Date: 6/17/2024

Virtual Meeting

RISK-BASED CAPITAL INVESTMENT RISK AND EVALUATION (E) WORKING GROUP
Friday, June 21, 2024
12:00 – 2:00 p.m. ET / 11:00 a.m. – 1:00 p.m. CT / 10:00 a.m. – 12:00 p.m. MT / 9:00 – 11:00 a.m. PT

ROLL CALL

RISK-BASED CAPITAL INVESTMENT RISK AND EVALUATION (E) WORKING GROUP

Philip Barlow, Chair	District of Columbia	William Leung/Debbie Doggett	Missouri
Thomas Reedy, Vice Chair	California	Lindsay Crawford	Nebraska
Wanchin Chou	Connecticut	Jennifer Li	New Hampshire
Ray Spudeck/Carolyn Morgan	Florida	Bob Kasinow/Bill Carmello	New York
Vincent Tsang	Illinois	Dale Bruggeman/Tom Botsko	Ohio
Roy Eft	Indiana	Rachel Hemphill	Texas
Carrie Mears/Kevin Clark	Iowa	Doug Stolte	Virginia
Fred Andersen	Minnesota	Steve Drutz/Tim Hays	Washington
		Amy Malm	Wisconsin

NAIC Support Staff: Dave Fleming/Julie Gann

AGENDA

1. Discuss Comment Letters Received on Residual Proposal —*Philip Barlow (DC)*

   - Alternative Credit Council — Attachment 1
   - American Academy of Actuaries' C1 Subcommittee — Attachment 2
   - Americans for Tax Reform — Attachment 3
   - Athene — Attachment 4
   - Everlake — Attachment 5
   - Global Atlantic — Attachment 6
   - Guardian & TIAA — Attachment 7
   - Joint (Equitable, MetLife, Pacific Life, Western & Southern) — Attachment 8
   - NCMM — Attachment 9
   - Pinpoint — Attachment 10
   - Resolution Life — Attachment 11
   - SBE Council — Attachment 12

2. Discuss American Council of Life Insurers' Survey Data—*Philip Barlow (DC)* — Attachment 13

3. Consider Adoption of Proposal 2024-19-I —*Philip Barlow (DC)* — Attachment 14

4. Discuss Any Other Matters Brought Before the Working Group
   —Philip Barlow (DC)

5. Adjournment

ALTERNATIVE CREDIT COUNCIL
LENDING FOR GROWTH

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acc.aima.org

Philip Barlow
Chair Risk-Based Capital Investment Risk and Evaluation (E) Working Group ("RBC-IRE")
National Association of Insurance Commissioners

Via Electronic Submission

June 13, 2024

Dear Chairman Barlow:

Re: Structured Securities – Interim RBC Factor for Residual Tranches, Proposal 2024-19-I

The Alternative Credit Council ("ACC")[1], the private credit affiliate of the Alternative Investment Management Association Ltd ("AIMA"), appreciates the opportunity to provide comments on Proposal 2024-19-I[2] and the presentation by the NAIC's Structured Securities Group ("SSG")[3]. Given the focus on middle-market collateralized loan obligations ("MM CLOs"), we suggest a definition to distinguish between MM CLOs and broadly syndicated CLOs ("BSL CLOs") and present additional data analysis that demonstrates the relative safety and outperformance of MM CLOs compared to BSL CLOs.

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1 The Alternative Credit Council (ACC) is a global body that represents asset management firms in the private credit and direct lending space. It currently represents 250 members that manage over $1trn of private credit assets. The ACC is an affiliate of AIMA and is governed by its own board which ultimately reports to the AIMA Council. ACC members provide an important source of funding to the economy. They provide finance to mid-market corporates, SMEs, commercial and residential real estate developments, infrastructure, and the trade and receivables business. The ACC's core objectives are to provide guidance on policy and regulatory matters, support wider advocacy and educational efforts and generate industry research with the view to strengthening the sector's sustainability and wider economic and financial benefits. Alternative credit, private debt or direct lending funds have grown substantially in recent years and are becoming a key segment of the asset management industry. The ACC seeks to explain the value of private credit by highlighting the sector's wider economic and financial stability benefits.

2 RBC-IRE Proposal 2024-19-I ("the ABS Residual Proposal"), which updates the Risk-Based Capital ("RBC") instructions for "other long-term assets, Form LR008 (5/17/2024) at https://content.naic.org/sites/default/files/inline-files/2024-19-I%20ResidualCombined_Updated.pdf

3 SSG Presentation, which lists five concerns about the ABS Residual Proposal (5/17/2024) at https://content.naic.org/sites/default/files/inline-files/IRE%20RBC%20Note.pdf

Executive Summary

The ACC generally supports the ABS Residual Proposal, which is based on the data-driven analysis in the Oliver Wyman ABS Residual Study and assigns a 30% capital charge for the residual tranches of MM CLOs, CMBS, RMBS and the other ABS listed in the proposal. The ABS Residual Proposal assigns a 45% charge for all other ABS residuals, including BSL CLOs and CFOs. However, the ACC also supports the concerns expressed in point 4 of the SSG Presentation regarding CRE CLOs and CMBS. As a result, we recommend adding those two types of assets to the 45% capital charge bucket.

We disagree with the assertion in Point 2 of the SSG presentation that the OW study indicates that the risk of MM CLOs is similar enough to BSL CLOs to deserve a 45% charge. The SSG presentation provides no data to support its hypothesis regarding what MM CLOs insurers actually invest in compared to the representative sample of MM CLOs in the Oliver Wyman study. The American Academy of Actuaries is in the middle of a process to determine the comparable attributes of the ABS structure, and its underlying collateral should determine the appropriate capital charge. The interim charge should not presuppose the outcome of their analysis.

More importantly, the OW study was designed to provide a relative comparison of the level of risk of ABS residuals to similar assets with an established NAIC capital charge to ensure the same tail risk gets the same capital charge. As detailed in the Appendix, the OW study results indicated that, to be consistent with the principle of "the same capital charge for the same tail risk," even if BSL CLOs are given a 45% charge, MM CLOs should receive a 30% charge. Furthermore, as detailed in the appendix, there is a vast amount of historical data that demonstrates that MM CLOs have outperformed BSL CLOs.

Finally, we agree with Point 5 of the SSG Presentation regarding the need for classification of the transactions. In response to this point, we recommend a definition of a MM CLO based on how MM CLOs are originated and managed over time in a very different way than BSL CLOs, which helps explain why MM CLOs are less likely to default. We also support Everlake's proposed refinements to the categorization of ABS residuals to generally correspond to the relevant reporting lines in an insurer's annual statement. This approach results in ABS where the underlying has debt-like characteristics in the 30% capital charge bucket (with the exception of BSL CLOs), and those with equity-like characteristics such as CFOs, in the 45% bucket.

We welcome the opportunity to provide supplementary comments and additional data analysis. From our perspective, there are now only two data-driven analyses available to the NAIC, both of which demonstrate that a single 45% charge on ABS residuals would not correspond to the actual levels of risk. If you have any questions about this new information, please reach out to me or Joe Engelhard, Head of Private Credit & Asset Management Policy, Americas, at 202-304-0311 or jengelhard@aima.org.

Respectfully,

Jiří Król
Global Head of Alternative Credit Council

Appendix

Distinguishing MM CLOs from BSL CLOs

BSLs are typically negotiated by banks using documents similar to the standardized loan documentation forms of the Loan Syndications and Trading Association. The bank then broadly offers it to a wide variety of potential investors who have a very limited period of time, usually just a few days, to sign onto that syndicated loan. Furthermore, banks provide liquidity by supporting secondary market trading in BSLs. These loans typically have a very large number of investors, hence the term "broadly syndicated."

Middle-market loans are originated in a quite different way that offers much greater protection for the lender. MM loans are typically directly negotiated by a long-term lender or, in club deals, a small group of lenders who each do their own deep due diligence and directly interact with the borrower. This results in a customized loan agreement that better aligns the risk appetite of the lender with the needs of the corporate borrower. MM loans are structured to allow the lender to take early preventative action to avoid a default, which is not possible under the terms of BSL deals with standardized terms and many creditors. Middle-market lenders remain directly engaged with the borrower throughout the loan term, which allows for greater management control and flexibility. Further, from a structural perspective, MM CLOs typically have more par subordination and rating cushion at a given tranche level relative to BSL CLOs.

Definition of a MM CLO

A middle-market CLO can be defined as one where the underlying collateral consists of a loan where the key lenders directly negotiate the loan without the intermediation of a bank and develop a bespoke loan contract that forms the basis of a long-term relationship with the borrower and that allows for greater management control during the course of the loan.

Historical Data Shows MM CLOs Default Less Than BSL CLOs

S&P began rating CLOs in the mid-1990s and has now rated over 18,000 CLOs. This 25-year rating history includes three separate periods of significant market stress: the dot.com bust in 2001, the 2008 financial crisis, and the COVID-19 market crash. During the entire period of S&P's coverage of CLOs, only 60 U.S. CLOs defaulted, and 40 of those were CLO 1.0 structures that were originated prior to 2009. Of the CLO 2.0 tranches issued since 2009, only 20 have defaulted, and all of those are BSL CLOs.[4] This means that since 2009, no MM CLOs in the S&P coverage universe have defaulted.

S&P periodically runs hypothetical stress scenarios on its rated MM and BSL CLOs to generate a quantitative analysis using its CLO rating models—the CDO Evaluator and S&P Cash Flow Evaluator. In its most recently published results, S&P applied four separate stress scenarios on a sample of 137 MM CLOs and the results confirmed its previous published stress scenarios of CLO ratings that "middle-market CLOs can withstand comparable defaults with less rating impact than BSL CLOs."[5]

A January Voya paper on middle-market lending notes that since 2007, middle-market loans, unlike broadly syndicated loans, have generally maintained robust structural protections: "'Cov-lite' loans as a percentage of total middle market loan issuance has generally been below 10% since 2007. In contrast, Cov-lite loans as a percentage of the S&P/LSTA Leveraged Loan Index are significantly higher, reaching 79% in 2018."[6]

The Oliver Wyman ABS Study

Table 8 of the Oliver Wyman study summarizes the results of the three stress scenarios for MM and BSL CLOs, concluding that "residual tranches for MM CLOs consistently perform better than BSL ones across our scenarios." (See Table 8 below for detailed results.)

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4 S&P Private Credit and Middle-Market Quarterly, Q2 2024 Update, April 24, 2024, at https://www.spglobal.com/ratings/en/research/pdf-articles/240424-private-credit-and-middle-market-clo-quarterly-not-a-sunset-just-an-eclipse-q2-2024-101596636

5 Stephen Anderberg, Scenario Analysis: How Resilient Are Middle Market CLO Ratings (2023 Update), October 16, 2023, at https://www.spglobal.com/ratings/en/research/articles/231016-scenario-analysis-how-resilient-are-middle-market-clo-ratings-2023-update-12884065

6 Avi Tolani, Voya Financial, Middle Market Lending, January 2024 at https://institutional.voya.com/system/files/system/files/article/file/middle-market-lending-benefits-diversified-approach.pdf

ALTERNATIVE CREDIT COUNCIL

Table 8 provides the average losses for residual tranches of CLO in each of the stress scenarios:

Table 8: CLO summary statistics

Scenario Severity	Scenario	CLO type	Simple average losses	Portfolio average losses
95th percentile	Dot-Com	BSL	-48%	-45%
		MM	-34%	-27%
	GFC[25]	BSL	-46%	-42%
		MM	-32%	-25%
99th percentile	Deep-tail	BSL	-74%	-72%
		MM	-64%	-55%

In addition, we considered the losses at the deal-level to understand the characteristics that affect the potential losses on residuals tranches. **Figure 19** illustrates losses by residual thickness in our GFC scenario. These results indicate:

- Residual tranches for MM CLOs consistently perform better than BSLs ones across our scenarios.

Some have argued that the Oliver Wyman study justifies a 45% capital charge for BSL CLO residuals (despite BSL CLOs overall outperforming common stock with a 30% charge). However, using the 45% charge as the reference, the average BSL CLO losses under all three scenarios would need to be scaled by .85 to result in a 45% charge. In other words, the 45% charge is 85% of the average of portfolio losses in the three stress scenarios.

In all three stress scenarios, the average loss for MM CLOs is 35.66%. If the same .85 scalar for BSLs is applied, the capital charge would be 30.32% for MM CLOs. <u>Put simply, applying the same ratio of losses to the resulting 45% capital charge for BSL CLOs would result in a 30% capital charge for middle-market CLOs.</u>

The SSG review claims that MM CLOs have similar losses to BSL CLOs, but—as noted above—that is not what the results of the three stress tests in the Oliver Wyman study demonstrate. The SSG Presentation makes no reference to the number of CLO ABS tranches held by insurers, nor does it provide evidence of what MM CLOs insurers actually hold. Instead, it simply asserts that insurers only hold MM CLOs of a certain thickness. This claim cannot be substantiated with data, as even the ACLI survey only covers a certain percentage of actual holdings. Anecdotally, our members have told us that insurers hold MM CLOs with both thick and thin residuals. What we do know is that the OW study was representative of the MM CLOs that are available for insurers to participate in—and they either have done so already or may do so in the future.

AMERICAN ACADEMY of ACTUARIES

June 13, 2024

Mr. Philip Barlow
Chair, Risk-Based Capital Investment Risk and Evaluation (E) Working Group ("RBCIRE WG")
National Association of Insurance Commissioners ("NAIC")

Re: Exposure 2024-19-I—Interim Residual Tranche C1 Factors

Dear Mr. Barlow,

On behalf of the American Academy of Actuaries[1] C1 Subcommittee, I am providing comments on the exposed interim residual tranche proposal by Everlake Life Insurance Company.

The subcommittee is focused on developing a proposal for a long-term asset-backed securities C1 framework, including for residual tranches. Consistent with the Everlake proposal, our comparable attributes approach is likely to result in multiple C-1 factors across different categories of residual tranche. However, it is unlikely that these categories will be determined by collateral type alone, as is proposed by Everlake.

The Oliver Wyman study that was presented to RBCIRE at the Spring National Meeting concluded that middle-market ("MM") collateralized loan obligation ("CLO") residual tranches experience a lower reduction to net present value ("NPV") in tail scenarios vs. broadly syndicated loan ("BSL") CLOs. But this study also showed that MM CLOs tend to have thicker residual tranches and more highly rated debt tranches sitting directly above the residual tranche. The specific MM CLOs that had similar residual thickness and similarly rated debt tranches compared to BSL CLOs did not exhibit a lower reduction to NPV in tail scenarios vs. BSL CLOs. This suggests that MM CLO residual tranches do not inherently have less risk than BSL CLO residual tranches. Within the Oliver Wyman study, MM loan collateral is shown to be correlated with lower risk but is unlikely to cause lower risk. In fact, causation is likely the opposite—all else equal, MM collateral may be riskier than BSL. Common rating agency models assign higher risk to loans made by smaller companies with less access to capital. The structural enhancements observed in MM CLOs relative to BSL CLOs may have been created to mitigate higher risk in MM collateral.

Collateral type (MM vs. BSL), residual tranche thickness, and rating of associated debt tranches are among the candidates that we are considering as potential comparable attributes. We understand that a careful consideration of multiple comparable attributes may not be practical as an interim solution, and we seek to avoid applying selective rigor to this specific proposal. We appreciate the opportunity to use this example to highlight the importance of identifying comparable attributes that represent drivers of risk, not only correlates of risk.

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1. The American Academy of Actuaries is a 20,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

If you have any questions or would like to discuss further, please contact Amanda Barry-Moilanen, the Academy's life policy analyst, at barrymoilanen@actuary.org.

Sincerely,

Stephen Smith
Chairperson, C1 Subcommittee
American Academy of Actuaries

Attachment 3

AMERICANS *for* TAX REFORM

722 12th Street, N.W. • 4th Floor • Washington, D.C. 20005

June 13, 2024

Mr. Philip Barlow
Chair, Risk-Based Capital Investment Risk and Evaluation (E) Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Dear Chair Barlow:

Americans for Tax Reform (ATR)[1] appreciates the opportunity to comment again on the National Association of Insurance Commissioners' (NAIC) proposed increase to the risk-based capital (RBC) charge for residual tranches and interests of asset-backed securities (ABS). ATR also appreciates the opportunity to comment on Proposal 2024-19-I, which would narrow the scope of the 45 percent RBC charge. **Based on the data provided by the Oliver Wyman (OW) report, ATR requests that the NAIC vote to impose a 30 percent RBC charge on all residual tranches and interests unless the NAIC produces an independent and credible third-party justification for an increase.[2] Alternatively, ATR requests that the NAIC vote to adopt Proposal 2024-19-I to narrow the scope of the RBC charge increase.**

This request is more than reasonable considering the NAIC has not conducted a comprehensive cost-benefit analysis for increasing the RBC charge to 45 percent. Moreover, the OW report clearly shows the NAIC's proposed increase is gratuitous. To date, no substantive quantitative analysis has been conducted to justify the NAIC's proposed 45 percent RBC charge for all residuals.

ATR remains concerned that the NAIC is committed to arbitrarily increasing the RBC charge on life insurance companies and annuity policyholders. The NAIC appears to want to deter insurance companies from investing in ABS residuals without any data to justify an increase of the RBC charge. **ATR is deeply concerned that proceeding with the 45 percent RBC charge will reduce the affordability and availability of life insurance and annuities for all Americans.**

Securitizations facilitate lending to creditworthy businesses and consumers across the economy. Examples of assets that facilitate the cash flows of securitizations and act as underlying collateral include, credit card receivables, auto loans, business loans, mortgages, student loans, aircraft leases, and cell tower leases. When insurers invest in ABS residuals, it allows them to keep life insurance and annuity costs down for consumers while simultaneously allowing businesses and individuals to receive loans at affordable interest rates. Proceeding with an overly broad RBC charge would impose

[1] ATR is a nonprofit, 501(c)(4) taxpayer advocacy organization that opposes all tax increases and supports limited government, free market policies. In support of these goals, ATR opposes heavy regulation and taxation of financial services. ATR was founded in 1985 at the request of President Ronald Reagan.
[2] https://content.naic.org/sites/default/files/inline-files/Oliver%20Wyman%20Residual%20Tranche%20Report.pdf.

an arbitrary *de facto* tax on annuity policyholders and borrowers who benefit from securitized financial products.

ATR remains concerned that the NAIC's RBC charge increase is a result of pressure from intergovernmental organizations[3] and foreign banking regulators.[4] The proposed bank capital requirements arbitrarily punish securitizations by doubling the p-factor.[5] The increase in the p-factor fails to take into consideration the varying riskiness of different types of underlying collateral—just like the NAIC's proposal to increase the RBC charge to 45 percent.

The RBC IRE working group discussed applying the RBC charge to residuals of specific structured securities, such as middle market (MM) collateralized loan obligations (CLOs). It is worth noting that "CLO equity exhibits a great deal of resilience to market volatility."[6] In fact, "CLOs in general, and MM CLOs specifically, have continued to perform very well through various economic cycles and market shocks."[7] Heavy regulation of banks has forced certain MM companies to turn to other avenues of financing. MM CLOs provide the necessary secondary market liquidity that is needed to successfully finance MM companies. The foundation of these CLOs is the residual tranche. If the RBC charge for residuals is increased, investors will be less willing to buy into residuals, which will either significantly increase borrowing costs for MM companies, or in some cases, eliminate lending to MM companies altogether.

Contrary to the NAIC staff's structured securities presentation, broadly syndicated loan (BSL) CLOs tend to underperform compared to MM CLOs. According to S&P Global, "middle-market CLOs can withstand comparable defaults with less rating impact than BSL CLOs. The study also notes that middle-market CLOs have performed better than BSL CLOs during the amortization phase, with less deterioration in credit metrics." Additionally, the OW report demonstrates with concrete evidence that across all risk scenarios, "MM CLOs consistently perform better than" BSL CLOs.[8] If the NAIC does not choose to retain a 30 percent RBC charge for all residuals, then this shows Proposal 2024-19-I is a reasonable alternative.

Applying a 45 percent RBC charge to residuals of MM CLOs would increase borrowing costs for the 200,000 MM companies that are the backbone of the U.S. economy. MM companies employ about 48 million people, which constitutes about 30 percent of all private employment in the U.S.[9] Additionally, MM companies create $12.9 trillion of revenue annually,[10] or 33 percent of revenue generated by businesses in the U.S.[11] At a time when interest rates remain high, increasing the RBC

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3 https://www.imf.org/en/Blogs/Articles/2024/04/08/fast-growing-USD2-trillion-private-credit-market-warrants-closer-watch.

4 https://docs.house.gov/meetings/BA/BA20/20240131/116775/HHRG-118-BA20-Wstate-BashurB-20240131.pdf.

5 https://www.federalregister.gov/d/2023-19200/p-564.

6 https://w4.stern.nyu.edu/finance/docs/pdfs/Seminars/CLO-Performance.pdf.

7 https://www.valuationresearch.com/insights/middle-market-clos-proven-stable-performance-in-volatile-credit-markets/.

8 https://content.naic.org/sites/default/files/inline-files/Oliver%20Wyman%20Residual%20Tranche%20Report.pdf.

9 https://www.middlemarketcenter.org/Media/Documents/MiddleMarketIndicators/2023-Q4/FullReport/NCMM_MMI_YEAR-END_2023_012524.pdf.

10 https://www.jpmorgan.com/content/dam/jpmorgan/documents/cb/insights/banking/commercial-banking/next-street-the-middle-matters-report.pdf.

11 https://www.middlemarketcenter.org/Media/Documents/MiddleMarketIndicators/2023-Q4/FullReport/NCMM_MMI_YEAR-END_2023_012524.pdf.

charge for MM CLO residuals would be disastrous for the U.S. economy, and could even exacerbate a recessionary trend in the macroeconomy.

The NAIC should not arbitrarily and capriciously increase the RBC charge for residual ABS tranches without a proper quantitative and cost-benefit analysis. State regulators and NAIC staff wield significant power over the insurance industry. All decisions made by these individuals need to be data-driven. Although the NAIC is not subject to the *Administrative Procedure Act* (APA),[12] as a matter of proper due process, the NAIC should consider abiding by the APA's principles and allow for a structured notice-and-comment process that considers and analyzes hard data. The NAIC possesses no hard evidence to suggest that raising the RBC charge for all residuals to 45 percent is necessary to mitigate risk. Data-driven regulation and due process protections are especially important when, such as in this case, the NAIC is contemplating action that is controversial, significant, and economically detrimental.

The NAIC should avoid making life insurance and annuities more expensive for American families. Increasing the RBC charge for residuals would increase costs of annuities for American workers and increase borrowing costs for securitized consumer financial products. Currently, there is no quantitative evidence to substantiate this RBC charge increase. **Consequently, ATR requests the 45 percent RBC charge on ABS residuals remain at 30 percent, or that the NAIC adopt Proposal 2024-19-I.**

*   *   *   *

ATR appreciates the opportunity to comment on the 45 percent RBC charge on residuals. If you have any questions or need any additional information, please contact Bryan Bashur at bbashur@atr.org.

Sincerely,

Americans for Tax Reform

cc: Mr. Dave Fleming
Senior Life Risk-Based Capital Analyst
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Submitted via electronic mail

[12] https://www.justice.gov/sites/default/files/jmd/legacy/2014/05/01/act-pl79-404.pdf.

June 13, 2024

Mr. Philip Barlow
Chair, RBC Investment Risk & Evaluation (E) Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Via email: dfleming@naic.org

Re: Proposal 2024-19-1 and Structured Securities Group Presentation

Dear Mr. Barlow:

Thank you for the opportunity to comment on the RBC Proposal 2024-19-1 submitted by Everlake Life Insurance Company (the Proposal) and on the accompanying comments from the Structured Securities Group (SSG). We appreciate the Working Group's willingness to consider a more data-driven approach to interim charge(s) for residuals of asset backed securities (ABS).

We understand the Working Group's decision to impose a 45% charge was intended to be a compromise and only a temporary solution. As we have previously commented we believe this process should be aligned with the holistic Framework for Regulation of Insurer Investments (Framework), which provides the basis for a principles-based, deliberative approach to regulatory capital decision making. The goal of the Framework is to establish "a long-term strategic direction for investment regulation and ensure current and future initiatives are thoughtfully coordinated and supportive of this holistic direction." Under the Framework, changes to RBC factors would need to first take into account solvency impacts but should also consider consistency across asset classes and market impacts.

The Proposal recommends including residuals that can be demonstrated to exhibit superior performance in an "Exempted Residual Tranches or Interests" line. We are supportive of adding this line as this differentiation aligns with the Framework principles, particularly making data-informed decisions. See *Appendix* for our own data-driven observations and recommendations on middle market (MM) CLOs, which were discussed on the last Working Group call.

During the last Working Group call, there was significant debate regarding which assets should be classified as "Exempted Residual Tranches or Interests." The Working Group could adopt the "Exempted Residual Tranches or Interests" line and spend the rest of the year gathering detailed analysis from stakeholders about which asset classes should be included. This would enable implementation by the end of 2024 and provide a more Framework-consistent approach to reaching interim decisions. Alternatively, the Working Group could decide on the list of asset classes now but allow stakeholders to submit more detailed analysis throughout the next year on which asset classes to include in the "Exempted Residual Tranches or Interests" line for year-end 2025.

We propose that regardless of the interim solution adopted, the Working Group should commit to revisiting the approach within two to three years if the Academy and NAIC have not finished work on determining the appropriate long-term charges to replace the interim solution for ABS residuals. This review would allow for additional data collection on asset classes.

Finally, we offer some observations on the exposed SSG presentation on the Proposal. We strongly support the Framework's vision of the SVO and SSG as key advisors to NAIC members on solvency and capital-markets related matters and believe that NAIC members should have the benefit of this advice to make informed decisions. However, in this case, as well as in the case of Oliver Wyman's Residual Tranche Analysis, the SSG commentary appears to be based on tools and methods that are being designed to assess CLO designations and which we do not believe are appropriate in the context of estimating portfolio capital, which should consider correlation and concentration effects and nuances related to statutory accounting. Moreover, the CLO modeling methodology is still in draft form. It has not been finalized within the CLO Modeling ad hoc group or reviewed or sanctioned by regulators and may be significantly revised by SSG and ultimately by NAIC members. We are concerned that any inferences related to the analysis will result in unreliable conclusions.

We therefore recommend that the NAIC and this Working Group establish clear and consistent procedures aligned with the Framework to govern how NAIC staff, particularly those involved in technical aspects of the RBC framework such as VOSTF designations, should address issues potentially beyond their current remit. This would ensure that all advice provided to NAIC members is both informed and appropriately scoped.

Sincerely,

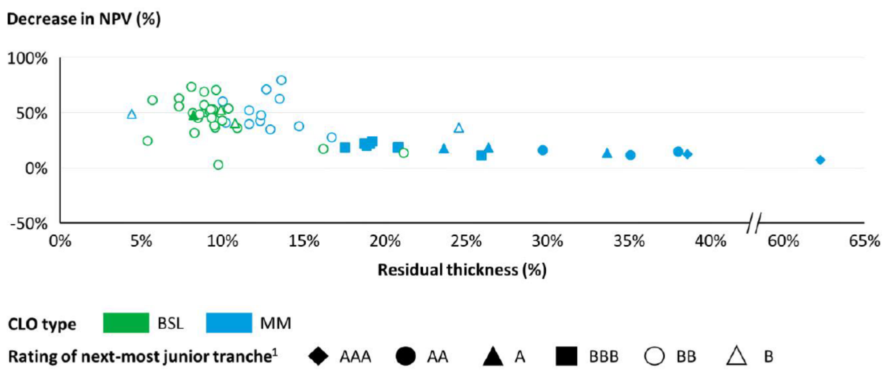
Michael Consedine

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

Appendix

We provide the following observations and suggestions on (MM) CLOs. We would not dispute that MM CLOs may be similar to BSL CLOs when they both have similar structures with AAA, AA, A, BBB, BB, B, and equity tranches. For BSL CLOs, the lowest rated tranche is typically below investment grade with "BB" or "B" ratings. In contrast, most MM CLOs have greater equity tranche thickness and some MM CLOs do not issue any below investment grade tranches that are more likely to experience downgrades than more senior, investment grade tranches. Indeed, this is supported by Oliver Wyman's study. See chart below.

Figure 19: Losses by CLO residual thickness – Mid-tail (GFC) scenario, %



Regardless, MM CLOs have consistently performed better than BSL CLOs. The lower loss/default for rated tranches means lower loss to equity as well. See the table below[1].

U.S. BSL and middle-market CLO 1.0 and 2.0 default summary by original rating

	CLO 1.0 Transactions (2009 and prior)				CLO 2.0 Transactions (2010 and later)			
	Original rating(i)	BSL CLO Defaults(ii)	MM CLO Defaults(ii)	Currently rated(ii)	Original rating(i)	BSL CLO Defaults(ii)	MM CLO Defaults(ii)	Currently rated(ii)
AAA (sf)	1,540	0	0	0	3,639	0	0	1,626
AA (sf)	616	1	0	0	2,964	0	0	1,398
A (sf)	790	4	1	0	2,449	0	0	1,198
BBB (sf)	783	7	2	0	2,230	0	0	1,184
BB (sf)	565	19	3	0	1,818	8	0	975
B (sf)	28	3	0	0	389	11	0	187
Total	4,322	34	6	0	**13,489**	**19**	**0**	6,568

(i)Original rating counts as of June 30, 2023. (ii)CLO tranche default counts as of August 1st, 2023. Source: S&P Global Ratings.

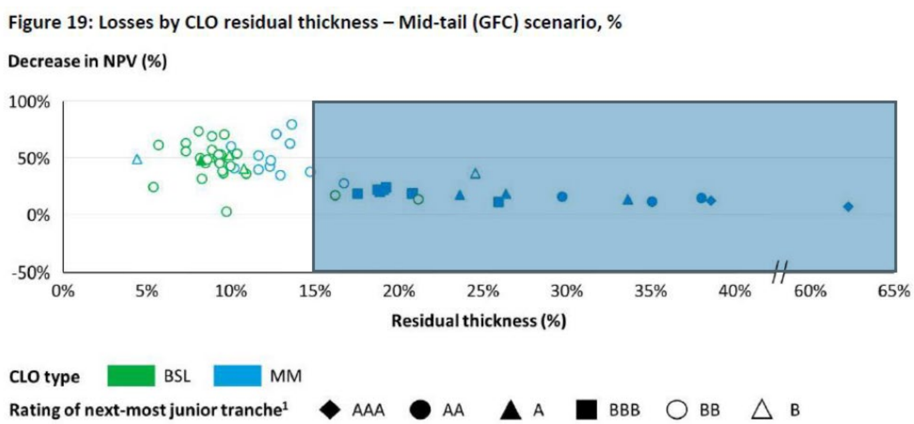
[1] S&P Private Credit And Middle-Market CLO Quarterly: Shelter From The Storm Q1 2024 (p. 33): https://www.spglobal.com/ratings/en/research/pdf-articles/240126-slides-private-credit-and-middle-market-clo-quarterly-shelter-from-the-storm-q1-2024-101592415

Moreover, the application of a 45% capital factor to the equity tranche regardless of the thickness of the equity or the rating of the next rated tranche, may change current practices and result in the creation of thinner equity tranches for MM CLOs.

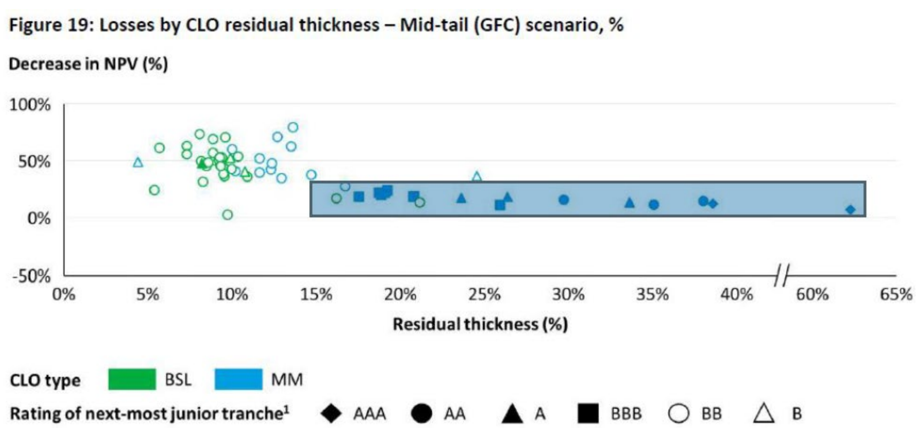
For MM CLOs, we believe that both Oliver Wyman's study and historical data support a conclusion for purposes of an interim charge, that MM CLOs are less risky than BSL CLOs. We think it would be reasonable to include MM CLOs in the "Exempted Residual Tranches or Interests" line for purposes of an interim solution while the Academy and NAIC work towards developing more sensitive, data-driven charges for all ABS tranches.

Alternatively, either of the following two more conservative comparable attributes approaches would be reasonable for a more data driven interim solution as indicated by the blue shaded areas in Oliver Wyman's Figure 19 below.

- Narrower screen test: Make the regulatory capital for equity sensitive to the risk, requiring at least 15% tranche thickness to support 30% equity capital. The Working Group could build in excess conservatism (e.g., 18% or 20%) if preferred.



- Narrowest screen test: Make regulatory capital for equity more sensitive to the risk and require both 15% or greater tranche thickness *and* the next closest tranche to be rated higher than BB (i.e., NAIC 2 or higher).



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June 13, 2024

VIA E-mail

Philip Barlow, Chair of the Risk-Based Capital Investment Risk and Evaluation (E) Working Group and Associate Commissioner for Insurance, District of Columbia Department of Insurance, Securities and Banking
National Association of Insurance Commissioners
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Kansas City, MO 64106-2197

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RE: Consideration of Additional Information on Interim Factor for Residual Tranches

RE: Consideration of Additional Information on Interim Factor for Residual Tranches
Proposal 2024-19-I

Dear Mr. Barlow:

Thank you for the work that you and the Risk-Based Capital Investment Risk and Evaluation (E) Working Group ("Working Group") have done and continue to do on this important matter. We considered the discussion during the Working Group's May 21, 2024 meeting, and we continued engagement with various members of the regulatory community and expert stakeholders. Please accept this letter as response to the captioned exposure that followed the May 21, 2024 meeting.

Executive Summary

This comment letter is responding to the request for more specific information regarding our initial proposal. As you know, under our proposal, the NAIC would apply a 45% interim RBC charge to residual tranches of all structured securities as a default; however, certain residual tranches would be subject to a 30% charge.

Following feedback given by regulators at the previous RBC IRE meeting, we removed several items from the original list of residual tranche types that would be subject to a 30% charge; we do retain Middle Market ("MM") Collateralized Loan Obligations ("CLOs") as being subject to a 30% charge.

In Appendix 1A, we show the proposed changes to Proposal 2024-19-I, with the changes marked, in ~~red~~, against the original. In Appendix 1B, we show which types of residual tranches would be subject to a 45% charge, and which would be subject to a 30% charge, using the data reported to the Working Group by the ACLI as a reference. In Appendix 2, we provide an analytical framework to be used, by asset type, and using Schedule BA as a reference.

I. Middle Market CLOs – Who Do They Serve and What Is the Risk Profile

Middle Market CLOs Provide Important Financing to Mid-Size Businesses Nationally

In 2023, there was more than $28B in lending to middle market companies through middle market CLOs.[1] There are 200,000 mid-size businesses across the country,[2] that provide about 61 million jobs to US workers.[3]

These businesses often have a more difficult time getting BSL bank loans, and increasingly rely on private lending to finance their operations and growth.[4] Middle-market CLOs are a "segment of the U.S. CLO market backed by senior secured loans to smaller companies."[5]

Middle market companies rely on private loans for a significant portion of their capital needs. For example, companies between $10 and $50 million rely on private debt

[1] "US CLO Market Review", Fitch Ratings (15 Feb 2024),

[2] Lawrence Carrel, "Middle Market Companies See Revenue Growth, Hiring Challenges", March 1, 2024.

[3] U.S. Chamber of Commerce, "Small Business Data Center", May 20, 2024.

[4] "The Middle Matters: Exploring the Diverse Middle Market Business Landscape", Next Street & J.P.Morgan Chase, November 2023, 18. "[Midsized businesses] have encountered a shrinking pool of available bank financing due to a wave of consolidations, regulation-driven strategy changes, the end of low-cost capital, and tightening credit standards."

[5] "Scenario Analysis: How Resilient Are Middle-Market CLO Ratings (2023 Update)?" S&P Global, 16 October 2024 (https://www.spglobal.com/ratings/en/research/articles/231016-scenario-analysis-how-resilient-are-middle-market-clo-ratings-2023-update-12884065). See also, Mark Adelson, The Journal of Structured Finance, Fall 2022.

for 26% of their funding needs and companies between $50 and $100 million rely on private debt for 40% of their funding needs.

Access to capital for MM lenders via securitization is important because it provides financing for such lenders and helps them originate more loans to MM companies. Putting a high capital charge in excess of risk on MM CLOs residuals could hinder lending to businesses important to economic development.[6]

Middle Market CLOs – Strong Performance and Structural Protections

The MM CLO performance data does not suggest performance issues with the debt tranches or the residual equity. In fact, in May of this year, Moody's noted that rated notes of MM CLOs "exhibit strong performance".[7] Further, Fitch put out a report in March 2024 that demonstrated MM CLO performance metrics remained stable despite continued market downgrade activity and upticks in distressed assets in portfolios broadly.[8]

MM loans also feature strong structural protections, because they are bilaterally negotiated between borrowers and lenders who often have a long-term relationship.[9] This results in a customized loan agreement that better aligns the risk appetite of the lender with the needs of the corporate borrower.[10] MM loans are structured to prevent liquidity mismatches and typically contain at least two covenants that allow the lender to take early

[6] See, generally regarding CLO structures, Shohini Kundu, "The anatomy of corporate securitizations and contract design," Journal of Corporate Finance, Volume 81 (2023).
[7] Moody's Private Credit Conference, May 14, 2024 (https://events.moodys.com/2024-05-miu22814-private-credit-conference/resources).
[8] "U.S. BSL & MM CLO Spotlight – February 2024", March 15, 2024, Fitch Ratings, Inc.
[9] As a comparison, most business lending originated by banks that ends up in BSL CLOs through syndication.
[10] All CLOs, by their nature, generally have strong structural protections. "[. . . The] fundamentals of the CLO structure protecting the noteholders, especially for the senior CLO tranches, and shows that middle-market CLOs can withstand comparable defaults with less rating impact than BSL CLOs. "Scenario Analysis: How Resilient Are Middle-Market CLO Ratings (2023 Update)?" S&P Global, 16 October 2024 (https://www.spglobal.com/ratings/en/research/articles/231016-scenario-analysis-how-resilient-are-middle-market-clo-ratings-2023-update-12884065)

preventative action to avoid default that are not possible under the terms of other structures, such as BSLs that have standardized terms and many creditors.[11]

MM CLOs typically have more par subordination and rating cushion at a given tranche level relative to BSL CLOs.

OW Study and Middle Market CLOs

In the Oliver Wyman February 26, 2024 Residual Tranche Risk Analysis study, (the “OW Study”), MM CLO residuals recouped MORE than the original investment other than in the deep-tail where approximately 70% of the original investment was recovered. That is, even in the deep-tail scenario, majority of the investment is still recovered.

The OW Study Loss Analysis is Not Equivalent to RBC Charges

Some attention has been paid to “Figure 22” in the OW Study and some have said that the losses observed in the deep-tail stress scenario should roughly equal the interim capital charge, but only for certain assets. In fact, the OW Study specifically states that it provides data to help inform the calibration of the capital charge for structured security residual tranches – not a capital charge in and of itself.[12] Nothing in the OW study supports inconsistency in calibration of a capital charge across assets.

Under the OW Study – BB-rated corporate bonds have a ratio of capital charge to stress losses of 4/8 (i.e. a 4 % capital charge relative to 8 % average defaults across all three stress scenarios).[13] In other words, the capital charge is about 50 % of the average defaults across the three stress scenarios. Applying that same “equal capital for equal tail risk” ratio (capital charge relative to expected losses), based on the capital charge for bonds, MM CLO residuals should have a capital charge of about 17.8 percent based on the expected losses across all three stress scenarios. Per the OW results, applying a 45%

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[11] See, e.g. S&P Global Ratings, “Private Credit And Middle-Market CLO Quarterly: Shelter From The Storm Q1 2024, Jan 26, 2024, Slide 21. (https://www.spglobal.com/_assets/documents/ratings/research/101592415.pdf)
[12] Oliver Wyman, 1.
[13] Oliver Wyman, 30, Fig 22.

capital charge on MM CLOs means insurers would have to hold 79% of expected losses. No other asset in RBC has anywhere close to this level of capital required against expected losses under any stress scenario.

This does not reflect the strong historical performance of these assets. The RBC system has been calibrated appropriately and has been successful since its inception, as demonstrated by the extremely low numbers of insurance company insolvencies through multiple economic downturns.

II. SSG Presentation - MM CLO Residual Thickness

The SSG Materials and some of the Working Group conversation discuss the "thickness" of MM CLO residual tranches. While the OW Study did provide observations on residual thickness, it specifically did not take into account the characteristics of the underlying collateral in drawing conclusions about performance relating to residual thickness.

The available data suggests that residual thickness is worthy of further study, but does not suggest it is appropriate to use as the sole determination of an interim capital charge. For example, residual performance in MM CLOs is driven by a variety of factors, including credit quality of the underlying loans (i.e. whether they are first lien senior secured v. second lien or preferred equity), diversification of the underlying loans by borrower, industry and geography, and the amount of excess spread in a given transaction. Each of these underlying collateral characteristics will impact how thick or thin a MM CLO residual tranche needs to be to absorb losses before the debt tranches are impacted. Determining a capital charge based on an arbitrary residual thickness would punish MM CLOs with high credit quality collateral (and thinner residuals) and reward MM CLOs with lower or weak credit quality collateral (and thicker residuals).

Conclusion

Everlake Life is submitting these revisions in an effort to directly address regulator concerns regarding CLO residual tranches. We are making every effort to be responsive and utilize the best and most up to date data with a solution that will allow regulators to

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implement their interim solution for year end 2024 and focus on data-driven analysis as part of a permanent solution moving forward.

We appreciate your efforts and consideration of this request.

Very truly yours,

/s/ Patrick C Reeder

/s/ Theresa M. Resnick

Patrick C Reeder
Chief Government Affairs Officer

Theresa M. Resnick
Senior Vice President and Actuary

cc: Dave Fleming, Senior Life RBC Analyst, NAIC

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Appendix 1A

Suggested Changes to Proposal 2024-19-I

"Exempted Residual Tranches and Interests" are:

- Middle market ~~and commercial real estate~~ CLO residuals whether in feeder fund format or CLO;
- ~~CMBS and RMBS residuals~~;
- Residuals secured by:
  - Consumer assets including but not limited to consumer loans, credit card receivables, student loans, auto loans and leases, solar loans and leases, home improvement loans and other prime consumer assets;
  - Cashflows from leases secured by, but not limited, to data centers, fiber and wireless infrastructure, renewable energy projects backed by power purchase agreements, and loans and leases secured by physical assets, solar and other energy related projects backed by power purchase agreements, transportation assets such as railcars, containers and aircraft and engines, equipment, commercial and residential real estate;
  - Other loans and fixed income like cashflows including but not limited to residential and commercial PACE assets, insurance policy payments, commercial & industrial solar contracts, whole business securitizations, timeshares, royalties, intellectual property, tax liens, small business loans inventory finance, supply chain finance and accounts receivable finance; and
- any other category of residual tranche or interest or specific residual investment identified by a domiciliary regulator as appropriately receiving a 30 percent charge under the RBC calculations of insurers domiciled in that state. Such review will be based on the characteristics specific to the asset or analysis of the asset class under any methodology deemed appropriate by the domiciliary regulator.

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Appendix 1B

Impact of Proposal 2024-19-I on Residuals Reported via ACLI Survey

Type	BACV ($M)	Percentage Reported	RBC Charge Under Proposal
MM CLO	2,294	36.1%	30*
Feeder Funds	1,014	16.0%	45 for underlying equity collateral / 30 for underlying debt collateral*
CFOs	823	13.0%	45
BSL CLOs	694	10.9%	45
Other ABS	554	8.7%	45 for underlying equity collateral / 30 for underlying debt collateral*
Unsecured Consumer Loans ABS	480	7.6%	30
Aircraft Leases	175	2.8%	30
Equipment Lending / Leases	152	2.4%	30
Student Loans	102	1.6%	30
CRE CLO	43	0.7%	45
RMBS	14	0.2%	45
Credit Card	5	0.1%	30
Prime Auto	1	0.0%	30
NAV Loans	0	0.0%	45
Total	6,351	100.0%	
Total at 30	3,208	51%	
Total at 45	1,574	25%	
Total Split 30/ 45	1,568	25%	
Total	6,351	100%	

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Appendix 2

Analytical Support for Appendix 1B

The following is an analysis of types of ABS residuals and recommended RBC charge category for 2024 reporting.[14]

Broadly Syndicated Loan CLO Residuals

Receives a 45% charge based on the analysis in the OW Study.

Middle Market Loan CLO Residuals

The OW Study concludes that the public market appropriate charge is 30% and the data and detail put forth in our comment letter is further support of a 30 % charge.

Consumer Loan Residuals

The OW Study specifically studies student loans, subprime auto and prime auto loans. These 3 categories present an analysis of consumer behavior that can reasonably be extrapolated to other consumer loans such as credit cards, home improvement, residential solar loans/ leases and manufactured housing loans. A 30% charge is thus appropriate for all consumer loan backed residuals. If, however, a company has evidence that consumer loan backed residual portfolio experience differs from the results in the OW Study, 45% must be applied.

Aircraft and Equipment Loan/Lease Residuals

High performing asset classes with debt-like characteristics should not be automatically scoped out of 30 % simply because they were not included in the OW Study. These types of assets include loans and leases backed by data centers, digital infrastructure, rail, aircraft and other physical assets. These transactions not only have extensive strong performance history, but also have a tangible asset that can be used to repay debt (whether on a release or loan basis or due to a sale). A 30% charge is appropriate for these types of operating loans and leases.

[14] The applicability of the charge is based primarily on the results presented in the OW Study.

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Feeder Funds, CFOs or Other ABS Residuals

The RBC charge for Residual interests of Feeder Funds or Other ABS not contemplated above or in the OW Study should be bifurcated as 30 % or 45 % depending on whether the underlying collateral has debt v. equity characteristics. Other ABS with debt-like characteristics would more closely align with results in the OW Study and should be analogous enough to receive a 30 % capital charge. Feeder Funds that are ultimately backed by debt instruments have fixed-income like cash flows that are passed through the structure to the noteholders. The bond definition issuer paper notes that these types of structures produce “substantially the same risk profile to the debt holders as a CLO”. Given the majority of feeder funds backed by debt instruments are middle market or private credit loans, they can be best analogized to MM CLOs, which we have said should receive a 30% capital charge. Feeder Funds ultimately backed by equity interests in companies, Other ABS backed by equity-like collateral and CFOs were not analyzed in the OW Study. A charge greater than 30% is appropriate as 30% is the data-supported charge for the totality of the underlying assets of the structure.

CRE CLOs and RMBS Residuals

Given the SSG and Working Group’s stated concerns from last month’s meeting, and given the OW Study did not include a review of any residuals backed by real estate (commercial or residential), a charge of greater than 30 % may be appropriate.

Global Atlantic
FINANCIAL GROUP

June 13, 2024

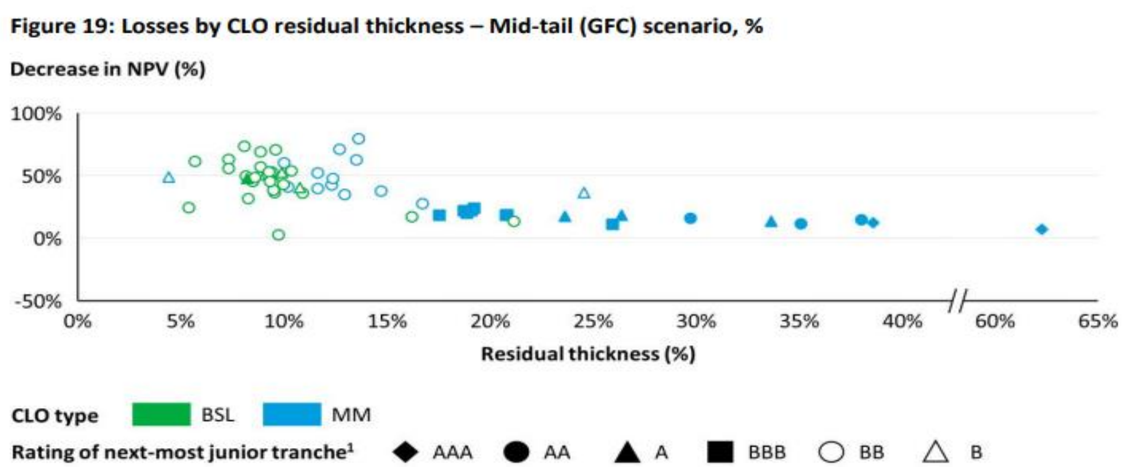
Mr. Philip Barlow, Chair
Risk-Based Capital Investment Risk and Evaluation (E) Working Group (RBCIRE)
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Re: Exempted Residual Tranches and Interests (RBC IRE Working Group Proposal 2024-19-I)

Dear Mr. Barlow:

Global Atlantic[1] appreciates the opportunity to comment on Proposal 2024-19-I which proposes to set the Risk Based Capital ("RBC") charge at 45% for all residual tranches except those specifically identified as exempted.

The purpose of this letter is to express support for a bifurcated interim solution in which certain residuals receive a RBC charge of 30% and all others 45%. This bifurcation gives due consideration to well structured transactions that are backed by fixed income like cashflows driving toward a more data driven approach. Global Atlantic recognizes that residual thickness and lowest rated tranche are factors in the potential loss experience of residuals, but they are not the only drivers of performance. The Oliver Wyman report shows significant variation in residual performance across asset classes. The report also shows that residual thickness, structure, and tranche rating results in varying performance within deals in the asset class (see Figure 19 Losses by CLO Residual Thickness - MML CLO results in OW report below).



[1] Global Atlantic Financial Group is a leading insurance company meeting the retirement and life insurance needs of individuals and institutions. With a strong financial foundation and risk and investment management expertise, the company delivers tailored solutions to create more secure financial futures. The company's performance has been driven by its culture and core values focused on integrity, teamwork, and the importance of building long-term client relationships. Through its relationship, the company leverages KKR's investment capabilities, scale, and access to capital markets to enhance the value it offers clients. KKR's parent company is KKR & Co. Inc. (NYSE: KKR).

Recommendation

Global Atlantic recommends that identification of residuals exempted from the 45% charge be based on both the underlying asset collateral as well as the leverage inherent in the structure (i.e. residual thickness). The historical performance of different asset classes drives the rating agency stresses that results in market accepted structures and required levels of credit enhancement. Using residual thickness as a method to assess risk is reasonable to do, on a relative basis, but needs to be done across similar asset classes. We propose the criteria below as a starting point to identify residuals which would receive a 30% capital charge. This criterion seeks to differentiate by asset class and residual thickness within an asset class.

Propose that the following residual tranches receive a 30% capital charge:

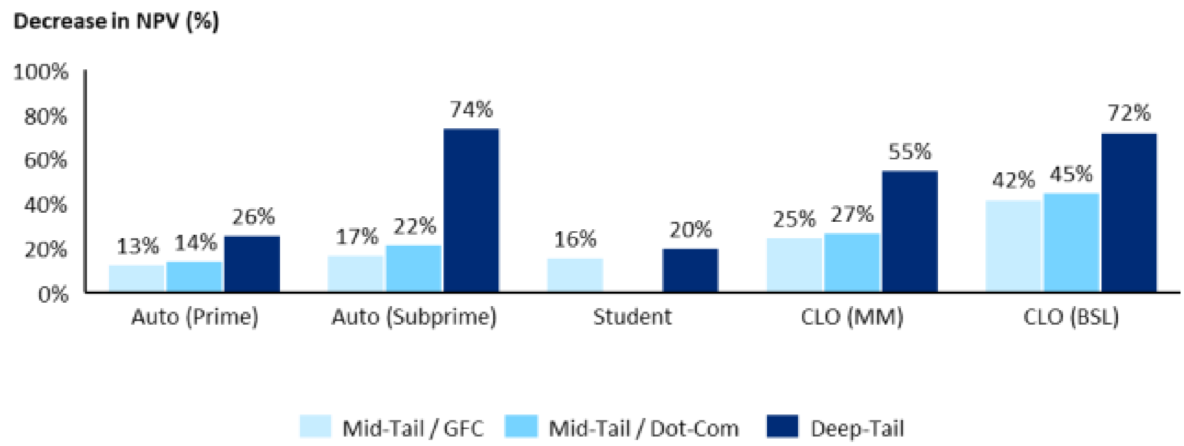
- Middle Market Loans (MML) and BSL CLOs where the size of the residuals is greater than, or equal to, 15% of the structure's collateral pool
- Transactions backed by loans or leases to prime consumers where the size of the residuals are greater than, or equal to, 5% of the structure's collateral pool
- Transactions secured by hard assets (including equipment, transportation, real estate assets, other hard assets) where the size of the residuals are greater than, or equal to, 10% of the structure's collateral pool

For the purposes of the calculation above, residual thickness is measured as of the initial rating date and is defined as the collateral value of the underlying collateral, or in the case of hard assets the initial appraised value (in either case as defined in the relevant deal documentation), minus the value of the rated notes or bonds (i.e., "initial overcollateralization").

Additional Rational

We recognize that many factors can impact the ultimate leverage in a deal including interest rates, market demand and an issuers other sources of funding and that residual size can vary significantly even across deals in the same asset class. Figure 19 in the OW report (shown on the previous page) shows a noticeable stability in CLO residual value declines (both BSL and MML) for residual thickness greater than or equal to 15%. That is further evidenced by the report stating that "CLO residual equity tranches with thicker residuals perform noticeably better than thinner residual tranches (average decrease in NPV of 49.1% when residual thickness is less than 15% vs. 18.3% when residual thickness is greater or equal to 15%)." Additionally, Figure 23 in the OW report (see below) shows better residual performance in Prime Auto loans and student loans in all three tail scenarios when compared to CLOs.

Figure 23: ABS residual losses by asset class (%, decrease in NPV)[31]



When we evaluate Figure 20 (see below) we note that a majority of the prime auto loan deals analyzed in the report have residuals greater than or equal to 5% (compared to 15% for MML CLOs) with tighter disparity in NPV outcomes. The conclusion drawn is that residuals of deals backed by prime borrowers have better performance despite having smaller residuals.

Thank you very much for your consideration and we look forward to participating on the NAIC's June 21st RBCIRE call and working on this important issue going forward.

Sincerely,

Lauren Scott
Global Atlantic Financial Group
Managing Director and Head of Regulatory & Government Affairs

June 13, 2024

Mr. Philip Barlow
Chair, RBC Investment Risk and Evaluation (E) Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Via e-mail: dfleming@naic.org

Re: Exempted Residual Tranches and Interests (RBC IRE Working Group Proposal 2024-19-I)

Dear Mr. Barlow:

We, the undersigned companies, appreciate the opportunity to provide comments on the NAIC's May 17, 2024, RBC IRE Working Group's Proposal 2024-19-I. We support the concept of identifying certain residual tranches and interests to continue to receive a 30% capital factor. Such classification should be based on the risk of loss to the residual tranche, which can vary greatly among structures.

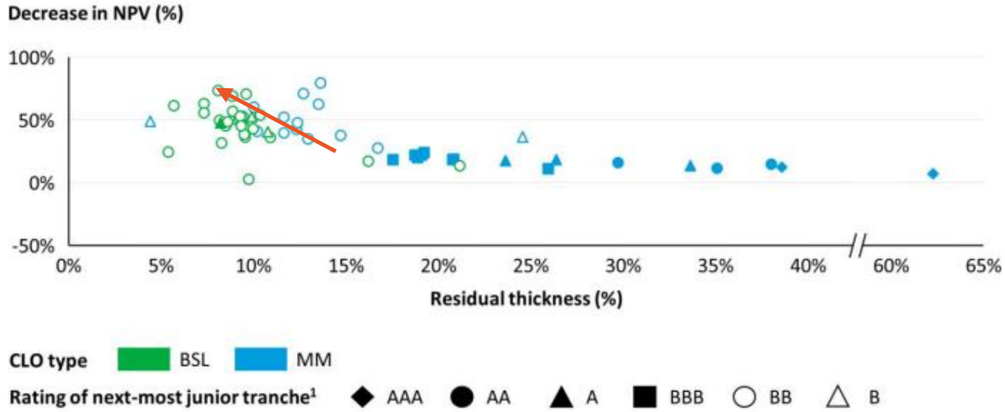
Accordingly, we suggest the best approach for an interim solution would be to create exemptions from a default 45% capital factor based on the "thickness" of the residual (i.e., how much leverage has been built into the structure) which highly correlates to the risk of loss to the residual tranche.

While no methodology is perfect, we believe utilizing residual thickness versus a collateral type (e.g., middle market loans, commercial mortgage loans, consumer assets, etc.) approach offers several benefits including:

- Easily observable input avoiding need for controversial assumptions
- Directionally increases capital for most aggressive structures benefiting from capital arbitrage
- Dissuades unintended consequences of further increasing leverage in structures
- Provides a risk-based approach to capture the potential severity of loss to the residual tranche
- Objectively determinable method to distinguish exemptions
- Ease of adoption and implementation

Risk of Loss Strongly Correlated with Leverage in the Structure
As shown by the February 26, 2024, Oliver Wyman Residual Tranche Risk Analysis (OW Report), risk of loss is largely driven by the amount of leverage in the structure, or the "thickness" of the residual tranche. The OW Report provides a data-driven analysis of the performance of Middle Market and Broadly Syndicated residual tranches, among others, under various stresses. Quoting that report, "As shown below in Figure 19, residual thickness is a significant driver of stress scenario impact. CLO residual equity tranches with thicker residuals perform noticeably better than thinner residual tranches (**average decrease in NPV of 49.1% when residual thickness is less than 15% vs. 18.3% when residual thickness is greater or equal to 15%**)." We believe this analysis reflects that all structures are not created equal and illustrates that the leverage within a structure is a critically important factor to consider when establishing a risk-based capital charge.

Figure 19: Losses by CLO residual thickness – Mid-tail (GFC) scenario, %



Exemption Based on a Conservative Level of Residual Thickness
Informed by the OW Report, we propose two criteria that must both be satisfied to determine eligibility for an exemption:

1) Residual Tranches or Interests with underlying assets having characteristics of Fixed Income Instruments (Investments with underlying collateral which, if held individually, would be reported on *Schedule D- Part 1 – Long-Term Bonds)*; and
2) The residual is 20% or more of the structure's collateral pool, at par value at origination.

We are proposing applying a cutoff at 20% residual thickness to qualify for the exemption based on the following reasons:

- A 20% level is greater than the level of "excess defaults" (volume of defaults that occurred over the adverse portion of the credit cycle) for both BSL and MM CLOs in both the Dot-Com and GFC mid-tail (~95th percentile) scenarios in Table 2 of the OW Report (copied below), *before* considering recoveries or loss given default.

- The 20% level applies excess conservatism relative to the 15% level referenced in the OW Report, intended to give regulators additional comfort in applying an exemption to the interim charge.

This approach provides a simplified approach in the interim that is supported by data and reflects a conservative level of relative risk across structures.

Table 2: Scenario-level parameters for CLOs

	Base	Mid-tail (~95th percentile)		
Parameter		**Dot-Com**	**GFC**	**Deep-tail**
Peak default rate *(BSL)*	2.6%	2.7x multiplier *(peak)*	3.9x multiplier *(peak)*	5.9x multiplier *(peak)*
Peak default rate *(MM)*	4.1%			
Excess defaults *(BSL)*	N/A	11.9%	7.6%	33.7%
Excess defaults *(MM)*	N/A	18.4%	11.8%	52.2%
Recovery rate	66.4%	61.1%	58.0%	55.9%
Prepayment rates	24.8%	18.4%	14.0%	10.0%
Recovery lag	18 months	18 months	18 months	18 months
Reinvestment	None	None	None	None

Alignment with NAIC Guidance

We believe that our proposal aligns with the NAIC memorandum regarding Consideration of Additional Information on Interim Factor for Residual Tranches, dated April 16, 2024. Specifically:

1) The proposal is credibly aligned with actual holdings of residuals by insurers, with middle-market loans and broadly syndicated loans being the most prevalent underlying collateral in ACLI members' ABS residual holdings. (See ACLI letter dated May 15, 2024, Table 2.0 copied below); and

2) The OW Report GFC and Dot-Com stress scenarios are of approximately 95th percentile severity, which is approximately equivalent to the CTE90 that the American Academy of Actuaries is applying in its work on CLOs.

Table 2.0 Allocation by Dollar Amount, Sector, Percentages – survey responses

SECTOR	BACV	PERCENTAGE
MM CLOS	$ 2,294,231,501	36.1%
FEEDER FUNDS†	$ 1,014,183,088	16%
CFOS‡	$ 822,598,092	13%
BSL CLOS	$ 694,225,569	10.9%
OTHER ABS*	$ 554,251,226	8.7%
UNSECURED CONSUMER LOANS	$ 480,105,560	7.6%
AIRCRAFT LEASES	$ 175,105,871	2.8%
EQUIPMENT LENDING/LEASES	$ 151,683,102	2.4%
STUDENT LOANS	$ 101,539,282	1.6%
CRE CLOS	$ 43,187,227	0.7%
RMBS	$ 14,015,686	0.2%
CREDIT CARD	$ 4,930,996	0.1%
PRIME AUTO	$ 897,163	0%
NAV LOANS	$ 189,521	0%
CMBS - -		
SUBPRIME AUTO ABS - -		
TOTAL	$ 6,351,143,883	100%

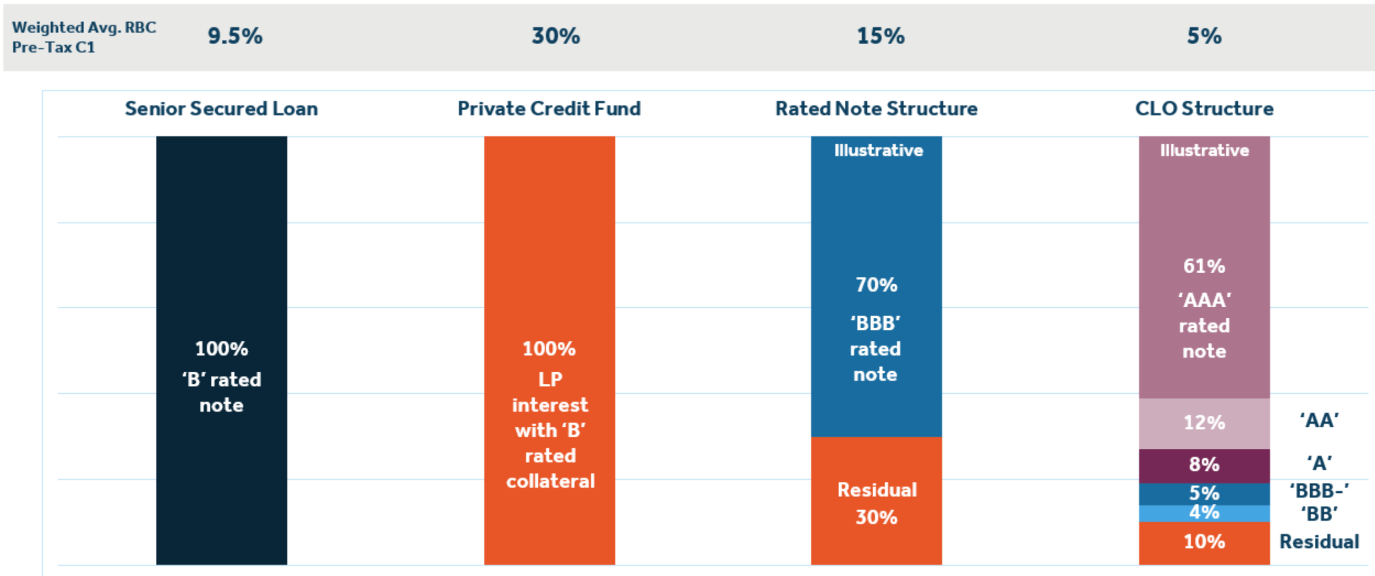
†Feeder Funds (underlying collateral): commercial real estate credit; equity investments, including LP stakes in PE funds; middle market credit; other leveraged credit; other loans and fixed income like assets; real estate equity.

‡CFOs (underlying collateral): equity investments, including LP stakes in PE funds; middle market credit.

* Other ABS* = ACLI requested data on 14 different sectors. Companies could also enter sectors into an other category if the sector was not one of the 14 sectors ACLI asked about. In this category, members reported: Aircraft Loan ABS; Commercial Loans; Equity – other, Infrastructure Debt, Powerplant, Prime Borrower Unsecured Consumer; Prime Home Improvement Loans; Solar, Utility Scale Solar.

Risk of Residuals Varies Widely Across Structures
The chart below compares four ways an insurance company can hold loans on their balance sheet, all with the same underlying exposure to 'B' senior secured loans, which receive a 9.5% capital charge if held directly (first column). Some insurers may not be able to source these loans directly, and therefore can partner with an asset manager to gain the exposure, generally through a fund. The second column depicts a limited partner interest in a private credit fund with underlying 'B' collateral, which receives an uneconomic 30% capital charge because the investment is in the form of a limited partnership interest. Because investing as a limited partner in a fund is capital inefficient, insurers often use a rated notes structure (column 3) to sit on top of the fund. As shown by the 15% weighted average RBC charge, a 45% charge on the residual results in anti-arbitrage for the structure. As a result, insurers could be incented to add further leverage to reduce the size of the residual. A typical CLO structure is shown in column 4. These structures can have a significant amount of leverage, leading to highly sensitive and exposed residuals. As shown in this exhibit, and supported by the OW Report, the thickness of the residual can vary across structures and represents different levels of risk and the ability to absorb losses.

Under our proposal, the residual tranche of the more conservative rated notes would be exempted and continue to receive a 30% interim capital charge (still reflecting the riskiness of the position, but also its ability to absorb some level of loss); meanwhile the residual tranche of the more highly levered CLO structure with 10% thickness would receive the 45% interim capital charge. Absent our proposed exemption, we believe an unintended consequence of the 45% interim capital charge across all structures could be a migration to more highly levered CLO structures, in an effort to minimize the size of residual tranches subject to the 45% interim capital charge.



Source: NAIC C1 charges for 2024, including 45% assumed charge for residuals

Practical to Implement
Importantly, we believe our proposal can be readily implemented, with Exempted Residual Tranches or Interests being reported as proposed by RBC IRE Working Group Proposal 2024-19-I. We expect the reported carrying values to be lower of amortized cost or fair value, consistent with statutory accounting principles. The calculation of "thickness" used to determine eligibility for exemption, can be simply calculated as:

Thickness = (Par Value of Collateral Pool – Par Value of Debt Outstanding)/ Par Value of Collateral Pool

We believe par value inputs for the thickness calculation are readily available from public sources, such as Bloomberg, or investor reporting in the case of non-public structures.

In conclusion, we the undersigned collectively support a risk-based approach to exempting residual tranches and interests eligible for a 30% capital factor. The data show that residual thickness is a key determinant of risk, and we believe that our proposal is both conservative, as appropriate for an interim solution, and can be readily implemented. We are supportive of the NAIC's efforts to further model and understand the complexities of structured securities and ensure that life insurers are holding the appropriate levels of capital to support the risk on their books.

We look forward to the opportunity to discuss our proposed solution and answer any questions you may have.

Sincerely,

Sarah Williams
Chief Risk Officer
The Guardian Life Insurance Company

Wen-Fu Wu
Managing Director, Asset Class Head,
Fixed Income & Deputy CIO
TIAA

June 13, 2024

Via email

Philip Barlow
Chair
Risk Based Capital Investment Risk and Evaluation Working Group
Washington, DC Department of Insurance, Securities and Banking
1050 First Street, NE, 801
Washington DC 20002

Re: Proposal to exempt certain residual tranches and interests from the adopted interim factor

Dear Mr. Barlow:

This letter is submitted on behalf of the undersigned life insurance companies (the "Companies"). We appreciate the opportunity to comment on the proposal to exempt certain residual tranches and interests from the adopted interim 45 percent RBC factor (the "Exemption Proposal") exposed for comment at the May 22 meeting of the Risk-Based Capital Investment Risk and Evaluation (E) Working Group (the "Working Group").

In its May 15 letter to the Working Group, the American Council of Life Insurers (the "ACLI") shared the results of a survey of residual holdings from its member companies. The results, which reflect the holdings of 19 out of 27 companies willing to disclose these details, show that well over 75 percent of these residuals are backed by higher risk collateral, including: middle market leveraged loans, various types of equity, transitional commercial mortgage loans, broadly syndicated leveraged loans, and unsecured subprime consumer loans, among others.

While a significant portion of the Oliver Wyman report on residual tranche risk analysis (the "OW Report") presented by the Alternative Credit Council in its February 26 letter to the Working Group focused on residuals minimally held by insurers (i.e. Subprime Auto ABS, Prime Auto ABS, and Student Loan ABS,) it did offer helpful insights on the impact that higher risk collateral can have on residual tranche losses in adverse scenarios. The OW Report shows that when residual tranche thickness is low and the underlying collateral for that residual is of higher risk (like the middle market and broadly syndicated leveraged loans considered in the OW Report,) the residual tranche losses can be high under adverse scenarios and an RBC factor of 45 percent or higher is therefore appropriate. The OW Report shows that this relative thinness of residual tranches can be easily identified by looking at the rating of the next junior-most tranche above the residual in a securitization. Residuals that are followed by a relatively low rated subordinate tranche tend to be thin (i.e., they represent less than 25 percent of a securitization's capital structure.)

The ACLI's survey of residual holdings collected valuable data highlighting the thickness of residuals held by the disclosing companies. It showed that for over 70 percent of reported residuals, the next junior-most tranche was rated BB or lower (including unrated tranches). These findings suggest that the residual tranches held by the companies willing to disclose their holdings are predominantly thin and, consequently, high-risk.

The Structured Securities Group (the "SSG") presented independent findings regarding Middle Market CLO residual holdings during the Working Group's May 22 meeting. The SSG's findings show that for the residual tranches of Middle Market CLOs they analyzed, the next junior-most tranche was rated BB or lower. The OW Report analysis, the relevant portion of which was also considered in the SSG's presentation, shows that those residuals would have a thickness of well under 25 percent – i.e., these are all thin residuals collateralized by risky assets, and therefore subject to losses in adverse scenarios consistent with a 45 percent or higher RBC factor.

Based on the fact set laid out in the prior paragraphs, the Companies continue to believe that the 45 percent interim RBC factor adopted in 2023 with delayed implementation to 2024 is an appropriate step in the direction of improving the alignment of capital and risk in the industry. The higher residual factor will help ensure that the significant growth in risk taking in structured securities seen in recent years will also be accompanied by the commensurate capitalization necessary to protect the continued solvency of our industry.

If the Working Group wishes to create a differentiated treatment for residuals, as suggested by the Exemption Proposal, we strongly recommend that it be based on collateral risk and tranche thickness rather than on current market nomenclature or labels that can be subject to change or manipulation. Residuals of securitizations where a significant portion of the collateral represents any type of equity position should in no circumstance be exempted. Residuals of securitizations with debt or other forms of collateral should only be exempted if the residual's size, defined as the difference between the par value of the securitization assets minus the par value of the securitization's rated tranches, represents at least 25 percent of the securitization's capital structure, and the next junior-most tranche in the securitization after the residual is currently investment grade rated.

Importantly, we advise against having such an exemption framework be open to state regulator override as suggested by the Exemption Proposal. Such flexibility would amount to an embedded “permitted practice” for RBC that may lead to an uneven competitive playing field based on state of domicile.

Finally, given the likely complexities of implementing such an exemption, we recommend that this framework be considered in connection with the permanent solution for residual tranches rather than as an amendment to the adopted and already delayed interim solution of a single 45 percent factor for residual tranches. In the interest of simplicity, consistency, and certainty, and considering the fulsome process that established the need for an extended empirical approach for any amendment, we continue to support a 45 percent interim factor for residuals. Any further implementation delay risks continued substantial growth in risk taking without a proportionate, prudent adjustment of capital. It also diverts the focus away from the much larger issue of better aligning capital and risk for rated subordinated tranches of CLOs and other structured products. If any “compromise” is to be considered, however, debt-based residuals would be more appropriate for exemption from a 45 percent capital charge if, at a minimum, they represent at least 25 percent of the securitization’s capital structure, **and** if the next junior-most tranche in the securitization after the residual is currently investment grade rated.

We appreciate the NAIC’s diligence in keeping pace with innovation and evolution in life insurer investment strategies. Prudent and calibrated approaches to the regulation of insurer investments that align with developments of capital markets support both consumer choice and policyholder protection. As the U.S. insurance standard setting body, decisive action by the NAIC on emergent risks such as those embodied in insurer securitization subordinate holdings, including residuals, is especially important in the context of concerns raised by authorities charged with systemic risk surveillance.

Respectfully Submitted,

Equitable
MetLife
Pacific Life
Western & Southern

June 13, 2024

Philip Barlow, Chair
Risk-Based Capital Investment Risk and Evaluation (E) Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1000
Kansas City, MO 64106-2197

RE: Consideration of Additional Information on Interim Factor for Residual Tranches (Proposal 2024-19-I)

Dear Mr. Barlow:

I write regarding the Risk-Based Capital Investment Risk and Evaluation (E) Working Group (RBC IRE WG) request for comment on the Consideration of Additional Information on Interim Factor for Residual Tranches (Proposal 2024-19-I). We appreciate the opportunity to comment on the proposal and the potential effect of the proposal on middle market companies nationally.

The proposal under discussion would limit the interim risk charge on residual tranches and interests to specific assets. Given the significant discussion regarding middle market collateralized loan obligations (middle market CLOs) at your last meeting, and our organization's focus on middle market companies, we wanted to share our expertise on the middle market and research to assist you in your decision-making.

The National Center for the Middle Market (NCMM) is located at The Ohio State University Fisher College of Business and was launched in 2011 with one mission – supporting middle market companies in the United States. Defined as organizations with annual revenues between $10 million and $1 billion, there are approximately 200,000 companies representing one-third of private sector GDP and employment. Through our research, we know that over 90% of these companies are privately held and have been in business approximately 40 years on average. During 2023, topline revenue in the middle market grew at 12.4%, far outpacing small and large businesses and further demonstrating the stability, resilience, and importance of this segment. Thus, one may question whether a 45% risk charge overstates the riskiness of middle market firms and suggests a need for research.

Middle market companies have consistently demonstrated strong growth and economic performance since the NCMM started tracking performance and sentiment in 2012. The center uses a semi-annual survey called the Middle Market Indicator to track a number of performance metrics including growth rates, economic confidence, key challenges, and capital investment planning. This and other data regarding middle market company performance is important to inform changes in risk charges. We also see variation in these performance metrics across middle market companies, which indicates a need for more research on corresponding variation in risk charges.

In the last several years, access to capital has become a more challenging hurdle. In our year-end 2023 survey, 28% of companies stated they had insufficient investment capital to support growth plans. These vital businesses need access to all different types of capital, both private and public. Over the past 13 years, with a leading role taken by the National Center for the Middle Market, significant research has been conducted to understand the very unique needs and challenges of middle market companies. They operate between small businesses and start-ups yet face problems of larger companies without the same resources and access to capital. Regulatory concerns have often been a challenge facing middle market companies in their operations and growth plans. In short, more research needs to be conducted to understand the full implications to U.S. middle market companies

The NCMM stands ready to engage with regulators, lenders, company borrowers, and academics to further study the capital needs and challenges for middle market companies. Data-driven insights and research are scarce and as the only center of its kind in the U.S., the NCMM is ideally positioned to provide the necessary insights for decision-making and policy guidance.

Sincerely,

Doug Farren
Managing Director
National Center for the Middle Market, The Ohio State University Fisher College of Business

Cc: Capital Adequacy Task Force
Financial Condition (E) Committee

Pinpoint
POLICY INSTITUTE

June 11, 2024

Mr. Philip Barlow
Chairman
Risk-Based Capital Investment Risk and Evaluation (E) Working Group
National Association of Insurance Commissioners (NAIC)

Dear Mr. Barlow:

I write to voice my support for Proposal 2024-19-I ("the Proposal") being considered by the Risk-Based Capital Investment Risk and Evaluation (RBC IRE) Working Group. This proposal takes the correct approach to addressing regulator concerns in a data-driven way. The Proposal would also help avoid unintended consequences by protecting lending to creditworthy individuals and businesses nationally.

The Proposal would apply a higher capital charge to certain assets based on credible third-party data and historical performance – which should always be the basis for changes to risk charges. To date, the conversation at the NAIC has focused on regulator questions and broad statements regarding asset structure and alleged performance. In fact, the NAIC has never documented a single performance problem associated with losses or defaults of any of these assets. Instead, it is focused on imposing an arbitrary increase in the charge based on a recommendation from a handful of companies that do not originate or hold the assets.

This approach is not only arbitrary, but it assumes that millions of American consumers and businesses are not creditworthy and that a very high percentage of these borrowers are likely to default on their loans. The original 45% residual charge on all structured investments also assumes that insurers are lending to these families and businesses without understanding the risk. Further, the 45% charge assumes that regulators are better informed to make investment and risk decisions than internal insurance company investment professionals.

We do not support these assumptions – and no data supports them, either. The higher charge would apply to student loans, auto loans, equipment leases, lending to businesses, credit card lending, and many, many other assets with no documented problems. This move is unprecedented in financial regulation in the United States. When regulators have moved quickly, it has always been in the face of an urgent, system-wide crisis with failing assets, which regulators have admitted we do not have in this case. Regulators have stated that the assets subject to the onerous capital charge are not material to insurer solvency and there is no negative performance history even through several business cycles.

The assumption that millions of American families and businesses take out loans likely to default doesn't reflect the careful analysis undertaken by insurance company lenders and the ability of American families and businesses to make responsible borrowing decisions. These families and companies are also insurance policyholders and a critically important insurance customer base. In the case of middle market company borrowing, which was a large focus of the last working group meeting, regulators seem to be acting on the basis of a misunderstanding about this market and the lender protections in the underlying loans. The data in the Oliver Wyman study does not support a double standard for assets simply based on which insurance companies hold them.

The NAIC's actions continue to defy market realities and do not adequately consider the impact they will have on the broader economy, businesses, and consumers. The group has continued to arrogate authority to itself as an unelected standard-setting body that's difficult, if not impossible, to hold accountable. I urge commissioners to do their duty and consider the broader economic harm of assigning a high capital charge that doesn't align with risk.

Sincerely,

Gordon Gray
Executive Director
Pinpoint Policy Institute

Resolution Life

Mr. Philip Barlow, Chair
Risk-Based Capital Investment Risk and Evaluation (E) Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

June 6, 2024

Re: Proposal 2014-19-I

Dear Mr. Barlow:

We appreciate the important work done to date by the Risk-Based Capital Investment Risk and Evaluation (E) Working Group ("the Working Group"), regarding the evaluation of proper RBC charges for residual tranche investments, and we are fully supportive of the Working Group's efforts to take action on this issue. However, our organization has concerns that the use of a "blanket" 45% RBC charge across all types of residual interests represents a rushed solution that is not fully supported by facts and thorough analysis.

We believe that the above referenced proposal provides a reasonable interim solution which would allow for substantially more time to evaluate appropriate RBC charges in a data-driven, thoughtful manner. The proposal will allow for those investments that have been the subject of significant regulatory concerns in recent years (equity-backed debt and collateralized fund obligations) to immediately receive the higher 45% RBC charge, without penalizing other investments that may not carry the same degree of risk. We strongly support the Working Group adopting this interim solution and hope it will continue to work with industry in developing rational, carefully considered RBC charges for residual interests on a permanent basis.

We appreciate your consideration of this letter and your efforts on this important issue.

Sincerely,

Paul Stephen

Paul Stephen
Chief Accounting Officer
Resolution Life U.S.

SBE COUNCIL
Small Business & Entrepreneurship Council

June 13, 2024

Mr. Philip Barlow, Chair
Risk-Based Capital Investment Risk and Evaluation (E) Working Group
National Association of Insurance Commissioners
via electronic mail

Dear Mr. Barlow:

In the current environment, businesses continue to navigate unprecedented challenges driven by rising costs, labor shortages, economic uncertainty, burdensome regulations and tax system uncertainty, and difficulty securing the capital they need to grow and thrive. Small- and medium-sized businesses often seek various resources to operate, invest and scale, and they need access to a variety of types of capital to do so. Middle-market (MM) lending through securitization vehicles fills a critical gap, opening the door to much-needed capital for the more than 200,000 MM companies that make up a third of the U.S. economy.

For this reason, the Small Business & Entrepreneurship Council (SBE Council) writes to urge the Risk-Based Capital Investment Risk and Evaluation (RBC IRE) Working Group to establish the interim risk charge for residuals at 30 percent or to adopt Proposal 2014-19-I. Either option would appropriately reflect the low level of risk associated with MM collateralized loan obligations (CLOs) relative to other assets, as demonstrated by research and real-world performance. Assessing capital charges commensurate with the performance of these securities ensures that MM lending remains a valuable and viable option for the many creditworthy businesses that depend on it. This approach also adheres to the principles of due process by evaluating the data and acting accordingly.

Absent the NAIC taking this action, a 45% charge for equity in MM CLOs would go into effect at the end of this year. Such an increase assumes that a vast swath of the American economy is mid-size companies that are likely to default on loans under stress. This simply does not correspond to the stability and performance of these businesses or any available data. The study conducted by respected management consultant Oliver Wyman and made available to the NAIC compared the losses of the most common types of asset-backed securities under various stress scenarios to determine whether capital charges are commensurate with risk. This study found that a 45% charge wildly overestimated risk and, in fact, a capital charge of less than 20% would be commensurate with the treatment of other assets under the risk-based capital system.

In addition to this strong performance under a forward-looking model in the Oliver Wyman study, middle market companies themselves have proven to be remarkably resilient and continue to experience growth. Middle market companies of all sizes and across nearly all industry segments reported strong growth over the last year, and these businesses outperformed through the last financial crisis, adding 2.2 million jobs.[1] The rate of year-over-year revenue growth for middle market businesses reached a new all-time high in 2023 with 55% of companies experiencing double-digit growth compared to 2022.[2]

The controversial nature of this proposed change makes it critical that the NAIC and individual commissioners voting on the policy carefully consider available data and the economic impact of these actions. The failure to consider the data is a failure of due process, made all the more troubling by the fact that the NAIC is a not-for-profit association and not a regulator. We are concerned that a small group of vocal regulators and unelected NAIC staff appear to be able to drive regulatory outcomes in all 50 states. This creates serious concerns regarding non-delegation of regulatory authority and is a deeply flawed and possibly unconstitutional way to set state insurance regulatory policy.

As representatives of small- and medium-sized businesses, we urge the RBC IRE WG and the NAIC at large to alleviate due process concerns by making complete and accurate assessments of assets like MM CLOs and the creditworthiness of borrowers in such vehicles before adopting regulations that vastly overstate their risk. The planned increase in risk charge would have a direct effect on middle-market lending and create uncertainty for businesses that represent a major segment of the U.S. economy – and a major policyholder base of insurance companies of all types.

We urge RBC IRE WG to support Proposal 2014-19-I because it appropriately assesses MM CLOs and protects the lending that American businesses need.

Sincerely,

Karen Kerrigan
President & CEO

[1] National Center for the Middle Market: Year-End 2023 Middle Market Indicator
[2] National Center for the Middle Market: Year-End 2023 Middle Market Indicator

800 Connecticut Ave. NW ● Suite 300

Washington, D.C. 20006

(703)-242-5840

www.sbecouncil.org

Protecting Small Business, Promoting Entrepreneurship

Table 1 **(6-4-2024 Update)**

Aggregate Totals for Residual Tranches Survey Responses

			% BACV of Residuals Where Rating Category of Next Junior-Most Tranche is:						
SECTOR	**Book/Adjusted Carrying Value**	**percent distribution of BACV**	**Rating AAA**	**Rating AA**	**Rating A**	**Rating BBB**	**Rating BB**	**Rating B or Lower**	**Not Rated**
MM CLOs	$2,294,231,501	36.1	0%	0%	10%	10%	64%	15%	1%
Feeder Funds	1,014,183,088	16.0	0%	1%	2%	63%	9%	0%	24%
CFOs	822,598,092	13.0	0%	0%	0%	6%	41%	0%	52%
BSL CLOs	694,225,569	10.9	0%	0%	0%	6%	68%	20%	6%
Other ABS[1]	554,251,226	8.7	0%	1%	2%	27%	44%	26%	0%
Unsecured Consumer Loans ABS	480,105,560	7.6	0%	0%	0%	32%	0%	67%	0%
Aircraft Leases ABS	175,105,871	2.8	0%	0%	92%	8%	0%	0%	0%
Equipment Lending/Leases ABS	151,683,102	2.4	0%	0%	0%	0%	0%	100%	0%
Student Loans ABS	101,539,282	1.6	0%	0%	3%	77%	17%	3%	0%
CRE CLOs	43,187,227	0.7	0%	0%	0%	100%	0%	0%	0%
RMBS	14,015,686	0.2	0%	0%	0%	0%	9%	91%	0%
Credit Card ABS	4,930,996	0.1	0%	0%	0%	0%	0%	0%	100%
Prime Auto ABS	897,163	0.0	0%	0%	0%	0%	0%	100%	0%
NAV Loans	189,521	0.0	0%	0%	100%	0%	0%	0%	0%
CMBS	-	-	0%	0%	0%	0%	0%	0%	0%
Subprime Auto ABS	-	-	0%	0%	0%	0%	0%	0%	0%
TOTAL	6,351,143,883	100.0							

[1] Includes: Aircraft Loan ABS, Commercial Loans, Equity - other, Infrastructure Debt, Powerplant, Prime Borrower Unsecured Consumer, Prime Home Improvement Loans, Solar, Utility Scale Solar.

Source: ACLI tabulations of Residual Tranches survey of 2023 year-end data.

Capital Adequacy (E) Task Force

RBC Proposal Form

☐ Capital Adequacy (E) Task Force ☐ Health RBC (E) Working Group ☐ Life RBC (E) Working Group
☐ Catastrophe Risk (E) Subgroup ☐ P/C RBC (E) Working Group ☐ Longevity Risk (A/E) Subgroup
☐ Variable Annuities Capital. & Reserve (E/A) Subgroup ☐ Economic Scenarios (E/A) Subgroup ☒ RBC Investment Risk & Evaluation (E) Working Group

DATE: 5/17/24		**FOR NAIC USE ONLY**
CONTACT PERSON:		Agenda Item # 2024-19-I Year 2024
TELEPHONE:		**DISPOSITION**
EMAIL ADDRESS:		**ADOPTED:** ☐ TASK FORCE (TF) ______ ☐ WORKING GROUP (WG) ______ ☐ SUBGROUP (SG) ______
ON BEHALF OF:		**EXPOSED:** ☐ TASK FORCE (TF) ______ ☐ WORKING GROUP (WG) ______ ☐ SUBGROUP (SG) ______
NAME:	**Patrick Reeder**	**REJECTED:** ☐ TF ☐ WG ☐ SG ______
TITLE:	**Chief Governmental Affairs Officer**	**OTHER:** ☐ DEFERRED TO ______
AFFILIATION:	**EverLake Life Insurance Comany**	☐ REFERRED TO OTHER NAIC GROUP
ADDRESS:		☐ (SPECIFY) ______

IDENTIFICATION OF SOURCE AND FORM(S)/INSTRUCTIONS TO BE CHANGED

☐ Health RBC Blanks ☐ Property/Casualty RBC Blanks ☒ Life and Fraternal RBC Blanks
☐ Health RBC Instructions ☐ Property/Casualty RBC Instructions ☒ Life and Fraternal RBC Instructions
☐ Health RBC Formula ☐ Property/Casualty RBC Formula ☒ Life and Fraternal RBC Formula
☐ OTHER ______

DESCRIPTION/REASON OR JUSTIFICATION OF CHANGE(S)

This proposal provides for the inclusion of residual tranches or interests reported on Schedule BA to be included in LR008 Other Long-Term Assets on two lines. It applies a 45% factor to all residual tranches and interests except those specifically identified as Exempted.

Additional Staff Comments:

****   This section must be completed on all forms.** **Revised 2-2023**

OTHER LONG-TERM ASSETS

LR008

Basis of Factors

Recognizing the diverse nature of Schedule BA assets, the RBC is calculated by assigning different risk factors according to the different type of assets. Assets with underlying characteristics of bonds and preferred stocks designated by the NAIC Capital Markets and Investment Analysis Office have different factors according to the NAIC assigned classification. Unrated fixed-income securities will be treated the same as Other Schedule BA Assets and assessed a 30 percent pre-tax charge. Rated surplus and capital notes have the same factors applied as Schedule BA assets with the characteristics of preferred stock. Where it is not possible to determine the RBC classification of an asset, a 30 percent pre-tax factor is applied.

Specific Instructions for Application of the Formula

Line (49.1)
Schedule BA affiliated common stock – all others should be included in C-1cs. Specifically this means that all subs with an affiliate code 13 in the current life-based framework and "holding company in excess of indirect subsidiaries" or subsidiaries with affiliate code 7 are to be included in C-1cs.

Line (49.2)
New lines were added for yearend 2022 reporting to Schedule BA and the AVR Equity Component to capture amounts related to residual tranches or interest. For yearend 2022 life RBC reporting, AVR Equity Component, Column 1, Line 93 will be included in Line (49.2). For year end 2024, Life RBC reporting, AVR Equity Component, Column 1, line 93 will be included in line (49.2) for only Exempted Residuals Tranches and Interests as described below. All other residuals tranches and interests will be captured in line (51).

Line (51)
For year end 2024 Life RBC reporting, reporting entities should report residual tranches (other than Exempted Residual Tranches and Interests) on Line 51. Reporting entities should add a footnote to indicate if their overall RBC changes by 10 percent or more from their 2023 RBC based on this reporting change.

Exempted Residual Tranches and Interests" are:

- Middle market and commercial real estate CLO residuals whether in feeder fund format or CLO;
- CMBS and RMBS residuals;
- Residuals backed by:
  - Consumer Assets including but not limited to consumer loans, credit card receivables, student loans, auto loans and leases, solar loans and leases, home improvement loans and other prime consumer assets;
  - Cashflows from leases secured by, but not limited, to data centers, fiber and wireless infrastructure, renewable energy projects backed by power purchase agreements, and loans and leases secured by physical assets, solar and other energy related projects backed by power purchase agreements, transportation assets such as railcars, containers and aircraft and engines, equipment, commercial and residential real estate;
  - Other loans and fixed income like cashflows including but not limited to residential and commercial PACE assets, insurance policy payments, commercial & industrial solar contracts, whole business securitizations, timeshares, royalties, intellectual property, tax liens, small business loans inventory finance, supply chain finance and accounts receivable finance; and
- and any other category of residual tranche or interest or specific residual investment identified by a domiciliary regulator as appropriately receiving a 30 percent charge demonstrated using a methodology acceptable to the domiciliary regulator.

Line (57)
Total Schedule BA assets [LR008 Other Long-Term Assets Column (1) Line (57) plus LR007 Real Estate Column (1) Line (14) plus Lines (17) through Line (21) plus LR009 Schedule BA Mortgages Column (1) Line (21)] should equal the total Schedule BA assets reported in the Annual Statement Page 2, Column 3, Line 8.

OTHER LONG-TERM ASSETS (CONTINUED)

		Annual Statement Source	(1) Book / Adjusted Carrying Value	(2) Unrated Items ‡	(3) RBC Subtotal †		(4) Factor		(5) RBC Requirement
	Schedule BA - All Other								
(48.1)	BA Affiliated Common Stock - Life with AVR	AVR Equity Component Column 1 Line 67							
(48.2)	BA Affiliated Common Stock - Certain Other	AVR Equity Component Column 1 Line 68							
(48.3)	Total Schedule BA Affiliated Common Stock - C-1o	Line (48.1) + (48.2)				X	0.3000	=	
(49.1)	BA Affiliated Common Stock - All Other	AVR Equity Component Column 1 Line 69							
(49.2)	Total Sch. BA Affiliated Common Stock - C-1cs **and Exempted Residual Tranches or Interests as described in the instructions.**	Line (49.1) **+ AVR Equity Component Column 1 Line 93, in part**				X	0.3000	=	
(50)	Schedule BA Collateral Loans	Schedule BA Part 1 Column 12 Line 2999999 + Line 3099999				X	0.0680	=	
(51)	~~Total~~ Residual Tranches or Interests **- Other**	AVR Equity Component Column 1 Line 93**, in part**				X	**0.4500**	=	
(52.1)	NAIC 01 Working Capital Finance Notes	AVR Equity Component Column 1 Line 94				X	0.0050	=	
(52.2)	NAIC 02 Working Capital Finance Notes	AVR Equity Component Column 1 Line 95				X	0.0163	=	
(52.3)	Total Admitted Working Capital Finance Notes	Line (52.1) + (52.2)							
(53.1)	Other Schedule BA Assets	AVR Equity Component Column 1 Line 96							
(53.2)	Less NAIC 2 thru 6 Rated/Designated Surplus Notes and Capital Notes	Column (1) Lines (23) through (27) + Column (1) Lines (33) through (37)							
(53.3)	Net Other Schedule BA Assets	Line (53.1) less (53.2)				X	0.3000	=	
(54)	Total Schedule BA Assets C-1o (pre-MODCO/Funds Withheld)	Lines (11) + (21) + (31) + (41) + (48.3) + (50)+ (52.3) + (53.3)							
(55)	Reduction in RBC for MODCO/Funds Withheld Reinsurance Ceded Agreements	Company Records (enter a pre-tax amount)							
(56)	Increase in RBC for MODCO/Funds Withheld Reinsurance Assumed Agreements	Company Records (enter a pre-tax amount)							
(57)	Total Schedule BA Assets C-1o (including MODCO/Funds Withheld.)	Lines (54) - (55) + (56)							
(58)	Total Schedule BA Assets Excluding Mortgages and Real Estate	Line (47) + (49.2) + (51) + (57)							

† Fixed income instruments and surplus notes designated by the NAIC Capital Markets and Investment Analysis Office or considered exempt from filing as specified in the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* should be reported in Column (3).

‡ Column (2) is calculated as Column (1) less Column (3) for Lines (1) through (17). Column (2) equals Column (3) - Column (1) for Line (53.3).

§ The factor for Schedule BA publicly traded common stock should equal 30 percent adjusted up or down by the weighted average beta for the Schedule BA publicly traded common stock portfolio subject to a minimum of 22.5 percent and a maximum of 45 percent in the same manner that the similar 15.8 percent factor for Schedule BA publicly traded common stock in the Asset Valuation Reserve (AVR) calculation is adjusted up or down. The rules for calculating the beta adjustment are set forth in the AVR section of the annual statement instructions.

 # Did the reporting entity experience a 10% or more change from their 2023 ACL RBC based on the 2024 RBC changes. **Yes [ ]** **No [ ]**

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CALCULATION OF AUTHORIZED CONTROL LEVEL RISK-BASED CAPITAL

		Source	(1) RBC Requirement
	Insurance Affiliates and Misc. Other Amounts (C-0)		
(1)	Directly Owned Health Insurance Companies or Health Entities	LR042 Summary for Affiliated/Subsidiary Stocks Column (4) Line (1)	
(2)	Directly Owned Property and Casualty Insurance Affiliates	LR042 Summary for Affiliated/Subsidiary Stocks Column (4) Line (2)	
(3)	Directly Owned Life Insurance Affiliates	LR042 Summary for Affiliated/Subsidiary Stocks Column (4) Line (3)	
(4)	Indirectly Owned Health Insurance Companies or Health Entities	LR042 Summary for Affiliated/Subsidiary Stocks Column (4) Line (4)	
(5)	Indirectly Owned Property and Casualty Insurance Affiliates	LR042 Summary for Affiliated/Subsidiary Stocks Column (4) Line (5)	
(6)	Indirectly Owned Life Insurance Affiliates	LR042 Summary for Affiliated/Subsidiary Stocks Column (4) Line (6)	
(7)	Affiliated Alien Insurers - Directly Owned	LR042 Summary for Affiliated/Subsidiary Stocks Column (4) Lines (9) + (10) + (11)	
(8)	Affiliated Alien Insurers - Indirectly Owned	LR042 Summary for Affiliated/Subsidiary Stocks Column (4) Lines (12) + (13) + (14)	
(9)	Off-Balance Sheet and Other Items	LR017 Off-Balance Sheet and Other Items Column (5) Line (34)	
(10)	Total (C-0) - Pre-Tax	Sum of Lines (1) through (9)	
(11)	(C-0) Tax Effect	LR030 Calculation of Tax Effect for Life and Fraternal Risk-Based Capital Column (2) Line (122)	
(12)	Net (C-0) - Post-Tax	Line (10) - Line (11)	
	Asset Risk – Unaffiliated Common Stock and Affiliated Non-Insurance Stock (C-1cs)		
(13)	Schedule D Unaffiliated Common Stock	LR005 Unaffiliated Common Stock Column (5) Line (21) + LR018 Off-Balance Sheet Collateral Column (3) Line (16)	
(14)	Schedule BA Unaffiliated Common Stock	LR008 Other Long-Term Assets Column (5) line (47)	
(15)	Schedule BA Affiliated Common Stock - C-1cs **and Residual Tranches or Interests**	LR008 Other Long-Term Assets Column (5) lines (49.2) + (51)	
(16)	Common Stock Concentration Factor	LR011 Common Stock Concentration Factor Column (6) Line (6)	
(17)	Holding Company in Excess of Indirect Subs	LR042 Summary for Affiliated/Subsidiary Stocks Column (4) Line (7)	
(18)	Affiliated Non-Insurers	LR042 Summary for Affiliated/Subsidiary Stocks Column (4) Lines (19) + (20) + (21)	
(19)	Total (C-1cs) - Pre-Tax	Sum of Lines (13) through (18)	
(20)	(C-1cs) Tax Effect	LR030 Calculation of Tax Effect for Life and Fraternal Risk-Based Capital Column (2) Line (134)	
(21)	Net (C-1cs) - Post-Tax	Line (19) - Line (20)	
	Asset Risk - All Other (C-1o)		
(22)	Bonds after Size Factor	LR002 Bonds Column (2) Line (27) + LR018 Off-Balance Sheet Collateral Column (3) Line (8)	
(23)	Mortgages (including past due and unpaid taxes)	LR004 Mortgages Column (6) Line (31)	
(24)	Unaffiliated Preferred Stock	LR005 Unaffiliated Preferred and Common Stock Column (5) Line (10) + LR018 Off-Balance Sheet Collateral Column (3) Line (15)	
(25)	Investment Affiliates	LR042 Summary for Affiliated/Subsidiary Stocks Column (4) Line (8)	
(26)	Investment in Upstream Affiliate (Parent)	LR042 Summary for Affiliated/Subsidiary Stocks Column (4) Line (15)	
(27)	Directly Owned Health Insurance Companies or Health Entities Not Subject to RBC	LR042 Summary for Affiliated/Subsidiary Stocks Column (4) Line (16)	
(28)	Directly Owned Property and Casualty Insurance Companies Not Subject to RBC	LR042 Summary for Affiliated/Subsidiary Stocks Column (4) Line (17)	
(29)	Directly Owned Life Insurance Companies Not Subject to RBC	LR042 Summary for Affiliated/Subsidiary Stocks Column (4) Line (18)	
(30)	Publicly Traded Insurance Affiliates	LR042 Summary for Affiliated/Subsidiary Stocks Column (4) Line (22)	
(31)	Separate Accounts with Guarantees	LR006 Separate Accounts Column (3) Line (7)	

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SENSITIVITY TESTS - AUTHORIZED CONTROL LEVEL

	Sensitivity Tests Affecting Authorized Control Level Risk-Based Capital	Source	(1) Statement Value	Additional Sensitivity Factor	(2) Additional RBC	(3) Authorized Control Level Before Test	(4) Authorized Control Level After Test
(1.1)	Other Affiliates: Company	LR042 Summary for Affiliated Investments Column (1) Lines (19), (20) and (21)		0.700			
(1.2)	Other Affiliates: Subsidiaries	LR038 Additional Information Required Column (1) Line (1.2)		0.700			
(1.99)	Total Other Affiliates			0.700			
(2.1)	Noncontrolled Assets - Company	LR017 Off-Balance Sheet and Other Items Column (1) Line (15)		0.020			
(2.2)	Noncontrolled Assets - Subsidiaries	LR038 Additional Information Required Column (1) Line (2.2)		0.020			
(2.99)	Total Noncontrolled Assets			0.020			
(3.1)	Guarantees for Affiliates: Company	LR017 Off-Balance Sheet and Other Items Column (1) Line (24)		0.020			
(3.2)	Guarantees for Affiliates: Subsidiaries	LR038 Additional Information Required Column (1) Line (3.2)		0.020			
(3.99)	Total Guarantees for Affiliates			0.020			
(4.1)	Contingent Liabilities: Company	LR017 Off-Balance Sheet and Other Items Column (1) Line (25)		0.020			
(4.2)	Contingent Liabilities: Subsidiaries	LR038 Additional Information Required Column (1) Line (4.2)		0.020			
(4.99)	Total Contingent Liabilities			0.020			
(5.1)	Long-Term Leases: Company	LR017 Off-Balance Sheet and Other Items Column (1) Line (26)		0.030			
(5.2)	Long-Term Leases: Subsidiaries	LR038 Additional Information Required Column (1) Line (5.2)		0.030			
(5.99)	Total Long-Term Leases			0.030			
(7.1)	Affiliated Investments†: Company	LR038 Additional Information Required Column (1) Line (7.14)		0.100			
(7.2)	Affiliated Investments†: Subsidiaries	LR038 Additional Information Required Column (1) Line (7.2)		0.100			
(7.99)	Total Affiliated Investments			0.100			
(8.1)	~~Total~~ Residual Tranches or Interests **Receiving a 30% Base Factor**	**LR008 Other Long-Term Assets Column (1) Line (49.2), in part**		**0.150**			

† Excluding affiliated preferred and common stock

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#REF!