MEMORANDUM

To: Interested Parties of the Financial Condition (E) Committee

From: Commissioner Nathan Houdek (WI), Chair of the Financial Condition (E) Committee

DATE: August 2, 2024

RE: Response to Written Comments on Holistic Framework on Insurers Investments & Workplan

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On February 15, 2024, the Financial Condition (E) Committee exposed a revised draft of its proposed *Framework for Regulation of Insurer Investments – A Holistic Review,* along with a proposed Workplan and regulators responses to the previous comments submitted by interested parties. The following sets forth regulators responses to comments received on the February 15 exposure which were submitted April 8.

General Comments-Comments Not in Response to a Specific Recommendation in the Framework

Commentor	**Comments**
The Lease-Backed Securities WG	The Lease-Backed Securities Working Group, is fully in support of the NAIC engaging an outside consultant to design and help implement a new process under which the NAIC develops a strong due diligence program over the ongoing use of credit rating providers (CRPs) in accordance with the principals laid out in the E Committee Framework -- a Holistic Approach. Over the past few years, we have followed the many discussions regarding the NAIC's desire to improve their oversight and monitoring of CRP ratings, with a particular focus on the ratings of private placement securities. Much of the discussion has been based on repeated suggestions from the SVO that there is a quality difference between the ratings of public and private placement securities (or between the larger agencies that typically rate the large public transaction and the smaller ratings providers who frequently rate private placements) and that because "private" securities do not have the same "market validation and transparency" of publicly-rated securities, there are potential hidden risks in the "private" market.
Regulators Response: The observation that private ratings may need to have special considerations is related to the lack of transparency of those ratings to the broader market, as well as the common approach of a single rating. Regulators do not assert a performance difference between private and public investments, but rather recognize we may not be able to rely on customary mechanisms such as comparability and market validation in any assessment of performance.	
ACLI	The American Council of Life Insurers (ACLI) appreciates the exposure of holistic investment framework documents and we applaud the work that you and your fellow members and staff have put into this project to date. In particular, the Memo to Interested Parties (Memo) was especially useful in understanding the thought process that went into making the workplan and framework updates, and as one of our members noted, the

	transparency included in that document is exemplary. Overall, ACLI supports the concept of a holistic approach to regulating insurer investments and we continue to do so. As the committee works on items related to action items four and five, we appreciate the regulators already transparent process, and look forward to participating in the process further regarding the conceptual centralized investment support and an investment focused work group. When reviewing the changes to the framework document, our members generally thought the updates were thoughtful and appropriate. We appreciated the clarification that the purpose of the framework is for regulators to best achieve their duties to oversee the insurance industry they regulate. Additionally, we agree and understand that the broad goal of regulators is to ensure company solvency as a part of consumer protection. We also understand that other impacts of the regulatory requirements, such as impacts to the market, are secondary to consumer protection. To be clear, we positively viewed the framework as an indication that there are other impacts to consider if regulatory requirements change and the NAIC was to take a broader view than just solvency. We further appreciate the call out to coordination and believe that coordination and transparency will be key.
Regulators Response: Comments in support	
American Investment Council	As noted in our October 9, 2023 comment letter, AIC members believe the Investment Framework and E Committee's receptiveness to meeting with stakeholders on the Investment Framework represents a positive development in the NAIC's ongoing efforts to modernize the regulation and supervision of insurer investments. There is a clear need for a holistic, top-down approach to evaluating regulators' concerns with the existing regulatory framework and coordinating any resulting workstreams. Given the precedential value and knock-on effects, it is critical that any potential changes to the US regulatory framework for insurer investments be carefully considered and implemented through an open and deliberative process. Such initiatives should include processes to identify state insurance regulators' specific concerns and assess whether those concerns are valid. In this regard, we were happy to hear the NAIC's recent announcement that it will delay implementation of its collateralized loan obligation ("CLO") modeling initiative until year-end 2025 to allow time for the American Academy of Actuaries ("Academy") to complete its foundational work on a new RBC framework for all asset-backed securities (including the Academy's assessment of whether individual CLO modeling is necessary or appropriate). We are similarly hopeful that E Committee's work to develop a due diligence framework for credit rating providers ("CRP") and address the NAIC's concerns with respect to "blind reliance" on CRPs will include methodical discussions related to the specific concerns that state insurance regulators have with respect to the current regime and an evaluation of all potential paths forward.
Regulators Response: Comments in support	
Met Life	First, and as expressed in our oral remarks during the March 18 meeting, MetLife wishes to express our gratitude to the Committee for conducting this process with exemplary transparency. We are confident that such an approach can only lead to more robust outcomes for our industry. We also want to reiterate our full support for the Committee's resolve to continue with all its current initiatives without pause or delay. Risks continue to

	build in industry investment portfolios, and stakeholders in the media and fellow regulatory bodies have taken note. We are confident that your continued resolute action in this area will exemplify the NAIC's active leadership in insurance standard setting and address any stakeholder concerns.
Athene	We continue to strongly support the Framework's aims of modernizing investment risk oversight and creating a consistent approach in calculating C1 capital across a diverse set of asset classes and structures. Insurer solvency is paramount, and we believe that a principles-based, RBC framework that is built on consistency and data-driven analysis will promote insurer solvency, while also providing stability to insurers' investment activities and fostering a vibrant life insurance market that meets the needs of US consumers.
Regulators Response: Comments in support	

<u>**Section I-Proposed Framework to Modernize the SVO**</u>

#1-Reduce/Eliminate "Blind" Reliance on CRPs but Retain Overall Utilization of CRPs with Due Diligence Framework (utilize an external consultant/resource to design and implement)

Commentor	Comments
Anderson Insights	**Assessing CRPs** A question posed by the Committee is what "analytical or performance criteria" can be used to produce "meaningful and consistent" measures of the nine CRPs for the many sectors and types of assets for which they produce credit ratings. A secondary question is how ratings of various asset types map across the different CRPs. Given the hundreds of thousands of debt instruments that insurers invest in it would take a very large number of analyses of individual securities to come up with reliable and demonstrable patterns of acceptable -- or unacceptable -- performance of each CRP for every asset type. Case-by-case determinations could be attempted. CRPs could be evaluated by comparing the ratings of one CRP against those of another. This is difficult given the fact that ratings are costly so many issues do not carry multiple ratings. Even so there is then the task of determining which opinions of the future will turn out to be "right". Another way would be for the NAIC itself to derive its own opinion of the likelihood of the realization of promised payments in the future and compare that to the opinion of the CRP. This is certainly being considered by the Valuation of Securities Task Force for specific instances. Given the hundreds of thousands of individual securities owned by insurers it would be quite difficult to analyze enough securities in order to develop patterns and actionable conclusions. Even then, these would simply be "opinions that are inherently subjective." **The Analytical Way to Evaluate Performance** The examination of the actual track records of the CRPs is probably the best way to measure the accuracy of their ratings. It is much easier to develop robust evaluations by comparing past projections to actual experience than to compare one projection against another. It would be logical and most productive for the RFP being develop by the Committee, then, to focus on the ability of consultants to use performance data to determine which opinions for which CRPs for which sectors have been more or less reliable. **The SEC mandates the annual publication of detailed performance data for all of the rating agencies it regulates. This, and perhaps the NAIC's own extensive historic data, could be helpful. For even more revealing results, however, the consultant would need to have access and the technical ability to combine and mine multiple databases. This could even include data as detailed as the characteristics of many individual**

securities. Such analyses would not only provide hard data concerning historic performance of each CRP by asset sector but it would also facilitate the mapping of ratings. If ratings can be categorized by security type then the performance of like security types can be compared from one CRP to others which would provide a reasonable basis for comparing ratings. Initially such a system could assess and map CRP ratings, but ideally the consultant would build a system that the NAIC itself could use to provide regular updates even though this may pose certain challenges. Other Tools for Evaluating CRPs -- And the SVO Itself Quantitative analyses may be the best and most efficient way to identify potential issues with CRPs but the NAIC and its consultants should also be aware of and utilize many of the other elements that the SEC has required for many years to allow the public to make its own determinations of the amount of reliance they decide to place on the rating agencies.

These include:

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

Even as the NAIC uses these tools and others "to eliminate blind reliance on CRPs" it can use similar tools to evaluate the most important credit rating provider of all -- the Securities Valuation Office. An essential function of regulators is to conduct independent examinations of insurers. Departments of insurance themselves are examined every five years by the NAIC so all accredited members can have confidence that others are meeting the high standards of the NAIC. Of course the SEC conducts its own detailed annual examinations of all NRSROs and the financial statements of all public companies are audited. In this context it would be extraordinary for the NAIC not to commission periodic independent examinations of the SVO to provide the substantiation for its reliance on this key resource. Disclosures that are similar to some of those provided by all of the CRPs recognized by the NAIC could be required by the SVO itself. The SVO presently prepares none of the disclosures listed above. The most revealing would be "performance measurement statistics consisting of transition and default rates for each class"[1] prepared by all of the NRSROs. Instead the SVO releases a two or three page "Annual Report from the SVO on Year-End Carry-Over Filings." This may be useful to EX-1 for budgeting and planning purposes but it provides no indication or insights into the actual quality of the work done by the office; just its volume. **An independent review of carefully sampled credit files would also provide a basis for justifying the substantial reliance the NAIC and**

	departments of insurance place on the SVO. In addition to conducting an independent review of the SVO there is a need on an ongoing bases for greater clarity concerning how regulators themselves can assess the quality of the analytical work of the SVO. As a part of the current review consideration should be given to explicitly charging an entity composed of regulators with oversight responsibilities. Of course the SVO staff has its own technical abilities and is a trusted advisor to regulators serving within the NAIC but it should be clear that in all instances it is the regulators themselves, considering this advice, who have the ultimate decision-making authority in all instances. In other words there should be no ambiguity as to whether staff is required to follow the directions of regulators. **To put this into effect the group responsible for SVO performance would need to have procedures in place to fulfil its responsibilities, perhaps relying to some degree on the types of reports recommended above. An outside consultant could assist in developing appropriate continuing procedures.** The group would also need to have clear authority over SVO management in analytic, but not necessarily administrative, matters. This would mean that a presumably small group of regulators would have visibility and input into the formal performance assessments of at least the top two levels of SVO management. Presently the VOS/TF sets forth requirements of the SVO in the Purposes and Procedures Manual but it has no explicit power to motivate or assess actual performance of the leadership of the SVO. This could be addressed effectively as a part of the current review process and would enhance effectiveness. **“Different Standards for Public Versus Private Ratings”** It seems to be widely assumed within the NAIC that private placements deserve special attention. It is said that they lack “the market validation and transparency of public ratings” and that insurers may “rating shop.” In the interest of “making the most effective use of regulatory resources,” both of these assumptions deserve examination either prior to or during a consulting engagement. Any consultant or advisor to the NAIC on this matter should have real world experience and actual market knowledge. The assumption that publics have greater “market validation” and “transparency” is suspect. The fact is that public bond offerings may have advance “road shows” to acquaint investors with an issuer in general terms and there are some “investor days” and earnings calls. Even so, the information available to the general market pales in comparison to what is available to the offerees of private placements. For publics it is not unusual to have extremely limited time to review actual offering documents before being expected to enter orders. Investors entering large orders quickly after announcements are favored in their allocations so often they must act very rapidly in order to receive preferential allocations of the bonds they seek. The contrast with privates is stark. Investors have access to a depth of information inaccessible in public transactions. They, their attorneys and credit experts review offering terms and documents in detail. They can and do demand access, detail and concessions to meet their needs. All of this is overseen by senior management and credit committees. Of course it is true that “the market” sees publics, but that is superficial compared to what is the actual practice for privates and there is no “take it or leave it” for privates either. **As to the contention that insurers “ratings shop” for privates it is important to note that the decision to retain one rating agency or another is a matter for the issuer**, working with the dealer for privates exactly as it is for publics. The SEC has identical requirements for the two types of issues and in any event the selection of a rating agency by the issuer

	is done for many reasons. Obviously the rating agency must have appropriate methodologies and a staff trained in the asset type. A rating agency may be sidelined because it has a backlog that would delay the rating or its prices may be uncompetitive for various reasons. An often-overlooked fact is that rating agencies add another set of eyes in the investment process. Their observations during the rating process can be invaluable even for insurers that have their own large and experienced investment staffs. The market perception that one rating offers more expertise and valuable insights is another reason a rating agency might be preferred. In short, the idea that there is "rating shopping" rather than "shopping for rating agencies" is no different for publics and privates. It is important to remember that the central objective of this draft framework is to determine what ratings can and cannot be relied upon. Ratings that are not up to standard or are unreliable should be weeded out for publics and privates alike as the work of the Committee reaches fruition. There is also substantial evidence that there are significant performance differences between publics and privates. It has been well established that privates actually perform better, not worse, than publics and have for a very long time. This is substantiated by work of the Society of Actuaries and academic researchers. These facts, too, should be considered when allocating scarce resources so as not to allocate a disproportionate amount of effort where it is not warranted. Another concern may be that within assets structured as bonds there could be provisions that regulators believe may not actually require issuers to make payments ("risk of non-payment for reasons other than credit"). Addressing this concern was the specific objective of SAPWG's bond project. On 1/1/2025 insurers themselves will be explicitly responsible for properly classifying assets that do not conform to the SSAPs. Consider how much easier this will be for insurers to make these important decisions when they have had in-depth access to the exact terms and provisions of a private placement. They will be much better informed and positioned to fulfill their obligations. Private placements are already being subjected to special scrutiny. Each year insurers are required to submit detailed and lengthy rating agency "rating rationales" for many thousands of privates for review by the SVO. Given that the SVO only provides Designations for less than 4,000 new filings a year3 it is reasonable to ask if adding many thousands more is an effective use of resources. Justification for all of this might become clear if the SVO can demonstrate that its analysis of all of this material has produced actionable results. If not, then sampling or elimination of this requirement should be considered. This is especially true in light of the fact that NRSROs are accountable for producing all of their rationales to exactly the same standards for both publics and privates. In summary, the reasons given that privates may deserve special attention may not survive scrutiny by those familiar with actual market practices. Careful consideration should be given to what degree of resources should be devoted to private placements.
Regulators Response: First major comment; the RFP will consider utilizing processes and data as already exist (e.g. the SEC) as well as how to better utilize data held by the NAIC itself via normal course filings. The potential to use data mining procedures should be a consideration as well and will be incorporated into the RFP. Second major comment; the NAIC Financial Condition (E) Committee will discuss and determine whether it wants to recommend to the Executive (EX) Committee that the NAIC commit to an annual examination, and possible public publication, from an independent party on SVO experience on its own designations. The RFP will	

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<tr><td colspan="2">incorporate this component as well, seeking recommendations on how to best implement this oversight process of the SVO.

Third major comment; the comment suggests that a Due Diligence Framework should consider the issuer of the bond, not the investor, who selects the rating agency. Regulators recognize this structure; however, there are an increasing number of insurers who structure and purchase investments through affiliates in a coordinated process.

Fourth major comment; regulators agree regarding the qualifications of the desired consultant</td></tr>
<tr><td>Lease-Backed Securities WG</td><td>The Committee suggests that “the process may want to consider different standards for public versus private ratings, given the market validation and transparency of public ratings…..”

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

Lastly, in response to the comment in the memorandum regarding “ratings-shopping” by investors (e.g. obtaining the highest public or private rating by selecting the weakest methodology), it is worth pointing out to regulators that it is the issuer of the bond, not the investor, who selects the rating agency or agencies for the issue. Many factors may influence that decision by the issuer: pricing is certainly one factor, but so is timing, relative expertise with the product type, appropriate methodology, etc., etc. But perhaps the most important factor, for both public and private issues, is the credibility or ‘market acceptance’ of the ratings provider. This credibility is essential to ensure that the issuer can successfully place the bonds. And as we indicated above, it is really y in the public markets, not the private markets, that investors are forced to “buy” a rating.

Finally, it goes without saying that the firm engaged through the RFP process should be somebody not only familiar with the NAIC organizational structure and current principles and practices, but also with a broad exposure to, and knowledge of, capital markets: Assessing the impact of any changes made to current practices on insurers’ ability to successfully access capital markets - - both in terms of availability and pricing of investments -- will be a key part of any recommendations coming out of this study.</td></tr>
<tr><td colspan="2">Regulators Response: The observation that private ratings may need to have special considerations is related to the lack of transparency of those ratings to the broader market, as well as the common approach of a single rating. Regulators do not assert a performance difference between private and public investments, but rather recognize we may not be able to rely on customary mechanisms such as comparability and market validation in any assessment of performance.

Second major comment; the comment suggests that a Due Diligence Framework should consider the issuer of the bond, not the investor, who selects the rating agency. Regulators recognize this structure; however, there are an increasing number of insurers who structure and purchase investments through affiliates in a coordinated process. Third comment; regulators agree regarding the qualifications of the desired consultant.</td></tr>
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Bridgeway Analytics	**Addressing regulators' concerns over the "blind" reliance on agency ratings** Between the ongoing Valuation of Securities (E) Task Force workstream to design a process that would extend NAIC staff discretion over agency ranting-based Designations and the posted petition for the development of a request for proposal (RFP) to engage a consultant who would help the NAIC develop a due diligence program over the ongoing use of agency ratings (Attachment Eleven), regulators have made clear their determination to address concerns with "blind" reliance on agency ratings. Related to both initiatives, we encourage regulators to consider cost-effective and transparent mechanisms that are attainable relatively easily and quickly, recognizing that, while helpful, they are not a substitute for more comprehensive mechanisms that might involve longer-term efforts. Our reports, Overseeing Designations and the Prudent Use of Agency Ratings and Investment Risk Oversight, articulate a spectrum of mechanisms with varying costs and timelines. Independence, which the Framework references, and precision must be balanced. On one end of the spectrum, systems and models can be developed at the standards set by rating agencies, which is not in the spirit of the Framework's intent, given the costs. On the other end, regulators can place the onus on insurers to defend their use of agency ratings in business applications beyond regulatory compliance, demonstrating their genuine belief that the risk assessment is prudent and accurate, and avoiding flagrant misuse of ratings. This mechanism very much aligns with Principle (6) of the Workplan: *The ultimate responsibility for prudent investment oversight is with the insurers themselves, notwithstanding any of the work done to bolster regulatory resources and oversight over-reliance on credit rating providers (CRPs). This responsibility should not be "outsourced" to CRPs or the regulators.* By requiring insurers to use agency ratings in business applications beyond regulatory compliance and otherwise disclose differences between credit risk measures used in their internal processes and Designations used for regulatory purposes, regulators will be provided transparency on the degree to which Designations are credible.1 Confidentiality considerations might require the data to be reported publicly on an aggregated basis but available to regulators individually. As stated above, while not a substitute for more comprehensive governance mechanisms, disclosure requirements can be implemented relatively quickly since they do not rely on the NAIC to develop new methodologies or onboard new tools or personnel.
Regulators Response: Constructive comments are always encouraged and helpful; these suggestions will be considered in the framing of the RFP and future actions taken by the regulators.	
Structured Finance Association	The SFA's membership represents most, if not all, sectors of the securitization industry that will be impacted by the final RFP. Importantly, any advocacy efforts undertaken by SFA must be based on the consensus of its broad membership. As such, any feedback provided by SFA regarding the RFP will represent a thoughtful compromise position of our industry membership. SFA believes that early engagement in the RFP drafting process between the NAIC and industry would be helpful. The opportunity to receive feedback from our CRP members, which each have unique approaches to the ratings process and bespoke methodologies, would seem especially useful. A collaborative approach should result in a more comprehensive RFP that ultimately generates a more meaningful analysis.

	A. By design, CRPs are large organizations with diverse operations and extensive global relationships. If a consulting firm carries ratings from certain CRPs, or is a subsidiary of a firm that is rated by one or more CRPs, how will the SVO view this in terms of independence. B. Many consulting firms have a global presence, with their mandates cutting across industries. Will consulting firms be required to disclose all direct or indirect mandates at CRPs? If CRP mandates do exist, will information walls within a consulting firm be considered a mitigating factor? C. Will the criteria for determining independence also consider whether a consultant is on a rotational basis for certain mandates at a CRP, such as financial auditing? D. Will individuals at the independent consultant or the NAIC with prior CRP experience be viewed as potentially conflicted or will that be looked upon favorably? E. Which working group or task force within the NAIC will ensure the true independence of the consultant? Will the independent consultant have to attest to their independence prior to receiving a mandate? If the due diligence process will be continuous, will the independent consultant also periodically be evaluated for independence? F. Regardless of the criteria chosen to determine independence, will they be shared with the industry for comment before being made final? Equally as important as establishing independence will be confirming that a consultant has the technical prowess and relevant experience to prepare a due diligence framework for evaluating CRPs. For both criteria, members have questioned which specific benchmarks the SVO will reference to determine whether a consultant is qualified. Given the evolving nature of the structured finance market, our members have inquired if the RFP will require the due diligence framework to have an "initial" phase as well as an "ongoing" phase, the latter being used for a) newly emerging asset classes and b) ongoing reviews of CRP performance. Members have also inquired if the RFP/due diligence framework will make available an appeal process for CRPs that are not deemed to be acceptable for either phase. In designing the due diligence framework, given the acknowledgement by the NAIC that there are potential differences in transparency between public and private ratings, does the NAIC anticipate SFA Response to "Response to Written Comments on Holistic Framework on Insurers Investments" April 5, 2024 Page 4 creating separate processes and standards for evaluating CRPs as it relates to private versus public ratings? Members have also inquired about how the results of the due diligence process will be applied. Does the SVO anticipate mandating the independent consultant to perform a firmwide assessment of each CRP where, after assessment, the ratings from that CRP will or will not be eligible regardless of sector? Or will the due diligence process be performed on an asset-class, sector, or other specified basis, where certain ratings from a specific CRP may be eligible while other ratings from the same CRP may not? If some or all of a CRP's ratings are deemed ineligible, how often will that decision be reevaluated? Members have inquired as to the amount of time the independent consultant will have to respond to the RFP and, once returned, how the work product will be validated and which working group or task force of the NAIC will conduct the review. The current language references the "[Drafting] Committee to consider". Given the decision will impact regulators in all states, will the Drafting Committee elicit input from state regulators as well as other resources (internal or external)? Members have asked for clarification as to

	the expected frequency of CRP reviews to be conducted by the independent consultant. Some questions include: a. Will the due diligence be conducted periodically to capture changes in CRP performance? b. Would the independent consultant develop a framework for periodic monitoring and the objective measures on which it will be based? c. Will such a framework consider new asset classes or material changes in methodologies that may render past performance moot? Regardless, will such work be conducted by independent consultants once the recommendation is implemented, or would that fall on NAIC staff? iv. The third bullet point of Action Item #2 states: "The Committee would expose this communication for industry comment, including encouraging CRPs to comment."

Regulators Response: First major comment supportive of developing an RFP publicly with opportunity to comment, which is what was communicated up to and at the 2024 Spring National Meeting. With respect to each of the comments the following is noted:

A. To be clear, the intent of the RFP is to select a consultant that will assist the NAIC in designing a due diligence framework. The NAIC will develop the RFP through a public process, therefore requesting input from credit rating agencies, members of the industry and other impacted parties. While it's possible the consultant could be a public firm that is rated by one of the agencies, , selection of the consultant will consider this and any mitigating circumstances in the selection process.
B. Consultants will be asked to disclose conflicts of interest and selection of the consultant will consider this and any mitigating circumstances in the selection process. The existence of mandates/relationships will not automatically preclude a consultant from being selected.
C. It's not clear to us how a consultant that is asked to develop a framework that performs financial auditing will represent a conflict, however, the existence of mandates/relationships will not automatically preclude a consultant from being selected
D. Its not clear to us how an independent consultant that is asked to develop a framework with prior CRP experience will represent a conflict, however, the existence of mandates/relationships will not automatically preclude a consultant from being selected
E. Selection of an NAIC consultant will be made by the Executive Committee after receiving a recommendation from NAIC corporate, which includes NAIC employees and a limited number of state insurance regulators from Committee leadership. The recommendation will be made based upon perceived independence given the work of developing a framework and how that may conflict with the duties assigned to the consultant.
F. Criteria will not be shared with the industry unless it's part of the RFP finalized publicly.

Second major comment; note that with respect to initial and ongoing work, the NAIC only anticipates this consultant being utilized to draft an initial Due Diligence process; the regulators themselves will implement the process designed by the consultant.

Third major comment; to reiterate, the RFP will be developed publicly. In addition, at this point the regulators have not determined if the Due Diligence process should be different for public vs private ratings, and while it's possible that it could be different for different asset classes, that is not anticipated at this time. No decisions have been made regarding if some or all of the CRPs ratings are deemed ineligible, however a result such as that would be expected to occur as a result of decisions by the Valuation of Securities Task Force and E Committee based on the implementation of the process, and not the development of the Due Diligence process.

Fourth major comment; as previously noted by the Committee, the RFP will initially be drafted by regulators and the proposal will then proceed through a public process with an opportunity to comment and potential modifications made to the proposed RFP. To clarify, this is to develop a Due Diligence process, which will not involve implementation of the process. **Other comments** a. This has yet to be determined and is dependent upon the Due Diligence process drafted. b. This has yet to be determined and is dependent upon the Due Diligence process drafted. c. This has yet to be determined and is dependent upon the Due Diligence process drafted.

#2-Retain Ability within the SVO to Perform Individualized Credit Assessments and Regulatory Discretion When Needed under Well Documented Parameters (ideally rarely used)

Commentor	Comments
No comments received	

#3-Enhance SVOs Portfolio Risk Analytics Capabilities through tools and personnel which would be company specific and industry wide. Increase staffing to include analysts with investment actuarial and risk management backgrounds.

Commentor	Comments
Bridgeway Analytics	**The buildout of a CIE function** As explained by regulators, the recommendation would invest in risk analytics tools and corresponding personnel, which could perform company-specific, industry-wide, and macroprudential analysis and build a broader and holistic policy advisory function. We view the capabilities of forming independent opinions on risk and policy as critical to the holistic goals of the Framework. The function should consider resources that have a deep understanding of the interconnected elements of statutory accounting and RBC that are often challenged by the nature of needed subject expertise, which is often siloed. Action Item #4 under the Workplan, which addresses this recommendation, lists examples of initial related discussion points. We are encouraged by the initiative and suggest this Action Item also consider lessons learned from how other rulemaking bodies structured their supervisory and policy/regulatory processes, including expensive regulatory initiatives, such as CCAR and Solvency II, that can provide important guidance on governance and the effectiveness of various mechanisms.
Regulators Response: These comments are in support, and include constructive feedback regulators can consider.	
RRC	We believe that while credit risk that is represented in Bond portfolios is material, the regulatory needs there are incremental. Our greater concern lies in credit risk that exists in other parts of the insurance industry's invested assets, and in other aspects of investment risk. We have, at different times, highlighted two specific examples where we see exposure to credit risk outside of Bond holdings. The insurance industry's exposure to Mortgage Loans that are reported on Schedule B has grown significantly in recent years. Most of that growth has been within Life insurance companies, but there has also been material increases in exposure among other insurer types. The type and tenor of Mortgage Loans have also changed. At many

	insurance companies this has expanded to increasing amounts of direct exposure to Residential Mortgage Loans and to Construction Loans. Growth in Commercial Mortgage Loans, which consists primarily of non-amortizing bullet loans, is creating Memo 2 additional risk due to changes in markets in recent years in the Office and Retail sectors. Investments in Collateral Loans that are reported on Schedule BA have increased materially in the industry and represent a significant percentage of assets at some insurance companies. Collateral Loans are treated as fixed income instruments with a fixed income-like Risk-Based Capital factor. But the underlying assets supporting those Collateral Loans and the strategies behind them are varied. Beyond the issue of exposure to credit risk, we are concerned about significant increases in exposure to market volatility and liquidity risk. What tools and support are available to regulators to understand and assess these risks within insurance companies? Whether it is in Bonds reported on Schedule D or in other parts of the investment portfolio, the investment portfolios are more vulnerable to changes in markets and are less liquid than they were a few years ago. The significant increase in interest rates in 2022 that continues today had a substantial negative impact on the fair value of the portfolios. With the relative calm in the markets from 2008 to 2020 that prevailed along with low interest rates, it is possible that insurance company risk management systems are not sufficient to cover this increased level of market volatility. Liquidity policies and liquidity stress testing regimes may not fully take into account fair values that in many cases are significantly below carrying value. Market volatility and liquidity risk are potentially impacted by asset concentrations in illiquid, more complex and less transparent asset classes. The Investment Framework Workplan includes six Action Items as next steps. Based on our comments in this letter, there are two Action Items that we strongly endorse and encourage expedited consideration. Action Item #5 proposes the formation of a new regulatory working group that would also support the Financial Analysis Working Group, the Valuation Analysis Working Group and other working groups. Incorporating the views of regulators that have a firsthand view into actual changes in insurance company portfolios and investment practices, and concerns on how this could impact the ability of those companies to meet policyholder claims would be extremely valuable in the discussion and in the development of regulatory priorities. We encourage the E Committee to move on this Action Item quickly. Action Item #4 proposes the formation of centralized investment expertise with a focus on expertise that may not currently be sufficient within the NAIC. Risk-Focused Analysis and Risk-Focused Examinations encourage regulators to recognize where the risk is and where it is going, not just where it has been. It is important to not just review where past problems or issues were, but to look at prospective risks, i.e., where the next problem or issue may be. We understand that this requires discussion and the engagement of specialized resources that may not currently be available and therefore will take time to develop. We recommend that this effort begin quickly. This should include an agreed upon timeline so that regulators and other stakeholders have a clear view of the goals and progress toward those goals.
Regulators Response: Members agree that the risk analysis capabilities contemplated in the Framework should be broader than just bonds and credit risk. With respect to the Workplan, Members agree that action item #5 is important, but does not plan on forming such a group until the members have greater availability to take on this work (e.g. after this workplan is finalized). Members also agree with respect to action item #4 and the need for that to be forward looking, however, the NAIC will need to hire additional staff to take this on which could take	

some time to put into place considering the NAIC budgeting process and hiring process. The suggestion of a timeline and roadmap is a helpful suggestion in moving forward.

#4-Enhance Structured Asset Modeling Capabilities in line with #3 and in support of CRP due diligence function (inclusive of model governance and validation of key parameters).

Commentor	**Comments**
Athene	The Framework envisions continued utilization of CRPs, together with the development of a strong SVO due diligence function. A strong SVO due diligence function will complement the role of CRPs, by focusing on broader risk analysis and not replicating their capabilities. We believe the SVO's CLO modeling tool is best suited for due diligence, benchmarking, and advisory functions. This avoids inefficiency, leverages market mechanisms, and allows assessing the tool's effectiveness before potentially impacting capital parity by replacing CRPs for CLO designation purposes. We understand the question of the appropriate uses for the SVO's CLO modeling methodology will be addressed at the technical work stream level as the methodology is further developed, and we will continue to provide our input into those discussions.
Regulators Response: Comments supported the Framework proposal to develop a due diligence framework over the use of CRPs. Technical comments regarding the CLO modeling project should be referred to the VOSTF. We appreciate your willingness to do so as noted in your letter.	

#5-Build Out a Broad Policy Advisory Function that can recommend future policy changes. If needed, hire key external consultants to be on retainer. This would be akin to the use of the AAA of similar for RBC and reserving.

Commentor	**Comments**
No comments received	

#6-Establish a Broad Investment Working Group under E Committee that acts in an advisory capacity to various investment items (similar to FAWG/VAWG) including 1) review of bond reporting under new principles-based bond definition 2) challenges to individual designations provided by CRPs; 3) review of work provided by external consultants.

Commentor	Comments
No comments received	

#7-Rename the SVO and VOSTF to better reflect the groups beyond securities valuation (Establish a Broad Investment Working Group under E Committee. Empower SVO to utilize tools and analysis to raise issues to other groups. Reduce the size of VOSTF.

Commentor	**Comments**
No comments received	

<u>Section II-Risk-Based Capital for Investments</u>

1-Changes in RBC factors should consider market impacts and consistency across asset classes. Should be a goal of "Equal Capital for Equal Risk." Care should be taken to consider the impacts of developing RBC factors for CLOs for an asset class while similar asset classes remain the same. Factors to consider may include impacts on asset allocation and financial markets, in balance with the level of urgency of regulatory action.

<table>
<tr><th>Commentor</th><th>Comments</th></tr>
<tr><td>American Investment Council</td><td>Notwithstanding these encouraging developments, we are concerned by – and opposed to – the introduction of the concept of "equal capital for equal tail risk" that was included in the latest iteration of the Investment Framework. While the specific intent of this change is not clear, the potential narrowing of the concept of capital parity is not appropriate. Instead, the language should be revised to reflect that the Investment Framework recognizes that tail risk is an important element of the broader, more appropriate, concept of "equal capital for equal risk," for example that the concept "includes, but is not limited to, tail risk."</td></tr>
<tr><td colspan="2">Regulators Response: Regulators agree that tail risk is a key component to be evaluated in the setting of capital factors, as well as the impact of concentration in particular assets. The intent is for this phrase to be worded as equal capital for equal risk which includes consideration of tail risk.</td></tr>
<tr><td>ACLI</td><td>Clarifying the intent for including "tail" risk under the principle of "equal capital for equal risk". ACLI supports the C-1 bond factors and the appropriate emphasis on tail risk as is captured all throughout the NAIC's capital framework, measured in risk-based capital (RBC). However, the conversation around the holistic framework would suggest E Committee's approach is broader than just a focus on RBC. As a result, clarity on the inclusion of the "tail" concept in the framework would better inform industry understanding and further comments on this point.

Is the goal of this framework to be focused only on capital charges for asset-risk (C-1) or is it meant to be true holistic view including both capital and reserves together when using "equal capital for equal risk" in the framework? For example, ACLI supports the C-1 bond factors and the appropriate emphasis on tail risk as is captured all throughout the NAIC's capital framework measured in risk-based capital. However, it was not clear to us whether the committee was looking at this framework as only addressing capital, or if it was looking at overall solvency that would also include reserves. The change to include "tail" might suggest the former, but clarity on this point will provide a better understanding of the goal of this approach.</td></tr>
<tr><td colspan="2">Regulators Response: Regulators agree that tail risk is a key component to be evaluated in the setting of capital factors, as well as the impact of concentration in particular assets. The intent is for this phrase to be worded as equal capital for equal risk which includes consideration of tail risk.

With respect to equal capital for equal risk, since this refers to capital, we believed it was self-evident that this does not refer to reserving, for which actuaries use various methods of reserving to assure adequacy of reserves. This is not to suggest that other initiatives of the NAIC to address investment related matters are not appropriate, rather that they are not intended to specifically address the Framework, which is guiding in terms of future potential changes, but is not based upon principles that might be more guiding in terms of future aims for investments by insurers and that may impact reserving.</td></tr>
</table>

Met Life	Finally, we want to express our support for the Framework's focus on tail risk as the key equalizer of capital. As the American Academy of Actuaries has noted, the loss behavior of subordinated structured securities in tail scenarios is significantly more adverse than the behavior of corporate credit of the same rating in those scenarios. Subordinated structured securities are behind much of the increase in industry portfolio risks seen in the last few years. Determining the appropriate capital that insurers should hold against these investments by focusing on their tail risks through modeling, when practical, will greatly enhance the current RBC approach and will help the NAIC achieve its stated goal of reducing blind reliance on ratings.
Regulators Response: Comments are in support.	
Athene	As stated in our October 9 letter on the draft Framework, Athene supports the concept of capital parity, or 'Equal Capital for Equal Risk', and the Framework's goal of achieving such capital parity. The revised Framework now refers to 'Equal Capital for Equal Tail Risk' throughout the document, but the E Committee Memo to Interested Parties explains that the "Drafting Group Members are supportive of the view of equal capital for equal risk which includes consideration of tail risk." We agree that tail risk is a critical consideration for RBC but believe the E Committee Framework's original language provided a more appropriate characterization than the draft revised Framework, which could inadvertently narrow the meaning of Equal Capital for Equal Risk. Additionally, at this point there are varying views on the precise definition and scope of 'tail risk' as an NAIC approved terminology within the RBC environment. We believe that the Equal Capital for Equal Risk concept should be explored both in the context of asset capital charges, as well as in broader tail risks captured by RBC, such as reserving for difficult-to-value liabilities (e.g., long-term care) and soft capital benefits achieved through covariance from riskier blocks of business. In our view, it is premature to limit regulatory assessment to only those risks that might be considered 'tail risk', which has not been fully defined. By way of example, RBC C1 bond factors are calibrated to a 96th percentile risk of loss over 10 years using default rate data from 1983-2020 and recovery data from 1987−2019; however, this is not the case for all asset classes. For example, the common stock C1 factor is measured as the 94th percentile worst 2-year loss on the S&P 500 using data between 1960 and 1991, and the commercial mortgage factor is the tail expected loss at the 92nd percentile of modeled loss projected using 10-year periods that begin in each calendar quarter from 1980–2000, and with default algorithms that are based on commercial mortgage loan experience tracked from the 1970s through 2010. One would presume that all of these models are assessing 'tail risk', though we are unaware of an NAIC workstream that has attempted to delineate how each of these meets a common definition of tail risk across asset classes. As noted in the E Committee Memo, "Regulators agree that tail risk is a key component to be evaluated in the setting of capital factors, as well as the impact of concentration in particular assets", and that "comments on tail risk should be directed to the appropriate technical work streams" (emphasis added). Given the foregoing, we recommend the Framework be revised to clarify that the goal remains "Equal Capital for Equal Risk," and that this concept "includes consideration of tail risk" when the term is first referenced. This will allow the NAIC processes to advance to a place where RBC risk tolerances can be better analyzed, including for consistency, and the definition and scope of tail risk can be better defined.
Regulators Response: Regulators agree that tail risk is a key component to be evaluated in the setting of capital factors, as well as the impact of concentration in particular assets. The intent is for this phrase to be worded as **equal capital for equal risk which includes consideration of tail risk.**	

Regulators have not suggested the current RBC framework is inadequate when it comes to matching the principle and does not believe the same methodology is required to be used for the development of all factors, as the degree of data and other circumstances and materiality of the asset class may dictate other methods are satisfactory.	
Structured Finance Association	II. Revision of "Equal Capital for Equal Risk" to "Equal Capital for Equal Tail Risk" With the release of the Memo, the NAIC noted the change in the language regarding future revisions to RBC Risk Factors from "Equal Capital for Equal Risk" to "Equal Capital for Equal Tail Risk". While the NAIC has stated that this change was not meant to be material, and the two terms are used interchangeably within the NAIC, differing opinions exist within our membership as to which term is more appropriate. Some members believe that "Equal Capital for Equal Tail Risk" is consistent with the RBC framework where capital factors should be calculated by evaluating the tail risks specific to the assets in question. Other members have proposed restoring "Equal Capital for Equal Risk" as the operative term, but for its first instance adding an appended clause as follows: "Equal Capital for Equal Risk, noting that the full distribution of risk that includes tail risk should be considered." SFA requests that the definition and its intended use be clarified
Regulators Response: Regulators agree that tail risk is a key component to be evaluated in the setting of capital factors, as well as the impact of concentration in particular assets. The intent is for this phrase to be worded as **equal capital for equal risk which includes consideration of tail risk.**	

2-The RBC-IRE WG should consider and address areas where inconsistencies in treatment across asset classes incentivize a particular legal form. A key example is private credit funds, where underlying assets are fixed income, but regulatory barriers assign an equity factor.

American Investment Council	We will be submitting a separate comment letter to the Risk-Based Capital Investment Risk and Evaluation (E) Working Group ("RBCIRE") regarding the Oliver Wyman study exposure on the performance of asset backed security residual tranche investments and the associated potential increase in capital charge on such assets from 30% to 45%. Having carefully reviewed the Oliver Wyman study, we feel strongly that the study does not support a 45% capital charge on such residual tranches and remain committed to supporting a data driven capital charge that appropriately reflects the risk of these assets. We are also concerned with public statements by state insurance regulators indicating that the imposition of a 45% capital charge on residual tranches is viewed as a template by regulators to justify punitive capital charges for other high-performing assets that are well understood by the capital markets but relatively newer to insurance company balance sheets. This concept is referenced in the Investment Framework Recommendation 9, but we are concerned with the precedential impact of these statements as they seem to suggest that any future interim charge imposed using the residual template would not be supported by data
Regulators Response: Regulators continue to support the idea for a process that would provide new asset classes a temporary factor when materiality, timing and historical data may preclude specific or immediate analysis to immediately develop a capital charge that is more long-term. The process would initially assign different factors for different broad categories of risk. This is in contrast to the current process where the form of the investment directs the reporting which drives the RBC factor. Regulators would also like to clarify that RBC charges are not punitive.	

WORKPLAN

Action Item 1-

ACLI	The workplan document opens with a set of core principles. These principles help us fully understand the E Committee's direction and seem thoughtful and appropriate. We agree that prudent investments need to be managed by the insurers. However, a crucial aspect of this function is understanding the perspective of regulators, which helps shape the insurer's management of its assets. For this reason, transparency with the industry and regulators across all levels will be critical to success. Further, we believe it is necessary to consider not only the 3 agendas of existing workstreams but also any new work that may emerge during the development of the holistic approach. Accordingly, we agree and support Action Item One – updating the framework as needed.
Regulators Response: Comments support action item therefore no further comment.	

Action Item 2-

ACLI	As noted in our previous comments, we continue to support hiring a consultant to provide recommendations for a due diligence framework for credit rating providers (CRPs) -- Action Item Two. We applaud the committee for its work and receiving approval for hiring a consultant and for its focus on transparency during the RFP process. ACLI looks forward to engaging with the committee and the Valuations of Securities Task Force on this work.
Regulators Response: Comments support action item therefore no further comment.	

Action Item 3-

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

Action Item 4-

ACLI	Action Items Four and Five include an assessment of conceptual centralized investment expertise and appointing an investment focused working group to support the

	committee and its groups/task forces. We generally support conducting the assessment and the addition of an investment-focused workgroup.
Regulators Response: Comments support action item therefore no further comment.	

Action Item 5-

ACLI	Action Items Four and Five include an assessment of conceptual centralized investment expertise and appointing an investment focused working group to support the committee and its groups/task forces. We generally support conducting the assessment and the addition of an investment-focused workgroup.
Regulators Response: Comments support action item therefore no further comment.	

Action Item 6-

ACLI	Coordination with investment-related initiatives of the Life Actuarial Task Force (LATF) and other related work. The framework includes references to work being done at LATF as an example, but we are not aware of any additional conversations about what work LATF is doing that would be overseen by this holistic process. Additionally, it is possible – if not likely— there would be new work that is not yet contemplated or not yet begun, that should be included in the holistic approach as well. Clarity on how LATF and other related work will be included in the framework would be helpful. We think that much of the work LATF is currently conducting should be considered a part of the framework and would suggest it be included in the coordination and transparency umbrella that the holistic approach requires. Development of a new document to help identify and strengthen coordination of work being included under the framework. Similar to the 13 macroprudential considerations, such a document would complement the framework and the workplan and help track all the work that is being overseen by the framework. We believe new work should also be included so that all the work, both current and new, being overseen would be tracked and updated. We also suggest that a more defined process for continued coordination and transparency is necessary to foster all parties being on the same page. We are cognizant of not wanting to add layers of bureaucracy or delay to an already public process. As noted above, our recommendation is to create a document to track current work and new work that is included in the scope of the holistic framework. We would suggest the document include 1) the name of the group, 2) the overarching goal of the work, and 3) whether the work would impact any other solvency related item. To be clear, we are not recommending a change to the framework or the workplan but rather the addition of a new document that would continue to be tracked and updated as work proceeds. Such a document seems like a good best practice that could be utilized to support better coordination and will give more visibility into the collective impact of all the work being done in this space. ACLI was present for the recent E Committee meeting in Phoenix and heard comments from the workgroups and task forces chairs. We think that was a good step forward in hearing from those groups. We are wondering if interested parties can comment during that process or if there is a way to introduce some interested party comments into this process? If there is an alternative option for incorporating interested party feedback into this process, we would be happy to engage in further conversation.

Regulators Response: The Drafting Group will develop a matrix of work originated by the Committee directly related to the implementation of the Investment Framework, or originated by subordinate groups of the Committee that help to implement the Investment Framework. Such a matrix will NOT include individual technical matters at Task Force's and Working Groups (e.g. unrelated changes to the SVO Manual, Blanks and Instructions, RBC changes, etc) not directly related to the Framework. Such a list would also include initiatives at the Life Actuarial Task Force directly related to the implementation of the Investment Framework. As such, this matrix will NOT list whether the work would impact any other solvency related item, but rather only other matters included in the matrix directly related to the Framework, otherwise the Matrix would include all activities within the Committee, which would be far too cumbersome for its requested objective.

With respect to coordination, and the reporting by chairs to the Committee at the Spring National Meeting, this is specifically designed to provide the Committee with an update on work related to the Investment Framework, and like other reports, the Committee chair asks for comments from members and interested regulators and interested parties and would suggest comments be made after such reports to the extent they are specific to the role of the committee in coordination, but if they are related to the technical matters being consider by those groups, those comments should be directed to those groups.

INVESTMENT FRAMEWORK
RECOMMENDED WORK PLAN FOR THE FINANCIAL CONDITION (E) COMMITTEE

~~During the 2023 Summer National Meeting, the Financial Condition (E) Committee exposed a draft of its proposed *Framework for Regulation of Insurer Investments – A Holistic Review* (Investment Framework or Framework). On Oct. 25, 2023, the Committee received 17 comment letters on the exposed Framework and, during the 2023 Fall National Meeting, received oral summaries of the written comments. Subsequent to that meeting,~~ In early 2024, the Committee formed a drafting group, which, among other things, developed this work plan to guide the implementation of the Investment Framework.

NOTE: This work plan is intended to be a working document. Additional action plans may be added, and current action plans may evolve as more information becomes available. The drafting group will provide updates to the Committee, including the work plan, on a regular basis.

Core Principles

(1) The goal of the Framework is to set a long-term, strategic direction for investment regulation and ensure current and future initiatives are thoughtfully coordinated and supportive of this holistic direction. It does not have an objective of reaching technical conclusions on ongoing initiatives.
(2) The primary objective of the Framework and all supporting initiatives is to ensure state insurance regulators have appropriate tools to ensure the solvency of insurers. While other impacts will be assessed in the design and implementation of current and future initiatives, they will be secondary to ensuring insurer solvency.
(3) Ongoing work will continue without delay or pause. Current workstreams are directionally consistent with the Framework and produce iterative feedback to inform future progress toward its objectives. As is always the case, workstreams and the Framework are subject to future refinement based on this iterative process of incorporating new information.
(4) Initiatives are, and will continue to be, regulator-driven. Any enhancements to centralized resources are for the benefit of regulators, and regulators will retain the authority over how to use such resources.
(5) This work plan commits to being fully transparent, with multiple checkpoints for deliberation with interested parties.
(6) The ultimate responsibility for prudent investment oversight is with the insurers themselves, notwithstanding any of the work done to bolster regulatory resources and oversight over-reliance on credit rating providers (CRPs). This responsibility should not be "outsourced" to CRPs or the regulators.

Action Item #1

The drafting group will propose updates to the exposed Framework to the Committee as deemed appropriate. The Committee will re-expose the Framework for comment and further discussion at the next NAIC national meeting or an interim or virtual meeting as deemed appropriate. The Committee will engage in public discussion. Avoiding any perception of the drafting group not being all-inclusive is emphasized.

The updates to the Framework may be somewhat minimal at the beginning of the process. The drafting group anticipates the ultimate Framework will be the ongoing foundation of principles for investment oversight and less of an "action plan" as it exists today.

Action Item #2

The Committee received ~~will request~~ approval from the NAIC Executive (EX) Committee at the 2024 Spring National Meeting to develop a request for proposal (RFP) to hire an independent consultant to provide recommendations for a due diligence framework for CRPs.

- ~~If approved, the drafting group will work in concert with~~ T~~t~~he NAIC Securities Valuation Office (SVO) is currently working to create a robust RFP proposal with consultant independence as a priority. Once developed, the drafting group will review the proposed RFP, make modifications deemed appropriate, and invite further changes by the Committee. Once completed, the Committee will expose this communication for industry comment, including encouraging CRPs to comment. We note that the selection of a consultant needs to consider potential conflicts with CRPs or industry.
- The consultant would deliver a comprehensive recommendation/request for the Committee to consider.
- ~~The Committee would expose this communication for industry comment, including encouraging CRPs to comment.~~

Action Item #3

Consistent with the commitment not to pause or delay any of the current workstreams, the Committee will ensure implementation of the Framework in parallel and without interference with the work that the Valuation of Securities (E) Task Force and the Risk-Based Capital Investment Risk and Evaluation (E) Working Group are developing related to the Framework. This work being completed by these groups (workstreams) is directionally consistent with the Framework. Therefore, the Committee will continue to defer to the workstreams as they progress toward and reach outcomes. Further, the workstreams must not slow their progress in waiting for the Framework's finalization. For example, the Valuation of Securities (E) Task Force is deliberating potential changes to regulator discretion over CRP ratings. The Framework's consideration of a due diligence framework over CRPs must not alter or impede any changes being considered or adopted by the Valuation of Securities (E) Task Force to CRP ratings.

Action Item #4

The Committee or the drafting group will begin an assessment of a conceptual centralized investment expertise (CIE). This term purposely differs from references to NAIC investment staff currently used, such as the Investment Analysis Office (IAO), Structured Securities Group (SSG), and SVO. While we expect much overlap between those existing organizations and this conceptual organization, we want to be deliberate when referring to a conceptual outcome.

Following are examples of initial discussion points (regulator- and comment letter-driven, but not exhaustive):

- Conducting a survey of all states, asking what output they would like from a CIE to assist in individual insurer examination/assessment. For instance, how could current portfolio reviews be improved?
- Investment risks that should be incorporated into a CIE. The current SVO is predominantly focused on credit risk in terms of a designation assessment for Schedule D investments.
- The enhancement of macroprudential and prospective risk capabilities.
- The ideal structure of a CIE, focusing on overarching holistic regulatory policy advisory staffing supported by strong capabilities in credit assessment, portfolio/market risk, asset adequacy, and macroprudential risk assessment.
- The enhancement of structured asset modeling capabilities to support due diligence, validation, and stress testing.
- Tools and resources (beyond personnel) that should be considered.
- The establishment of standards for validating tools and processes, including periodic assessments, model governance, etc.

Discussions should include open dialogue with interested parties.

An external consultant resource can be considered to add additional independent expertise.

This will and should be a longer-term initiative to ensure robust dialogue and value-added changes. However, regulators should consider phased implementation to have more timely results and manage costs.

Action Item #5

The drafting group will recommend appointing an investment-focused working group to support the Committee, the Financial Analysis (E) Working Group, the Valuation Analysis (E) Working Group, and other working groups.

- Define potential charges for this working group, which will help identify the appropriate time for formation. For example, charges may include support for initiatives not slated until 2025 or later.

Action Item #6

The drafting group will develop and implement best practices for enhanced coordination between the Committee's workstreams. Such efforts to harmonize efforts may involve regular reporting to the Committee and/or this new investment-focused working group, identification of dependencies and impacts between projects, and fostering improved communication between workstreams. These types of best practices can be informed by the work on the collateralized loan obligation (CLO)-related projects in process within the Valuation of Securities (E) Task Force and Risk-Based Capital Investment Risk and Evaluation (E) Working Group, including current efforts to highlight the coordination between the two during progress updates.

Action Item #7

~~The work plan does not include action items related to risk-based capital (RBC) recommendations at this time, but it will continue to review appropriate incorporation into the final Framework and whether an action item should be included in the work plan in a future iteration.~~ The work plan will continue to review appropriate incorporation of risk-based capital (RBC) recommendations into the final Framework, However, at this time the work plan does not include related action items and will continue to review inclusion in a future iteration.

Framework for Regulation of Insurer Investments – A Holistic Review

Executive Summary

- Recent initiatives to address gaps in the regulatory framework for insurer investments have received much attention by a variety of stakeholders.
- While the broader commentary has included many misconceptions around these initiatives, it has also included constructive feedback with themes and observations that many regulators have shared.
- At the most basic level, the question has arisen – **what is the most effective use of regulatory resources in the modern environment of insurance regulation for investments?**
- The historical focus of the SVO has been on risk assessment of individual securities, with filing exempt securities blindly reliant on credit rating providers (CRPs) for designations.
- The SVO currently lacks the tools to provide due diligence and assessment over the use and effectiveness of CRPs, or to conduct enterprise- or industry-wide risk analytics.
- Rather than a framework that utilizes valuable SVO resources to prioritize synthesizing CRP functions, a more effective use of those resources would be to prioritize the establishment of a robust and effective governance structure for the due diligence of CRPs.
- Further, with investment in modern risk analytics tools, the SVO could provide invaluable risk analysis capabilities to better support the risk-focused approach to supervision, at both a micro- and macro-prudential level.
- This memo provides concrete proposals envisioning a modernization of the role and capabilities of the SVO in a way that correlates with the observed shift towards more complex and asset-intensive insurer business strategies.
- It also provides high-level guidelines for considering consistency of capital across assets as the investment RBC initiatives move forward, recognizing the practical limitations of absolute capital parity.

Background
The NAIC is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators of the 50 states, the District of Columbia and the five U.S. territories. NAIC Designations are produced solely for the benefit of NAIC members in their capacity as state insurance regulators as a tool to help assess insurer's solvency.

There are several workstreams underway related to investments, which are meant to address a material, observable shift in insurer investment strategies – primarily but not limited to life insurance/reinsurance – toward more private assets, more structured assets and more complex assets. The workstreams are not meant to be punitive for the sake of being punitive, or to discourage innovation in insurers' investment strategies, but they recognize existing frameworks did not contemplate these investment strategies and will need to be enhanced to appropriately incorporate their characteristics into the regulatory framework.

While this goal is largely accepted by all interested parties as being necessary, the details of various proposals and the processes by which they have been undertaken have received an immense amount of attention from industry, other supervisory stakeholders and special interest groups, with stark divides in approval or disapproval of various initiatives. The collective commentary has included a significant amount of constructive feedback and valid critique, but has also been marked by misconceptions and competitive dynamics.

Recent comments have referred to these projects as "piecemeal" and "disjointed" and recommended a pause to all such workstreams. Others have suggested that these efforts are motivated by objectives other than enhancing regulators' ability to protect policyholders. In reality, what is being observed is the natural strain that results from solving complex problems through open and democratic processes. ~~A number of compounding factors contribute towards making these projects particularly challenging endeavors:~~

~~**Highly technical nature** – the ability to assess risk and design a regulatory framework for structured assets is highly dependent on the ability to model collateral performance through the capital structure of an extremely wide variety of securitization types. This requires highly specialized expertise. With experts from a divided group of stakeholders providing differing assessments of the modeled data, it is difficult for policy-making regulators to parse without conducting an impartial analytical study.~~

~~**Separate working groups** – the state-based framework has long utilized a "three-legged stool" approach to addressing accounting, risk assessment, and capital, which are governed by separate working groups. While all three legs of the stool have always needed to contemplate what the other legs were doing in order to have a cohesive regulatory framework, a project of this magnitude that spans all three legs requires a much more intensive level of coordination, which is further challenged by its exploratory nature.~~

~~**Exploratory nature** – assessing risk and capital is a balance between being too broad, and failing to appropriately capture material risks, and being too detailed, such that the framework is impractical to apply and too complex to be understood. Finding this balance is an iterative process of developing proposals, soliciting feedback, and adjusting or replacing proposals in response. This process inherently takes time and involves uncertainty around final outcome, but it also is not well understood by all stakeholders. This can result in disproportionately adverse reactions rather than the productive feedback that is necessary to reach what are often the common goals of all stakeholders. It also makes the coordination of working groups challenging, as the end state of each working group's initiatives is unknown while in process.~~

~~**Capital parity** – as a number of stakeholders have pointed out, the capital framework should have a goal of assigning "equal capital for equal risk". While this goal is likely non-controversial in the abstract, it doesn't address the practical limitations of achieving this goal in absolute terms. First are the balancing considerations noted elsewhere here. But it also implies that all risks must be holistically evaluated at the same time, in order to prevent a change for one asset class from disadvantaging another by comparison. There is no question that these impacts are very important to consider as updates are made, and mitigating unequal treatment to the extent possible should be a goal. However, practical constraints may prevent this aspiration from being realized to the satisfaction of all parties.~~

~~**Limited resources** – just as the regulatory framework is a balance between being too broad and too detailed, so too is the use of regulatory resources a balance between impartiality and practicality. State regulators have at their disposal a valuable resource in the NAIC, and SVO specifically. However, these resources are not unlimited. There should be a deliberate evaluation of the best use~~

~~of these limited resources. State regulators should not develop frameworks that prioritize using such resources in reperforming functions that can otherwise be satisfied using available market mechanisms, leaving no capacity for more impactful and macro-level risk assessment and analysis.~~

Purpose

While much of the characterization of these ongoing projects in the broader commentary is misplaced, it is prudent to reflect periodically on a holistic basis over the course of a complex project to evaluate potential areas for process improvement to the overall regulatory framework. **The intent of this memo is to highlight areas that regulators have identified where the insurance regulatory framework for investments could be enhanced based on reflections on the past several years of work on these issues, as well as comments on individual current initiatives and how they could be improved upon by addressing certain of the challenges described above.** This memo is not directly responsive to any particular feedback from stakeholders, but draws upon the experience of regulators involved in these workstreams, as well as comment letters written on current proposals, stakeholder communications not directly related to working group exposures, and ongoing conversations among regulators and stakeholders.

Proposed Regulatory Enhancements

The goal of the Framework and its proposed enhancements is to set a long-term, strategic direction for investment regulation and ensure current and future initiatives are thoughtfully coordinated and supportive of this holistic direction. A workplan will be utilized to further consider such proposed enhancements in more detail and where appropriate, changes will be made to this to reflect the final enhancement. The Framework does not have an objective of reaching technical conclusions on ongoing initiatives. Ongoing work will continue without delay or pause. Current workstreams are directionally consistent with the Framework and are producing iterative feedback that will inform future progress towards their objectives. As is always the case, workstreams and the Framework itself are subject to future refinement based on this iterative process of incorporating new information.

This Framework will be updated and retained in the future, but the following principles are expected to remain in place after the implementation of the work.

Core Principles

(1) The goal of the Framework is to set a long-term, strategic direction for investment regulation and ensure current and future initiatives are thoughtfully coordinated and supportive of this holistic direction. It does not have an objective of reaching technical conclusions on ongoing initiatives.
(2) The primary objective of the Framework and all supporting initiatives is to ensure state insurance regulators have appropriate tools to ensure the solvency of insurers. While other impacts will be assessed in the design and implementation of current and future initiatives, they will be secondary to ensuring insurer solvency.
(3) Ongoing work will continue without delay or pause. Current workstreams are directionally consistent with the Framework and produce iterative feedback to inform future progress toward its objectives. As is always the case, workstreams and the Framework are subject to future refinement based on this iterative process of incorporating new information.

(4) Initiatives are, and will continue to be, regulator-driven. Any enhancements to centralized resources are for the benefit of regulators, and regulators will retain the authority over how to use such resources.
(5) This work plan commits to being fully transparent, with multiple checkpoints for deliberation with interested parties.
(6) The ultimate responsibility for prudent investment oversight is with the insurers themselves, notwithstanding any of the work done to bolster regulatory resources and oversight over-reliance on credit rating providers (CRPs). This responsibility should not be "outsourced" to CRPs or the regulators.

A. Investment risk assessment / role of a centralized investment expertise function (e.g. SVO: IAO/SSG)

Currently, risk-based capital charges ~~The current framework~~ reliesy upon NAIC Designations for assets reported as bonds, with limited risk assessment for non-bond holdings. NAIC Designations ~~currently~~ are either provided directly by the SVO for filed securities or by a direct translation of a credit rating from a Credit Rating Provider ("CRP") for those securities that are exempt from filing ("FE"). There is currently a "blind" reliance on the CRP rating, with no mechanism for overall due diligence around CRP usage, nor an ability to challenge an individual rating for not conforming to regulator expectations of how it was determined. Both of these issues are potentially addressed through current initiatives of the Valuation of Securities Task Force ("VOSTF"), with multiple challenges and concerns (both warranted and unwarranted) of how they may be implemented.

Proposed Framework to modernize the SVO:

(1) Reduce/eliminate "blind" reliance on CRPs but retain overall utilization of CRPs ***with the implementation of a strong due diligence framework***. This framework should be extremely robust with focused resources within the NAIC in its implementation and maintenance. This initiative should be a ***primary*** focus of the NAIC and ***utilize an external consultant/resource to design & implement***. It is both inefficient and impractical for the SVO to effectively replicate the capabilities of CRPs on a large scale, and would not provide incremental benefit if the output is substantially similar. Rather, the SVO should focus primarily on holistic due diligence around CRP usage. That process must be vigorous and consequential (e.g. clear quantitative and qualitative parameters for CRPs utilized to provide ratings for use as NAIC designations).

(2) ***Retain ability*** within the SVO to perform individualized credit assessment and utilize regulatory discretion when needed, ***under well-documented and governed parameters***. This "backstop" should be embedded in the regulatory regime, but ideally would be rarely used if other governance is optimized.

(3) ***Enhance SVO's portfolio risk analysis capabilities*** with investment in a risk analytics tool and corresponding personnel, which could perform both company-specific risk analytics at the request of regulators, and industry-wide risk analytics for use in macroprudential efforts. ***Review/ increase staffing*** to include analysts with investment actuarial and risk management backgrounds that can provide dedicated investment-related support to risk-based capital and reserving teams, understanding the key functions of asset-liability management and resulting portfolio impacts. Changes to this centralized investment expertise at the NAIC will be determined based upon the needs of regulators.

(4) ***Enhance structured asset modeling capabilities*** in line with #3 with less focus on individual designation production, but in support of the CRP due diligence function (can provide tools for validation of CRP designations), company and industry stress testing, and emerging risk identification. Provide additional resources to SSG to continue to build this capability, inclusive of ***model governance*** and validation of key parameters.

(5) ***Build out a broad policy advisory function*** at the SVO that can consider and recommend future policy changes to regulators under a holistic lens, considering input from all impacted processes. If needed, ***hire key external consultants*** to be on retainer to provide key guidance on policy related issues, assess market impact and provide recommendations. This would be akin to the use of the Academy of Actuaries or similar for risk-based capital and reserving initiatives.

(6) Consider establishing a ***broad investment working group*** under E committee that acts in an advisory capacity to various investment processes that would ultimately need more intensive regulator engagement and analysis on confidential basis (similar to FAWG/VAWG), including (1) review of bond reporting analysis under the principles-based bond definition, (2) challenges to individual designations provided by CRPs, (3) review of work provided by external consultants for investment-related projects for broad impacts to the framework (beyond the group that would have commissioned the review)

(7) If the multitude of the above recommendations are implemented, rename the SVO and VOSTF to better reflect the responsibilities of the groups beyond securities valuation. ***Empower SVO*** to utilize the tools and analysis available to raise key issues to other applicable working groups, such as SAPWG or LATF (or RBC-IRE, but also noting key support for that group via an investment-focused actuarial team). ***Reduce the size*** of VOSTF membership or its successor to encourage active regulator engagement on core issues.

Impacts of Proposed Framework on Current Initiatives:

VOSTF:

(1) CRP Due Diligence: Re-prioritize this initiative (currently in place with limited resources) and retain an external consultant to build out the framework. Allow for engagement with CRPs in its creation.

(2) Regulatory Discretion over CRP designations: Continue deliberative process on this existing proposal to incorporate interested parties' constructive feedback on framework.

(3) CLO/RMBS/CMBS Modeling: Review output in conjunction with the Academy of Actuaries and RBC-IRE to determine if (1) NAIC designations, (2) dynamic ad hoc modeling/stress capabilities or (3) a combination of both, are the most valuable use of SSG resources, noting the request above to provide additional resources to this group.

LATF:

(1) SVO Staff enhanced as suggested above could be an additional resource in AG 53 type reviews, and may be able to provide validating analysis via its analytical tools.

(2) Investment actuarial staff can provide key recommendations to enhancements to asset adequacy testing based on investment characteristics identified.

SAPWG:

(1) No direct impact to implementation of the bond project outside of establishment of a working group that can assess specific assets for reporting purposes.

RBC-IRE:

(1) Increased investment actuarial and risk management could provide key support to establishment of structured asset RBC factors given the cross-functional understanding of investments and RBC parameters.

B. Risk-Based Capital for Investments

The project to review RBC factors for investments remains ongoing ~~in its infancy,~~ but has made considerable strides with the formation for the RBC-IRE Working Group in 2022 and the engagement of the American Academy of Actuaries to begin developing factors for CLOs. As this project moves forward, the following guidelines should be considered:

(1) **Secondarily to the emphasis on ensuring insurer solvency, changes in RBC factors should consider market impacts ~~secondarily to solvency impact~~ and consistency across asset classes in** ~~Changes in RBC factors~~ ~~***should consider market impacts and consistency across asset classes***~~ in determining when and how to implement such changes. While perfection under a principle of "Equal Capital for Equal Risk which includes consideration of tail risk" is likely unachievable, it should nevertheless be a goal to create consistent standards to the highest degree practicable. For example, the current work at RBC-IRE is appropriately beginning with studying CLOs for developing RBC factors for structured securities. It is possible that new factors for CLOs would be available before a determination has been made for how to extrapolate a framework to other types of structured securities. As the phases of this project progress, care should be taken to consider the impacts of changing factors for an asset class while similar asset classes may remain unchanged. Factors to consider may include impacts to asset allocation and financial markets, in balance with the level of urgency of regulatory action.

(2) The RBC-IRE Working Group should consider and address areas where inconsistencies in treatment across asset classes ***incentivize a particular legal form***. The RBC-IRE Working Group should coordinate with the SAPWG where needed on this item. A key example of this is private credit funds, where the underlying assets are fixed income, but regulatory barriers frequently prevent them from receiving a fixed income capital charge, instead assigning an equity factor. This requires insurers to structure such investments into bond-form through securitization in order to receive a fixed income charge, which may ***"overcorrect"*** and lead to ***capital arbitrage***. Developing an avenue for such assets to receive a capital charge commensurate with the underlying asset risk would significantly reduce the need to form structured securities out of many types of private fixed income assets.

NAIC WG/TF	NAIC Identifier	Topic	Subtopic	Purpose of Purposed Work	Committee Consideration	Exposure Date	Targeted Effective Date	Most Recent Update
RBC Investment Risk and Evaluation (E) Working Group	IR4	Comprehensive Fund Review for investments reported on Schedule D Pt 2 Sn2		Review inconsistencies across asset classes based on legal form	Added to working agenda on 11/16/18 call			Pending completion of other work
RBC Investment Risk and Evaluation (E) Working Group	IR5	RBC for ABS including CLOs, CFOs or other similar		Long-Term Different RBC Requirement	Committee made request 1/12/22			American Academy Update Expected Quarterly
RBC Investment Risk and Evaluation (E) Working Group	IR7	Evaluate and develop an approach to map other ABS to current bond factors. Project will likely require outside consultant.		Long-Term Different RBC Requirement	Committee made request 1/12/22			Pending completion of other work
RBC Investment Risk and Evaluation (E) Working Group	IR8	Address the tail risk concerns not captured by reserves for privately structured securities		Long-Term Different RBC Requirement	Added to working agenda on 8/11/22 call (Referral from Macroprudential)			Pending completion of other work
Valuation of Securities (E) Task Force	VOSTF 2023-005	Authorizing the Procedures for the SVO's Discretion Over NAIC Designations Assigned Through the Filing Exemption Process		Reduce Reliance on Rating Agencies	Proposal addresses charge from the Committee from 2021	07/26/24		06/18/24
Valuation of Securities (E) Task Force	VOSTF 2024-007	Implement financial modeling of CLOs for purposes of designations		Reduce Reliance on Rating Agencies / Enhance Structured Asset Modeling Capabilities	Coordination with related workstream IR5 at RBC-IRE		1/1/2025 (but subject to finalization of methodlogy and coordination with RBC-IRE)	6/18/24 - Effective date change adopted
Financial Condition (E) Committee		Draft Request for Proposal to develop a dilligence process related to use of rating agency ratings		Address proposal from Investment Framework	Drafted by Valuation of Securities Task Force and Committee regulators			