Date: 2/27/23

Virtual Meeting

RISK-BASED CAPITAL INVESTMENT RISK AND EVALUATION (E) WORKING GROUP
Monday, February 27, 2023
11:00 a.m. – 12:00 p.m. ET / 10:00 – 11:00 a.m. CT / 9:00 – 10:00 a.m. MT / 8:00 – 9:00 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/Carolyn Morgan	Florida	Dale Bruggeman/Tom Botsko	Ohio
Vincent Tsang	Illinois	Rachel Hemphill	Texas
Roy Eft	Indiana	Steve Drutz/Tim Hays	Washington
Carrie Mears/Kevin Clark	Iowa	Amy Malm	Wisconsin
Fred Andersen	Minnesota		

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

AGENDA

1. Discuss American Academy of Actuaries' (Academy) Follow Up to Presentation on Collateralized Loan Obligations (CLOs)—*Philip Barlow (DC)* — Attachment 1

2. Discuss Comment Letters—*Philip Barlow (DC)* — Attachments 2 - 6

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

4. Adjournment

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Attachment 1

AMERICAN ACADEMY *of* ACTUARIES

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January 31, 2023

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

Re: Follow-up to Academy Presentation on CLOs given to RBCIRE WG

Dear Mr. Barlow,

On behalf of the American Academy of Actuaries[1] C1 Work Group (C1WG), thank you for the opportunity to present early findings on collateralized loan obligations (CLOs) risk-based capital (RBC). As the work group continues to research the issue, it aims to produce analysis that is relevant for regulators. To that end, this letter seeks clarification on several issues raised in the December CLO report to the RBCIRE WG that needs regulatory judgment.

1. Given the exposure statistics that the C1WG shared with RBCIRE, what is the urgency of updating C-1 factors for CLOs? Is the risk sufficiently material to warrant a short-term solution before a long-term solution can be determined?
2. What information does the RBCIRE need to establish the statistical safety level (SSL)? The SSL specifies the statistical measure for the capital requirement, including the choice of risk measure (percentile vs. conditional tail expectation vs. other) and the level, and the time horizon. For reference, the C1 bond factors are set at the 96th percentile over a ten-year period.
3. Does RBCIRE believe that the "no RBC arbitrage" principle should be applied to the C-1 factor methodology?
4. Would RBCIRE like to follow up on exploring possible C-3 implications of the optionality embedded in CLOs (including callability, resets, or other choices available to the equity tranche vis-à-vis the debt tranches)?
5. Should active management within the CLO structure be considered when developing C-1 factors?

The C1WG appreciates your attention to the issues raised in this letter and looks forward to discussing them further with you. Should you have any questions or comments in response to

[1] The American Academy of Actuaries is a 19,500-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.

this letter, please contact Amanda Barry-Moilanen, life policy analyst (barrymoilanen@actuary.org).

Sincerely,

Stephen Smith
Chair, C1 Work Group
American Academy of Actuaries

ACLI
Financial Security for Life

Steve Clayburn, FSA, MAAA
Senior Actuary, Health Insurance & Reinsurance
steveclayburn@acli.com

February 3, 2023

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: Residual Tranches - Interim Solution

Dear Mr. Barlow:

ACLI appreciates the opportunity to provide comments on the exposure of the Valuation of Securities (E) Task Force (VoSTF) referral to RBC Investment Risk & Evaluation (E) Working Group (RBC IRE WG) on a proposed "interim solution" for additional RBC factor categories for securitized residuals.

<u>Executive Summary</u>
The ACLI supports the efforts to assess the potential need for determining capital charges associated with CLO investments that better reflects the actual risk of the various tranches. We also understand that the additional RBC factors (75% and 100%, in addition to the existing 30% factor) recommended by the SSG are intended to support an interim solution until structured finance securities can be studied and modeled more fully by the NAIC.

While we understand some regulators' desire to develop an interim solution with some level of expediency, we do have concerns that these factors were recommended without the normal level of rigor provided when making RBC changes. As such, it is important to understand the impact that the recommended changes will have. If the NAIC finds it prudent to adopt an interim approach to RBC factors for residual tranches of structured securities reported through Schedule BA, we recommend that the interim approach be simple and in place for as short of a time as possible.

Thus, we urge the RBC IRE WG to transition quickly from the work on the interim solution to the development of factors based on actual loss experience of the securities in question. We also

The American Council of Life Insurers (ACLI) is the leading trade association driving public policy and advocacy on behalf of the life insurance industry. 90 million American families rely on the life insurance industry for financial protection and retirement security. ACLI's member companies are dedicated to protecting consumers' financial wellbeing through life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, and dental, vision and other supplemental benefits. ACLI's 280 member companies represent 94 percent of industry assets in the United States.

acli.com

suggest for simplicity purposes that such tranches of structured securities be mapped to a single factor, as they are today. We have some suggested paths for the interim solution below.

Comments on Exposure

Understanding that some regulators desire an interim solution, we have some observations, concerns, questions, and suggestions for your consideration as outlined further in our comments.

One Factor for Interim Solution

The goal of an interim solution should be “do no harm” when compared to what the ultimate solution will be, especially given the “rough justice” nature of RBC. Neither the VoSTF referral nor the structural exhibit change proposal provides a rationale for setting temporary RBC factors at 30%, 75%, and 100%, nor how a reporting entity would distinguish among the three. In considering an interim solution, we recommend the use of only one factor for residual tranches reported on Schedule BA, as is the case currently. Because the factor may be chosen without the normal quantitative analysis that goes into RBC factor development, ACLI members have a variety of views on the selection of the single factor. Some companies believe that a higher factor is appropriate. Some companies recommend that the single factor continue to be 30%, augmented with a higher factor within the Sensitivity Testing exhibit on Pages LR038 and LR039. This sensitivity testing would allow regulators to determine whether any companies have a material risk from their residual tranches as well as be the basis for an analysis of other factors.

Since the factor does not need to be adopted until June 30, 2023, ACLI would like to see consideration by the NAIC to do additional quantitative analysis before the single factor is chosen. We believe that whatever factor is chosen, it should not be materially more conservative than complete non-admittance of the asset for the average industry participant, and likely a little less so, given the risk premium already contained in policy reserves. We recommend that the RBC IRE WG use information gathered from the year-end 2022 RBC reports to help identify a rational factor, and, if possible, review of any available experience data on CLO residual tranches to help check for reasonableness.

To prepare for the potential for a variety of solutions, ACLI recommends that the structural changes to the RBC forms accommodate a single factor and additional sensitivity testing. ACLI would be happy to support NAIC staff in developing these structural changes.

Scope of Application

It is not clear from the VoSTF referral memorandum as well as the exposed RBC exhibit form whether the proposal is intended to apply to the residual tranches of collateralized loan obligations (CLOs) or a broader application to all residual tranches for the variety of structured finance securities. We recommend that any future exposure draft clarify specifically to what types of investments the interim solution is intended to apply.

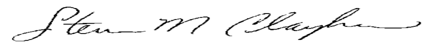
Define Timeframe of Use

The VoSTF referral does not mention any proposed implementation timeframe. Reviewing an RBC structural change during the first quarter of the year implies the possibility of implementation for year-end 2023 financial statements. Is this the intent or expectation? Furthermore, will this be in conjunction with review of the recent updates to Schedule BA for residual tranches which are to have the 30% RBC factor? Will the proposed factor, if any, be exposed for comment? And finally, how long would the interim solution remain in place?

Conclusion

Thank you for the opportunity to continue to participate and comment on this issue. We understand some regulators feel the need to do something additional to the 30% charge that has been applied to residual tranches for year-end 2022; however, we believe that appropriate review and analysis to provide a basis for factor selection is necessary for the stability of the NAIC's RBC framework. We look forward to future discussions and continued collaboration with the NAIC on this important initiative.

Sincerely,



Steve Clayburn

cc: Mike Monahan, ACLI
Paul Graham, ACLI

January 27, 2023

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

Re: **The American Academy of Actuaries C1 Work Group Presentation to the Risk-Based Capital Investment Risk and Evaluation Working Group (RBCIRE WG) on collateralized loan obligations (CLOs)** (the "AAA Report") and the **Valuation of Securities Task Force ("VOSTF") Referral on the Risk Assessment of Structured Securities- CLOs** and **Risk-based capital (RBC) structural proposal addressing residual tranches**, together, the "Exposures")

Dear Mr. Barlow:

We are a group of insurance companies concerned about the proposal to adopt an interim solution for residual tranches of securitized assets that is not supported by the thoughtful analysis and field testing that the NAIC has implemented in the past. We believe such thoughtful analysis is the hallmark of any responsible regulatory regime. We appreciate the opportunity to provide comments on the Valuation of Securities Task Force ("VOSTF") proposed interim solution as well as the American Academy of Actuaries' ("the Academy") presentation on CLOs.

Our group of companies agrees that the RBC treatment of the investments commonly referred to as "structured securities" is important and deserving of review and analysis. Our view is that:

- RBC factors for structured securities should be thoughtfully analyzed and developed following a similar process to the successful C-1 bond factor development project.
- Calculating RBC using factors developed without sufficient analysis and due diligence risks presenting a misleading assessment of a company's financial position to users of a company's statutory financial information, including the public.
- A rushed approach, without appropriate analytical rigor disincentivizes companies from investing in an important asset class, has the potential of causing market disruption, and negatively impacts the liquidity of these assets and the markets that rely on insurance company investments.
- The Academy's report stating that CLOs are not a current risk to insurance industry solvency builds a strongly constructive case for having the NAIC perform thorough and thoughtful quantitative analysis and field testing.
- A more rational and less disruptive approach is to have companies provide RBC sensitivities to regulators that will enable regulators to risk assess company balance sheets along with the baseline RBC measurement. It should be understood that any such assessment would be measured against factors that were developed without sufficient analysis and due diligence, as discussed in this letter, and therefore should be viewed as indicative only and not meant to be a definitive quantification of the risk associated with the sensitivities.

RBC factors currently applicable to the senior tranches of structured securities are based on the review of default and loss experience of corporate bonds. Based on a long track record of available data, it is clear that corporate bonds have higher default and loss experience than equivalently rated structured securities, making comparable structured securities' RBC factors overly conservative as they currently stand. Further, the RBC factors currently applicable to residual tranches of structured securities were developed based on a study of unaffiliated common stock over a two-year time horizon and we are not aware of any analysis completed in connection with the Exposures that evaluates whether these RBC factors are conservative or aggressive. Given the current state of both conservative and untested RBC factors, we believe, and the Academy agrees, that an arbitrary interim charge is not appropriate and that any new factors should be developed using the proven, collaborative process that was used during the changes to the C-1 bond factors. We are confident that this could be done in an expedited manner to produce rational and predictable results that regulators and industry alike would support as long-term rather than interim solutions. Like the C-1 process, we propose that the plan should be to engage an expert consultant or consulting actuary with the relevant expertise and significant resources to perform the necessary quantitative analysis. That expert should also work with industry to propose changes, perform field testing, and then promulgate appropriate charges to ensure "equal capital for equal risk across different asset classes." We expect that a streamlined process to develop appropriate factors could be performed in time to be released concurrently with the principle-based bond definition currently being worked on by the Statutory Accounting Principles Working Group.

Additional specific comments on the two exposures recently released by the Risk-Based Capital Investment Risk and Evaluation (E) Working Group ("the Working Group") are provided in the balance of this document.

First, we commend you for engaging the Academy to prepare a report on CLOs. The Academy report is thoughtfully prepared and enlightening, and we agree with the Academy's summary observations. With respect to residual tranches, we found the Academy's observation about the lack of quantitative analysis to support the current 30% capital charge or the Investment Analysis Office's ("IAO") proposed sub-categories of NAIC 6 particularly insightful. We agree with the Academy that justification of a CLO residual tranche charge or new sub-categories of NAIC 6 will require substantial analysis.

The Academy report made the point that CLOs do not present a danger to the solvency of the insurance industry. In fact, the NAIC Capital Markets Bureau's special report, released on January 5, 2023, states: "Based on the NAIC's stress test results, U.S. insurer investments in CLOs remain an insignificant risk." Based on the work of the Academy and the NAIC Capital Markets Bureau, NAIC has ample time to conduct the necessary quantitative analysis to develop a solution that can be supported with data, is properly field tested, and would result in a capital charge that is based on sufficient analysis and due diligence so that it is not misleading to the public or other users of a company's financial information. An interim solution not grounded in quantitative analysis is unnecessary and potentially harmful because a temporary increase in the capital charge that is unrelated to the actual risk of the investment, and which may ultimately be reversed, could be difficult for a company to manage and for stakeholders to

understand. As we stated above, a more appropriate course of action would be to add sensitivity analysis information to the 2023 RBC submission designed to target the risks and populations important to regulators. This approach would have the added benefit of time to incorporate impact analysis required by the Capital Adequacy Task Force for any RBC factor changes. Industry partners would be willing to assist in the development of the information regulators are targeting, such as the impact of increased factors applied to CLO residual tranches.

We also note that given changes in blanks guidance for YE 2022 requiring residual tranches to be moved to schedule BA, regulators and other key stakeholders will have more transparency into the holdings related to this asset class.

Second, we strongly object to the proposal from VOSTF to use three new sub-categories of NAIC 6 as the interim solution for residual tranches of any structured finance security for the reasons stated above. To our knowledge, no proposed framework for sorting investments into these sub-categories currently exists, and no rationale has been offered as to why these respective proposed capital charges are appropriate, adding confusion to the implementation of this proposed treatment. Further detail as to the rationale behind the charges and clarity as to what would be required to differentiate the 3 sub-categories would be needed before they could be implemented by the industry. Without quantitative analysis and field testing, we risk misleading the public, policyholders, regulators, and other users of the financial statements as to the risk inherent in these structures. Additionally, if the charges are driven by inherent risk specific to CLO residuals rather than all structured finance residuals (which is not entirely clear based on the release), time should be taken to understand the differences in those structures and the potential that the “regulatory capital arbitrage” normalization might not be easily calculated.

Furthermore, we agree with the observation in the Academy report that CLO structures can transform the risk such that vertical ownership versus ownership of the underlying loans can have different RBC values. Factors such as active trading of loans, excess spread being used to cover principal losses and strict reinvestment criteria that ensures diversity, and reduced concentration risk can alter CLO risks as compared to underlying loans. We think it is appropriate to stress structured securities in an analytical way which includes both a fundamental analysis of the underlying asset risk as well as the way the structure will absorb those losses. As the Academy suggests, analyzing the tail risk embedded in any structure ensures that the structures themselves can absorb (or not) the losses that may occur under different scenarios. Ignoring the structural protections in a transaction is not a transparent method to stress these assets

Finally, we note that the IAO proposal states that the proposed interim solution is intended to be applied to all structured securities, but only CLOs have been the focus of recent discussions. Any interim rule must clearly state with specificity which securities are covered. If the scope includes other types of investments, then we believe a cohesive plan, including a similar analytical approach should be employed with respect to those other investments consistent with the work done on RMBS, CMBS and CLOs and must be exposed. If, against the best advice of this industry group, an interim solution is adopted, we request a concrete, definitive timeframe

for the interim solution so that industry has time to plan and ensure that a robust and transparent process is achieved.

We appreciate that the Working Group is focused on these issues with the goal of ensuring that RBC is appropriate for the risk that insurance companies are taking. We look forward to engaging with the Working Group in a transparent process to develop a new framework for residual tranches that incorporates appropriate quantitative analytics based on their historical performance of defaults and losses and aligns with other asset classes ensuring "equal capital for equal risk."

Athene
Clear Spring Life and Annuity Company
Delaware Life Insurance Company
Everlake Life Insurance Company
F&G Annuities and Life
Global Atlantic Financial Group
Nassau Financial Group
Security Benefit Life Insurance Company

cc: Superintendent Elizabeth Dwyer, Chair, Financial Condition (E) Committee

February 3, 2023

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: Referral on the Risk Assessment of Structured Securities - CLOs

Dear Mr. Barlow,

On behalf of the undersigned life insurance companies ("the companies"), we are writing to express our strong support for the steps the NAIC is taking to model collateralized loan obligations (CLO) for risk-based capital (RBC) purposes. The companies are also supportive of the Valuation of Securities Task Force (VOSTF) recommendation that the Risk-Based Capital and Investment Risk and Evaluation (RBC IRE) Working Group develop interim RBC factors for the NAIC 6 designation. Aligning RBC with the underlying investment risk of the residual tranches of structured securities is a critical component of minimizing RBC arbitrage in securitized assets, a regulatory objective that we also support.

Structured securities, including CLOs, are material to insurer solvency. Structured credit has become a core asset strategy in US Life General Accounts, similar in size to Commercial Mortgages. CLOs in particular are a fast-growing asset class that are highly correlated to other credit exposures within insurers' asset management portfolios and have indirect implications for other insurer capital holdings under stress.

Structured securities are important financial products, but they also have unique "cliff risks" not present in most financial assets. While small levels of default will not translate into immediate losses within a transaction's rated tranches, once the first loss protection is depleted small additional collateral losses will result in large losses within those tranches. Residual tranches are the first loss protection layer shielding the rest of the structure but are not themselves protected.

The companies recognize the significant progress made to date by the RBC IRE Working group and VOSTF to develop an appropriate modeling methodology and accompanying RBC framework. As this work progresses, we agree that it is critical for regulators to enact interim RBC factors for the residual tranches while NAIC fulsomely evaluates more permanent changes to its RBC framework for structured securities. The current capital factor of 30% was designed for more traditional equity holdings, not the highly levered residual tranches of structured securities. A practicable interim solution could address the risks of investing in residual tranches while providing regulators with additional information for that long-term solution.

The companies agree with ACLI that there is no need to pursue three new NAIC 6 designation categories (i.e., 6.A, 6.B, and 6.C) in the interim. Instead, the companies recommend use of a single interim RBC factor for structured securities tranches with an NAIC 6 designation. **We support an interim RBC factor for the residual tranches of *at least* 45%, which is the highest current factor for high beta equity holdings.**

There have also been industry discussions about maintaining the current 30% factor and using a higher factor in sensitivity testing to help regulators assess risk. While sensitivity testing or impact analysis can provide regulators with valuable information on materiality and solvency of the residual tranches, sensitivity testing alone will not provide data on what appropriate RBC factors should be nor will it meet the regulators' goals of reducing RBC arbitrage while more refined charges are developed. As such, should the regulators decide to employ sensitivity testing, the companies believe a higher factor for residual traches is also needed.

*****

Thank you in advance for your consideration of our comments. We are committed to working with NAIC and regulators to enact reasonable RBC factors for structured securities that reflect the underlying risk for all tranches. The companies join ACLI in urging the RBC IRE Working Group to transition quickly from the work on the interim solution to the development of permanent RBC factors.

Respectfully Submitted,

Equitable
MetLife
New York Life
Northwestern Mutual
Pacific Life
Prudential Financial, Inc.
Western & Southern

February 6, 2023

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 email: dfleming@naic.org

Re: Residual Tranches - Interim Solution

Dear Mr. Barlow:

We, the undersigned companies, appreciate the opportunity to provide comments on the NAIC's exposure of the Valuation of Securities (E) Task Force (VoSTF) referral to Risk-Based Capital Investment Risk and Evaluation (E) Working Group (RBC IRE) on a proposed "interim solution" for additional RBC factor categories for securitized residuals.

Overall, 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. Some have raised concerns about the potential for capital arbitrage specific to collateralized loan obligations (CLOs). However, we believe this is premature. We are not aware of underlying facts which would call for an immediate modification to Risk-Based Capital (RBC) prior to completing a comprehensive analysis. We believe it would be unwise to set a precedent for disruptive intra-year changes to what is a stable long-term capital framework and ignore what has been a successful data-driven approach historically.

Accordingly, we do not believe the proposed interim factors should be applied to CLO holdings. Instead, an expeditious undertaking of information gathering through disclosures of the Residual Tranche portion of AVR (already in place for YE 2022 reporting) and adding structure to existing sensitivity testing would provide transparency regarding the scope and reach of individual company CLO or other residual tranche holdings. Such a process would avoid unnecessary and potentially uneconomic volatility in company reported financial strength while still addressing the Task Force's concerns in a timely manner.

Recent Independent Experts State an Immediate RBC Correction is Not Needed or Necessarily Appropriate

We support swift information gathering in advance of taking action to modify a company's reported RBC. Our view is based on recent reports from the American Academy of Actuaries (Academy) and the NAIC Capital Markets Bureau, which both state that on an aggregate basis, CLOs do not present a material solvency risk to our industry as noted in:

1) The January 2023, NAIC Capital Markets Bureau Special Report on Collateralized Loan Obligations (NAIC Report) states "Based on the NAIC's stress test results, U.S. insurer investments in CLOs *remain an insignificant risk*." (Emphasis added)
2) The Academy's C1 Work Group's (C1WG) December 14, 2022, presentation to the NAIC's RBC IRE states on Slide 12: "In the C1WG's view, *CLOs do not present a material risk to the aggregate solvency of the life insurance industry currently*." (Emphasis added)

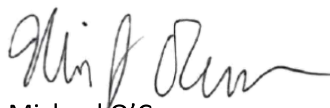
3) Slide 21 of the C1WG's presentation states: "While a CLO's total collateral and a vertical slice of its tranches have the same *risk* at a point in time, it does not follow that they must have the same total C-1 requirement." Noting in support of this statement:
    a. Each of corporate bonds, bank loans, and CLOs have unique structures and risk profiles.
    b. C-1 corporate bond factors are not appropriate for bank loans or for CLOs due to different assumptions and models (e.g., secured vs. unsecured, time horizon, etc.)
    c. It would not be appropriate to force equivalence using the current C-1 corporate bond factors.

Sensitivity Testing is More Appropriate than Applying an Interim Capital Charge to Residual Tranche Holdings
Following other recent examples of a non-urgent nature (such as RBC sensitivity tests or Group Capital Calculation calibration), we propose the sensitivity testing section of the Life RBC Exhibits (Pages LR038 and LR039) as the interim solution. Doing so, the NAIC could apply one or more sensitivity factors to residual results to get a sense of impact to each company, without modifying the reported result. This alternative interim solution will accomplish multiple goals:
1) It is expedient, without damaging the integrity of a company's RBC calculation.
2) It allows regulators to see the impacts to their respective domestic companies in a "what if" scenario, helping to identify companies with potential material risk from residual tranches of CLOs.
3) It allows the RBC IRE WG time to undertake extensive analysis and testing of CLO experience, without having a hurried approach for YE 2023.
4) It allows regulators and industry to review the sensitivity testing results, to discuss the advantages and disadvantages of alternatives, and to understand the broad, long-term impacts to industry and reinsurance counterparties, and the impact to availability and pricing in the risk transfer marketplace.
5) It does not create the same potential for disruption in the structured securities market.
6) Disclosure, identification of material ownership, and sensitivity testing would dissuade material owners from significantly increasing exposure.

In conclusion, the proposal to collect sensitivity testing data rather than apply an interim RBC charge in 2023 is based on (i) recent independent reports that conclude CLOs do not present material risk to the life insurance industry and (ii) the Academy report which notes forcing the sum of capital charges for all CLO tranches to equal a C-1 bond charge is inappropriate. Moreover, sensitivity testing presents an expeditious information gathering opportunity to allow regulators to target needed adjustments while avoiding a threat of unneeded market disruptions.

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

Sincerely,



Sarah Williams
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February 17, 2023

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

Re: Valuation of Securities (E) Task Force referral and risk-based capital (RBC) structural proposal addressing residual tranches

Dear Mr. Barlow

The Structured Finance Association (SFA) appreciates the opportunity to provide feedback on the referral from the Valuation of Securities (VOS) (E) Task Force (VOS TF) to the Risk Based Capital Investment and Risk Evaluation Working Group (RBCIRE WG) on the proposed interim subcategories within the current NAIC Category 6. Our members expressed an interest in providing feedback to this exposure, especially given the degree of subject matter overlap on related exposure drafts from VOS (E) TF.

The Structured Finance Association's mission is: "*To help its members and public policy markers grow credit availability and the real economy in a responsible manner*." Insurance companies actively participate in the structured finance market including as investors. As such the purpose of imposing a risk-based capital (RBC) requirement as a foundational element to ensuring that insurance companies can fulfill their financial obligations to insurance policyholders is keenly aligned with our mission.

The Structured Finance Association is a consensus-driven trade association with over 370 institutional members representing the entire value chain of the securitization market. By facilitating the responsible issuance and investing of loans and securities, the market provides trillions of dollars of capital to consumers and businesses in communities across the country. SFA members include issuers and investors, broker-dealers, rating agencies, data analytic firms, law firms, servicers, trustees and accounting firms. As such, unlike many trade associations, before we take any advocacy position our governance requires us to achieve consensus by agreement rather than majority vote, ensuing the perspective of all our diverse membership are included. This diversity is our strength, as it builds healthy tension in arriving at our consensus position. Because of this, we are methodical and thoughtful as we analyze the pros and cons of regulatory proposals before we reach a mutually acceptable position.

STRUCTURED FINANCE ASSOCIATION

Given the alignment of SFA mission with the purpose of RBC requirements, our membership quickly built full consensus in support of the RBCIRE WG's goal to eliminate any material RBC arbitrage. Our members also believe that the RBC requirements must account for the unique structures and risk profiles of bank loans versus CLOs. However, our membership is split on the interim process and approach that the RBCIRE WG has recommended to accomplish this goal. As a consequence, in this instance where there is not consensus, we will instead inform RBCIRE WG and other policymakers of the differing views. Additionally, while all members who participate in the CLO market were invited to participate in our consensus building process, below we have only highlighted the differing viewpoints of our insurance company members as they are the economic stakeholders most directly impacted by the proposed RBC levels.

Below our feedback focuses on two areas: (1) The proposed interim RBC capital levels of 30%, 75%, and 100%, and (2) The potential application of the proposed interims RBC levels.

1. ***Proposed Interim Capital Levels of 30%, 75%, and 100%***

In seeking to achieve consensus amongst our members, approximately 70% of the insurance companies believed that more work is needed prior to instituting any changes to NAIC Category 6 RBC levels even if only proposed to be interim given the lack of direct supporting analysis behind the RBC levels of 30%, 75%, and 100% within NAIC Category 6. As noted in the American Academy of Actuaries presentation, those levels are not supported by data related to the performance of the CLO tranches which would justify the creation of such levels. Given that, these insurance company members believe that the proposed interim levels should not be adopted until RBCIRE WG has performed an analysis to justify any new interim or permanent RBC levels.

On the other hand, approximately 30% of our insurance company members believe that it would be appropriate for RBCIRE WG to proceed with the proposed changes to NAIC Category Six and implement interim subcategories of 30%, 75%, and 100%. They noted that the current level of 30% is equally unsupported by any analysis and believe that the interim categories more closely reflect the relevant risk of residual tranches in NAIC Category 6. Importantly, they note that these interim factors, when used under the SVO's proposed modeling of CLOs for NAIC designation determination, will provide RBC alternatives for the SVO to select from based on which one better aligns with the actual modeling results. This process of modeling itself, these insurers argue, will provide the necessary analysis to ensure the appropriateness of whichever of the 3 interim designations is selected for a particular modeled residual tranche.

2. ***Clarification on Applicability of Category 6 Subcategories***

Nonetheless, regardless of the their viewpoint on the adoption of the proposed interim subcategories within NAIC Category 6, SFA members collectively share a call for the RBCIRE WG to clarify whether such interim RBC charges would apply only to CLOs or apply more broadly to residuals across all asset classes. The VOS (E) TF referral referenced CLOs, and

presumably forms the basis for the newly proposed interim levels. However, our members expressed that it was not clear whether VOS (E) intended the referral to apply only to CLOs, or whether—if such levels were to be adopted—RBCIRE WG would intend that they apply to residuals across other structured finance asset classes as well. We therefore urge RBCIRE WG to clarify whether any changes to subcategories within NAIC Category 6 apply narrowly (i.e., only to CLOs) or broadly (i.e., across all structured securities).

Once again, we thank you for the opportunity to share our members views on these points and look forward to continuing engaging with you on these topics. If you have any questions, please do not hesitate to contact SFA staff.

Regards,

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Kristi Leo
President, Structured Finance Association