July 25, 2023

The Honorable Rep. Warren Davidson
Member of Congress
2113 Rayburn House Office Building
Washington, DC 20515-3508

The Honorable Rep. Andy Barr
Member of Congress
2430 Rayburn House Office Building
Washington, DC 20515-1706

The Honorable Rep. Bill Posey
Member of Congress
2150 Rayburn House Office Building
Washington, DC 20515-0908

The Honorable Rep. Blaine Luetkemeyer
Member of Congress
2230 Rayburn House Office Building
Washington, DC 20515-2503

The Honorable Rep. Scott Fitzgerald
Member of Congress
1507 Longworth House Office Building
Washington, DC 20515-4905

The Honorable Rep. Andrew Garbarino
Member of Congress
2344 Rayburn House Office Building
Washington, DC 20515-3202

The Honorable Rep. Mike Flood
Member of Congress
343 Cannon House Office Building
Washington, DC 20515-2701

The Honorable Rep. Mike Lawler
Member of Congress
1013 Longworth House Office Building
Washington, DC 20515-3217

Dear Chairman Davidson and Representatives Barr, Posey, Luetkemeyer, Fitzgerald, Garbarino, Flood, and Lawler:

We appreciate the opportunity to clarify any confusion and address any concerns you have with the National Association of Insurance Commissioners' (NAIC)[1], ongoing efforts to improve state insurance regulation. We also appreciate your continued support for our national system of state-based regulation, which over the past 150 plus years has worked to ensure the solvency of the largest and most competitive insurance market in the world.

Before addressing the specifics of your inquiry, we want to provide some background on our regulatory approach to insurer investments and capital as well as changes that we are observing in insurer investment behavior, which helps put our current work in context. Insurers have invested more than $8 trillion in our economy and use those investments to support their obligations to

[1] As part of our state-based system of insurance regulation in the United States, the NAIC provides expertise, data, and analysis for insurance commissioners to effectively regulate the industry and protect consumers. The U.S. standard-setting organization is governed by the chief insurance regulators from the 50 states, the District of Columbia and five U.S. territories. Through the NAIC, state insurance regulators establish standards and best practices, conduct peer reviews, and coordinate regulatory oversight. NAIC staff supports these efforts and represents the collective views of state regulators domestically and internationally. For more information, visit www.naic.org.

policyholders. The amount of risk-based capital they are required to hold, which directly impacts on their ability to pay claims, is linked to the risk of those investments. All insurer investments are given a "NAIC designation," which corresponds with a prescribed capital factor. If an investment is rated by one or more of the Nationally Recognized Statistical Ratings Organizations (NRSROs)—and roughly 80% of all insurer investments are rated—the NAIC designation is mapped directly to that rating with no further analysis or oversight by state regulators or the NAIC. These are called "filing exempt" or FE securities, in that they do not have to be filed with the NAIC's Securities Valuation Office (SVO) for review.

However, if an insurer chooses to invest in an unrated investment, the SVO provides centralized credit analysis for that security and produces the corresponding NAIC designation. This allows insurers the flexibility to go beyond traditional rated securities, while ensuring that the state regulatory system has confidence in the credit quality of those investments. Due to the vast scope of insurer investments, reliance on NRSROs provides an efficiency that we have no intention of displacing or competing with; however, because our risk-based capital system is linked directly to investment strength, this deference to NRSROs' opinions is not unconditional. It is also worth noting that the work the SVO performs on behalf of the states is for regulatory purposes only and is not released publicly or used to compete with NRSROs.

Insurers, and particularly life insurers, have long been relatively conservative, long-term investors to match the nature and duration of their long-term liabilities. However, a decade of historically low interest rates led to low yields on the traditional treasuries, municipal bonds, and high-quality corporate bonds the industry favored. This in turn compelled many insurers to seek higher yielding, but often more complex, less-liquid, and potentially riskier asset-backed securities, private placements, or other bespoke investments, which require consideration of whether a higher Risk-Based Capital (RBC) charge is appropriate due to increased risk.

In recent years, state regulators have noticed growing discrepancies between the ratings provided by competing NRSROs for the same security—in some cases, five or more notches difference in the ratings. Keeping in mind that the better the rating, the less capital an insurer is required to hold, the potential for "rating shopping" is a real concern and one with historical precedent. Indeed, because of such discrepancies for residential and commercial mortgage-backed securities, revealed during the Great Financial Crisis, we developed a separate credit analysis process for those securities that continues to this day.

In response to growing regulatory concerns with the financial engineering seen in bespoke investments today, the insurance commissioner members of the NAIC's Financial Condition (E) Committee's adopted a charge to:

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> *Establish criteria to permit staff's discretion over the assignment of NAIC designations for securities subject to the FE process (the use of CRP ratings to determine an NAIC designation) to ensure greater consistency, uniformity, and appropriateness to achieve the NAIC's financial solvency objectives*.

In response to this direction from insurance commissioners on the Financial Condition (E) Committee, the NAIC Valuation of Securities Task Force (the "Task Force"), comprised of state insurance regulators, is now proposing to establish a process by which the SVO would be authorized to challenge the credit rating for a filing exempt security when certain conditions are met. The process, as it was exposed for public comment, would include the following steps:

- Establishment of a materiality threshold required to flag a CRP rating. To limit the SVO's use of this process to only that which would be considered truly material differences of opinion, the SVO would only be able to put a security or CRP rating on notice if it determines, based on the information at hand, that the CRP rating used in the FE process is three or more notches different than the SVO's assessment.
- A means to electronically identify to insurers an FE Designation of concern.
- Sufficient notice to allow an insurer to appeal/provide additional information before any action is taken. Insurers would have up to 120-days to appeal the SVO's assessment by introducing additional information and data, as necessary. This 120-day appeal period is similar to the existing appeal period for SVO assigned NAIC Designations.
- A formal review process by the SVO, with an opportunity for applicable insurance regulator(s) to consult on the deliberation, if they request.

These procedural steps ensure insurers are given due process: ample notification, an opportunity to appeal the SVO's initial assessment, an opportunity to get an alternate CRP rating, and sufficient time to file the security, if needed.

At the request of the Task Force Chair, the SVO would provide a report to a regulator-only meeting of the Task Force summarizing the eligible NAIC CRP credit ratings and securities removed from Filing Exemption Eligibility over the prior calendar year and the reason for the removal.

This proposal, as with all NAIC policy proposals, is subject to a transparent and deliberative public comment process that gathers and considers feedback from all interested parties. Interested parties have shared recommendations during the comment period that will be considered and incorporated if deemed appropriate by the Task Force.

We believe the proposal, when adopted by our membership, is an appropriate approach to ensure that insurers are holding sufficient capital based on the risk they are taking with their investments and ultimately will leave policyholders better protected. We do not anticipate any competitive imbalance for NRSROs because our work is for regulatory purposes, to arrive at appropriate capital charges, and will not be released publicly or to the broader capital markets. The materiality thresholds we have put in place ensure that challenging a CRP will only commence when a significant red flag occurs, and even then, the notice and appeal process ensures fair treatment for all parties.

While we have no intention of challenging the NRSRO's methodologies or opinions or disrupting the important role they play in our public markets, we are also under no obligation to defer to them without judgment or exception as the de facto driver of our risk-based capital framework. Past financial crises and recent banking turmoil illustrate the importance of regulators ensuring that financial institutions' investments are suited to their customers' obligations, and accurately reflect the risks they choose to take.

We thank you for your interest in our work and your continued support for state-based regulation, and we are happy to provide more detailed briefings to you or any members of your staff on this important work.

Sincerely,

Chlora Lindley-Myers
NAIC President
Director
Missouri Department of Commerce and Insurance

Andrew N. Mais (He/Him/His)
NAIC President-Elect
Commissioner
Connecticut Insurance Department

Jon Godfread
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NAIC Secretary-Treasurer
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