NAIC NATIONAL MEETING SPRING 2022

Date: 3/17/22

Virtual Meeting
(in lieu of meeting at the 2022 Spring National Meeting)

RISK-BASED CAPITAL (RBC) INVESTMENT RISK AND EVALUATION (E) WORKING GROUP
Tuesday, March 22, 2022
1:00 – 2:00 p.m. ET / 12:00 – 1:00 p.m. CT / 11:00 a.m. – 12:00 p.m. MT / 10:00 – 11:00 a.m. PT

ROLL CALL

Philip Barlow, Chair	District of Columbia	William Leung/Debbie Doggett	Missouri
Thomas Reedy	California	Lindsay Crawford	Nebraska
Wanchin Chou	Connecticut	Bob Kasinow/Bill Carmello	New York
Ray Spudeck	Florida	Dale Bruggeman/Tom Botsko	Ohio
Vincent Tsang	Illinois	Mike Boerner/Rachel Hemphill	Texas
Carrie Mears	Iowa	Steve Drutz/Tim Hays	Washington
Fred Andersen	Minnesota	Amy Malm	Wisconsin

NAIC Support Staff: Jane Barr/Dave Fleming/Julie Gann/Charles Therriault/Linda Phelps/Peter Kelly

AGENDA

1. Consider Adoption of its Feb. 28 Minutes—*Philip Barlow (DC)* — Attachment A

2. Discuss Comment Letters—*Philip Barlow (DC)*
   A. American Council of Life Insurers (ACLI) — Attachment B
   B. Bridgeway Analytics — Attachment C
   C. Risk & Regulatory Consulting LLC — Attachment D
   D. Florida Office of Insurance Regulation — Attachment E

3. Consider Adoption of its Working Agenda—*Philip Barlow (DC)* — Attachment F

4. Discuss Next Steps—*Philip Barlow (DC)*

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

6. Adjournment

SharePoint/NAIC Support Staff Hub/Member Meetings/Spring 2022 National Meeting/Agendas/RBC IRE 3.22.22 Agenda

Draft: 3/11/22

Risk-Based Capital (RBC) Investment Risk and Evaluation (E) Working Group
Virtual Meeting
February 28, 2022

The RBC Investment Risk and Evaluation (E) Working Group of the Capital Adequacy (E) Task Force met Feb. 28, 2022. The following Working Group members participated: Philip Barlow, Chair (DC); Thomas Reedy (CA); Wanchin Chou (CT); Ray Spudeck (FL); Carrie Mears (IA); Vincent Tsang (IL); Fred Andersen (MN); William Leung and Debbie Doggett (MO); Lindsay Crawford (NE); Bill Carmello (NY); Tom Botsko (OH); Mike Boerner and Rachel Hemphill (TX); Steve Drutz and Tim Hays (WA); and Amy Malm (WI).

1. Discussed its Formation, its Charges, and Financial Condition (E) Committee Direction

Mr. Barlow introduced the call and referred to a memorandum from Mr. Botsko, chair of the Capital Adequacy (E) Task Force, to the Financial Condition (E) Committee requesting the formation of the Working Group. Mr. Botsko stated that the formation of the Working Group was primarily for the evaluation of investments and risk from an RBC perspective, and the Committee was supportive of the formation. Mr. Barlow summarized the Working Group's initial charges: 1) identifying and acknowledging uses of RBC beyond the purpose of the *Risk-Based Capital (RBC) for Insurers Model Act* (#312); 2) assessing the impact of potential changes in contributing to the identification of weakly capitalized companies; and 3) documenting the modifications made over time to the formulas. He stated that during an initial Jan. 12 joint call of the Working Group with the Committee, the Committee provided direction on two projects: 1) consider a second phase of the bond factors; and 2) review residual tranches for RBC. He stated that the requested work of the Committee could be completed with the scope of the Working Group charges, and he identified that the Working Group will likely have extensive coordination with the Statutory Accounting Principles (E) Working Group, the Valuation of Securities (E) Task Force, as well as other groups, while completing a comprehensive review of the investment component of the RBC calculation.

2. Discussed Desired Outcomes

Ms. Mears, chair of the Valuation of Securities (E) Task Force and vice chair of the Statutory Accounting Principles (E) Working Group, provided viewpoints on behalf of both groups, as Dale Bruggeman (OH), chair of the Statutory Accounting Principles (E) Working Group, was unable to attend. She stated that the bond project of the Statutory Accounting Principles (E) Working Group came about as state insurance regulators identified a shift in insurer portfolios from traditional bond holdings to more structured products. She identified that the accounting framework did not contemplate the type of collateral that could be held under these innovative products. She stated that the bond project initially began with a focus on equity investments that could be securitized, resulting in movement from Schedule BA: Other Invested Assets to Schedule D-1: Long-Term Bonds, but the project ultimately became a holistic review of Schedule D-1 and the principle concepts in classifying investments as bonds. She stated that the desire to have similar focuses on these types of investments at the Task Force and the RBC Investment Risk and Evaluation (E) Working Group to ensure that the ratings and capital framework continues to be appropriate for these types of investments.

Ms. Mears noted that a specific concern from a Statutory Accounting Principles (E) Working Group perspective occurs when an insurer holds an "entire stack" from a securitization, which is basically akin to continued holdings of the entire pool or portfolio of underlying collateral, and this concern is more prevalent when the collateral is equity-based. She provided an example of a collateralized fund obligation (CFO) where equity funds were held on Schedule BA with a 30% RBC charge but then went through a securitization process in which higher-level tranches were moved to Schedule D-1, resulting in much less RBC charges, and the remaining residual tranches were

retained on Schedule BA. In this scenario, the economics and overall risk are not different from the insurer holding the entire investment on Schedule BA, but with the securitization and the ability to divide the holdings between Schedule D-1 and BA, the insurer RBC position is significantly different. Ms. Mears noted that an original proposal as part of the bond project tried to address this issue; however, it was quickly identified that this dynamic is not an accounting issue but pertains to risk assessment and ultimately RBC concepts. As such, there is a desire for the Working Group to address this as part of the residual tranche review. Ms. Mears stated that this residual review would be applicable to all securitizations but would be most impactful to CFO investments. She stated that the risk assessment may also be easier for residuals of a collateralized loan obligation (CLO), which have underlying collateral that is rated and may be more difficult for other structures that have underlying collateral that is not rated or does not fit within the existing RBC framework. She proposed moving forward with structural changes in the calculation, with subsequent edits to reflect the determined factors.

Ms. Mears then presented comments from the Valuation of Securities (E) Task Force, noting that there is a clear connection for some investments between the reported designations and resulting RBC factors. She stated that the Task Force has a project this year to undertake a review on how it uses credit rating providers (CRPs) and assess the types of risks that are encompassed within ratings from the various CRPs to ensure an understanding of the differences between CRPs. She stated that understanding the risks that are reflected in the CRP ratings, which translate to NAIC designations, will correspond to the Working Group in understanding the factors that should be considered in response to those designations. She stated that extensive collaboration of the impacted groups is paramount in ensuring that an appropriate overall statutory framework encompassing accounting, designations, and RBC is in place for all investments, but particularly for securitizations.

Mr. Barlow stated that the comments of Ms. Mears align with his perceptions for the Working Group. He stated that the Working Group should first focus on setting RBC charges that correlate with the risk insurers are undertaking and ensure that the risk the RBC is addressing is commonly understood. He said he believes this is in line with the Ms. Mears' comments on understanding what is represented with CRP ratings and NAIC designations. He stated that he has been adherent to the concept that RBC is intended to identify weakly capitalized companies, and that has driven historical work of the Life Risk-Based Capital (E) Working Group; however, the work of the RBC Investment Risk and Evaluation (E) Working Group will not necessarily be focused on the work to identify weakly capitalized companies. Instead, the Working Group is likely going to be focusing on a more granular breakdown of investment risk. Although not focusing on weakly capitalized companies, this approach will add clarity and guidance for the other purposes in which RBC is used by insurance companies in making investment decisions. Mr. Barlow stated that the intent is to make RBC a non-factor in determining insurer investment decisions, as each investment will have a charge aligned with the investment risk. He stated that there are differences in the life, property/casualty (P/C), and health formulas, and the Working Group should assess whether the work being completed should be identical in all three formulas or if circumstances exist that support different formulas. He noted that representatives from the various RBC groups are participating in the Working Group, so this assessment will be completed as part of the process.

Mr. Barlow stated that he would like the Working Group to work holistically with its projects and ultimately have a broad methodology that will also address new assets and can be regularly updated with asset factors. He stated that the historical use of the RBC formula attempted to pull information from the financial statements; therefore, two identical companies would have similar RBC. This approach did not allow subjectivity into the RBC formula. Mr. Barlow stated that with changes in investments, two companies could seemingly look the same, but the underlying components of the investments could be different, and the RBC formula may have not been adjusted to reflect this dynamic. He stated that it would be ideal to be as objective as possible with the identification of investment risk, so that with sufficient information in the financial statement, investments can be categorized to ensure appropriate treatment for RBC formula purposes. He also stated that having a clear understanding of the designations, as well as the risk they represent, will also assist in calculating RBC factors that recognize the way

the assets are rated. Although this may not be a short-term result, it would be a goal for the Working Group, particularly with the path of developing a framework that will be appropriate in categorizing new assets and investment structures. Mr. Barlow stated that the RBC groups have historically been reactive to the decisions from other groups in the reporting of investments, and he would suggest developing a framework that can address current and future investments.

Mr. Botsko, representing the chair of the Capital Adequacy (E) Task Force and the Property and Casualty Risk-Based Capital (E) Working Group, affirmed the comments of Mr. Barlow, noting that the groups need to work together in determining an appropriate framework that allows for correct RBC charges. He stated that working together will allow a more efficient outcome for industry. Mr. Drutz, representing the chair of the Health Risk-Based Capital (E) Working Group, confirmed the comments of both Mr. Barlow and Mr. Botsko. Ms. Mears also agreed and encouraged participation of industry and state insurance regulators across the different groups. Mr. Barlow agreed and stated that the RBC Investment Risk and Evaluation (E) Working Group should assist with the coordination effort between the different groups.

Mr. Barlow stated that an exposure on Jan. 12 by the Financial Condition (E) Committee directed comments to the Working Group. The deadline for those comments is Feb. 28, and a specific call will occur to consider the comments from that exposure.

3. Received a Presentation on the High-Level Overview of Investment Development

Charles Therriault (NAIC) presented a summary of structured finance securities on behalf of NAIC Investment Analysis Office (IAO) staff. In principle, securitization is a simple concept involving the legal isolations of assets in a bankruptcy remote entity for the purpose of either collateralizing or generating cash flows sufficient to issue a debt security from the bankruptcy remote entity. However, since its inception in the late 1960s, securitization has evolved to become a tool to finance or monetize just about any asset imaginable.

Mr. Therriault stated that there is a very broad range of structured finance securities that may or may not be divided into different classes called tranches. The only real common theme is the legal isolation of assets in a bankruptcy remote entity. Beyond that, structured finance securities have no uniformity as to the nature of the assets, cash flow generation, classes or tranches, payments to the investor, or method of repaying the principal at maturity. The structures include asset backed securities (ABS), mortgage-backed securities, residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), collateralized debt obligations (CDOs), collateralized loan obligations (CLOs), insurance-linked risk transfer securities, future flow securitizations, credit tenant lease financing, ground lease financing, military housing administration fee securitization, and whole business securitization, along with many other names. Mr. Therriault stated that the underlying assets can be any asset such as mortgages, credit card receivables, commercial loans, home equity loans, student loans, equipment and property leases, movie revenues, royalty payments, aircraft landing slots, toll roads, or oil reserves, as just about any cash-producing vehicle or situation can be securitized.

Mr. Therriault stated that ratings play an important role in structured finance, as most of these securities are filing exempt (FE), meaning ratings are used to assign an NAIC designation. There is no universal standard for assessing their risk or any consistency in the methodologies across credit rating agencies to provide a uniform credit rating or risk assessment. The performance of structured finance has also varied across the asset class and types. The IAO raised the issue regarding the reliance upon CRP ratings and the lack of oversight as to the analytical basis for those ratings to the Valuation of Securities (E) Task Force in its Nov. 29, 2021, memo. The greater risk assessment variation rewards risk-taking without the commensurate RBC. Mr. Therriault stated that there can be potentially significant distortions of an insurer's RBC ratio if the underlying rating used to set an NAIC designation is not derived in a manner that is comparable to or consistent with the risk assessment used in determining those RBC

factors. Ratings are not interchangeable, and IAO staff believe the NAIC's use of them in its regulatory processes needs to reflect those differences efficiently and effectively.

4. Discussed Investment Reporting Perspectives

Ms. Mears stated that the Statutory Accounting Principles (E) Working Group and the Valuation of Securities (E) Task Force, as part of the bond project and investment analysis, will be making reporting changes. As such, if there are data points or analysis requests from the RBC Investment Risk and Evaluation (E) Working Group, those can be considered as part of the reporting changes being considered under the bond project. Ms. Mears inquired about the RBC structural change deadlines, stating a preference to have the structural changes in place as soon as possible for residual tranches so the framework is in place for potential factor changes. Mr. Barlow stated that structural changes need to be exposed by the end of January and adopted by the end of April. For instructional changes, which includes changing factors in the existing structure, those changes need to be exposed by April 30 and adopted by June 30. Mr. Barlow stated that in the past, the Life Risk-Based Capital (E) Working Group has incorporated structural changes in advance of factor changes to allow the deadlines to be met. He stated a presumption that such an approach has also been followed by the other RBC working groups. He stated that the intent for a more objective approach may consider differences in the schedule—i.e., grouping items together—or capture more identifiers for assets, allowing RBC to use the identifiers to better apply factors. He stated that this may be more feasible than increasing the schedules in the annual statement. Ms. Mears noted that these comments are helpful and beneficial, as the reporting changes are considered as part of the bond project. She stated that significant reporting revisions are anticipated, particularly to Schedule D-1 as part of the bond project.

Ralph Blanchard (Travelers) stated that he has historically looked to determine bond default rates by classification, and it was difficult to do so, as the reporting schedules have changed frequently over the years. He requested that the new structure be designed so it can be retained over time so that future analysis on bond classifications would be easier to complete. He stated that this detail was not in the investment schedule but supplemental data, but the format has changed over the years, so it was difficult to track. Julie Gann (NAIC) stated that she is not familiar with the location in the financial statements that captured bond defaults, but she said she would research this information and see what has changed from a historical perspective.

5. Discussed Other Matters

Mr. Barlow identified that Ms. Gann developed a chart of the pending investment-related referrals previously provided to the Capital Adequacy (E) Task Force or RBC working groups. He stated that some of the referrals were deferred for the bond factor proposal. Included within the chart are the two projects directed by the Financial Condition (E) Committee, which includes Phase II of the bond factors and residual interests. Mr. Barlow stated that these two projects will be addressed first, noting that they can be worked on concurrently. Next, the other projects on the chart would be prioritized by the Working Group, and additional investment-related referrals may be added to this list of projects. Mr. Barlow stated that the work on Phase II of the bond factors will begin first with a consideration of the comments received. He stated the intent to work holistically, so all projects should be reviewed with consideration of how assets are reported and how RBC factors are applied under the financial statement framework.

Having no further business, the RBC Investment Risk and Evaluation (E) Working Group adjourned.

Att RBCIREWG 2-28-22 Minutes.docx

ACLI
Financial Security for Life

Paul Graham
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March 4, 2022

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

Re: Phase II Bond RBC Initiative for Structured Securities

Dear Philip:

ACLI appreciates the opportunity to provide comments on the NAIC's project to review the Risk-based Capital (RBC) treatment of Asset-backed Securities (ABS), including collateralized loan obligations (CLOs), collateralized fund obligations (CFOs), or other similar securities carrying similar types of tail risk. We note that these are preliminary comments on the project, rather than specific comments on any of the technical aspects of the RBC treatment of Asset-backed Securities.

Overview

ACLI agrees with the NAIC that review of the RBC treatment of structured securities is an important follow-up to the work done to develop new RBC factors for bonds. The Phase 1 bond factors were based on the review of default and loss experience of corporate bonds based on their rating, which might not be appropriate for structured securities.

We suggest that, due to the complexity of this project, it would be helpful once an initial path forward (e.g., defining project plan, scope, and writing RFP, if necessary) is decided, or also as part of those discussions, to assemble a representative working group of regulators, NAIC staff, and industry subject matter experts to help address technical elements, with full transparency for all interested parties. It also seems to reason that a significant amount of this technical work would need vetting more broadly at certain stages of development.

Our comments start with a possible outline of a project plan and then we provide our initial responses to the RFC questions.

Suggested Outline of Project Plan

From a timing perspective, ACLI envisions that the project can be covered in two phases. Work on the two phases can be accomplished either sequentially or in parallel, with longer implementation for the second phase as it's more involved with more steps.

Phase 1

- Develop a modeling approach or other approach for CLOs and map to current C1 bond factors, potentially leveraging the existing NAIC modeling infrastructure for RMBS and CMBS; review rating agency methodologies.
- Apply a "no arbitrage" principle and evaluate equalization of RBC on the underlying (if available) and the securitization tranches through calibration and by allowing residual tranches to have a variable RBC based on measurable investment risk.
- The implementation plan for Phase 1 could be developed by year-end 2022 and may be less likely to need the assistance of a consultant.

Phase 2

- Assess mapping adequacy and consistency across modeled categories (RMBS, CMBS and CLOs).
- Implement refinements to modeling approaches to ensure appropriate assessment of tail risk.
- Develop a practical approach to map other ABS to current bond factors following the established principles from Phase 1 where the collateral has an assigned RBC. Define alternative approaches, e.g., bottoms-up underwriting, where collateral does not have a well-established RBC.
- Phase 2 is more complex – will likely take 2-3 years. Phase 2 likely requires hiring a consultant that could be engaged from time to time but is not a condition to implement partial solutions.

Project Timeframe

ACLI agrees that this project is a high priority. As noted above, the RBC charges for certain ABS structures, such as CLOs, may be completed relatively expediently, while other structures may take multiple years to complete. While we would expect that the RBC charges would be implemented as they are completed, care should be taken to determine the impact to industry before setting a specific implementation date.

Responses to Specific RFC Questions

Methodologies for capturing the risk (including tail risk) that exists with such assets (e.g., ratings-determined bond factors, a modeling process akin to the current CMBS/RMBS approach, or other proposals).

It is too early to suggest an exact methodology and this needs to be studied further. Structured securities do require a methodology that models collateral outcomes against the capital structure and cashflow waterfall of the security to derive loss projections for each tranche that are representative of the underlying collateral.

Risk modeling approaches for structured securities (beyond RMBS/CMBS) should be evaluated on the basis that they capture the tail risk of a skewed or heavy-tailed loss distribution (e.g., statistical approaches such as Conditional Tail Expectation ("CTE") / TVaR / Expected Shortfall, scenario/stress testing, etc.).

How a consultant or consulting actuary could be used by the NAIC to determine the appropriate charge based upon certain data.

As exemplified during the Phase 1 RBC discussions, a consultant with capital markets expertise can add considerable value. Structured securities are significantly more complex than corporate bonds, reinforcing the need for this expertise. Once the scope of the project has been determined, the consultant could:

- Survey existing regulatory frameworks
- Provide initial modeling and calibration
- If needed, provide ongoing modeling and calibration

Given the technical complexity of structured securities, the ACLI recommends that the consultant coordinate closely with NAIC Structured Securities and Capital Markets Bureau to ensure a robust implementation of the developed recommendations.

The need for review outside of Life RBC (Health, P&C).

Since most insurance investments in structured securities reside in life insurance portfolios, the ACLI supports the initial focus being limited to Life RBC; however, it would be wise for the other two Working Groups to be kept apprised of the work done.

Whether residual tranches in ABS structures can be evaluated in conjunction with and under similar methodologies as the debt tranches.

The full structure, inclusive of all tranches, should be evaluated on a consistent methodological basis. For example, if the NAIC modeled all of the debt tranches of a particular CLO, the cashflow accruing to the residual is simply the difference between the cashflow accruing to the underlying collateral and the cashflow accruing to the sum of the debt tranches.

Specific proposals for addressing RBC treatment of residual tranches to reduce arbitrage incentives.

As a general principle, the level of capital held for all securitized tranches including the residual should generally be consistent with the capital held for the underlying collateral (where specific NAIC capital methodologies are available for such underlying collateral), recognizing retained exposures, diversification within the collateral pool and other relevant attributes, inclusive of any structural enhancements that improve economic outcomes for investors. Modeling of the full waterfall structure would permit the NAIC to perform ongoing checks to ensure that capital arbitrage incentives are minimized.

The ACLI looks forward to working with the NAIC on this project.

Sincerely,

Paul S. Graham, III, FSA, MAAA

cc: Commissioner Scott White, Chair, Financial Condition (E) Committee

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BRIDGEWAY
ANALYTICS

Attachment C

Amnon Levy
Chief Executive Officer, Bridgeway Analytics
Amnon.Levy@BridgewayAnalytics.com
www.BridgewayAnalytics.com

February 28, 2022
Mr. Philip Barlow
Chair
NAIC Risk-Based Capital Investment Risk and Evaluation Working Group
Sent via email: JBarr@naic.org

RE: RBC treatment of asset backed securities

Dear Philip:

Bridgeway Analytics appreciates the opportunity to provide comments on RBC treatment of asset backed securities. Bridgeway Analytics encourages the NAIC and regulators to explore potential differentiated capital charges across credit segments, and in particular the treatment of structured assets, particularly for Life RBC. When redesigning the 2021 c1 factors, the reports I provided to the NAIC Life Risk-Based Capital Working Group on behalf of the ACLI highlighted the material differentiated risks, including tail risks, across asset classes that are not differentiated by NRSRO ratings alone and thus NAIC designations.[1,2]

With the 2021 reports providing details regarding our views on data and methodologies, our comments in this letter are more general. There are a wide range of approaches that can revise the RBC framework to provide regulators with tools to better identify weakly capitalized companies, and better align investment incentives. With that context, we feel it is critical for the RBC framework to have the following characteristics:

- Parsimony, scalability, and consistency, allowing for a holistic articulation of portfolio tail risk that aspires to be level-set across asset classes and over time. To the extent practical, the framework should be consistent with its use and measurement of differentiated risk measures, including that of a single credit investment (e.g., a rating and thus designation), tail loss of a single credit investment (which impacts loss given default), and a portfolio loss concept that considers diversification and concentration (e.g., c1 factors).
- Ongoing governance and monitoring of tail risks, that can change materially from year to year with varying risk factors and to a varying degree across RMBS, CMBS, CLO and other structured assets. Risks, that are not captured by ratings, and thus NAIC designations, alone.
- Data on ratings and thus NAIC designations, that are fundamental to c1 RBC, are particularly sparse for structured assets. By and large, NRSRO methodologies were modified substantially after the financial crisis, with few credit events since. With data on collateral experience generally more robust than tranche experience, we feel reliance on model-based approaches can better capture nuanced and varying characteristics across structured asset segments; characteristics that can have material implications for portfolio tail risks.

We raise these points to hopefully provide a level of transparency for the complexity and efforts that will be needed to address these important issues, as compared to, say, revising the c1 factors in 2021.

We appreciate the opportunity to comment on this exposure.

Sincerely,
Amnon Levy

[1] Assessment of the Proposed Revisions to the RBC C1 Bond Factors Prepared for the NAIC and ACLI https://content.naic.org/sites/default/files/call_materials/Agenda%20%26%20Materials%20LRBC%202-11-21.pdf
[2] Revisions to the RBC C1 Bond Factors Prepared for the NAIC and ACLI https://content.naic.org/sites/default/files/inline-files/2021%20Revisions%20to%20the%20RBC%20C1%20Bond%20Factors%205-24.pdf

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rrc risk&regulatory CONSULTING

Memo

To:	Scott White, Chair, Financial Condition (E) Committee
Cc:	Tom Botsko, Chair, Capital Adequacy (E) Task Force Phil Barlow, Chair, Investment Risk and Evaluation (E) Working Group
From:	Tricia Matson, Partner and Edward Toy, Director
Date:	February 25, 2022
Subject:	RRC comments for the exposure related to certain Complex Assets before the Investment Risk and Evaluation Working Group

Background

The Financial Condition (E) Committee (E Committee) exposed for comment a set of questions regarding the appropriate Risk-Based Capital (RBC) treatment of Asset-Backed Securities (ABS), including Collateralized Loan Obligations (CLO), collateralized fund obligations (CFOs), or other similar securities carrying similar types of tail risk (Complex Assets). RRC appreciates the opportunity to offer our comments. Should you have any questions, we would be glad to discuss our comments with you and the E Committee members.

RRC Comments

- We have the following general comments:
  - We applaud these efforts. We agree that the RBC framework should be reviewed to ensure that Complex Assets have RBC charges that are commensurate with the risk, in particular highly structured assets that may not have significant risk at moderately adverse levels but have a very significant potential for loss in tail scenarios.
  - We believe that it is important for the RBC recognize that different asset classes have different characteristics, in particular in terms of loss severity after a default occurs, but also in the pattern of defaults. For example, the loss severity and pattern of default loss can vary significantly among corporate bonds versus government bonds versus structured securities (RMBS, CMBS and ABS), as well as investments not on Schedule D such as mortgage loans. We believe that the regulators should carefully consider the issue of tail risk and how that should be treated across all asset classes.
- We have the following specific comments on individual items exposed:
  - Regarding methodologies for capturing the risk (including tail risk): Different measures of tail risk could be appropriately reflected in different RBC factors while continuing the current process for assigning NAIC Designations. However, given that the exposure is focused on loss severity, this should recognize that bonds that are held at a discount to par also have a different profile from the perspective of risk of loss to surplus. There is also a question of timing of that loss after a default event occurs, which may require a methodology that projects losses over a relatively long time horizon after the occurrence of the event. Use of a conditional tail expectation (which takes an average over the full tail events) rather than Value

at Risk (which looks at a specific point in the tail) may be more appropriate for Complex Assets since, for example, some may not have significant risk charges at a 95th percentile, but would have significant risk charges if the average of the highest 10% of risks were evaluated since it would capture deeper tail risk.

- Regarding use of a consultant: Since capturing tail risk may require more robust modeling approaches such as CTE, it could be helpful to the NAIC to engage a consulting actuary.

- Regarding the need for review outside of Life RBC (Health, P&C): If the E Committee decides that Risk-Based Capital factors should be adjusted to reflect different kinds of tail risk, we believe this should be applicable to the relevant assets and there should not be differences based on insurer type. Asset risk is specific to the asset. That is not to say that investment practices are not different across insurer types, but that is more appropriately adjusted for in the way that the overall RBC formulae work.

- Whether residual tranches in ABS structures can be evaluated in conjunction with and under similar methodologies as the debt tranches: Guidance for residual tranches of all Structured Securities was recently clarified to have those reported on Schedule BA, and not on Schedule D. This reflects appropriately on the fact that these are in a first loss position, much the same as an equity holding, in the capital structure, and are generally not considered securities that can be rated by the Nationally Recognized Statistical Rating Organizations (NRSROs). While they may have some characteristics akin to a debt security, they are more appropriately treated as equity-like and we believe they should take the RBC factor of similar assets that are reported on Schedule BA.

- Specific proposals for addressing RBC treatment of residual tranches to reduce arbitrage incentives: A substantive question is what the actual exposure is across the insurance industry. There are a number of factors that may be worth considering, not just for residual tranches of structured securities (assuming they will be treated as equity) but also other investments that receive equity treatment. Before considering a specific proposal, we recommend addressing a key principle, namely what are the actual exposures and what are the different characteristics of those exposures. The profile of residual tranches differs from publicly traded common stock, which differs from investments in private funds.

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

MEMO

FLORIDA OFFICE OF Insurance Regulation

To: Risk-Based Capital Investment Risk and Evaluation (E) Working Group

From: Ray Spudeck

cc: Jane Barr, NAIC

Date: February 18, 2022

Re: Response to Request for Comments on RBC project for Certain Asset Back Securities

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The Office has been closely following this issue and has been actively involved in the discussion. In response to your request, we would like to reiterate and reinforce some of the thinking we have already expressed.

We continue to believe that the risk, especially tail risk, of this growing class of asset structures cannot be realistically captured in traditional ratings and have been in support of a modeling-based approach as has been adopted for CMBS. These securities share many of the same features that led the NAIC to move to modeling for CMBS, but in many cases are more complex and intricate.

Clearly, outside expertise will be needed to guide the regulatory community toward the "best" answers. Whether it is an actuarial expertise, investment expertise or some combination of the two is an open question. As to whether to publish an NAIC RFP for an outside vendor, or accept the offer of the ACLI to pay for the consultants, using the previous approach, we feel the important concern is to ensure that we are getting the right expertise in a group who is responsive to regulator concerns and issues.

We do believe that while, in the current market, this issue is likely to be more critical in the Life sector, as we are building this structure with a forward looking lens, the other groups (P&C, and Health) should be involved as they may well have to address these as the market evolves and grows.

Lastly, with regard to the residual tranches, we continue to be of the opinion that the ability of the methodologies used for debt tranches to fully capture the unique risks that can be associated with the residual tranches is an open question that will require more detailed research and analysis.

Further, as to specific proposals for addressing these residual tranches, while getting the "right" RBC charge for them is of course essential, we also think that the ability to provide transparency to the regulator as to who is holding these and in what amounts is equally important. And this transparency should be easily identifiable.

Priority 1 – High priority
Priority 2 – Medium priority
Priority 3 – Low priority

RBC INVESTMENT RISK AND EVALUATION (E) WORKING GROUP
WORKING AGENDA ITEMS FOR CALENDAR YEAR 2022

Capital Adequacy (E) Task Force
Attachment F

2022 #	Owner	2022 Priority	Expected Completion Date	Working Agenda Item	Source	Comments	Date Added to Agenda
				Carryover Items – RBC IR &E			
8	RBC IRE	2	2022 or Later	Supplementary Investment Risks Interrogatories (SIRI)	**Referred from CADTF** Referral from Blackrock and IL DOI	The Task Force received the referral on Oct. 27. This referral will be tabled until the bond factors have been adopted and the TF will conduct a holistic review all investment referrals.	**1/12/2022** 11/19/2020
9	RBC IRE	2	2022 or Later	NAIC Designation for Schedule D, Part 2 Section 2 - Common Stocks Equity investments that have an underlying bond characteristic should have a lower RBC charge? Similar to existing guidance for SVO-identified ETFs reported on Schedule D-1, are treated as bonds.	**Referred from CADTF** Referral from SAPWG 8/13/2018	10/8/19 - Exposed for a 30-day Comment period ending 11/8/2019 3-22-20 - Tabled discussion pending adoption of the bond structure and factors.	**1/12/2022** 10/11/2018
10	RBC IRE	2	2022 or Later	Structured Notes - defined as an investment that is structured to resemble a debt instrument, where the contractual amount of the instrument to be paid at maturity is at risk for other than the failure of the borrower to pay the contractual amount due. Structured notes reflect derivative instruments (i.e. put option or forward contract) that are wrapped by a debt structure.	**Referred from CADTF** Referral from SAPWG April 16, 2019	10/8/19 - Exposed for a 30-day Comment period ending 11/8/2019 3-22-20 - Tabled discussion pending adoption of the bond structure and factors.	**1/12/2022** 8/4/2019
11	RBC IRE	2	2022 or Later	Comprehensive Fund Review for investments reported on Schedule D Pt 2 Sn2	**Referred from CADTF** Referral from VOSTF 9/21/2018	Discussed during Spring Mtg. NAIC staff to do analysis. 10/8/19 - Exposed for a 30-day comment period ending 11/8/19 3-22-20 - Tabled discussion pending adoption of the bond structure and factors.	**1/12/2022** 11/16/2018
				Ongoing Items – RBC IR&E			
				New Items - RBC IR &E			
12			2023 or later	Evaluate the appropriate RBC treatment of Asset-Backed Securites (ABS), including Collateralized Loan Obligations (CLO), collateriazed fund obliations (FSOs), or other similar securites carrying similar types of tail risk (Comples Assets).	Request from E Committee, SAPWG, VOSTF	Per the request of E Committee comments were solictied asking if these typs of assets should be considered a part of the RBC framework.	1/12/2022
13			2025 or later	Phase 2 Bond analysis - evaluate and develop an approach to map other ABS to current bond factors following the establised principles from Phase I where the collateral has an assigned RBC. This project will likely require an outside consultant and the timeline could exceeds 2-3 years.	Request from E Committee	Per the request of E Committee commest were solicited requesting the need for outside review.	1/12/2022