Memo

To:	Commissioner Nathan Houdek, Chair, Financial Condition (E) Committee
Cc:	Dan Daveline
From:	Tricia Matson, Partner and Edward Toy, Director
Date:	March 28, 2024
Subject:	RRC comments regarding the Framework for Regulation of Insurer Investments

Background

The Financial Condition (E) Committee ("E Committee") exposed a document on August 15, 2023, for comment entitled "*Framework for Regulation of Insurer Investments – A Holistic Review*". RRC submitted a comment letter dated September 15, 2023. RRC also made oral comments in Orlando at the NAIC's 2023 Fall National Meeting.

E Committee exposed three documents on February 15, 2024, consisting of "*Memo from E Committee to Interested Parties*", "*Investment Framework as Revised E Committee*" and "*Investment Framework Workplan*". RRC was provided with the opportunity and made verbal comments at the E Committee meeting in Phoenix during the NAIC's 2024 Spring National Meeting.

RRC appreciates the opportunity to follow up with our written comments. Should you have any questions, we would be glad to discuss our comments with you and the committee members.

RRC Comments

In our previous comment letter on the Framework, we acknowledged the importance of NAIC oversight on the use of rating agency ratings as a regulatory tool. We continue to believe that having a firm understanding and comfort with respect to the methodologies employed by the individual rating agencies is critical to their use and do not have anything further to add at this time.

We also acknowledge that Bonds reported on Schedule D continue to be a majority of the insurance industry's invested assets and that, because of that, having comfort in the assignment of appropriate NAIC Designations is an important aspect of continued regulatory oversight.

Our comments in Phoenix and in this letter focus on investment risks that have evolved and that continue to evolve and grow within insurance company portfolios and in their respective investment practices. We believe that while credit risk that is represented in Bond portfolios is material, the regulatory needs there are incremental. Our greater concern lies in credit risk that exists in other parts of the insurance industry's invested assets, and in other aspects of investment risk.

We have, at different times, highlighted two specific examples where we see exposure to credit risk outside of Bond holdings. The insurance industry's exposure to Mortgage Loans that are reported on Schedule B has grown significantly in recent years. Most of that growth has been within Life insurance companies, but there has also been material increases in exposure among other insurer types. The type and tenor of Mortgage Loans have also changed. At many insurance companies this has expanded to increasing amounts of direct exposure to Residential Mortgage Loans and to Construction Loans. Growth in Commercial Mortgage Loans, which consists primarily of non-amortizing bullet loans, is creating additional risk due to changes in markets in recent years in the Office and Retail sectors. Investments in Collateral Loans that are reported on Schedule BA have increased materially in the industry and represent a significant percentage of assets at some insurance companies. Collateral Loans are treated as fixed income instruments with a fixed income-like Risk-Based Capital factor. But the underlying assets supporting those Collateral Loans and the strategies behind them are varied.

Beyond the issue of exposure to credit risk, we are concerned about significant increases in exposure to market volatility and liquidity risk. What tools and support are available to regulators to understand and assess these risks within insurance companies? Whether it is in Bonds reported on Schedule D or in other parts of the investment portfolio, the investment portfolios are more vulnerable to changes in markets and are less liquid than they were a few years ago. The significant increase in interest rates in 2022 that continues today had a substantial negative impact on the fair value of the portfolios. With the relative calm in the markets from 2008 to 2020 that prevailed along with low interest rates, it is possible that insurance company risk management systems are not sufficient to cover this increased level of market volatility. Liquidity policies and liquidity stress testing regimes may not fully take into account fair values that in many cases are significantly below carrying value. Market volatility and liquidity risk are potentially impacted by asset concentrations in illiquid, more complex and less transparent asset classes.

The *Investment Framework Workplan* includes six Action Items as next steps. Based on our comments in this letter, there are two Action Items that we strongly endorse and encourage expedited consideration.

Action Item #5 proposes the formation of a new regulatory working group that would also support the Financial Analysis Working Group, the Valuation Analysis Working Group and other working groups. Incorporating the views of regulators that have a firsthand view into actual changes in insurance company portfolios and investment practices, and concerns on how this could impact the ability of those companies to meet policyholder claims would be extremely valuable in the discussion and in the development of regulatory priorities. We encourage the E Committee to move on this Action Item quickly.

Action Item #4 proposes the formation of centralized investment expertise with a focus on expertise that may not currently be sufficient within the NAIC. Risk-Focused Analysis and Risk-Focused Examinations encourage regulators to recognize where the risk is and where it is going, not just where it has been. It is important to not just review where past problems or issues were, but to look at prospective risks, i.e., where the next problem or issue may be. We understand that this requires discussion and the engagement of specialized resources that may not currently be available and therefore will take time to develop. We recommend that this effort begin quickly. This should include an agreed upon timeline so that regulators and other stakeholders have a clear view of the goals and progress toward those goals.

Thank you for the opportunity to provide comments on this important initiative. We can be reached at tricia.matson@riskreg.com (860) 305-0701 and edward.toy@riskreg.com (917) 561-5605 if you or other committee members have any questions.

STRUCTURED FINANCE ASSOCIATION

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April 5, 2024

Commissioner Nathan Houdek (WI)
Chair of the Financial Condition (E) Committee
National Association of Insurance Commissioners

Re: Response to Written Comments on Holistic Framework on Insurers Investments

Dear Mr. Houdek,

The Structured Finance Association (SFA) appreciates the opportunity to provide feedback to the memorandum from the Financial Condition (E) Committee regarding its "Response to Written Comments on Holistic Framework on Insurers Investments," dated February 14, 2024 (the "Memo").

In gathering feedback to respond to the Memo and associated "Investment Framework Recommended Work Plan For The Financial Condition (E) Committee" (the "Work Plan"), SFA engaged with various market participants, including insurance companies, asset managers, credit rating agencies, law firms, and others who may be directly and/or indirectly impacted by the changes to the Framework recommended by the drafting group to address the comments previously received on the Framework for Regulation of Insurer Investments – A Holistic Review (the "Framework").

While the Memo and Work Plan demonstrate progress in the development of the Framework, the new workstreams, especially as they relate to the Request for Proposal (RFP) and due diligence framework for credit rating providers ("CRPs"), have generated additional questions and comments from market participants. The recommendations and questions in this comment letter will focus on "Drafting Group Members Views on Comments Related to Recommendation 1" ("Recommendation 1") of the Memo, and "Action Item #2" of the Work Plan, specifically as they relate to the preparation of the RFP, the identification and credentialing of the "independent consultant", and the preparation and processes of the due diligence framework. SFA also requests clarification about the change in terminology of "Equal capital for equal risk" to "Equal capital for equal tail risk" as it relates to future revisions to risk-based capital (RBC) factors.

I. Credit Rating Provider Due Diligence Framework and Independent Consultant Definition

i. Recommendation 1 states: "*Drafting Group Members are also supportive of engaging a consultant to develop the due diligence framework. In furtherance of its views, the Drafting Group Members developed a memorandum to the Executive (EX) Committee that once* *discussed and if approved, may result in a Request for Proposal (RFP) to be submitted for further consideration*." In addition, the first paragraph of Action Item #2 states "*The Committee will request approval from the NAIC Executive (EX) Committee to develop a request for proposal (RFP) to hire an independent consultant to provide recommendations for a due diligence framework for CRPs*."

SFA views the Memo to the Executive Committee as the foundation of the CRP due diligence process that will likely define the scope of the RFP. The RFP will have far-reaching implications for market participants, so it is critical that the problems it aims to solve are well defined and the ultimate goals are clear. As such, we believe it is important that the views of market participants from various sectors of the industry are considered, including those from investors, rating agencies, and insurance companies. As addressed in detail below, SFA and its members would welcome the opportunity to review and comment on the draft RFP prior to its submission to the Executive Committee.

The SFA's membership represents most, if not all, sectors of the securitization industry that will be impacted by the final RFP. Importantly, any advocacy efforts undertaken by SFA must be based on the consensus of its broad membership. As such, any feedback provided by SFA regarding the RFP will represent a thoughtful compromise position of our industry membership. SFA believes that early engagement in the RFP drafting process between the NAIC and industry would be helpful. The opportunity to receive feedback from our CRP members, which each have unique approaches to the ratings process and bespoke methodologies, would seem especially useful. A collaborative approach should result in a more comprehensive RFP that ultimately generates a more meaningful analysis.

ii. The first bullet point of Action Item #2 states: "*If approved, the drafting group will work in concert with the NAIC Securities Valuation Office (SVO) to create a robust RFP proposal with consultant independence as a priority. We note that the selection of a consultant needs to consider potential conflicts with CRPs or industry*."

SFA agrees that consultant independence is paramount to ensure the impartiality and accuracy of the CRP evaluation methods defined and applied under the RFP. However, members have questioned how the SVO will define "consultant independence" given how interwoven CRPs and consulting firms are in the financial markets. Some specific member questions regarding independence include:

a. By design, CRPs are large organizations with diverse operations and extensive global relationships. If a consulting firm carries ratings from certain CRPs, or is a subsidiary of a firm that is rated by one or more CRPs, how will the SVO view this in terms of independence?

b. Many consulting firms have a global presence, with their mandates cutting across industries. Will consulting firms be required to disclose all direct or indirect mandates at CRPs? If CRP mandates do exist, will information walls within a consulting firm be considered a mitigating factor?

c. Will the criteria for determining independence also consider whether a consultant is on a rotational basis for certain mandates at a CRP, such as financial auditing?

d. Will individuals at the independent consultant or the NAIC with prior CRP experience be viewed as potentially conflicted or will that be looked upon favorably?

e. Which working group or task force within the NAIC will ensure the true independence of the consultant? Will the independent consultant have to attest to their independence prior to receiving a mandate? If the due diligence process will be continuous, will the independent consultant also periodically be evaluated for independence?

f. Regardless of the criteria chosen to determine independence, will they be shared with the industry for comment before being made final?

SFA also believes it would be prudent for the individual employees at the consultancy responsible for conducting the CRP due diligence, as well as individuals within the NAIC that are tasked with drafting the RFP and determining consultant independence, be evaluated for any potential conflicts that may affect their impartiality. When establishing eligibility criteria for evaluating consultant independence, SFA and its members believe a comprehensive and conservative approach will lessen the likelihood that the RFP and the due diligence results of the consultant are later called into question.

Equally as important as establishing independence will be confirming that a consultant has the technical prowess and relevant experience to prepare a due diligence framework for evaluating CRPs. For both criteria, members have questioned which specific benchmarks the SVO will reference to determine whether a consultant is qualified. Given the evolving nature of the structured finance market, our members have inquired if the RFP will require the due diligence framework to have an "initial" phase as well as an "ongoing" phase, the latter being used for a) newly emerging asset classes and b) ongoing reviews of CRP performance. Members have also inquired if the RFP/due diligence framework will make available an appeal process for CRPs that are not deemed to be acceptable for either phase.

SFA appreciates that the NAIC has been transparent about the fact that the development of the RFP is in its early stages. However, our members have raised questions about the anticipated structure of the RFP, including whether it will provide the independent consultant a highly structured and detailed "roadmap" of the due diligence process, or only define broad parameters with the expectation that the process will be fully designed by the consultant. Additionally, in designing the due diligence framework, given the acknowledgement by the NAIC that there are potential differences in transparency between public and private ratings, does the NAIC anticipate creating separate processes and standards for evaluating CRPs as it relates to private versus public ratings? Members have also inquired about how the results of the due diligence process will be applied. Does the SVO anticipate mandating the independent consultant to perform a firmwide assessment of each CRP where, after assessment, the ratings from that CRP will or will not be eligible regardless of sector? Or will the due diligence process be performed on an asset-class, sector, or other specified basis, where certain ratings from a specific CRP may be eligible while other ratings from the same CRP may not? If some or all of a CRP's ratings are deemed ineligible, how often will that decision be reevaluated?

Again, the SFA strongly believes the draft RFP should be made available to the industry for review and comment prior to being finalized, as incorporating the views of the broader market will result in a more comprehensive final RFP.

iii. The second bullet point of Action Item #2 states: "<u>*The consultant would deliver a comprehensive recommendation/request for the Committee to consider*</u>."

Members have inquired as to the amount of time the independent consultant will have to respond to the RFP and, once returned, how the work product will be validated and which working group or task force of the NAIC will conduct the review. The current language references the "[Drafting] Committee to consider". Given the decision will impact regulators in all states, will the Drafting Committee elicit input from state regulators as well as other resources (internal or external)?

Members have asked for clarification as to the expected frequency of CRP reviews to be conducted by the independent consultant. Some questions include:

a. Will the due diligence be conducted periodically to capture changes in CRP performance?
b. Would the independent consultant develop a framework for periodic monitoring and the objective measures on which it will be based?
c. Will such a framework consider new asset classes or material changes in methodologies that may render past performance moot? Regardless, will such work be conducted by independent consultants once the recommendation is implemented, or would that fall on NAIC staff?

iv. The third bullet point of Action Item #2 states: "<u>*The Committee would expose this communication for industry comment, including encouraging CRPs to comment.*</u>"

SFA and its members fully support exposing the work of the independent consultant to the industry as soon as it is practical. However, we caution that it would be less efficient and effective to do so without also engaging with the industry earlier in the process, as outlined above.

STRUCTURED FINANCE ASSOCIATION

II. Revision of "Equal Capital for Equal Risk" to "Equal Capital for Equal Tail Risk"

With the release of the Memo, the NAIC noted the change in the language regarding future revisions to RBC Risk Factors from "Equal Capital for Equal Risk" to "Equal Capital for Equal Tail Risk". While the NAIC has stated that this change was not meant to be material, and the two terms are used interchangeably within the NAIC, differing opinions exist within our membership as to which term is more appropriate. Some members believe that "Equal Capital for Equal Tail Risk" is consistent with the RBC framework where capital factors should be calculated by evaluating the tail risks specific to the assets in question. Other members have proposed restoring "Equal Capital for Equal Risk" as the operative term, but for its first instance adding an appended clause as follows: "Equal Capital for Equal Risk, noting that the full distribution of risk that includes tail risk should be considered." SFA requests that the definition and its intended use be clarified.

III. Conclusion

SFA believes that the RFP and CRP due diligence framework being in their nascent stages afford the NAIC the opportunity to engage early with the industry and provide clarity on the methodology and the assumptions applicable to the independent consultant and CRP due diligence processes. It also provides the NAIC the ability to leverage the broad experience of the industry to refine the associated documentation and workstreams, and ultimately develop a more robust and broadly accepted methodology. Finally, the industry asks for guidance on whether "Equal Capital for Equal Risk" or "Equal Capital for Equal Tail Risk" should be the operative term as it relates to futures revisions of RBC factors.

We again thank the NAIC for the opportunity to share these views and look forward to continuing our engagement with the NAIC on this issue.

Sincerely,

Michael Bright, CEO, Structured Finance Association

<u>The Lease-Backed Securities Working Group</u>

April 8, 2024

Nathan Houdek, Chair
Financial Conditions (E) Committee
National Association of Insurance Commissioners
110 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Re: Memorandum to the Executive Committee: **<u>Request for Approval to Develop an RFP</u>**

Our group, the Lease-Backed Securities Working Group, is fully in support of the NAIC engaging an outside consultant to design and help implement a new process under which the NAIC develops a strong due diligence program over the ongoing use of credit rating providers (CRPs) in accordance with the principals laid out in the E Committee Framework -- a Holistic Approach.

Over the past few years, we have followed the many discussions regarding the NAIC's desire to improve their oversight and monitoring of CRP ratings, with a particular focus on the ratings of private placement securities. Much of the discussion has been based on repeated suggestions from the SVO that there is a quality difference between the ratings of public and private-placement securities (or between the larger agencies that typically rate the large public transaction and the smaller ratings providers who frequently rate private placements) and that because "private" securities do not have the same "*market validation and transparency"* of publicly-rated securities, there are potential hidden risks in the "private" market.

As a result, the memorandum suggests that *"the process may want to consider different standards for public versus private ratings, given the market validation and transparency of public ratings….."*

However, some of the most thorough studies on the credit performance of private-placement securities in insurance company portfolios are those conducted over a 29-year period by the American Society of Actuaries [see Appendix I]. These studies show that ***insurance company private placement securities have consistently had <u>better credit performance</u> than the broad public markets by a significant margin -- both in terms of rates of default (or the broader category used in the study of "Credit Risk Event"-- see Appendix) and loss-given-default.***

These studies, taken together, cover the period 1986-2015 (the most recent study was published in 2019) -- a period that encompasses several recessions, including the real-estate collapse of the late '80s/early '90's, the bursting of the dot-com bubble in the early 2000's and the Global Financial Crisis.

The studies are based on detailed investment portfolio data submitted to the Society by up to 20 major life insurance companies, including AIG, Metlife, John Hancock, Nationwide, and many others. These studies are a wealth of detailed information on insurance company investments and credit performance over an extended period (the most recent study, covering the period 2003-2015, runs to 131 pages).

To quote from the most recent study: "Private placements showed a 0.10% annual advantage relative to public bonds" [higher in earlier studies]…and "Private bonds generally experienced lower loss rates [Loss-Given-Default] than public bonds. Speculative-grade privates had significantly better experience than their public counterparts." (The advantage in loss rates over public bonds was 14.5% for senior unsecured bonds, and even higher, 15.5%, for subordinated bonds.) The study goes on to note: "this may speak to ***the efficacy of private placement underwriting teams*** and ***the power of covenants***" (emphasis added).

The study also states that "It is important to note that private placement bonds are individually negotiated with borrowers" and that while "private placement bonds are similar to public bonds in many respects, they are widely perceived by investors as offering not only additional ***value***, but additional ***protections".***

In fact, from the insurance company perspective, the private-placement market is just about the only place where companies are able to find "value" in the markets: that is, being adequately compensated in terms of investment yield relative to the perceived investment risk.

Illiquidity is the reason most frequently cited for this differential in pricing, but it is far from the only one. Among other factors, market timing, investor appetite (or lack of capacity) for specific assets or credits also influence pricing. However, the main reason for advantageous pricing -- as mentioned in the study above -- is that these deals tend to be highly negotiated between the issuer and a small group of investors who specialize in the type of investment, and are able to invest the time and effort to analyze these deals. (This is the main reason we remain skeptical of using the market yield of a private placement security as a "screen" to question its ratings level.)

This distinction between *breadth* of exposure for public bonds and *depth* of analysis by private bond investors (aka: "the efficacy of private placement underwriting teams") is an important one that needs to be kept in mind in any discussion of publics vs. private-placements:

When public bonds come to the market, the only decision for the investor is a "buy-or-no-buy" decision at the offered market price. That investment decision must usually be made quickly in the course of less than a day or even a few hours, and there is no time for investment teams to analyze the investment closely or even read all the offering materials. For this reason, it is in the public markets, not the private markets, that insurance companies must frequently "blindly" rely on the rating that comes with the issue.

In contrast, private placements are typically offered to -- and individually negotiated with -- a small number of investors: those most familiar with either the product or the credit, and those investors have weeks or even in some cases, months, to review the offering materials in detail. In many cases they also have the ability to influence both the pricing and the final terms of the deal, achieving favorable terms for investors -- something that is never possible with broadly-marketed public bonds. Finally, these deals receive additional scrutiny in the form of detailed presentations to (and probing questions from) the company's internal credit committees. The ratings reports received by the investor, while not generally available to the public, are no less "transparent" (that is: they are no different in scope and thoroughness of analysis) than the reports produced by the same agencies for their public issues.

In line with the statement in the memorandum that the implemented changes "should utilize existing resources to the extent possible", we would hope that the regulators and any consultants would familiarize themselves with the Society of Actuaries studies, as well as any other existing studies that have examined insurance company credit performance over long periods of time.

Lastly, in response to the comment in the memorandum regarding “ratings-shopping” by investors (e.g. obtaining the highest public or private rating by selecting the weakest methodology), it is worth pointing out to regulators that it is the issuer of the bond, not the investor, who selects the rating agency or agencies for the issue.

Many factors may influence that decision by the issuer: pricing is certainly one factor, but so is timing, relative expertise with the product type, appropriate methodology, etc., etc. But perhaps the most important factor, for both public and private issues, is the credibility or ‘market acceptance’ of the ratings provider. This credibility is essential to ensure that the issuer can successfully place the bonds. And as we indicated above, it is really in the public markets, not the private markets, that investors are forced to “buy” a rating.

Finally, it goes without saying that the firm engaged through the RFP process should be somebody not only familiar with the NAIC organizational structure and current principles and practices, but also with a broad exposure to, and knowledge of, capital markets: Assessing the impact of any changes made to current practices on insurers’ ability to successfully access capital markets - - both in terms of availability and pricing of investments -- will be a key part of any recommendations coming out of this study.

Given the crucial role that private placement securities play in insurance company investment portfolios, it is also important that whatever firm is hired be given direct and unfiltered access to insurance investors. We are fully in support of having well-regulated markets -- and effective oversight of credit ratings providers -- but it is essential that any changes implemented through this process preserve insurance companies’ ability to access to this important class of investments.

We hope the Committee finds these comments helpful, and we look forward to continuing our dialog with the regulators as the RFP process moves forward.

Sincerely,

John Garrison
On behalf of The Lease-Backed Securities Working Group
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508-561-2162

APPENDIX I: Two figures from the 113-page study:

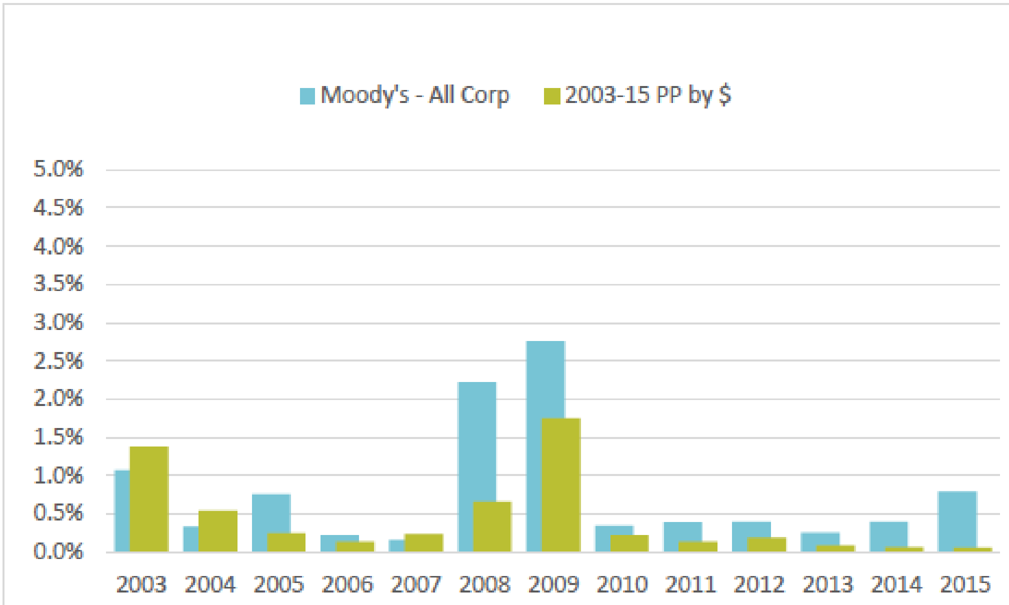
<u>"2003-2015 Credit Risk Loss Experience Study -- Private Placement Bonds".</u>

[https://www.soa.org/resources/experience-studies/2019/private-placement-bond/]

Comparing default rates (or "Credit Risk Event" rates) for public and private securities:

Figure 7

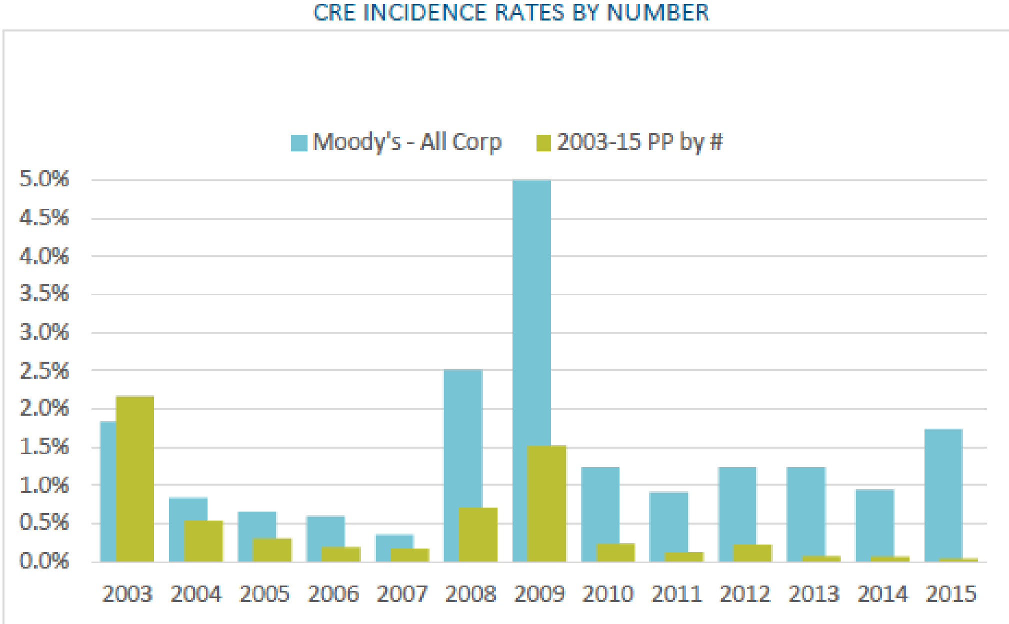
CRE INCIDENCE RATES BY AMOUNT



***Source for Moody's All Corp:** Moody's 2017 Public Corporate Bond Default Study (1970-2017), Exhibit 39*

Figure 8

CRE INCIDENCE RATES BY NUMBER



***Source for Moody's All Corp:** Moody's 2017 Public Corporate Bond Default Study (1970-2017), Exhibit 30*

("CRE" = "Credit Risk Event" & includes events of default plus selling the bond for less than 70% of BV.)

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April 8, 2024

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Re: Framework for Regulation of Insurer Investments – A Holistic Review (Revised)

Dear Commissioner Houdek and Task Force Members,

It is gratifying that the Committee welcomes feedback and interaction as it proceeds to determine "what is the most effective use of regulatory resources in the modern environment."

Credit Rating Providers Provide Credit Ratings

A fundamental point is that it is credit ratings themselves that are the principal products of Nationally Recognized Statistical Rating Organizations. This implies that when the quality of their work is assessed it must be measured based on the accuracy of their credit opinions alone. Exactly how those opinions can or should be used by investors, including insurers or their regulators, is a separate question. When these rating agencies are evaluated that must be based upon what they actually deliver and these are opinions of creditworthiness.

Assessing CRPs

A question posed by the Committee is what "analytical or performance criteria" can be used to produce "meaningful and consistent" measures of the nine CRPs for the many sectors and types of assets for which they produce credit ratings. A secondary question is how ratings of various asset types map across the different CRPs. Given the hundreds of thousands of debt instruments that insurers invest in it would take a very large number of analyses of <u>individual</u> securities to come up with reliable and demonstrable patterns of acceptable -- or unacceptable -- performance of each CRP for every asset type.

Case-by-case determinations could be attempted. CRPs could be evaluated by comparing the ratings of one CRP against those of another. This is difficult given the fact that ratings are costly so many issues do not carry multiple ratings. Even so there is then the task of determining which opinions of the future will turn out to be "right". Another way would be for the NAIC itself to derive its own opinion of the likelihood of the realization of promised payments in the future and compare that to the opinion of the CRP. This is certainly being considered by the Valuation of Securities Task Force for specific instances. Given the hundreds of thousands of individual securities owned by insurers it would be quite difficult to analyze enough securities in order to develop patterns and actionable conclusions. Even then, these would simply be "opinions that are inherently subjective."

The Analytical Way to Evaluate Performance

The examination of the actual track records of the CRPs is probably the best way to measure the accuracy of their ratings. It is much easier to develop robust evaluations by comparing past projections to actual experience than to compare one projection against another. It would be logical and most productive for the RFP being develop by the Committee, then, to focus on the ability of consultants to use performance data to determine which opinions for which CRPs for which sectors have been more or less reliable.

The SEC mandates the annual publication of detailed performance data for all of the rating agencies it regulates. This, and perhaps the NAIC's own extensive historic data, could be helpful. For even more revealing results, however, the consultant would need to have access and the technical ability to combine and mine multiple databases. This could even include data as detailed as the characteristics of many individual securities.

Such analyses would not only provide hard data concerning historic performance of each CRP by asset sector but it would also facilitate the mapping of ratings. If ratings can be categorized by security type then the performance of like security types can be compared from one CRP to others which would provide a reasonable basis for comparing ratings.

Initially such a system could assess and map CRP ratings, but ideally the consultant would build a system that the NAIC itself could use to provide regular updates even though this may pose certain challenges.

Other Tools for Evaluating CRPs -- And the SVO Itself

Quantitative analyses may be the best and most efficient way to identify potential issues with CRPs but the NAIC and its consultants should also be aware of and utilize many of the other elements that the SEC has required for many years to allow the public to make its own determinations of the amount of reliance they decide to place on the rating agencies. These include:

- Public disclosure of rating methodologies and procedures used to determine credit ratings
- Preparation of rating rationales explaining how the methodologies were applied for each rating (with no distinction between public and private offerings)
- Policies to prevent misuse of material non-public information
- Code of ethics
- Disclosure of and policies to address and manage conflicts of interest
- Qualifications of credit analysts and credit analyst supervisors
- Information regarding designated compliance officer
- Limits on the authority of rating agencies to act in the capacity of NRSROs only for assets in the five asset classes for which they were specifically registered with the SEC
- Published Administrative Proceeding Orders which provide details concerning specific compliance issues for the individual rating agencies and
- The annual report of the SEC's Office of Credit Ratings which "…summarizes the findings from our annual examinations and also provides information about NRSROs, their credit ratings businesses, and the industry more broadly." These are based on examinations to determine whether NRSROs were complying with their published procedures.

Even as the NAIC uses these tools and others "to eliminate blind reliance on CRPs" it can use similar tools to evaluate the most important credit rating provider of all -- the Securities Valuation Office. An essential function of regulators is to conduct independent examinations of insurers. Departments of insurance themselves are examined every five years by the NAIC so all accredited members can have confidence that others are meeting the high standards of the NAIC. Of course the SEC conducts its own detailed annual examinations of all NRSROs and the financial statements of all public companies are audited.

In this context it would be extraordinary for the NAIC not to commission periodic independent examinations of the SVO to provide the substantiation for its reliance on this key resource. Disclosures that are similar to some of those provided by all of the CRPs recognized by the NAIC could be required by the SVO itself. The SVO presently prepares none of the disclosures listed above. The most revealing would be "performance measurement statistics consisting of transition and default rates for each class"[1] prepared by all of the NRSROs. Instead the SVO releases a two or three page "Annual Report from the SVO on Year-End Carry-Over Filings." This may be useful to EX-1 for budgeting and planning purposes but it provides no indication or insights into the actual *quality* of the work done by the office; just its volume. An independent review of carefully sampled credit files would also provide a basis for justifying the substantial reliance the NAIC and departments of insurance place on the SVO.

In addition to conducting an independent review of the SVO there is a need on an ongoing bases for greater clarity concerning how regulators themselves can assess the quality of the analytical work of the SVO. As a part of the current review consideration should be given to explicitly charging an entity composed of regulators with oversight responsibilities. Of course the SVO staff has its own technical abilities and is a trusted advisor to regulators serving within the NAIC but it should be clear that in all instances it is the regulators themselves, considering this advice, who have the ultimate decision-making authority in all instances. In other words there should be no ambiguity as to whether staff is required to follow the directions of regulators.

To put this into effect the group responsible for SVO performance would need to have procedures in place to fulfil its responsibilities, perhaps relying to some degree on the types of reports recommended above. An outside consultant could assist in developing appropriate continuing procedures. The group would also need to have clear authority over SVO management in analytic, but not necessarily administrative, matters. This would mean that a presumably small group of regulators would have visibility and input into the formal performance assessments of at least the top two levels of SVO management. Presently the VOS/TF sets forth requirements of the SVO in the Purposes and Procedures Manual but it has no explicit power to motivate or assess actual performance of the leadership of the SVO. This could be addressed effectively as a part of the current review process and would enhance effectiveness.

"Different Standards for Public Versus Private Ratings"

It seems to be widely assumed within the NAIC that private placements deserve special attention. It is said that they lack "the market validation and transparency of public ratings" and that insurers may "rating shop." In the interest of "making the most effective use of regulatory resources," both of these assumptions deserve examination either prior to or during a consulting engagement.

Any consultant or advisor to the NAIC on this matter should have real world experience and actual market knowledge. The assumption that publics have greater "market validation" and "transparency" is suspect. The fact is that public bond offerings may have advance "road shows" to acquaint investors with an issuer in general terms and there are some "investor days" and earnings calls. Even so, the information available to the general market pales in comparison to what is available to the offerees of private placements.

For publics it is not unusual to have extremely limited time to review actual offering documents before being expected to enter orders. Investors entering large orders quickly after announcements are favored in

[1] Exhibit 1 of Form NRSRO required annually by the SEC

their allocations so often they must act very rapidly in order to receive preferential allocations of the bonds they seek.

The contrast with privates is stark. Investors have access to a depth of information inaccessible in public transactions. They, their attorneys and credit experts review offering terms and documents in detail. They can and do demand access, detail and concessions to meet their needs. All of this is overseen by senior management and credit committees. Of course it is true that "the market" sees publics, but that is superficial compared to what is the actual practice for privates and there is no "take it or leave it" for privates either.

As to the contention that insurers "ratings shop" for privates it is important to note that the decision to retain one rating agency or another is a matter for the issuer, working with the dealer for privates exactly as it is for publics. The SEC has identical requirements for the two types of issues and in any event the selection of a rating agency by the issuer is done for many reasons. Obviously the rating agency must have appropriate methodologies and a staff trained in the asset type. A rating agency may be sidelined because it has a backlog that would delay the rating or its prices may be uncompetitive for various reasons. An often-overlooked fact is that rating agencies add another set of eyes in the investment process. Their observations during the rating process can be invaluable even for insurers that have their own large and experienced investment staffs. The market perception that one rating offers more expertise and valuable insights is another reason a rating agency might be preferred. In short, the idea that there is "rating shopping" rather than "shopping for rating agencies" is no different for publics and privates. It is important to remember that the central objective of this draft framework is to determine what ratings can and cannot be relied upon. Ratings that are not up to standard or are unreliable should be weeded out for publics and privates alike as the work of the Committee reaches fruition.

There is also substantial evidence that there are significant performance differences between publics and privates. It has been well established that privates actually perform better, not worse, than publics and have for a very long time. This is substantiated by work of the Society of Actuaries and academic researchers[2]. These facts, too, should be considered when allocating scarce resources so as not to allocate a disproportionate amount of effort where it is not warranted.

Another concern may be that within assets structured as bonds there could be provisions that regulators believe may not actually require issuers to make payments ("risk of non-payment for reasons other than credit"). Addressing this concern was the specific objective of SAPWG's bond project. On 1/1/2025 insurers themselves will be explicitly responsible for properly classifying assets that do not conform to the SSAPs. Consider how much easier this will be for insurers to make these important decisions when they have had in-depth access to the exact terms and provisions of a private placement. They will be much better informed and positioned to fulfill their obligations.

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[2] Private Placement Experience Committee Society of Actuaries, 2003-2015 Credit Risk Loss Experience Study: Private Placement Bonds, https://www.soa.org/resources/experience-studies/2019/private-placement-bond/

Asset Risk Experience Committee and Private Placement Subcommittee, Society of Actuaries, 1986-92 Credit Rosk Loss Experience Study: Private Placement Bonds, https://www.soa.org/globalassets/assets/library/research/transactions-reports-of-mortality-moribidity-and-experience/1990-99/1997/january/tsr975.pdf

Carey, Mark The Journal of Finance , Aug., 1998, Vol. 53, No. 4, Papers and Proceedings of the Fifty-Eighth Annual Meeting of the American Finance Association, Chicago, Illinois, January 3-5, 1998 (Aug., 1998), pp. 1363-1387

Private placements are already being subjected to special scrutiny. Each year insurers are required to submit detailed and lengthy rating agency "rating rationales" for many thousands of privates for review by the SVO. Given that the SVO only provides Designations for less than 4,000 new filings a year[3] it is reasonable to ask if adding many thousands more is an effective use of resources. Justification for all of this might become clear if the SVO can demonstrate that its analysis of all of this material has produced actionable results. If not, then sampling or elimination of this requirement should be considered. This is especially true in light of the fact that NRSROs are accountable for producing all of their rationales to exactly the same standards for both publics and privates.

In summary, the reasons given that privates may deserve special attention may not survive scrutiny by those familiar with actual market practices. Careful consideration should be given to what degree of resources should be devoted to private placements.

Enhance SVO's Portfolio Analysis Capabilities

It may seem desirable to ask more of what is now the Investment Analysis Office and the SVO but there are challenges to doing this. The first question is what the NAIC can and should do itself that individual departments of insurance are not already doing or cannot do efficiently. Regulators today make substantial use of consultants on examinations and they can tailor their selection of consultants to specific examinations based on their needs. That way they do not have idle capacity. As a standard setter possibly the NAIC could assist departments in devising standards that could be used by departments between exams, with or without independent consultants, along with some centralized NAIC resources, to improve their insight into investment accounts and even enterprises.

It should be noted that the skills required for analyzing individual securities are significantly different from analyzing portfolios or enterprises and the SVO itself has no obvious experience in these areas. In any event, lessons can be learned from the past when the Capital Markets Bureau offered an investment portfolio analysis service. The reasons that was not successful could be analyzed and could help better understand how to best proceed. It is important, however, to be realistic about the range and extent of resources that are required to understand the many types of complex insurance enterprises that are regulated in the US. As just one example, it would take a full suite of actuaries, with all of their different specialties in order to be able to evaluate all manner of regulated insurers, especially at the enterprise level. Centralizing all necessary resources would be a monumental task.

Of course the future direction in this regard will be "needs driven" so individual insurance departments will really be the drivers of any expansion of centralized resources.

Creating a Broad Investment Working Group

This is an excellent and very necessary function that if formalized can coordinate the NAIC's investment oversight, including for new asset types, as well as being responsible for overseeing what is now the SVO.

Summary

As the Committee proceeds with its work to design and implement new processes it would do well to give favorable consideration to consultants who are skilled in data mining and those with actual market experience. They must also have a deep understanding of the full range of insurers that are regulated in the

[3] 3,893 new filings, 11,257 annual updates, 12 appeals, 366 material changes and 21 renumberings source: "SVO 2024 Carry Over Filings" February 16, 2024, Charles Therriault and Marc Perlman

US, the capabilities and needs of their regulators and, of course, the structure and workings of the NAIC. This is a very tall order so it may be necessary to assemble and coordinate experts with their own relevant skill sets or use a certain amount of creativity to accomplish all that is hoped for in the successful realization of the objectives of this Framework. Accomplishing these goals has tremendous potential for the future of insurance regulation and this, in turn, bodes well for the continued success of the insurance industry.

Copies: Dan Daveline

Carrie Haughawout
Vice President of Life Insurance and Regulatory Policy
202-624-2049
CarrieHaughawout@acli.com

April 8, 2024

Commissioner Nathan Houdek, Chair
Financial Condition (E) Committee
National Association of Insurance Commissioners (NAIC)
Via email ddaveline@naic.org

Re: Re-Exposure of the Framework for Regulation of Insurer Investments and Work Plan

Dear Commissioner Houdek:

The American Council of Life Insurers (ACLI) appreciates the opportunity to comment on the E Committee's February 15, 2024, exposure of holistic investment framework documents and we applaud the work that you and your fellow members and staff have put into this project to date. In particular, the Memo to Interested Parties (Memo) was especially useful in understanding the thought process that went into making the workplan and framework updates, and as one of our members noted, the transparency included in that document is exemplary.

Overall, ACLI supports the concept of a holistic approach to regulating insurer investments and we continue to do so. In the spirit of transparency, and to promote compliance, we are also recommending several items that would help support and strengthen industry understanding of this effort.

1. **Clarifying the intent for including "tail" risk under the principle of "equal capital for equal risk".** ACLI supports the C-1 bond factors and the appropriate emphasis on tail risk as is captured all throughout the NAIC's capital framework, measured in risk-based capital (RBC). However, the conversation around the holistic framework would suggest E Committee's approach is broader than just a focus on RBC. As a result, clarity on the inclusion of the "tail" concept in the framework would better inform industry understanding and further comments on this point.

2. **Coordination with investment-related initiatives of the Life Actuarial Task Force (LATF) and other related work.** The framework includes references to work being done at LATF as an example, but we are not aware of any additional conversations about what work LATF is

doing that would be overseen by this holistic process. Additionally, it is possible – if not likely— there would be new work that is not yet contemplated or not yet begun, that should be included in the holistic approach as well. Clarity on how LATF and other related work will be included in the framework would be helpful.

3. **Development of a new document to help identify and strengthen coordination of work being included under the framework**. Similar to the 13 macroprudential considerations, such a document would complement the framework and the workplan and help track all the work that is being overseen by the framework. We believe new work should also be included so that all the work, both current and new, being overseen would be tracked and updated.

4. **Continued stakeholder engagement and transparency.** As the committee works on items related to action items four and five, we appreciate the regulators already transparent process, and look forward to participating in the process further regarding the conceptual centralized investment support and an investment focused work group.

We believe these recommendations will be helpful to achieving the goals of the holistic approach and we discuss these items further below.

FRAMEWORK FOR REGULATION OF INSURER INVESTMENTS—A HOLISTIC REVIEW

When reviewing the changes to the framework document, our members generally thought the updates were thoughtful and appropriate. We appreciated the clarification that the purpose of the framework is for regulators to best achieve their duties to oversee the insurance industry they regulate. Additionally, we agree and understand that the broad goal of regulators is to ensure company solvency as a part of consumer protection. We also understand that other impacts of the regulatory requirements, such as impacts to the market, are secondary to consumer protection. To be clear, we positively viewed the framework as an indication that there are other impacts to consider if regulatory requirements change and the NAIC was to take a broader view than just solvency. We further appreciate the call out to coordination and believe that coordination and transparency will be key.

As noted above, the change to the phrase “equal capital for equal risk” to “equal capital for equal tail risk” has raised questions for us. Is the goal of this framework to be focused only on capital charges for asset-risk (C-1) or is it meant to be true holistic view including both capital and reserves together when using “equal capital for equal risk” in the framework? For example, ACLI supports the C-1 bond factors and the appropriate emphasis on tail risk as is captured all throughout the NAIC’s capital framework measured in risk-based capital. However, it was not clear to us whether the committee was looking at this framework as only addressing capital, or if it was looking at overall solvency that would also include reserves. The change to include “tail” might suggest the former, but clarity on this point will provide a better understanding of the goal of this approach.

INVESTMENT FRAMEWORK WORKPLAN

The workplan document opens with a set of core principles. These principles help us fully understand the E Committee's direction and seem thoughtful and appropriate. We agree that prudent investments need to be managed by the insurers. However, a crucial aspect of this function is understanding the perspective of regulators, which helps shape the insurer’s management of its assets. For this reason, transparency with the industry and regulators across all levels will be critical to success. Further, we believe it is necessary to consider not only the agendas of existing workstreams but also any new work that may emerge during the development of the holistic approach. Accordingly, we agree and support Action Item One – updating the framework as needed.

As noted in our previous comments, we continue to support hiring a consultant to provide recommendations for a due diligence framework for credit rating providers (CRPs) -- Action Item Two. We applaud the committee for its work and receiving approval for hiring a consultant and for its focus on transparency during the RFP process. ACLI looks forward to engaging with the committee and the Valuations of Securities Task Force on this work.

Action Item Three of the workplan notes again that there will be no pause in existing work and the Committee will continue to defer to the subgroups. We also will comment on Action Item Six, the development and implementation of best practices for enhanced coordination between the Committee's workstreams. We understand that the framework is meant to be a longer-term flexible document, coupled with the core principles. It makes sense to continue the current work, as discussed previously. Continuing the existing work will require clear coordination between E Committee and the workgroups. For example, the framework notes that LATF might have some work that would be considered a part of the framework. To our knowledge, there has been no further mention of the framework in the Task Force's existing work or any potential new work being considered. We think that much of the work LATF is currently conducting should be considered a part of the framework and would suggest it be included in the coordination and transparency umbrella that the holistic approach requires.

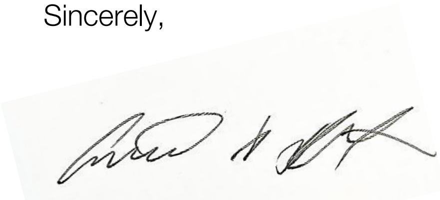
ACLI was present for the recent E Committee meeting in Phoenix and heard comments from the workgroups and task forces chairs. We think that was a good step forward in hearing from those groups. We are wondering if interested parties can comment during that process or if there is a way to introduce some interested party comments into this process? If there is an alternative option for incorporating interested party feedback into this process, we would be happy to engage in further conversation.

We also suggest that a more defined process for continued coordination and transparency is necessary to foster all parties being on the same page. We are cognizant of not wanting to add layers of bureaucracy or delay to an already public process. As noted above, our recommendation is to create a document to track current work and new work that is included in the scope of the holistic framework. We would suggest the document include 1) the name of the group, 2) the overarching goal of the work, and 3) whether the work would impact any other solvency related item. To be clear, we are not recommending a change to the framework or the workplan but rather the addition of a new document that would continue to be tracked and updated as work proceeds. Such a document seems like a good best practice that could be utilized to support better coordination and will give more visibility into the collective impact of all the work being done in this space.

Action Items Four and Five include an assessment of conceptual centralized investment expertise and appointing an investment focused working group to support the committee and its groups/task forces. We generally support conducting the assessment and the addition of an investment-focused workgroup. We appreciate the opportunity to better understand how those items develop and want to ensure we have a seat at the table to provide feedback on such expertise as it unfolds.

Thank you once again for the opportunity to share our thoughts and comments and we look forward to further engagement with NAIC regulators and staff as this project proceeds.

Sincerely,



Carrie Haughawout
Senior Vice President of Life Insurance and Regulatory Policy
American Council of Life Insurers

April 8, 2024

<u>VIA ELECTRONIC SUBMISSION</u>

Commissioner Nathan Houdek
Chair, Financial Condition (E) Committee
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Re: Framework for Regulation of Insurer Investments – A Holistic Review
February 14, 2024 Exposure

Dear Commissioner Houdek and Members of the Financial Condition (E) Committee:

The American Investment Council ("AIC")[1] appreciates the opportunity to comment on the revised draft *Framework for Regulation of Insurer Investments – A Holistic Review* ("Investment Framework") and the supporting materials – inclusive of the corresponding *Memo to Interested Parties* and *Investment Framework Work Plan* – that were exposed for public comment on February 14, 2024. As noted in our October 9, 2023 comment letter, AIC members believe the Investment Framework and E Committee's receptiveness to meeting with stakeholders on the Investment Framework represents a positive development in the NAIC's ongoing efforts to modernize the regulation and supervision of insurer investments. There is a clear need for a holistic, top-down approach to evaluating regulators' concerns with the existing regulatory framework and coordinating any resulting workstreams.

Given the precedential value and knock-on effects, it is critical that any potential changes to the US regulatory framework for insurer investments be carefully considered and implemented through an open and deliberative process. Such initiatives should include processes to identify state insurance regulators' specific concerns and assess whether those concerns are valid. In this regard, we were happy to hear the NAIC's recent announcement that it will delay implementation of its collateralized loan obligation ("CLO") modeling initiative until year-end 2025 to allow time for the American Academy of Actuaries ("Academy") to complete its foundational work on a new RBC framework for all asset-backed securities (including the Academy's assessment of whether individual CLO modeling is necessary or appropriate). We are similarly hopeful that E Committee's work to develop a due diligence framework for credit rating providers ("CRP") and address the NAIC's concerns with respect to "blind reliance" on CRPs will include methodical discussions related to the specific concerns that state insurance regulators have with respect to the current regime and an evaluation of all potential paths forward.

[1] The AIC is an advocacy, communications, and research organization established to advance access to capital, job creation, retirement security, innovation, and economic growth by promoting responsible long-term investment. The AIC's members include the world's leading private equity and private credit firms, many of which partner with insurers to achieve their long-term investment objectives and ensure the continued success of insurers and their policyholders. Among other things, by adopting appropriate, risk-adjusted investment strategies, our members are committed to helping secure the retirement of millions of pension holders and to policyholder protection. For further information about the AIC and its members, please visit our website at http://www.investmentcouncil.org.

Notwithstanding these encouraging developments, we are concerned by – and opposed to – the introduction of the concept of "equal capital for equal *tail* risk" that was included in the latest iteration of the Investment Framework. While the specific intent of this change is not clear, the potential narrowing of the concept of capital parity is not appropriate. Instead, the language should be revised to reflect that the Investment Framework recognizes that tail risk is an important element of the broader, more appropriate, concept of "equal capital for equal risk," for example that the concept "includes, but is not limited to, tail risk."

In addition, we will be submitting a separate comment letter to the Risk-Based Capital Investment Risk and Evaluation (E) Working Group ("RBCIRE") regarding the Oliver Wyman study exposure on the performance of asset backed security residual tranche investments and the associated potential increase in capital charge on such assets from 30% to 45%. Having carefully reviewed the Oliver Wyman study, we feel strongly that the study does not support a 45% capital charge on such residual tranches and remain committed to supporting a data driven capital charge that appropriately reflects the risk of these assets. We are also concerned with public statements by state insurance regulators indicating that the imposition of a 45% capital charge on residual tranches is viewed as a template by regulators to justify punitive capital charges for other high-performing assets that are well understood by the capital markets but relatively newer to insurance company balance sheets. This concept is referenced in the Investment Framework Recommendation 9, but we are concerned with the precedential impact of these statements as they seem to suggest that any future interim charge imposed using the residual template would not be supported by data.

The AIC and its members remain committed to working with members of the E Committee, state insurance regulators, and NAIC staff on solutions that best serve the needs of regulators, policyholders, and insurers alike. This includes both "technical" issues that are properly within the purview of designated working groups and task forces, including the Oliver Wyman study currently exposed at the RBCIRE, and foundational issues and concerns that should be addressed at the E Committee level. We look forward to continuing to work with you on these important issues.

Sincerely,

/s/ Rebekah Goshorn Jurata
General Counsel
American Investment Council

cc: Mr. Dan Daveline
Director, Financial Regulatory Services
National Association of Insurance Commissioners (via email)

April 8, 2024

Commissioner Nathan Houdek
Chair
Financial Condition (E) Committee
National Association of Insurance Commissioners

Transmitted via email to Dan Daveline at ddaveline@naic.org

Re: Investment Framework as Revised by (E) Committee

Dear Chair Houdek:

This letter is submitted on behalf of MetLife, Inc. ("MetLife"). MetLife appreciates the opportunity to comment on the Investment Framework as Revised by (E) Committee ("the Committee") and related documents exposed after the March 18, 2024 Committee meeting.

First, and as expressed in our oral remarks during the March 18 meeting, MetLife wishes to express our gratitude to the Committee for conducting this process with exemplary transparency. We are confident that such an approach can only lead to more robust outcomes for our industry.

We also want to reiterate our full support for the Committee's resolve to continue with all its current initiatives without pause or delay. Risks continue to build in industry investment portfolios, and stakeholders in the media and fellow regulatory bodies have taken note. We are confident that your continued resolute action in this area will exemplify the NAIC's active leadership in insurance standard setting and address any stakeholder concerns.

Finally, we want to express our support for the Framework's focus on tail risk as the key equalizer of capital. As the American Academy of Actuaries has noted, the loss behavior of subordinated structured securities in tail scenarios is significantly more adverse than the behavior of corporate credit of the same rating in those scenarios. Subordinated structured securities are behind much of the increase in industry portfolio risks seen in the last few years. Determining the appropriate capital that insurers should hold against these investments by focusing on their tail risks through modeling, when practical, will greatly enhance the current RBC approach and will help the NAIC achieve its stated goal of reducing blind reliance on ratings.

We reiterate MetLife's sincere appreciation for the opportunity to comment on the thoughtful Investment Framework as Revised by (E) Committee. If you have any question regarding the present letter, please contact Ben Cushman, Head of Global Regulatory Policy, via email at ben.cushman@metlife.com.

Sincerely,

Chuck Scully
Executive Vice President and CIO
MetLife Insurance Investments

BRIDGEWAY
ANALYTICS

Amnon Levy
Bridgeway Analytics
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April 8, 2024

Financial Condition (E) Committee
National Association of Insurance Commissioners
110 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

RE: The Revised Framework for Regulation of Insurer Investments, its Workplan, and a memorandum summarizing regulators' reaction

Dear Commissioner Houdek,

On behalf of Bridgeway Analytics, I am grateful for the opportunity to comment on the revised Framework for Regulation of Insurer Investments (Framework), its Workplan, and a memorandum summarizing regulators' reaction to previously submitted comments on the Framework. The NAIC has embarked on a much-needed and historic effort to modernize investment risk oversight with aspirations to achieve "equal capital for equal risk," which we encourage. Our comments build upon those we made dated October 2, 2023 (see posted comments, pages 45-82) and summarize thoughts from our latest report, Modernizing Investment Risk Oversight, which provides our opinion on each Framework recommendation. Our comments focus on two themes embedded within the recommendations to modernize the SVO and the Workplan:

- Addressing regulators' concerns over the "blind" reliance on agency ratings, with no mechanism for overall due diligence around their usage.
- The buildout of a centralized investment expertise (CIE) function, appropriately staffed and resourced, intended to provide regulators with the needed transparency to ensure insurer solvency.

Addressing regulators' concerns over the "blind" reliance on agency ratings. Between the ongoing Valuation of Securities (E) Task Force workstream to design a process that would extend NAIC staff discretion over agency ranting-based Designations and the posted petition for the development of a request for proposal (RFP) to engage a consultant who would help the NAIC develop a due diligence program over the ongoing use of agency ratings (Attachment Eleven), regulators have made clear their determination to address concerns with "blind" reliance on agency ratings.

Related to both initiatives, we encourage regulators to consider cost-effective and transparent mechanisms that are attainable relatively easily and quickly, recognizing that, while helpful, they are not a substitute for more comprehensive mechanisms that might involve longer-term efforts. Our reports, Overseeing Designations and the Prudent Use of Agency Ratings and Investment Risk Oversight, articulate a spectrum of mechanisms with varying costs and timelines. Independence, which the Framework references, and precision must be balanced. On one end of the spectrum, systems and models can be developed at the standards set by rating agencies, which is not in the spirit of the Framework's intent, given the costs. On the other end, regulators can place the onus on insurers to defend their use of agency ratings in business applications beyond regulatory compliance, demonstrating their genuine belief that the risk assessment is prudent and accurate, and avoiding flagrant misuse of ratings. This mechanism very much aligns with Principle (6) of the Workplan:

> *The ultimate responsibility for prudent investment oversight is with the insurers themselves, notwithstanding any of the work done to bolster regulatory resources and oversight over-reliance on credit rating providers (CRPs). This responsibility should not be "outsourced" to CRPs or the regulators.*

By requiring insurers to use agency ratings in business applications beyond regulatory compliance and otherwise disclose differences between credit risk measures used in their internal processes and Designations used for regulatory purposes, regulators will be provided transparency on the degree to which Designations are credible.[1] Confidentiality considerations might require the data to be reported publicly on an aggregated basis but available to regulators individually. As stated above, while not a substitute for more comprehensive governance mechanisms, disclosure requirements can be implemented relatively quickly since they do not rely on the NAIC to develop new methodologies or onboard new tools or personnel.

The buildout of a CIE function. As explained by regulators, the recommendation would invest in risk analytics tools and corresponding personnel, which could perform company-specific, industry-wide, and macroprudential analysis and build a broader and holistic policy advisory function. We view the capabilities of forming independent opinions on risk and policy as critical to the holistic goals of the Framework. The function should consider resources that have a deep understanding of the interconnected elements of statutory accounting and RBC that are often challenged by the nature of needed subject expertise, which is often siloed. Action Item #4 under the Workplan, which addresses this recommendation, lists examples of initial related discussion points. We are encouraged by the initiative and suggest this Action Item also consider lessons learned from how other rulemaking bodies structured their supervisory and policy/regulatory processes, including expensive regulatory initiatives, such as CCAR and Solvency II, that can provide important guidance on governance and the effectiveness of various mechanisms.

Bridgeway Analytics was founded with a mission to support insurers and their regulators in navigating capital markets and their regulatory landscape. We often gravitate toward the most complex and dividing issues and aspire to form consensus by framing issues objectively and through data-driven analysis that can be easily understood. We are grateful for the opportunity to contribute to this process and look forward to engaging further.

Sincerely,

Amnon Levy

[1] In some cases, as with CMBS and RMBS, insurers do not have a choice over the source of Designations and are required to use an NAIC model-based Designation, which they may not view as prudent. In such cases, disclosing differences between their internal risk measure and Designations may be more appropriate than requiring the use of the Designations in their internal processes.

Founder and Chief Executive Officer

Bridgeway Analytics supports the investment and regulatory community work to optimize the design, organization, and utility of regulations surrounding the management of insurance company portfolios. While the content in this document is informed by extensive discussions with our client base, the broader industry, NAIC staff, and state regulators and may contain analysis that Bridgeway Analytics had conducted as part of a commercial engagement and retains the right to reuse, the views in this document are solely those of Bridgeway Analytics and are based on an objective assessment of data, modeling approaches, and referenced documentation, that in our judgment and experience, are viewed as appropriate in articulating the issues at hand. Methodologies are available to the public through an email request at support@bridgewayanalytics.com. For more information visit www.BridgewayAnalytics.com.

April 8, 2024

Dan Daveline
Director, Financial Regulatory Services
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197
Via email: ddaveline@naic.org

Re: Revised E Committee Framework Exposures

Dear Mr. Daveline:

I write on behalf of Athene Holding (Athene) to reiterate our support for the E Committee's Framework for Regulation of Insurer Investments and the associated Work Plan and Memo. We continue to strongly support the Framework's aims of modernizing investment risk oversight and creating a consistent approach in calculating C1 capital across a diverse set of asset classes and structures. Insurer solvency is paramount, and we believe that a principles-based, RBC framework that is built on consistency and data-driven analysis will promote insurer solvency, while also providing stability to insurers' investment activities and fostering a vibrant life insurance market that meets the needs of US consumers.

Below are our specific comments on the exposures.

Importance to the Goal of "Equal Capital for Equal Risk"

As stated in our October 9 letter on the draft Framework, Athene supports the concept of capital parity, or 'Equal Capital for Equal Risk', and the Framework's goal of achieving such capital parity. The revised Framework now refers to 'Equal Capital for Equal ***Tail*** Risk' throughout the document, but the E Committee Memo to Interested Parties explains that the "Drafting Group Members are supportive of the view of equal capital for equal risk which includes consideration of tail risk." We agree that tail risk is a critical consideration for RBC but believe the E Committee Framework's original language provided a more appropriate characterization than the draft revised Framework, which could inadvertently narrow the meaning of Equal Capital for Equal Risk.

Additionally, at this point there are varying views on the precise definition and scope of 'tail risk' as an NAIC approved terminology within the RBC environment. We believe that the Equal Capital for Equal Risk concept should be explored both in the context of asset capital charges, as well as in broader tail risks captured by RBC, such as reserving for difficult-to-value liabilities (e.g., long-term care) and soft capital benefits achieved through covariance from riskier blocks of business. In our view, it is premature to limit regulatory assessment to only those risks that might be considered 'tail risk', which has not been fully defined. By way of example, RBC C1 bond factors are calibrated to a 96^{th} percentile risk of loss over 10 years using default rate data from 1983-2020 and recovery data from 1987–2019; however, this is not the case for all asset classes. For example, the common stock C1 factor is measured as the 94^{th} percentile worst 2-year loss on the S&P 500 using data between 1960 and 1991, and the commercial mortgage factor is the tail expected loss at the 92^{nd} percentile of modeled loss projected using 10-year periods that begin in each calendar quarter from 1980–2000, and with default algorithms that are based on commercial mortgage loan experience tracked from the 1970s through 2010. One would presume that all of these models are assessing 'tail risk', though we are unaware of an NAIC workstream that has attempted to delineate how each of these meets a common definition of tail risk across asset classes.

As noted in the E Committee Memo, "Regulators agree that tail risk is *a* key component to be evaluated in the setting of capital factors, as well as the impact of concentration in particular assets", and that "comments on tail risk should be directed to the appropriate technical work streams" (emphasis added).

Given the foregoing, we recommend the Framework be revised to clarify that the goal remains "Equal Capital for Equal Risk," and that this concept "includes consideration of tail risk" when the term is first referenced. This will allow the NAIC processes to advance to a place where RBC risk tolerances can be better analyzed, including for consistency, and the definition and scope of tail risk can be better defined.

<u>SVO Modeling</u>

The Framework envisions continued utilization of CRPs, together with the development of a strong SVO due diligence function. A strong SVO due diligence function will complement the role of CRPs, by focusing on broader risk analysis and not replicating their capabilities. We believe the SVO's CLO modeling tool is best suited for due diligence, benchmarking, and advisory functions. This avoids inefficiency, leverages market mechanisms, and allows assessing the tool's effectiveness before potentially impacting capital parity by replacing CRPs for CLO designation purposes. We understand the question of the appropriate uses for the SVO's CLO modeling methodology will be addressed at the technical work stream level as the methodology is further developed, and we will continue to provide our input into those discussions.

We appreciate the NAIC's continued transparency and the opportunity to provide feedback on this important initiative. We look forward to the finalization and implementation of the Framework.

Sincerely,

Michael Consedine
Executive Vice President
Head of US Government Relations & Regulatory Affairs