obligation to pay must be independent of any other contracts or claims that might be raised in defense arising from any transaction financed in connection with the WCFP, the confirmed supplier receivable, or any other courses of performance or courses of dealing with the supplier.

14. In the case of participation, the investor must certify that it has a commercially reasonable belief that its participation interest meets the Uniform Commercial Code's standards for creating and preserving first priority security interests in the payments due and in the confirmed supplier receivables. Commercially reasonable belief shall mean the SVO deems the investor's belief reasonable in light of the systems, policies, or practices commonly recognized in the field of investing in participations. The investor must be able to demonstrate to a regulator or to the SVO, upon either's request, the basis for its commercially reasonable belief that the WCFP creates and preserves the investor's ability to enforce a first priority perfected security interest in the confirmed supplier receivables.

15. In the case of a certificate, note, or other manifestation, capable of verification, representing a right to payment from a trust, other special purpose entity, or special purpose pool holding confirmed supplier receivables, the investor must certify that it has a commercially reasonable belief that the documents establishing and governing the working capital finance program create and preserve interests in the confirmed supplier receivables capable of being enforced by the trustee or other entity holding confirmed supplier receivables as first priority perfected security interests under the Uniform Commercial

Code. The investor must be able to demonstrate the basis for such belief to a regulator or to the SVO upon either's request. Commercially reasonable belief shall mean the SVO deems the investor's belief reasonable in light of the systems, policies, and practices commonly recognized in the field of investing in securitizations, loan backed, structured, or trust-issued securities.

Program Requirements

16. The Working Capital Finance Program investor must provide in its annual filing with the Securities Valuation Office an annual audit of the consolidated financial statements of the group of which the finance agent is part, which does not report any qualifications related to servicing, and one of the following:

- a. An annual independent report according to Statement on Standards for Attestation Engagements (SSAE) No. 16, reporting on controls at a service organization related to the administration of the investment; or
- b. An annual audit of the internal controls of the consolidated group of which the finance agent is part, which does not note any material weaknesses related to servicing.

The NAIC Securities Valuation Office would review the materiality of the report findings in making their determination of the assignment of a designation.

17. If the credit rating of the working capital finance program or obligor falls to non-investment grade (below the equivalent of NAIC designation "1" or "2"), the reporting entity shall nonadmit the working capital finance investments obtained under the related working capital finance program and/or the related obligor. Due to the short-term nature of these investments, once an investment is nonadmitted due to the credit rating of the working capital finance program or the obligor, those investments will continue to be nonadmitted.

18. Reporting entity investors must have the ability to monitor the working capital finance program and the credit-related activities of the obligor. Reporting entity investors must provide information as requested to the state of domicile indicating that they have the ability to monitor on an ongoing basis the activities of the working capital finance program. Initial permission to invest in Working Capital Finance Investment Programs may be required from the domiciliary commissioner.

19. All contracts or agreements that are a part of or that together constitute a working capital finance program must provide that if a dispute arises among any of the parties under any of the contracts or agreements that are a part of or that together constitute the working capital finance program, each party agrees that the dispute will be submitted to a court of competent jurisdiction in the United States or a constituent state thereof or of an alternative dispute resolution process recognized thereby. All contracts or agreements that are a part of or that together constitute a working capital finance program must provide that any dispute arising under any of the contracts or agreements that are a part of or that together constitute the working capital finance program must be resolved pursuant to the laws of the United States or a constituent state thereof that address the substance of the dispute but excluding those laws addressing conflicts of law.

Exclusions

20. A working capital finance investment excludes any receivables financed through:

- a. Factoring: the purchase of receivables in bulk from a supplier where the receivables represent the payment obligations of potentially thousands of buyers to a single supplier, in which the buyers have no relationship with or contractual obligation to pay the factor and retain all legal defenses to payment they may have against the supplier;

- b. Forfaiting: the purchase of one or a series of receivables from exporters by a forfaiter to enable the exporter (seller) to finance a commercial transaction with a buyer in which the Obligor has no relationship with or contractual obligation to pay the forfaiter and retains all legal defenses to pay it may have against the seller;
 - c. Invoice discounting: the advancement of funds by a finance company to a business entity with the funds advanced limited to a defined percentage of the business entity's eligible and outstanding receivables.
21. Eligible Confirmed Supplier Receivables must not:
- a. Include insurance or insurance related assets;
 - b. Be impaired or in default at the time of purchase;
 - c. Have a payment (maturity) date longer than one year from the date of the invoice from the Supplier to the Obligor giving rise to the confirmed supplier receivable, and the maturity date must not be subject to change or rolling; nor
 - d. Include any receivable of any parent or affiliate of the reporting entity investor, and neither the Obligor nor any Supplier may be affiliated with the reporting entity investor. Working Capital Finance Investments that have obligors or vendors that are affiliated with the investor are ineligible, and therefore, nonadmitted assets.

ACCOUNTING AND REPORTING

22. The right to receive payment generated by a working capital finance investment issued under a working capital finance program is considered to meet the definition of an asset as defined in *SSAP No. 4—Assets and Nonadmitted Assets*, and is an admitted asset to the extent the investment conforms to the requirements of this issue paper and the *Purposes and Procedures Manual of the NAIC Securities Valuation Office*. For programs that comply with all of these elements, working capital finance investments shall be valued and reported in accordance with this issue paper, the *Purposes and Procedures Manual of the NAIC Securities Valuation Office*, and the designation assigned in the NAIC Valuations of Securities product. Programs that do not comply with the elements in this Issue Paper are nonadmitted. Working Capital Finance Investments are reported as other invested assets in the financial statements.

23. A Working Capital Finance Investment shall be recorded on the trade date. At acquisition, the Working Capital Finance Investment shall be initially reported at cost, excluding brokerage and other related fees, and all other costs (internal costs, or costs paid for origination, purchase or commitment to purchase such investments), which shall be expensed as incurred.

24. After initial acquisition, the Working Capital Finance Investment shall be reported at amortized cost until the specified maturity date, unless the investment, or a portion thereof, is deemed to be uncollectible or when an other-than-temporary impairment has occurred. In the event that a working capital finance investment is purchased by a reporting entity investor at a premium (amount to be received by the entity under the confirmed supplier receivable is less than the price paid for the investment), the excess paid by the reporting entity investor in comparison to the amount receivable under the confirmed supplier receivable must be immediately expensed.

25. For reporting entities required to maintain an Interest Maintenance Reserve (IMR), the accounting for realized capital gains and losses from working capital finance investments shall be in accordance with *SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve* (SSAP No. 7). For reporting entities not required to maintain an IMR, realized gains and losses from working capital finance investments shall be reported as net realized capital gains or losses in the statement of income.

For reporting entities not required to maintain an AVR, unrealized gains and losses shall be recorded as a direct credit or charge to unassigned funds (surplus).

26. A Working Capital Finance Investment may provide for a prepayment penalty or acceleration fee in the event the working capital finance investment is liquidated prior to its scheduled termination date. Such fees shall be reported as investment income when received.

27. *SSAP No. 34—Investment Income Due and Accrued* shall be followed for determining and recording investment income earned on working capital finance investments acquired at a discount. In accordance with *SSAP No. 34—Investment Income Due and Accrued*, investment income shall be reduced for amounts that have been determined to be uncollectible, however amounts more than 15 days overdue are nonadmitted.

Default

28. A working capital finance investment payment that is uncollected by the reporting entity within fifteen days after the due date shall be considered in default and nonadmitted. If the reporting entity has any other working capital finance investment assets from the same defaulting counterparty, all other working capital finance investments from that counterparty shall be nonadmitted. All working capital finance investments from a counterparty identified in default shall be evaluated for impairment.

Impairment

29. An other-than-temporary impairment^{INT 06-07} shall be considered to have occurred if it is probable that the reporting entity will be unable to collect all amounts due according to the contractual terms of a confirmed supplier receivable, including the payment on the established due date. Pursuant to this guidance, assessment of other-than-temporary impairment shall include an evaluation of the financial condition and short-term prospects of the obligor. If it is determined that a decline in the fair value of a working capital finance investment below book/adjusted carrying value is due to an other-than-temporary impairment, an impairment loss shall be recognized as a realized loss equal to the entire difference between the working capital finance investment's carrying value and fair value as of the reporting period for which the assessment is made. Fair value shall be determined in accordance with *SSAP No. 100—Fair Value Measurements*, and reflect the price to sell the asset in an orderly market between market participants. As such, the fair value shall reflect the assumptions market participants will use in pricing the asset, including assumptions about risk.

30. For reporting entities required to maintain an AVR/IMR, the entire amount of the realized loss from the other-than temporary impairment shall be recorded through the AVR, in accordance with *SSAP No. 7*.

31. Upon recognition of an other-than-temporary impairment, the fair value of the working capital finance investment on the measurement date shall become the new cost basis of the working capital finance investment and the new cost basis shall not be adjusted for subsequent recoveries in fair value. Once an investment is determined to be other-than-temporarily impaired, until all expected payments are received, the reporting entity must re-evaluate the investment quarterly and reassess fair value, with recognized realized losses for the difference between the book/adjusted carrying value and the current fair value. This process shall continue until either all expected payments are received, or the entity has recognized a realized loss for the entire uncollected carrying value.

Disclosures

32. The financial statements shall include the following disclosures:

- a. Fair value in accordance with *SSAP No. 100—Fair Value Measurements*

- b. Concentrations of credit risk in accordance with SSAP No. 27—*Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk* (SSAP No. 27) in the annual audited statutory financial reports only.
- c. Information regarding the aggregate book/adjusted carrying value of working capital finance investment by designation including gross assets with nonadmitted and net admitted amounts annually. (Note that programs designated 3-6 are nonadmitted.)

	Gross Asset CY	Non-admitted Asset CY	Net Admitted Asset CY
WCFI Designation 1			
WCFI Designation 2			
WCFI Designation 3			
WCFI Designation 4			
WCFI Designation 5			
WCFI Designation 6			
Total			

- d. Annual and quarterly information regarding the aggregate book/adjusted carrying value maturity distribution on the underlying working capital finance investments by the following categories: maturities up to 180 days and 181 to 365 days.
 - e. Any events of default of working capital finance investments during the reporting period.
33. Refer to the preamble for further discussion regarding disclosure requirements.

DISCUSSION

34. Bills receivable in general are an asset class that has been historically nonadmitted by statutory accounting. They were nonadmitted prior to codification and explicitly nonadmitted in *SSAP No. 20—Nonadmitted Assets*.

35. This work was originated by discussions with the Valuation of Securities (E) Task Force. In May 2011, the Statutory Accounting Principles (E) Working Group replied to the Valuation of Securities (E) Task Force regarding a current exposure they had to the *Purposes and Procedures of the Securities Valuation Office*. The Statutory Accounting Principles (E) Working Group indicated that such assets are nonadmitted by statutory accounting and that a more defined and structured program for working capital finance investments would be required before consideration for admitted asset status. The Working Group noted that because bills receivable are explicitly nonadmitted under statutory accounting, a robust discussion was needed.

Date: May 9, 2011
 RE: SVO exposure draft of Working Capital Notes.

This memo is to provide brief formal comments on the exposure draft of proposed changes to the Purposes and Procedures Manual of the Securities Valuation Office for Working Capital Notes. It does not provide detailed comments on the proposed wording, at this time. The Statutory Accounting Principles Working Group is willing to hold meetings to learn more about the proposed new invested asset class which are based on bills receivable. Currently under *SSAP No. 20—Nonadmitted Assets* the following are nonadmitted assets.

4. Consistent with paragraph 2, the following assets shall be nonadmitted:
 - b. Bills Receivable Not for Premium and Loans Unsecured or Secured by Assets That Do Not Qualify As Investments—In accordance with SSAP No. 5R, amounts determined to be uncollectible or otherwise impaired shall be written off. Amounts in excess of that written off are not considered to be properly collateralized as there are no underlying assets, which would otherwise be admitted assets. Such amounts shall be nonadmitted as they may be of questionable economic value if needed to fulfill policyholder obligations;

According to our preliminary understanding of the proposal, these Working Capital Notes would, in substance, be uncollateralized bills receivable, not for premium, and would be **nonadmitted** under current statutory accounting guidance. Any reporting entity currently investing in these as admitted assets, would need some type of state prescribed or permitted practice to be an admitted asset; this practice would be listed in the annual statement as part of note 1. Formal changes would be needed to the statutory accounting guidance before these could be considered admitted invested assets without a prescribed or permitted practice.

Because bills receivable are explicitly nonadmitted under statutory accounting, we believe a robust discussion is needed. The Working Group urges Valuation of Securities Task Force to delay the adoption of changes to the Purposes and Procedures Manual of the Securities Valuation Office until such time as a comprehensive discussion throughout the solvency framework can occur to fully review and address this proposed new invested asset class. We are also concerned about the potential to have the SVO assign NAIC designation (unless requested by a state) for what is ultimately a nonadmitted asset under the NAIC Accounting Practices and Procedures Manual.

The Statutory Accounting Principles Working Group is planning a call with the company to hear more about the proposed admitted invested assets in May. Because admitting a new invested asset class involves changes in valuation, accounting, reporting and risk based capital, we believe that it is preferable to have a comprehensive proposal submitted by industry to the multiple groups which would be impacted, similar to the type of multi-faceted proposal that was submitted for low income housing tax credits a few years ago. Historically, some of this work has been coordinated by the Invested Assets Working Group, and we would support a referral to that working group for a more robust discussion and coordination between the various relevant working groups and task forces of the proposed new invested assets. Regardless of the outcome of a referral, we urge that the proposed changes to the SVO P&P Manual be delayed until such time as the asset has been comprehensively addressed by Statutory Accounting Principles Working Group, Blanks Working Group and Capital Adequacy Task Force.

The Working Group stands ready to accept a comprehensive proposal on this topic from industry.

36. The Valuation of Securities (E) Task Force and the Invested Assets (E) Working Group both conducted calls on this issue in 2011 and 2012. In addition, the Statutory Accounting Principles (E) Working Group also received a presentation from a finance agent regarding their program.

37. In October 2012, a referral from the Valuation of Securities (E) Task Force recommended consideration of granting Securities Valuation Office designated programs admitted other invested assets status. The referral is excerpted in Appendix A. The referral was based on a New York proposal and also recommended annual statement Schedule BA treatment. If supported, changes will also need to be adopted into the *Purposes and Procedures Manual of the Securities Valuation Office*.

38. Some regulators continued to expressed concerns regarding the ability of smaller entities to monitor the investments in such programs on an ongoing basis. That concern was the basis of the recommendation reflected in the initial draft presented to the Working Group to have department of insurance approval.

39. The October 2012 referral incorporated a statutory accounting request to include information in the filing to the Securities Valuation Office that includes an annual audit of the consolidated financial statements of the finance agent which does not report any qualifications relating to servicing, and one of the following:

- a. An annual independent report according to Statement on Standards for Attestation Engagements (SSAE) No. 16, reporting on controls at a service organization related to the administration of the investment; or
- b. An annual audit of the internal controls of the consolidated group of which the finance agent is part, which does not note any material weaknesses related to servicing.

This request was to address internal control risk concerns with regard the program.

40. Capital Adequacy (E) Task Force has also determined a capital charge for the receivables.

RELEVANT STATUTORY ACCOUNTING

Statutory Accounting

41. *SSAP No. 20—Nonadmitted Assets*, paragraph 4.b. explicitly prohibited bills receivable as admitted assets:

4. Consistent with paragraph 2, the following assets shall be nonadmitted:
 - b. Bills Receivable Not for Premium and Loans Unsecured or Secured by Assets That Do Not Qualify As Investments—In accordance with SSAP No. 5R, amounts determined to be uncollectible or otherwise impaired shall be written off. Amounts in excess of that written off are not considered to be properly collateralized, as there are no underlying assets, which would otherwise be admitted assets. Such amounts shall be nonadmitted as they may be of questionable economic value if needed to fulfill policyholder obligations.

Effective Date and Transition

42. Upon adoption of this issue paper, the NAIC will release a Statement of Statutory Accounting Principle (SSAP) for comment. The SSAP will contain the adopted Summary Conclusion of this issue paper. Users of the *Accounting Practices and Procedures Manual* should note that issue papers are not represented in the Statutory Hierarchy (see Section IV of the Preamble) and, therefore, the conclusions reached in this issue paper should not be applied until the corresponding SSAP has been adopted by the Plenary of the NAIC. It is expected that the SSAP will contain an effective date of years beginning on or after January 1, 2014. A change resulting from the adoption of the resulting SSAP shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*.

Amendment to SSAP No. 20—Nonadmitted Assets

43. Upon adoption of the statement related to this issue paper, *SSAP No. 20—Nonadmitted Assets* paragraph 4.b. is amended to allow the admission of working capital finance investments as follows:

4. Consistent with paragraph 2, the following assets shall be nonadmitted:
 - b. Bills Receivable Not for Premium and Loans Unsecured or Secured by Assets That Do Not Qualify As Investments—In accordance with SSAP No. 5R, amounts determined to be uncollectible or otherwise impaired shall be written off. Amounts in excess of that written off are not considered to be properly collateralized, as

there are no underlying assets, which would otherwise be admitted assets. Such amounts shall be nonadmitted as they may be of questionable economic value if needed to fulfill policyholder obligations. Receivables arising from working capital finance programs designated by the Securities Valuation Office are subject to the guidance in SSAP No. 105;

Appendix A: October 2012 Valuation of Securities Task Force Referral

During a conference call held on September 6, 2012, the Valuation of Securities (E) Task Force adopted a New York proposal (Attached) that would provide statutory accounting guidance for Working Capital Finance Investments (WCFI), described in the attachment. During the discussion held on September 6, the Task Force agreed to adopt and refer the proposal to the Statutory Accounting Principles (E) Working Group - so it can determine statutory accounting guidance; the Capital Adequacy (E) Task Force - so it can consider risk-based capital issues and the Blanks Working Group - so it could consider reporting and related issues.

We recommend that the Statutory Accounting Principles (E) Working Group adopt the proposed statutory accounting guidance. In addition, the Task Force recommends that the Capital Adequacy (E) Task Force consider that WCFIs must be preapproved by the SVO before an insurer can engage in them and that the SVO has developed a corporate methodology which would assign NAIC 1 or 2 Designations based on the credit risk associated with the corporate obligor, as it currently does for other bonds. The Task Force urges the Blanks (E) Working Group to consider the Task Force's opinion that WCFIs be reported on Schedule BA. The Task Force discussed the relative benefits between Schedule BA and DA and concluded that WCFIs should be reported as Other Invested Assets and therefore Schedule BA provides an enhanced disclosure framework deemed more appropriate for the investment.

It would be desirable to permit investments in WCFIs effective January 1, 2013. However, we recognize that the time remaining in this calendar year may not permit the Statutory Accounting Principles (E) Working Group, the Capital Adequacy (E) Task Force and the Blanks Working Group to finalize and implement regulatory instructions for this asset class. In that case, we would support the development of an interim process to permit insurers to purchase WCFIs beginning January 1, 2013.

NY Proposal:

Refer the language below, defining Working Capital Finance Investments, to Statutory Accounting Principles (E) Working Group, with a request for an amendment to SSAP No. 20 and additional SSAP guidance as necessary, if SAPWG determines that WCFIs should be admitted assets.

Background:

The SAPWG returned to VOS TF an earlier proposal and asked for additional criteria that would cover these investments to be added to that original proposal. The responsibility to develop the additional criteria was given to IAWG, which presented a list of criteria at the NAIC 2012 Spring Meeting.

This proposal on Working Capital Finance Investments and Working Capital Finance Arrangement incorporates, as appropriate, the criteria developed by the IAWG and those set forth in the SVO Staff Proposal ("Permit Working Capital Finance Notes to be Invested Assets", dated March 2, 2011) and adds certain criteria and controls to the requirements as necessary.

Changes to earlier language on WCFI/WCFA

This proposal:

- provides an alternative to the requirement that WCFIs are bought directly from the vendor;
- helps preserve Investors' interests by requiring first priority perfected security interests;
- only requires ledgers to be filed upon request (instead of continuously);

- permits participations;
- permits obligations arising from transactions outside of the United States;
- allows all insurers to invest in WCFI;
- allows affiliates of parties (e.g., vendors or Finance Agent) to the transaction to make transfers to the program;
- permits WCFI to be denominated in currencies other than USD;
- permits vendors and Obligors to be non-U.S. entities; and
- permits servicers and trust administrators to be entities subject to supervision by non-U.S. financial regulators.

Working Capital Finance Investment (WCFI)

Definition: Each investment in Confirmed Supplier Receivables (as defined below) under a program that is approved by the SVO as meeting the criteria specified in the *Purposes and Procedures Manual of the NAIC Securities Valuation Office*.

A WCFI manifests a right to payment and arises from transactions among:

- a buyer of goods or services that becomes an obligor of a supplier of goods or services,
- the supplier/s of those goods or services,
- a financial intermediary, and
- an investor.

A WCFI represents the transfer of the right to payment from the supplier to the investor and confirms the investor's right to payment free of any holdback, delay, or other stoppage in payment arising from claims that the obligor might otherwise assert against the supplier.

The supplier and the financial intermediary negotiate the discount rate to be applied to the receivable.

The obligor, prior to or upon transfer to the investor or financial intermediary confirms its obligation to make payments due under the investment:

- the sum due on that receivable;
- the date on which payments under it are to be made; and
- free of any and all defenses to payment arising from claims that it otherwise assert against the supplier or anyone taking interests from the supplier.

The financial intermediary or the investor then pays the supplier in exchange for the confirmed receivable.

Only investments that are commercial non-insurance receivables, meet the criteria specified in the NAIC *Accounting Practices and Procedures Manual*, accord with all applicable Statutory Accounting Principles, that are not impaired or in default, and that have been issued by a program to which the SVO has assigned a NAIC designation of "1" or "2" may be considered to be eligible for admitted asset treatment.

Investments in Confirmed Supplier Receivables of obligors affiliated with the investor are ineligible, and therefore non-admitted, assets.

Working Capital Finance Arrangement (WCFA)

A Working Capital Finance Arrangement (WCFA) is an open account program under which an Investor may purchase interests, or evidence thereof, in commercial non-insurance receivables. A WCFA is created for the benefit of a commercial investment grade obligor and its suppliers of goods or services, and facilitated by a financial intermediary.

Under a WCFA, an Investor reviews individual supplier receivables or evidence of interests therein presented to it by either the obligor or supplier itself or an intervening financial intermediary and then exercises its discretion to purchase or finance, or refrain from purchasing or financing, the receivables.

All contracts or agreements that are a part of or that together constitute a WCFA must state expressly that if a dispute arises among any of the parties under any of the contracts or agreements that are a part of or that together constitute the WCFA, each party agrees that the dispute will be submitted to a court of competent jurisdiction in the United States or a constituent state thereof or of an alternative dispute resolution process recognized thereby. All contracts or agreements that are a part of or that together constitute a WCFA must state expressly that any dispute arising under any of the contracts or agreements that are a part of or that together constitute the WCFA must be resolved pursuant to the laws of the United States or a constituent state thereof that address the substance of the dispute but excluding those laws addressing conflicts of law.

A WCFA must include the availability, from the servicer or another third party, of a detailed ledger recording details of each trade receivable purchased, including but not limited to the origination date, purchase date, confirmed payment date, actual dates when payments are received, face value and purchase cost. Upon request, the ledger must be submitted to the SVO or the regulator of the state of domicile of the Investor.

The Investor in a WCFA must have a reasonable belief, based on express representations and warranties, and must be able to demonstrate (through, for example, proof of funding, possession, the filing of UCC financing statements) to its regulators and the SVO upon request, that the holder in a WCFA under an approved WCFA has a first priority perfected security interest in the WCFA.

For WCFAs structured as sales, assignments, or transfers to the Investor, the Investor is considered to be the holder.

For WCFAs structured as participations where the Finance Agent is the payee of the confirmed supplier receivables, the Finance Agent is considered to be the holder.

For WCFAs structured as participations where each participant is a payee, the Investor is considered to be the holder.

For WCFAs where the WCFAs under the program are transferred to a trust or other legal structure, the trust or legal structure is considered to be the holder.

WCFI – Detailed Defined Terms

Working Capital Finance Investment (WCFI)

A Working Capital Finance Investment (WCFI) is an interest in a Confirmed Supplier Receivable issued pursuant to a WCFA. It is created when the Investor purchases from a WCFA that has been assigned a NAIC 1 or 2 designation:

- one or more Confirmed Supplier Receivables;
- in case of a participation, a participation certificate issued by the Finance Agent or lead; or

- in case of a securitization, a certificate or note representing an interest in and right to payment from a trust, other separate special purpose entity, or pool holding Confirmed Supplier Receivables.

Confirmed Supplier Receivables

A Confirmed Supplier Receivable is a first priority perfected security interest claim or right to payment of a monetary obligation from the Obligor arising from the sale of goods or services from the Supplier to the Obligor the payment of which the Obligor has confirmed by representing and warranting that it will not protest, delay, or deny, nor offer nor assert any defenses against, payment to the supplier or any party taking claim or right to payment from the supplier.

Once confirmed, a confirmed supplier receivables may be sold, assigned, or otherwise transferred by the Supplier to:

- the Investor; or
- a Finance Agent that:
 - a. in turn resells, the rights as payee to the Investor or to a trust or other legal structure that is obligated to transfer payments received from the Obligor with respect to the confirmed supplier receivables to the Investor; or
 - b. acts as a “lead” in a participation in which the Finance Agent is the payee under the WCFA and is obligated to transfer to the Investor, payments received from the Obligor with respect to the confirmed supplier receivables and without reduction for any reason other than those specifically identified in the WCFA and directly related to the WCFA program (e.g., there be no reduction for cross-default provisions under other arrangements between the Finance Agent and the Investor).

Eligible confirmed supplier receivables cannot include insurance or insurance related assets.

Confirmed supplier receivables are sold, assigned, or otherwise transferred under the terms of a WCFA individually from the Suppliers.

Confirmed supplier receivables must be sold, assigned, or otherwise transferred in a manner that results in an absolute, irrevocable and legally enforceable obligation that the Obligor pay the amount represented by the confirmed supplier receivables and provide the new owner or holder (Seller or Investor) with the full legal rights to the Obligor’s payment and, either directly or through the Finance Agent, to the exercise of creditor rights to receive the payments flow associated with the confirmed supplier receivables.

In the case of a participation, the certificates or other evidence of participation provide an absolute, irrevocable, and legally enforceable obligation that the Finance Agent or holder of the confirmed supplier receivables to pay to the Investor all of the amounts due to it under the confirmed supplier receivables, without reduction or delay arising from any claims that the Finance Agent may have against the Investor, and that the Investor’s ability to exercise its rights as creditor, or to direct the Finance Agent to exercise the rights of a creditor on its behalf, not be subject to the discretion of the Finance Agent or other lenders or investors, other than for a period of cure not to exceed 30 days.

Obligor

Obligor is the party that purchases the goods or services that generate the original supplier receivable (and payable for the Obligor).

Obligor must be a single entity that itself must be rated investment grade. No receivable of any parent or affiliate may be transferred under, or serve as an underlying for any evidence issued pursuant to, the program.

Obligor sets up the program with the eligible/approved Finance Agent.

Obligor must have a NAIC Designation of 1 or 2 or CRP equivalent.

Obligor must confirm the Supplier receivable as described in the Confirmation Process below.

Supplier

Supplier is the party that sells the goods or services to the Obligor.

Supplier sells the confirmed supplier receivables in accordance with the terms of the SVO approved WCFA at a discounted price agreed to by the Investor.

Investor

Investor is the party purchasing a WCFI in accordance with the terms of the WCFA.

Finance Agent

The Finance Agent is a bank, financial institution, service provider, or other financial intermediary that facilitates the program; arranges the sale, assignment or transfer of the Confirmed Supplier Receivable to the Investor for a fee and administers the payment mechanism. The payment mechanism may be, for example, a lockbox arrangement. Prior to the sale, this party verifies that the Obligor has confirmed both the amount due and the due date, and has waived defenses to payment.

One of these requirements must be in effect:

- a. The Finance Agent is directly regulated by or falls under the supervision of a financial regulator of its domiciliary country provided that such country appears on the SVO P&P Manual's List of Jurisdictions Eligible for Netting and that the SVO determines that the regulator is the equivalent of the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, or the Federal Deposit Insurance Corporation; or
- b. payments from the Obligor must be paid directly to the insurer or into a lockbox and cannot flow through the Finance Agent and there can be no commingling of payments or assets with those of the Obligor, servicer, or trust administrator or other Investors.

The annual SVO filing regarding the program must include an annual audit of the consolidated financial statements of the Finance Agent that does not note any qualifications relating to servicing; and one of the following:

- a. an annual independent report according to Statement on Standards for Attestation Engagements (SSAE) No. 16, reporting on Controls at a Service Organization related to the administration of the investment; or
- b. an annual audit of the internal controls of the consolidated group of which the Finance Agent is part, which does not note any material weaknesses relating to servicing.

Confirmation Process

The Obligor confirms that it has an obligation, independent of any other contracts or claims which might be raised in defense against such payment arising from the transactions financed by the WCFA, or any other courses of performance or courses of dealing with the Supplier, to pay to the Finance Agent or Investor a sum equal to the amount of the supplier receivable to be purchased by the Finance Agent or Investor. The Obligor must expressly waive any right of setoff or other defenses to the full and timely payment of such Confirmed Supplier Receivable.

The Obligor asserts that it will not assert any right which it may have acquired, or may acquire, to not pay the Supplier (the amounts due under the supplier receivable) as a result of a dispute arising under the

commercial transaction between Obligor and Supplier against payments due to the Finance Agent or Investor.

Maximum Maturity

The maximum maturity of a WFCI of a confirmed supplier receivables must not exceed a final maturity of one year from the date of the extension or advance from the Supplier to the Obligor giving rise to the confirmed supplier receivables.

Participations

In the case of a participation, in considering whether the Investors' interests meet the Uniform Commercial Code's standards for preserving first priority perfected security interests, the SVO must

- a. consider, among other factors, where relevant:
 - the extent to which the relationships among the parties are stated expressly;
 - the extent to which financial covenants exist that may provide early warning signs of deteriorating credit;
 - the obligations of the Finance Agent, administrator, or other lead to inform the Investor of a default or an event of default;
 - whether the Investor's ability to exercise its rights in a default or event of default are subject to the consent or agreement of the Finance Agent, lead, or other Investors;
 - the extent of management and administration by the Finance Agent or lead, whether the Finance Agent or lead is required to notify participants of events of it is aware that may constitute a default or an event of default under the agreement with the Obligor;
 - the standard of care by which the lead's liability or duties to the participants should be defined;
 - the allocation of payments; and the presence of any third party guarantees in favor of the Finance Agent, the lead, or any other participants;
 - the manner of sharing expenses;
 - how liabilities and losses are addressed;
 - the ability of the Finance Agent, lead, or a participant to assign or encumber its interests;
 - the existence of cross-purchase agreements;
 - the existence of an option exercisable by the Finance Agent, lead, or another participant to buy the interests of other participants;
 - and the ability of another participant, other than the Finance Agent, to assume the administration and management of the transaction, or;
- b. require that the insurance company certify that its participation interest meets the Uniform Commercial Code's standards for preserving first priority perfected security interests

In the case of a participation, the Finance Agent from which the Investor took the note must inform the Investor of a default or event of default as soon as it becomes aware of such default or event of default.

Exclusions

A WFCI excludes any receivable/s financed through:

- Factoring: the purchase of receivables in bulk from a supplier where the receivables represent the payment obligations of potentially thousands of buyers to a single supplier, in which the buyers have no relationship with or contractual obligation to pay the factor and retain all legal defenses to payment they may have against the supplier;
- Forfaiting: the purchase of one or a series of receivables from exporters by a forfaiter to enable the exporter (seller) to finance a commercial transaction with a buyer in which the Obligor has no relationship with or contractual obligation to pay the forfaiter and retains all legal defenses to pay it may have against the seller; or

- Invoice discounting: the advancement of funds by a finance company to a business entity with the funds advanced limited to a defined percentage of the business entity's eligible and outstanding receivables.

SVO Approval and Designation

Any amendment to the WCFA, and any WCFI issued thereunder that differs from those approved by the SVO, must be filed with the SVO.

An insurance company that files a WCFI with the SVO must have in place such policies and procedures as they consider necessary to monitor and manage risks associated with this investment activity. Such policies and procedures must reflect an understanding of the private nature of the receivables market, the tri-party nature of WCFI and confirmed supplier receivables, the risks identified and provided for by the SVO credit assessment process, such other issues as may be relevant to recovery of the loan assuming a default has occurred as well as such aspects usages of trade in receivables financing as they determine are consistent with their underlying due diligence obligations. Insurance companies are encouraged to build such protections as they believe are necessary to them into the terms of the programs they intend to invest in.

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