

CAPITAL ADEQUACY (E) TASK FORCE

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Draft Pending Adoption

Draft: 8/19/24

Capital Adequacy (E) Task Force
Chicago, Illinois
August 14, 2024

The Capital Adequacy (E) Task Force met in Chicago, IL, Aug. 14, 2024. The following Task Force members participated: Judith L. French, Chair, represented by Tom Botsko (OH); Doug Ommen, Vice Chair, represented by Mike Yanacheak (IA); Lori K. Wing-Heier represented by David Phifer (AK); Mark Fowler represented by Charles Hale (AL); Ricardo Lara represented by Thomas Reedy (CA); Michael Conway represented by Rolf Kaumann (CO); Andrew N. Mais represented by Wanchin Chou (CT); Michael Yaworsky represented by Carly Wagoner (FL); Ann Gillespie represented by Vincent Tsang (IL); Amy L. Beard represented by Roy Eft (IN); Vicki Schmidt represented by Tish Becker (KS); Sharon P. Clark represented by Russell Coy (KY); Joy Y. Hatchette represented by Lynn Beckner (MD); Grace Arnold represented by Fred Andersen (MN); Chlora Lindley-Myers represented by John Rehagen (MO); Mike Causey represented by Jackie Obusek (NC); Jon Godfread represented by Matt Fischer (ND); Eric Dunning represented by Andrea Johnson and Tadd Wegner (NE); D.J. Bettencourt represented by Jennifer Li (NH); Justin Zimmerman represented by David Wolf (NJ); Scott Kipper represented by Hermoliva Abejar (NV); Glen Mulready (OK); Michael Wise represented by Ryan Basnett (SC); Cassie Brown represented by Jamie Walker (TX); Mike Kreidler represented by Steve Drutz (WA); and Nathan Houdek represented by Amy Malm (WI). Also participating was: Diana Sherman (PA).

1. Adopted its June 28, April 30, and Spring National Meeting Minutes

Botsko said the Task Force met June 28, April 30, and March 17. During its June 28 and April 30 meetings, the Task Force took the following action: 1) adopted proposal 2024-09-CA (Underwriting Risk Investment Risk Factor), proposal 2014-13-CA (Receivable for Securities Factors), proposal 2024-15-L (Collateral Loans), proposal 2024-17-L (BA Mortgages Omitted Asset Valuation Reserve [AVR] Line Factor), proposal 2024-12-H (Modified Health Care Receivable Factors), proposal 2024-14-P (Property/Casualty [P/C] Underwriting Line 1 Factors), a Risk-Based Capital Investment Risk and Evaluation (E) Working Group June 25 meeting summary, proposal 2024-18-CA (Residual Factor for P/C and Health), proposal 2024-04-L (Total Adjusted Capital [TAC] for Non-Admitted Affiliate), proposal 2024-05-L (BA Mortgages Omitted AVR Line), proposal 2024-08-CA (Column 12 Affiliated Investment), proposal 2024-10-P (PR019 Other Health Line), proposal 2024-11-P (2024 and 2025 Underwriting Risk Lines 4 and 8 Factors), and proposal 2023-17-CR (Climate Scenario Analysis). However, the Financial Condition (E) Committee adopted proposal 2024-20-CR to replace the 2023-17-CR during its Aug. 2 meeting; 2) received updates from the Statutory Accounting Principles (E) Working Group on the potential revisions on Schedule BA collateral loans disclosures and reporting lines; 3) discussed proposal 2024-16-CA (Revised Preamble); 4) the possibility of establishing a new working group to evaluate non-investment risk issues; 5) discussed and exposed a referral from the Statutory Accounting Principles (E) Working Group regarding the investment in tax credit structures; 6) forwarded a referral regarding the issue of asset concentration to the Risk-Based Capital Investment Risk and Evaluation (E) Working Group; and 7) referred issues regarding geographic concentration to the Catastrophe Risk (E) Subgroup.

Yanacheak made a motion, seconded by Eft, to adopt the Task Force's June 28 (Attachment One), April 30 (Attachment Two), and March 17 (*see NAIC Proceedings – Spring 2024, Capital Adequacy (E) Task Force*) minutes. The motion passed unanimously.

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2. Adopted the Reports of its Working Groups

A. Health Risk-Based Capital (E) Working Group

Drutz said the Health Risk-Based Capital (E) Working Group met July 25. During this meeting, the Working Group took the following action: 1) adopted its June 24, June 6, and April 16 minutes, which included the following action: a) adopted its Feb. 22 minutes; b) referred proposal 2024-09-CA to the Task Force; c) heard an update from the American Academy of Actuaries (Academy) on the health care receivables and H2 – Underwriting Risk review projects; d) exposed a referral letter on pandemic risk to the Financial Analysis Solvency Tools (E) Working Group and Financial Examiners Handbook (E) Technical Group; e) discussed the excessive growth charge; f) exposed proposal 2024-12-H for a 30-day public comment period ending May 16; g) exposed proposal 2024-12-H (MOD) for a 14-day public comment period ending June 20; h) adopted proposal 2024-12-H (MOD) by e-vote June 24; 2) adopted the 2024 health risk-based capital (RBC) newsletter; 3) adopted the 2023 health RBC statistics; 4) received an update from the Academy on the H2 – Underwriting Risk review project; 5) directed NAIC staff to forward a referral letter on pandemic risk to the Risk-Focused Surveillance (E) Working Group; and 6) adopted its 2024 working agenda.

B. Risk-Based Capital Investment Risk and Evaluation (E) Working Group

Botsko said the Risk-Based Capital Investment Risk and Evaluation (E) Working Group met Aug. 14. During this meeting, the Working Group took the following action: 1) adopted its June 21, May 22, and April 12 minutes, which included the following action: a) discussed a review of year-end 2023 data reported for residual tranches; b) heard a presentation from the NAIC's Structured Securities Group; c) discussed comment letters received on Oliver Wyman's Residual Tranche Risk Analysis; d) discussed comment letters received on a memorandum requesting additional feedback from industry stakeholders to substantiate their request for an additional one-year delay in implementing the 45% RBC factor for residual tranches; e) discussed comment letters received on proposal 2024-19-I and other potential alternative proposals; f) discussed the American Council of Life Insurers' (ACLI's) survey data on residual ownerships by life insurers; and g) voted to retain the original adoption of the 45% charge to be applied to all residuals; 2) adopted its Spring National Meeting minutes; 3) received updates from the Valuation of Securities (E) Task Force and the Statutory Accounting Principles (E) Working Group; 4) heard an update from the Academy on the Structured Securities RBC project; 5) discussed referrals that are related to funds and considering RBC formula and instruction changes to reflect Securities Valuation Office (SVO)-assigned designations in U.S. Securities and Exchange Commission (SEC)-registered funds, as well as to review and consider convergence with exposure aggregations for funds consistently with the Supplemental Investment Risk Interrogatories (SIRI); 6) adopted its 2024 working agenda.

Botsko also said that the Working Group has asked the Academy for support in creating a RBC framework for asset-backed securities (ABS). During the 2023 Fall National Meeting, the Academy presented a set of six principles that will guide its work, for which the Working Group has expressed support. He stated the Academy is now working to identify a set of comparable attributes that can be used to segregate collateralized loan obligations (CLOs) into risk buckets. The Academy will likely identify different sets of comparable attributes for debt tranches versus residual tranches and plan to present its findings on CLOs in spring 2025. Lastly, he said the remaining steps will be the development of the factors and the extension from CLOs to other ABS.

C. Life Risk-Based Capital (E) Working Group

Botsko said the Life Risk-Based Capital (E) Working Group met Aug. 14. During this meeting, the Working Group took the following action: 1) adopted its June 18, and April 19, minutes, which included the following action: a) adopted proposal 2024-15-L, proposal 2024-17-L, proposal 2024-04-L, and proposal 2024-05-L; and b) discussed covariance, C-3 risk, proposal 2024-03-L, and proposal 2024-07-L; 2) adopted its Spring National Meeting minutes;

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3) received updates from the Generator of Economic Scenarios (GOES) (E/A) Subgroup, Longevity Risk (E/A) Subgroup, and Variable Annuities Capital and Reserve (E/A) Subgroup; 4) adopted the 2024 life risk-based capital (RBC) newsletter; 5) adopted its 2023 life RBC statistics; 6) received a referral from the Statutory Accounting Principles (E) Working Group for investments in tax credit structures; 7) discussed the Schedule BA proposal for non-bond debt securities; and 8) adopted its working agenda.

D. Property and Casualty Risk-Based Capital (E) Working Group and the Catastrophe Risk (E) Subgroup

Botsko said the Property and Casualty Risk-Based Capital (E) Working Group and the Catastrophe Risk (E) Subgroup met Aug. 14 and took the following action: 1) adopted the Working Group's June 17 and April 25 minutes, which included the following action: a) adopted proposal 2023-14-P (Underwriting Risk Line 1 Factors), proposal 2023-17-CR (Climate Scenario Analysis), proposal 2024-10-P (Other Health Line), and proposal 2024-11-P (Underwriting Risk Lines 4 and 8 Factors); 2) adopted the Catastrophe Risk (E) Subgroup's June 10 and April 23 minutes, which took the following action: a) adopted proposal 2023-17-CR (Climate Scenario Analysis); b) exposed a referral from the Capital Adequacy (E) Task Force regarding the geographic concentration issue; c) discussed wildfire peril impact analysis, CoreLogic's wildfire model review, and the possibility of adding flood period to the Rcat component; d) heard an update on severe convective storm peril; 3) adopted their Spring National Meeting minutes; 4) adopted the 2024 P/C RBC newsletter; 5) discussed 2023 P/C RBC statistics, their working agenda, the geographic concentration issue, wildfire peril impact analysis, the CoreLogic Wildfire model review, the possibility of adding flood peril to the Rcat component, and how to handle the flood peril with the Florida Commission on Hurricane Projection Loss Methodology (FCHLPM); and 6) heard updates on the severe convective storm peril and from the Academy on current and future research topics.

Chou made a motion, seconded by Wolf, to adopt the reports of the Health Risk-Based Capital (E) Working Group (Attachment Three), the Life Risk-Based Capital (E) Working Group (Attachment Four), the Property and Casualty Risk-Based Capital (E) Working Group (Attachment Five), and the Risk-Based Capital Investment Risk and Evaluation (E) Working Group (Attachment Six). The motion passed unanimously.

3. Adopted its Working Agenda

Botsko summarized the changes to the Task Force's 2024 working agenda, which included the following substantial changes in the Health Risk-Based Capital (E) Working Group section: 1) item X1 was updated to reference the adoption of proposal 2024-09-CA; 2) item X4 was removed, as the Working Group adopted proposal 2024-12-H (MOD); 3) item X6 was removed, as consented by the Working Group at its June 6 meeting; and 4) the remaining agenda items were renumbered as necessary.

Botsko also stated that the following changes are included in the P/C section: 1) update comments on items P1, P4, P8, P9, P10, P11, and P12; 2) provide edits on P6 to clarify R5 ex-cat factors; and 3) add one item for the Subgroup in the "New Item" section. He said changes in the Life Risk-Based Capital (E) Working Group section included the following items: 1) the expected completion date was updated to 2024 or later for items L2 through L6; 2) item L7 was removed; and 3) four items were added to the "New Item" section.

In addition, Botsko said there are a couple of updates in the Risk-Based Capital Investment Risk and Evaluation (E) Working Group section, which included the following: 1) the expected completion date for items IR1 through IR6 and IR 8 was changed to 2024 or later; and 2) one item was added to the "New Item" section. Regarding the Capital Adequacy (E) Task Force, he said the comment column was updated for CA1 through CA6; four items were removed; and three items were added to the Task Force's section.

Kaumann made a motion, seconded by Malm, to adopt the Task Force's revised 2024 working agenda (Attachment Seven). The motion passed unanimously.

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4. Exposed its Revised Procedure Document

Botsko said the revision's purpose is to extend the structure proposal exposure deadline for the Task Force or its Working Groups to March 31. The revision must be adopted by the Task Force no later than May 15 of the effective year of the change. He encouraged interested parties to review the revision and welcomed any comments during the exposure period.

The Task Force agreed to expose its revised procedure document (Attachment Eight for a 30-day public comment period ending Sept. 13.

5. Exposed its 2025 Proposed Charges

Botsko said the purpose of changing the structure date in the document is to align the changes in the proposed revised procedure document.

The Task Force agreed to expose its proposed charges (Attachment Nine) for a 30-day public comment period ending Sept. 13.

6. Exposed the Request for a New Working Group Memorandum

Botsko said, as indicated during the Task Force's June 28 meeting, the Task Force is considering establishing a subgroup to: 1) review the possibility of removing the TAC and authorized control level (ACL) amounts in the annual statement's five-year historical data page; 2) re-evaluate some of the missing non-investment risks to determine whether the Task Force should now include them in the RBC calculation or if it should appropriately handle those risks utilizing other regulatory methods; and 3) review those non-investment factors and instructions that have not been reviewed since being developed to determine if modifications should be made. He stated that a request for a new working group memorandum had been drafted earlier. He encouraged all interested parties to review it and welcomed any comments during the exposure period.

Tsang said that it is a great idea to create this new group to re-evaluate the current RBC formulas. He expressed his concern about the current life RBC formula about putting too much focus on the C1 component but not enough on C2 and C3 components. He believed that it was the right time to revisit the covariance structure and make the appropriate adjustment to it. In addition, he does not support the idea of eliminating the TAC and ACL amounts in the annual statement five-year historical data page. He stated that these two amounts provide regulators with valuable information to take corrective action ahead of time. Botsko said these two items would be a good starting project for this new group.

The Task Force agreed to expose the request for a new working group memorandum (Attachment Ten) for a 30-day public comment period ending Sept. 13.

Having no further business, the Capital Adequacy (E) Task Force adjourned.

SharePoint/NAIC Support Staff Hub/Member Meetings/E CMTE/CADTF/2024-1-Summer/August 14 CADTF minutes.docx

Draft: 7/17/24

Capital Adequacy (E) Task Force
Virtual Meeting
June 28, 2024

The Capital Adequacy (E) Task Force met June 28, 2024. The following Task Force members participated: Judith L. French, Chair, Tom Botsko, Brad Wolfenbarger, Laura Miller, Stewart Trego, Whitney Fitch, Sean Sheridan, Daniel Bradford, and Dale Bruggeman (OH); Doug Ommen, Vice Chair, Mike Yanacheak, Kevin Clark, and Carrie Mears (IA); Mark Fowler represented by Blase Abreo and Charles Hale (AL); Ricardo Lara represented by Thomas Reedy and Kim Hudson (CA); Michael Conway represented by Eric Unger, Mitchell Bronson, and Rolf Kaumann (CO); Andrew N. Mais represented by Wanchin Chou, Philip Barrett, and Jack Broccoli (CT); Karima M. Woods represented by Philip Barlow (DC); Michael Yaworsky represented by Jane Nelson (FL); Ann Gillespie represented by Vincent Tsang (IL); Amy L. Beard represented by Roy Eft (IN); Vicki Schmidt represented by Tish Becker and Chut Tee (KS); Sharon P. Clark, Russell Coy, and Vicki Lloyd (KY); Kathleen A. Birrane represented by Greg Ricci and Lynn Beckner (MD); Grace Arnold represented by David Nelson (MN); Chlora Lindley-Myers represented by Debbie Doggett, William Leung, John Rehagen, and Laurie Pleus (MO); Jon Godfread represented by Matt Fischer (ND); Eric Dunning represented by Lindsay Crawford (NE); D.J. Bettencourt represented by Christian Citarella (NH); Justin Zimmerman represented by David Wolf (NJ); Scott Kipper represented by Hermoliva Abejar and Dede Benissan (NV); Glen Mulready represented by Diane Carter (OK); Michael Wise represented by Brian Fomby, Will Davis, and Ryan Basnett (SC); Cassie Brown represented by Rachel Hemphill, Amy Garcia, Brenda Talavera, Mei-Li Pitaktong, Miriam Fisk, and Jamie Walker (TX); Mike Kreidler represented by Steve Drutz (WA); and Nathan Houdek represented by Adrian Jaramillo, Rebecca Easland, and Michael Erdman (WI).

1. Adopted Proposal 2024-09-CA (Underwriting Risk Investment Risk Factor)

Drutz said the purpose of this proposal is to update the underwriting risk factors for the annual investment income adjustment to the comprehensive medical, Medicare supplement, and dental and vision factors. He stated that the proposed changes will result in a decrease of between 0.4% and 1.2% for those underwriting risk factors, depending on the line of business and the tier of revenue. In addition, he indicated that this proposal was originally exposed by the Health Risk-Based Capital (E) Working Group for a 32-day comment period that ended March 25. No comments were received. Drutz said the Working Group referred this proposal to the Task Force for another 30-day exposure period that ended May 30, as this proposal affects all three lines of business; no comments were received.

Drutz made a motion, seconded by Chou, to adopt proposal 2024-09-CA (Attachment One-A). The motion passed unanimously.

2. Adopted Proposal 2024-13-CA (Receivable for Securities Factors)

Botsko said the intent of proposal 2024-13-CA is to provide a routine three-year update to the receivable for securities for all three lines of business by using a weighted average methodology. He also stated that the proposed factors are consistent with the past factors. During its April 30 meeting, the Task Force exposed this proposal for a 30-day public comment period that ended May 30. No comments were received.

Chou made a motion, seconded by Yanacheak, to adopt proposal 2024-13-CA (Attachment One-B). The motion passed unanimously.

3. Adopted Proposal 2024-15-L (Collateral Loans)

Barlow said the purpose of proposal 2024-15-L is to update risk-based capital (RBC) mapping to capture certain mortgage-type investments as collateral loans backed by mortgages without changing the capital treatment of Schedule BA mortgage investments. Barlow also said that a comment letter received from the Iowa Insurance Division (IID) on May 1 indicated that Iowa supports this proposal to allow look-through treatment for collateral loans secured by mortgages. This proposal was adopted by the Life Risk-Based Capital (E) Working Group during its June 18 meeting.

Barlow made a motion, seconded by Reedy, to adopt proposal 2024-15-L (Attachment One-C). The motion passed unanimously.

4. Received Updates from the Statutory Accounting Principles (E) Working Group on the Potential Revisions on Schedule BA Collateral Loans Disclosures and Reporting Lines

Bruggeman said the Statutory Accounting Principles (E) Working Group has had several discussions involving collateral loans in the last couple of years. He stated that revisions have been adopted to *Statement of Statutory Accounting Principle (SSAP) No. 21R—Other Admitted Assets* to clarify the collateral requirements for the loan to be admitted and to require a data-captured disclosure for year-end 2024. The Working Group has also directed a memorandum, in line with the Life Risk-Based Capital (E) Working Group action captured in proposal 2024-15-L, to allow certain collateral loans backed by mortgage loans to flow through asset valuation reserve (AVR) as an interim step while further consideration occurs on more granular reporting lines for collateral loans and the extent to which look-through could occur for AVR or RBC purposes. This memorandum has been provided to the Blanks (E) Working Group and will be considered at its next meeting. Bruggeman also indicated that the NAIC staff for the Statutory Accounting Principles (E) Working Group is currently considering expanded reporting of collateral loans for Schedule BA based on the type of collateral asset and the extent to which a look-through to underlying collateral may be warranted. An updated agenda item is anticipated to be exposed at the Summer National Meeting. As these more granular reporting lines may need to result in changes to AVR and/or RBC, the Task Force will be given notice when that item is exposed to allow for consideration and feedback during the exposure period.

5. Adopted Proposal 2024-17-L (BA Mortgages Omitted AVR Line)

Barlow said the intent of this proposal is to add a factor for the line added to LR009 to specifically address Line 44 of the AVR equity component as part of proposal 2024-06-L. This proposal was adopted by the Life Risk-Based Capital (E) Working Group during its June 18 meeting.

Barlow made a motion, seconded by Chou, to adopt proposal 2024-17-L (Attachment One-D). The motion passed unanimously.

6. Discussed Proposal 2024-16-CA (Revised Preamble)

Botsko said the intent of this proposal is to provide edits to the RBC preamble based on the RBC Purposes & Guidelines Ad Hoc Subgroup discussions to clarify and emphasize the purposes and intent of using RBC. He stated that during its April 30 meeting, this proposal was exposed for a 30-day public comment period that ended May 30 and three comments were received. William J. Schwegler (Transamerica) urged the Task Force to defer action on this proposal because: 1) eliminating RBC transparency would introduce uncertainty among investors; and 2) making RBC confidential would make state regulation an outlier and in contravention of international standards. Tim Finnie (American Academy of Actuaries—Academy) shared two comments with the Task Force, including: 1) that removal of the individual companies' RBC level may lead to the development of alternative metrics of

solvency risk assessment and public reliance on those metrics, which would be detrimental to the public given the effectiveness of RBC; and 2) recommend tempering the language in the revised Section E for the sole emphasis of identifying weakly capitalized companies. Brian Bayerle (American Council of Life Insurers—ACLI) said the ACLI requests a delay in proceeding to allow industry and state insurance regulators more time to craft appropriate updates that both address concerns around the public usage of RBC and harmonize with other ongoing projects at the NAIC. Botsko said he agrees that this issue will require further discussion during upcoming meetings.

7. Adopted Proposal 2024-12-H (Modified Health Care Receivable Factors)

Drutz said the purpose of proposal 2024-12-H is to propose tiered factors recommended by the Academy to apply on health care receivables in XR021. Specifically, this proposal modified the application of tiered factors for non-pharmaceutical health care receivables, applying tiered factors on an aggregated basis. This proposal only impacts the health RBC formula and was adopted by the Health Risk-Based Capital (E) Working Group via e-vote June 24.

Drutz made a motion, seconded by Chou, to adopt proposal 2024-12-H (Attachment One-E). The motion passed unanimously.

8. Adopted Proposal 2024-14-P (PC Underwriting Line 1 Factors)

Botsko said proposal 2024-14-P (Underwriting Risk Line 1 Factors) provided a routine annual update to the Line 1 premium and reserve industry underwriting factors in the property/casualty (P/C) RBC formula. He indicated that for some lines of business with smaller populations, such as the international line of business, both reserve and premium factors are driven by a handful of companies and could fluctuate or be biased by different factors. He also stated that the Academy is in the process of reviewing the Line 1 calculation methodology and will provide recommendations soon. Botsko said that at its April 30 meeting, the Working Group exposed this proposal for a 30-day public comment period that ended May 30. No comments were received.

Drutz made a motion, seconded by Davis, to adopt proposal 2023-14-P (Attachment One-F). The motion passed unanimously.

9. Adopted a Risk-Based Capital Investment Risk and Evaluation (E) Working Group Meeting Summary

Botsko said the Task Force received a meeting summary from the Risk-Based Capital Investment Risk and Evaluation (E) Working Group June 25. Barlow said the Working Group adopted a motion to retain the 45% life RBC factor for all residual tranches for year-end 2024. He said the motion passed with nine affirmative votes and six opposing votes by the members present. The 45% RBC factor for residual tranches was adopted fully through the NAIC committee structure in 2023; therefore, no further action is needed to incorporate this RBC factor. He also stated that the Academy is working diligently to establish a methodology for this item, and information will be shared with the Working Group in upcoming meetings. Director French said she believed that the process should be more expedited; scheduling regular updates with the Academy on the progress of the work may improve the process. Stephen Smith (Academy) said the Academy's goal is to share a substantive set of analyses with the Task Force and Working Group at the Fall National Meeting. He said that in the meantime, the Academy will provide interim updates upon request.

Kevin Clark said he appreciates the work and resources dedicated by the industry to provide data for the Working Group's consideration on this issue. He stated that while there have been varying views on how to interpret that data, there is no question that it has contributed to a significantly better understanding of the asset class than the Task Force had when considering an interim charge last year. As we noted during the Working Group's discussion, the Oliver Wyman report did result in a couple of indisputable observations: 1) risk varies rather widely within the

residual tranche asset class; and 2) comparable attributes exist that have a strong correlation to the level of risk. He also indicated that the previously shared memorandum from the IID analyzed these attributes and several options for how to do this. Kevin Clark said that the Task Force does not have enough time to adequately consider the alternatives for the 2024 reporting year. He said that as the Academy continues to progress with its work to develop permanent factors for structured securities, including residual tranches, starting with collateralized loan obligations (CLOs), he recommended the Task Force should: 1) do everything to support the Academy in moving this work forward as expeditiously as possible; and 2) consider what is learned from this project as it progresses; 3) address those asset-backed securities (ABS) other than CLOs after the CLO is completed, as most of what the Task Force has considered in the development of the interim charge has been in relation to CLO, which is the most significant portion of the population, and also the first asset class being addressed by the Academy's work; and 4) reconsider the appropriate charge for the remaining population once a permanent solution for the CLOs is in place.

Kevin Clark stated that the Statutory Accounting Principles (E) Working Group has adopted a change in the accounting for residual tranches that goes into effect next year. He said the methodology is the most conservative accounting methodology that exists for any asset class, such that the risk of loss to surplus due to poor performance of residual tranches will be significantly reduced going forward. Finally, he urged the Task Force and Working Group members to remain engaged on this topic and commit to working toward a data-driven approach to assigning required capital. Patrick Reeder (Everlake Life) said ensuring the industry is engaged in this project moving forward is important.

Drutz made a motion, seconded by Chou, to adopt the Risk-Based Capital Investment Risk and Evaluation (E) Working Group meeting summary (Attachment One-G). The motion passed unanimously.

10. Adopted Proposal 2024-18-CA (Residual Factor for PC & Health)

Botsko said that during the Task Force's April 30 meeting, the members decided to adopt proposal 2024-02-CA but deferred consideration of the factor until after finalizing the life factor at the Risk-Based Capital Investment Risk and Evaluation (E) Working Group meeting. As indicated in the last item, the Working Group adopted a motion of retaining the 45% life RBC factor for all residual tranches for year-end 2024. He stated that since the Working Group and the Task Force do not have enough time to review the factors for property and health companies, he recommended the Task Force consider retaining the 20% charge for year-end 2024 reporting until further review of this issue. Botsko said he also anticipates that the ultimate factor will be consistent across the RBC formulas, with adjustments for a particular type of insurance.

Chou made a motion, seconded by Walker, to adopt proposal 2024-18-CA (Attachment One-H). The motion passed unanimously.

11. Discussed the Possibility of Establishing a New Working Group to Evaluate the Non-Investment Risk Issues

Botsko said, as indicated during the Task Force's April 30 meeting, that the Risk-Based Capital Risk Evaluation Purposes and Guidelines Ad Hoc Subgroup had a robust discussion before the Ad Hoc Subgroup was disbanded. He said one of the key items identified by the Ad Hoc Subgroup that requires further review is the possibility of removing the total adjusted capital (TAC) and authorized control level (ACL) amounts in the annual statement's five-year historical data page. In addition, Botsko said he thought some RBC formulas, factors, and methodologies have not been reviewed since they were developed. He asked the Task Force to consider establishing a subgroup to: 1) review the possibility of removing the TAC and ACL amounts in the annual statement's five-year historical data page; 2) re-evaluate some of the missing non-investment risks to determine whether the Task Force should now include them in the RBC calculation or if it should appropriately handle those risks utilizing other regulatory

methods; and 3) review those non-investment factors and instructions that have not been reviewed since being developed to determine if modifications should be made. Yanacheak said he supports establishing this new working group to review different RBC issues across all formulas, such as preamble discussion. Botsko encouraged all the interested parties to provide thoughts on the potential group's charges at the Summer National Meeting.

12. Discussed a Referral from the Statutory Accounting Principles (E) Working Group Regarding the Investment in Tax Credit Structures

Bruggeman said this March 2024 referral communicates that the Statutory Accounting Principles (E) Working Group adopted revisions to *SSAP No. 93* to expand and revise the guidance for investments in tax credits. Pursuant to the revisions, which go into effect Jan. 1, 2025, all investments that predominantly provide tax credits or other tax benefits, regardless of whether in the form of debt or equity, will be in the scope of *SSAP No. 93—Low-Income Housing Tax Credit Property Investments*. This expansion from the prior guidance limited the scope to low-income housing tax credits. With the revisions, modified blanks changes have also been proposed to rename and revise the reporting lines to reflect the tax credit investments. During the Blanks (E) Working Group's May 23 meeting, the reporting revisions were not adopted but were deferred to allow further comment from interested parties. As shown in the attachment, the reporting line revisions will impact the RBC reporting lines, either directly for P/C companies and health companies or through AVR for life companies. In addition to the reporting line revisions, the proposal will eliminate the federal guaranteed reporting line, as federal tax credit investments are not permitted to have the extent of guarantees supporting that classification under current tax law. As the blanks reporting revisions have not yet been adopted, this is just an update to the Task Force on the pending revisions. Further communication will inform the Task Force once the reporting revisions are adopted and indicate whether there are changes from the current exposure that should be considered for RBC purposes.

13. Discussed Other Matters

Botsko said the Capital Adequacy (E) Task Force plans to meet at the Summer National Meeting to continue discussing outstanding issues.

Having no further business, the Capital Adequacy (E) Task Force adjourned.

SharePoint/NAIC Support Staff Hub/Member Meetings/E CMTE/CADTF/2024-2-Summer/June 28 CADTF minutes.docx

Capital Adequacy (E) Task Force RBC Proposal Form

- | | | |
|---|--|---|
| <input checked="" type="checkbox"/> Capital Adequacy (E) Task Force | <input type="checkbox"/> Health RBC (E) Working Group | <input type="checkbox"/> Life RBC (E) Working Group |
| <input type="checkbox"/> Catastrophe Risk (E) Subgroup | <input type="checkbox"/> P/C RBC (E) Working Group | <input type="checkbox"/> Longevity Risk (A/E) Subgroup |
| <input type="checkbox"/> Variable Annuities Capital. & Reserve (E/A) Subgroup | <input type="checkbox"/> Economic Scenarios (E/A) Subgroup | <input type="checkbox"/> RBC Investment Risk & Evaluation (E) Working Group |

<p style="text-align: right;">DATE: <u>2-12-24</u></p> <p>CONTACT PERSON: <u>Crystal Brown</u></p> <p>TELEPHONE: <u>816-783-8146</u></p> <p>EMAIL ADDRESS: <u>cbrown@naic.org</u></p> <p>ON BEHALF OF: <u>Health Risk-Based Capital (E) Working Group</u></p> <p>NAME: <u>Steve Drutz</u></p> <p>TITLE: <u>Chief Financial Analyst/Chair</u></p> <p>AFFILIATION: <u>WA Office of Insurance Commissioner</u></p> <p>ADDRESS: <u>5000 Capitol Blvd SE</u> <u>Tumwater, WA 98501</u></p>	<p style="text-align: center;">FOR NAIC USE ONLY</p> <p>Agenda Item # <u>2024-09-CA</u> Year <u>2024</u></p> <p style="text-align: center;">DISPOSITION</p> <p>ADOPTED:</p> <p><input checked="" type="checkbox"/> TASK FORCE (TF) <u>06/28/2024</u></p> <p><input type="checkbox"/> WORKING GROUP (WG) _____</p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>EXPOSED:</p> <p><input checked="" type="checkbox"/> TASK FORCE (TF) <u>04/30/2024</u></p> <p><input checked="" type="checkbox"/> WORKING GROUP (WG) <u>02/22/2024</u></p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>REJECTED:</p> <p><input type="checkbox"/> TF <input type="checkbox"/> WG <input type="checkbox"/> SG _____</p> <p>OTHER:</p> <p><input type="checkbox"/> DEFERRED TO _____</p> <p><input type="checkbox"/> REFERRED TO OTHER NAIC GROUP _____</p> <p><input type="checkbox"/> (SPECIFY) _____</p>
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IDENTIFICATION OF SOURCE AND FORM(S)/INSTRUCTIONS TO BE CHANGED

- | | | |
|---|--|---|
| <input checked="" type="checkbox"/> Health RBC Blanks | <input checked="" type="checkbox"/> Property/Casualty RBC Blanks | <input checked="" type="checkbox"/> Life and Fraternal RBC Blanks |
| <input checked="" type="checkbox"/> Health RBC Instructions | <input checked="" type="checkbox"/> Property/Casualty RBC Instructions | <input checked="" type="checkbox"/> Life and Fraternal RBC Instructions |
| <input type="checkbox"/> Health RBC Formula | <input type="checkbox"/> Property/Casualty RBC Formula | <input type="checkbox"/> Life and Fraternal RBC Formula |
| <input type="checkbox"/> OTHER _____ | | |

DESCRIPTION/REASON OR JUSTIFICATION OF CHANGE(S)

Annual update of the underwriting factors for Comprehensive Medical, Medicare Supplement and Dental & Vision for investment income adjustment.

Update the underwriting factors for Comprehensive Medical, Medicare Supplement and Dental & Vision on pages XR013, LR019, LR020, PR019 and PR020 for the investment income adjustment.

Additional Staff Comments:

2-2-24 mkc – WG exposed for 32-day comment period ending 3/25/2024
 3-26-24 mkc – No comment received.
 4-30-24 eky – TF exposed for 30-day comment period ending 5/30/2024

**** This section must be completed on all forms.**

Revised 2-2023

2024 Investment Yield for Investment Income Adjustment

<https://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/TextView.aspx?data=yield>

Date	1 Mo	2 Mo	3 Mo	4 Mo	6 Mo	1 Yr	2 Yr	3 Yr	5 Yr	7 Yr	10 Yr	20 Yr	30 Yr
01/02/2024	5.55	5.54	5.46	5.41	5.24	4.80	4.33	4.09	3.93	3.95	3.95	4.25	4.08
01/03/2024	5.54	5.54	5.48	5.41	5.25	4.81	4.33	4.07	3.90	3.92	3.91	4.21	4.05
01/04/2024	5.56	5.48	5.48	5.41	5.25	4.85	4.38	4.14	3.97	3.99	3.99	4.30	4.13
01/05/2024	5.54	5.48	5.47	5.41	5.24	4.84	4.40	4.17	4.02	4.04	4.05	4.37	4.21
01/08/2024	5.54	5.48	5.49	5.39	5.24	4.82	4.36	4.11	3.97	3.99	4.01	4.33	4.17
01/09/2024	5.53	5.46	5.47	5.38	5.24	4.82	4.36	4.09	3.97	4.00	4.02	4.33	4.18
01/10/2024	5.53	5.46	5.46	5.39	5.23	4.82	4.37	4.10	3.99	4.01	4.04	4.35	4.20
01/11/2024	5.54	5.47	5.46	5.38	5.22	4.75	4.26	4.02	3.90	3.95	3.98	4.32	4.18
01/12/2024	5.55	5.47	5.45	5.37	5.16	4.65	4.14	3.92	3.84	3.91	3.96	4.32	4.20
01/16/2024	5.54	5.47	5.45	5.37	5.18	4.70	4.22	4.02	3.95	4.01	4.07	4.43	4.30
01/17/2024	5.54	5.47	5.47	5.40	5.20	4.80	4.34	4.12	4.02	4.07	4.10	4.42	4.31
01/18/2024	5.53	5.48	5.45	5.39	5.20	4.80	4.34	4.13	4.04	4.10	4.14	4.48	4.37
01/19/2024	5.54	5.47	5.45	5.39	5.21	4.84	4.39	4.18	4.08	4.12	4.15	4.47	4.36
01/22/2024	5.53	5.47	5.46	5.39	5.22	4.83	4.37	4.14	4.03	4.07	4.11	4.44	4.32
01/23/2024	5.53	5.46	5.45	5.38	5.21	4.81	4.31	4.16	4.06	4.11	4.14	4.48	4.38
01/24/2024	5.52	5.44	5.44	5.40	5.22	4.83	4.34	4.19	4.06	4.14	4.18	4.52	4.41
01/25/2024	5.54	5.48	5.44	5.39	5.19	4.76	4.28	4.12	4.01	4.07	4.14	4.49	4.38
01/26/2024	5.54	5.45	5.44	5.39	5.19	4.78	4.34	4.15	4.04	4.10	4.15	4.49	4.38
01/29/2024	5.53	5.46	5.42	5.37	5.19	4.76	4.29	4.10	3.97	4.02	4.08	4.42	4.31
01/30/2024	5.53	5.47	5.42	5.38	5.19	4.80	4.36	4.14	4.00	4.03	4.06	4.40	4.28
01/31/2024	5.53	5.46	5.42	5.40	5.18	4.73	4.27	4.05	3.91	3.95	3.99	4.34	4.22



February 2, 2023

Steve Drutz
 Chair, Health Risk-Based Capital (E) Working Group
 National Association of Insurance Commissioners (NAIC)

Re: Request for Additional Analysis to Incorporate Investment Income into the Underwriting Risk Component of the Health Risk-Based Capital (HRBC) Formula

Dear Mr. Drutz:

On behalf of the American Academy of Actuaries¹ Health Solvency Subcommittee (the subcommittee), I am pleased to provide this response letter to the NAIC's Health Risk-Based Capital (E) Working Group request to provide additional investment return scenarios within the subcommittee's summary of the Investment Income Adjusted Health H2 Experience Fluctuation Risk Factors. These factors are included within the table below.

Investment Income Adjusted Tiered Risk-Based Capital (RBC) Factors

Assumed Investment Return	Comprehensive Medical (CM)	Medicare Supplement	Dental/Vision
	High Tier (i.e., less than \$3Million (M) or less than \$25M)		
0.0%	15.00%	10.50%	12.00%
3.5%	14.53%	10.01%	11.63%
4.0%	14.47%	9.94%	11.58%
4.5%	14.40%	9.87%	11.53%
5.0%	14.34%	9.80%	11.48%
5.5%	14.27%	9.73%	11.43%
6.0%	14.21%	9.67%	11.38%
	Low Tier		
0.0%	9.00%	6.70%	7.60%
3.5%	8.56%	6.23%	7.25%
4.0%	8.50%	6.16%	7.20%
4.5%	8.44%	6.09%	7.16%
5.0%	8.38%	6.03%	7.11%
5.5%	8.32%	5.96%	7.06%
6.0%	8.25%	5.90%	7.01%

¹ The American Academy of Actuaries is a 19,500-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

Please note that the subcommittee updated the claims completion pattern assumptions slightly in this analysis. The impact of this change on the RBC factors is approximately 0.01%. Otherwise, the methodology is unchanged.

If you have any questions or would like to discuss further, please contact Matthew Williams, the Academy's senior health policy analyst, at williams@actuary.org.

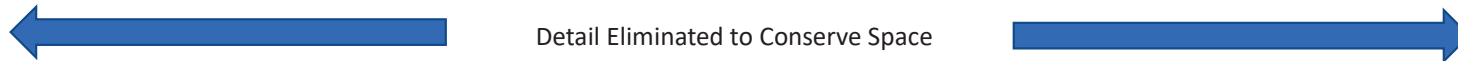
Sincerely,

Derek Skoog, MAAA, FSA
Chairperson, Health Solvency Subcommittee
American Academy of Actuaries

Cc: Crystal Brown, Senior Health RBC Analyst & Education Coordinator, Financial Regulatory Affairs, NAIC

Health Instructions

Page XR013, Line 13



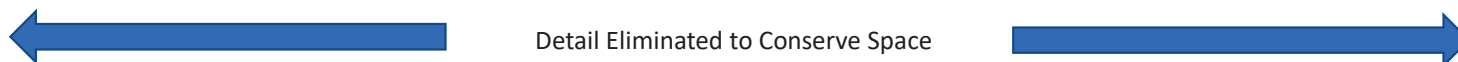
Line (13) Underwriting Risk Factor. A weighted average factor based on the amount reported in Line (6), Underwriting Risk Revenue. The factors for Column (1) through (3) have incorporated an investment income yield of 5.05%.

	\$0 – \$3 Million	\$3 – \$25 Million	Over \$25 Million
Comprehensive (Hospital & Medical) Individual & Group	0.142734	0.142734	0.08328
Medicare Supplement	0.097380	0.0596603	0.0596603
Dental & Vision	0.11438	0.070611	0.070611
Stand-Alone Medicare Part D Coverage	0.251	0.251	0.151
Other Health	0.130	0.130	0.130
Other Non-Health	0.130	0.130	0.130

The investment income yield was incorporated into the Comprehensive (Hospital & Medical) individual & group, Medicare Supplement and Dental & Vision lines of business. The purpose was to incorporate an offset to reduce the underwriting risk factor for investment income earned by the insurer. The Working Group incorporated a 0.5% income yield that was based on the yield of a 6-month US Treasury Bond. Each year, the Working Group will identify the yield of the 6-month Treasury bond ([U.S. Department of the Treasury](https://www.treasury.gov/)) on each Monday through the month of January and determine if further modifications to the 5.50% adjustment is needed. Any adjustments will be rounded up to the nearest 0.5%.

P/C Instructions

Page PR020, Line 10

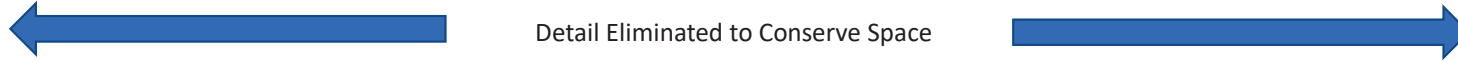


Line (10) Underwriting Risk Factor
 A weighted average factor based on the amount reported in Line (5), Underwriting Risk Revenue.

	\$0 - \$3 Million	\$3-\$25 Million	Over \$25 Million
Comprehensive Medical	0.142734	0.142734	0.08328
Medicare Supplement	0.097380	0.0596603	0.0596603
Dental & Vision	0.11438	0.070611	0.070611
Stand-Alone Medicare Part D Coverage	0.251	0.251	0.151

Life Instructions

LR020, Line 10



Line (10) Underwriting Risk Factor

A weighted average factor based on the amount reported in Line (5), Underwriting Risk Revenue. The factors for Column 1-3 have incorporated investment income.

	\$0 - \$3 Million	\$3 - \$25 Million	Over \$25 Million
Comprehensive Medical	0.14 2734	0.14 2734	0.083 28
Medicare Supplement	0.09 7380	0.05 96603	0.05 96603
Dental	0.114 38	0.07 0611	0.07 0611
Stand-Alone Medicare Part D Coverage	0.251	0.251	0.151

UNDERWRITING RISK

Experience Fluctuation Risk

		(1) Comprehensive (Hospital & Medical) - Individual & Group	(2) Medicare Supplement	(3) Dental & Vision	(4) Stand-Alone Medicare Part D Coverage	(5) Other Health	(6) Other Non- Health	(7) Total
(1) †	Premium							
(2) †	Title XVIII-Medicare		XXX	XXX	XXX	XXX	XXX	
(3) †	Title XIX-Medicaid		XXX	XXX	XXX	XXX	XXX	
(4) †	Other Health Risk Revenue		XXX				XXX	
(5)	Medicaid Pass-Through Payments Reported as Premiums		XXX	XXX	XXX	XXX	XXX	
(6)	Underwriting Risk Revenue = Lines (1) + (2) + (3) + (4) - (5)							
(7) †	Net Incurred Claims						XXX	
(8)	Medicaid Pass-Through Payments Reported as Claims		XXX	XXX	XXX	XXX	XXX	
(9)	Total Net Incurred Claims Less Medicaid Pass-Through Payments Reported as Claims = Lines (7) - (8)						XXX	
(10) †	Fee-For-Service Offset		XXX				XXX	
(11)	Underwriting Risk Incurred Claims = Lines (9) - (10)						XXX	
(12)	Underwriting Risk Claims Ratio = For Column (1) through (5), Line (11)/(6)						1.000	XXX
(13)	Underwriting Risk Factor*					0.130	0.130	XXX
(14)	Base Underwriting Risk RBC = Lines (6) x (12) x (13)							
(15)	Managed Care Discount Factor						XXX	XXX
(16)	RBC After Managed Care Discount = Lines (14) x (15)						XXX	
(17) †	Maximum Per-Individual Risk After Reinsurance						XXX	XXX
(18)	Alternate Risk Charge **						XXX	XXX
(19)	Alternate Risk Adjustment						XXX	XXX
(20)	Net Alternate Risk Charge***						XXX	
(21)	Net Underwriting Risk RBC (MAX{Line (16), Line (20)}) for Columns (1) through (5), Column (6), Line (14)							

TIERED RBC FACTORS*						
	Comprehensive (Hospital & Medical) - Individual & Group	Medicare Supplement	Dental & Vision	Stand-Alone Medicare Part D Coverage	Other Health	Other Non- Health
\$0 - \$3 Million	0.142734	0.09738	0.11438	0.251	0.130	0.130
\$3 - \$25 Million	0.142734	0.0596603	0.07064	0.251	0.130	0.130
Over \$25 Million	0.08328	0.0596603	0.07064	0.151	0.130	0.130

ALTERNATE RISK CHARGE**

** The Line (18) Alternate Risk Charge is calculated as follows:						
LESSER OF:	\$1,500,000 or 2 x Maximum Individual Risk	\$50,000 or 2 x Maximum Individual Risk	\$50,000 or 2 x Maximum Individual Risk	\$150,000 or 6 x Maximum Individual Risk	\$50,000 or 2 x Maximum Individual Risk	N/A

Denotes items that must be manually entered on filing software.

† The Annual Statement Sources are found on page XR014.

* This column is for a single result for the Comprehensive Medical & Hospital, Medicare Supplement and Dental/Vision managed care discount factor.

*** Limited to the largest of the applicable alternate risk adjustments, prorated if necessary.

UNDERWRITING RISK - PREMIUM RISK FOR COMPREHENSIVE MEDICAL, MEDICARE SUPPLEMENT AND

(Experience Fluctuation Risk in Life RBC Formula)

	(1)	(2)	(3)	(4)	(5)
	Comprehensive Medical	Medicare Supplement	Dental & Vision	Stand-Alone Medicare Part D Coverage	TOTAL
(1.1) Premium – Individual	0	0	0	0	0
(1.2) Premium – Group	0	0	0	0	0
(1.3) Premium – Total = Line (1.1) + Line (1.2)	0	0	0	0	0
(2) Title XVIII-Medicare†	0	XXX	XXX	XXX	0
(3) Title XIX-Medicaid†	0	XXX	XXX	XXX	0
(4) Other Health Risk Revenue†	0	XXX	0	0	0
(5) Underwriting Risk Revenue = Lines (1.3) + (2) + (3) + (4)	0	0	0	0	0
(6) Net Incurred Claims	0	0	0	0	0
(7) Fee-for-Service Offset†	0	XXX	0	0	0
(8) Underwriting Risk Incurred Claims = Line (6) – Line (7)	0	0	0	0	0
(9) Underwriting Risk Claims Ratio = Line (8) / Line (5)	0.0000	0.0000	0.0000	0.000	XXX
(10.1) Underwriting Risk Factor for Initial Amounts Of Premium‡	0.142734	0.09738	0.11438	0.251	XXX
(10.2) Underwriting Risk Factor for Excess of Initial Amount‡	0.08328	0.0596603	0.070644	0.151	XXX
(10.3) Composite Underwriting Risk Factor	0.0000	0.0000	0.0000	0.000	XXX
(11) Base Underwriting Risk RBC = Line (5) x Line (9) x Line (10.3)	0	0	0	0	0
(12) Managed Care Discount Factor = PR021 Line (12)	0.0000	0.0000	0.0000	0.000	XXX
(13) Base RBC After Managed Care Discount = Line (11) x Line (12)	0	0	0	0	0
(14) RBC Adjustment For Individual = [{Line(1.1) x 1.2 + Line (1.2)} / Line (1.3)] x Line (13)§	0	0	0	0	0
(15) Maximum Per-Individual Risk After Reinsurance†	0	0	0	0	XXX
(16) Alternate Risk Charge*	0	0	0	0	0
(17) Net Alternate Risk Charge£	0	0	0	0	0
(18) Net Underwriting Risk RBC (Maximum of Line (14) or Line (17))	0	0	0	0	0

† Source is company records unless already included in premiums.

‡ For Comprehensive Medical the Initial Premium Amount is \$25,000,000 or the amount in Line (1.3) if smaller. For Medicare Supplement and Dental & Vision the Initial Premium Amount is \$3,000,000 or the amount in Line (1.3) if smaller. For Stand-Alone Medicare Part D the Initial Premium Amount is \$25,000,000 or the amount in Line (1.3) if smaller.

§ Formula applies only to Column (1), for all other columns Line (14) should equal Line (13).

* The Line (16) Alternate Risk Charge is calculated as follows:

LESSER OF:	\$1,500,000	\$50,000	\$50,000	\$150,000	Maximum of Columns (1), (2) (3) and (4)
	or 2 x Maximum Individual Risk	or 2 x Maximum Individual Risk	or 2 x Maximum Individual Risk	or 6 x Maximum Individual Risk	

£ Applicable only if Line (16) for a column equals Line (16) for Column (5), otherwise zero.

Denotes items that must be manually entered on the filing software.

UNDERWRITING RISK

Experience Fluctuation Risk

		(1)	(2)	(3)	(4)	(5)
	Line of Business	Comprehensive Medical	Medicare Supplement	Dental & Vision	Stand-Alone Medicare Part D Coverage	Total
(1.1)	Premium – Individual					
(1.2)	Premium – Group					
(1.3)	Premium – Total = Line (1.1) + Line (1.2)					
(2)	Title XVIII-Medicare†		XXX			
(3)	Title XIX-Medicaid†		XXX			
(4)	Other Health Risk Revenue†		XXX			
(5)	Underwriting Risk Revenue = Lines (1.3) + (2) + (3) + (4)					
(6)	Net Incurred Claims					
(7)	Fee-for-Service Offset†		XXX			
(8)	Underwriting Risk Incurred Claims = Line (6) – Line (7)					
(9)	Underwriting Risk Claims Ratio = Line (8) / Line (5)					XXX
(10.1)	Underwriting Risk Factor for Initial Amounts Of Premium‡	0.142734	0.09738	0.11438	0.251	XXX
(10.2)	Underwriting Risk Factor for Excess of Initial Amount‡	0.08328	0.0596603	0.070644	0.151	XXX
(10.3)	Composite Underwriting Risk Factor					XXX
(11)	Base Underwriting Risk RBC = Line (5) x Line (9) x Line (10.3)					
(12)	Managed Care Discount Factor = LR022 Line (17)					XXX
(13)	Base RBC After Managed Care Discount = Line (11) x Line (12)					
(14)	RBC Adjustment For Individual = [Line(1.1) x 1.2 + Line (1.2)] / Line (1.3)] x Line (13)§					
(15)	Maximum Per-Individual Risk After Reinsurance†					XXX
(16)	Alternate Risk Charge*					
(17)	Net Alternate Risk Charge£					
(18)	Net Underwriting Risk RBC (Maximum of Line (14) or Line (17))					

† Source is company records unless already included in premiums.

‡ For Comprehensive Medical, the Initial Premium Amount is \$25,000,000 or the amount in Line (1.3) if smaller. For Medicare Supplement and Dental & Vision, the Initial Premium Amount is \$3,000,000 or the amount in Line (1.3) if smaller. For Stand-Alone Medicare Part D, the Initial Premium Amount is \$25,000,000 or the amount in Line (1.3) if smaller.

§ Formula applies only to Column (1), for all other columns Line (14) should equal Line (13).

* The Line (16) Alternate Risk Charge is calculated as follows:

LESSER OF:	\$1,500,000	\$50,000	\$50,000	\$150,000	Maximum of Columns (1), (2), (3) and (4)
	or 2 x Maximum Individual Risk	or 2 x Maximum Individual Risk	or 2 x Maximum Individual Risk	or 6 x Maximum Individual Risk	

£ Applicable only if Line (16) for a column equals Line (16) for Column (5), otherwise zero.

Denotes items that must be manually entered on the filing software.

Capital Adequacy (E) Task Force RBC Proposal Form

- | | | |
|---|--|---|
| <input checked="" type="checkbox"/> Capital Adequacy (E) Task Force | <input type="checkbox"/> Health RBC (E) Working Group | <input type="checkbox"/> Life RBC (E) Working Group |
| <input type="checkbox"/> Catastrophe Risk (E) Subgroup | <input type="checkbox"/> P/C RBC (E) Working Group | <input type="checkbox"/> Longevity Risk (A/E) Subgroup |
| <input type="checkbox"/> Variable Annuities Capital. & Reserve (E/A) Subgroup | <input type="checkbox"/> Economic Scenarios (E/A) Subgroup | <input type="checkbox"/> RBC Investment Risk & Evaluation (E) Working Group |

<p style="text-align: right;">DATE: <u>4-8-24</u></p> <p>CONTACT PERSON: <u>Eva Yeung</u></p> <p>TELEPHONE: <u>816-783-8407</u></p> <p>EMAIL ADDRESS: <u>eyeung@naic.org</u></p> <p>ON BEHALF OF: <u>Capital Adequacy (E) Task Force</u></p> <p>NAME: <u>Tom Botsko</u></p> <p>TITLE: <u>Chair</u></p> <p>AFFILIATION: <u>Ohio Department of Insurance</u></p> <p>ADDRESS: <u>50 West Town Street, Suite 300</u> <u>Columbus, OH 43215</u></p>	<p style="text-align: center;">FOR NAIC USE ONLY</p> <p>Agenda Item # <u>2024-13-CA</u> Year <u>2024</u></p> <p style="text-align: center;">DISPOSITION</p> <p>ADOPTED: <input checked="" type="checkbox"/> TASK FORCE (TF) <u>06/28/2024</u> <input type="checkbox"/> WORKING GROUP (WG) _____ <input type="checkbox"/> SUBGROUP (SG) _____</p> <p>EXPOSED: <input checked="" type="checkbox"/> TASK FORCE (TF) <u>04/30/2024</u> <input type="checkbox"/> WORKING GROUP (WG) _____ <input type="checkbox"/> SUBGROUP (SG) _____</p> <p>REJECTED: <input type="checkbox"/> TF <input type="checkbox"/> WG <input type="checkbox"/> SG _____</p> <p>OTHER: <input type="checkbox"/> DEFERRED TO _____ <input type="checkbox"/> REFERRED TO OTHER NAIC GROUP _____ <input type="checkbox"/> (SPECIFY) _____</p>
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IDENTIFICATION OF SOURCE AND FORM(S)/INSTRUCTIONS TO BE CHANGED

- | | | |
|---|--|---|
| <input checked="" type="checkbox"/> Health RBC Blanks | <input checked="" type="checkbox"/> Property/Casualty RBC Blanks | <input checked="" type="checkbox"/> Life and Fraternal RBC Blanks |
| <input type="checkbox"/> Health RBC Instructions | <input type="checkbox"/> Property/Casualty RBC Instructions | <input type="checkbox"/> Life and Fraternal RBC Instructions |
| <input type="checkbox"/> Health RBC Formula | <input type="checkbox"/> Property/Casualty RBC Formula | <input type="checkbox"/> Life and Fraternal RBC Formula |
| <input type="checkbox"/> OTHER _____ | | |

DESCRIPTION/REASON OR JUSTIFICATION OF CHANGE(S)

Update the RBC factors for Receivables for Securities.
Based on a weighted average calculation of bonds, common, preferred and hybrid stock investments, the receivable for securities factors were adjusted for all RBC forecasting blanks.

Additional Staff Comments:

** This section must be completed on all forms.

Revised 2-2023

	Proposed 2024	2021	2018	2016	2014
Life	0.016	0.015	0.014	0.014	0.014
Health	0.024	0.024	0.025	0.024	0.024
P/C	0.025	0.020	0.025	0.023	0.024

Proposed 2024 Life RBC Factor for Receivables for Securities

	(1)	(2)	(3)	(4)	(5)	(6)	
	Statement Value	Allocation % by Class Type	RBC Factors by Class Type	Weighted Avg RBC Factor by Class type (2)x(3)	Allocation % by Asset type (1)/Total (1)	Weighted Avg RBC by Asset type (4)x(5)	
Bonds and Hybrids							
Exempt Obligations	194,021,789,334	5.24%	0.00000	0.000			
NAIC 1.A	506,148,695,508	13.67%	0.00158	0.000			
NAIC 1.B	90,036,719,503	2.43%	0.00271	0.000			
NAIC 1.C	156,268,586,715	4.22%	0.00419	0.000			
NAIC 1.D	173,081,182,677	4.67%	0.00523	0.000			
NAIC 1.E	204,207,960,748	5.51%	0.00657	0.000			
NAIC 1.F	421,796,587,793	11.39%	0.00816	0.001			
NAIC 1.G	438,737,173,476	11.85%	0.01016	0.001			
NAIC 2.A	442,373,341,861	11.94%	0.01261	0.002			
NAIC 2.B	571,155,764,811	15.42%	0.01523	0.002			
NAIC 2.C	319,838,831,236	8.64%	0.02168	0.002			
NAIC 3.A	40,428,385,027	1.09%	0.03151	0.000			
NAIC 3.B	33,826,609,661	0.91%	0.04537	0.000			
NAIC 3.C	41,859,274,788	1.13%	0.06017	0.001			
NAIC 4.A	17,558,056,343	0.47%	0.07386	0.000			
NAIC 4.B	18,027,424,521	0.49%	0.09535	0.000			
NAIC 4.C	14,980,620,137	0.40%	0.12428	0.001			
NAIC 5.A	4,618,312,997	0.12%	0.16942	0.000			
NAIC 5.B	11,908,785,835	0.32%	0.23798	0.001			
NAIC 5.C	1,008,244,423	0.03%	0.30000	0.000			
NAIC 6	2,087,040,768	0.06%	0.30000	0.000			
Subtotal	3,703,969,388,162	100.00%		0.013	98.37%	0.013	
Preferred stock							
NAIC 1	3,273,389,198	18.48%	0.0039	0.001			
NAIC 2	10,075,067,030	56.89%	0.0126	0.007			
NAIC 3	2,058,350,579	11.62%	0.0446	0.005			
NAIC 4	980,582,619	5.54%	0.0970	0.005			
NAIC 5	866,090,716	4.89%	0.2231	0.011			
NAIC 6	455,936,493	2.57%	0.3000	0.008			
Subtotal	17,709,416,635	100.00%		0.037	0.47%	0.000	
Common stock (subtotal)	43,789,344,739	100.00%	0.3000	0.300	1.16%	0.003	
Total	3,765,468,149,536				100.00%	0.016	RBC Factor Receivables for Securities Life

Proposed 2023 P&C RBC Factor for Receivables for Securities

	(1)	(2)	(3)	(4)	(5)	(6)	
	Statement Value	Allocation % by Class Type	RBC Factors by Class Type	Weighted Avg RBC Factor by Class type (2)x(3)	Allocation % by Asset type (1)/Total (1)	Weighted Avg RBC by Asset type (4)x(5)	
Bonds and Hybrids							
Exempt Obligations	252,990,862,025	20.57%	0.00000	0.000			
NAIC 1.A	293,555,850,261	23.87%	0.00200	0.000			
NAIC 1.B	57,186,968,605	4.65%	0.00400	0.000			
NAIC 1.C	57,461,059,052	4.67%	0.00600	0.000			
NAIC 1.D	50,141,495,694	4.08%	0.00800	0.000			
NAIC 1.E	61,085,788,433	4.97%	0.01000	0.000			
NAIC 1.F	85,436,350,941	6.95%	0.01300	0.001			
NAIC 1.G	86,898,961,945	7.07%	0.01500	0.001			
NAIC 2.A	79,007,157,871	6.43%	0.01800	0.001			
NAIC 2.B	96,122,789,301	7.82%	0.02100	0.002			
NAIC 2.C	54,436,332,403	4.43%	0.02500	0.001			
NAIC 3.A	7,779,786,778	0.63%	0.05500	0.000			
NAIC 3.B	8,926,659,821	0.73%	0.06000	0.000			
NAIC 3.C	10,342,767,727	0.84%	0.06600	0.001			
NAIC 4.A	7,546,890,280	0.61%	0.07100	0.000			
NAIC 4.B	9,061,773,416	0.74%	0.07700	0.001			
NAIC 4.C	6,003,639,607	0.49%	0.08700	0.000			
NAIC 5.A	1,137,504,077	0.09%	0.09800	0.000			
NAIC 5.B	3,454,683,084	0.28%	0.10900	0.000			
NAIC 5.C	244,917,020	0.02%	0.12000	0.000			
NAIC 6	809,283,663	0.07%	0.30000	0.000			
Subtotal	1,229,631,522,004	100.00%		0.011	89.38%	0.010	
Preferred stock							
NAIC 1	375,682,422	6.59%	0.0030	0.000			
NAIC 2	3,418,704,780	59.95%	0.0100	0.006			
NAIC 3	1,096,732,027	19.23%	0.0200	0.004			
NAIC 4	102,641,767	1.80%	0.0450	0.001			
NAIC 5	451,218,320	7.91%	0.1000	0.008			
NAIC 6	257,641,690	4.52%	0.3000	0.014			
Subtotal	5,702,621,006	100.00%		0.032	0.41%	0.000	
Common stock (subtotal)	140,397,670,137	100.00%	0.1500	0.150	10.21%	0.015	
Total	1,375,731,813,147				100.00%	0.025	RBC Factor Receivables for Securities P/C

Proposed 2023 Health RBC Factor for Receivables for Securities

	(1)	(2)	(3)	(4)	(5)	(6)	
	Statement Value	Allocation % by Class Type	RBC Factors by Class Type	Weighted Avg RBC Factor by Class type (2)x(3)	Allocation % by Asset type (1)/Total (1)	Weighted Avg RBC by Asset type (4)x(5)	
Bonds and Hybrids							
Exempt Obligations	52,262,379,200	22.62%	0.00000	0.000			
NAIC 1.A	62,144,903,778	26.90%	0.00200	0.001			
NAIC 1.B	7,492,842,706	3.24%	0.00400	0.000			
NAIC 1.C	7,065,813,766	3.06%	0.00600	0.000			
NAIC 1.D	7,721,775,528	3.34%	0.00800	0.000			
NAIC 1.E	12,240,802,320	5.30%	0.01000	0.001			
NAIC 1.F	13,817,276,206	5.98%	0.01300	0.001			
NAIC 1.G	15,890,795,938	6.88%	0.01500	0.001			
NAIC 2.A	15,262,265,442	6.61%	0.01800	0.001			
NAIC 2.B	15,431,587,412	6.68%	0.02100	0.001			
NAIC 2.C	10,763,397,705	4.66%	0.02500	0.001			
NAIC 3.A	1,673,474,938	0.72%	0.05500	0.000			
NAIC 3.B	2,260,008,331	0.98%	0.06000	0.001			
NAIC 3.C	2,557,378,488	1.11%	0.06600	0.001			
NAIC 4.A	1,324,818,598	0.57%	0.07100	0.000			
NAIC 4.B	1,735,799,906	0.75%	0.07700	0.001			
NAIC 4.C	838,977,643	0.36%	0.08700	0.000			
NAIC 5.A	172,416,227	0.07%	0.09800	0.000			
NAIC 5.B	122,085,597	0.05%	0.10900	0.000			
NAIC 5.C	59,483,949	0.03%	0.12000	0.000			
NAIC 6	163,161,494	0.07%	0.30000	0.000			
Subtotal	231,001,445,172	100.00%		0.011	90.02%	0.010	
Preferred stock							
NAIC 1	91,479,908	13.53%	0.0030	0.000			
NAIC 2	312,656,134	46.23%	0.0100	0.005			
NAIC 3	130,474,575	19.29%	0.0200	0.004			
NAIC 4	25,557,463	3.78%	0.0450	0.002			
NAIC 5	98,310,363	14.54%	0.1000	0.015			
NAIC 6	17,838,817	2.64%	0.3000	0.008			
Subtotal	676,317,260	100.00%		0.033	0.26%	0.000	
Common stock (subtotal)	24,939,438,935	100.00%	0.1500	0.150	9.72%	0.015	
Total	256,617,201,367				100.00%	0.024	RBC Factor Receivables for Securities Health

Capital Adequacy (E) Task Force RBC Proposal Form

- | | | |
|---|---|---|
| <input type="checkbox"/> Capital Adequacy (E) Task Force | <input type="checkbox"/> Health RBC (E) Working Group | <input checked="" type="checkbox"/> Life RBC (E) Working Group |
| <input type="checkbox"/> Catastrophe Risk (E) Subgroup | <input type="checkbox"/> Investment RBC (E) Working Group | <input type="checkbox"/> Longevity Risk (A/E) Subgroup |
| <input type="checkbox"/> Variable Annuities Capital. & Reserve (E/A) Subgroup | <input type="checkbox"/> P/C RBC (E) Working Group | <input type="checkbox"/> RBC Investment Risk & Evaluation (E) Working Group |

<p style="text-align: right; margin: 0;">DATE: <u>03/15/2023</u></p> <p>CONTACT PERSON: <u>Brian Bayerle</u></p> <p>TELEPHONE: <u>(202) 624-2169</u></p> <p>EMAIL ADDRESS: <u>BrianBayerle@acli.com</u></p> <p>ON BEHALF OF: <u>ACLI</u></p> <p>NAME: <u>Brian Bayerle</u></p> <p>TITLE: <u>Chief Life Actuary</u></p> <p>AFFILIATION: <u>ACLI</u></p> <p>ADDRESS: <u>101 Constitution Ave, NW Suite 700</u> <u>Washington, DC 20001</u></p>	<p style="text-align: center; margin: 0;">FOR NAIC USE ONLY</p> <hr/> <p>Agenda Item # <u>2024-15-L</u> Year _____</p> <hr/> <p style="text-align: center; margin: 0;">DISPOSITION</p> <p>ADOPTED:</p> <p><input checked="" type="checkbox"/> TASK FORCE (TF) <u>06/28/2024</u></p> <p><input checked="" type="checkbox"/> WORKINGGROUP (WG) <u>6/17/2024</u></p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>EXPOSED:</p> <p><input type="checkbox"/> TASK FORCE (TF) _____</p> <p><input checked="" type="checkbox"/> WORKING GROUP (WG) _____</p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>REJECTED:</p> <p><input type="checkbox"/> TF <input type="checkbox"/> WG <input type="checkbox"/> SG _____</p> <p>OTHER:</p> <p><input type="checkbox"/> DEFERRED TO _____</p> <p><input type="checkbox"/> REFERRED TO OTHER NAIC GROUP _____</p> <p><input type="checkbox"/> (SPECIFY) _____</p>
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IDENTIFICATION OF SOURCE AND FORM(S)/INSTRUCTIONS TO BE CHANGED

- | | | |
|--|---|---|
| <input type="checkbox"/> Health RBC Blanks | <input type="checkbox"/> Property/Casualty RBC Blanks | <input checked="" type="checkbox"/> Life and Fraternal RBC Blanks |
| <input type="checkbox"/> Health RBC Instructions | <input type="checkbox"/> Property/Casualty RBC Instructions | <input checked="" type="checkbox"/> Life and Fraternal RBC Instructions |
| <input type="checkbox"/> Health RBC Formula | <input type="checkbox"/> Property/Casualty RBC Formula | <input type="checkbox"/> Life and Fraternal RBC Formula |
| <input type="checkbox"/> OTHER _____ | | |

DESCRIPTION/REASON OR JUSTIFICATION OF CHANGE(S)

Background: In order to support reporting of certain mortgage-type investments as collateral loans backed by mortgages in 2024, without changing capital treatment of BA mortgage investments, in 2024, update RBC mapping capture those investments consistent with existing practice. Note that those investments will map to AVR for Investments with Underlying Characteristics with Mortgages and be captured in that RBC category.

While this change accomplishes a “no change” result for 2024, it is expected that a broader discussion, including structural changes, will occur in 2025.

ACLI Proposal:

Life and Fraternal RBC Blanks LR008:

Update Line “(50) Schedule BA Collateral Loans” Annual Statement Source to be updated as follows:

Schedule BA Part 1 Column 12 Line 2999999 + Line 3099999, in part

The value in Column (1) Book / Adjusted Carrying Value will now be a company records entry and should represent all collateral loans which have not been captured elsewhere in the RBC formula.

Update to LR008 RBC Instructions:

Line (50)

Exclude: any collateral loan amounts which have been included elsewhere in the RBC formula, e.g., BA mortgages.

Update to LR009 RBC Instructions:

Column (1) Except for Line (1), (12), and (16), calculations are done on an individual mortgage basis and then the summary amounts are entered in this column for each class of mortgage investment. Refer to the Schedule BA mortgage calculation worksheet (Figure 10) for how the individual mortgage calculations are completed. Line (20) should equal Schedule BA Part 1, Column 12, Lines 1199999, 1299999, 2399999 and 2499999, and collateral loans backed by mortgages, as reported in footnote 5T, line 7.

Additional Staff Comments:

**** This section must be completed on all forms.**

Revised 11-2023

Collateral Loan → AVR → RBC mapping proposal - 2024

For Life RBC Working Group

Overview

In 2024, certain investments will be required to be reported as collateral loans backed by mortgages. The attached proposal comprises a mapping change from BA → AVR → RBC which results in those assets maintaining their historical capital treatment as BA mortgages. This would be appropriate given that they are fixed income instruments which are collateralized by mortgages (generally first lien mortgages) and that they therefore have mortgage-like risk.

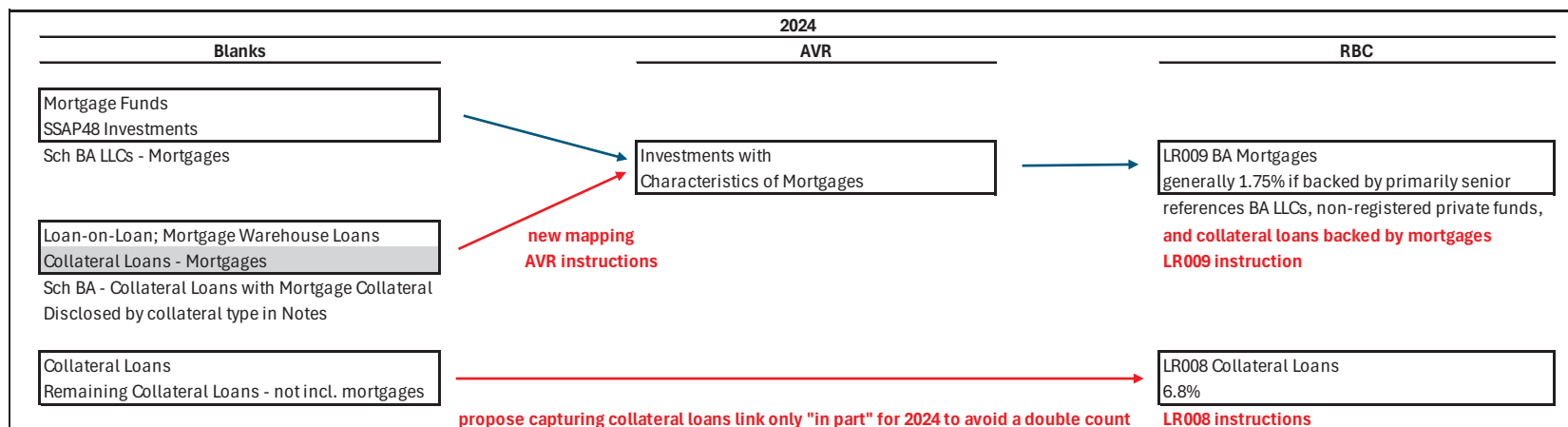
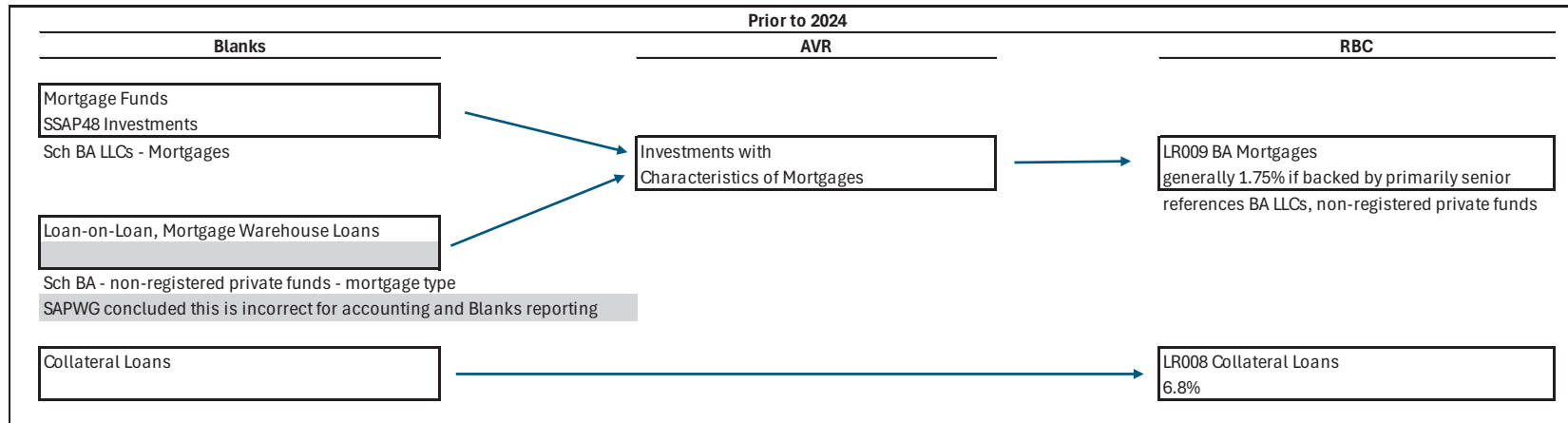
1- Overview of Proposal

2- Note on AVR mapping proposal supported by SAPWG

3- Review of proposed Life RBC instruction changes

Note that this is designed to solve 2024 reporting and capital with no disruption on the transition year. If a more comprehensive set of changes is adopted in 2025, we would expect those changes would supercede this fix. In other words, the focus of this proposal is to maintain current capital treatment this year, even as accounting changes occur.

Invested Assets Which are Captured for Capital as BA Mortgages



2025

Subsequent to determination of 2024 guidance, expose for comment a mapping of all collateral loans to AVR to RBC
 Result of 2025 exposure should be that everything maps directly through all of the steps, 1-to-1, or many-to-1, with no "in part" reference needed

Blanks Proposal for 2024 Reporting:

Annual Statement Instructions - AVR

Blanks proposal ensures that Collateral Loans backed by Mortgages map the AVR section which categorizes those investments in the appropriate buckets for RBC.

Life RBC Proposal:

To maintain capital treatment of loan-on-loan investments as BA mortgages, in a year when their accounting presentation navigates to Collateral Loans back by Mortgages, the following changes are proposed:

LR008

Line (50)

Exclude: any collateral loan amounts which have been included elsewhere in the RBC formula, e.g, BA mortgages.

8	(49.2)	Total Sch. BA Affiliated Common Stock - C-1cs	Line (49.1)
9	(50)	Schedule BA Collateral Loans	Schedule BA Part 1 Column 12 Line 2999999 + Line 3099999, in part
10	(51)	Total Residual Tranches or Interests	AVR Equity Component Column 1 Line 93

LR009

Reference to tie out should be adjusted to include new category: Line (20) should equal Schedule BA Part 1, Column 12, Lines 1199999,12999999, 23999999 ~~and~~ 24999999 **and collateral loans backed by mortgages (footnote 5T, line 7).**

The minor changes listed above to LR008, and LR009, will be provided in an RBC Proposal Form, and would result in BA mortgages maintaining their capital charge in 2024, even as reporting for those investments changes to Collateral Loans backed by Mortgages.

OTHER LONG-TERM ASSETS

	(1) Book / Adjusted Carrying Value	(2) Unrated Items ‡	(3) RBC Subtotal †	(4) Factor	(5) RBC Requirement
<u>Schedule BA - Unaffiliated Common Stock</u>					
(42) Schedule BA Unaffiliated Common Stock-Public	AVR Equity Component Column 1 Line 65			X §	=
(43) Schedule BA Unaffiliated Common Stock-Private	AVR Equity Component Column 1 Line 66			X 0.3000	=
(44) Total Schedule BA Unaffiliated Common Stock (pre-MODCO/Funds Withheld)	Line (42) + (43)				
(45) Reduction in RBC for MODCO/Funds Withheld Reinsurance Ceded Agreements	Company Records (enter a pre-tax amount)				
(46) Increase in RBC for MODCO/Funds Withheld Reinsurance Assumed Agreements	Company Records (enter a pre-tax amount)				
(47) Total Schedule BA Unaffiliated Common Stock (including MODCO/Funds Withheld.)	Lines (44) - (45) + (46)				
<u>Schedule BA - All Other</u>					
(48.1) BA Affiliated Common Stock - Life with AVR	AVR Equity Component Column 1 Line 67				
(48.2) BA Affiliated Common Stock - Certain Other	AVR Equity Component Column 1 Line 68				
(48.3) Total Schedule BA Affiliated Common Stock - C-1o	Line (48.1) + (48.2)			X 0.3000	=
(49.1) BA Affiliated Common Stock - All Other	AVR Equity Component Column 1 Line 69				
(49.2) Total Sch. BA Affiliated Common Stock - C-1es	Line (49.1)			X 0.3000	=
(50) Schedule BA Collateral Loans	Schedule BA Part 1 Column 12 Line 2999999 + Line 3099999, in part			X 0.0680	=
(51) Total Residual Tranches or Interests	AVR Equity Component Column 1 Line 93			X 0.3000	=
(52.1) NAIC 01 Working Capital Finance Notes	AVR Equity Component Column 1 Line 94			X 0.0050	=
(52.2) NAIC 02 Working Capital Finance Notes	AVR Equity Component Column 1 Line 95			X 0.0163	=
(52.3) Total Admitted Working Capital Finance Notes	Line (52.1) + (52.2)				
(53.1) Other Schedule BA Assets	AVR Equity Component Column 1 Line 96				
(53.2) Less NAIC 2 thru 6 Rated/Designated Surplus Notes and Capital Notes	Column (1) Lines (23) through (27) + Column (1) Lines (33) through (37)				
(53.3) Net Other Schedule BA Assets	Line (53.1) less (53.2)			X 0.3000	=
(54) Total Schedule BA Assets C-1o (pre-MODCO/Funds Withheld)	Lines (11) + (21) + (31) + (41) + (48.3) + (50) + (52.3) + (53.3)				
(55) Reduction in RBC for MODCO/Funds Withheld Reinsurance Ceded Agreements	Company Records (enter a pre-tax amount)				
(56) Increase in RBC for MODCO/Funds Withheld Reinsurance Assumed Agreements	Company Records (enter a pre-tax amount)				
(57) Total Schedule BA Assets C-1o (including MODCO/Funds Withheld.)	Lines (54) - (55) + (56)				
(58) Total Schedule BA Assets Excluding Mortgages and Real Estate	Line (47) + (49.2) + (51) + (57)				

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

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

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

Denotes items that must be manually entered on the filing software.

Capital Adequacy (E) Task Force
RBC Proposal Form

- | | | |
|---|--|---|
| <input type="checkbox"/> Capital Adequacy (E) Task Force | <input type="checkbox"/> Health RBC (E) Working Group | <input checked="" type="checkbox"/> Life RBC (E) Working Group |
| <input type="checkbox"/> Catastrophe Risk (E) Subgroup | <input type="checkbox"/> P/C RBC (E) Working Group | <input type="checkbox"/> Longevity Risk (A/E) Subgroup |
| <input type="checkbox"/> Variable Annuities Capital. & Reserve (E/A) Subgroup | <input type="checkbox"/> Economic Scenarios (E/A) Subgroup | <input type="checkbox"/> RBC Investment Risk & Evaluation (E) Working Group |

<p align="right">DATE: <u>4/25/2024</u></p> <p>CONTACT PERSON: <u>Dave Fleming</u></p> <p>TELEPHONE: <u>816-783-8121</u></p> <p>EMAIL ADDRESS: <u>dfleming@naic.org</u></p> <p>ON BEHALF OF: <u>Life Risk-Based Capital (E) Working Group</u></p> <p>NAME: <u>Philip Barlow, Chair</u></p> <p>TITLE: <u>Associate Commissioner of Insurance</u></p> <p>AFFILIATION: <u>District of Columbia</u></p> <p>ADDRESS: <u>1050 First Street, NE Suite 801</u> <u>Washington, DC 20002</u></p>	<p align="center">FOR NAIC USE ONLY</p> <p>Agenda Item # <u>2024-17-L</u> Year <u>2024</u></p> <p align="center">DISPOSITION</p> <p>ADOPTED:</p> <p><input type="checkbox"/> TASK FORCE (TF) <u>6/28/2024</u></p> <p><input checked="" type="checkbox"/> WORKING GROUP (WG) <u>6/18/2024</u></p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>EXPOSED:</p> <p><input type="checkbox"/> TASK FORCE (TF) _____</p> <p><input checked="" type="checkbox"/> WORKING GROUP (WG) <u>4/25/2024</u></p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>REJECTED:</p> <p><input type="checkbox"/> TF <input type="checkbox"/> WG <input type="checkbox"/> SG _____</p> <p>OTHER:</p> <p><input type="checkbox"/> DEFERRED TO _____</p> <p><input type="checkbox"/> REFERRED TO OTHER NAIC GROUP _____</p> <p><input type="checkbox"/> (SPECIFY) _____</p>
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IDENTIFICATION OF SOURCE AND FORM(S)/INSTRUCTIONS TO BE CHANGED

- | | | |
|--|---|---|
| <input type="checkbox"/> Health RBC Blanks | <input type="checkbox"/> Property/Casualty RBC Blanks | <input checked="" type="checkbox"/> Life and Fraternal RBC Blanks |
| <input type="checkbox"/> Health RBC Instructions | <input type="checkbox"/> Property/Casualty RBC Instructions | <input type="checkbox"/> Life and Fraternal RBC Instructions |
| <input type="checkbox"/> Health RBC Formula | <input type="checkbox"/> Property/Casualty RBC Formula | <input type="checkbox"/> Life and Fraternal RBC Formula |
| <input type="checkbox"/> OTHER _____ | | |

DESCRIPTION/REASON OR JUSTIFICATION OF CHANGE(S)

This proposal adds a factor for the line added to LR009 to specifically address line 44 of the Asset Valuation Reserve (AVR) Equity Component as part of proposal 2024-05-L. This AVR line was not included in the LR009 changes made with the mortgage methodology change in 2013.

Additional Staff Comments:

** This section must be completed on all forms.

Revised 2-2023

SCHEDULE BA MORTGAGES

		(1)	(2)	(3)	(4)	(5)	(6)
	Annual Statement Source	Book / Adjusted Carrying Value	Involuntary Reserve Adjustment †	RBC Subtotal	Cumulative Writedowns ‡	Average Factor	RBC Requirement
In Good Standing							
(1) Insured or Guaranteed	AVR Equity Component Column 1 Line 43 + Line 45				XXX X	0.0014	=
(2) Affiliated Mortgages – Residential – All Other	AVR Equity Component Column 1 Line 44				XXX X	0.0068	=
(3) Unaffiliated Mortgages with Covenants	AVR Equity Component Column 1 Line 57				XXX X	*	=
(4) Unaffiliated Mortgages - Defeased with Government Securities	AVR Equity Component Column 1 Line 58				XXX X	0.0090	=
(5) Unaffiliated Mortgages - Primarily Senior	AVR Equity Component Column 1 Line 59				XXX X	0.0175	=
(6) Unaffiliated Mortgages - All Other	AVR Equity Component Column 1 Line 60				XXX X	0.0300	=
(7) Affiliated Mortgages - Category CM1	AVR Equity Component Column 1 Line 38				XXX X	0.0090	=
(8) Affiliated Mortgages - Category CM2	AVR Equity Component Column 1 Line 39				XXX X	0.0175	=
(9) Affiliated Mortgages - Category CM3	AVR Equity Component Column 1 Line 40				XXX X	0.0300	=
(10) Affiliated Mortgages - Category CM4	AVR Equity Component Column 1 Line 41				XXX X	0.0500	=
(11) Affiliated Mortgages - Category CM5	AVR Equity Component Column 1 Line 42				XXX X	0.0750	=
(12) Total In Good Standing	Sum of Lines (1) through (11)						
90 Days Overdue, Not in Process of Foreclosure							
(13) Insured or Guaranteed 90 Days Overdue	AVR Equity Component Column 1 Line 47 + Line 49				XXX X	0.0027	=
(14) All Other 90 Days Overdue - Unaffiliated	AVR Equity Component Column 1 Line 61				XXX X	0.1100	=
(15) All Other 90 Days Overdue - Affiliated	AVR Equity Component Column 1 Line 48 + Line 50				XXX X	0.1100	=
(16) Total 90 Days Overdue, Not in Process of Foreclosure	Lines (13) + (14) + (15)						
In Process of Foreclosure							
(17) Insured or Guaranteed in Process of Foreclosure	AVR Equity Component Column 1 Line 52 + Line 54				XXX X	0.0054	=
(18) All Other in Process of Foreclosure - Unaffiliated	AVR Equity Component Column 1 Line 62				XXX X	0.1300	=
(19) All Other in Process of Foreclosure - Affiliated	AVR Equity Component Column 1 Line 53 + Line 55				XXX X	0.1300	=
(20) Total In Process of Foreclosure	Lines (17) + (18) + (19)						
(21) Total Schedule BA Mortgages (pre-MODCO/Funds Withheld)	Lines (12) + (16) + (20)						
(22) Reduction in RBC for MODCO/Funds Withheld Reinsurance Ceded Agreements	Company Records (enter a pre-tax amount)						
(23) Increase in RBC for MODCO/Funds Withheld Reinsurance Assumed Agreements	Company Records (enter a pre-tax amount)						
(24) Total Schedule BA Mortgages (including MODCO/Funds Withheld.)	Lines (21) - (22) + (23)						

† Involuntary reserves are reserves that are held as an offset to a particular asset that is clearly a troubled asset and are included on Page 3 Line 25 of the Annual Statement.
‡ Cumulative writedowns include the total amount of writedowns, non-admissions, and involuntary reserves that have been taken or established with respect to a particular mortgage.
* This will be calculated as Column (6) divided by Column (3).

Denotes items that must be manually entered on the filing software.

Capital Adequacy (E) Task Force RBC Proposal Form

- | | | |
|---|--|---|
| <input type="checkbox"/> Capital Adequacy (E) Task Force | <input checked="" type="checkbox"/> Health RBC (E) Working Group | <input type="checkbox"/> Life RBC (E) Working Group |
| <input type="checkbox"/> Catastrophe Risk (E) Subgroup | <input type="checkbox"/> P/C RBC (E) Working Group | <input type="checkbox"/> Longevity Risk (A/E) Subgroup |
| <input type="checkbox"/> Variable Annuities Capital. & Reserve (E/A) Subgroup | <input type="checkbox"/> Economic Scenarios (E/A) Subgroup | <input type="checkbox"/> RBC Investment Risk & Evaluation (E) Working Group |

<p style="text-align: right;">DATE: <u>6-6-24</u></p> <p>CONTACT PERSON: <u>Maggie Chang</u></p> <p>TELEPHONE: <u>816-783-8976</u></p> <p>EMAIL ADDRESS: <u>mchang@naic.org</u></p> <p>ON BEHALF OF: <u>Health Risk-Based Capital (E) Working Group</u></p> <p>NAME: <u>Steve Drutz</u></p> <p>TITLE: <u>Chief Financial Analyst/Chair</u></p> <p>AFFILIATION: <u>WA Office of Insurance Commissioner</u></p> <p>ADDRESS: <u>5000 Capitol Blvd SE</u> <u>Tumwater, WA 98501</u></p>	<p style="text-align: center;">FOR NAIC USE ONLY</p> <p>Agenda Item # <u>2024-12-H-MOD</u> Year <u>2024</u></p> <p style="text-align: center;">DISPOSITION</p> <p>ADOPTED:</p> <p><input checked="" type="checkbox"/> TASK FORCE (TF) <u>6/28/24</u></p> <p><input checked="" type="checkbox"/> WORKING GROUP (WG) <u>6/24/24</u></p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>EXPOSED:</p> <p><input type="checkbox"/> TASK FORCE (TF) _____</p> <p><input checked="" type="checkbox"/> WORKINGGROUP(WG) <u>6/6/24</u></p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>REJECTED:</p> <p><input type="checkbox"/> TF <input type="checkbox"/> WG <input type="checkbox"/> SG _____</p> <p>OTHER:</p> <p><input type="checkbox"/> DEFERRED TO _____</p> <p><input type="checkbox"/> REFERRED TO OTHER NAIC GROUP _____</p> <p><input type="checkbox"/> (SPECIFY) _____</p>
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IDENTIFICATION OF SOURCE AND FORM(S)/INSTRUCTIONS TO BE CHANGED

- | | | |
|---|---|--|
| <input checked="" type="checkbox"/> Health RBC Blanks | <input type="checkbox"/> Property/Casualty RBC Blanks | <input type="checkbox"/> Life and Fraternal RBC Blanks |
| <input checked="" type="checkbox"/> Health RBC Instructions | <input type="checkbox"/> Property/Casualty RBC Instructions | <input type="checkbox"/> Life and Fraternal RBC Instructions |
| <input checked="" type="checkbox"/> Health RBC Formula | <input type="checkbox"/> Property/Casualty RBC Formula | <input type="checkbox"/> Life and Fraternal RBC Formula |
| <input type="checkbox"/> OTHER _____ | | |

DESCRIPTION/REASON OR JUSTIFICATION OF CHANGE(S)

Adjust the health care receivable factors in XR021 to include a tiered adjustment.

Additional Staff Comments:

6/6/24 – Modified from Proposal 2024-12-H, to apply tiered factor on non-pharmaceutical rebate receivables in aggregate (i.e., aggregation of Claim Overpayment Receivables, Loan and Advances to Providers, Capitation Arrangement Receivables, Risk Sharing Receivables and Other Health Care Receivables). The Working Group directed re-expose for 14-day public comment period ending 6/20/24.

6/25/24 – The Working Group conducted an e-vote to adopt this proposal on 6/24/24.

**** This section must be completed on all forms.**

Revised 2-2023

Proposal 2024-12-H MOD

Other Receivables – L(25) through L(31)

There is an RBC requirement of 1 percent of the annual statement amount of investment income receivable and an RBC requirement of 5 percent of the annual statement amount for ~~pharmaceutical rebates and~~ amounts due from parents, subsidiaries, and affiliates, and aggregate write-ins for other than invested assets. ~~The RBC requirement for pharmaceutical rebates receivables is 20 percent of the first \$5 million and a 3 percent charge will be applied to the amount in excess. and~~ An RBC requirement of ~~19-40 percent of~~ ~~is applied to the first \$10 million of the aggregated annual statement amount and 5 -percent will be applied to the amounts in excess of the \$10 million the annual statement amount~~ for all other health care receivables reported in Lines (26.2) through (26.6) in aggregate. Enter the appropriate value in Lines (25) through (31).

Line (26.1). Pharmaceutical rebates are arrangements between pharmaceutical companies and reporting entities in which the reporting entities receive rebates based upon the drug utilization of its subscribers at participating pharmacies. These rebates are sometimes recorded as receivables by reporting entities using estimates based upon historical trends which should be adjusted to reflect significant variables involved in the calculation, such as number of prescriptions written/filled, type of drugs prescribed, use of generic vs. brand-name drugs, etc. In other cases, the reporting entity determines the amount of the rebate due based on the actual use of various prescription drugs during the accumulation period and then bills the pharmaceutical company. Oftentimes, a pharmacy benefits management company may determine the amount of the rebate based on a listing (of prescription drugs filled) prepared for the reporting entity's review. The reporting entity will confirm the listing and the pharmaceutical rebate receivable. Pharmaceutical rebates may relate to insured plans or uninsured plans. Only the receivable amount related to the insured plans should be reported on this line. Amount comes from annual statement Exhibit 3, Column 7, Line 0199999.

Line (26.2). Claim overpayments may occur as a result of several events, including but not limited to claim payments made in error to a provider. Reporting entities often establish receivables for claim overpayments. Amount comes from annual statement Exhibit 3, Column 7, Line 0299999.

Line (26.3). A health entity may make loans or advances to large hospitals or other providers. Such loans or advances are supported by legally enforceable contracts and are generally entered into at the request of the provider. In many cases, loans or advances are paid monthly and are intended to represent one month of fee-for-service claims activity with the respective provider. Amount comes from annual statement Exhibit 3, Column 7, Line 0399999.

Line (26.4). A capitation arrangement is a compensation plan used in connection with some managed care contracts in which a physician or other medical provider is paid a flat amount, usually on a monthly basis, for each subscriber who has elected to use that physician or medical provider. In some instances, advances are made to a provider under a capitation arrangement in anticipation of future services. Amount comes from annual statement Exhibit 3, Column 7, Line 0499999.

Line (26.5). Risk sharing agreements are contracts between reporting entities and providers with a risk sharing element based upon utilization. The compensation payments for risk sharing agreements are typically estimated monthly and settled annually. These agreements can result in receivables due from the providers if annual utilization is different than that used in estimating the monthly compensation. Amount comes from annual statement Exhibit 3, Column 7, Line 0599999.

Line (26.6). Any other health care receivable not reported in Lines (26.1) through (26.5). Amount comes from annual statement Exhibit 3, Column 7, Line 0699999.

Line (27). Only include on this line amounts receivable related to pharmaceutical rebates on uninsured plans that are in excess of the liability estimated by the reporting entity for the portion of such rebates due to the uninsured accident and health plans.

	Annual Statement Source	(1)		(2)	
		Amount	Factor	RBC Requirement	
(25) Investment Income Receivable	Page 2, Column 3, Line 14		0.010	\$0	
(26) Health Care Receivables	Exhibit 3, Column 7, Line 0799999				
(26.1) Pharmaceutical Rebate Receivables	Exhibit 3, Column 7, Line 0199999		*	\$0	=MAX(0,ROUND((F6<=5000000,F6*0.2,(5000000*0.2)+((F6-5000000)*0.03),0))
(26.2) Claim Overpayment Receivables	Exhibit 3, Column 7, Line 0299999		**	\$0	=MAX(0,ROUND((F7<=10000000,F7*0.4,(10000000*0.4)+((F7-10000000)*0.05),0))
(26.3) Loan and Advances to Providers	Exhibit 3, Column 7, Line 0399999		**	\$0	=MAX(0,ROUND((F8+F7<=10000000,F8*0.4,(10000000*0.4)+((F8+F7-10000000)*0.05),H7),0))
(26.4) Capitation Arrangement Receivables	Exhibit 3, Column 7, Line 0499999		**	\$0	=MAX(0,ROUND((F9+F8+F7<=10000000,F9*0.4,(10000000*0.4)+((F9+F8+F7-10000000)*0.05)-SUM(H7:H8),0))
(26.5) Risk Sharing Receivables	Exhibit 3, Column 7, Line 0599999		**	\$0	=MAX(0,ROUND((F10+F9+F8+F7<=10000000,F10*0.4,(10000000*0.4)+((F10+F9+F8+F7-10000000)*0.05)-SUM(H7:H9),0))
(26.6) Other Health Care Receivables	Exhibit 3, Column 7, Line 0699999		**	\$0	=MAX(0,ROUND((F11+F10+F9+F8+F7<=10000000,F11*0.4,(10000000*0.4)+((F11+F10+F9+F8+F7-10000000)*0.05)-SUM(H7:H10),0))
(27) Amounts Receivable Relating to Uninsured Accident and Health Plans	Included in Page 2, Column 3, Line 17		0.050	\$0	
(28) Amounts Due from Parents, Subs, and Affiliates	Page 2, Column 3, Line 23		0.050	\$0	
(29) Aggregate Write-Ins For Other Than Invested Assets	Page 2, Column 3, Line 25		0.050	\$0	
(30) Total Other Receivables RBC	Line (25) + Sum Lines (26.1) through (29)			\$0	
(31) Total Credit RBC	Lines (17) + (24) + (30)			\$0	

* Line (26.1) Pharmaceutical Rebates - A factor of .200 will be applied to the first \$5,000,000 in Column (1), and a factor of .030 will be applied to the remaining amount in excess of \$5,000,000.
 **Lines (26.2) - (26.6) Non-Pharmaceutical Rebates - These lines are aggregated first and a factor of .400 will be applied to the first \$10,000,000 in Column (1) and a factor of .050 will be applied to the remaining amount in excess of \$10,000,000.

Capital Adequacy (E) Task Force RBC Proposal Form

- | | | |
|---|---|---|
| <input type="checkbox"/> Capital Adequacy (E) Task Force | <input type="checkbox"/> Health RBC (E) Working Group | <input type="checkbox"/> Life RBC (E) Working Group |
| <input type="checkbox"/> Catastrophe Risk (E) Subgroup | <input type="checkbox"/> Investment RBC (E) Working Group | <input type="checkbox"/> Longevity Risk (A/E) Subgroup |
| <input type="checkbox"/> Variable Annuities Capital. & Reserve (E/A) Subgroup | <input checked="" type="checkbox"/> P/C RBC (E) Working Group | <input type="checkbox"/> RBC Investment Risk & Evaluation (E) Working Group |

<p style="text-align: right;">DATE: <u>4/12/24</u></p> <p>CONTACT PERSON: <u>Eva Yeung</u></p> <p>TELEPHONE: <u>816-783-8407</u></p> <p>EMAIL ADDRESS: <u>eyeung@naic.org</u></p> <p>ON BEHALF OF: <u>P/C RBC (E) Working Group</u></p> <p>NAME: <u>Tom Botsko</u></p> <p>TITLE: <u>Chair</u></p> <p>AFFILIATION: <u>Ohio Department of Insurance</u></p> <p>ADDRESS: <u>50 West Town Street, Suite 300</u> <u>Columbus, OH 43215</u></p>	<p style="text-align: center;">FOR NAIC USE ONLY</p> <p>Agenda Item # <u>2024-14-P</u> Year <u>2024</u></p> <p style="text-align: center;">DISPOSITION</p> <p>ADOPTED:</p> <p><input checked="" type="checkbox"/> TASK FORCE (TF) <u>06/28/2024</u></p> <p><input type="checkbox"/> WORKING GROUP (WF) _____</p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>EXPOSED:</p> <p><input type="checkbox"/> TASK FORCE (TF) _____</p> <p><input checked="" type="checkbox"/> WORKING GROUP (WG) <u>04/25/2024</u></p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>REJECTED:</p> <p><input type="checkbox"/> TF <input type="checkbox"/> WG <input type="checkbox"/> SG _____</p> <p>OTHER:</p> <p><input type="checkbox"/> DEFERRED TO _____</p> <p><input type="checkbox"/> REFERRED TO OTHER NAIC GROUP _____</p> <p><input type="checkbox"/> (SPECIFY) _____</p>
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IDENTIFICATION OF SOURCE AND FORM(S)/INSTRUCTIONS TO BE CHANGED

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|--|--|--|
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| <input type="checkbox"/> Health RBC Instructions | <input type="checkbox"/> Property/Casualty RBC Instructions | <input type="checkbox"/> Life and Fraternal RBC Instructions |
| <input type="checkbox"/> Health RBC Formula | <input type="checkbox"/> Property/Casualty RBC Formula | <input type="checkbox"/> Life and Fraternal RBC Formula |
| <input type="checkbox"/> OTHER _____ | | |

DESCRIPTION/REASON OR JUSTIFICATION OF CHANGE(S)

The proposed change would provide a routine annual update of the industry underwriting factors (premium and reserve) in the PCRBC formula.

Additional Staff Comments:

** This section must be completed on all forms.

Revised 2-2023

PR017 Line 1 Reserves

Schedule P Line of Business	LOB	Proposed for adoption - 2024 Industry Average Development Ratio	2023 Industry Average Development	2022 Industry Average Development	2021 Industry Average Development	2020 Industry Average Development	2019 Industry Average Development	2018 Industry Average Development	2017 Industry Average Development	2016 Industry Average Development	2015 Industry Average Development
H/F	A	1.020	0.999	1.001	0.998	0.993	0.989	0.989	0.984	0.972	0.962
PPA	B	1.061	1.047	1.022	1.025	1.035	1.026	1.022	1.012	1.002	1.002
CA	C	1.115	1.106	1.082	1.083	1.078	1.087	1.060	1.034	1.015	0.987
WC	D	0.882	0.873	0.906	0.912	0.916	0.955	0.952	0.971	0.971	0.961
CMP	E	1.024	1.026	1.037	0.999	1.016	0.992	0.967	0.956	0.942	0.938
MM Occurrence	F1	0.910	0.906	0.887	0.874	0.861	0.864	0.871	0.868	0.841	0.966
MM Clms Made	F2	0.996	0.984	0.983	0.973	0.940	0.907	0.886	0.854	0.822	0.839
SL	G	0.996	0.994	0.990	0.976	0.963	0.938	0.933	0.926	0.919	0.975
OL	H	0.993	0.969	0.995	0.964	0.968	0.971	0.966	0.952	0.929	0.923
Fidelity / Surety	K	0.875	0.852	0.842	0.915	0.907	0.995	0.996	1.016	1.035	1.016
Special Property/ Pet Insurance Plan	I/U	0.989	0.983	0.993	0.978	0.977	0.972	0.971	0.982	0.973	0.991
Auto Physical Damage	J	0.999	1.016	1.011	0.989	0.993	0.996	1.000	1.001	0.995	0.995
Other (Credut, A&H)	L	0.942	0.946	0.955	0.965	0.971	0.973	0.976	0.981	0.986	1.041
Financial / Mortgage Guaranty	S	0.493	0.674	0.694	0.723	0.682	0.788	0.870	0.820	0.853	1.185
Intl	M	2.168	2.414	3.041	1.104	1.162	1.037	0.851	0.855	0.897	1.350
Rein. Property & Financial Lines	NP	0.930	0.924	0.917	0.893	0.886	0.872	0.834	0.814	0.814	1.002
Rein. Liability	O	1.054	1.024	1.008	0.989	0.985	0.955	0.945	0.914	0.896	0.938
PL	R	0.882	0.874	0.867	0.879	0.900	0.913	0.921	0.935	0.937	1.072
Warranty	T	0.991	0.995	0.998	1.007	1.013	1.017	1.015	0.989	0.977	0.994

PR018 Line 1 Premiums

Schedule P Line of Business	LOB	Proposed 2024 Industry Average Loss & Expense Ratio	2023 Industry Average Loss & Expense Ratio	2022 Industry Average Loss & Expense Ratio	2021 Industry Average Loss & Expense Ratio	2020 Industry Average Loss & Expense Ratio	2019 Industry Average Loss & Expense Ratio	2018 Industry Average Loss & Expense Ratio	2017 Industry Average Loss & Expense Ratio	2016 Industry Average Loss & Expense Ratio	2015 Industry Average Loss & Expense Ratio
H/F	A	0.695	0.679	0.665	0.681	0.678	0.681	0.687	0.688	0.701	0.701
PPA	B	0.799	0.791	0.793	0.795	0.810	0.810	0.806	0.800	0.792	0.786
CA	C	0.787	0.777	0.761	0.761	0.759	0.737	0.724	0.706	0.689	0.684
WC	D	0.646	0.651	0.664	0.682	0.705	0.726	0.744	0.751	0.752	0.751
CMP	E	0.684	0.671	0.661	0.673	0.672	0.666	0.664	0.647	0.648	0.655
MM Occurrence	F1	0.752	0.767	0.750	0.731	0.726	0.730	0.780	0.777	0.767	0.880
MM Clms Made	F2	0.828	0.815	0.829	0.821	0.797	0.768	0.747	0.722	0.691	0.697
SL	G	0.583	0.578	0.585	0.593	0.603	0.593	0.569	0.567	0.572	0.630
OL	H	0.649	0.641	0.637	0.635	0.639	0.638	0.633	0.629	0.618	0.616
Fidelity / Surety	K	0.375	0.363	0.366	0.394	0.384	0.399	0.417	0.430	0.464	0.462
Special Property/Pet Insurance Plan	I/U	0.559	0.550	0.547	0.559	0.553	0.554	0.563	0.555	0.559	0.571
Auto Physical Damage	J	0.733	0.727	0.718	0.726	0.732	0.730	0.732	0.727	0.711	0.703
Other (Credit, A&H)	L	0.711	0.702	0.698	0.693	0.684	0.682	0.709	0.712	0.699	0.706
Financial / Mortgage Guaranty	S	0.158	0.209	0.203	0.252	0.513	0.811	1.099	1.175	1.293	1.096
Intl	M	1.153	1.136	1.166	0.769	0.758	0.795	0.584	0.565	0.607	1.150
Rein. Property & Financial Lines	NP	0.587	0.578	0.566	0.558	0.534	0.522	0.486	0.459	0.512	0.723
Rein. Liability	O	0.760	0.743	0.725	0.713	0.708	0.679	0.666	0.609	0.600	0.749
PL	R	0.594	0.597	0.601	0.617	0.645	0.656	0.671	0.670	0.684	0.715
Warranty	T	0.641	0.652	0.665	0.681	0.691	0.695	0.732	0.645	0.611	0.799



NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

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

Meeting Summary Report for the Capital Adequacy (E) Task Force June 28, 2024

1. The Risk-Based Capital Investment Risk and Evaluation (E) Working Group met June 21, May 22, and April 12 to discuss residual tranches and the 45% risk-based capital (RBC) factor in place for year-end 2024. After consideration of comments, as well as a review of alternative proposals to bifurcate residual tranches between 30% and 45% RBC categories, the Working Group adopted a motion to retain the 45% RBC factor for all residual tranches for year-end 2024. This motion passed with nine affirmative votes and six opposing votes by the members present. The 45% RBC factor for residual tranches was adopted fully through the NAIC committee structure in 2023. Therefore, no further action is needed to incorporate this RBC factor. Key comments in support of the motion include:
 - A. The creation of a second category with a lower 30% RBC charge based on overall underlying investment classification (type of residual) would rely on reporting entities to classify residuals based on ill-defined classification types and does not factor any risk attributes other than collateral type, which may not be a reliable predictor of risk.
 - B. The creation of a second category with a lower 30% RBC charge based on the next most junior tranche rating could create an incentive to combine residual tranches with the next lowest tranche to allow for a higher-level tranche to be used as the metric in determining residual RBC category. Furthermore, it was noted that it would increase reliance on ratings and could result in rating shopping for residual classification.
 - C. Middle market collateralized loan obligations (CLOs) are the largest category of residual interests held by life-reporting entities as surveyed by the American Council of Life Insurers (ACLI). As the assessed risk is similar to broadly syndicated loans (BSLs) when characteristics are comparable (residual thickness and next most junior tranche rating), these residuals should be classified for a 45% RBC factor, similar to BSL residuals, during the interim.
 - D. State insurance regulators noted that the 2023 adoption of the 45% RBC factor was delayed for implementation until 2024 to allow industry to present a rationale supporting a lower risk factor, and without such data justifying a lower charge, there should be no more delay in implementation.
2. The alternative proposals the Working Group contemplated June 21 included:
 - A. The exposed proposal 2024-19-I with modifications to: 1) classify all middle market CLOs into the 45% RBC category; and 2) eliminate the ability for state insurance regulators to direct certain residual interests to the 30% category. (This state discretion was inconsistent with the RBC preamble that precludes deviations from the adopted RBC formula.)
 - B. A new proposal presented by the Iowa Insurance Division to classify residual tranches between 30% and 45% RBC categories based on the rating of the next most junior tranche.
3. The discussion of the RBC factor for residual tranches has been subject to much discussion, including those taking place on the following dates in 2024:

- A. Spring National Meeting: Discussion and exposure of an Oliver Wyman residual tranche report and analysis.
- B. April 12: Consideration of comments on the exposures and a motion to incorporate an additional one-year implementation delay to move the interim 45% charge on residuals from 2024 to 2025. This motion did not pass, with 11 members opposing, four supporting, and one abstaining.
- C. April 16: Exposure of a memorandum requesting additional feedback by industry stakeholders to substantiate their request for an additional one-year delay in implementing the 45% residual tranche factor.
- D. May 22: Discussion of comment letters received on the exposed memorandum and exposure of a proposal to bifurcate residual tranches between 30% and 45% based on the classification of the underlying collateral of the residual.
- E. June 21: Discussion of comments on the exposed proposal and alternatives to classify residual tranches between 30% and 45% reporting categories. This consideration resulted in the action to retain the 45% factor for all residual tranches for year-end 2024. This motion passed with nine affirmative votes and six opposing votes by the members present.

Capital Adequacy (E) Task Force RBC Proposal Form

- | | | |
|---|---|---|
| <input checked="" type="checkbox"/> Capital Adequacy (E) Task Force | <input type="checkbox"/> Health RBC (E) Working Group | <input type="checkbox"/> Life RBC (E) Working Group |
| <input type="checkbox"/> Catastrophe Risk (E) Subgroup | <input type="checkbox"/> Investment RBC (E) Working Group | <input type="checkbox"/> Longevity Risk (A/E) Subgroup |
| <input type="checkbox"/> Variable Annuities Capital. & Reserve (E/A) Subgroup | <input type="checkbox"/> P/C RBC (E) Working Group | <input type="checkbox"/> RBC Investment Risk & Evaluation (E) Working Group |

<p style="text-align: right;">DATE: <u>1/27/24</u></p> <p>CONTACT PERSON: <u>Eva Yeung</u></p> <p>TELEPHONE: <u>816-783-8407</u></p> <p>EMAIL ADDRESS: <u>eyeung@naic.org</u></p> <p>ON BEHALF OF: <u>P/C RBC (E) Working Group</u></p> <p>NAME: <u>Tom Botsko</u></p> <p>TITLE: <u>Chair</u></p> <p>AFFILIATION: <u>Ohio Department of Insurance</u></p> <p>ADDRESS: <u>50 West Town Street, Suite 300</u> <u>Columbus, OH 43215</u></p>	<p style="text-align: center;">FOR NAIC USE ONLY</p> <hr/> <p>Agenda Item # <u>2024-18-CA</u> Year <u>2024</u></p> <hr/> <p style="text-align: center;">DISPOSITION</p> <p>ADOPTED:</p> <p><input checked="" type="checkbox"/> TASK FORCE (TF) <u>06/28/2024</u></p> <p><input type="checkbox"/> WORKING GROUP (WF) _____</p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>EXPOSED:</p> <p><input type="checkbox"/> TASK Force(TF) _____</p> <p><input type="checkbox"/> WORKING GROUP (WG) _____</p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>REJECTED:</p> <p><input type="checkbox"/> TF <input type="checkbox"/> WG <input type="checkbox"/> SG _____</p> <p>OTHER:</p> <p><input type="checkbox"/> DEFERRED TO _____</p> <p><input type="checkbox"/> REFERRED TO OTHER NAIC GROUP _____</p> <p><input type="checkbox"/> (SPECIFY) _____</p>
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IDENTIFICATION OF SOURCE AND FORM(S)/INSTRUCTIONS TO BE CHANGED

- | | | |
|---|--|--|
| <input checked="" type="checkbox"/> Health RBC Blanks | <input checked="" type="checkbox"/> Property/Casualty RBC Blanks | <input type="checkbox"/> Life and Fraternal RBC Blanks |
| <input checked="" type="checkbox"/> Health RBC Instructions | <input checked="" type="checkbox"/> Property/Casualty RBC Instructions | <input type="checkbox"/> Life and Fraternal RBC Instructions |
| <input type="checkbox"/> Health RBC Formula | <input type="checkbox"/> Property/Casualty RBC Formula | <input type="checkbox"/> Life and Fraternal RBC Formula |
| <input type="checkbox"/> OTHER _____ | | |

DESCRIPTION/REASON OR JUSTIFICATION OF CHANGE(S)

This proposal adds a 20% charge for the Total Residual Tranches or Interests in PR008 for P/C and XR008 for Health.

Additional Staff Comments:

06-13-24 eky The Task Force adopted the proposal 2024-02-CA Residual Tranches "Structure" in April 30.

** This section must be completed on all forms.

Revised 2-2023

Fixed Income Assets XR007 and XR008

The RBC requirement for fixed income assets is largely driven by the default risk on those assets. There are two major subcategories: Bonds and Miscellaneous. Bonds include items that meet the definition of a bond, regardless if the bond is long-term (reported on Schedule D-1), short-term (reported on Schedule DA), or a cash equivalent (reported on Schedule E-2). Miscellaneous fixed income assets include non-bond items reported on the cash equivalent and short-term schedules, derivatives, mortgage loans, collateral loans, and other items reported on Schedule BA: Other Long-Term Invested Assets.

Bonds (XR007)

The bond factors for investment grade bonds (NAIC Designation (1.A-2.C) are based on cash flow modeling. Each bond of a portfolio was annually tested for default (based on a “roll of the dice”) where the default probability varies by NAIC Designation Category and that year’s economic environment. The default probabilities were based on historical data intended to reflect a complete business cycle of favorable or unfavorable credit environments. The risk of default was measured over a five-year time horizon, based on the duration of assets held for health companies.

The factors for NAIC Designation Category 3.A to 6 recognize that these non-investment grade bonds are reported at the lower of amortized cost or fair value. These bond risk factors are based on the market value fluctuation for each of the NAIC Designation Category compared to the market value fluctuation of stocks during the 2008-2009 financial crisis.

While the life and property/casualty formulas have a separate calculation for the bond size factor (based on the number of issuers in the RBC filer’s portfolio), the health formula does not include a separate calculation, instead a bond size component was incorporated into the bond factors. A representative portfolio of 382 issuers was used in calculating the bond risk factors.

There is no RBC requirement for bonds guaranteed by the full faith and credit of the United States, Other U.S. Government Obligations, and securities on the NAIC U.S. Government Money Market Fund List because it is assumed that there is no default risk associated with U.S. Government issued securities.

The book/adjusted carrying value of all bonds should be reported in Columns (1), (2) or (3). The bonds are split into twenty-one different risk classifications. These risk classifications are based on the NAIC Designation Category as defined and permitted in the *Purposes and Procedures Manual of the Investment Analysis Office*. The subtotal of Columns (1), (2), and (3) will be calculated in Column (4). The RBC requirement will be automatically calculated in Column (5).

Miscellaneous Fixed Income Assets (XR008)

The factor for cash is 0.3 percent. It is recognized that there is a small risk related to possible insolvency of the bank where cash deposits are held. This factor was based on the original unaffiliated NAIC 01 bond risk factor prior to the increased granularity of the NAIC Designation Categories in 2021 and reflects the short-term nature of this risk. The required risk-based capital for cash will not be less than zero, even if the company’s cash position is negative.

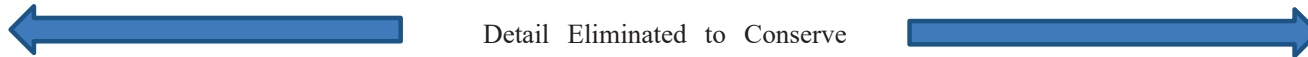
The Short-Term Investments to be included in this section are those short-term investments not reflected elsewhere in the formula. The 0.3 percent factor is equal to the factor for cash. The amount reported in Line (8) reflects the total from Schedule DA: Short-Term Investments (Line (6)), less the short-term bonds (Line (7)). (The short-term bonds reported in Line (7) should equal Schedule DA, Part 1, Column 7, Line 2509999999.)

Mortgage loans (reported on Schedule B) and Derivatives (reported on Schedule DB) receive a factor of 5 percent, consistent with other risk-based capital formulas studied by the Working Group.

The following investment types are captured on Schedule BA: Other Long-Term Invested Assets. Specific factors have been established for certain Schedule BA assets based on the nature of the investment. Those Schedule BA assets not specifically identified below receive a 20 percent factor (Line (16) and Line (22)).

- Collateral Loans reported on Line (13) receive a factor of 5 percent, consistent with other risk-based capital formulas studied by the Working Group.
- Working Capital Finance Investments: The book adjusted carrying value of NAIC 01 and 02 Working Capital Finance Investments, Lines (14) and (15), should equal the Notes to Financial Statement, Lines 5M(01a) and 5M(01b), Column 3 of the annual statement.
- Low-income housing tax credit investment are reported on Column (1) in accordance with *SSAP No. 93—Low Income Housing Tax Credit Property Investments*.
 - Federal Guaranteed Low-Income Housing Tax Credit (LIHTC) investments are to be included in Line (17). There must be an all-inclusive guarantee from an ARO-rated entity that guarantees the yield on the investment.
 - Federal Non-Guaranteed LIHTC investments with the following risk mitigation factors are to be included in Line (18):
 - a) A level of leverage below 50 percent. For a LIHTC Fund, the level of leverage is measured at the fund level.
 - b) There is a tax credit guarantee agreement from general partner or managing member. This agreement requires the general partner or managing member to reimburse investors for any shortfalls in tax credits due to errors of compliance, for the life of the partnership. For an LIHTC fund, a tax credit guarantee is required from the developers of the lower-tier LIHTC properties to the upper-tier partnership.
 - State Guaranteed LIHTC investments that at a minimum meet the federal requirements for guaranteed LIHTC investments are to be included in Line (19).
 - State Non-Guaranteed LIHTC investments that at a minimum meet the federal requirements for non-guaranteed LIHTC investments are to be included on Line (20).
 - All Other LIHTC investments, state and federal LIHTC investments that do not meet the requirements of Lines (17) through (20) would be reported on Line (21).

PR008 – Other Long-Term Assets



Schedule BA Assets (Other Invested Assets – excluding collateral loans, low income housing tax credits and Working Capital Finance Investments)

Other Invested Assets are those that are listed in Schedule BA and are somewhat more speculative and risky than most other investments. The factor for Schedule BA assets excluding collateral loans, low income housing tax credits, and working capital finance investments is 20%.

The book/adjusted carrying value of total Schedule BA assets (including collateral loans, low income housing tax credits and Working Capital Finance Investments) should equal Page 2, Line 8, Column 3 of the annual statement.

Low Income Housing Tax Credits

Report Column (1) in accordance with *SSAP No. 93—Low Income Housing Tax Credit Property Investments*.

Federal Guaranteed low-income housing tax credit (LIHTC) investments are to be included in Line (13). There must be an all-inclusive guarantee from an ARO-rated entity that guarantees the yield on the investment.

Federal Non-guaranteed LIHTC investments with the following risk mitigation factors are to be included in Line (14):

- a) A level of leverage below 50 percent. For a LIHTC Fund, the level of leverage is measured at the fund level.
- b) There is a tax credit guarantee agreement from general partner or managing member. This agreement requires the general partner or managing member to reimburse investors for any shortfalls in tax credits due to errors of compliance, for the life of the partnership. For an LIHTC fund, a tax credit guarantee is required from the developers of the lower-tier LIHTC properties to the upper-tier partnership.

State LIHTC investments that at a minimum meet the federal requirements for guaranteed LIHTC investments are to be included in Line (15).

State LIHTC investments that at a minimum meet the federal requirements for non-guaranteed LIHTC investments are to be included in Line (16).

State and federal LIHTC investments that do not meet the requirements of lines (13) through (16) would be reported on Line (17).

Working Capital Finance Investments

The book/adjusted carrying value of NAIC 01 and 02 Working Capital Finance Investments should equal Note to the Financial Statement, Lines 5M(01a) and 5M(01b), Column 3 of the annual statement.

FIXED INCOME ASSETS - MISCELLANEOUS

	Annual Statement Source	(1) Bk/Adj Carrying Value	Factor	(2) RBC Requirement
(1) Cash	Page 2, Line 5, inside amount 1		0.0030	
(2) Cash Equivalents	Page 2, Line 5, inside amount 2			
(3) Less: Cash Equivalents, Total Bonds	Schedule E, Part 2, Column 7, Line 2509999999			
(4) Less: Exempt Money Market Mutual Funds as Identified by SVO	Schedule E, Part 2, Column 7, Line 8209999999			
(5) Net Cash Equivalents	Lines (2) - (3) - (4)		0.0030	
(6) Short-Term Investments	Page 2, Line 5, inside amount 3			
(7) Short-Term Bonds	Schedule DA, Part 1, Column 7, Line 2509999999			
(8) Total Other Short-Term Investments	Lines (6) - (7)		0.0030	
(9) Mortgage Loans - First Liens	Page 2, Column 3, Line 3.1		0.0500	
(10) Mortgage Loans - Other Than First Liens	Page 2, Column 3, Line 3.2		0.0500	
(11) Receivable for Securities	Page 2, Column 3, Line 9		0.0240	
(12) Aggregate Write-Ins for Invested Assets	Page 2, Column 3, Line 11		0.0500	
(13) Collateral Loans	Included in Page 2, Column 3, Line 8		0.0500	
(14) NAIC 01 Working Capital Finance Investments	Notes to Financial Statement 5M(01a), Column 3		0.0038	
(15) NAIC 02 Working Capital Finance Investments	Notes to Financial Statement 5M(01b), Column 3		0.0125	
(16) Other Long-Term Invested Assets Excluding Collateral Loans, Residual Tranches or Interests and Working Capital Finance Investments	Included in Page 2, Column 3, Line 8		0.2000	
(17) Federal Guaranteed Low Income Housing Tax Credits	Schedule BA Part 1, Column 12 Lines 3599999 + 3699999		0.0014	
(18) Federal Non-Guaranteed Low Income Housing Tax Credits	Schedule BA Part 1, Column 12 Lines 3799999 + 3899999		0.0260	
(19) State Guaranteed Low Income Housing Tax Credits	Schedule BA Part 1, Column 12 Lines 3999999 + 4099999		0.0014	
(20) State Non-Guaranteed Low Income Housing Tax Credits	Schedule BA Part 1, Column 12 Lines 4199999 + 4299999		0.0260	
(21) All Other Low Income Housing Tax Credits	Schedule BA Part 1, Column 12 Lines 4399999 + 4499999		0.1500	
(22) Total Residual Tranches or Interests	Schedule BA, Part 1, Column 12 Lines 4699999 + 4799999 + 4899999 + 4999999 + 5099999 + 5199999 + 5299999 + 5399999 + 5499999 + 5599999 + 5699999 + 5799999		0.2000	
(23) Total Other Long-Term Invested Assets (Page 2, Column 3, Line 8)	Lines (13) + (14) + (15) + (16) + (17) + (18) + (19) + (20) + (21) + (22)			
(24) Derivatives	Page 2, Column 3, Line 7		0.0500	
(25) Total Miscellaneous Fixed Income Assets RBC	Lines (1) + (5) + (8) + (9) + (10) + (11) + (12) + (23) + (24)			

Denotes items that must be manually entered on filing software.

OTHER LONG-TERM ASSETS PR008

	Annual Statement Source	(1) <u>Book/Adjusted</u> <u>Carrying Value</u>	Factor	(2) <u>RBC Requirement</u>
(1) Company Occupied Real Estate	P2 L4.1 C3	0	0.100	0
(2) Encumbrances	P2 L4.1, inside item	0	0.100	0
(3) Property Held For the Production of Income	P2 L4.2 C3	0	0.100	0
(4) Property Held For Sale	P2 L4.3 C3	0	0.100	0
(5) Encumbrances (Property Held For the Production of Income)	P2 L4.2, inside item	0	0.100	0
(6) Encumbrances (Property Held For Sale)	P2 L4.3, inside item	0	0.100	0
(7) Total Real Estate	L(1)+L(2)+L(3)+L(4)+L(5)+L(6)	0		0
(8) Mortgage Loans - First Liens	P2 L3.1 C3	0	0.050	0
(9) Mortgage Loans - Other Than First Liens	P2 L3.2 C3	0	0.050	0
(10) Total Mortgage Loans	L(8) + L(9)	0		0
(11) Schedule BA Assets - Total	P2 L8 C3	0		
(12) Less: Collateral Loans	PR009 L(13)	0		
(13) Federal Guaranteed Low Income Housing Tax Credits	Schedule BA Part 1, C12 L3599999 +L3699999	0	0.0014	0
(14) Federal Non-Guaranteed Low Income Housing Tax Credits	Schedule BA Part 1, C12 L3799999 +L3899999	0	0.0260	0
(15) State Guaranteed Low Income Housing Tax Credits	Schedule BA Part 1, C12 L3999999 +L4099999	0	0.0014	0
(16) State Non-Guaranteed Low Income Housing Tax Credits	Schedule BA Part 1, C12 L4199999 +L4299999	0	0.0260	0
(17) All Other Low Income Housing Tax Credits	Schedule BA Part 1, C12 L4399999 +L4499999	0	0.1500	0
(18) Working Capital Finance Investments	L(21)+L(22)	0		
(19) Total Residual Tranches or Interests	Schedule BA, Part 1, Column 12 Lines 4699999 + 4799999 + 4899999 + 4999999 + 5099999 + 5199999 + 5299999 + 5399999 + 5499999 + 5599999 + 5699999 + 5799999		0.2000	
(20) Schedule BA Assets Excluding Collateral Loans, LIHTC, &-WCFI, & Residual Tranches or Interests	L(11)-L(12)-L(13)-L(14)-L(15) -L(16)-L(17)-L(18)-L(19)	0	0.2000	0
(21) NAIC 01 Working Capital Finance Investments	Notes to Financial Statement Item L5M(01a) C3	0	0.0038	0
(22) NAIC 02 Working Capital Finance Investments	Notes to Financial Statement Item L5M(01b) C3	0	0.0125	0
(23) Total Other Long-Term Assets	L(7)+L(10)+L(13)+L(14)+L(15) +L(16)+L(17)+L(19)+L(20)+L(21)+L(22)	0		0

PR008

Draft: 5/29/24

Capital Adequacy (E) Task Force
Virtual Meeting
April 30, 2024

The Capital Adequacy (E) Task Force met April 30, 2024. The following Task Force members participated: Judith L. French, Chair, Tom Botsko, Matt Peters, Dwight Radel, Whitney Fitch, Tim Biler, Daniel Bradford, and Dale Bruggeman (OH); Doug Ommen, Vice Chair, represented by Mike Yanacheak, Carrie Mears, Kevin Clark, and Kim Cross (IA); Lori K. Wing-Heier represented by David Phifer and Kevin Richard (AK); Mark Fowler represented by Charles Hale and Kristina Jones (AL); Ricardo Lara represented by Mike Peterson, Rabab Charafeddine, and Kim Hudson (CA); Michael Conway represented by Mitchell Bronson, Eric Unger, and Rolf Kaumann (CO); Andrew N. Mais represented by Wanchin Chou and Sarah Mu (CT); Karima M. Woods represented by Howard Liebers (DC); Michael Yaworsky represented by Jane Nelson, Virginia Christy, and Ainsley Hurley (FL); Ann Gillespie represented by Vincent Tsang and Beth Sill (IL); Amy L. Beard represented by Roy Eft (IN); Vicki Schmidt represented by Tish Becker and Sarah Smith (KS); Sharon P. Clark represented by Russell Coy (KY); Kathleen A. Birrane represented by Greg Ricci (MD); Chlora Lindley-Myers, Debbie Goeller, John Rehagen, Laurie Pleus, Julie Lederer, and Danielle K. Smith (MO); Mike Causey represented by Jessica Price and Teresa Browning (NC); Jon Godfread represented by Matt Fischer (ND); Eric Dunning represented by Michael Muldoon and Lindsay Crawford (NE); D.J. Bettencourt represented by Jennifer Li and Sandra Barlow (NH); Justin Zimmerman represented by David Wolf (NJ); Scott Kipper represented by Jordan Lumpkin, Steve Ross, Nick Stosic, and Dede Benissan (NV); Glen Mulready represented by Andrew Schallhorn (OK); Michael Wise represented by Will Davis and Ryan Basnett (SC); Cassie Brown represented by Miriam Fisk (TX); Mike Kreidler represented by Steve Drutz and Jay Bruns (WA); and Nathan Houdek, Amy Malm, and Michael Erdman (WI).

1. Adopted Proposal 2024-04-L (TAC for Non-Admitted Affiliate)

Botsko said proposal 2024-04-L adds a line to LR033, Calculation of Total Adjusted Capital (TAC), to address the treatment of non-admitted insurance affiliates. This treatment was adopted as part of proposal 2022-09-CA, the revised treatment of affiliated investments. This line was omitted from the life structure change but was done for 2023 by including it in an existing line. This proposal does not change the treatment but makes the life formula consistent with the other risk-based capital (RBC) formulas. The Life Risk-Based Capital (E) Working Group agreed to expose the proposal for a 30-day public comment period during its Jan. 25 meeting. No comments were received.

Chou made a motion, seconded by Yanacheak, to adopt proposal 2024-04-L (Attachment Two-A). The motion passed unanimously.

2. Adopted Proposal 2024-05-L (BA Mortgages Omitted AVR Line)

Botsko said proposal 2024-05-L adds a line to LR009 to specifically address line 44 of the Asset Valuation Reserve (AVR) Equity Component. This AVR line was not included in the LR009 changes made with the mortgage methodology change in 2013. This proposal does not include a factor but facilitates the application of one specific to this category if appropriate. The Life Risk-Based Capital (E) Working Group agreed to expose the proposal for a 30-day public comment period during its Jan. 25 meeting. One comment was received. Botsko also indicated that a new proposal, 2024-17-L, which adds a factor for this new line, is currently exposed for a 30-day public comment period ending May 28.

Chou made a motion, seconded by Yanacheak, to adopt proposal 2024-05-L (Attachment Two-B). The motion passed unanimously.

3. Adopted Proposal 2024-08-CA (Column 12 Affiliated Investment)

Botsko said the purpose of proposal 2024-08-CA is to remove the reference to “H0 Component” and “R0 Component” from the Column 12 heading on pages XR002 and PR003, respectively. He stated that the “H0” and “R0” references are misleading because only affiliate types 1, 2, 5, and 6 flow into H0 and R0, while all other affiliate types flow into H1 and R2. He stated that the Task Force exposed this proposal for a 30-day public comment period at the Spring National Meeting. No comments were received.

Chou made a motion, seconded by Kaumann, to adopt proposal 2024-08-CA (Attachment Two-C). The motion passed unanimously.

4. Exposed Proposal 2024-09-CA (Underwriting Risk Investment Risk Factor)

Drutz said the purpose of this proposal is to update the underwriting risk factors for the annual investment income adjustment to the comprehensive medical, Medicare supplement, and dental and vision factors. This proposal was originally exposed by the Health Risk-Based Capital (E) Working Group for a 32-day comment period ending March 25. No comments were received. Drutz also stated that the Working Group referred the proposal to the Task Force as the proposal affects all three lines of business. He also indicated that the proposed changes will result in a decrease of between 0.4% and 1.2% for comprehensive medical, Medicare supplement, and dental and vision underwriting risk factors, depending on the line of business and the tier of revenue.

The Task Force agreed to expose proposal 2024-09-CA for a 30-day public comment period ending May 30.

5. Adopted Proposal 2024-10-P (PR019 Other Health Line)

Botsko said proposal 2024-10-P would address the current double-counting issue for companies with stop-loss premium, as the stop-loss premium is expected to be entered on line 9 of PR019. He also stated that the Property and Casualty Risk-Based Capital (E) Working Group exposed this proposal for a 30-day public comment period at the Spring National Meeting. No comments were received.

Chou made a motion, seconded by Eft, to adopt proposal 2024-10-P (Attachment Two-D). The motion passed unanimously.

6. Adopted Proposal 2024-11-P (2024 and 2025 Underwriting Risk Lines 4 and 8 Factors)

Botsko said that at the Spring National Meeting, the Property and Casualty Risk-Based Capital (E) Working Group agreed to expose the: 1) 50% indicated change with capped international and product liability lines in 2024, and 100% indicated change with capped international and product liability lines in 2025 for reserve factors; and 2) 50% indicated change with capped financial mortgage guaranty line in 2024, and 100% indicated change with capped financial mortgage guaranty line in 2025 for premium factors for a 30-day public comment period. No comments were received.

Malm made a motion, seconded by Chou, to adopt Proposal 2024-11-P (Attachment Two-E). The motion passed unanimously.

7. Exposed Proposal 2024-13-CA (Receivable for Securities Factors)

Botsko said the intent of proposal 2024-13-CA is to provide a routine three-year update to the receivable for securities for all three lines of business by using a weighted average methodology. He also stated that the proposed factors are consistent with the past factors.

The Task Force agreed to expose proposal 2024-13-CA for a 30-day public comment period ending May 30.

8. Exposed Proposal 2024-16-CA (Revised Preamble)

Botsko said the Risk-Based Capital Risk Evaluation Purposes and Guidelines Ad Hoc Subgroup met several times between September 2023 and January 2024 to have a robust discussion on the preamble revisions among stakeholders. He stated that the intent of this proposal is to provide edits to the RBC preamble based on the Ad Hoc Subgroup's discussions to clarify and emphasize the purposes and intent of using RBC. Hemphill also indicated that it clarifies the *Risk-Based Capital for Insurers Model Act* (#312) and the *Risk-Based Capital for Health Organizations Model Act* (#315) around the purpose of RBC and what it is and is not designed to do.

The Task Force agreed to expose proposal 2024-16-CA (Attachment Two-F) for a 30-day public comment period ending May 30.

9. Forwarded a Referral Regarding the Issue of Asset Concentration to the Risk-Based Capital Investment Risk and Evaluation (E) Working Group

Botsko said that during the Spring National Meeting, the Task Force agreed to disband the Risk-Based Capital Risk Evaluation Asset Concentration Ad Hoc Subgroup and refer its outstanding issues to the Risk-Based Capital Investment Risk and Evaluation (E) Working Group. He also stated that the Task Force recommends the Working Group consider: 1) further investigating any potential asset concentration issues; 2) possibly modifying the structure and instructions for all lines of business; and 3) providing updates on this project at each national meeting until its completion.

The Task Force agreed to forward the referral to the Risk-Based Capital Investment Risk and Evaluation (E) Working Group.

10. Referred Issues Regarding Geographic Concentration to the Catastrophe Risk (E) Subgroup

Botsko said that during the Spring National Meeting, the Task Force agreed to disband the Risk-Based Capital Geographic Concentration Ad Hoc Subgroup and refer its outstanding issues to the Catastrophe Risk (E) Subgroup. He also stated that the Task Force recommends the Subgroup consider: 1) further investigating all outstanding issues; 2) possibly modifying the property and casualty (P/C) RBC formula; and 3) providing updates on this project at each national meeting until its completion.

The Task Force agreed to forward the referral to the Catastrophe Risk (E) Subgroup.

11. Exposed a Referral from the Statutory Accounting Principles (E) Working Group Regarding the Investment in Tax Credit Structures

Botsko said the Task Force received a referral from the Statutory Accounting Principles (E) Working Group March 27 regarding the blank changes on investments in tax credit structures. These changes may include: 1) the re-naming of the existing low-income housing tax credit investment lines in the RBC formulas to allow the expansion of including any type of state or federal tax credit program, assuming the investment meets the criteria described

in paragraph two of *Statement of Statutory Accounting Principle (SSAP) No. 93R*; and 2) the need for a review to update factors and/or reporting lines. He encouraged all interested parties to review it. The Task Force will discuss it during its June meeting.

The Task Force agreed to expose this referral for a 30-day public comment period ending May 30.

12. Discussed the Possibility of Establishing a New Subgroup to Evaluate the Non-Investment Risk Issues

Botsko said, as indicated earlier, that the Risk-Based Capital Risk Evaluation Purposes and Guidelines Ad Hoc Subgroup had a robust discussion before the Ad Hoc Subgroup was disbanded. He said one of the key items identified by the Ad Hoc Subgroup that requires further review is the possibility of removing the TAC and authorized control level (ACL) amounts in the annual statement's five-year historical data page. In addition, Botsko said he thought that some of the RBC formulas, factors, and methodologies have not been reviewed since they were developed. He asked the Task Force to consider establishing a subgroup to: 1) review the possibility of removing the TAC and ACL amounts in the annual statement's five-year historical data page; 2) re-evaluate some of the missing non-investment risks to determine whether the Task Force should now include them in the RBC calculation or if it should appropriately handle those risks utilizing other regulatory methods; and 3) review those non-investment factors and instructions that have not been reviewed since being developed to determine if modifications should be made. Botsko encouraged all the Task Force members to consider the possibility of establishing a new subgroup to handle these items and provide feedback in the upcoming meetings.

13. Adopted Proposal 2023-17-CR (Climate Scenario Analysis)

Chou said the Catastrophe Risk (E) Subgroup and the Property and Casualty Risk-Based Capital (E) Working Group met April 25 and April 23, respectively, to adopt this proposal. He stated that the Subgroup appreciates all the valuable comments submitted by different industry parties during the exposure period. After reviewing industry comments, the Solvency Workstream of the Climate and Resiliency (EX) Task Force and the Subgroup made the following revisions to the proposal: 1) implementing a three-year sunset clause in the instructions; and 2) updating the line 7 question in PR027BI, PR027BII, PR027CI, and PR027CII. Hale said Commissioner Fowler suggested delaying the adoption for a few months to allow better enhancement to the proposal. Chou said a delay of a few months may not necessarily remove any uncertainty on top of the assumption. Rather, gathering the information will enable the state insurance regulators to further enhance the proposal. Eli Russo (NAIC) said the NAIC had already made changes to the Financial Analysis Handbook to allow state insurance regulators to start asking questions to dive deep into the catastrophe exposures. Russo also stated that the regulatory framework had been created to utilize this information.

Steve Broadie (American Property Casualty Insurance Association—APCIA) said the APCIA, the National Association of Mutual Insurance Companies (NAMIC), and the Reinsurance Association of America (RAA) (collectively, "the Associations") appreciated the modification of including a three-year sunset clause in the proposal. He stated that among the issues is that climate is not the primary driver of exposure to increasing hurricane loss costs; rather, it's inflation. Increased population and exposed areas are the key factors for the climate issue. He also indicated that projecting losses to the years 2040 and 2050 has little relevance to companies' current portfolio of exposures. Also, the scientific difference in risk between those time periods is minimal and poorly constrained. Broadie also said the Associations believed that the data from this proposal would not be comparable across companies and could not be meaningfully aggregated. In addition, the cost of the proposal will be significant in terms of both money and limited staff resources. He stated that the Associations came up with an alternative proposal, which they believe will be less expensive in providing state insurance regulators with information to hold discussions with insurers that may have a greater degree of indicated risk levels for hurricane and wildfire perils. Lastly, Broadie said that given the short time period, the associations urge the Task Force either

to adopt the industry alternative or to defer this item to the 2025 RBC reporting to give the industry additional time to collectively work together to identify a mutually agreeable scenario that will produce useful results. Kelly Hereid (Liberty Mutual Insurance) said the alternative comes from the most comprehensive review produced by scientific communities to date. Chou said the Subgroup plans to consider the revised proposal at this time. He reiterated that the intent of this proposal is to collect some useful information for state insurance regulators holding conversations with insurers that may have a greater degree of risk of these perils. The Subgroup and the Solvency Workstream of the Climate and Resiliency (EX) Task Force have no desire to require reporting companies to hold capital up to specific levels based on this provided information. He also indicated that the Subgroup plans to re-evaluate the information in the future to determine whether further enhancement should be made on these pages.

Chou made a motion, seconded by Kaumann, to adopt proposal 2023-17-CR (Attachment Two-G). The motion passed.

14. Discussed Proposal 2024-02-CA (Residual Structure PC & Health)

Botsko said there has been a significant amount of discussion on this topic, especially during the prior two months in the Risk-Based Capital Investment Risk and Evaluation (E) Working Group. He stated that the Task Force and the Working Group received different requests from interested parties for the delay in implementing the 45% charge for 2024 reporting. Botsko also indicated that the American Academy of Actuaries (Academy) is planning to provide updates on its research on this topic at the Summer National Meeting. He also stated that based on the currently available information, the impact on the P/C and health lines of business are minimal as the percentage of the residual tranches reported investment dollars are less than 0.5% of surplus, while on the life side, it is just under 2.0% of the surplus. Botsko asked all interested parties to consider the following options: 1) delaying implementation until the life residual tranche project is completed; 2) adopting the structure today, and deciding the charge during the Task Force meeting June 28; 3) adopting the structure today with the current charge of 20%; 4) adopting the structure today with the life charge of 45%; and 5) considering other options not listed above.

Botsko said the Task Force received eight comment letters (Attachment Two-H) during the exposure period, mainly requesting the NAIC delay the implementation of the 45% RBC charge. While it is important to have consistency warranted in the RBC formulas, it is fine to have differences or even delays in implementing changes. He thought the first option was worth consideration until the Task Force obtained more information to make a better decision. He stated that as a reminder, the Risk-Based Capital Investment Risk and Evaluation (E) Working Group has requested additional feedback regarding a one-year delay of the 45% charge for the residual tranches in the life RBC formula.

Joe Engelhard (Alternative Credit Council—ACC) said three basic points that the ACC wanted to make are: 1) that the RBC investment charges should use historical track record and proper analysis; 2) there are only two internal studies on equity and residual tranches; and 3) it is unclear what is the insurance exposure for the asset-backed securities (ABS) residuals. Broadie said the APCIA supports Connecticut's comment that the current factor should not be changed at this time. Bryan Bashur (Americans for Tax Reform—ATR) said it would not be prudent to move forward with this proposal when the Investment Risk and Evaluation (E) Working Group continues to deliberate on this issue. Mariana Gomez (American Council of Life Insurers—ACLI) said the ACLI endorsed a delay and the comments made by APCIA. Chou said Connecticut recommended delaying the implementation as this proposal is not for informational purposes only. He stated that accuracy, consistency, and materiality are the key factors that the Task Force should consider for this issue. Walker said Texas supports adopting the structural changes but defers consideration of the factor until after the Risk-Based Capital Investment Risk and Evaluation (E) Working Group meeting May 22.

Walker made a motion, seconded by Schallhorn, to adopt the proposal 2024-02-CA (Attachment Two-I) structural change, leave the risk charge blank for now, and defer consideration of the risk charge until after the Risk-Based Capital Investment Risk and Evaluation (E) Working Group's May 22 meeting. The motion passed.

15. Discussed Other Matters

To provide sufficient time to study the meeting materials, Botsko urged all interested parties to submit their comment letters on or before the comment deadline. He also asked that interested parties email NAIC staff to request an extension and clearly indicate the submission date in the email.

Having no further business, the Capital Adequacy (E) Task Force adjourned.

SharePoint/NAIC Support Staff Hub/Member Meetings/E CMTE/CADTF/2024-2-Summer/April 30 CADTF minutes.docx

Capital Adequacy (E) Task Force RBC Proposal Form

- | | | |
|---|--|---|
| <input type="checkbox"/> Capital Adequacy (E) Task Force | <input type="checkbox"/> Health RBC (E) Working Group | <input checked="" type="checkbox"/> Life RBC (E) Working Group |
| <input type="checkbox"/> Catastrophe Risk (E) Subgroup | <input type="checkbox"/> P/C RBC (E) Working Group | <input type="checkbox"/> Longevity Risk (A/E) Subgroup |
| <input type="checkbox"/> Variable Annuities Capital. & Reserve (E/A) Subgroup | <input type="checkbox"/> Economic Scenarios (E/A) Subgroup | <input type="checkbox"/> RBC Investment Risk & Evaluation (E) Working Group |

	DATE: <u>1/18/2024</u>
CONTACT PERSON: <u>Dave Fleming</u> TELEPHONE: <u>816-783-8121</u> EMAIL ADDRESS: <u>dfleming@naic.org</u> ON BEHALF OF: <u>Life Risk-Based Capital (E) Working Group</u> NAME: <u>Philip Barlow, Chair</u> TITLE: <u>Associate Commissioner of Insurance</u> AFFILIATION: <u>District of Columbia</u> ADDRESS: <u>1050 First Street, NE Suite 801</u> <u>Washington, DC 20002</u>	FOR NAIC USE ONLY Agenda Item # <u>2024-04-L</u> Year <u>2024</u> DISPOSITION ADOPTED: <input checked="" type="checkbox"/> TASK FORCE (TF) <u>04/30/2024</u> <input checked="" type="checkbox"/> WORKING GROUP (WG) <u>04/19/2024</u> <input type="checkbox"/> SUBGROUP (SG) _____ EXPOSED: <input type="checkbox"/> TASK FORCE (TF) _____ <input checked="" type="checkbox"/> WORKING GROUP (WG) <u>01/25/2024</u> <input type="checkbox"/> SUBGROUP (SG) _____ REJECTED: <input type="checkbox"/> TF <input type="checkbox"/> WG <input type="checkbox"/> SG _____ OTHER: <input type="checkbox"/> DEFERRED TO _____ <input type="checkbox"/> REFERRED TO OTHER NAIC GROUP _____ <input type="checkbox"/> (SPECIFY) _____

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

- | | | |
|--|---|---|
| <input type="checkbox"/> Health RBC Blanks | <input type="checkbox"/> Property/Casualty RBC Blanks | <input checked="" type="checkbox"/> Life and Fraternal RBC Blanks |
| <input type="checkbox"/> Health RBC Instructions | <input type="checkbox"/> Property/Casualty RBC Instructions | <input type="checkbox"/> Life and Fraternal RBC Instructions |
| <input type="checkbox"/> Health RBC Formula | <input type="checkbox"/> Property/Casualty RBC Formula | <input type="checkbox"/> Life and Fraternal RBC Formula |
| <input type="checkbox"/> OTHER _____ | | |

DESCRIPTION/REASON OR JUSTIFICATION OF CHANGE(S)

This proposal adds a line to LR033, Calculation of Total Adjusted Capital, to address the treatment of non-admitted insurance affiliates. This treatment was adopted as part of proposal 2022-09-CA, the revised treatment of affiliated investments. This line was omitted from the life structure change but was done for 2023 by including it in an existing line. This proposal makes no change in the treatment but makes the life formula consistent with the other RBC formulas.

Additional Staff Comments:

** This section must be completed on all forms.

Revised 2-2023

Attachment Two-A
Capital Adequacy (E) Task Force
8/14/24

CALCULATION OF TOTAL ADJUSTED CAPITAL
(Including Total Adjusted Capital Tax Sensitivity Test)

	Annual Statement Source	(1)	(2)	
		Statement Value	Factor	Adjusted Capital
<u>Company Amounts</u>				
(1) Capital and Surplus	Page 3 Column 1 Line 38	X	1.000	=
(2) Asset Valuation Reserve	Page 3 Column 1 Line 24.01 ‡	X	1.000	=
(3) Dividends Apportioned for Payment	Page 3 Column 1 Line 6.1, in part	X	0.500	=
(4) Dividends Not Yet Apportioned	Page 3 Column 1 Line 6.2, in part	X	0.500	=
(5) Hedging Fair Value Adjustment	Company Records	X	-1.000	=
<u>Life Subsidiary Company Amounts†</u>				
(6) Asset Valuation Reserve / Carrying Value of Non-Admitted Insurance Affiliates	Subsidiaries' Annual Statement Page 3 Column 1 Line 24.01 ‡ § Included in LR044 Columns 5 and 7	X	1.000	=
(7) Dividend Liability	Subsidiaries' Annual Statement Page 3 Column 1 Line 6.1 + Line 6.2 ‡	X	0.500	=
(8) Carrying Value of Non-Admitted Insurance Affiliates	Included in LR044 Columns (5) and (7)	X	1.000	=
<u>Property and Casualty and Other Non-U.S. Affiliated Amounts</u>				
(9) Non-Tabular discount and/or Alien Insurance Subsidiaries: Other	Included in Subsidiaries' Annual Statement Page 3 Column 1 Line 1 + 3 ‡ and/or Schedule D Part 6, Section 1 Column 8 Line 0599999 and Line 1499999, in part	X	1.000	=
(10) Total Adjusted Capital Before Capital Notes	Sum of Lines (1) through (8) less Line (9)			=
<u>Credit for Capital Notes</u>				
(11.1) Surplus Notes	Page 3 Column 1 Line 32			=
(11.2) Limitation on Capital Notes	0.5 x [(Line (10) - Line (11.1)) - Line (11.1)], but not less than 0			=
(11.3) Capital Notes Before Limitation	LR032 Capital Notes Before Limitation Column (4) Line (18)			=
(11.4) Credit for Capital Notes	Lesser of Column (1) Line (11.2) or Line (11.3)			=
(12) XXX/AXXX Reinsurance RBC Shortfall	LR037 XXX/AXXX Captive Reinsurance Consolidated Exhibit Column (10) Line (10)			=
(13) Total Adjusted Capital	Line (10) + Line (11.4) - Line (12)			=
<u>Tax Sensitivity Test</u>				
<u>Company Amounts</u>				
(14) Deferred Tax Asset (DTA) Value	Page 2 Column 3 Line 18.2	X	-1.000	=
(15) Deferred Tax Liability (DTL) Value	Page 3 Column 1 Line 15.2	X	1.000	=
<u>Subsidiary Amounts</u>				
(16) Deferred Tax Asset (DTA) Value	Company Records	X	-1.000	=
(17) Deferred Tax Liability (DTL) Value	Company Records	X	1.000	=
(18) Tax Sensitivity Test: Total Adjusted Capital	Line (13)+(14)+(15)+(16)+(17)			=
<u>Ex DTA ACL RBC Ratio Sensitivity Test</u>				
(19) Deferred Tax Asset-Company Amounts	Page 2 Column 3 Line 18.2	X	1.000	=
(20) Total Adjusted Capital Less Deferred Tax Asset Amounts	Line (13) less Line (19)			=
(21) Authorized Control Level RBC	LR034 Risk-Based Capital Level of Action Line (4)	X	1.000	=
(22) Ex DTA ACL RBC Ratio	Line (20) / Line (21)			0.000%

† Including subsidiaries owned by holding companies.

‡ Multiply statement value by percent of ownership.

§ The portion of the AVR that can be counted as capital is limited to the amount not utilized in asset adequacy testing in support of the Actuarial Opinion for reserves. ~~The amount on line (6) will also include the carrying value of non-admitted insurance affiliates.~~

Denotes items that must be manually entered on the filing software.

**Capital Adequacy (E) Task Force
RBC Proposal Form**

- | | | |
|---|--|---|
| <input type="checkbox"/> Capital Adequacy (E) Task Force | <input type="checkbox"/> Health RBC (E) Working Group | <input checked="" type="checkbox"/> Life RBC (E) Working Group |
| <input type="checkbox"/> Catastrophe Risk (E) Subgroup | <input type="checkbox"/> P/C RBC (E) Working Group | <input type="checkbox"/> Longevity Risk (A/E) Subgroup |
| <input type="checkbox"/> Variable Annuities Capital. & Reserve (E/A) Subgroup | <input type="checkbox"/> Economic Scenarios (E/A) Subgroup | <input type="checkbox"/> RBC Investment Risk & Evaluation (E) Working Group |

<p align="right">DATE: <u>1/18/2024</u></p> <p>CONTACT PERSON: <u>Dave Fleming</u></p> <p>TELEPHONE: <u>816-783-8121</u></p> <p>EMAIL ADDRESS: <u>dfleming@naic.org</u></p> <p>ON BEHALF OF: <u>Life Risk-Based Capital (E) Working Group</u></p> <p>NAME: <u>Philip Barlow, Chair</u></p> <p>TITLE: <u>Associate Commissioner of Insurance</u></p> <p>AFFILIATION: <u>District of Columbia</u></p> <p>ADDRESS: <u>1050 First Street, NE Suite 801</u> <u>Washington, DC 20002</u></p>	<p align="center">FOR NAIC USE ONLY</p> <p>Agenda Item # <u>2024-05-L</u> Year <u>2024</u></p> <p align="center">DISPOSITION</p> <p>ADOPTED: <input checked="" type="checkbox"/> TSK FORCE (TF) <u>04/30/2024</u> <input checked="" type="checkbox"/> WORKING GROUP (WG) <u>04/19/2024</u> <input type="checkbox"/> SUBGROUP (SG) _____</p> <p>EXPOSED: <input type="checkbox"/> TASK FORCE (TF) _____ <input checked="" type="checkbox"/> WORKING GROUP (WG) <u>01/25/2024</u> <input type="checkbox"/> SUBGROUP (SG) _____</p> <p>REJECTED: <input type="checkbox"/> TF <input type="checkbox"/> WG <input type="checkbox"/> SG _____</p> <p>OTHER: <input type="checkbox"/> DEFERRED TO _____ <input type="checkbox"/> REFERRED TO OTHER NAIC GROUP _____ <input type="checkbox"/> (SPECIFY) _____</p>
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IDENTIFICATION OF SOURCE AND FORM(S)/INSTRUCTIONS TO BE CHANGED

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|--|---|---|
| <input type="checkbox"/> Health RBC Blanks | <input type="checkbox"/> Property/Casualty RBC Blanks | <input checked="" type="checkbox"/> Life and Fraternal RBC Blanks |
| <input type="checkbox"/> Health RBC Instructions | <input type="checkbox"/> Property/Casualty RBC Instructions | <input type="checkbox"/> Life and Fraternal RBC Instructions |
| <input type="checkbox"/> Health RBC Formula | <input type="checkbox"/> Property/Casualty RBC Formula | <input type="checkbox"/> Life and Fraternal RBC Formula |
| <input type="checkbox"/> OTHER _____ | | |

DESCRIPTION/REASON OR JUSTIFICATION OF CHANGE(S)

This proposal adds a line to LR009 to specifically address line 44 of the Asset Valuation Reserve (AVR) Equity Component. This AVR line was not included in the LR009 changes made with the mortgage methodology change in 2013. This proposal does not include a factor but facilitates the application of one specific to this category if appropriate.

Additional Staff Comments:

** This section must be completed on all forms.

Revised 2-2023

SCHEDULE BA MORTGAGES

		(1)	(2)	(3)	(4)	(5)	(6)
	Annual Statement Source	Book / Adjusted Carrying Value	Involuntary Reserve Adjustment †	RBC Subtotal	Cumulative Writedowns ‡	Average Factor	RBC Requirement
<u>In Good Standing</u>							
(1) Insured or Guaranteed	AVR Equity Component Column 1 Line 43 + Line 45				XXX X	0.0014	=
(2) Residential - All Other	AVR Equity Component Column 1 Line 44				XXX X	TBD	=
(3) Unaffiliated Mortgages with Covenants	AVR Equity Component Column 1 Line 57				XXX X	*	=
(4) Unaffiliated Mortgages - Defeased with Government Securities	AVR Equity Component Column 1 Line 58				XXX X	0.0090	=
(5) Unaffiliated Mortgages - Primarily Senior	AVR Equity Component Column 1 Line 59				XXX X	0.0175	=
(6) Unaffiliated Mortgages - All Other	AVR Equity Component Column 1 Line 60				XXX X	0.0300	=
(7) Affiliated Mortgages - Category CM1	AVR Equity Component Column 1 Line 38				XXX X	0.0090	=
(8) Affiliated Mortgages - Category CM2	AVR Equity Component Column 1 Line 39				XXX X	0.0175	=
(9) Affiliated Mortgages - Category CM3	AVR Equity Component Column 1 Line 40				XXX X	0.0300	=
(10) Affiliated Mortgages - Category CM4	AVR Equity Component Column 1 Line 41				XXX X	0.0500	=
(11) Affiliated Mortgages - Category CM5	AVR Equity Component Column 1 Line 42				XXX X	0.0750	=
(12) Total In Good Standing	Sum of Lines (1) through (11)						=
<u>90 Days Overdue, Not in Process of Foreclosure</u>							
(13) Insured or Guaranteed 90 Days Overdue	AVR Equity Component Column 1 Line 47 + Line 49				XXX X	0.0027	=
(14) All Other 90 Days Overdue - Unaffiliated	AVR Equity Component Column 1 Line 61				XXX X	0.1100	=
(15) All Other 90 Days Overdue - Affiliated	AVR Equity Component Column 1 Line 48 + Line 50				XXX X	0.1100	=
(16) Total 90 Days Overdue, Not in Process of Foreclosure	Lines (13) + (14) + (15)						=
<u>In Process of Foreclosure</u>							
(17) Insured or Guaranteed in Process of Foreclosure	AVR Equity Component Column 1 Line 52 + Line 54				XXX X	0.0054	=
(18) All Other in Process of Foreclosure - Unaffiliated	AVR Equity Component Column 1 Line 62				XXX X	0.1300	=
(19) All Other in Process of Foreclosure - Affiliated	AVR Equity Component Column 1 Line 53 + Line 55				XXX X	0.1300	=
(20) Total In Process of Foreclosure	Lines (17) + (18) + (19)						=
(21) Total Schedule BA Mortgages (pre-MODCO/Funds Withheld)	Lines (12) + (16) + (20)						=
(22) Reduction in RBC for MODCO/Funds Withheld Reinsurance Ceded Agreements	Company Records (enter a pre-tax amount)						=
(23) Increase in RBC for MODCO/Funds Withheld Reinsurance Assumed Agreements	Company Records (enter a pre-tax amount)						=
(24) Total Schedule BA Mortgages (including MODCO/Funds Withheld.)	Lines (21) - (22) + (23)						=

† Involuntary reserves are reserves that are held as an offset to a particular asset that is clearly a troubled asset and are included on Page 3 Line 25 of the Annual Statement.

‡ Cumulative writedowns include the total amount of writedowns, non-admissions, and involuntary reserves that have been taken or established with respect to a particular mortgage.

* This will be calculated as Column (6) divided by Column (3).

Denotes items that must be manually entered on the filing software.

Capital Adequacy (E) Task Force RBC Proposal Form

- | | | |
|---|---|---|
| <input checked="" type="checkbox"/> Capital Adequacy (E) Task Force | <input type="checkbox"/> Health RBC (E) Working Group | <input type="checkbox"/> Life RBC (E) Working Group |
| <input type="checkbox"/> Catastrophe Risk (E) Subgroup | <input type="checkbox"/> Investment RBC (E) Working Group | <input type="checkbox"/> Longevity Risk (A/E) Subgroup |
| <input type="checkbox"/> Variable Annuities Capital. & Reserve (E/A) Subgroup | <input type="checkbox"/> P/C RBC (E) Working Group | <input type="checkbox"/> RBC Investment Risk & Evaluation (E) Working Group |

<p style="text-align: right;">DATE: <u>2/8/2024</u></p> <p>CONTACT PERSON: <u>Eva Yeung</u></p> <p>TELEPHONE: <u>816-783-8407</u></p> <p>EMAIL ADDRESS: <u>eyeung@naic.org</u></p> <p>ON BEHALF OF: <u>Capital Adequacy (E) Task Force</u></p> <p>NAME: <u>Tom Botsko</u></p> <p>TITLE: <u>Chair</u></p> <p>AFFILIATION: <u>Ohio Department of Insurance</u></p> <p>ADDRESS: <u>50 West Town Street, Suite 300</u> <u>Columbus, OH 43215</u></p>	<p style="text-align: center;">FOR NAIC USE ONLY</p> <p>Agenda Item # <u>2024-08-CA</u> Year <u>2024</u></p> <p style="text-align: center;">DISPOSITION</p> <p>ADOPTED:</p> <p><input checked="" type="checkbox"/> TASK FORCE (TF) <u>4/30/2024</u></p> <p><input type="checkbox"/> WORKING GROUP (WF) _____</p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>EXPOSED:</p> <p><input checked="" type="checkbox"/> TASK FORCE (TF) <u>3/17/2024</u></p> <p><input type="checkbox"/> WORKING GROUP (WG) _____</p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>REJECTED:</p> <p><input type="checkbox"/> TF <input type="checkbox"/> WG <input type="checkbox"/> SG _____</p> <p>OTHER:</p> <p><input type="checkbox"/> DEFERRED TO _____</p> <p><input type="checkbox"/> REFERRED TO OTHER NAIC GROUP _____</p> <p><input type="checkbox"/> (SPECIFY) _____</p>
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IDENTIFICATION OF SOURCE AND FORM(S)/INSTRUCTIONS TO BE CHANGED

- | | | |
|---|--|--|
| <input checked="" type="checkbox"/> Health RBC Blanks | <input checked="" type="checkbox"/> Property/Casualty RBC Blanks | <input type="checkbox"/> Life and Fraternal RBC Blanks |
| <input type="checkbox"/> Health RBC Instructions | <input type="checkbox"/> Property/Casualty RBC Instructions | <input type="checkbox"/> Life and Fraternal RBC Instructions |
| <input type="checkbox"/> Health RBC Formula | <input type="checkbox"/> Property/Casualty RBC Formula | <input type="checkbox"/> Life and Fraternal RBC Formula |
| <input type="checkbox"/> OTHER _____ | | |

DESCRIPTION/REASON OR JUSTIFICATION OF CHANGE(S)

This proposal removes the reference of "H0 Component" and "R0 Component" from the Column 12 heading on pages XR002 and PR003, respectively. The "H0" and "R0" references are misleading in that only affiliate types 1, 2, 5 and 6 flow into H0 and R0, while affiliate types 3, 7-9 flow into H1 and R2.

Additional Staff Comments:

** This section must be completed on all forms.

Revised 2-2023

XR002

DETAILS FOR AFFILIATED STOCKS

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
Name of Affiliate	Affil Type	NAIC Company Code or Alien ID Number	Affiliate's RBC after Covariance Before Basic Operational Risk XR025 Line (41) PR032 Line (60) LR031 Line (69) + (73)	Book/Adjusted Carrying Value (Statement Value) of Affiliate's Common Stock	Valuation Basis of Col (5) M - Market Value after any "discount" A - All Other	Total Value of Affiliate's Outstanding Common Stock	Statutory Surplus of Affiliate Subject to RBC (Adjusted for % Owned)	Book/Adjusted Carrying Value (Statement Value) of Affiliate's Preferred Stock	Total Value of Affiliate's Outstanding Preferred Stock	Percent Owned *	RBC Required (#0 Component)	Market Value Excess Component Affiliated Common Stock RBC Required (H1 Component)
(01)										100.000%	0	0
(02)										100.000%	0	0
(03)										100.000%	0	0
(04)										100.000%	0	0
(05)										100.000%	0	0
(06)										100.000%	0	0
(07)										100.000%	0	0
(08)										100.000%	0	0
(09)										100.000%	0	0
(10)										100.000%	0	0

PR003

DETAILS FOR AFFILIATED STOCKS PR003

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
Name of Affiliate	Affil Type	NAIC Company Code or Alien ID Number	Affiliate's RBC After Covariance before Basic Operational Risk LR031 L69 + L73 PR032 L60 XR025 L41	Book/Adjusted Carrying Value (statement value) of Affiliate's Common Stock	Valuation Basis of Column (5) M - Market Value after any "discount" A - All Other	Total Value of Affiliate's Outstanding Common Stock	Statutory Surplus of Affiliate Subject to RBC (Adjusted for % Owned)	Book/Adjusted Carrying Value (statement value) of Affiliate's Preferred Stock	Total Value of Affiliate's Outstanding Preferred Stock	Percent Owned*	RBC Required (R0 Component)	Market Value Excess Component Affiliate Common Stock RBC Required (R2 Component)
0000001										100.000%	0	0
0000002										100.000%	0	0
0000003										100.000%	0	0
0000004										100.000%	0	0
0000005										100.000%	0	0
0000006										100.000%	0	0
0000007										100.000%	0	0
0000008										100.000%	0	0
0000009										100.000%	0	0
0000010										100.000%	0	0

Capital Adequacy (E) Task Force RBC Proposal Form

- | | | |
|---|---|---|
| <input type="checkbox"/> Capital Adequacy (E) Task Force | <input type="checkbox"/> Health RBC (E) Working Group | <input type="checkbox"/> Life RBC (E) Working Group |
| <input type="checkbox"/> Catastrophe Risk (E) Subgroup | <input type="checkbox"/> Investment RBC (E) Working Group | <input type="checkbox"/> Longevity Risk (A/E) Subgroup |
| <input type="checkbox"/> Variable Annuities Capital. & Reserve (E/A) Subgroup | <input checked="" type="checkbox"/> P/C RBC (E) Working Group | <input type="checkbox"/> RBC Investment Risk & Evaluation (E) Working Group |

<p style="text-align: right;">DATE: <u>1/10/24</u></p> <p>CONTACT PERSON: <u>Eva Yeung</u></p> <p>TELEPHONE: <u>816-783-8407</u></p> <p>EMAIL ADDRESS: <u>eyeung@naic.org</u></p> <p>ON BEHALF OF: <u>P/C RBC (E) Working Group</u></p> <p>NAME: <u>Tom Botsko</u></p> <p>TITLE: <u>Chair</u></p> <p>AFFILIATION: <u>Ohio Department of Insurance</u></p> <p>ADDRESS: <u>50 West Town Street, Suite 300</u> <u>Columbus, OH 43215</u></p>	<p style="text-align: center;">FOR NAIC USE ONLY</p> <p>Agenda Item # <u>2024-10-P</u> Year <u>2024</u></p> <p style="text-align: center;">DISPOSITION</p> <p>ADOPTED:</p> <p><input checked="" type="checkbox"/> TASK FORCE (TF) <u>04/30/2024</u></p> <p><input checked="" type="checkbox"/> WORKING GROUP (WF) <u>04/24/2024</u></p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>EXPOSED:</p> <p><input type="checkbox"/> TASK FORCE (TF) _____</p> <p><input checked="" type="checkbox"/> WORKING GROUP (WG) <u>03/17/24</u></p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>REJECTED:</p> <p><input type="checkbox"/> TF <input type="checkbox"/> WG <input type="checkbox"/> SG _____</p> <p>OTHER:</p> <p><input type="checkbox"/> DEFERRED TO _____</p> <p><input type="checkbox"/> REFERRED TO OTHER NAIC GROUP _____</p> <p><input type="checkbox"/> (SPECIFY) _____</p>
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IDENTIFICATION OF SOURCE AND FORM(S)/INSTRUCTIONS TO BE CHANGED

- | | | |
|--|--|--|
| <input type="checkbox"/> Health RBC Blanks | <input checked="" type="checkbox"/> Property/Casualty RBC Blanks | <input type="checkbox"/> Life and Fraternal RBC Blanks |
| <input type="checkbox"/> Health RBC Instructions | <input type="checkbox"/> Property/Casualty RBC Instructions | <input type="checkbox"/> Life and Fraternal RBC Instructions |
| <input type="checkbox"/> Health RBC Formula | <input type="checkbox"/> Property/Casualty RBC Formula | <input type="checkbox"/> Life and Fraternal RBC Formula |
| <input type="checkbox"/> OTHER _____ | | |

DESCRIPTION/REASON OR JUSTIFICATION OF CHANGE(S)

This proposal included the following changes:

- 1) Add "in part" to the Line 25 Annual Statement Source.
- 2) Update Column 1, Line 25 to "Company Record".

The reason for the change is to eliminate the double-counting issue for those companies that have stop-loss premium as the stop loss premium is expected to be entered on Line 9 of PR019.

Additional Staff Comments:

** This section must be completed on all forms.

Revised 2-2023

HEALTH PREMIUMS PR019

	Annual Statement Source	(1) Statement Value	Factor	(2) RBC Requirement
Medical Insurance Premium - Individual				
(1)	Comprehensive (Medical and Hospital)	Earned Premium (Schedule H Part 1 Column 3 Line 2)	0	† XXX
(2)	Medicare Supplement	Earned Premium (Schedule H Part 1 Column 7 Line 2 in part)	0	† XXX
(3)	Dental & Vision	Earned Premium (Schedule H Part 1 Columns 9 + 11 Line 2 in part)	0	† XXX
(3.1)	Stand-Alone Medicare Part D Coverage	Earned Premium (Schedule H Part 1 Line 2 in part)	0	† XXX
(3.2)	Supplemental Benefits within Stand-Alone Part D Coverage (Claims Incurred)	Company Records	0 0.500	0
(3.3)	Medicaid Pass-Through Payments Reported as Premium	Company Records	0 0.020	0
(4)	Hospital Indemnity and Specified Disease	Earned Premium (Schedule H Part 1 Line 2 in part)	0 0.035	* 0
(5)	AD&D (Maximum Retained Risk Per Life 0)	Earned Premium (Schedule H Part 1 Line 2 in part)	0 ‡	0
(6)	Other Accident	Earned Premium (Schedule H Part 1 Line 2 in part)	0 0.050	0
Medical Insurance Premium - Group and Credit				
(7)	Comprehensive (Medical and Hospital)	Earned Premium (Schedule H Part 1 Column 5 Line 2)	0	† XXX
(8)	Dental & Vision	Earned Premium (Schedule H Part 1 Columns 9 + 11 Line 2 in part)	0	† XXX
(9)	Stop Loss and Minimum Premium	Earned Premium (Schedule H Part 1 Line 2 in part)	0	¥ 0
(10)	Medicare Supplement	Earned Premium (Schedule H Part 1 Column 7 Line 2 in part)	0	† XXX
(10.1)	Stand-Alone Medicare Part D Coverage (see instructions for limits)	Earned Premium (Schedule H Part 1 Line 2 in part)	0	† XXX
(10.2)	Supplemental benefits within Stand-Alone Part D Coverage (Claims Incurred)	Company Records	0 0.500	0
(10.3)	Medicaid Pass-Through Payments Reported as Premium	Company Records	0 0.020	0
(11)	Hospital Indemnity and Specified Disease	Earned Premium (Schedule H Part 1 Line 2 in part)	0 0.035	* 0
(12)	AD&D (Maximum Retained Risk Per Life 0)	Earned Premium (Schedule H Part 1 Line 2 in part)	0 ‡	0
(13)	Other Accident	Earned Premium (Schedule H Part 1 Line 2 in part)	0 0.050	0
(14)	Federal Employee Health Benefit Plan	Earned Premium (Schedule H Part 1 Column 13, Line 2)	0 0.000	0
Disability Income Premium				
(15)	Noncancellable Disability Income - Individual Morbidity	Earned Premium (Schedule H Part 1 Column 21 Line 2 in part)	0 ‡	0
(16)	Other Disability Income - Individual Morbidity	Earned Premium (Schedule H Part 1 Column 21 Line 2 in part)	0 ‡	0
(17)	Disability Income - Credit Monthly Balance Plans	Earned Premium (Schedule H Part 1 Column 21 Line 2 in part)	0 ‡	0
(18)	Disability Income - Group Long-Term	Earned Premium (Schedule H Part 1 Column 21 Line 2 in part)	0 ‡	0
(19)	Disability Income - Credit Single Premium with Additional Reserve	Earned Premium (Schedule H Part 1 Column 21 Line 2 in part)	0 ‡	0
(20)	Disability Income - Credit Single Premium without Additional Reserve	Earned Premium (Schedule H Part 1 Column 21 Line 2 in part)	0 ‡	0
(21)	Disability Income - Group Short-Term	Earned Premium (Schedule H Part 1 Column 21 Line 2 in part)	0 ‡	0
Long-Term Care				
(22)	Noncancellable Long-Term Care Premium - Rate Risk**	Earned Premium (Schedule H Part 1 Column 23 Line 2 in part)	0 0.100	0
(23)	Other Long-Term Care Premium ‡ †	Earned Premium (Schedule H Part 1 Column 23 Line 2 in part)	0 0.000	0 ‡ †
Health Premium with Limited Underwriting Risk				
(24)	ASC Business with Premium Revenue	Earned Premium (Schedule H Part 1 Line 2 in part)	0 0.000	0
Other Health				
(25)	Other Health	Earned Premium (Schedule H Part 1 Column 25 Line 2 in part)	0 0.120	0
(26)	Total Earned Premiums	Sum of Lines (1) through (25)	0	0
C(1), L(26) should equal Schedule H Part 1 Column 1 Line 2				
(27)	Additional Reserves for Credit Disability Plans	Company records	0 §	
(28)	Additional Reserves for Credit Disability Plans, prior year	Company records	0 §	

† The premium amounts in these lines are transferred to PR020 Underwriting Risk – Premium Risk for Comprehensive Medical, Medicare Supplement, Dental & Vision and Stand-Alone Medicare Part D Coverage Lines (1.1) and (1.2) for the calculation of risk-based capital. The premium amounts are included here to assist in the balancing of total health premium. If managed care arrangements have been entered into, the company may also complete PR021 Underwriting Risk – Managed Care Credit. In which case, the company will also need to complete PR012 Health Credit Risk in the formula. If there are amounts in any of lines (1), (2), (3), (7), (8) or (10) on page PR019 Health Premiums, the company will also be directed to complete the Health Administrative Expense portion of PR023.

‡ The two tiered calculation is illustrated in the risk-based capital instructions for PR019 Health Premiums.

‡ † The balance of the RBC requirement for Long Term Care - Morbidity Risk is calculated on Page PR023. The premium is shown to allow totals to check to Schedule H.

* If there is premium included on either or both of these lines, the RBC value in Column (2) will include 3.5% of such premium and \$50,000 (included in the line with the larger premium).

** The factor applies to all Noncancellable premium.

§ These amounts are used to adjust the premium base for single premium credit disability plans that carry additional tabular reserves.

¥ A factor of .350 will be applied to the first \$25,000,000 in Column (1), Line (9) and a factor of .250 will be applied to the remaining premium in excess of \$25,000,000.

Denotes items that must be manually entered on the filing software.

**Capital Adequacy (E) Task Force
RBC Proposal Form**

- | | | |
|---|---|---|
| <input type="checkbox"/> Capital Adequacy (E) Task Force | <input type="checkbox"/> Health RBC (E) Working Group | <input type="checkbox"/> Life RBC (E) Working Group |
| <input type="checkbox"/> Catastrophe Risk (E) Subgroup | <input type="checkbox"/> Investment RBC (E) Working Group | <input type="checkbox"/> Longevity Risk (A/E) Subgroup |
| <input type="checkbox"/> Variable Annuities Capital. & Reserve (E/A) Subgroup | <input checked="" type="checkbox"/> P/C RBC (E) Working Group | <input type="checkbox"/> RBC Investment Risk & Evaluation (E) Working Group |

<p style="text-align: right;">DATE: <u>1/10/24</u></p> <p>CONTACT PERSON: <u>Eva Yeung</u></p> <p>TELEPHONE: <u>816-783-8407</u></p> <p>EMAIL ADDRESS: <u>eyeung@naic.org</u></p> <p>ON BEHALF OF: <u>P/C RBC (E) Working Group</u></p> <p>NAME: <u>Tom Botsko</u></p> <p>TITLE: <u>Chair</u></p> <p>AFFILIATION: <u>Ohio Department of Insurance</u></p> <p>ADDRESS: <u>50 West Town Street, Suite 300</u> <u>Columbus, OH 43215</u></p>	<p style="text-align: center;">FOR NAIC USE ONLY</p> <p>Agenda Item # <u>2024-11-P</u> Year <u>2024 & 2025</u></p> <p style="text-align: center;">DISPOSITION</p> <p>ADOPTED:</p> <p><input checked="" type="checkbox"/> TASK FORCE (TF) <u>04/30/2024</u></p> <p><input checked="" type="checkbox"/> WORKING GROUP (WF) <u>04/25/2024</u></p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>EXPOSED:</p> <p><input type="checkbox"/> TASK FORCE (TF) _____</p> <p><input checked="" type="checkbox"/> WORKING GROUP (WG) <u>3/17/24</u></p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>REJECTED:</p> <p><input type="checkbox"/> TF <input type="checkbox"/> WG <input type="checkbox"/> SG _____</p> <p>OTHER:</p> <p><input type="checkbox"/> DEFERRED TO _____</p> <p><input type="checkbox"/> REFERRED TO OTHER NAIC GROUP _____</p> <p><input type="checkbox"/> (SPECIFY) _____</p>
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IDENTIFICATION OF SOURCE AND FORM(S)/INSTRUCTIONS TO BE CHANGED

- | | | |
|--|--|--|
| <input type="checkbox"/> Health RBC Blanks | <input checked="" type="checkbox"/> Property/Casualty RBC Blanks | <input type="checkbox"/> Life and Fraternal RBC Blanks |
| <input type="checkbox"/> Health RBC Instructions | <input type="checkbox"/> Property/Casualty RBC Instructions | <input type="checkbox"/> Life and Fraternal RBC Instructions |
| <input type="checkbox"/> Health RBC Formula | <input type="checkbox"/> Property/Casualty RBC Formula | <input type="checkbox"/> Life and Fraternal RBC Formula |
| <input type="checkbox"/> OTHER _____ | | |

DESCRIPTION/REASON OR JUSTIFICATION OF CHANGE(S)

The Factors are developed based on the 2023 American Academy of Actuaries (Academy) Report for "Update to Property and Casualty Risk-Based Capital Underwriting Factors and Investment Income Adjustment Factors" At the 2024 Spring National Meeting, the Working Group agreed to expose the following for a 30-day public comment period ending April 16:

- 1) Reserve Factors: 2024 Reporting - 50% indicated change with capped international and product liability lines for 2024.
2025 Reporting - 100% indicated change with capped international and product liability lines for 2025.
- 2) Premium Factors: 2024 Reporting - 50% indicated change with capped Financial Mortgage Guaranty line for 2024.
2025 Reporting - 100% indicated change with capped Financial Mortgage Guaranty line for 2025.

Additional Staff Comments:

** This section must be completed on all forms.

Revised 2-2023

50% Indicated Change with Capped International and Product Liability in 2024
100% Indicated Change with Capped International and Product Liability in 2025

PR017 Underwriting Risk - Reserves Proposed Line (4), Industry Loss & Expense RBC Factors				PR017 Underwriting Risk - Reserves Proposed Line (8), Adjustment for Investment Income			
Col.	Line of Business	2024 Factor	2025 Factor	Col.	Line of Business	2024 Factor	2025 Factor
(1)	H/F	0.220	0.226	(1)	H/F	0.945	0.951
(2)	PPA	0.192	0.205	(2)	PPA	0.933	0.937
(3)	CA	0.318	0.360	(3)	CA	0.919	0.926
(4)	WC	0.363	0.382	(4)	WC	0.807	0.783
(5)	CMP	0.485	0.475	(5)	CMP	0.887	0.898
(6)	MPL Occurrence	0.327	0.271	(6)	MPL Occurrence	0.863	0.861
(7)	MPL Claims Made	0.224	0.172	(7)	MPL Claims Made	0.890	0.896
(8)	SL	0.353	0.401	(8)	SL	0.887	0.884
(9)	OL	0.514	0.496	(9)	OL	0.858	0.864
(10)	Fidelity/Surety	0.479	0.586	(10)	Fidelity/Surety	0.924	0.908
(11)	Special Property	0.259	0.272	(11)	Special Property	0.960	0.954
(12)	Auto Physical Damage	0.146	0.137	(12)	Auto Physical Damage	0.977	0.978
(13)	Other (Credit A&H)	0.223	0.225	(13)	Other (Credit A&H)	0.952	0.936
(14)	Financial/Mortgage Guaranty	0.163	0.146	(14)	Financial/Mortgage Guaranty	0.921	0.916
(15)	INTL	0.514	0.669	(15)	INTL	0.878	0.881
(16)	REIN. P&F Lines	0.367	0.319	(16)	REIN. P&F Lines	0.907	0.913
(17)	REIN. Liability	0.626	0.596	(17)	REIN. Liability	0.816	0.793
(18)	PL	1.014	1.226	(18)	PL	0.843	0.844
(19)	Warranty	0.363	0.355	(19)	Warranty	0.951	0.961
(20)	Pet Insurance	0.259	0.272	(20)	Pet Insurance	0.960	0.954

50% Indicated Change with Capped Financial Mortgage Guaranty in 2024
100% Indicated Change with Capped Financial Mortgage Guaranty in 2025

PR018 Underwriting Risk - Premiums			
Proposed Line (4), Industry Losses & Loss Adjustment Expense Ratio			
Col.	Line of Business	2024 Factor	2025 Factor
(1)*	H/F	0.933	0.930
(2)	PPA	0.970	0.970
(3)	CA	1.012	1.014
(4)	WC	1.041	1.037
(5)*	CMP	0.878	0.873
(6)	MPL Occurrence	1.531	1.394
(7)	MPL Claims Made	1.138	1.146
(8)*	SL	0.908	0.894
(9)	OL	1.003	0.993
(10)	Fidelity/Surety	0.756	0.657
(11)*	Special Property	0.829	0.795
(12)	Auto Physical Damage	0.836	0.835
(13)	Other (Credit A&H)	0.931	0.926
(14)	Financial/Mortgage Guaranty	1.805	2.012
(15)*	INTL	1.355	1.476
(16)*	REIN. P&F Lines	1.072	0.973
(17)*	REIN. Liability	1.253	1.183
(18)	PL	1.229	1.194
(19)	Warranty	0.920	0.985
(20)*	Pet Insurance	0.829	0.795

*Cat Lines

PR018 Underwriting Risk - Premiums			
Proposed Line (7), Adjustment for Investment Income			
Col.	Line of Business	2024 Factor	2025 Factor
(1)*	H/F	0.960	0.966
(2)	PPA	0.931	0.937
(3)	CA	0.897	0.903
(4)	WC	0.836	0.833
(5)*	CMP	0.909	0.921
(6)	MPL Occurrence	0.781	0.795
(7)	MPL Claims Made	0.845	0.863
(8)*	SL	0.911	0.924
(9)	OL	0.827	0.837
(10)	Fidelity/Surety	0.913	0.922
(11)*	Special Property	0.953	0.957
(12)	Auto Physical Damage	0.975	0.979
(13)	Other (Credit A&H)	0.953	0.958
(14)	Financial/Mortgage Guaranty	0.888	0.891
(15)*	INTL	0.915	0.925
(16)*	REIN. P&F Lines	0.906	0.919
(17)*	REIN. Liability	0.794	0.811
(18)	PL	0.788	0.801
(19)	Warranty	0.938	0.972
(20)*	Pet Insurance	0.953	0.957

Capital Adequacy (E) Task Force RBC Proposal Form

- | | | |
|---|--|---|
| <input checked="" type="checkbox"/> Capital Adequacy (E) Task Force | <input type="checkbox"/> Health RBC (E) Working Group | <input type="checkbox"/> Life RBC (E) Working Group |
| <input type="checkbox"/> Catastrophe Risk (E) Subgroup | <input type="checkbox"/> P/C RBC (E) Working Group | <input type="checkbox"/> Longevity Risk (A/E) Subgroup |
| <input type="checkbox"/> Variable Annuities Capital. & Reserve (E/A) Subgroup | <input type="checkbox"/> Economic Scenarios (E/A) Subgroup | <input type="checkbox"/> RBC Investment Risk & Evaluation (E) Working Group |

<p style="text-align: right;">DATE: <u>4-24-24</u></p> <p>CONTACT PERSON: <u>Eva Yeung</u></p> <p>TELEPHONE: <u>816-783-8407</u></p> <p>EMAIL ADDRESS: <u>eyeung@naic.org</u></p> <p>ON BEHALF OF: <u>Capital Adequacy (E) Task Force</u></p> <p>NAME: <u>Tom Botsko</u></p> <p>TITLE: <u>Chair</u></p> <p>AFFILIATION: <u>Ohio Department of Insurance</u></p> <p>ADDRESS: <u>50 West Town Street, Suite 300</u> <u>Columbus, OH 43215</u></p>	<p style="text-align: center;">FOR NAIC USE ONLY</p> <p>Agenda Item # <u>2024-16-CA</u> Year <u>2024</u></p> <hr/> <p style="text-align: center;">DISPOSITION</p> <p>ADOPTED:</p> <p><input type="checkbox"/> TASK FORCE (TF) _____</p> <p><input type="checkbox"/> WORKING GROUP (WG) _____</p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>EXPOSED:</p> <p><input checked="" type="checkbox"/> TASK FORCE (TF) <u>04/30/2024</u></p> <p><input type="checkbox"/> WORKING GROUP (WG) _____</p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>REJECTED:</p> <p><input type="checkbox"/> TF <input type="checkbox"/> WG <input type="checkbox"/> SG _____</p> <p>OTHER:</p> <p><input type="checkbox"/> DEFERRED TO _____</p> <p><input type="checkbox"/> REFERRED TO OTHER NAIC GROUP _____</p> <p><input type="checkbox"/> (SPECIFY) _____</p>
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IDENTIFICATION OF SOURCE AND FORM(S)/INSTRUCTIONS TO BE CHANGED

- | | | |
|---|--|---|
| <input checked="" type="checkbox"/> Health RBC Blanks | <input checked="" type="checkbox"/> Property/Casualty RBC Blanks | <input checked="" type="checkbox"/> Life and Fraternal RBC Blanks |
| <input type="checkbox"/> Health RBC Instructions | <input type="checkbox"/> Property/Casualty RBC Instructions | <input type="checkbox"/> Life and Fraternal RBC Instructions |
| <input type="checkbox"/> Health RBC Formula | <input type="checkbox"/> Property/Casualty RBC Formula | <input type="checkbox"/> Life and Fraternal RBC Formula |
| <input type="checkbox"/> OTHER _____ | | |

DESCRIPTION/REASON OR JUSTIFICATION OF CHANGE(S)

The purpose of this proposal is to provide edits to the RBC Preamble to clarify and emphasize the purposes and the intent of using RBC.

Additional Staff Comments:

** This section must be completed on all forms.

Revised 2-2023

Risk-Based Capital Preamble

History of Risk-Based Capital by the NAIC

A. Background

1. The NAIC, through its committees and working groups, facilitated many projects of importance to state insurance regulators, the industry, and users of statutory financial information in the early 1990s. That was evidenced by the original mission statement and charges given to the Capital Adequacy (E) Task Force (CADTF) of the Financial Condition (E) Committee.
2. From the inception of insurance regulation in the mid-1800s, the limitation of insurance company insolvency risk has been a major goal of the regulatory process. The requirement of adequate capital has been a major tool in limiting insolvency costs throughout the history of insurance regulation. Initially, the states enacted statutes requiring a specified minimum amount of capital and surplus for an insurance company to enter the business or to remain in business.
3. Fixed minimum capital requirements were largely based on the judgment of the drafters of the statutes and varied widely among the states. Those fixed minimum capital and surplus requirements have served to protect the public reasonably well for more than a century. However, they fail to recognize variations in risk between broad categories of key elements of insurance, nor do they recognize differences in the amount of capital appropriate for the size of various insurers.
4. In 1992, the NAIC adopted the life risk-based capital (RBC) formula with an implementation date of year-end 1993. The formula was developed for specific regulatory needs. Four major categories were identified for the life formula: asset risk; insurance risk; interest rate risk; and all other business risk. The property/casualty and health formulas were implemented in 1994 and 1998, respectively. The focus of these two formulas is: asset risk; underwriting risk; credit risk; and business risk (health).
5. The total RBC needed by an insurer to avoid being taken into conservatorship is the Authorized Control Level RBC, which is 50% of the sum of the RBC for the categories, adjusted for covariance. The covariance adjustment is meant to take into account that problems in all risk categories are not likely to occur at the same time.
6. The mission of the CADTF was to determine the amount of capital an insurer should be required to hold to avoid triggering various specific regulatory actions. The RBC formula largely consists of a series of risk factors that are applied to selected assets, liabilities, or other specific company financial data to establish the threshold levels generally needed to bear the risk arising from that item.
7. To carry out its mission, the CADTF was charged with carrying out the following initiatives:
 - Evaluate emerging “risk” issues for referral to the RBC working groups/subgroups for certain issues involving more than one RBC formula.
 - Monitor emerging and existing risks relative to their consistent or divergent treatment in the three RBC formulas.
 - Review and evaluate company submissions for the schedule and corresponding adjustment to total adjusted capital (TAC).
 - Monitor changes in accounting and reporting requirements resulting from the adoption and continuing maintenance of the *Accounting Practices and Procedures Manual* and the *Valuation Manual* to ensure that model laws, publications, formulas, analysis tools, etc., supported by the CADTF continue to meet regulatory objectives.

Preamble

8. The RBC forecasting, and instructions were developed and are now maintained in accordance with the mission of the CADTF as a method of measuring the threshold amount of capital appropriate for an insurance company to avoid capital specific regulatory requirements based on its size and risk profile.

B. Purpose of Risk-Based Capital

9. The purpose of RBC is to identify potentially weakly capitalized companies **in order to** facilitate regulatory actions **designed to**, in most cases, ensure policyholders will receive the benefits promised without relying on a guaranty association or taxpayer funds. Consequently, the RBC formula calculates capital level trigger points that enable regulatory intervention in the operation of such companies.
10. **RBC instructions**, RBC reports and adjusted report(s) are intended solely for use by the commissioner/state in monitoring the solvency of insurers and the need for possible corrective action with respect to insurers and are considered confidential. All domestic insurers are required to file an RBC report unless exempt by the commissioner. There are no state permitted practices to modify the RBC formula and all insurers are required to abide by the RBC instructions.
11. Comparison of an insurer's TAC to any RBC level is a regulatory tool that may indicate the need for **possible** corrective action with respect to the insurer and is **not intended or appropriate as a means to rank insurers generally**. Therefore—except as otherwise required under the provisions of *Risk-Based Capital (RBC) for Insurers Model Act* (#312) or the *Risk-Based Capital (RBC) for Health Organizations Model Act* (#315)—the making, publishing, disseminating, circulation or placing before the public, or causing, directly or indirectly to be made, published, disseminated, circulated or place before the public, in a newspaper, magazine or other publication, or in a form of a notice, or in any other way, an advertisement, announcement or statement **(including but not limited to press releases, earnings releases, webcast materials, or any other earnings presentations or webcasts)** containing an assertion, representation or statement with regard to the RBC levels of any insurer or of any component derived in the calculation by any insurer is prohibited.

C. Objectives of Risk-Based Capital Reports

12. The primary responsibility of each state insurance department is to regulate insurance companies in accordance with state laws, with an emphasis on solvency for the protection of policyholders. The ultimate objective of solvency regulation is to ensure that policyholder, contract holder and other legal obligations are met when they come due and that companies maintain capital and surplus at all times and in such forms as required by statute.

To support this role, the RBC reports identify potentially weakly capitalized companies in that each insurer must report situations where the actual TAC is below a threshold amount for any of the several RBC levels. This is known as an "RBC event" and reporting is mandatory. The state regulatory response is likely to be unique to each insurer, as each insurer's risk profile will have some differences from the average risk profile used to develop the RBC formula factors and calculations.

There are several RBC levels with different levels of anticipated additional regulatory oversight following the reporting of an RBC event. Company Action Level (CAL) has the least amount of additional regulatory oversight, as it envisions the company providing to its regulator a plan of action to increase capital or reduce risk or otherwise satisfy the regulator of the adequacy of its capital. Regulatory Action Level (RAL) is the next higher level, where the regulator is more directly involved in the development of the plan of action. Authorized Control Level (ACL) anticipates an even higher amount of regulatory action in implementing the plan of action. **Mandatory Control Level (MCL) requires the insurance commissioner to place the reporting entity under regulatory control.**

D. Critical Concepts of Risk-Based Capital

13. Over the years, various financial models have been developed to try to measure the "right" amount of capital that an insurance company should hold.¹ "No single formula or ratio can give a complete picture of a company's

¹ Report of the Industry Advisory Committee to the Life Risk-Based Capital (E) Working Group, p. 6; Nov. 17, 1991.

Preamble

operations, let alone the operation of an entire industry. However, a properly designed formula will help in the early identification of companies with inadequate capital levels and allow corrective action to begin sooner. This should ultimately lower the number of company failures and reduce the cost of any failures that may occur.”

14. Because the NAIC formula develops threshold levels of capitalization rather than a target level, it is **neither useful nor appropriate** to use the RBC formula to compare the RBC ratio developed by one insurance company to the RBC ratio developed by another. Comparisons of amounts that exceed the threshold standards do not provide a **reliable** assessment of their relative financial strength. **For example, a company with an RBC ratio of 600% is not necessarily financially stronger than a company with an RBC ratio of 400%.** For this reason, Model #312 and Model #315 prohibit insurance companies, their agents and others involved in the business of insurance using the company’s RBC results to compare competitors.
15. The principal focus of solvency measurement is the determination of financial condition through an analysis of the financial statements and RBC. However, protection of the policyholders can only be maintained through continued monitoring of the financial condition of the insurance enterprise. Operating performance is another indicator of an enterprise’s ability to maintain itself as a going concern.
16. The CADTF and its RBC working groups are charged with evaluating refinements to the existing NAIC RBC formula and considering improvements and revisions to the various RBC blanks to 1) conform the RBC blanks to changes made in other areas of the NAIC to promote uniformity (when it is determined to be necessary); and 2) oversee the development of additional reporting formats within the existing RBC blanks as needs are identified.
17. The CADTF and its RBC working groups will monitor and evaluate changes to the annual financial statement blanks and the *Purposes and Procedure Manual of the NAIC Investment Analysis Office* to determine if assets or, specifically, investments evaluated by the NAIC Securities Valuation Office are relevant to the RBC formula in determining the threshold capital and surplus for all insurance companies or whether reporting available to the regulator is a more appropriate means to addressing the risk. The CADTF will consider different methods of determining whether a particular risk should be added as a new risk to be studied and selected for a change to the applicable RBC formula, but due consideration will be given to the materiality of the risk to the industry, as well as the very specific purpose of the RBC formulas to develop regulatory threshold capital levels.

E. Limited use of Risk-Based Capital

18. Use of RBC is limited to identifying potentially weakly capitalized companies to facilitate regulatory action and oversight. Any other application of RBC would be inappropriate to the detriment of policyholders, companies, and investors. While RBC may be used in other components of the regulatory framework, such uses should be in the context of identifying potentially weakly capitalized companies. For example, statutory accounting may leverage RBC in determining the admissibility of certain types of assets, when the benefits of those assets may not be readily available to the policyholders of a troubled company.
19. RBC does not provide a complete, clear, or meaningful ranking of insurers. For example, an insurer voluntarily strengthening assumptions used for reserving would generally reduce an insurer's RBC ratio but does not indicate a weaker position than a similarly situated insurer who did not elect to strengthen assumptions used for reserving. Regulators are able to consider a complete picture of the insurer's financial situation to appropriately follow up on RBC action levels. Using RBC beyond its intended purpose could create perverse incentives for companies that are not at risk of triggering an action level.
20. RBC requirements for particular risk categories were developed based on specific regulatory guidelines and following agreed upon procedures and methodologies. The RBC requirements were developed with regulatory needs in mind. They were not developed or intended for any other use. As such, except where prescribed, RBC requirements would not be appropriate to rely on in other contexts such as reserve setting or risk management or evaluating the risk of investments. While the development of RBC requirements often rely on historical data points, the data used extends over a substantial period of years and the actuarial modeling extends out over a long time horizon. They do not reflect risk at any one point in time. Moreover, the granularity of an analysis for

Preamble

RBC purposes likely differs from the granularity appropriate for other applications. Therefore, RBC requirements are not appropriate to evaluate the relative or absolute level of risk outside of the context of a regulatory framework for identifying potentially weakly capitalized companies.

21. Because RBC is a broad tool to facilitate regulatory oversight, an insurer's RBC can fluctuate without indicating a corresponding change in the insurer's financial strength.

Capital Adequacy (E) Task Force RBC Proposal Form

- | | | |
|---|--|---|
| <input type="checkbox"/> Capital Adequacy (E) Task Force | <input type="checkbox"/> Health RBC (E) Working Group | <input checked="" type="checkbox"/> Life RBC (E) Working Group |
| <input type="checkbox"/> Catastrophe Risk (E) Subgroup | <input type="checkbox"/> P/C RBC (E) Working Group | <input type="checkbox"/> Longevity Risk (A/E) Subgroup |
| <input type="checkbox"/> Variable Annuities Capital. & Reserve (E/A) Subgroup | <input type="checkbox"/> Economic Scenarios (E/A) Subgroup | <input type="checkbox"/> RBC Investment Risk & Evaluation (E) Working Group |

	DATE: <u>4/25/2024</u>
CONTACT PERSON: <u>Dave Fleming</u>	FOR NAIC USE ONLY
TELEPHONE: <u>816-783-8121</u>	Agenda Item # <u>2024-17-L</u>
EMAIL ADDRESS: <u>dfleming@naic.org</u>	Year <u>2024</u>
ON BEHALF OF: <u>Life Risk-Based Capital (E) Working Group</u>	DISPOSITION
NAME: <u>Philip Barlow, Chair</u>	ADOPTED:
TITLE: <u>Associate Commissioner of Insurance</u>	<input type="checkbox"/> TASK FORCE (TF) <u>6/28/2024</u>
AFFILIATION: <u>District of Columbia</u>	<input checked="" type="checkbox"/> WORKING GROUP (WG) <u>6/18/2024</u>
ADDRESS: <u>1050 First Street, NE Suite 801</u>	<input type="checkbox"/> SUBGROUP (SG) _____
<u>Washington, DC 20002</u>	EXPOSED:
	<input type="checkbox"/> TASK FORCE (TF) _____
	<input checked="" type="checkbox"/> WORKING GROUP (WG) <u>4/25/2024</u>
	<input type="checkbox"/> SUBGROUP (SG) _____
	REJECTED:
	<input type="checkbox"/> TF <input type="checkbox"/> WG <input type="checkbox"/> SG _____
	OTHER:
	<input type="checkbox"/> DEFERRED TO _____
	<input type="checkbox"/> REFERRED TO OTHER NAIC GROUP _____
	<input type="checkbox"/> (SPECIFY) _____

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

- | | | |
|--|---|---|
| <input type="checkbox"/> Health RBC Blanks | <input type="checkbox"/> Property/Casualty RBC Blanks | <input checked="" type="checkbox"/> Life and Fraternal RBC Blanks |
| <input type="checkbox"/> Health RBC Instructions | <input type="checkbox"/> Property/Casualty RBC Instructions | <input type="checkbox"/> Life and Fraternal RBC Instructions |
| <input type="checkbox"/> Health RBC Formula | <input type="checkbox"/> Property/Casualty RBC Formula | <input type="checkbox"/> Life and Fraternal RBC Formula |
| <input type="checkbox"/> OTHER _____ | | |

DESCRIPTION/REASON OR JUSTIFICATION OF CHANGE(S)

This proposal adds a factor for the line added to LR009 to specifically address line 44 of the Asset Valuation Reserve (AVR) Equity Component as part of proposal 2024-05-L. This AVR line was not included in the LR009 changes made with the mortgage methodology change in 2013.

Additional Staff Comments:

** This section must be completed on all forms.

Revised 2-2023

SCHEDULE BA MORTGAGES

		(1)	(2)	(3)	(4)	(5)	(6)
	<u>Annual Statement Source</u>	<u>Book / Adjusted Carrying Value</u>	<u>Involuntary Reserve Adjustment †</u>	<u>RBC Subtotal</u>	<u>Cumulative Writedowns ‡</u>	<u>Average Factor</u>	<u>RBC Requirement</u>
<u>In Good Standing</u>							
(1) Insured or Guaranteed	AVR Equity Component Column 1 Line 43 + Line 45				XXX X	0.0014	=
(2) Affiliated Mortgages – Residential – All Other	AVR Equity Component Column 1 Line 44				XXX X	0.0068	=
(3) Unaffiliated Mortgages with Covenants	AVR Equity Component Column 1 Line 57				XXX X	*	=
(4) Unaffiliated Mortgages - Defeased with Government Securities	AVR Equity Component Column 1 Line 58				XXX X	0.0090	=
(5) Unaffiliated Mortgages - Primarily Senior	AVR Equity Component Column 1 Line 59				XXX X	0.0175	=
(6) Unaffiliated Mortgages - All Other	AVR Equity Component Column 1 Line 60				XXX X	0.0300	=
(7) Affiliated Mortgages - Category CM1	AVR Equity Component Column 1 Line 38				XXX X	0.0090	=
(8) Affiliated Mortgages - Category CM2	AVR Equity Component Column 1 Line 39				XXX X	0.0175	=
(9) Affiliated Mortgages - Category CM3	AVR Equity Component Column 1 Line 40				XXX X	0.0300	=
(10) Affiliated Mortgages - Category CM4	AVR Equity Component Column 1 Line 41				XXX X	0.0500	=
(11) Affiliated Mortgages - Category CM5	AVR Equity Component Column 1 Line 42				XXX X	0.0750	=
(12) Total In Good Standing	Sum of Lines (1) through (11)						
<u>90 Days Overdue, Not in Process of Foreclosure</u>							
(13) Insured or Guaranteed 90 Days Overdue	AVR Equity Component Column 1 Line 47 + Line 49				XXX X	0.0027	=
(14) All Other 90 Days Overdue - Unaffiliated	AVR Equity Component Column 1 Line 61				XXX X	0.1100	=
(15) All Other 90 Days Overdue - Affiliated	AVR Equity Component Column 1 Line 48 + Line 50				XXX X	0.1100	=
(16) Total 90 Days Overdue, Not in Process of Foreclosure	Lines (13) + (14) + (15)						
<u>In Process of Foreclosure</u>							
(17) Insured or Guaranteed in Process of Foreclosure	AVR Equity Component Column 1 Line 52 + Line 54				XXX X	0.0054	=
(18) All Other in Process of Foreclosure - Unaffiliated	AVR Equity Component Column 1 Line 62				XXX X	0.1300	=
(19) All Other in Process of Foreclosure - Affiliated	AVR Equity Component Column 1 Line 53 + Line 55				XXX X	0.1300	=
(20) Total In Process of Foreclosure	Lines (17) + (18) + (19)						
(21) Total Schedule BA Mortgages (pre-MODCO/Funds Withheld)	Lines (12) + (16) + (20)						
(22) Reduction in RBC for MODCO/Funds Withheld Reinsurance Ceded Agreements	Company Records (enter a pre-tax amount)						
(23) Increase in RBC for MODCO/Funds Withheld Reinsurance Assumed Agreements	Company Records (enter a pre-tax amount)						
(24) Total Schedule BA Mortgages (including MODCO/Funds Withheld.)	Lines (21) - (22) + (23)						

† Involuntary reserves are reserves that are held as an offset to a particular asset that is clearly a troubled asset and are included on Page 3 Line 25 of the Annual Statement.

‡ Cumulative writedowns include the total amount of writedowns, non-admissions, and involuntary reserves that have been taken or established with respect to a particular mortgage.

* This will be calculated as Column (6) divided by Column (3).

■ Denotes items that must be manually entered on the filing software.



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info@aima.org

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Mr. Tom Botsko
Chair, Capital Adequacy Task Force ("CATF")
National Association of Insurance Commissioners ("NAIC")
via email to Eva Yeung (eyeung@naic.org)

April 16, 2024

Dear Chair Botsko:

Re: Proposal 2024-02-CA (Residual Structure PC & Health)

The Alternative Credit Council ("ACC")¹, the private credit affiliate of the Alternative Investment Management Association Ltd ("AIMA"), appreciates the opportunity to comment on CATF's proposal to increase the capital charge for the residual tranches of asset-backed securities ("ABS") contained in Proposal 2024-02-CA. For CATF members that are not members of the Risk-Based Capital Investment Risk and Evaluation (E) Working Group ("RBC-IRE"), on February 26, the ACC submitted an independent study conducted by Oliver Wyman ("OW") that compared the 45% ABS residual charge to similar investments that have already received an NAIC capital charge.²

The study concludes that, on a portfolio basis, ABS residuals perform better than common equity under all modeled stress scenarios. Further, common stock losses are 30 percent higher than ABS residuals in the Deep-Tail stress scenario and 35-50 percent

-
- ¹ The Alternative Credit Council (ACC) is a global body that represents asset management firms in the private credit and direct lending space. It currently represents 250 members that manage over \$1trn of private credit assets. The ACC is an affiliate of AIMA and is governed by its own board which ultimately reports to the AIMA Council. ACC members provide an important source of funding to the economy. They provide finance to mid-market corporates, SMEs, commercial and residential real estate developments, infrastructure, and the trade and receivables business. The ACC's core objectives are to provide guidance on policy and regulatory matters, support wider advocacy and educational efforts and generate industry research with the view to strengthening the sector's sustainability and wider economic and financial benefits. Alternative credit, private debt or direct lending funds have grown substantially in recent years and are becoming a key segment of the asset management industry. The ACC seeks to explain the value of private credit by highlighting the sector's wider economic and financial stability benefits.
 - ² A copy of the February 26, 2024, ACC letter to the RBC-IRE can be found on pages 11-13 of the RBC-IRE March 17, 2024 meeting materials and the OW report can be found on pages 14-65 at rbcire-materials-20240317.pdf (naic.org).

Alternative Credit Council (ACC)

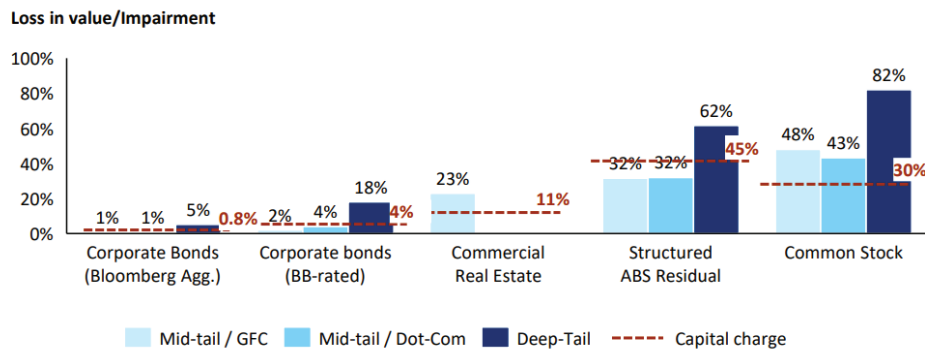
The ACC is the private credit affiliate of the Alternative Investment Management Association Limited (AIMA)
AIMA is registered in England as a Company Limited by Guarantee, No. 4437037. VAT Registration no. 577 5913 90. Registered Office as above.





higher than ABS residuals in the Mid-Tail stress scenarios. This conclusion is shown in Figure 22 on page 30 of the Oliver Wyman research paper (copied below).

Figure 22: Capital charges compared to modeled scenario losses for selected asset classes³⁰



The OW analysis indicates that a 45% charge would not be consistent with the capital charge imposed on similar equity investments such as commercial real estate equity and common stock. In addition to this OW study, in this letter we provide additional data analyses that demonstrate the relative safety and outperformance of CLO equity tranches compared to common stock.

Claims of 100% cliff losses versus historical track record

One concern raised by regulators is whether ABS residual tail losses during periods of market stress could be 100% in absolute terms and much greater in comparison to public equities. However, Larry Cordell, an economist at the Federal Reserve Bank of Philadelphia, along with Professor Michael Roberts of the Wharton School at the University of Pennsylvania, performed a detailed analysis of CLO residuals from 1997-2021. The results of their analysis were published in the Journal of Finance and found that CLO equity outperformed the S&P 500 during that time period.³ Their study also found that on a risk-adjusted basis, CLO equity outperformed equity “against a variety of public benchmarks.”⁴ A key finding of this study was the relative stability of CLO equity during two periods of significant market instability, namely the 2001 dot-com bubble and the 2008 Great Financial Crisis. The authors noted that CLOs’ “equity performance highlights the resilience of CLOs to market volatility.”⁵ The authors attributed the outperformance of CLO equity to several of the structural features of CLOs, including “their closed-end structure, long-term funding, and embedded options to reinvest principal proceeds.”⁶

3 Cordell, R, and Schwert, M, CLO Performance, Journal of Finance, 2023. <https://doi.org/10.1111/jofi.13224>
 4 *Id.* at 2. “Our central finding is that CLO equity tranches provide statistically and economically significant abnormal returns, or “alpha,” against a variety of public benchmarks...”
 5 *Id.* at 20.
 6 *Id.* at 1. See also Jeff Helsing, Can CLO Equity Outperform if the Economy Tips into Recession?, September 26, 2022, [Can CLO Equity Outperform If the Economy Tips Into Recession? | Western Asset](#)





The Cordell study provides a clear historical track record that CLO residuals do not suffer complete losses during periods of financial stress. In addition to the reasons cited above, residuals are priced well below par (unlike corporate bonds), reflecting both the high discount rates and an expectation of some credit losses. As a result, the interest payments are a meaningful contributor to the overall value--again, unlike corporate bonds. Even in a severe stress, both the Cordell and OW studies demonstrate that CLO equity investors can still expect to receive cash flows.

CTE 90 vs VAR 95-99 percentile

Some RBC-IRE members have asked about the difference between contingent tail exposure ("CTE") 90 and Value at Risk ("VaR") at the 95th or 99th percentile. While CTE represents the average probability-weighted loss above a certain probability level, VaR represents the loss at a specific probability level. The American Academy of Actuaries is using a CTE approach, so if the CTE 90 level is what becomes adopted, that would calculate the average of losses above the 90th percentile. The OW study examined losses at both the 95th and 99th percentiles. Those are both specific percentile points of the loss distribution but are at the higher end of the CTE 90 average range. This difference can also be explained by the fact that the OW study used stress tests during three different periods of financial stress, which is not compatible with the kind of Monte Carlo simulation used to calculate CTE. Also, the purpose of the OW study was to compare the interim capital charge for ABS residuals to that of established NAIC capital charges for similar assets, and the NAIC has historically used a 94-96th percentile VaR to establish capital charges.

BSL residuals vs. the other ABS residuals in the OW study

The OW study clearly demonstrates that all three analyzed types of ABS equity outperformed common stock during periods of market stress, including the 2001 dot-com bubble, the 2008 Great Financial Crisis, and the 1930s Great Depression. However, given that the equity of one sub-type of collateralized loans ("CLOs"), namely broadly syndicated loans ("BSLs"), performed better overall than common stock but similar in the two medium-tail stresses, we asked finance Professor Daniel Svogun to perform a beta analysis to determine whether or not BSL equity has lower volatility than common stock.⁷

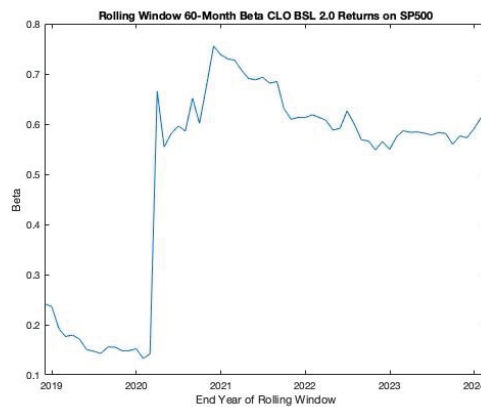
Professor Svogun was able to use time series data from Bank of America on CLO BSLs monthly median equity prices to calculate BSL equity beta using the NAIC's formula for measuring monthly volatility over a 60-month rolling window. The results of Professor Svogun's analysis (see chart below) demonstrate that the 60-month rolling beta of BSL

⁷ Professor Daniel Svogun is a professor of finance at the Busch School of Business, Catholic University of America, whose research specializes in the "time value of money, ratio analysis, [and] the valuation of stock and bonds."
<https://business.catholic.edu/faculty-and-research/faculty-profiles/svogun-daniel/index.html>





equity is well below 1 (any beta result lower than 1 indicates less volatility relative to the S&P 500). This beta analysis compared the monthly CLO equity price change to the S&P 500 index performance each month. The beta of the full period studied (Dec. 2013 – Feb. 2024) with over 750 BSL CLOs included is .4989, which is well below the NAIC’s .75 beta threshold for the lowest charge of 20%. The chart shows the 60-month rolling average beta following the NAIC’s formula. During that time period, the beta of BSL equity remains below the .75 threshold in all but one month, where it reaches .7564. Note the time indicated in the x-axis is the ending period of the 60-month rolling beta. As a result, to be consistent with the principle of equal capital for equal risk, it would be more appropriate for the NAIC RBC charge for BSL equity to be adjusted to 20% using the NAIC’s formula to adjust the equity capital charge according to its level of volatility compared to the S&P 500.



Bank of America CLO data; calculations from finance professor Daniel Svogun, Ph.D., Busch School of Business, CUA

This finding that BSL equity is less volatile than the S&P 500 should not be a surprise because it is consistent with the results of both the OW study and the Cordell CLO equity research paper. Furthermore, it provides additional evidence of the relative outperformance of BSL CLO equity compared to common stock.

The overly conservative nature of a single 45% ABS residual charge

In response to regulators’ requests, we were able to anecdotally confirm that insurers invest in CLOs, investment-grade auto loan and student loan ABS residuals. However, several of our insurance and investment members noted that they invest in other types of ABS as well and expressed concerns about the inequity of a single residual C-1 charge of 45% for all ABS regardless of the type or quality of the underlying collateral.

One specific example where a 45% residual C-1 factor would be unwarranted is for





Commercial Property Assessed Clean Energy (C-PACE) ABS⁸. C-PACE ABS are backed by loans to U.S. commercial property owners that finance energy efficiency, water conservation and renewable energy projects. C-PACE loans are high-quality, super senior to a mortgage loan on a property, given that the loans are repaid as a benefit assessment on the property tax bill. However, it is uneconomic and unfeasible to rate or invest in individual C-PACE loans at scale due to the relatively small average ticket size.

As a result, C-PACE loans are aggregated in a securitization or structured product so that insurers can invest in the C-PACE asset class. However, the 45% C-1 charge on the residual tranche, even if it is a small part of the structure, can negatively impact the capital-adjusted risk-return profile of a C-PACE ABS. Insurance investors in C-PACE ABS are already subject to higher capital charges compared to investing directly in the underlying, so the interim 45% residual charge makes it even harder to justify the relative risk-reward analysis for an insurance investment. Investors are aware that the 45% residual charge is meant to be an interim one, but the reality is that it may be in place for many years, particularly for smaller ABS asset classes. This would, in effect, significantly disincentivize insurers from investing in high-quality and sustainable C-PACE assets.

Conclusion

At a high level, the OW analysis and findings demonstrate that expected losses in stress scenarios can vary depending on the underlying collateral and structure, which makes a single 45% residual charge inappropriate. As more information is gained on insurers' residual exposure, there are likely other types of ABS besides student loan ABS, auto loan ABS and C-PACE ABS for which a 45% charge would not be appropriate based on their specific level of risk. As a result, we respectfully request the NAIC to reconsider imposing the highest capital charge level in its history until the impact of this charge on all ABS residuals is better understood and determined to be appropriate.

We welcome the opportunity to discuss these supplementary comments and additional data analyses. From our perspective, there are now only two data-driven analyses available to you, both of which demonstrate that a single 45% charge on ABS residuals would not correspond to the actual levels of risk.

If you have any questions about the OW study, the Cordell paper or any other points made in this letter, please contact me or Joe Engelhard, Head of Private Credit & Asset Management Policy, Americas, at 202-304-0311 or jengelhard@aima.org. The ACC has

⁸ C-PACE loans are used by commercial property owners to finance climate and environment-related projects, including climate resiliency, renewable energy, and water and energy efficiency improvements. *See generally*, "Credit FAQ: ABS Frontiers: The C-PACE Space Explained", (2024) at <https://www.spglobal.com/ratings/en/research/articles/231213-credit-faq-abs-frontiers-the-c-pace-space-explained-12943764>.





provided two similar comment letters to the RBC-IRE regarding the Oliver Wyman study (copy attached). All of the points in those two comment letters are summarized in this updated version.

Respectfully,

A handwritten signature in blue ink, appearing to read "Jiří Król".

Jiří Król
Global Head of Alternative Credit Council





RESIDUAL TRANCHE RISK ANALYSIS

February 26, 2024

A business of Marsh McLennan

Confidentiality

Our clients' industries are extremely competitive, and the maintenance of confidentiality with respect to our clients' plans and data is critical. Oliver Wyman rigorously applies internal confidentiality practices to protect the confidentiality of all client information.

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1. Executive Summary

This report presents a quantitative analysis of the relative risk of residual tranches of Asset-Backed Securities (ABS). We analyzed the potential losses under historically-calibrated stress scenarios, considering both “mid-tail” (~95th percentile) and “deep-tail” stress scenarios, on a portfolios of residual tranche deals. This analysis then enables us to compare the decline in valuation of these assets to the losses experienced by other asset classes in the corresponding stress periods.

In Section 1, we observe the growing significance of structured products to insurer balance sheets. We then outline the primary objectives of this report: to conduct a fact-based assessment of ABS residual tranches that enables objective comparisons to other common assets and provides data to help inform the calibration of the capital charge of residual tranches. We then outline the guiding principles on which we based our analytical approach, including aligning our approach with the approaches taken by the NAIC in its calibration of the capital charges for other investment assets.

In Section 2, we describe our methodological approach to assessing the risk associated with residual tranches ABS deals. We begin by describing the process by which we determine the scope of assets for our analysis, namely CLOs, auto loans, and student loans, and the selection of the specific deals in our analysis. Next, we present our modeling approach, a scenario-based approach that considered the cash flows available to these tranches. We then describe, for each asset type, the method used to calibrate our base scenario, mid-tail (95th percentile), and deep-tail stress scenarios, including the choice of historical data. We conclude this section with a discussion of the balance sheet treatment of residual tranches and the output metrics examined.

In Section 3, we discuss the results of our analysis. Our analysis focused on the decline in fair-value, measures as the net present value of the cash flows available to the residual tranche under each scenario. We find that these losses vary, among other factors, based on the underlying collateral and residual thickness. For the asset types examined, losses at a portfolio-level ranged from -42% for broadly syndicated CLOs to -6% for prime auto loans under mid-tail scenario.

In Section 4, we compare the observed losses, on both an aggregate basis and for each asset type, with those of other common assets, specifically common stock, commercial real estate, and corporate bond. We find that ABS residual tranches realize lower losses on a portfolio-level than does common stock under corresponding levels of macroeconomic stress, though ABS residual tranches realize greater losses than do commercial real estate and low-rated corporate bonds.

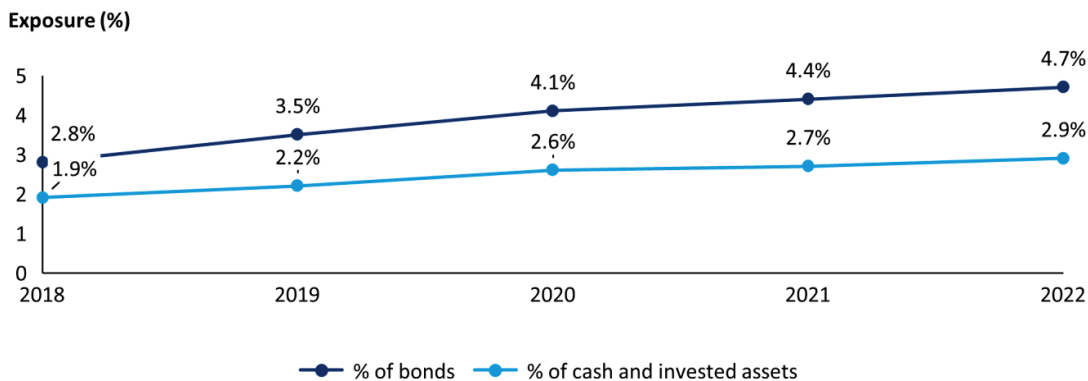
The subsequent report is intended to provide a data-driven and objective analysis to bring fact-based insight into an under-researched topic within the insurance industry.

2. Introduction

2.1. Context

In recent years, insurance companies have increased their allocation assets to structured products – including Asset-Backed Securities (ABS) – in efforts to build an attractive investment portfolio to support policy obligations. These insurers strategically allocate a portion of their assets to these securities, typically with the dual goals of enhancing their investment returns and diversifying their portfolio by accessing a broader spectrum of investment opportunities. Figure 1¹ illustrates this growth in CLO exposure across insurers as a percentage of bonds and of cash and invested assets. The complexity of structured ABS, particularly the residual tranches, have raised concerns about the value of these assets during stress periods.

Figure 1: US insurer CLO exposure, % (annual 2018-2022)



Structured products are financial instruments crafted to offer investors exposure to a wide range of underlying collateral including, but not limited to, corporate loans, auto loans, and student loans. The specific mechanics of these products have evolved over time and vary by sector. However, the products most often have different tranches, ranging from most-senior (often AAA-rated) to most junior (residual equity), to meet the risk appetite and return requirements of different types of investors. The relative risk of the tranches is largely determined by the order of the cash flows paid from the underlying collateral; that is, senior tranches receive cash flows first, and subsequent payments cascade down the deal’s “waterfall” until they reach the equity tranche, which is paid last. This payment hierarchy ensures that investors in different tranches are treated fairly and receive their payments according to the predetermined order.

The complexity of structured ABS, particularly the residual tranches, combined with their increased prevalence, has raised concerns about the potential losses on these assets during stress periods and resulted in an increase in scrutiny from regulators and other industry stakeholders. The NAIC recently begun to undertake a broader review in 2023 of its capital approach for structured products, including ongoing efforts around CLOs. However, as an intermediate measure, it has proposed applying a 45% capital charge for residual

¹ U.S. insurer CLO exposure to bonds and cash & invested assets from 2018 - 2022 (%): NAIC, “Continued Double-Digit Increase in U.S. Insurers’ Collateralized Loan Obligation Exposure in 2022” (2022)

tranches. The NAIC has indicated an interest in receiving quantitative analysis of the risk profile of residual tranches from industry participants to inform its calibration of the factor applied to these assets.

2.2. Objective of report

In this report, we focus on the residual equity tranche of asset-backed securities (ABS), which generally have the lowest-priority entitlement to cash flows within the broader deal waterfall. Limited rigorous quantitative analysis has been performed to evaluate the risk associated with these assets and support a calibration of a capital charge for use within the NAIC's Risk-Based Capital framework. This report seeks to remedy this gap by:

- Applying a fact-based assessment to evaluate the risk profile of residual tranches of ABS
- Enabling an objective comparison of the risk profile of residual tranches to other commonly held assets, such as equities, real estate, or corporate bonds
- Providing data to help inform the calibration of the capital charge of residual equity tranches

2.3. Guiding Principles

We designed our analytical approach based on three guiding principles:

- First, our modeling approach was, to the extent possible, based on the NAIC's own methodology to calibrate RBC charges for other investment assets
- Second, our approach aimed to capture the substantial variation in the underlying collateral as well as structuring between asset classes.
- Third, we designed our approach to be based on projected cash flows isolating losses due to credit risk, as opposed to other risks such as interest rate or liquidity risk

2.4. Precedents

Historically, the NAIC has used a range of similar methodologies to calibrate the capital charge of different asset classes. To inform the analysis undertaken in this paper, we surveyed these approaches to identify the methodologies and approaches applied. **Table 1** shows the approach the NAIC has taken in determining the RBC charges for corporate bonds, equities, and real estate.

Table 1: Select RBC charge calibration approaches

Asset	RBC charge	Timing	Severity	Calibration approach
Corporate bonds	NAIC 1	0.16%-1%	10-year loss horizon	96 th percentile (for the entire bond portfolio)
	NAIC 2	1%-2%		
	NAIC 3	3%-6%		
	NAIC 4	7%-12%		
	NAIC 5	16%-30%		
				Simulation (cumulative defaults under 2,000 stochastic trials)

	NAIC 6	30%			
Equities		30% ²	2-year loss horizon	94 th percentile	Historical data (S&P 500 from 1960-1991)
Real Estate		11%-13%	2-year loss horizon (to capture economic cycle)	96.8 th percentile confidence level	Historical data (national database of real property and mortgage securities data from 1978-2020)

Based on this survey, we identified five components of the prior calibration efforts that informed our methodological approach:

- Capital charges were calibrated at a 94-96th percentile
- Calibration was based on historical data (period and length vary by asset class)
- Calibration considered a multi-year window to capture full length of an adverse event
- Losses were measured on an aggregated basis for the relevant asset class, by examining performance of an index or diversified portfolio
- Metrics used to measure losses, while varying, reflect the balance sheet treatment for asset type

Our methodology is consistent with these observations by:

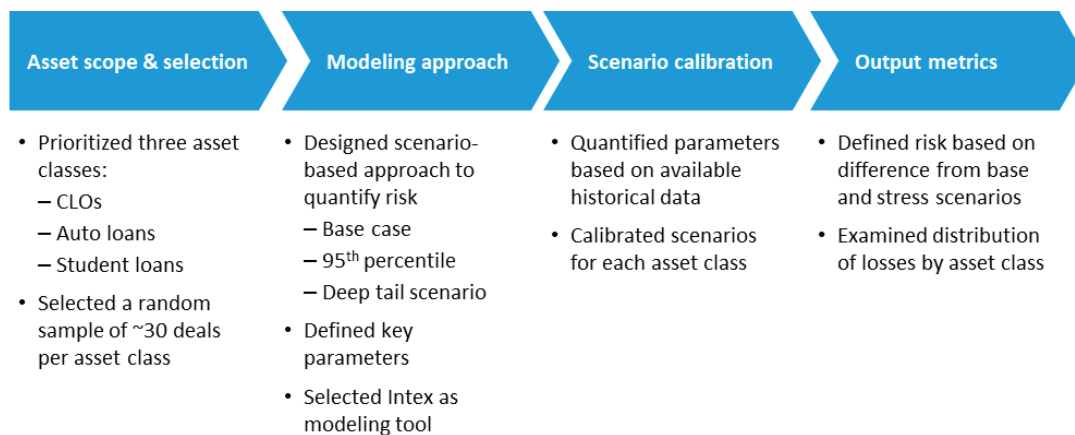
- Evaluating losses at the 95th percentile event or “mid-tail” (vs. Deep-tail)
- Using historical experience for underlying collateral to calibrate potential losses
- Calibrating losses over the full credit cycle
- Considering aggregate performance of a representative portfolio of assets
- Defining risk metrics consistent with balance sheet treatment

² For $\beta = 1$

3. Methodology

We structured our methodological approach into four primary steps. First, we determined the asset scope and selection of deals for modeling. Second, we determined our modeling approach, which utilized a scenario-based methodology to quantify the relative risk of these assets. Third, we calibrated specific stress scenarios to simulate against these deals. Fourth, we defined the output metrics to measure the impact of these stress scenarios on the portfolio of in-scope deals. **Figure 2** provides an overview of this approach.

Figure 2: Overview of approach



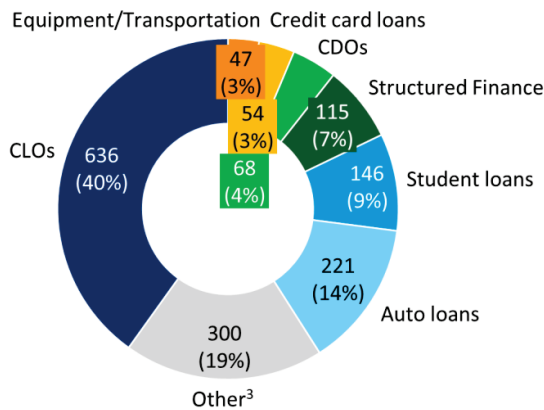
The following sections provide additional information on the asset scope & selection, modeling approach, scenario calibration, and chosen metrics.

3.1. Asset Scope & Selection

3.1.1. Asset Scope:

We selected three classes of ABS on which to focus our analysis: CLOs, auto loans, and student loans. These classes were chosen as they compose the largest share of outstanding ABS volume. We further segmented CLOs into Middle-Market (MM) and Broadly Syndicated Loan (BSL) CLOs and auto loan ABS into prime and subprime auto loan ABS. **Figure 3** illustrates the total ABS outstanding volume by asset class.

Figure 3: ABS total outstanding volume by asset class, \$B (%) (2021)³



The figure shows that CLOs represent the plurality of the total US ABS market (40%), while auto and student loan ABS represent the next largest shares among individual asset classes (14% and 9%, respectively). Asset classes such as Collateralized Debt Obligations (CDO), credit card loans, and equipment/transportation represent a small share of the ABS market (4%, 3%, and 3%, respectively).

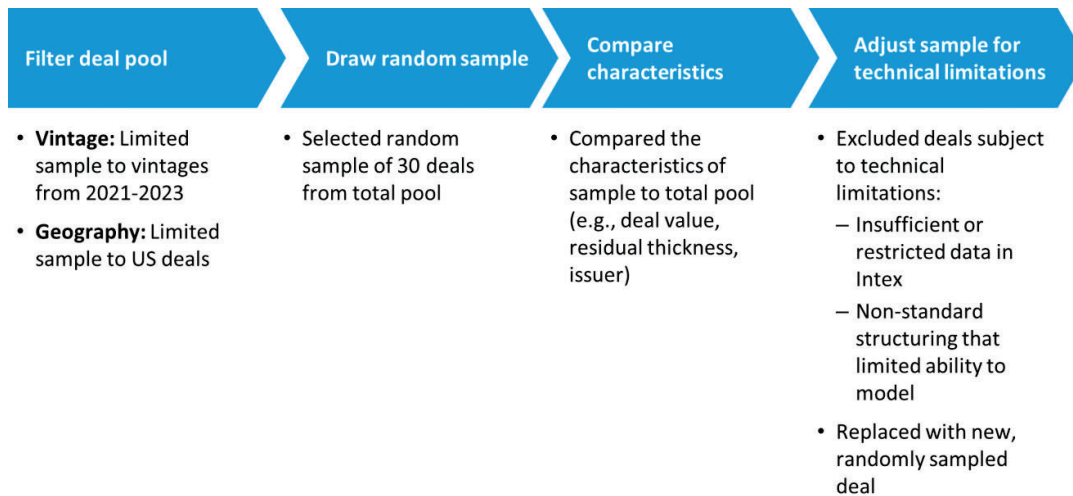
We examined the two largest segments of the CLO market: Middle-Market (MM) and Broadly Syndicated Loan (BSL) CLOs (which make up roughly 90% of the CLO market). Similarly, we examined the two largest segments of the auto loan ABS market: prime and subprime (which make up roughly 75% of the Auto ABS market).

³ ABS total outstanding volume by asset class in 2021 (%): *SIFMA US ABS Securities*

3.1.2. Selection Process:

For each subclass of ABS, we followed the steps below in **Figure 4** to select an appropriate set of securities to model.

Figure 4: Overview of asset selection process



We selected a random sample of deals to model within each subclass: CLOs (both MM and BSL), auto loans (both prime and subprime), and student loans. The selection process was consistent across all the asset classes in scope. This process, although random, controlled for two factors: vintage and geography. First, we limited our sample to vintages originated between 2021 and 2023. This approach was taken to reflect current deal structures and because these deals comprise a greater portion of the outstanding issuance – and will thus be most relevant to future implementations of proposed capital rules. Additionally, we only included US deals, as these are the most relevant for US-based life insurers. After applying the two filters to the broader deal universe of each respective asset class, we selected a random sample of thirty deals from the total pool of deals modeled in Intex⁴. This sample size was chosen to achieve sufficient statistical breadth while maintaining a manageable volume of deals. We assumed that the process of random sampling would yield a statistically representative sample. After selecting a random sample of deals, we compared summary statistics of our sample with the full universe of US deals originated between 2021 and 2023, which can be seen in Section A.4 of the Appendix, and in all cases observe similar distributions across the examined characteristics. Finally, we adjusted the sample as needed on a case-by-case basis, due to either technical constraints (e.g., insufficient or restricted data on the deal in Intex) or individual deal characteristics (e.g., nonstandard structuring). **Table 35** provides a list of all deals excluded from our analysis.

⁴ See Section A.4 of appendix for summary statistics of sample compared to total deal universe

3.2. Modeling Approach

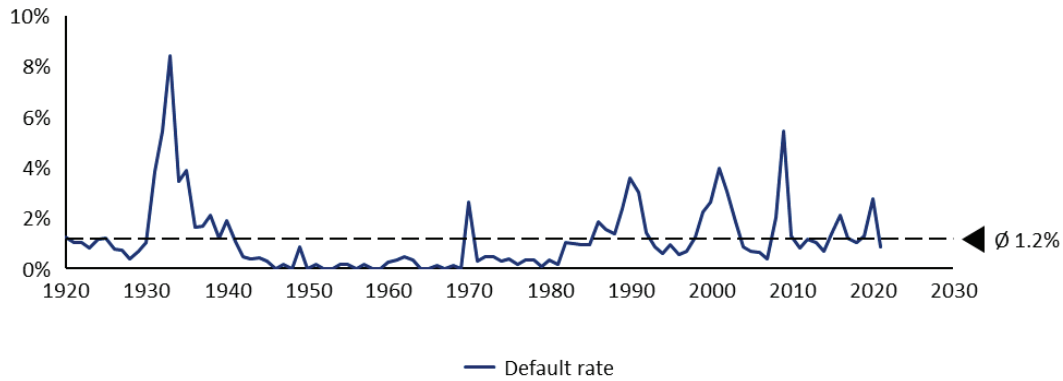
We utilized a scenario-based approach to measure the relative risk of ABS residuals across simulated base and stress cases in Intex. We chose to use Intex due to the breadth of ABS deals accessible within the platform, the thorough coverage of the specific legal terms of our in-scope ABS, and Intex's capability to generate resulting cash flows of deals based on assumptions about the underlying collateral behavior.

Several decisions guided our modeling approach:

- We evaluated multiple historical, stress scenarios which was consistent with NAIC's methodology of calibrating the RBC charges of other asset classes based on observed historical experience (e.g., equities and real estate). We did not use a stochastic methodology to estimate the impact of stress on the value of residuals because of a lack of historical data of the underlying investment sufficient to make such a complex statistical models robust.
- We designed three stress scenarios to simulate the impact of a range of severities in adverse economic conditions on the in-scope asset classes.
- We applied stress to the underlying collateral of the assets rather than the bonds comprising the ABS. This is because the value of equity tranches is derived from the value of the underlying assets, for which there is more robust available data.
- We determined the severity of our scenarios based on several factors. To maintain consistency with how the NAIC has calibrated capital charges historically, we created two stress scenarios of approximately 95th percentile severity⁵, considering relative historical and economic significance events with different default timing profiles. In addition, to understand the potential for losses in a deep-tail event, we also considered a "Deep-tail" scenario, modeled after the Great Depression, and intended to reflect approximately a 99th percentile severity. We did not have sufficient data to conduct a robust statistical analysis to directly model the severity for this scenario. Rather, we used default rates of Corporate Bonds from Moody's Investors Service as a proxy for increase in credit losses under the Deep-tail scenario. **Figure 5** illustrates annual corporate bond default rates from 1920-2021. During this approximately 100-year period, we observed four large spikes in default rates: the Great Depression (1931-1940), Savings & Loan Crisis (1986-1992), the Dot-Com Crisis (1998-2003), and the Global Financial Crisis (2008-2010). This experience suggests that the spikes observed in these events are approximately 1-in-20 events in terms of excess defaults. The Great Depression, by contrast, is closer to a 1-in-100 event in terms of excess defaults.

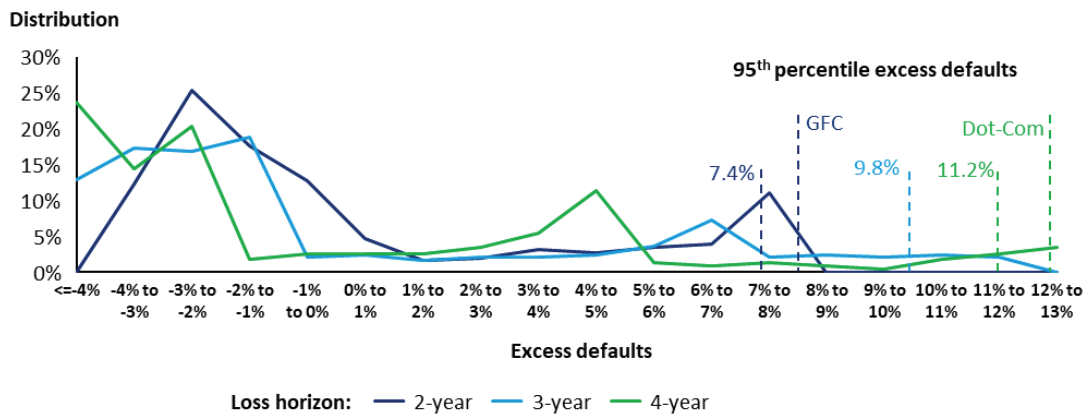
⁵ This approach differs from the methodology that the American Academy of Actuaries is applying in its work on CLOs, which uses CTE90 as the risk metric. For a normal distribution, CTE90 is equivalent to approximately the 95th percentile. The choice of CTE90 reflected in part concerns around the performance of residual tranche ABS in more severe, or "Deep-tail" scenarios. The analysis in this report also considers the performance of these assets in a deep-tail scenario.

Figure 5: US corporate bond default rates, % (annual 1920-2021)⁶



- Additionally, we observed that excess default losses (i.e., principal in default above the long-term average) for the US LSTA 100 were both higher than 95th percentile excess default losses for the relevant loss horizons (2 years for GFC and 4 years for Dot-Com bubble), as depicted in Figure 6. This analysis applies a similar approach to that used by the NAIC in its calibration of the capital charges for common stock and real estate, namely determining the percentile losses based on a rolling window, and the approach was chosen to reflect our guiding principle of consistency. While this analysis is based on a 24-year time series, it supports use of the GFC and Dot-Com stresses as suitable 95th percentile stress scenarios.

Figure 6: US LSTA 100 95th percentile excess defaults by loss horizon, % (1999-2022)⁷



⁶ Annual U.S. corporate bond default rates from 1920 - 2021 (%): *Moody's Investors Service, "Corporate Default and Recovery Rates" (2021)*

⁷ Excess defaults are defined as the defaults in excess of the long-term average (1999 – 2022). The 95th percentile excess defaults are calculated for each loss horizon from 1999-2022 (%): *S&P, U.S. LSTA*

- Our selection of parameters was determined based on relevance to the underlying assets being stressed. We used available historical data to derive parameters which we used as inputs in Intex. We used these parameters to build stress scenarios and applied those scenarios to a portfolio of randomly selected deals within each in-scope asset class. The subsequent section provides more detail on specific parameters used for each segment.

3.3. Scenario Calibration

This section discusses the methodology used to calibrate scenario-level modeling parameters, including default rates, recovery rates, prepayment rates, recovery lags, delinquency rates (for auto loans), and reinvestment period assumptions. In the calibration of the scenarios, the intention was to reflect both the severity and duration of a Mid-tail (~95th percentile) and Deep-tail event. As such, we consider the level of excess defaults over the credit cycle. A limitation of this approach is that no historical time series on the relevant underlying collateral included a Deep-tail event (that is, an event of similar severity to the Great Depression). As a result, we relied on the experience of corporate bonds during this period to serve as a proxy for the potential performance of the underlying collateral and applied a similar increase in default rates and/or level of excess defaults.

3.3.1. CLOs

Table 2 shows the calibration of scenario-specific modeling parameters. With the exception of the default rate, which was calibrated separately to account for difference in the credit quality of the underlying loans, common parameters were used for the BSL and MM segments.

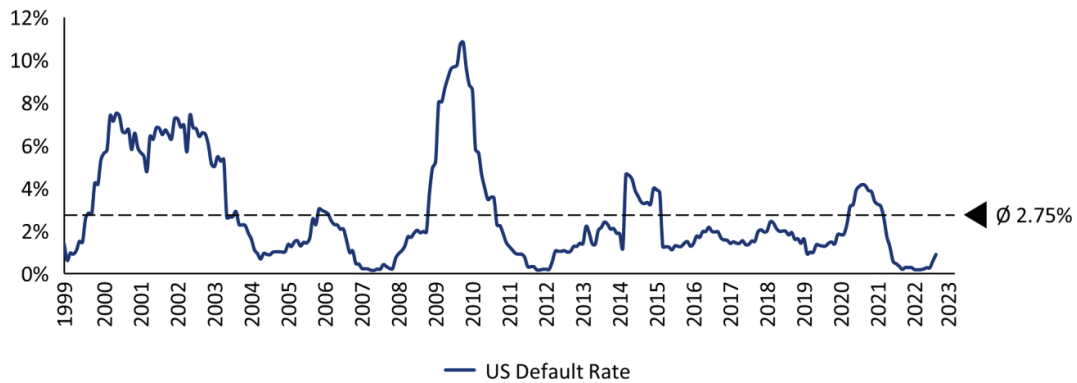
Table 2: Scenario-level parameters for CLOs

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

3.3.1.1. Baseline scenario

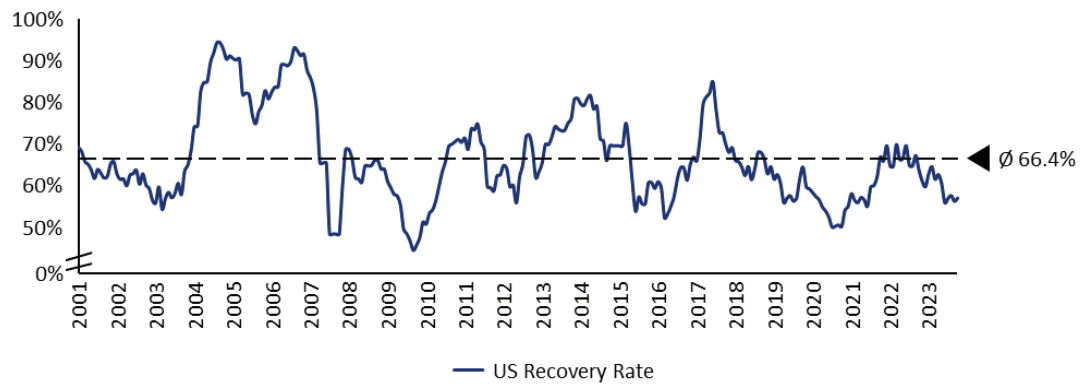
We constructed a baseline scenario for CLOs by calculating long-term averages of the applicable parameters based on available historical data. For default rates, we primarily relied on historical data from the S&P Loan Syndications and Trading Association (LSTA) 100 index series from 1999-2022, which is shown in **Figure 7** below. Additional adjustments were made to account for differences in the underlying collateral quality of BSL and MM and discussed later.

Figure 7: Default rates, % of principal (monthly 1999-2022)⁸



For recovery rates, we set a baseline recovery rate of 66.4%, which is the long-term average rate of the LSTA series from 2001 to 2023,⁹ as shown in **Figure 8**.

Figure 8: Recovery rates (1st lien loans), % of principal, (monthly 2001-2023)¹⁰



⁸ Bank loan default rates from 1999 - 2022 (% of principal): S&P, U.S. LSTA

⁹ Monthly 1st lien loan recovery rates from 2001 - 2023 (% of principal): BofA Global Research, LCD, Moody's

¹⁰ Monthly 1st lien loan recovery rates from 2001 - 2023 (% of principal): BofA Global Research, LCD, Moody's

Although our assumptions for MM and BSL CLOs were similar for most parameters, they varied with regard to the assumed baseline default rate, which was derived as a weighted average based on the credit rating distribution of the two CLO types. We assume that rating-adjusted corporate bond default rates are approximately equal to rating-adjusted bank loan default rates. The ratings, which were sourced from S&P Global, can be seen in **Figure 9**, while the market shares can be seen in **Figure 10**.

Figure 9: Ratings distribution of CLO obligors, % (2023)¹¹

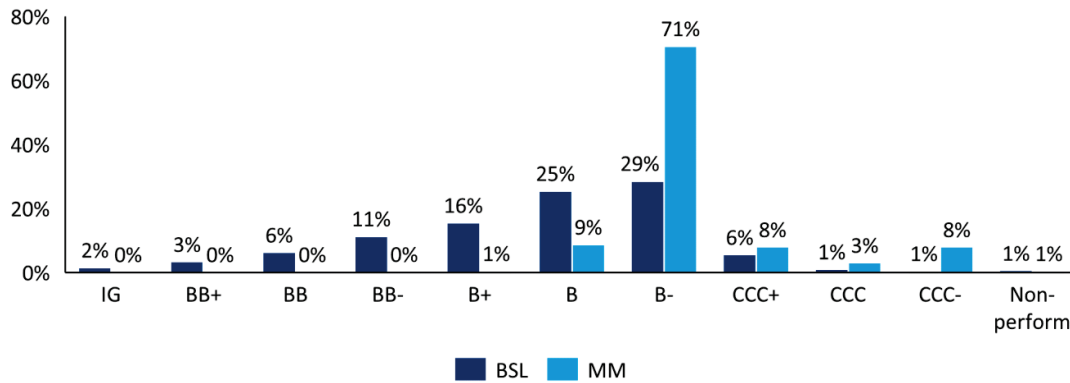
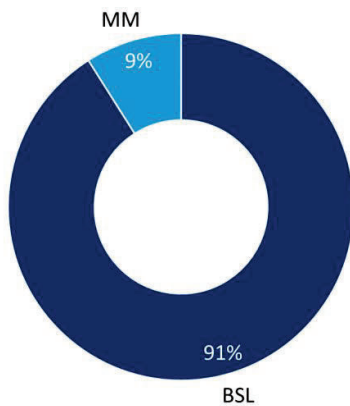


Figure 10: CLO market shares by type, % (2023)¹²



¹¹ Ratings distribution of CLO obligors in 2023 (%): S&P Global Ratings, "Middle-Market CLO and Private Credit Quarterly (Q4 2023)"

¹² MM CLO and BSL market share in 2023 (%): S&P Global Ratings, "Middle-Market CLO and Private Credit Quarterly (Q4 2023)"

Ultimately, this approach yielded a baseline default rate of 4.1% for MM CLOs and 2.6% for BSL CLOs. As a check on this methodology, we compared our aggregated weighted average default rate (2.80%) with that of the average default rate of the S&P LSTA index (2.75%) based on the available time series data (1999-2021). The remaining parameters were consistent across both MM and BSL CLOs.

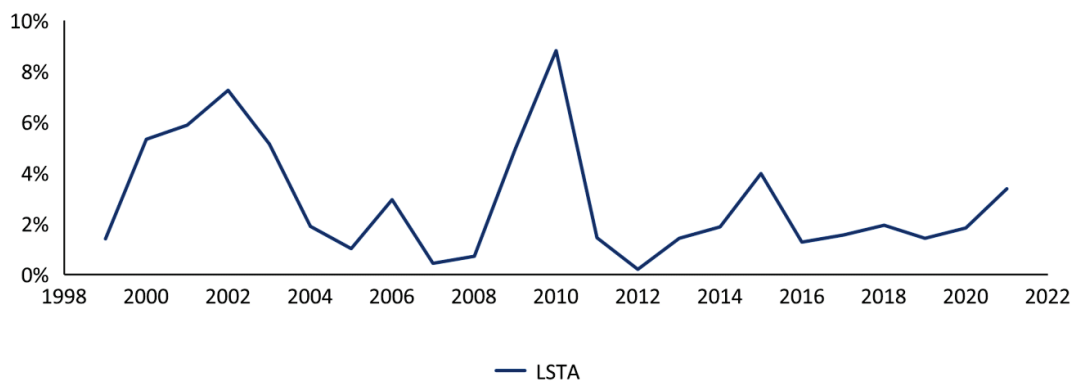
Our prepayment rate of 24.8% was derived from the average 1m annualized CPR based on the accessible historical data from BofA Global Research (2002-2023)¹³. We assumed an 18-month recovery lag across the base scenario based on an industry standard assumption; for example, Moody’s¹⁴ assumes an 18-month recovery lag in their CLO modeling. We assumed no reinvestment in all scenario; this approach is more conservative than typical market practice that assumes reinvestment at market rates. Additionally, sensitivity testing was conducted on these assumptions and is discussed later.

3.3.1.2. Mid-tail (~95th percentile) scenarios

To calibrate the default rates under the “Mid-tail” scenarios, we examined the level of defaults under two adverse credit cycles, the GFC and Dot-Com Crisis, for the S&P LSTA. While both credit events had similar levels of “excess defaults”, that is the volume of defaults that occurred over the adverse portion of the credit cycle compared with the long-term average, the shape of these events differed significantly. The GFC represented a shorter, but deeper credit shock (22 months of excess defaults); the Dot-Com Crisis was a longer event (45 months of excess defaults). For both events, we applied the ratio of the default rate to the long-term average from the start of the adverse credit period (that is, when the default rate above the long-term average) until it returned to the long-term average. This path was then applied as a multiplier to the Base default rates for both BSL and MM to match the shape and scale of the two stress scenarios. This approach also allowed us to assess the sensitivity of our results to the shape of shock (short and deep vs. long and shallower).

Figure 11 below shows the historical default rate for the LSTA.

Figure 11: Bank loan default rates, % (monthly 1999-2021)¹⁵



¹³ 1m Annualized CPR from 2002 - 2023: BofA Global Research, LCD, Moody’s

¹⁴ Moody’s Investors Service, “Moody’s Global Approach to Rating Collateralized Loan Obligations” (2021)

¹⁵ Monthly bank loan default rates from 1999 - 2021 (%): S&P, U.S. LSTA

We calibrated recovery rates by using the average recovery rate throughout the stress cycle that followed the Dot-Com Crisis (61.1%) and GFC (58.0%), respectively, then reverting to the long-term average value (66.4%) in the periods that followed the stress. To calibrate prepayment rates, we calculated the average 1m annualized CPR for the duration of the stress (defined as periods in which the prepayment rate was less than the long-term average) for the Dot-Com Crisis and GFC, respectively. This approach yielded a prepayment rate of 18.4% for Dot-Com and 14.0% for GFC. We applied those prepayment rates for the duration of the stress, then reverted the rates back to the long-term average (24.8%) in the post-stress periods. Similar to the baseline scenario, we assumed an 18-month recovery lag based on the industry standard assumption and, for conservatism, no reinvestment.

3.3.1.3. Deep-tail scenario

As direct historical information is more limited for the “Deep-tail” scenario, we utilized historical performance data of corporate bonds during the Great Depression as a proxy for the relative losses accumulated during the modeled stress period.

To calibrate our default rates, we examined the experience for corporate bonds during the Great Depression and quantified the increase in default rates relative to the long-term average default rates. This default rate path (defined as percentage increase over the long-term average) was then applied to the baseline defaults for CLOs.

We determined stress recovery rates (55.9%) based on the lowest two-year average recovery rates within the available data range (which corresponds to June 2019 – June 2021¹⁶) and applied this value for a ten-year period (to match the duration of the Great Depression default curve) before reverting to the long-term average.

To calibrate our prepayment rates, we used the lowest two-year average CLO 1m Annualized CPR rate data (which corresponds to September 2007 – September 2009¹⁷) and applied this value (10.0%) for the ten-year stress period before reverting to the long-term average (24.8%). Similar to the baseline assumption, we assumed an 18-month recovery lag based on the industry standard assumption and, to be conservative, no reinvestment.

¹⁶ Recovery rates from June 2019 - June 2021: *BofA Global Research, LCD, Moody's*

¹⁷ CLO 1m annualized CPR rate from September 2007 - September 2009: *BofA Global Research, LCD, Moody's*

Methodology

Figure 12: Broadly syndicated CLO annualized CDR curves, %

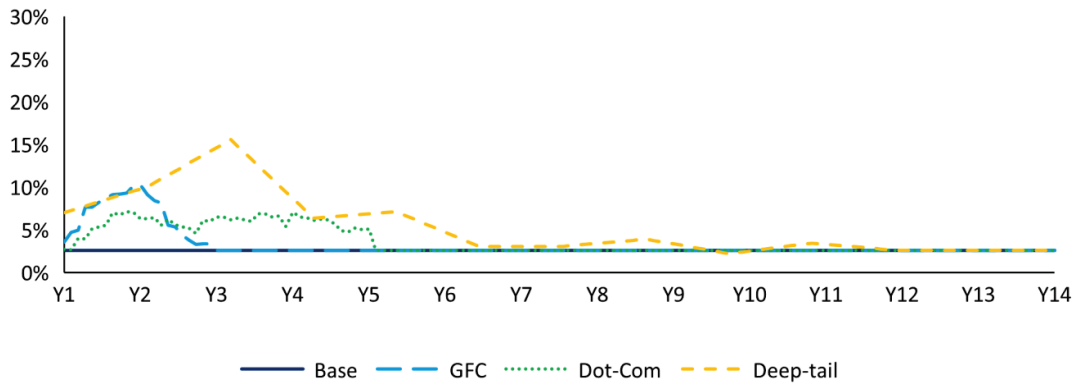
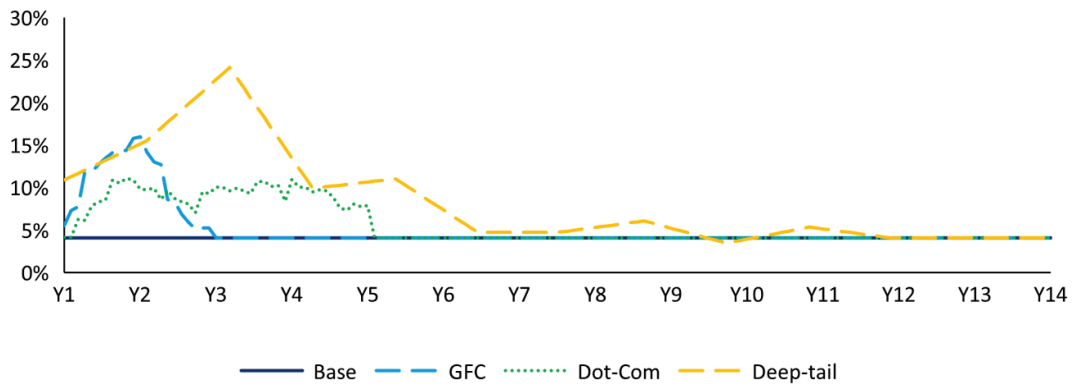


Figure 13: Middle-market CLO annualized CDR curves, %



3.3.2. Prime and subprime auto loan ABS

To calibrate scenario-level parameters for auto loan ABS, we followed a similar methodology as was followed for CLOs. Parameters were calibrated separately for prime and subprime auto loan ABS. We relied primarily on historical data on prime and subprime auto loan performance from Fitch Ratings; selected as it provided the longest time series from a reputable source.

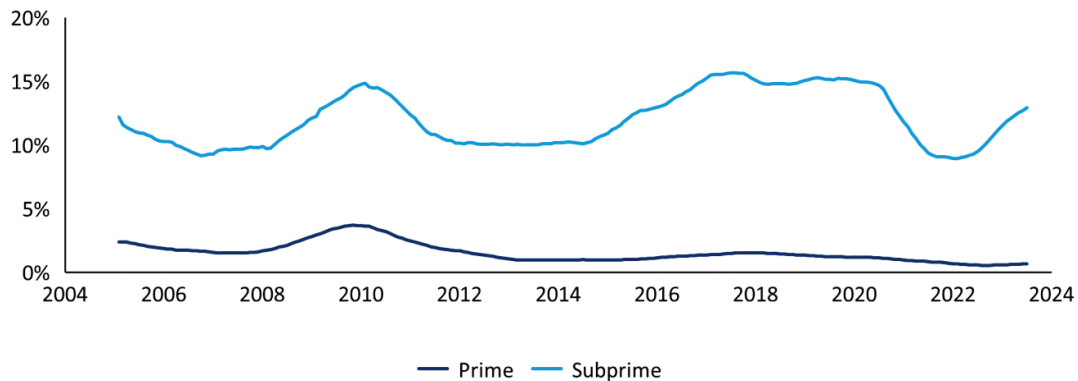
Table 3: Prime auto loan ABS scenario parameters

Parameter	Base	Mid-tail	GFC	Deep-tail
Peak default rate	1.6%	3.2%	4.4%	6.8%
Excess defaults	N/A	7%	5%	30%
Severity	41%	52%	52%	54%
Delinquency rate	0.4%	0.6%	0.6%	0.6%
Prepayment rate	1.5%	1.5%	1.5%	1.5%
Recovery lag	6 months	6 months	6 months	6 months

Table 4: Subprime auto ABS scenario parameters

Parameter	Base	Mid-tail	GFC	Deep-tail
Peak default rate	12%	16%	19%	41%
Excess defaults	N/A	14%	4%	27%
Severity	55%	61%	61%	62%
Prepayment rate	1%	1%	1%	1%
Recovery lag	6 months	6 months	6 months	6 months

Figure 14: Auto loan TTM annualized default rate, % (2005-2023)¹⁸



3.3.2.1. Base scenario

Our base scenario was constructed using the long-term average default rate and severity for prime and subprime for data from Fitch Ratings. Base prime delinquency rates were also determined by taking the average prime delinquency rate across the entire time series (from 2004 - 2023). Base prepayment rates were assumed based on deal-level data¹⁹ and held constant across scenarios. Recovery lag was assumed based on rating agency auto loan ABS stress testing methodology²⁰ and held constant across scenarios.

3.3.2.2. Mid-tail (~95th percentile) scenarios

To calibrate the default rates under the “Mid-tail” scenarios, we examined three events (i) the GFC, during which both prime (2007-2011) and subprime (2008-2010) auto experienced above-average default rates, (ii) for subprime, heightened losses in 2015 - 2020, and (iii) as prime loans did not experience elevated losses during that period, a hypothetical event calibrated to the Dot-Com bubble, using scaled corporate bond default rates during that period (1998-2003) as a proxy to estimate prime auto loan default rates.²¹

For the GFC scenario, behavior of the modeling parameters for both prime and subprime auto loans were based on observed, historical experience during the GFC. The default rate curves for prime and subprime auto loans, as well as the severity curves for prime and subprime auto were used in Intex to simulate the GFC stress. For prime auto loan ABS, stressed delinquency rates were assumed to be the average delinquency rate during the GFC. Delinquency rates were not used as a parameter for subprime auto loan ABS due to limitations in Intex.

¹⁸ Derived based on ANL and Recovery Rate data from Fitch Ratings

¹⁹ Auto loan ABS benchmarking: *S&P Research*

²⁰ Auto loan ABS benchmarking: *S&P Research*

²¹ Annual U.S. corporate bond default rates from 1920-2021 (%): *Moody’s Investors Service, “Corporate Default and Recovery Rates” (2021)*

Reliable historical data on auto loan performance was not available for the Dot-Com period as it was for CLO collateral. It was still desirable to measure the impact of a more attenuated, but longer, macroeconomic stress event. We designed a longer stress event for auto but the parameters for this event had to be estimated differently than for CLOs. For prime auto loan ABS, corporate bond default rates were scaled based on the ratio of default rates between two series during the GFC, a period during which both series had default rate data. This scaled default rate data was then used to estimate auto loan default rates during the Dot-Com bubble. Subprime auto, however, suffered a second stress period in addition between 2015 and 2020. We determined it preferable to use the actual historical data in this instance. Thus, the default rates from 2015-2020 were used as the default rates for the subprime auto loan ABS Mid-tail stress scenario. We term this scenario the “Mid-tail” scenario to avoid confusion with the historical Dot-Com scenario used for CLOs. Severity, prepayment, prime delinquency, and recovery lag each remained identical to their GFC calibrations, outlined above.

Note that because the average subprime auto loan default rate is relatively high (12%), the historical data shows that the GFC and 2015-2020 stress did not cause as extreme a spike in default rates relative to the historical average, as depicted in **Figure 16**, as is observed for prime auto loans. For comprehensiveness, the deep-tail scenario is more severe in terms of peak default rate and excess defaults than the two historical mid-tail scenarios.

3.3.2.3. Deep-tail scenario

Calibration of default rate curves for the Deep-tail stress followed a similar approach to that for CLOs. Corporate bond default rates during the Great Depression (1931-1940) were used as a proxy for the default rates of auto loans during a Great Depression-like economic event. As before, these default rates were scaled based on the ratio between the corporate bond and auto loan default rates during the shared GFC period. Deep-tail severity was estimated using the worst two-year average severity during the time series. Prime delinquency, prepayment, and recovery lag remained identical to their GFC calibrations.

Figure 15: Prime auto loan ABS annualized CDR curves, %

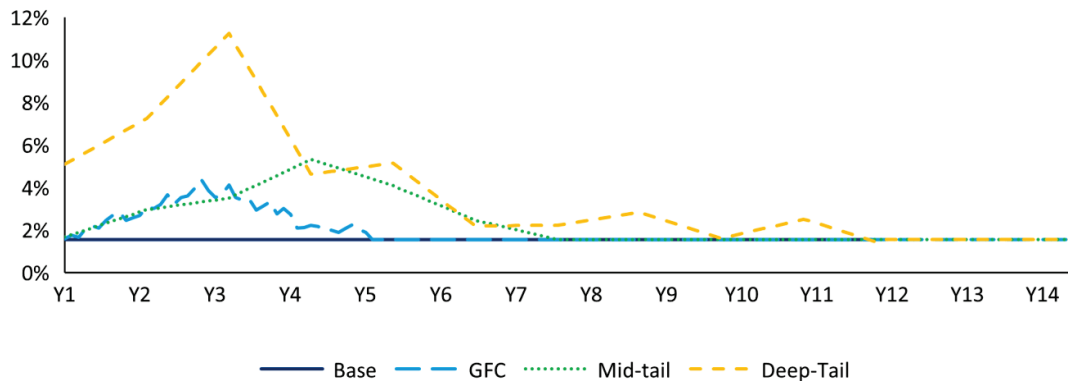
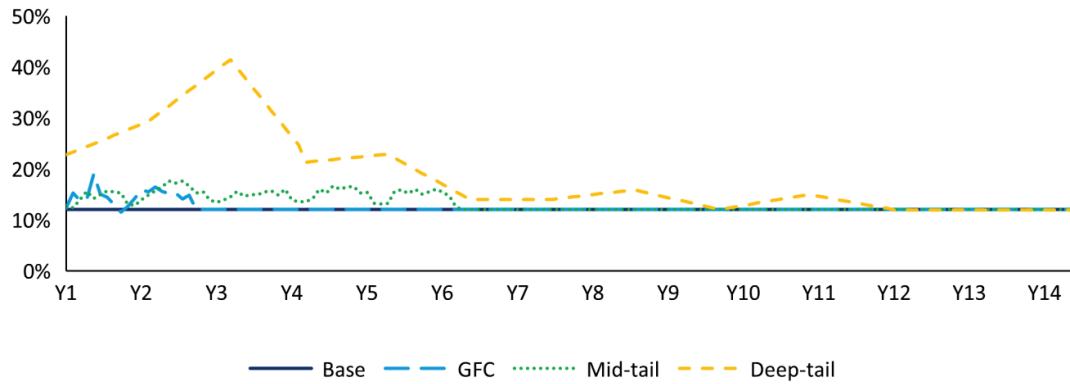


Figure 16: Subprime auto loan ABS annualized CDR curves, %



3.3.3. Student loan ABS

Table 5 shows the calibration of scenario-specific modeling parameters for private student loans. For student loans, we evaluated only a single “mid-tail” scenarios, that was calibrated based on the GFC.

Table 5: Student loan ABS scenario parameters

Parameter	Base	Mid-tail	Deep-tail
Default rate	10%	22%	22%
Excess defaults	N/A	10%	30%
Severity	69%	78%	78%
Deferment	5.8%	7.7%	7.7%
Forbearance	2.8%	4.5%	12.6%
Recovery lag	12 months	12 months	12 months

3.3.3.1. Base scenario

Analysis of student loan ABS presented challenges from a data adequacy perspective. We reviewed multiple potential sources of historical default rate data including, but not limited to, Intex, Fitch Ratings, and the National Center for Education Statistics (NCES), a federal agency. Each source captured a different universe of loans and definition of default rate that results in differences in the historical average default rates. Table 6 provides an overview of each potential source and its implied average default rates.

Table 6: Annualized student loan default rates by source

Source	Scope	Time span	Average annualized default rate
Intex	Private student loans	2008-2023	9.6%
Fitch	Private student loans	2015-2023	8.5%
NCES	Federal student loans	2011-2018	4.4% ²²

Ultimately, we chose to anchor our analysis on a base annualized default rate of 10%, but tested the robustness of our analysis to a base default rate of 8% or 12%. Base severity, deferment, and forbearance were assumed to be the long-term averages of each respective parameter, using the historical data available in Intex since 2008. Recovery lag was assumed to be 12 months, with sensitivity analysis for a longer recovery lag period.

3.3.3.2. ~95th percentile scenario

The limited historical data availability for private student loans also affects the construction of the 95th percentile scenario. Ultimately, we took the approach of isolating the impact of the GFC on default rates by observing that the onset of the GFC resulted in a 47-month spike in default rates observed in the Intex data. We then applied the resultant excess defaults to our base default rate scenario. Severity, deferment, and forbearance were estimated by taking the averages of these parameters during the GFC; for each parameter, the stress period was defined as that period for which it exceeded its long-term average. Recovery lag was, as in the base scenario, assumed to be 12 months.

3.3.3.3. Deep-tail scenario

The Deep-tail scenario did not follow a similar approach to CLOs and auto loans, as corporate bonds were determined to be an insufficient analog to the performance of student loans. Student loan default and loss trajectories are not expected to follow corporate bonds, as the exposure is to narrow portions of the employment rate, interest rates, and college costs, all of which have weak correlation to corporate strains, making the latter a poor proxy. Instead, we assumed the same default rate curve as was used in our ~95th percentile stress scenario extended in duration by a factor of three, resulting in a 141-month long period of elevated defaults. Severity and deferment remained the same between the ~95th percentile scenario and the

²² NCES measures 3-year default rates by dividing borrowers in default over a three-year period by total population of a given three-year cohort. Annualized default rate estimated by dividing NCES figure by 2.5. Sample only includes federal student loans, while Intex and Fitch series include only private student loans.

Deep-tail scenario. Forbearance was assumed to be 12.6% for the full 141-month period, the value achieved during the 2020 COVID-19 period, and the highest value recorded in our historical data series.

Figure 17 shows annualized default rate curves for 10% base default rate scenarios.

Figure 17: Student loan 10% base default rate annualized CDR curves, % default



3.4. Output Metrics

Our analysis seeks to examine the potential for losses on residual tranches in adverse scenarios. As identified as part of our guiding principles, we seek to measure losses in a manner consistent with the treatment of these assets on an insurer’s statutory balance sheet.

This point itself has been in flux and is subject to different interpretations within the industry: historically, residual tranches had been held at the lower of cost or fair value²³; more recently, this treatment has shifted to the lower of amortized cost or fair value²⁴; in addition, current proposals recommend the lesser of book-adjusted carrying value or fair value. Under each of these methods, the reported value of an asset will reflect not only its fair value at the time, but the market conditions at its acquisition.

For the purposes of this analysis, we focus on the decline in fair value of an asset under the stress scenario. In an adverse stress scenario, the fair value is expected to decline below other metrics, which are less responsive to market conditions, and be the binding constraint (“lower of”). Considering only the decline in fair value, rather than attempting to fully align with the accounting treatment, is conservative as it may overstate the potential for losses under certain conditions:

- If fair value is lower than amortized cost prior to applying a stress, then considering the decline in fair value will accurately capture the loss on an insurer’s balance sheet
- If fair value is greater than amortized cost prior to applying a stress, then considering the decline in fair value will overstate the potential loss on an insurer’s balance sheet (by an amount equal to the starting difference between fair value and amortized cost).

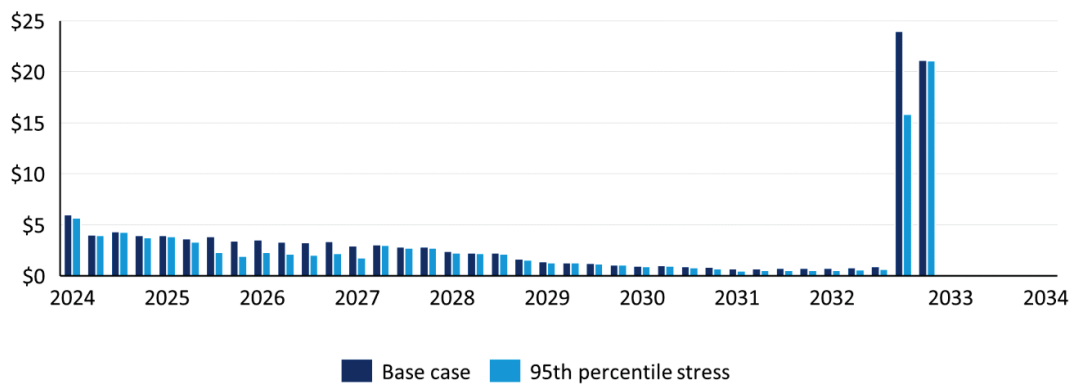
²³ SSAP No. 43R 2021-15

²⁴ SSAP No. 21R 12-1-23

We define 'fair value' as the net present value of the cash flows to the residual tranche at a 12% discount rate. This definition is consistent with the industry approach to valuing these types of assets (discounted cash flows) and represents a typical target return for equity-like assets. The robustness of our results relative to this parameter is evaluated in the sensitivity testing in Appendix A.3. A constant discount rate is applied in both the base and stress scenarios to isolate the impact of credit default risk from interest rate or liquidity risk.

The initial output of our modelling is a cash flow profile for each asset by scenario. **Figure 18** provides an illustrative example this output.

Figure 18: Illustrative deal level cash flow forecast, \$M



4. Results

4.1. Introduction

To understand the underlying risk in residual equity tranches, **Table 8 - Table 15** illustrate the decline in NPV using a constant discount rate of 12% across all modeled assets across our scenarios. We consider two approaches to aggregate the losses across the modeled set of assets:

- **Simple average losses:** this metric provides the simple average of losses (measured as the decline in NPV at a constant discount rate relative to the base scenario) across all modeled assets. This metric places equal weight on all assets.
- **Portfolio average losses:** this metric considers the aggregate losses on the set of modeled assets on a NPV basis; effectively, it weighs assets based on their initial fair value and illustrates the losses that an insurer would have faced if it owned that portfolio of assets.

4.2. Summary

Table 7 provides the portfolio average losses in each of the stress scenarios:

Table 7: Portfolio average losses for all modeled assets across stress scenarios

Scenario Severity	Scenario	CLOs (BSL)	CLOs (MM)	Student loans	Subprime auto loans	Prime auto loans
95 th percentile	Dot-Com	-45%	-27%	-	-	-
	GFC	-42%	-25%	-	-17%	-13%
	Mid-tail	-	-	-16%	-	-
	Long Mid-tail	-	-	-	-22%	-14%
99 th percentile	Deep-tail	-72%	-55%	-20%	-74%	-26%

These results indicate:

- Residual tranches for MM CLOs consistently perform better than BSL ones across our scenarios.
- Residual tranches for prime auto loans ABS consistently perform better than those backed by subprime auto loans across our scenarios.

4.3. Results by asset class

The following sections provide additional information on the results for each type of residual tranche: CLOs, auto loans, and student loans.

4.3.1. CLOs

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

Table 8: CLO summary statistics

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

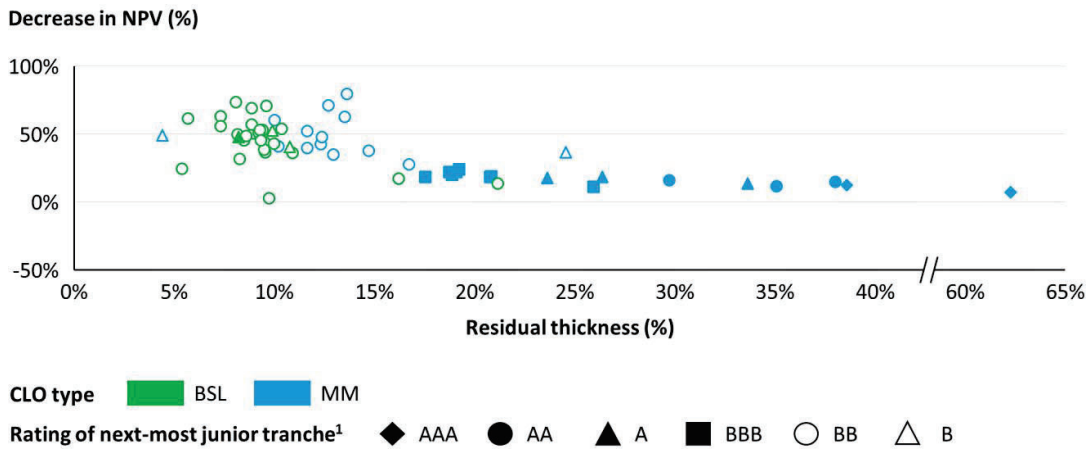
In addition, we considered the losses at the deal-level to understand the characteristics that affect the potential losses on residuals tranches. **Figure 19** illustrates losses by residual thickness in our GFC scenario. These results indicate:

- Residual tranches for MM CLOs consistently perform better than BSLs ones across our scenarios.
- CLO equity tranches with thicker residuals perform better than those with thinner residuals.
- Higher next-most junior rated CLO tranches are correlated with thicker residuals and perform better than lower rated tranches.

As shown below in **Figure 19**, residual thickness is a significant driver of stress scenario impact. CLO residual equity tranches with thicker residuals perform noticeably better than thinner residual tranches (average decrease in NPV of 49.1% when residual thickness is less than 15% vs. 18.3% when residual thickness is greater or equal to 15%). This result is consistent across our Dot-Com and Deep-tail stress scenarios as shown in **Figure 24** and **Figure 25** in the Appendix.

²⁵ While credit experience was calibrated to GFC, the modeled losses differ from observed performance of CLO residual tranches during the GFC. These differences reflect several, offsetting factors, including changes to the structures of CLOs since the GFC (CLO 1.0 vs. 2.0 vs. 3.0) and the modeled assumption of no reinvestment (vs. market practices), and differences in the funding structure.

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



To test the robustness of our assumptions, we conducted select sensitivity testing of key parameters and assumptions such as the discount rate, recovery lag, and the prepayment rate. Details of our sensitivity testing can be seen in the Appendix. In addition, we evaluated the effect of employing the same parameters and assumptions adopted by the NAIC in its ongoing efforts around CLOs, which can be seen in **Table 9** below. Use of the NAIC assumptions had minimal impact on the simple average losses and NPV within our GFC scenario (producing a simple average loss of -45.1% vs. -45.9% for BSL and -32.9% vs. -31.6% for MM). The NAIC assumptions were applied to both the base and stress scenarios and the minimal impact reflects an offset between that reinvestment and prepayment assumptions and the faster recovery period.

Table 9: NAIC CLO assumptions

Asset Class	Assumption	NAIC assumption
CLOs (MM and BSLs)	Prepayment rates	0.0%
	Recovery lag	6 months
	Reinvestment period	No post-reinvestment period reinvestment Reinvestment collateral is purchased at par

Although it differs from how these assets are held on the balance sheet, some stakeholders may look at a cash flow coverage metric. This metric compares the total, undiscounted cash flows in a scenario to the base scenario fair value and is shown for BSL CLOs and MM CLOs in **Table 10 – Table 11**, respectively, below.

Table 10: BSL CLO total coverage of cash flows relative to initial fair value²⁶

	Mid-tail (~95 th percentile)			
	Base	Dot-Com	GFC	Deep-tail
Deal-level average	1.7x	0.8x	0.9x	0.3x
Portfolio average	1.7x	0.9x	1.0x	0.3x

Table 11: MM CLO total coverage of cash flows relative to initial fair value²⁶

	Mid-tail (~95 th percentile)			
	Base	Dot-Com	GFC	Deep-tail
Deal-level average	1.7x	1.1x	1.2x	0.5x
Portfolio average	1.6x	1.2x	1.2x	0.7x

4.3.2. Auto loans

Table 12 provides the average loss for residual tranches of auto loans in each of the stress scenarios:

Table 12: Auto loan summary statistics

Scenario Severity	Scenario	Auto loan type	Simple average losses	Portfolio average losses
95th percentile	GFC	Prime	-13%	-13%
		Subprime	-18%	-17%
	Long Mid-tail	Prime	-14%	-14%
		Subprime	-22%	-22%
99th percentile	Deep-tail	Prime	-27%	-26%
		Subprime	-67%	-74%

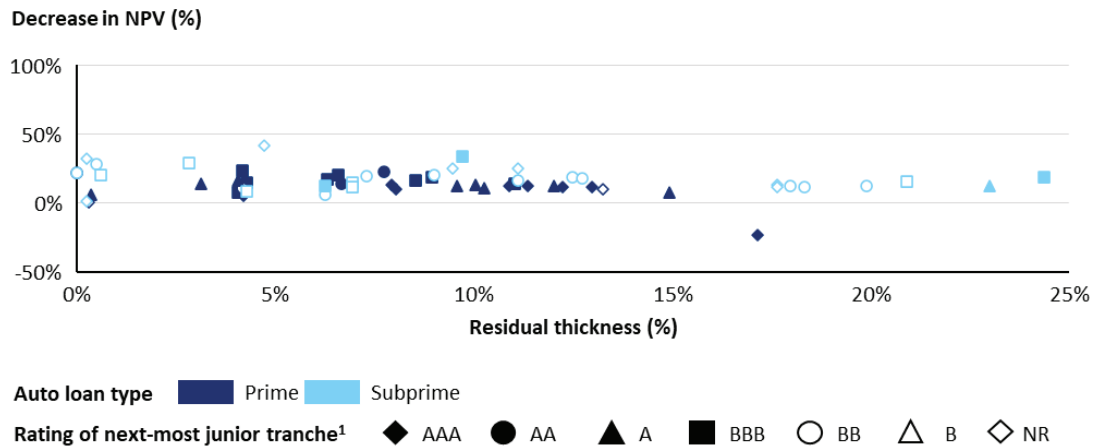
²⁶ Calculated by dividing total cash flow for each scenario by the base scenario fair value (base scenario cash flows discounted using a 12% discount rate)

In addition, we considered the losses at the deal-level to understand the characteristics that affect the potential losses on residual tranches. **Figure 20** illustrates losses by residual thickness in our GFC scenario. These results indicate:

- Residual tranches for prime auto loans ABS consistently perform better than those backed by subprime across our scenarios.
- Residual thickness is not as significant of a driver of stress scenario impact for auto loans as it is for CLOs.
- Higher next-most junior rated auto loan tranches perform on par with lower rated tranches.

As shown below in **Figure 20**, auto loan equity tranches with thicker residuals perform on par with those with thinner residuals in our GFC stress scenario. This result is consistent in our long Mid-tail stress scenario as shown in **Figure 26** in the Appendix. However, in our Deep-tail stress scenario, subprime auto loans with thicker residuals perform worse while prime auto loans with thicker residuals perform better as shown in **Figure 27** in the Appendix.

Figure 20: Losses by auto loan residual thickness – Mid-tail (GFC) scenario, %²⁷



Although it differs from how these assets are held on the balance sheet, some stakeholders may look at a cash flow coverage metric. This metric compares the total, undiscounted cash flows in a scenario to the base scenario fair value²⁸ and is shown for prime and subprime auto loan in **Table 13 – Table 14**, respectively.

²⁷ As shown in Figure 20, one deal experienced better performance during stress scenarios due to unique structural considerations. This deal was removed from the aggregate metrics due to outsized impacts to the portfolio and simple averages. Inclusion of this deal in portfolio aggregation would reduce losses to 6% (from 13%) under the GFC scenario and to 22% (from 26%) under the Deep-tail scenario.

²⁸ Calculated by dividing total cash flow for each scenario by the base scenario fair value (base scenario cash flows discounted using a 12% discount rate)

Table 13: Prime auto loan total coverage of cash flows relative to initial fair value

	Mid-tail (~95 th percentile)			
	Base	Long Mid-tail	GFC	Deep-tail
Deal-level average	1.3x	1.1x	1.1x	0.9x
Portfolio average	1.3x	1.1x	1.1x	1.0x

Table 14: Subprime auto loan total coverage of cash flows relative to initial fair value

	Mid-tail (~95 th percentile)			
	Base	Long Mid-tail	GFC	Deep-tail
Deal-level average	1.2x	0.9x	1.0x	0.3x
Portfolio average	1.2x	1.0x	1.0x	0.3x

To test the robustness of our assumptions, we conducted sensitivity testing of key parameters and assumptions such as the discount rate, recovery lag, base default rate, and interest rate levels. Details of our sensitivity testing can be seen in the Appendix. The results of these tests are that sensitivities had minimal impact on the simple average losses and NPV within our GFC scenario.

4.3.3. Student loans

Table 15 provides the average losses for residual tranches of student loans in each of the stress scenarios under the 10% base default rate assumption. Corresponding results for the 8% and 12% base default rate assumptions are located in the appendix.

Table 15: Student loan summary statistics

Scenario Severity	Scenario	Simple average losses	Portfolio average losses
95th percentile	Mid-tail	-31%	-16%
99th percentile	Deep-tail	-35%	-20%

In addition, we considered the losses at the deal-level to understand the characteristics that affect the potential losses on residual tranches. Figure 21 illustrates losses by residual thickness in our Mid-tail scenario. These results indicate:

- Student loan equity tranches with thinner residuals perform better than those with thicker residuals as they rely less on the principal and instead have a more consistent set of interest-based cashflows in all scenarios.
- Next-most junior rating of student loan tranches is not correlated with tranche performance.

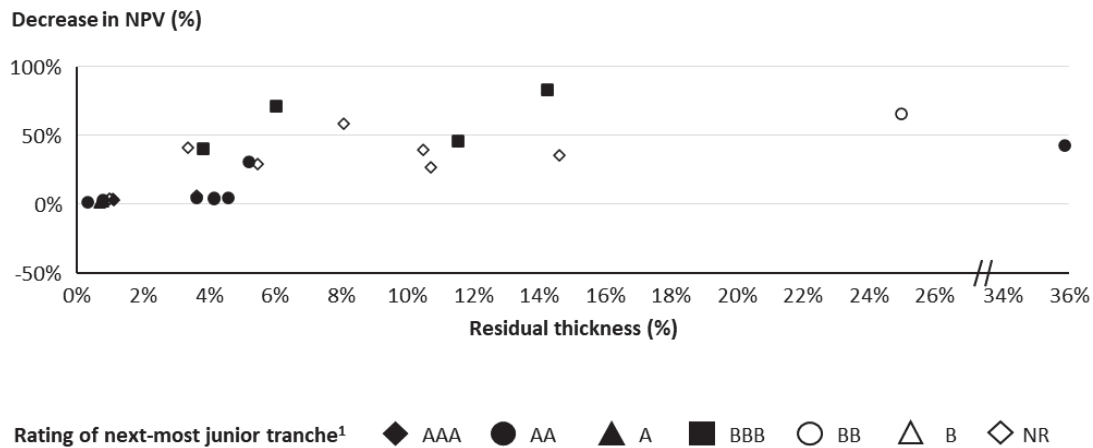
As shown below in **Figure 21**, student loan equity tranches with thinner residuals perform better than those with thicker residuals in our Mid-tail stress scenario. This result is consistent in our Deep-tail scenario as shown in **Figure 28** in the Appendix.

Although it differs from how these assets are held on the balance sheet, some stakeholders may look at a cash flow coverage metric. This metric compares the total, undiscounted cash flows in a scenario to the base scenario fair value²⁹ and is shown in **Table 16**.

Table 16: Student loan total coverage of cash flows relative to initial fair value

	Base	Mid-tail	Deep-tail
Deal-level average	1.6x	1.0x	1.0x
Portfolio average	1.6x	1.2x	1.2x

Figure 21: Losses by student loan residual thickness – Mid-tail scenario, %



To test the robustness of our assumptions, we chose to conduct select sensitivity testing of key parameters and assumptions such as the discount rate, recovery lag, severity, deferment rate, CRR, and forbearance. Details of our sensitivity testing can be seen in the Appendix. The results of these tests are that sensitivities had minimal impact on the simple average losses within our Mid-tail scenario.

²⁹ Calculated by dividing total cash flow for each scenario by the base scenario fair value (base scenario cash flows discounted using a 12% discount rate)

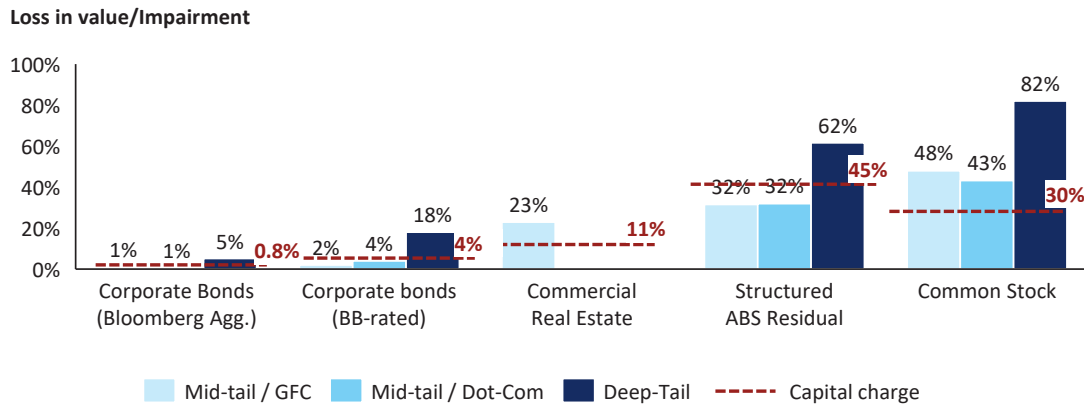
5. Conclusion

Our analysis sought to evaluate the potential for losses in the residual tranches of commonly-held types of structured assets and assess how this compares with the historical losses for other asset classes. We constructed our analysis to standardize (to the extent possible) the level of stress applied to each asset class such that an apples-to-apples, risk-based comparison could be made. We focused on two standardized points in the distribution: (i) the 95th percentile loss, as historically the NAIC has calibrated capital charges roughly to this severity and (ii) a Deep-tail event, to understand the potential for further losses in an extreme scenario.

We gauged the impact of the stress applied by measuring the decline in the Net Present Value (NPV) of the selected deals and compared them to the losses in the market value of common stock (S&P 500), due to credit impairment losses for corporate bonds (Bloomberg Aggregate Corporate Bond Index credit losses, BB rated bonds), and in the valuation of Real Estate (NCREIF index) during corresponding periods of stress.

Figure 22 below compares losses by asset class under each stress scenario. On a portfolio basis, the losses for the modeled residual tranches of structured products are lower than equities (S&P 500) under the corresponding scenarios, but higher than CRE and low-rated corporate bonds. Notably, structured ABS residuals performed better across all scenarios, when measured on a portfolio basis, than did common stock.

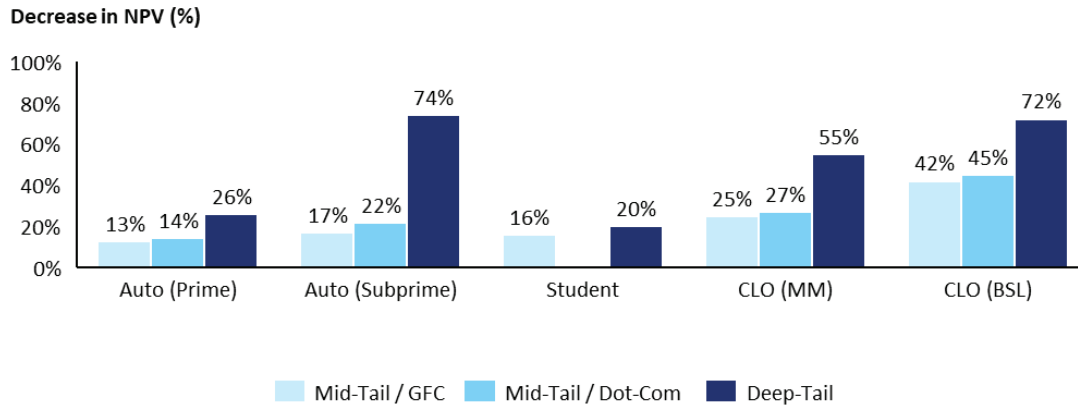
Figure 22: Capital charges compared to modeled scenario losses for selected asset classes³⁰



³⁰ For common stock, losses are measured as the largest 2-year decline in market value for the S&P 500 during Dot-Com bubble (2000-2002) and GFC (2007-2009). For commercial real estate, losses are measured as the largest 2-year decline valuations, as measured by the NCREIF Index. For both asset classes, a 2-year window was selected to align with the calibration window for the existing NAIC capital charges. For corporate bonds, losses net of recoveries based on historical default and recovery rate data from Moody's, are shown for the full length of the credit cycle including during Great Depression (1931-1940), Dot Com (1998-2003), and GFC (2008-2010). For structured ABS residuals, losses reflect the full credit cycle and the modeling approach outlined in this document; losses for modeled asset types were weighted based on the total outstanding volumes for those asset types (as-of 2021, SIFMA) and the relative volumes in the modeled sub-sectors. For student loan ABS, where only a single mid-tail scenario was evaluated, this scenario was used for aggregation purposes in both the GFC and Dot-Com scenarios. For auto loan ABS, the "long mid-tail" scenario was used for aggregation purposes in the Dot-Com scenario; this scenario was intended to capture a similar macroeconomic stress event to the Dot-Com scenario.

In addition, we consider the individual sectors and sub-sectors that were in-scope for this analysis. While significant variation is observed across sectors, reflecting differences in both the underlying collateral and the mechanics of the structures, the losses for the worse performing sector (broadly syndicated CLOs) are comparable to public equities.

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



³¹ For student loans, only a single mid-tail scenario was evaluated.

Appendix A.

A.1. Results

Figure 24: Losses by CLO residual thickness – Mid-tail (Dot-Com) scenario, %

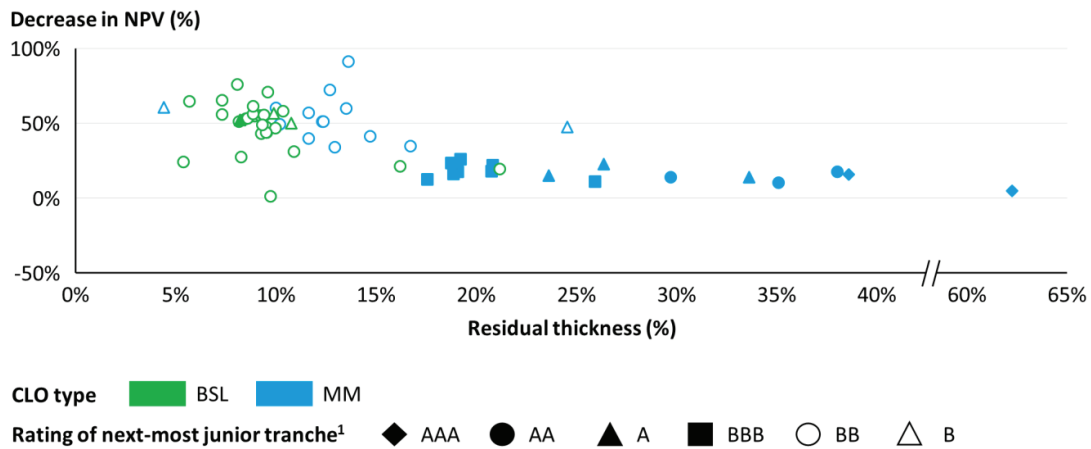


Figure 25: Losses by CLO residual thickness – Deep-tail scenario, %

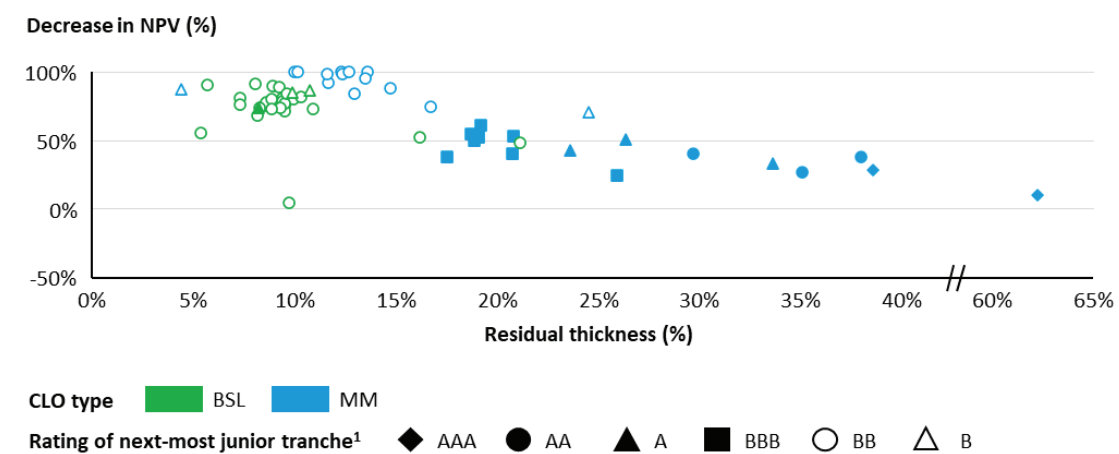


Figure 26: Losses by auto loan residual thickness – Mid-tail (Long Mid-tail) scenario, %

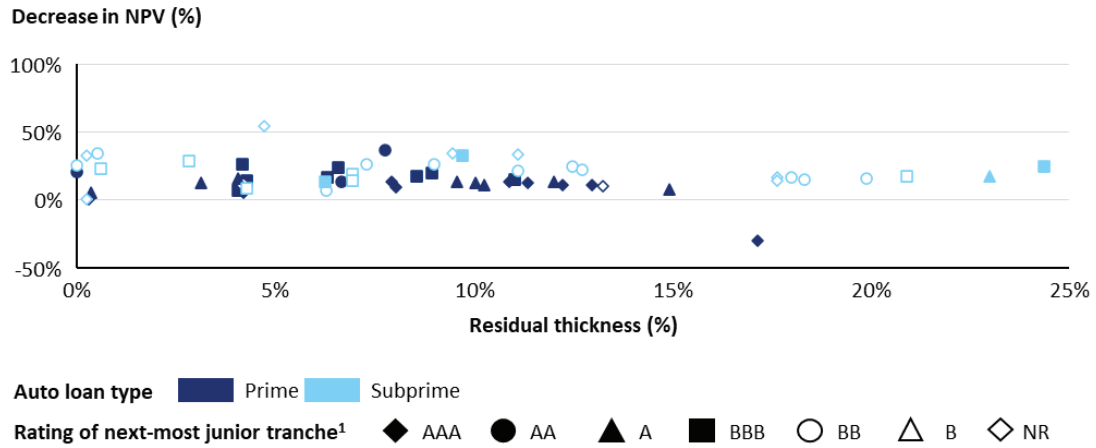


Figure 27: Losses by auto loan residual thickness – Deep-tail scenario, %

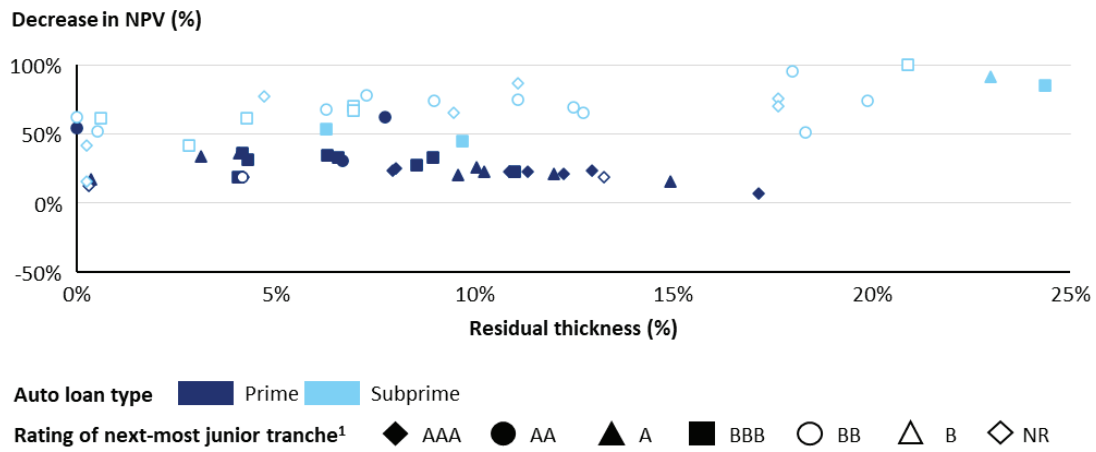
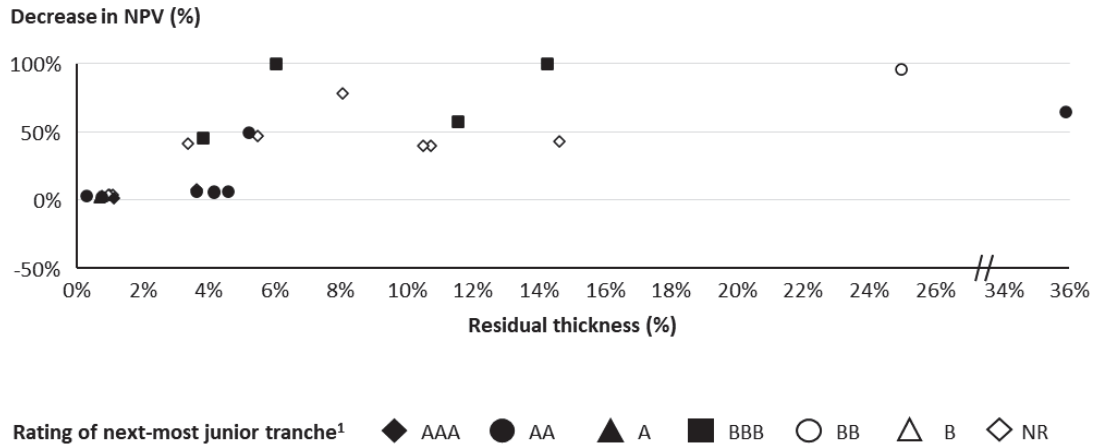


Figure 28: Losses by student loan residual thickness – Deep-tail scenario, %



A.2. Data Sources

Asset class	Sample (if known) / representative	Fields used	Time span	Provider(s)	Rationale for selection
CLOs	US LSTA 100 index leveraged loans	Default rate	1999 - 2022	S&P	Index well-used by industry, provides adequate sample of US leveraged loan market
	US first lien loans	Recovery rate	2001 – 2023	Moody's LCD Bank of America Global Research	Most comprehensive data available, compiled by BofA Global Research based on data from Moody's and LCD
Auto loans	US auto loans	Prime recovery rate Subprime recovery rate Prime ANL rate Subprime ANL rate	2004 – 2023	Fitch Ratings	Most comprehensive data available from reputable source

A.2 Data Sources

Asset class	Sample (if known) / representative	Fields used	Time span	Provider(s)	Rationale for selection
Student loans	US private student loans	Default rate	2008 – 2023	Intex	Most comprehensive data available FRBNY Household Debt and Credit report omitted due to use of delinquency rate over default rate NCES public student loan cohort default rates taken into consideration, but not used to calibrate scenarios Fitch Ratings private student loan default index taken into consideration, but not used to calibrate scenarios
Common stock	S&P 500 index	Share price Annual return	1928 – 2023	S&P	Used by NAIC for equity RBC framework for equities Russell 3000 omitted due to similarities of parameters to S&P 500 and shorter time span
Corporate bonds	Corporate bonds (aggregated all)	Default rate	1920-2021	Moody's	Most comprehensive data available from reputable source, well-used by industry
		Recovery rate	1982-2021	Moody's	
	Bloomberg US Corporate Bond Agg Total Return	Corporate bond price	1973-2023	Bloomberg	
Commercial Real Estate	NCREIF Property Index	Total Index Value	1978-2022	NCREIF	Used by NAIC for calibration of RBC framework for CRE FRED US Commercial Real Estate price index omitted due to greater sensitivity to market price rather than valuation, as well as due to the NAIC's use of NCREIF data for their RBC framework

A.3. Sensitivity Analysis

Details of CLO sensitivity testing in our GFC scenario can be found below:

- **Discount rate:**
 - For BSLs, a discount rate of 12% resulted in a simple average loss relative to the base scenario of -45.9% compared to -45.7% and -46.1% for discount rates of 9% and 15%, respectively.
 - For MMs, a discount rate of 12% resulted in a simple average loss relative to the base scenario of -31.6% compared to -31.1% and -32.1% for discount rates of 9% and 15%, respectively.
- **Recovery lag:**
 - For BSLs, a 6-month recovery lag resulted in a NPV 5.4% higher on average than our base 12-month assumption while a 12-month recovery lag resulted in a NPV 0.7% higher on average.
 - For MMs, a 6-month recovery lag resulted in a NPV 0.3% higher on average than our base 12-month assumption while a 12-month recovery lag resulted in a NPV 0.8% lower on average.
- **Prepayment rate:**
 - For BSLs, a consistent prepayment rate across base and GFC scenario resulted in a NPV 6.2% lower on average than when we apply scenario-specific prepayment assumptions.
 - For MMs, a consistent prepayment rate across base and GFC scenario resulted in a NPV 3.4% lower on average than when we apply scenario-specific prepayment assumptions.

Details of auto loan sensitivity testing in our GFC scenario can be found below:

- **Discount rate:**
 - For prime auto loans, a discount rate of 12% resulted in a simple average loss relative to the base scenario of -13.0% compared to -12.9% and -13.0% for discount rates of 9% and 15%, respectively.
 - For subprime auto loans, a discount rate of 12% resulted in a simple average loss relative to the base scenario of -18.2% compared to -18.5% and -17.9% for discount rates of 9% and 15%, respectively.
- **Recovery lag:**
 - For prime auto loans, a 3-month recovery lag resulted in a NPV 1.7% lower on average than our base 6-month assumption while a 9-month recovery lag resulted in a NPV 1.5% higher on average.
 - For subprime auto loans, a 3-month recovery lag resulted in a NPV 3.3% lower on average than our base 6-month assumption while a 9-month recovery lag resulted in a NPV 5.5% higher on average.
- **Base default rate:**
 - For prime auto loans, a 0.5% increase in our base default rate resulted in a NPV 0.0% lower on average while a 0.5% decrease in our base default rate resulted in a NPV 0.0% higher on average.
 - For subprime auto loans, a 1.0% increase in our base default rate resulted in a NPV 1.9% lower on average while a 1.0% decrease in our base default rate resulted in a NPV 2.0% higher on average.
- **Rate shock:**
 - For prime auto loans, applying a 50bps rate shock to forward curves resulted in a NPV 0.2% lower on average.

- For subprime auto loans, applying a 50bps rate shock to forward curves resulted in a NPV 1.6% lower on average.

Details of student loan sensitivity testing in our Mid-tail scenario can be found below:

- **Discount rate:**
 - A discount rate of 12% resulted in a simple average loss relative to the base scenario of -31.4% compared to -31.4% and -31.5% for discount rates of 9% and 15%, respectively.
- **Recovery lag:**
 - An 18-month recovery lag resulted in a simple average loss relative to the base scenario of -25.0% compared to a simple average loss of -31.4% with our base 12-month assumption.
- **Severity:**
 - 85% severity resulted in a simple average loss relative to the base scenario of -28.5% compared to a simple average loss of -31.4% with our base 77% severity assumption.
- **Deferment rate:**
 - A 10% deferment rate resulted in a simple average loss relative to the base scenario of -29.9% compared to a simple average loss of -31.4% with our base 8% assumption while a 12% deferment rate resulted in a simple average loss of -30.1%.
- **CRR:**
 - 15% CRR resulted in a simple average loss relative to the base scenario of -28.5% compared to a simple average loss of -31.4% with our base CRR assumptions while 25% CRR resulted in a simple average loss of -27.5%.
- **Forbearance:**
 - 10% forbearance resulted in a simple average loss relative to the base scenario of -28.6% compared to a simple average loss of -31.4% with our base forbearance assumptions while 15% forbearance resulted in a simple average loss of -25.7%.
- **Default rate:**
 - An 8% default rate resulted in a simple average loss relative to the base scenario of -25.2% compared to a simple average loss of -31.4% with our base default rate assumptions while a 12% default rate resulted in a simple average loss of -31.4%.

A.4. Deals Modeled

Table 17: Listing of MM CLO deals in random modeling sample

Deal	Vintage
Audax Senior Debt CLO 6	2021
Owl Rock CLO VII	2022
Guggenheim MM CLO 2021-4	2021
Lake Shore MM CLO V	2022
Maranon Loan Funding 2023-1	2023
Owl Rock CLO VI	2021
Woodmont 2023-12 Trust	2023
Owl Rock CLO X	2023
BCC Middle Market CLO 2023-2	2023
Fortress Credit Opportunities XXI CLO	2023
BlackRock DLF IX 2021-2 CLO	2021
MFIC Bethesda CLO 1	2023
Twin Brook CLO 2023-1	2023
Deerpath Capital CLO 2022-1	2022
Barings Middle Market CLO 2023-1	2023
Blackrock Mt Adams CLO IX	2021
Guggenheim MM CLO 2021-3	2021
Barings Private Credit Corporation CLO 2023-1	2023
Golub Capital Partners ABS Funding 2023-1	2023
ABPCI Direct Lending Fund CLO XIV	2023
Blackrock Rainier CLO VI	2021
Owl Rock CLO VIII	2022
ABPCI Direct Lending Fund CLO XVI	2023
Churchill MMSLF CLO-I	2021
Lake Shore MM CLO IV	2021
Golub Capital Partners CLO 56(M)	2021
BlackRock DLF X 2022-1 CLO	2022
Golub Capital Partners CLO 57(M)	2021
Antares CLO 2021-1	2021

Table 18: Comparison of characteristics random sample to full pool of deals: MM CLO

Statistic	Random sample	Full sample
Average deal balance	\$534M	\$489M
10 th – 90 th percentile	\$350M - 902M	\$304M - \$735M
Average residual thickness	20%	24%
10 th – 90 th percentile	10%-35%	12%-35%
2021 vintage	40%	33%
2022 vintage	20%	24%
2023 vintage	40%	43%

Table 19: Listing of BSL CLO deals in random modeling sample

Deal	Vintage
Venture 48 CLO	2023
Rockford Tower CLO 2021-1	2021
Palmer Square CLO 2023-3	2023
MidOcean Credit CLO XI	2022
Octagon Investment Partners 54	2021
Wellfleet CLO 2021-1	2021
Bain Capital Credit CLO 2023-1	2023
Sculptor CLO XXV	2021
Wellington Management CLO 1	2023
Fortress Credit BSL XX	2023
Rockford Tower Credit Funding I	2022
Milford Park CLO	2022
Dryden 90 CLO	2021
Carlyle U.S. CLO 2023-2	2023
KKR Static CLO I	2022
Sound Point CLO XXX	2021
Octagon 70 Alto	2023
Madison Park Funding LII	2021
OHA Credit Funding 12	2022
RRX 6	2021
AIMCO CLO 12	2021
Mountain View CLO XVI	2022
AGL CLO 10	2021
Ares LXVIII CLO	2023

A.4 Deals Modeled

Deal	Vintage
Carlyle U.S. CLO 2021-9	2021
Sculptor CLO XXVIII	2021
BCRED BSL CLO 2021-2	2021
Octagon 61	2023
Atlantic Avenue 2023-1	2023
Octagon Investment Partners 49	2021

Table 20: Comparison of characteristics random sample to full pool of deals: BSL CLO

Statistic	Random sample	Full sample
Average deal balance	\$443M	\$460M
10 th – 90 th percentile	\$366M – \$515M	\$383M – \$576M
Average residual thickness	10%	9%
10 th – 90 th percentile	7% - 11%	7% - 10%
2021 vintage	47%	44%
2022 vintage	20%	30%
2023 vintage	33%	26%

Table 21: Listing of Prime Auto ABS deals in random modeling sample

Deal	Vintage
Toyota Auto Receivables 2022-D Owner Trust	2022
Toyota Auto Receivables 2022-B Owner Trust	2022
Capital One Prime Auto Receivables Trust 2022-1	2022
World Omni Auto Receivables Trust 2022-B	2022
OCCU Auto Receivables Trust 2022-1	2022
SCCU Auto Receivables Trust 2023-1 (Space Coast Credit Union)	2023
Toyota Auto Receivables 2021-B Owner Trust	2021
SFS Auto Receivables Securitization Trust 2023-1	2023
Porsche Financial Auto Securitization Trust 2023-1	2023
World Omni Auto Receivables Trust 2022-D	2022
Lendbuzz Securitization Trust 2023-2	2023
OCCU Auto Receivables Trust 2023-1	2023
World Omni Auto Receivables Trust 2022-A	2022
World Omni Auto Receivables Trust 2021-D	2021
World Omni Auto Receivables Trust 2023-D	2023

Deal	Vintage
BVABS 2023-CAR2 aka BOF URSA VII Funding Trust I	2023
CarMax Auto Owner Trust 2021-1	2021
Hyundai Auto Receivables Trust 2022-C	2022
Ent Auto Receivables Trust 2023-1	2023
Toyota Auto Loan Extended Note Trust 2023-1	2023
Capital One Prime Auto Receivables Trust 2023-2	2023
Toyota Auto Receivables 2023-B Owner Trust	2023
Toyota Auto Receivables 2023-C Owner Trust	2023
Ally Auto Receivables Trust 2022-2	2022
Chase Auto Owner Trust 2022-A	2022
GM Financial Revolving Receivables Trust 2023-2	2023
Capital One Prime Auto Receivables Trust 2021-1	2021
Toyota Auto Receivables 2023-D Owner Trust	2023
Westlake Automobile Receivables Trust, Series 2023-P1	2023
GM Financial Consumer Automobile Receivables Trust 2022-4	2022

Table 22: Comparison of characteristics random sample to full pool of deals: Prime auto loan

Statistic	Random sample	Full sample
Average deal balance	\$1.1B	\$1.3B
10 th – 90 th percentile	\$256M – \$1.6B	\$419M – \$1.9B
Average residual thickness	8%	6%
10 th – 90 th percentile	3%-13%	0%-13%
2021 vintage	13%	26%
2022 vintage	37%	28%
2023 vintage	50%	46%

Table 23: Listing of Subprime Auto ABS deals in random modeling sample

Deal	Vintage
Santander Drive Auto Receivables Trust 2023-4	2023
United Auto Credit Securitization Trust 2023-1	2023
Flagship Credit Auto Trust 2021-3	2021
Research-Driven Pagaya Motor Asset Trust VI	2022
CPS Auto Receivables Trust 2023-B	2023
American Credit Acceptance Receivables Trust 2022-4	2022

A.4 Deals Modeled

Deal	Vintage
Research-Driven Pagaya Motor Asset Trust VII	2022
United Auto Credit Securitization Trust 2021-1	2021
First Investors Auto Owner Trust 2021-1	2021
AmeriCredit Automobile Receivables Trust 2021-1	2021
Tricolor Auto Securitization Trust 2022-1	2022
Lobel Automobile Receivables Trust 2023-2	2023
Westlake Automobile Receivables Trust 2023-3	2023
LAD Auto Receivables Trust 2023-2	2023
Foursight Capital Automobile Receivables Trust 2022-1	2022
Foursight Capital Automobile Receivables Trust 2021-2	2021
CPS Auto Receivables Trust 2021-A	2021
American Credit Acceptance Receivables Trust 2021-3	2021
Lendbuzz Securitization Trust 2023-1	2023
Strike Acceptance Auto Funding Trust 2023-2	2023
Flagship Credit Auto Trust 2022-4	2022
Westlake Automobile Receivables Trust 2023-2	2023
American Credit Acceptance Receivables Trust 2022-2	2022
Research-Driven Pagaya Motor Asset Trust IV	2021
GLS Auto Receivables Issuer Trust 2023-1	2023
Westlake Automobile Receivables Trust 2022-2	2022
Research-Driven Pagaya Motor Asset Trust III	2021
Arivo Acceptance Auto Loan Receivables Trust 2021-1	2021

Table 24: Comparison of characteristics random sample to full pool of deals: Subprime auto loan

Statistic	Random sample	Full sample
Average deal balance	\$506M	\$607M
10 th – 90 th percentile	\$44M – \$836M	\$183M – \$1.5B
Average residual thickness	10%	11%
10 th – 90 th percentile	1%-20%	1%-25%
2021 vintage	36%	33%
2022 vintage	29%	30%
2023 vintage	36%	36%

A.4 Deals Modeled

Table 25: Listing of Student Loan ABS deals in random modeling sample

Deal	Vintage
Nelnet Student Loan Trust 2023-A	2023
SMB Private Education Loan Trust 2021-A	2021
College Ave Student Loans 2021-A	2021
Nelnet Student Loan Trust 2023-PL1	2023
Commonbond Student Loan Trust 2021-A-GS	2021
College Ave Student Loans Trust 2021-5	2021
Navient Private Education Refi Loan Trust 2021-E	2021
College Ave Student Loans 2023-A	2023
Navient Private Education Refi Loan Trust 2022-B	2022
Commonbond Student Loan Trust 2021-B-GS	2021
College Ave Student Loans 2021-C	2021
Navient Private Education Refi Loan Trust 2021-F	2021
College Ave Student Loans 2021-B	2021
Nelnet Student Loan Trust 2021-A	2021
ELFI Graduate Loan Program 2021-A	2021
Navient Private Education Refi Loan Trust 2021-B	2021
College Ave Student Loans Trust 2021-3	2021
Nelnet Student Loan Trust 2021-C	2021
Navient Private Education Refi Loan Trust 2021-A	2021
Navient Private Education Loan Trust 2023-B	2023
College Ave Student Loans 2023-B	2023
Prodigy Finance CM2021-1	2021
Nelnet Student Loan Trust 2021-D	2021
Navient Private Education Refi Loan Trust 2021-G	2021
College Avenue Student Loans 2022-CLUB	2022
EDvestinU Private Education Loan Issue No. 4 Series 2022-A	2022
SMB Private Education Loan Trust 2023-A	2023
College Ave Student Loans Trust 2021-4	2021
SMB Private Education Loan Trust 2021-E	2021
Navient Private Education Refi Loan Trust 2022-A	2022

Table 26: Comparison of characteristics random sample to full pool of deals: Student loan

Statistic	Random sample	Full sample
Average deal balance	\$506M	\$484M
10 th – 90 th percentile	\$81M – \$1.0B	\$82M – \$999M
Average residual thickness	9%	-
10 th – 90 th percentile	1%-18%	-
2021 vintage	67%	71%
2022 vintage	13%	13%
2023 vintage	20%	16%

Table 27: Excluded deals³²

Class	Name
MM CLO	Churchill MMSLF CLO-II
Prime auto loan ABS	Bank of America Auto Trust 2023-2
	Carvana Auto Receivables Trust 2023-P1
	Carvana Auto Receivables Trust 2023-P4
	Westlake Automobile Receivables Trust, Series 2023-P1
	Carvana Auto Receivables Trust 2023-P2
	Honda Auto Receivables 2022-1 Owner Trust
Subprime auto loan ABS	Honda Auto Receivables 2023-4 Owner Trust
	Carvana Auto Receivables Trust 2021-N4
	Juniper Receivables 2022-1
	Credit Acceptance Auto Loan Trust 2023-3
	Credit Acceptance Auto Loan Trust 2023-5
	Flagship Credit Auto Grantor Trust 2023-R
Student loan ABS	Carvana Auto Receivables Trust 2022-N1
	SMB Private Education Loan Trust 2022-A
	Brazos Education Loan Authority Series 2021-1
	SMB Private Education Loan Trust 2022-B
	Kentucky Higher Education Student Loan Corporation, Series 2021-1
	Navigent Student Loan Trust 2021-3
	Higher Education Loan Authority of the State of Missouri Series 2021-2
	Higher Education Loan Authority of the State of Missouri Series 2021-3
SoFi Professional Loan Program 2021-A	

³² No BLS CLO deals were excluded

A.4 Deals Modeled

New Mexico Educational Assistance Foundation, Series 2021-1

Towd Point Asset Trust 2021-SL1

Qualifications, assumptions, and limiting conditions

This report was commissioned by the Alternative Credit Council and its membership. Oliver Wyman maintained full control of the modeling methodology and assumptions. This report is not intended for general circulation or publication, nor is it to be reproduced, quoted, or distributed for any purpose without the prior written permission of Oliver Wyman. There are no third-party beneficiaries with respect to this report, and Oliver Wyman does not accept any liability to any third party.

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All decisions in connection with the implementation or use of advice or recommendations contained in this report are the sole responsibility of the client. This report does not represent investment advice nor does it provide an opinion regarding the fairness of any transaction to any and all parties. In addition, this report does not represent legal, medical, accounting, safety, or other specialized advice. For any such advice, Oliver Wyman recommends seeking and obtaining advice from a qualified professional.

Oliver Wyman, LLC (DE)



April 8, 2024

Mr. Tom Botsko
Chair, NAIC Capital Adequacy (E) Task Force
Via email: Eva Yeung (eyeung@naic.org)

Mr. Philip Barlow
Chair, Risk-Based Capital Investment Risk and Evaluation (E) Working Group (RBC IRE WG)
Via email: Dave Fleming (dfleming@naic.org)

Re: Proposal 2024-02-CA (Residual Structure PC & Health)
Oliver Wyman Residual Tranche Report

Dear Mr. Botsko and Mr. Barlow,

The American Property Casualty Insurance Association¹ (APCIA) appreciates the opportunity to express our views on the Oliver Wyman study of the performance of residuals relative to other asset classes, exposed by the RBC IRE WG. We are also responding to the Capital Adequacy (E) Task Force's (CATF) proposal to impose a 45 percent interim risk-based capital (RBC) charge on residual tranche of asset-backed securities (residuals) held by property casualty insurers. We do not believe a sufficient basis has been demonstrated for this increase and agree with the American Council of Life Insurers (ACLI) that the NAIC should delay the implementation of an increased RBC charge on residuals by an additional year for all insurance lines.

Last year, the NAIC appropriately delayed imposition of a 45 percent charge on residuals on life insurers and sought industry data to conduct additional study. While we believe that any significant change in RBC charges, whether "interim" or not, should be underpinned by careful analysis conducted by the NAIC, regulators now have access to a thoughtful and credible study prepared by Oliver Wyman. In our opinion, the study does not justify a 45 percent charge on residuals. It does support the need for additional analysis in establishing an interim capital charge that is reflective of risk.

Moving forward with the 45 percent charge would be inappropriate in light of the new data. Oliver Wyman is a highly credible firm that the NAIC has appropriately relied on over the years to analyze important aspects of solvency regulation. The study constitutes compelling evidence that regulators should take additional time and analysis before making major changes to RBC. The NAIC has required substantially more rigor in the analysis underpinning every prior increase in RBC. We are concerned that failure to do so here would be inappropriate, especially insofar as applying this interim charge to property casualty and health insurers was only proposed at the March 2024 NAIC meeting.

¹ APCIA is the primary national trade association for home, auto, and business insurers. APCIA promotes and protects the viability of private competition for the benefit of consumers and insurers, with a legacy dating back 150 years. APCIA members represent all sizes, structures, and regions—protecting families, communities, and businesses in the U.S. and across the globe.

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We are also concerned that this charge appears to be designed to align with the “Basel III Endgame” banking capital rules proposed by the Federal Reserve Board. For many years, the insurance industry and insurance regulators have rightly pointed out that banking capital rules cannot and should not be applied to insurance companies. The two business models are quite different, as property casualty insurers do not hold demand deposits and the terms of our liabilities do not subject insurers to a run on the bank, i.e., are not runnable. The Basel III Endgame proposal, whether it is appropriate or inappropriate for structured securities held by banks, should not translate to state insurance regulation. The charge of state regulators is to set insurance-specific rules that protect policyholders, not to adopt global banking rules that do not reflect the best available data.

Finally, we would like to point out that, unlike the life RBC formula, there is no current mechanism for assigning property casualty Schedule BA asset RBC charges by investment type. Assigning a different charge to one particular investment type currently within Schedule BA is a significant change and should be supported by a more holistic review of the treatment of property casualty Schedule BA investments in general. This consideration further supports ACLI’s call for a one-year extension of the implementation date.

Thank you for the opportunity to convey our views and your continued commitment to ensuring that RBC changes reflect analysis and consistent standards of review by regulators. We hope that you will seriously consider our request to delay the implementation of this charge by an additional year to ensure that an appropriate charge is developed and adopted.

Sincerely,

A handwritten signature in black ink, appearing to read "Step W Broadie". The signature is fluid and cursive, with the first name "Step" and last name "Broadie" clearly visible.

Stephen W. Broadie
Vice President, Financial & Counsel



April 17, 2024

Mr. Tom Botsko
Chair, Capital Adequacy (E) Task Force
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Re: Oliver Wyman Report: *Residual Tranche Risk Analysis*

Dear Chair Botsko:

Americans for Tax Reform (ATR)¹ appreciates the opportunity to comment on the National Association of Insurance Commissioners' (NAIC) proposed increase to the risk-based capital (RBC) charge for residual tranches and interests of asset-backed securities (ABS). ATR also appreciates the opportunity to comment on Oliver Wyman's (OW) report analyzing the risk of losses to the residual tranches and interests of ABS under certain stress scenarios.² **ATR requests that the NAIC delay the implementation of the 45 percent RBC charge by at least one year. If the NAIC fails to delay the implementation of the 45 percent capital charge, then the NAIC should vote to establish the interim charge for residuals at 30 percent.**

The NAIC is arbitrarily increasing regulations on life insurance companies that invest in residual tranches and interests of ABS.³ It appears that the NAIC's goal is to push life insurance companies out of residual tranches without any quantitative analysis to justify this change. The implementation of the proposed regulations will disincentivize life insurance companies from investing in residual ABS tranches, which could increase the cost of Americans' life insurance and annuities. **ATR is deeply concerned the NAIC will deter financial companies from keeping life insurance and annuity products affordable for Americans.**

Third-party data and analysis provide evidence that NAIC's proposed regulations go too far. The OW report finds that common stock losses are higher than losses on residual ABS tranches on a portfolio level. The NAIC's proposed equity capital increase from 30 percent to 45 percent for residual ABS tranches is not commensurate with the residual tranche risk observed within the OW report. Meanwhile, the common stock charge is 30 percent. The OW report offers support for a 30 percent capital charge, not a 45 percent charge.

¹ ATR is a nonprofit, 501(c)(4) taxpayer advocacy organization that opposes all tax increases and supports limited government, free market policies. In support of these goals, ATR opposes heavy regulation and taxation of financial services. ATR was founded in 1985 at the request of President Ronald Reagan.

² <https://content.naic.org/sites/default/files/inline-files/Oliver%20Wyman%20Residual%20Tranche%20Report.pdf>.

³ <https://content.naic.org/about>.



Notably, another paper analyzing collateralized loan obligations (CLOs) found that “CLO equity exhibits a great deal of resilience to market volatility.”⁴

ABS residuals offer significant returns to life insurance and annuities. Residuals are a “great return enhancer and fundamental diversifier.”⁵ These tranches and interests can also “play an effective role in generating return while keeping portfolio risk constant.”⁶ Increasing the RBC charge to 45 percent would limit life insurance companies’ exposure to residuals, hamper returns, and increase costs for annuities that rely on those enhanced returns. Ultimately, American workers and retirees will bear the brunt of the increased RBC charge.

The NAIC’s proposed regulations should be delayed by at least one year. If the NAIC fails to delay the implementation of the 45 percent RBC charge, then the charge should remain at 30 percent. This is more than reasonable considering the NAIC has not conducted a comprehensive cost-benefit analysis for increasing the RBC charge to 45 percent. Moreover, the OW report clearly shows the NAIC’s proposed regulations are gratuitous. To date, no substantive quantitative analysis has been conducted to justify the NAIC’s proposed 45 percent RBC charge for residuals.

Additionally, NAIC’s proposed RBC charge should not be implemented simply to create parity with federal regulators’ implementation of the Basel III Endgame bank capital requirements.⁷ These bank regulations were originally formed by unelected bureaucrats in Basel, Switzerland. The NAIC should not implement rules for life insurance companies that will align with heavy-handed European-based regulations.

The proposed bank capital requirements arbitrarily punish securitizations by doubling the p-factor.⁸ The increase in the p-factor fails to take into consideration the varying riskiness of different types of underlying collateral. So, the p-factor treats credit card debt and commercial paper as equally risky. Adding the NAIC’s arbitrary RBC charge to residuals would unnecessarily, and without empirical evidence, label ABS as too risky for life insurance. The higher capital charges from the NAIC and the bank regulators will disincentivize banks and life insurance companies from adding exposure to securitizations. Life insurance companies will be forced to increase the cost of annuities, making them less attractive to American workers and retirees. Businesses “tend to pass on cost increases far more quickly than cost reductions.”⁹ Government-mandated capital controls will likely force life insurance companies to pass down these costs through annuities. It is widely observed that “[o]utput prices tend to respond faster to input increases than to decreases” in the producer and consumer goods markets.¹⁰ Similarly, the cost of annuities will increase more quickly if the RBC charge for residuals increases to 45 percent.

⁴ <https://w4.stern.nyu.edu/finance/docs/pdfs/Seminars/CLO-Performance.pdf>.

⁵ <https://www.thornburg.com/article/think-abs-residuals-to-improve-your-risk-reward-trade-off/>.

⁶ Id.

⁷ <https://docs.house.gov/meetings/BA/BA20/20240131/116775/HHRG-118-BA20-Wstate-BashurB-20240131.pdf>.

⁸ <https://www.federalregister.gov/d/2023-19200/p-564>.

⁹ <https://www.cuna.org/content/dam/cuna/advocacy/priorities/documents/True-Impact-of-Interchange-Regulation-CornerstoneAdvisors-June-2023.pdf>.

¹⁰ <https://www.jstor.org/stable/10.1086/262126>.



NAIC’s proposed regulations will force annuity providers to hold significantly more cash on hand. **Essentially, this will raise costs for consumers—acting as a *de facto* tax increase.** This is especially harmful to Americans considering the guaranteed lifetime income that annuities provide.¹¹

The NAIC should not arbitrarily and capriciously increase the RBC charge for residual ABS tranches without a proper quantitative analysis. Since insurance is primarily regulated at the state level, state regulators wield significant power over the insurance industry. Although the NAIC is not subject to the *Administrative Procedure Act* (APA),¹² as a matter of proper due process, the NAIC should consider abiding by the APA’s principles and allow for a structured notice-and-comment process that considers and analyzes hard data. Today, the NAIC possesses no hard evidence to suggest that raising the capital charge for residuals to 45 percent would provide any material benefits to life insurance companies or their clients.

One key element of ABS special purpose vehicles (SPVs)¹³ is that they benefit from bankruptcy remoteness. Bankruptcy remoteness possesses advantages such as:

*(i) the ability to segregate the assets to be financed such that they are held solely for the benefit of specific creditors and (ii) avoiding bankruptcy risks, costs, and delays including cram-down risk, the suspension of payments to creditors, and the limitations on enforcement actions against the [SPV] for nonpayment due to the automatic stay taking effect upon the filing of a bankruptcy case.*¹⁴

Legally isolating the securitized assets acquired by a SPV also gives ABS an advantage over corporate bonds and other non-securitized instruments. The “true sale” of assets creates a legal isolation between the SPV and the entity that originated the assets.¹⁵ This structure “allows creditors financing the assets to focus on the credit quality of the assets rather than the credit quality of the originator, resulting in better financing terms for the issuer/borrower.”¹⁶ The “economic benefits” of bankruptcy remoteness “can significantly lower borrowing costs.”¹⁷ Increasing the RBC charge for residuals to 45 percent is more likely to worsen financing terms for annuities, not improve them.

The level of riskiness observed in ABS is further delineated by the NAIC itself. The NAIC has previously stated that “[a]sset-backed securities have proven over the years to be stable investments.”¹⁸

The NAIC should avoid hindering American families from maximizing their nest eggs. Increasing the RBC charge for residuals to 45 percent would increase costs on annuities—effectively increasing costs on retirement options for American workers and retirees. Currently, there is no quantitative evidence to substantiate this RBC charge increase. **Consequently, ATR requests the 45 percent RBC charge on ABS residuals be delayed and remain at 30 percent.**

¹¹ <https://www.actuary.org/sites/default/files/2022-08/IB.SECUREact.8.22.pdf>.

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

¹³ <https://am.credit-suisse.com/content/dam/csam/docs/articles/2022/cig-white-paper-collateralized-loan-obligations.pdf>.

¹⁴ <https://www.choate.com/images/content/1/0/v2/104168/Bankruptcy-Remoteness-A-Summary-Analysis.pdf>.

¹⁵ Id.

¹⁶ Id.

¹⁷ https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4178280.

¹⁸ <https://content.naic.org/cipr-topics/asset-backed-securities>.



* * * *

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

Sincerely,

Americans for Tax Reform

cc: Ms. Eva Yeung
Senior Property/Casualty RBC Specialist & Technical Lead
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Submitted via electronic mail

Mr. Tom Botsko
Chair, Capital Adequacy (E) Task Force (CATF)
Via email: Eva Yeung (eyeung@naic.org)

Philip Barlow
Chair, Life Risk-Based Capital (E) Working Group (RBC IRE WG)
Via email: Dave Fleming (dfleming@naic.org)

Dear Mr. Barlow and Mr. Botsko:

As the President and CEO of the Florida State Hispanic Chamber of Commerce, I have always supported economic growth and free market principles to ensure success for all residents in our state. The strength of Florida's economy can be attributed to its free market practices. Following the recent National Association of Insurance Commissioners (NAIC) meeting, it seems the organization is seeking to stamp out competition that allows the free market to thrive. I find the precedent being set by the Risk-Based Capital Investment Risk and Evaluation Working Group (RBC IRE WG) and the Capital Adequacy (E) Task Force (CATF) troublesome. Both the RBC IRE WG's and CATF's decision to disregard objective, third-party data that they requested is concerning, and the findings should mandate a reexamination of the proposed 45% capital charge on residual tranches.

We've recently learned that many of the initiatives pushed by the NAIC are done so behind closed doors and not open to public input. However, this aggressive attempt at suppressing competition in the insurance market is open to public comment, and we'd like our voice to be heard. In the past, the NAIC has valued research and used data to drive its decisions, but now it seems like a lack of oversight has allowed the organization to run astray and be influenced by individual priorities and politics. The recent independent study conducted by Oliver Wyman provides validated data that demonstrates that asset-backed security (ABS) residuals don't have a higher risk, making the 45% charge in question unnecessary.

If the NAIC continues pursuing this charge, it would confirm that its real goal is to drive competition out of insurance markets, including life insurance and annuity markets. A frivolous 45% charge would clearly have an adverse effect on the market. The life insurance and annuity industry is critical to Florida's retirees, a community that primarily operates on a fixed income and would not be able to handle the impact of this proposed charge, which could reduce the number of affordable policies.

Further, this charge is also being proposed for property and casualty insurance companies, which would further increase costs in that market. As you know, Florida is experiencing an unprecedented crisis in the availability and affordability of homeowners insurance. Floridians are already leaving the state in droves because of skyrocketing insurance costs.¹ This is the

¹ <https://www.newsweek.com/florida-faces-exodus-insurance-costs-cause-residents-leave-state-1838206>

absolute worst time for regulators to arbitrarily raise costs. The effect of such increased costs will hit Hispanic communities particularly hard given that Hispanics are already substantially less likely to have homeowners insurance than the general population.² When insurers are prevented from investing in high-returning assets, they will be forced to minimize their offerings, which will lead to higher costs.

Unfortunately, the NAIC's recent actions are seemingly guided by political agendas rather than sound policymaking. The NAIC should be forging new ways to lower costs and provide more options for consumers, especially in states like Florida, not working to suppress the free market. I ask the NAIC to act in favor of data and in favor of consumers and vote in support of the one-year delay.

Sincerely,
Julio Fuentes
President and CEO of the Florida State Hispanic Chamber of Commerce

² <https://consumerfed.org/wp-content/uploads/2024/03/Exposed-UninsuredHomes-1.pdf>



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April 8, 2024

Mr. Philip Barlow, Chair
Chair, Risk-Based Capital Investment and Evaluation (E) Working Group
National Association of Insurance Commissioners
c/o Dave Fleming
Via Email: dfleming@naic.org

Mr. Tom Botsko
Chair, Capital Adequacy (E) Task Force
National Association of Insurance Commissioners
c/o Eva Yueng
Via Email: eyeung@naic.org

RE: Oliver Wyman Residual Tranche Risk Analysis and Proposal 2024-02-CA

Dear Mr. Barlow and Mr. Bostko,

Thank you for the opportunity to comment on the Oliver Wyman Residual Tranche Risk Analysis and Proposal 2024-02-CA. The following is submitted on behalf of the member companies of the National Association of Mutual Insurance Companies (NAMIC).

NAMIC has more than 1,500-member companies representing 40 percent of the total U.S. property/casualty insurance market. NAMIC member companies serve more than 170 million policyholders and write more than \$323 billion in annual premiums. Our members' direct written premiums account for 67 percent of homeowners' insurance and 55 percent of automobile insurance. Through NAMIC advocacy programs it promotes public policy solutions that benefit NAMIC member companies and the policyholders they serve and fosters greater understanding and recognition of the unique alignment of interests between management and policyholders of mutual companies.

NAMIC is writing to express our support for an additional one-year implementation delay of the increased 45% capital charge on asset-backed security (ABS) residual tranches and interests.



As noted by the American Council of Life Insurers (ACLI) at the March National NAIC meeting, the insurance industry is aligned that regulators and stakeholders must thoroughly assess new data and discuss and evaluate all residual tranche charges to ensure that they align with the actual risk. Aligning risk with capital is also consistent with a foundational principle of the recently proposed Holistic Framework – equal capital for equal risk.

We believe that providing an additional year will allow additional analysis, including by the Academy of Actuaries, to help the regulatory community arrive at an informed decision and produce specific recommendations that are based on fact, and specific to individual types of assets. This additional year can provide an opportunity for understanding the impact to property and casualty companies, as opposed to assuming the risk is the same as the life industry. Unlike the life risk-based capital calculation, there is no current mechanism for assigning a property/casualty Schedule BA asset charge by investment type. Such a change in charge is significant and should be supported by a holistic review of the treatment of property/casualty Schedule BA investment types in general, rather done in isolation for one specific investment type, such as residual tranches. This concern also supports the need for additional analysis.

Thank you for your consideration of our views and your support for a process that provides consistent rigor and standards when evaluating insurance company investments for purposes of changing RBC.

Sincerely,

A handwritten signature in blue ink that reads "Colleen W. Scheele".

Colleen W. Scheele, Public Policy Counsel and Director of Financial and Tax Policy
National Association of Mutual Insurance Companies

From: Karen Melchert <KarenMelchert@acli.com>
Sent: Thursday, April 4, 2024 12:03 PM
To: French, Judith <Judith.French@insurance.ohio.gov>; Botsko, Thomas <Thomas.Botsko@insurance.ohio.gov>; Bruggeman, Dale <Dale.Bruggeman@insurance.ohio.gov>
Subject: Oliver Wyman Residual Tranche Report - ACLI Response

Dear Director French, Mr. Bruggeman and Mr. Botsko,

On behalf of the ACLI we wanted to thank you for the opportunity to comment at the RBC Capital Investment Risk and Evaluation Working Group Committee meeting on March 17th at the NAIC Spring meeting in Phoenix. As you may recall, ACLI spoke at the meeting and requested that regulators delay the implementation of the 45% charge for residuals for one year. We wanted to briefly follow up with you before we submit our comment letter on the Oliver Wyman Residual Tranche Report on April 8th.

ACLI respectfully requests the NAIC postpone implementation of the 45% charge for one additional year. During this additional year, regulators and stakeholders can thoroughly assess new data and discuss and evaluate all residual tranche charges to ensure that they align with the actual risk.

Given the complexities associated with ABS and the potential long-term consequences of changing capital charges, we believe more time is required to finalize the approach. Factors, especially those that are likely long-term, should be data driven. Aligning risk with capital is consistent with a foundational principle of the Holistic Framework – equal capital for equal risk. The factor(s) for residual tranches should align with the principles adopted by the RBC IRE group in December 2023, which emphasized the need for the capital charge to align with the tranche’s risk, to the extent possible.

ACLI supports further study on the potential drivers of risk within the residual tranches to determine appropriate interim RBC factors and we believe that a one-year implementation delay will allow further study to better understand and take into account emerging data and research by the Academy.

ACLI will share a copy of our April 8th comment letter with you as soon as it is ready, and we are happy to organize a call to discuss our request. Please let me know if you have any questions or if you are available for a call.

Thank you,

Karen Melchert

From: Chou, Wanchin <Wanchin.Chou@ct.gov>
Sent: Tuesday, April 16, 2024 10:53 AM
To: Botsko, Thomas <thomas.botsko@insurance.ohio.gov>; Yeung, Eva <EYeung@naic.org>
Cc: Chang, Maggie <mchang@naic.org>
Subject: Proposal 2024-02-CA (Residual Structure PC & Health)

CAUTION: This email originated from outside of the organization. Do not click links or open attachments unless you recognize the sender and know the content is safe.

Hi Tom,

I can follow up with more formal and detailed comment letter if needed. My major comments are as follows:

1. There are many moving pieces for the residual tranches currently discussed at the RBC IRE. It is not effective to adopt this specific proposal and revise it later when the final proposal in managing the residual tranches is to be approved. 45% is only an interim alternative and the split votes (4/11/1) last Friday showed significant concerns among RBC IRE members. Future better structure could be significant different from Proposal 2024-02-CA exposed. AAA has preliminary estimate to complete the study in 2 years if not longer.
2. Historically, the Bond and other investment asset RBC charges in Life RBC, P&C, and Health are different due to different considerations and impacts of their investment assets, LOB, operations, strategy, and ALM, etc. Without a study, I would not recommend changing current 0.20 factor to 0.45 as a voting member.

My recommendation is to hold and wait or withdraw current proposal. We should discuss again later this year when RBC IRE has better guidance and strategic plans. The impacts to the P&C and Health RBC reporting are very limited and a delay in changing current RBC reporting is prudent. Please do not change the current factor (0.20) if a structure change is a must.

Best Regards,

Wanchin W. Chou, FCAS, MAAA, CPCU, CSPA, CCRMP
Chief Insurance Actuary and Asst. Deputy Commissioner
State of Connecticut Insurance Department
Office Phone: 860-297-3943
Cell Phone: 860-488-4408



April 8, 2024

Tom Botsko
Chair, Capital Adequacy Task Force
National Association of Insurance Commissioners

Re: Oliver Wyman Study on Residual Tranches and Interests

Dear Mr. Botsko:

The American Consumer Institute is honored to present the National Association of Insurance Commissioners (NAIC) with comments on its proposal to raise the risk-based capital (RBC) charge for residual tranches and interests of asset-backed securities (ABS) from 30 percent to 45 percent for life insurance companies. The effects of limiting financial options on life insurance policyholders are of great concern to us, particularly because the proposal will limit the availability and affordability of such a vital resource.

Life insurance provides financial solace for those who hold these policies and can be integral in supporting families after the passing of a household's primary breadwinner. The difference in feelings of financial security between those with and without life insurance is stark.¹ While nearly 70 percent of those with life insurance feel financially secure, less than half of those without insurance can say the same.

Furthermore, after just six months, nearly half of Americans say they feel the financial burden of losing their household's primary wage earner. Life insurance helps to provide families with the cushion they need to stave off the inevitable financial burdens of a loss. Even if a policy is never used, the peace of mind that it grants is still immeasurable to working families.

There is little debate that life insurance policies are beneficial. However, rules that limit investment opportunities for life insurance policyholders threaten to limit availability and affordability. Similar to the proposal from the Federal Reserve to impose "Basel Endgame"² requirements on banks, this sharp increase in RBC charges would

¹ Michael Jones, "Life Insurance Statistics and Industry Trends to Know in 2023," Annuity, January 24, 2024, <https://www.annuity.org/life-insurance/statistics/#:~:text=About%252050%2525%2520of%2520Americans%2520do.compared%2520to%252046%2525%2520of%2520women>.

² "Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity," Federal Register, September 18, 2023,

4350 North Fairfax Drive, Arlington, VA, Suite 725, 22203

functionally limit the investments into residual tranches and ultimately hinder ABS.³ These investments are high-performing and can offer life insurance holders greater access to financial markets. High RBC charges amount to cash-on-hand requirements, limiting investment capital which earns interest, and helping life insurers cover customers.

The report by Oliver Wyman on the risk of losses to residual tranches and interest of ABS under various stress tests does not lend support for a 45 percent RBC charge.⁴ Instead, the Wyman report indicates that a 30 percent RBC charge would best satisfy risk, making the proposed 45 percent charge unsubstantiated by testing. For the NAIC to continue implementing the current proposal would essentially create an arbitrary RBC charge that would unnecessarily limit life insurance policyholders' access to financial options.

The NAIC should not implement this rule change. At a minimum, the NAIC should hold off on rule implementation for at least a year and conduct further risk-based testing to substantiate the increase in RBC charges to 45 percent, or the charge should be set at 30 percent as the Wyman report concludes. Anything else would endanger Americans' access to valuable financial tools which could be the difference between having or not having access to health insurance.

Based on our analysis of the proposal, we conclude that consumers would be harmed in two major ways. First, the increase in RBC charges would drive the costs of life insurance and annuities up because the charge would artificially reduce insurer investment returns. As a result, insurers would have to pass this cost on to consumers. This is happening at the very time that more Americans are facing retirement insecurity and need to protect their families.

Second, the increase in RBC charges would hinder the origination of lending to consumers, because many originators of consumer loans require securitization to finance such lending. Thus, making these securitization structures/investments less attractive by jacking up the risk charge would significantly reduce demand and make consumer loans more expensive.

Considering life insurance provides benefits both in peace of mind and financial ease following losses, it is incumbent upon policymakers to not unnecessarily limit its

<https://www.federalregister.gov/documents/2023/09/18/2023-19200/regulatory-capital-rule-large-banking-organizations-and-banking-organizations-with-significant>.

³ Bill Hulse, "How New Banking Rules Might Harm Your Business," U.S. Chamber of Commerce, November 6, 2023, <https://www.uschamber.com/finance/how-new-banking-rules-might-harm-your-business#:~:text=As%20a%20whole%2C%20increasing%20capital,by%20more%20than%2020%20percent>.

⁴ "Oliver Wyman Residual Tranche Report," Alternative Credit Council, February 26, 2024, <https://content.naic.org/sites/default/files/inline-files/Oliver%20Wyman%20Residual%20Tranche%20Report.pdf>.

availability through the implementation of RBC charges that are higher than what is supported through stress testing.

If you have any questions, we can be reached on 703-282-9400.

Respectfully submitted,

Steve Pociask
President/CEO
American Consumer Institute
Steve@TheAmericanConsumer.Org

Isaac Schick
Policy Analyst
American Consumer Institute
Isaac@TheAmericanConsumer.Org

Capital Adequacy (E) Task Force RBC Proposal Form

- | | | |
|---|---|---|
| <input checked="" type="checkbox"/> Capital Adequacy (E) Task Force | <input type="checkbox"/> Health RBC (E) Working Group | <input type="checkbox"/> Life RBC (E) Working Group |
| <input type="checkbox"/> Catastrophe Risk (E) Subgroup | <input type="checkbox"/> Investment RBC (E) Working Group | <input type="checkbox"/> Longevity Risk (A/E) Subgroup |
| <input type="checkbox"/> Variable Annuities Capital. & Reserve (E/A) Subgroup | <input type="checkbox"/> P/C RBC (E) Working Group | <input type="checkbox"/> RBC Investment Risk & Evaluation (E) Working Group |

<p style="text-align: right;">DATE: <u>1/27/24</u></p> <p>CONTACT PERSON: <u>Eva Yeung</u></p> <p>TELEPHONE: <u>816-783-8407</u></p> <p>EMAIL ADDRESS: <u>eyeung@naic.org</u></p> <p>ON BEHALF OF: <u>P/C RBC (E) Working Group</u></p> <p>NAME: <u>Tom Botsko</u></p> <p>TITLE: <u>Chair</u></p> <p>AFFILIATION: <u>Ohio Department of Insurance</u></p> <p>ADDRESS: <u>50 West Town Street, Suite 300</u> <u>Columbus, OH 43215</u></p>	<p style="text-align: center;">FOR NAIC USE ONLY</p> <p>Agenda Item # <u>2024-02-CA</u> Year <u>2024</u></p> <p style="text-align: center;">DISPOSITION</p> <p>ADOPTED:</p> <p><input checked="" type="checkbox"/> TASK FORCE (TF) <u>04/30/2024</u></p> <p><input type="checkbox"/> WORKING GROUP (WF) _____</p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>EXPOSED:</p> <p><input checked="" type="checkbox"/> TASK Force(TF) <u>1/31/24, 3/17/24</u></p> <p><input type="checkbox"/> WORKING GROUP (WG) _____</p> <p><input type="checkbox"/> SUBGROUP (SG) _____</p> <p>REJECTED:</p> <p><input type="checkbox"/> TF <input type="checkbox"/> WG <input type="checkbox"/> SG _____</p> <p>OTHER:</p> <p><input type="checkbox"/> DEFERRED TO _____</p> <p><input type="checkbox"/> REFERRED TO OTHER NAIC GROUP _____</p> <p><input type="checkbox"/> (SPECIFY) _____</p>
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IDENTIFICATION OF SOURCE AND FORM(S)/INSTRUCTIONS TO BE CHANGED

- | | | |
|---|--|--|
| <input checked="" type="checkbox"/> Health RBC Blanks | <input checked="" type="checkbox"/> Property/Casualty RBC Blanks | <input type="checkbox"/> Life and Fraternal RBC Blanks |
| <input type="checkbox"/> Health RBC Instructions | <input type="checkbox"/> Property/Casualty RBC Instructions | <input type="checkbox"/> Life and Fraternal RBC Instructions |
| <input type="checkbox"/> Health RBC Formula | <input type="checkbox"/> Property/Casualty RBC Formula | <input type="checkbox"/> Life and Fraternal RBC Formula |
| <input type="checkbox"/> OTHER _____ | | |

DESCRIPTION/REASON OR JUSTIFICATION OF CHANGE(S)

This proposal adds a line in the Blanks; and updates the instruction on XR008 and PR008 to include the total of residual tranches. During the Spring National Meeting, the Task Force agreed to re-expose this proposal with a 45% charge for a 30-day public comment period.

Additional Staff Comments:

04-30-24 eky The Task Force adopted the Residual Tranches "Structure" only.

**** This section must be completed on all forms.**

Revised 2-2023

FIXED INCOME ASSETS - MISCELLANEOUS

	Annual Statement Source	(1) Bk/Adj Carrying Value	Factor	(2) RBC Requirement
(1) Cash	Page 2, Line 5, inside amount 1		0.0030	
(2) Cash Equivalents	Page 2, Line 5, inside amount 2			
(3) Less: Cash Equivalents, Total Bonds	Schedule E, Part 2, Column 7, Line 2509999999			
(4) Less: Exempt Money Market Mutual Funds as Identified by SVO	Schedule E, Part 2, Column 7, Line 8209999999			
(5) Net Cash Equivalents	Lines (2) - (3) - (4)		0.0030	
(6) Short-Term Investments	Page 2, Line 5, inside amount 3			
(7) Short-Term Bonds	Schedule DA, Part 1, Column 7, Line 2509999999			
(8) Total Other Short-Term Investments	Lines (6) - (7)		0.0030	
(9) Mortgage Loans - First Liens	Page 2, Column 3, Line 3.1		0.0500	
(10) Mortgage Loans - Other Than First Liens	Page 2, Column 3, Line 3.2		0.0500	
(11) Receivable for Securities	Page 2, Column 3, Line 9		0.0240	
(12) Aggregate Write-Ins for Invested Assets	Page 2, Column 3, Line 11		0.0500	
(13) Collateral Loans	Included in Page 2, Column 3, Line 8		0.0500	
(14) NAIC 01 Working Capital Finance Investments	Notes to Financial Statement 5M(01a), Column 3		0.0038	
(15) NAIC 02 Working Capital Finance Investments	Notes to Financial Statement 5M(01b), Column 3		0.0125	
(16) Other Long-Term Invested Assets Excluding Collateral Loans, Residual Tranches or Interests and Working Capital Finance Investments	Included in Page 2, Column 3, Line 8		0.2000	
(17) Federal Guaranteed Low Income Housing Tax Credits	Schedule BA Part 1, Column 12 Lines 3599999 + 3699999		0.0014	
(18) Federal Non-Guaranteed Low Income Housing Tax Credits	Schedule BA Part 1, Column 12 Lines 3799999 + 3899999		0.0260	
(19) State Guaranteed Low Income Housing Tax Credits	Schedule BA Part 1, Column 12 Lines 3999999 + 4099999		0.0014	
(20) State Non-Guaranteed Low Income Housing Tax Credits	Schedule BA Part 1, Column 12 Lines 4199999 + 4299999		0.0260	
(21) All Other Low Income Housing Tax Credits	Schedule BA Part 1, Column 12 Lines 4399999 + 4499999		0.1500	
(22) Total Residual Tranches or Interests	Schedule BA, Part 1, Column 12 Lines 4699999 + 4799999 + 4899999 + 4999999 + 5099999 + 5199999 + 5299999 + 5399999 + 5499999 + 5599999 + 5699999 + 5799999		TBD	
(23) Total Other Long-Term Invested Assets (Page 2, Column 3, Line 8)	Lines (13) + (14) + (15) + (16) + (17) + (18) + (19) + (20) + (21) + (22)			
(24) Derivatives	Page 2, Column 3, Line 7		0.0500	
(25) Total Miscellaneous Fixed Income Assets RBC	Lines (1) + (5) + (8) + (9) + (10) + (11) + (12) + (23) + (24)			

Denotes items that must be manually entered on filing software.

CALCULATION OF TOTAL RISK-BASED CAPITAL AFTER COVARIANCE

		(1)
		<u>RBC Amount</u>
H0 - INSURANCE AFFILIATES AND MISC. OTHER AMOUNTS		
(1) Off-Balance Sheet Items	XR005, Off-Balance Sheet Page, Line (21)	_____
(2) Directly Owned Health Insurance Companies or Health Entities	XR003, Affiliates Page, Column (2), Line (1)	_____
(3) Directly Owned Property and Casualty Insurance Affiliates	XR003, Affiliates Page, Column (2), Line (2)	_____
(4) Directly Owned Life Insurance Affiliates	XR003, Affiliates Page, Column (2), Line (3)	_____
(5) Indirectly Owned Health Insurance Companies or Health Entities	XR003, Affiliates Page, Column (2), Line (4)	_____
(6) Indirectly Owned Property and Casualty Insurance Affiliates	XR003, Affiliates Page, Column (2), Line (5)	_____
(7) Indirectly Owned Life Insurance Affiliates	XR003, Affiliates Page, Column (2), Line (6)	_____
(8) Affiliated Alien Insurers - Directly Owned	XR003, Affiliates Page, Column (2), Line (9) + (10) + (11)	_____
(9) Affiliated Alien Insurers - Indirectly Owned	XR003, Affiliates Page, Column (2), Line (12) + (13) + (14)	_____
(10) Total H0	Sum Lines (1) through (9)	=====
H1 - ASSET RISK - OTHER		
(11) Holding Company in Excess of Indirect Subs	XR003, Affiliates Page, Column (2), Line (7)	_____
(12) Investment Subsidiary	XR003, Affiliates Page, Column (2), Line (8)	_____
(13) Investment in Upstream Affiliate (Parent)	XR003, Affiliates Page, Column (2), Line (15)	_____
(14) Directly Owned Health Insurance Companies or Health Entities Not Subject to RBC	XR003, Affiliates Page, Column (2), Line (16)	_____
(15) Directly Owned Property and Casualty Insurance Companies Not Subject to RBC	XR003, Affiliates Page, Column (2), Line (17)	_____
(16) Directly Owned Life Insurance Companies Not Subject to RBC	XR003, Affiliates Page, Column (2), Line (18)	_____
(17) Affiliated Non-Insurer	XR003, Affiliates Page, Column (2), Line (19) + (20) + (21)	_____
(18) Fixed Income Assets	XR006, Off-Balance Sheet Collateral, Lines (27) + (37) + (38) + (39) + XR007, Fixed Income Assets - Bonds, Line (27) + XR008, Fixed Income Assets - Miscellaneous, Line (25)	_____
(19) Replication & Mandatory Convertible Securities	XR009, Replication/MCS Page, Line (9999999)	_____
(20) Unaffiliated Preferred Stock	XR006, Off-Balance Sheet Collateral, Line (34) + XR010, Equity Assets Page, Line (7)	_____
(21) Unaffiliated Common Stock	XR006, Off-Balance Sheet Collateral, Line (35) + XR010, Equity Assets Page, Line (13)	_____
(22) Property & Equipment	XR006, Off-Balance Sheet Collateral, Line (36) + XR011, Prop/Equip Assets Page, Line (9)	_____
(23) Asset Concentration	XR012, Grand Total Asset Concentration Page, Line (27)	_____
(24) Total H1	Sum Lines (11) through (23)	=====
H2 - UNDERWRITING RISK		
(25) Net Underwriting Risk	XR013, Underwriting Risk Page, Line (21)	_____
(26) Other Underwriting Risk	XR015, Underwriting Risk Page, Line (25.3)	_____
(27) Disability Income	XR015, Underwriting Risk Page, Lines (26.3) + (27.3) + (28.3) + (29.3) + (30.6) + (31.3) + (32.3)	_____
(28) Long-Term Care	XR016, Underwriting Risk Page, Line (41)	_____
(29) Limited Benefit Plans	XR017, Underwriting Risk Page, Lines (42.2) + (43.6) + (44)	_____
(30) Premium Stabilization Reserve	XR017, Underwriting Risk Page, Line (45)	_____
(31) Total H2	Sum Lines (25) through (30)	=====

Denotes items that must be manually entered on filing software.

CALCULATION OF TOTAL RISK-BASED CAPITAL AFTER COVARIANCE

		(1) <u>RBC Amount</u>
H3 - CREDIT RISK		
(32)	Total Reinsurance RBC	XR020, Credit Risk Page, Line (17) _____
(33)	Intermediaries Credit Risk RBC	XR020, Credit Risk Page, Line (24) _____
(34)	Total Other Receivables RBC	XR021, Credit Risk Page, Line (30) _____
(35)	Total H3	Sum Lines (32) through (34) =====
H4 - BUSINESS RISK		
(36)	Administrative Expense RBC	XR022, Business Risk Page, Line (7) _____
(37)	Non-Underwritten and Limited Risk Business RBC	XR022, Business Risk Page, Line (11) _____
(38)	Premiums Subject to Guaranty Fund Assessments	XR022, Business Risk Page, Line (12) _____
(39)	Excessive Growth RBC	XR022, Business Risk Page, Line (19) _____
(40)	Total H4	Sum Lines (36) through (39) =====
(41)	RBC after Covariance Before Basic Operational Risk	$H0 + \text{Square Root of } (H1^2 + H2^2 + H3^2 + H4^2)$ _____
(42)	Basic Operational Risk	0.030 x Line (41) _____
(43)	C-4a of U.S. Life Insurance Subsidiaries	Company Records <div style="background-color: #f08080; height: 15px; width: 100%;"></div>
(44)	Net Basic Operational Risk	Line (42) - (43) (not less than zero) _____
(45)	RBC After Covariance Including Basic Operational Risk	Lines (41) + (44) _____
(46)	Authorized Control Level RBC	.50 x Line (45) _____

Denotes items that must be manually entered on filing software.

OTHER LONG-TERM ASSETS PR008

	Annual Statement Source	(1) <u>Book/Adjusted</u> <u>Carrying Value</u>	Factor	(2) <u>RBC Requirement</u>
(1) Company Occupied Real Estate	P2 L4.1 C3	0	0.100	0
(2) Encumbrances	P2 L4.1, inside item	0	0.100	0
(3) Property Held For the Production of Income	P2 L4.2 C3	0	0.100	0
(4) Property Held For Sale	P2 L4.3 C3	0	0.100	0
(5) Encumbrances (Property Held For the Production of Income)	P2 L4.2, inside item	0	0.100	0
(6) Encumbrances (Property Held For Sale)	P2 L4.3, inside item	0	0.100	0
(7) Total Real Estate	L(1)+L(2)+L(3)+L(4)+L(5)+L(6)	0		0
(8) Mortgage Loans - First Liens	P2 L3.1 C3	0	0.050	0
(9) Mortgage Loans - Other Than First Liens	P2 L3.2 C3	0	0.050	0
(10) Total Mortgage Loans	L(8) + L(9)	0		0
(11) Schedule BA Assets - Total	P2 L8 C3	0		
(12) Less: Collateral Loans	PR009 L(13)	0		
(13) Federal Guaranteed Low Income Housing Tax Credits	Schedule BA Part 1, C12 L3599999 +L3699999	0	0.0014	0
(14) Federal Non-Guaranteed Low Income Housing Tax Credits	Schedule BA Part 1, C12 L3799999 +L3899999	0	0.0260	0
(15) State Guaranteed Low Income Housing Tax Credits	Schedule BA Part 1, C12 L3999999 +L4099999	0	0.0014	0
(16) State Non-Guaranteed Low Income Housing Tax Credits	Schedule BA Part 1, C12 L4199999 +L4299999	0	0.0260	0
(17) All Other Low Income Housing Tax Credits	Schedule BA Part 1, C12 L4399999 +L4499999	0	0.1500	0
(18) Working Capital Finance Investments	L(21)+L(22)	0		
(19) Total Residual Tranches or Interests	Schedule BA, Part 1, Column 12 Lines 4699999 + 4799999 + 4899999 + 4999999 + 5099999 + 5199999 + 5299999 + 5399999 + 5499999 + 5599999 + 5699999 + 5799999		TBD	
(20) Schedule BA Assets Excluding Collateral Loans, LIHTC, &-WCFI, & Residual Tranches or Interests	L(11)-L(12)-L(13)-L(14)-L(15) -L(16)-L(17)-L(18)-L(19)	0	0.2000	0
(21) NAIC 01 Working Capital Finance Investments	Notes to Financial Statement Item L5M(01a) C3	0	0.0038	0
(22) NAIC 02 Working Capital Finance Investments	Notes to Financial Statement Item L5M(01b) C3	0	0.0125	0
(23) Total Other Long-Term Assets	L(7)+L(10)+L(13)+L(14)+L(15) +L(16)+L(17)+L(19)+L(20)+L(21)+L(22)	0		0

PR008

Calculation of Total Risk-Based Capital After Covariance PR030 R0-R1

(1)

R0 - Subsidiary Insurance Companies and Misc. Other Amounts		PRBC O&I Reference	RBC Amount
(1)	Directly Owned Property and Casualty Insurance Affiliates	PR004 L(2)C(2)	0
(2)	Indirectly Owned Property and Casualty Insurance Affiliates	PR004 L(5)C(2)	0
(3)	Directly Owned Life Insurance Affiliates	PR004 L(3)C(2)	0
(4)	Indirectly Owned Life Insurance Affiliates	PR004 L(6)C(2)	0
(5)	Directly Owned Health Insurance Companies or Health Entities	PR004 L(1)C(2)	0
(6)	Indirectly Owned Health Insurance Companies or Health Entities	PR004 L(4)C(2)	0
(7)	Directly Owned Alien Insurance Companies or Health Entities	PR004 L(9)+L(10)+L(11)C(2)	0
(8)	Indirectly Owned Alien Insurance Companies or Health Entities	PR004 L(12)+L(13)+L(14)C(2)	0
(9)	Misc Off-Balance Sheet - Non-controlled Assets	PR014 L(15) C(3)	0
(10)	Misc Off-Balance Sheet - Guarantees for Affiliates	PR014 L(16) C(3)	0
(11)	Misc Off-Balance Sheet - Contingent Liabilities	PR014 L(17) C(3)	0
(12)	Misc Off-Balance Sheet - SSAP No.101 Par. 11A DTA	PR014 L(19) C(3)	0
(13)	Misc Off-Balance Sheet - SSAP No.101 Par. 11B DTA	PR014 L(20) C(3)	0
(14)	Total R0	L(1)+L(2)+L(3)+L(4)+L(5)+L(6)+L(7)+L(8)+L(9)+L(10)+L(11)+L(12)+L(13)	0
R1 - Asset Risk - Fixed Income			
(15)	Bonds Subject to Size Factor	PR006 L(27)C(5)	0
(16)	Bond Size Factor RBC	PR006 L(30)C(5)	0
(17)	Off-balance Sheet Collateral & Sch DL, PT1 - Total Bonds	PR015 L(27)C(4)	0
(18)	Off-balance Sheet Collateral & Sch DL, PT1 - Cash, & Short-Term Investments and Mort Loans on Real Est.	PR015 L(38)+(39)C(4)	0
(19)	Other Long-Term Assets - Mortgage Loans, LIHTC, & WCFI, & Residual Tranches or Interests	PR008 L(10)+L(13)+L(14)+L(15)+L(16)+L(17)+L(19)+L(21)+L(22)C(2)	0
(20)	Misc Assets - Collateral Loans	PR009 L(13)C(2)	0
(21)	Misc Assets - Cash	PR009 L(3)C(2)	0
(22)	Misc Assets - Cash Equivalents	PR009 L(7)C(2)	0
(23)	Misc Assets - Other Short-Term Investments	PR009 L(10)C(2)	0
(24)	Replication - Synthetic Asset: One Half	PR010 L(9999999)C(7)	0
(25)	Asset Concentration RBC - Fixed Income	PR011 L(21)C(3) Grand Total Page	0
(26)	Total R1	L(15)+L(16)+L(17)+L(18)+L(19)+L(20)+L(21)+L(22)+L(23)+L(24)+L(25)	0

PR030

Draft: 6/27/2024

Health Risk-Based Capital (E) Working Group
E-Vote
June 24, 2024

The Health Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force conducted an e-vote that concluded June 24, 2024. The following Working Group members participated: Steve Drutz, Chair (WA); Matthew Richard, Vice Chair (TX); Wanchin Chou (CT); Kyle Colins (FL); Tish Becker (KS); Danielle Smith and Debbie Doggett (MO); Margaret Garrison (NE), Michel Laverdiere (NY); and Diana Sherman (PA).

1. Adopted Proposal 2024-12-H Modified

The Working Group conducted an e-vote to consider adoption of proposal 2024-12-H modified. A majority of the members voted in favor of adopting the proposal (Attachment One-E). The motion passed.

Having no further business, the Health Risk-Based Capital (E) Working Group adjourned.

SharePoint/NAIC Support Staff Hub/Member Meetings/E CMTE/CADTF/2024-2-Summer/HRBCWG/HRBC
Proposal 2024-12-H Evote minutesTPR'd.docx

Draft: 6/17/2024

Health Risk-Based Capital (E) Working Group
Virtual Meeting
June 6, 2024

The Health Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met June 6, 2024. The following Working Group members participated: Steve Drutz, Chair (WA); Matthew Richard, Vice Chair (TX); Sarah Mu (CT); Casey Koon (FL); Tish Becker (KS); Danielle Smith and Debbie Doggett (MO); and Margaret Garrison (NE). Also participating was: Tom Botsko (OH).

1. Discussed Proposal 2024-12-H and Exposed Proposal 2024-12-H Modified

Drutz said the first item to consider was the adoption of proposal 2024-12-H (Attachment One-E). This proposal was developed to adjust the health care receivable factors in XR021 to include a tiered factor mechanism. The proposal was exposed for a 30-day public comment period that ended May 16, during which the Working Group received one comment letter from America's Health Insurance Plans (AHIP) (Attachment Three-A). Ray Nelson (AHIP) spoke on the comment letter, which focused on aggregating non-pharmaceutical health care receivables. Nelson said the current factor for the non-pharmaceutical health care receivables was developed by aggregating the data to achieve a sufficient volume of data. To remain consistent with the aggregation methodology, AHIP suggested applying tiered factors toward the \$10 million tier at the aggregate level. Nelson said the American Academy of Actuaries (Academy) presented during an April meeting on the use of aggregation methodology, noting no significant change from the results of the original proposal. Nelson said he was under the impression that the reason the original proposal did not use the aggregation method was to avoid a structural change to the blanks. He said there should be a way to implement the aggregation methodology with or without structural change.

Drutz asked whether AHIP has a specific idea of how the aggregation methodology should be applied in practice. Drutz said the modified proposal used a waterfall approach but acknowledged there could be alternative approaches, such as allocating aggregated charges based on the weighted significance of the respective non-pharmaceutical health care receivable amounts. Nelson said he was indifferent between the two approaches mentioned. Drutz asked if there was any concern that the modified proposal compromised the transparency of the calculation, as the aggregation and allocation are all embedded in the formula. Nelson said he did not believe so and that the instruction is clear enough about what the formula is trying to accomplish.

Kevin Russell (Academy) said the Academy's initial attempt to develop the tiers was to apply the tiered factors (40% on the first \$10 million and 5% on anything in excess) separately to each of the five types of non-pharmaceutical health care receivables. Next, the Academy applied the tiered factors developed to the five types of non-pharmaceutical health care receivables in aggregate and noted no appreciable difference. As such, Russell said he had no preference between the two approaches (standalone versus aggregate application). Russell said he also had no preference between the waterfall approach and the proportional allocation approach, as discussed by Nelson, based on the fact that both approaches ultimately yield the same total charges. Drutz described a scenario where a company has none of the non-pharmaceutical health care receivable types that exceed the \$10 million threshold individually but, in the aggregate, well exceed \$10 million. He asked Russell whether that company would benefit from the aggregate methodology so much that the range of reasonable outcomes the Academy targeted can no longer be achieved. Russell acknowledged the potential benefit but reassured the Working Group that the difference would be insignificant.

Drutz agreed and stated that the NAIC staff ran a query across 2018–2022 and noted that less than 10% of the health insurance companies filing health risk-based capital (RBC) blanks had non-pharmaceutical health care receivables aggregated to more than \$10 million. For 2022 alone, should the companies apply the modified proposed methodology, the risk charge on non-pharmaceutical health care receivables would be reduced by \$119 million compared to the original proposal.

Doggett said she is in favor of not making structural changes and that she is fine with the waterfall approach in the modified proposal. Garrison concurred. Doggett added that the door is still open for future structural change should the Working Group desire. Garrison thought the waterfall approach was clearer than the structural change approach.

Drutz said that in order to have a year-end 2024 effective date, the modified proposal needs to go through a shorter public comment period. He recommended a 14-day public comment period ending June 20. He said the Working Group may consider adoption via e-vote should there be no significant comments or discussions. There was no objection.

The Working Group agreed to re-expose proposal 2024-12-H (modified) for a 14-day public comment period ending June 20.

2. Forwarded a Referral Letter on Pandemic Risk to the Financial Analysis Solvency Tools (E) Working Group and Financial Examiners Handbook (E) Technical Group

Drutz said that during its Feb. 22 meeting, the Working Group directed NAIC staff to draft a referral to the Financial Analysis Solvency Tools (E) Working Group and Financial Examiners Handbook (E) Technical Group to inquire about whether pandemic risk should be addressed in the financial analysis and/or financial examination process, if it has not already been adequately addressed. The Working Group met April 16 and directed NAIC staff to expose the draft referral letter (Attachment Three-B) for a 30-day public comment period ending May 16. No comments were received.

Hearing no further questions or objections, the Working Group directed NAIC staff to forward the referral letter to the Financial Analysis Solvency Tools (E) Working Group and Financial Examiners Handbook (E) Technical Group.

3. Discussed the Excessive Growth Charge

Drutz said the Working Group met April 16 and received a report on the work performed by the Health Risk-Based Capital Excessive Growth Charge Ad Hoc Group. The report stated that the Ad Hoc Group reached a consensus after extensively exploring various alternatives, including member-month (MM) growth greater than 10%, disaggregation by lines of business, and Operational Risk Subgroup methodology. No specific alternative obviously outperformed the current excessive growth charge methodology. During that meeting, an interested party requested that the Working Group consider refining the methodology or removing large companies (companies with over 1 million MM) from the test. The Working Group directed NAIC staff to work with industry representatives to determine if there are other nuances to be introduced to the test to improve its predictive power for large companies. After meeting with UnitedHealth Group (UHG) April 26, an alternative was proposed to implement a safe harbor threshold of 20% (instead of 10% in the current methodology) for large companies only.

Analysis was performed using the 20% safe harbor for the period of 2013–2021 (Attachment Three-C). Drutz said the number of large companies that triggered the excessive growth charge and had a subsequent underwriting

loss declined under the proposed methodology. For example, in 2021, only three large companies (instead of 10) triggered the excessive growth charge and had an underwriting loss subsequently. However, the proposed methodology does not consistently outperform the existing methodology. For insurance, during the period of 2013–2015, underperformance was recorded, and there were also years when the improvement was marginal or close to none, such as in 2016 and 2018.

Drutz said the current excessive growth charge accounts for no more than one-half of 1% of total RBC before covariance. Neither of the possible refinements explored in the past years suggests there is a better alternative to the current methodology. Raising the safe harbor threshold to 20% has mixed results and decreases the number of companies triggering the charge. During the April meeting, at least one Working Group member voiced hesitancy about completely eliminating the charge for large companies. Given all these observations, Drutz asked the Working Group for ideas on how to move the project forward.

Doggett said that without any conclusive results, she would recommend keeping the current excessive growth charge methodology as is. Drutz said he appreciated the recommendation and suggested removing the excessive growth charge topic (X6) from the Working Group’s working agenda.

Hearing no further questions or objections, the Working Group consented to removing X6 from its working agenda.

4. Discussed Other Matters

Drutz said the Working Group plans to meet virtually in lieu of the Summer National Meeting, likely sometime in July.

Having no further business, the Health Risk-Based Capital (E) Working Group adjourned.

SharePoint/NAIC Support Staff Hub/Member Meetings/E CMTE/CADTF/2024-2-Summer/HRBCWG/6-6-2024 minutesTPR'd.docx

Draft: 4/22/2024

Health Risk-Based Capital (E) Working Group
Virtual Meeting
April 16, 2024

The Health Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met April 16, 2024. The following Working Group members participated: Steve Drutz, Chair (WA); Matthew Richard, Vice Chair, and Aaron Hodges (TX); Wanchin Chou and Sarah Mu (CT); Kyle Collins and Casey Koon (FL); Tish Becker (KS); Danielle Smith and Debbie Doggett (MO); Margaret Garrison (NE); and Diana Sherman (PA). Also participating was: Tom Botsko (OH).

1. Adopted its Feb. 22 Minutes

Drutz said the Working Group met Feb. 22. During this meeting, the Working Group took the following action: 1) adopted its Nov. 8, 2023, minutes; 2) exposed proposal 2024-09-CA for the Underwriting Risk Factors—Investment Income Adjustment for a 32-day public comment period ending March 25; 3) discussed comments received from UnitedHealth Group (UHG) on the American Academy of Actuaries’ (Academy’s) health care receivables presentation; 4) discussed pandemic risk and agreed to send a referral to the Financial Analysis Solvency Tools (E) Working Group and the Financial Examiners Handbook (E) Technical Group; 5) adopted its 2024 working agenda; and 6) heard an update from the Academy on the H2 – Underwriting Review project.

Sherman made a motion, seconded by Chou, to adopt the Working Group’s Feb. 22 (*see NAIC Proceedings – Fall 2023, Capital Adequacy (E) Task Force*) minutes. The motion passed unanimously.

2. Referred Proposal 2024-09-CA to the Capital Adequacy (E) Task Force

Drutz said the purpose of proposal 2024-09-CA (UW Risk Factors – Investment Income Adjustment) is to update the underwriting risk factors for the annual investment income adjustment to the comprehensive medical, Medicare supplement, and dental and vision lines of business. The proposal was originally exposed for a 32-day public comment period that ended March 25, and no comments were received.

Drutz said the proposal will affect all three lines of business and will need to be referred to the Capital Adequacy (E) Task Force for exposure. Botsko requested to obtain via email the impact of the factor changes for the three lines of business from NAIC staff.

Hearing no further question or objection, the Working Group referred proposal 2024-09-CA to the Capital Adequacy (E) Task Force for exposure during its late April call.

3. Heard an Update from the Academy on the Health Care Receivables presentation.

David Quinn (Academy) gave a presentation titled “Health Care Receivables Current and Proposed H3 Factors (Alternate)” (Attachment Three-D) to the Working Group. He said several changes were made in this presentation compared to the original presentation given in November 2023. Key modifications were detailed in slide three. One modification was removing life blank data in the updated presentation (Modification 1). Quinn said overall, the distribution of health care receivable types (pharmacy rebates vs. non-pharmacy rebates) by dollar does not change much with or without life blank data. Removal of life blank data only impacts 2022 company counts, as 2022 was the first year Exhibit 3a was in effect for life companies. Very little movement in the average collection

ratio is noted due to similar collection ratios observed among life companies and health companies. Another modification made in the updated presentation is the aggregation of the five non-pharmacy rebates receivables to apply to the tiered factors, with a tier cutoff point of \$10 million, as originally proposed (Modification 2). Quinn said that the reason a very minimal difference is observed with or without aggregation is because only very few companies have over \$10 million of aggregated non-pharmacy rebates receivables. Quinn said that after incorporating Modifications 1 and 2, the originally proposed factors and the tier cutoff still appear effective in achieving the goal summarized on slide 18. Quinn called out one number (-15%) in slide 24. He said he believed there was a miskey in the prior presentation that caused this -15% difference. He also cautioned the users that the dollar amount difference identified on slides 26 and 28 is not too meaningful because the change could be attributable to Modification 1, Modification 2, or both, and it is not easy to delineate which modifications contribute to what amount of dollar differences. Quinn concluded that the impact of adopting Modifications 1 and 2 is inconsequential. Drutz inquired whether it is reasonable to believe that only a small number of companies have non-pharmacy rebates receivables aggregated potentially over \$10 million. Quinn agreed. Jim Braue (UHG) asked how to interpret the \$137 million difference on slide 28. Quinn reiterated that the -\$137 million difference is attributable to Modifications 1 and 2, but he cannot quantify the impact made by each modification.

Quinn said the Academy received public feedback to deliberate the need to calibrate the health care receivable factors based on the relative weight of the health care receivable. Such a recommendation is grounded on the hypothesis that companies with health care receivables representing a higher percentage of capital and surplus should be more motivated to collect, thereby increasing the collection ratio (Hypothesis). The Academy used health care receivables as a percentage of claims as a proxy since claims data was more readily available. Quinn said that after performing the weighting analysis on slide 32, the Academy proposed not to calibrate factors by weight of health care receivable, as the analysis did not support the Hypothesis. Braue inquired whether it would be worthwhile to investigate the Hypothesis again just for companies with large ratios (health care receivables/claims or capital and surplus). Quinn deferred to the Working Group but agreed with Braue that there is no significant benefit to doing so, at least for the short term.

Drutz asked whether Working Group members have concerns about using tiered factors for health care receivables. There were no objections or discussion. Drutz said the next decision point is regarding whether the tiered factor should be applied to each health care receivable line (Option 1) or pharmacy and non-pharmacy rebates receivables in aggregate (Option 2). Drutz said Option 1 does not require structure change and can be implemented for 2024 reporting if adopted. Option 2 requires structure change and, therefore, cannot be implemented until 2025. The NAIC has drafted proposal 2024-12-H for Option 1. Without hearing any discussion or preference, Drutz directed exposure of proposal 2024-12-H for Option 1 for a 30-day comment period ending May 16.

4. Heard an Update from the Academy on the H-2 – Underwriting Risk Review

Matthew Williams (Academy) said the tiered risk-based capital (RBC) factor development (Track 2) work group continues to meet on a regular basis (typically weekly) to discuss various modeling and factor development considerations. Outside of the regular meetings, project teams are meeting to refine analysis and weigh the merits and constraints of current/proposed features of factor development. At the moment, the Academy is finalizing data exploration and analysis and continues to share additional questions with NAIC staff.

Williams said the Academy is in the process of generating a revised timeline but expects to have a draft finding available for review in the second half of 2024.

5. Exposed a Referral Letter to the Financial Analysis Solvency Tools (E) Working Group and Financial Examiners Handbook (E) Technical Group on Pandemic Risk

Drutz said during its Feb. 22 meeting, the Working Group directed NAIC staff to draft a referral to the Financial Analysis Solvency Tools (E) Working Group and Financial Examiners Handbook (E) Technical Group to inquire about whether the pandemic risk should be addressed in the financial analysis and/or financial examination process, if it has not already been addressed (Attachment Three-E). There was no further discussion.

There was no objection from the Working Group to expose the referral for a 30-day public comment period ending May 16.

6. Discussed the Excessive Growth Charge

Drutz said the Health RBC Excessive Growth Charge Ad Hoc Group met March 27 to discuss another methodology for assessing the excessive growth charge as recommended by the Operation Risk (E) Subgroup in 2019 (“Operational Risk SG methodology”). The suggested methodology reversed the variables used in the application of the growth safe harbor such that the excessive growth charge is triggered when the underwriting risk revenue is increasing faster than the growth rate of net underwriting risk RBC plus 10%. After reviewing the results of applying the Operational Risk SG methodology to a nine-year period (2013–2021), the ad hoc group concluded that the methodology did not perform better than the existing methodology in predicting an underwriting loss in the subsequent year.

To provide historical background, Drutz said that the analysis of the excessive growth risk charge was first taken up by the Operational Risk (E) Subgroup a number of years ago. Different analyses were considered at that time, but the subgroup was unable to find a reasonable alternative to the current methodology. That led to the referral to the Working Group to consider whether the existing methodology was working as intended. It included a request to determine if reversing the variables used in the formula yielded better results. It also included requests to determine whether the 10% threshold is still reasonable, whether the charge should apply to start-up companies, and whether the methodology should be adopted into the life RBC formula for companies that write a material amount of health business based on a specified percentage of premiums.

The issue related to the charge applying to start-up companies was addressed by adding a footnote to the RBC formula to base the charge on projected premiums. Analyses using different variables (including total revenue, total liabilities, total hospital and medical, and member months [MM]) were all considered, with growth in MM having the best correlation to when a company would be more likely to have an underwriting loss in the following year. While MM growth had the best overall correlation with underwriting losses in the following year, the correlation did not appear significantly better than the percentage of the general population of companies with an underwriting loss (the baseline). In addition, using higher MM growth rates as the trigger for a charge did not yield a significantly higher percentage of companies that would trigger the charge as compared to the baseline.

Drutz said that the ad hoc group reached a consensus that after an extensive exploration of various alternatives (e.g., MM growth greater than 10%, disaggregation by lines of business, Operational Risk SG methodology, etc.), there was no specific alternative that obviously outperformed the current excessive growth charge methodology. As such, the ad hoc group looked to the Working Group to determine the path forward. Drutz said his opinion was that the current methodology works reasonably well and better than the alternative calculations considered. He said, therefore, that the Working Group can either determine to keep the current excessive growth risk charge as

it currently stands or direct the ad hoc group to pursue alternatives if any Working Group members have ideas or suggestions. There were no questions, comments, or discussion from the Working Group.

Braue said that the “Disaggregated Results Based on Size of Company” (Attachment Three-F) graphically displayed that the current test, as well as the alternative test, did not perform well in terms of predicting subsequent years’ underwriting loss for large companies (defined as companies having over 1 million MM). He asked if the Working Group should pursue exempting large companies from the test in order to improve the test’s performance. Doggett said she is hesitant to remove large companies from the test. She suggested the Working Group work with industry members to determine if there are other nuances to be introduced to the test to improve its predictive power for large companies.

Drutz suggested disbanding the Excessive Growth Charge Ad Hoc Group and deferring future discussions to the Working Group. He said the excessive growth charge topic should not be removed from the working agenda until the observation on large companies raised by UHG is addressed. There was no objection from the Working Group.

Drutz asked if a Working Group member would direct NAIC staff to make a referral to the Life Risk-Based Capital (E) Working Group to deliberate on the need for the excessive growth charge. No Working Group member sponsored that referral; therefore, the referral was tabled for future consideration.

7. Discussed Other Matters

Drutz suggested discussing potential revisions to the working agenda based on the development of pandemic risk and excessive growth charge during the next Working Group meeting.

Having no further business, the Health Risk-Based Capital (E) Working Group adjourned.

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May 16, 2024

Steve Drutz, Chair
Health Risk-Based Capital (E) Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

By Email to Maggie Chang at mchang@NAIC.org and Steve Drutz at steve.drutz@oic.wa.gov

Re: Exposure of Proposal 2024-12-H

Dear Mr. Drutz:

On behalf of the members of America's Health Insurance Plans (AHIP), we appreciate the opportunity to provide comments on Proposal 2024-12-H regarding adjustments to Health Care Receivable factors in XR021 that was exposed during the Working Group's meeting held on April 16, 2024.

AHIP is also appreciative of the work done by the American Academy of Actuaries Health Care Receivables Factors Work Group and their presentations dated November 8, 2023 and April 16, 2024.

AHIP would like to request the Working Group's reconsideration of one item in regard to the non-pharmacy Health Care Receivable (HCR) factors. As was noted in previous Working Group discussions, the current H3 factors for non-pharmacy HCRs were developed by aggregating the data of the non-pharmacy HCRs together in order to achieve a sufficient volume of data and result in one factor that is applied to all of the non-pharmacy HCRs. The Academy studied this aggregation of non-pharmacy data in their revised April 16, 2024 presentation. Ultimately the Working Group's proposal for revised factors varying by volume tiers chose to apply the non-pharmacy tier of \$10 million to each individual non-pharmacy HCR rather than have the tier apply to all non-pharmacy HCRs combined. We believe this was done in part to avoid structural changes to XR021.

In the interest of remaining consistent with the aggregation methodology used to originally develop the H3 factors for non-pharmacy HCRs, AHIP would suggest that the \$10 million tier for the non-pharmacy HCR calculations be applied at the aggregate level. While it might be cleaner to apply such a change with a structural change to XR021, we do believe that the existing instructions and formula could be altered to account for this change.

Thank you for the opportunity to provide these comments. AHIP is looking forward to seeing how the revised factors and tiered approach impact the Health Care Receivable collection ratios. We look forward to continuing to work with the Health Risk-Based Capital (E) Working Group in the future.

Sincerely,

Bob Ridgeway
Bridgeway@ahip.org
501-333-2621

Ray Nelson – Consultant to AHIP
raymond.nelson@us.davies-group.com
224-217-9036



MEMORANDUM

TO: Greg Chew, Chair of Financial Analysis Solvency Tools (E) Working Group
Eli Snowbarger and John Litweiler, Co-Chairs of Financial Examiners Handbook (E) Technical Group

FROM: Steve Drutz, Chair of Health Risk-Based Capital (E) Working Group

DATE: March 22, 2024

RE: Referral for Pandemic Risk

In 2020, in light of the Covid-19 pandemic, the Health Risk-Based Capital (E) Working Group added into its working agenda an item to consider impact of COVID-19 and pandemic risks in the Health Risk-Based Capital (RBC) formula. During subsequent meetings held in 2023 and 2024, the Working Group evaluated whether RBC is the appropriate tool to capture pandemic risk. Some of the actions include:

- Looked into 2014 Health RBC interrogatories to analyze how companies allocated surplus or model for pandemic and biological risks.
- Received presentation by Texas Department of Insurance on “Pandemic Risk and Insurer Solvency – A Review of Personal Consumption Expenditures (PCE) on Healthcare Before, During, and After the COVID-19 Pandemic”.
- Reviewed RBC trends for an extended period (2015-2021).
- Considered capital requirements for pandemic risk in other jurisdictions (e.g., Solvency II).

One specific trend noted from the Texas Department of Insurance presentation was the decrease in healthcare expenditures during the pandemic, and the return to historical norms that occurred as the pandemic subsided. This appeared to increase the difficulty in adequately pricing policies post pandemic. Based on the work and findings above, the Working Group concluded that changes, resulting from pandemic risks, to the Health RBC formula are not warranted for the time being. The Working Group would like to ask the Financial Analysis Solvency Tools (E) Working Group and Financial Examiners Handbook (E) Technical Group to evaluate whether the pandemic risk is being sufficiently addressed from their perspective, and if not, the need for enhancement in the financial analysis and/or financial examination process.

If you have any questions, or would like to further discuss, please contact the Health Risk-Based Capital (E) Working Group chair or vice chair (Steve Drutz, Matthew Richard), or NAIC staff Maggie Chang (mchang@naic.org).

Cc: Julie Gann, Maggie Chang, Eva Yeung, Rodney Good, Bill Rivers, Ralph Villegas, Bailey Henning

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Growth Test Results of Queries - Based on Triggering Benchmark with an Underwriting Loss in the Following Year

Year	Baseline		Disaggregated Baseline for companies > 1M MM	
	# of Total Companies w/ an U/W Loss	% of Total Companies w/ an U/W Loss	# of Total Companies w/ an U/W Loss	% of Total Companies w/ an U/W Loss
2021	452	40%	80	20%
2020	460	44%	100	27%
2019	318	32%	43	12%
2018	366	39%	100	27%
2017	326	36%	78	21%
2016	329	37%	80	21%
2015	366	42%	109	29%
2014	377	44%	110	31%
2013	362	44%	105	31%

Year	Triggering Benchmark = Current Test			Triggering Benchmark = Based on 10% MM Growth			Triggering Benchmark = Based on Reversing 10% Threshold		
	# Cos Triggering	% of Companies Triggering	Difference from Baseline	# Cos Triggering	% of Companies Triggering	Difference from Baseline	# Cos Triggering	% of Companies Triggering	Difference from Baseline
2021	73	45%	5%	151	37%	-3%	67	52%	12%
2020	50	70%	26%	148	46%	2%	98	40%	-4%
2019	33	37%	5%	73	34%	2%	34	35%	3%
2018	22	49%	10%	92	41%	2%	52	43%	4%
2017	28	44%	8%	86	38%	2%	51	41%	5%
2016	53	60%	23%	122	43%	6%	43	41%	4%
2015	53	59%	17%	147	47%	5%	60	48%	6%
2014	62	60%	16%	139	44%	0%	40	35%	-9%
2013	36	53%	9%	89	43%	-1%	36	40%	-4%

Disaggregated Results Based on Size of Company (Size band by Member Months (MM))

Year	Based on Current Test (Difference in Total is Due to 0 MM Companies)			Based on 10% MM Growth		
	# Cos Triggering AND have U/W loss subsequent year (0-20K, 20K-100K, 100K-1M, >1M)	% of Companies Triggering AND have U/W loss subsequent year	Difference from Baseline	# Cos Triggering (0-20K, 20K-100K, 100K-1M, >1M)	% of Companies Triggering AND have U/W loss subsequent year	Difference from Baseline
2021	20, 11, 27, 10	71%, 52%, 56%, 17%	31%, 12%, 16%, -23%			
2020	23, 11, 7, 5	85%, 65%, 47%, 63%	41%, 21%, 3%, 19%			
2019	12, 10, 5, 4	60%, 67%, 20%, 17%	28%, 35%, -12%, -15%			
2018	10, 4, 4, 4	63%, 50%, 44%, 40%	24%, 11%, 5%, 1%			
2017	11, 3, 10, 2	79%, 43%, 43%, 14%	43%, 7%, 7%, -22%			
2016	13, 8, 16, 12	81%, 67%, 62%, 41%	44%, 30%, 25%, 4%			
2015	15, 8, 17, 12	79%, 80%, 63%, 39%	37%, 38%, 21%, -3%			
2014	12, 19, 17, 11	67%, 70%, 59%, 46%	25%, 26%, 19%, 2%			
2013	10, 7, 7, 9	59%, 70%, 54%, 41%	15%, 26%, 10%, -3%			

For companies over 1M Member Months (MM), use 20% as excessive growth safe harbour

Year	Triggering Benchmark = safe harbour 20% for companies over 1M MM				20% Safe Harbour
	# Cos Triggering AND have U/W Loss subsequent year	% of Companies Triggering AND have U/W Loss subsequent year	Difference from overall Baseline	Improvement (underperformance) from current test	
2021	3	21%	-19%	4%	1%
2020	1	100%	56%	37%	73%
2019	2	33%	1%	16%	21%
2018	2	40%	1%	0%	13%
2017	2	40%	4%	26%	19%
2016	5	42%	5%	1%	21%
2015	3	33%	-9%	-6%	4%
2014	3	38%	-7%	-9%	7%
2013	0	0%	-44%	-41%	-31%

RBC Statistics

Year	Industry Aggregated Excessive Growth		Total RBC Before Covariance	% of Total RBC Before Covariance
	Charge			
2021	221,810,536		86,088,680,244	0.26%
2020	152,344,797		73,985,158,328	0.21%
2019	98,665,133		68,762,077,526	0.14%
2018	43,685,938		63,525,815,586	0.07%
2017	96,339,347		60,318,297,216	0.16%
2016	218,535,115		58,717,892,148	0.37%
2015	158,655,196		54,145,297,113	0.29%
2014	205,395,550		49,008,627,972	0.42%
2013	143,808,800		44,214,480,776	0.33%

Health Care Receivables Current and Proposed H3 Factors (Alternate)

David A. Quinn, MAAA, FSA
Member, Health Care Receivables Factors Work Group
American Academy of Actuaries

Presentation to the National Association of Insurance Commissioners (NAIC)
Health Risk-Based Capital (E) Working Group
April 16, 2024



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Alternate

- This deck is a modified copy of the publicly available November 8, 2023, [presentation](#)
- The results contained within this presentation are a work in progress and should not be relied upon in draft form.
- It has two principal differences from the November 8, 2023, version
 - (1) Data from Life, Accident & Health, and Fraternal (Blue Blank) companies are omitted—Only Orange Blank data now
 - (2) Non-Rx HCR are aggregated and treated as one type of HCR instead of five separate HCRs
- An alternative weighting—based on the size of the HCR relative to the company's capital and surplus—was considered
- New slides are inserted to show the difference from the November 8 numbers and use a pink font color

Setting the Context


Authorized Control Level

- NAIC Risk-Based Capital Formula

Health Care Receivables (HCR)

- Part of the H3 Credit Risk
- Factors applied to all HCR assets are a part of the H3 result

$$\$Authorized\ Control\ Level = 1.03 \times \frac{H0 + \sqrt{(H1^2 + H2^2 + H3^2 + H4^2)}}{2}$$

Credit Risk


Applying HCR Factors

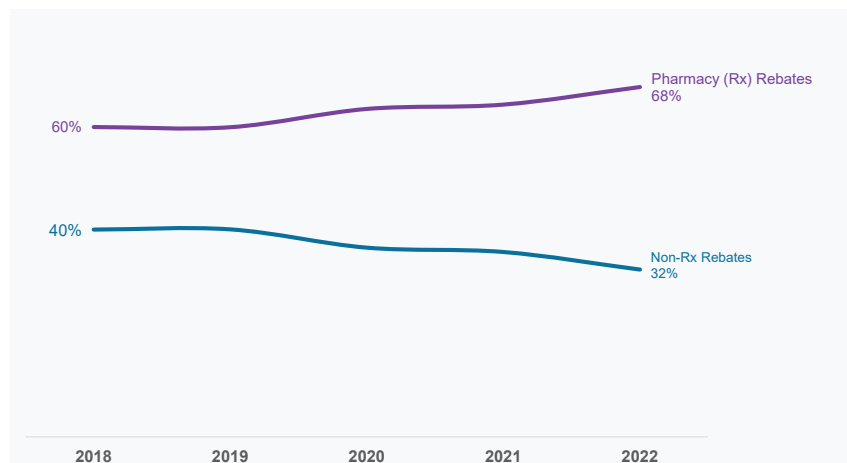
HCR Factors

- Vary by Pharmaceutical Rebates or Non-Pharmaceutical Rebates

HCR Type	Factor (Current)
Pharmaceutical (Rx) Rebate Receivables	0.05
Claim Overpayment Receivables	0.19
Loans and Advances to Providers	0.19
Capitation Arrangement Receivables	0.19
Risk Sharing Receivables	0.19
Other Health Care Receivables	0.19

} Non-Pharmaceutical Rebates Receivables

HCR Dollar Distributions (Only Orange Blanks)



Source: NAIC Annual Health Filings (Orange Blank) 2018–2022, for companies with established receivables

Collecting HCRs

$$\text{Collection Ratio} = \frac{\text{Surplus Component}_{t-1} + \text{Collections}_t}{\text{Admitted HCR Assets}_{t-1}}$$

- *Surplus Component*, prior year: Factors multiplied by admitted assets
- *Collections*, current year: Exhibit 3A Column 5 "Health Care Receivables in Prior Years (Columns 1 + 3)"
 - To clarify: includes collections made against non-admitted assets, as it did in the November 8 version
- *Admitted HCR Assets*, prior year: Exhibit 3 Column 7 "Admitted"
- *Collection Ratio*: Goal is for a company to collect $\geq 100\%$
- See Appendix A for exhibit layouts and column names

Collecting HCRs (Year)

Year (Rx Rebates HCR)	Company Count	Collection Ratio $\geq 100\%$
2019	519	87%
2020	559	83%
2021	621	86%
2022	655	84%
Year (Non-Rx Rebates HCR)	Company Count	Collection Ratio $\geq 100\%$
2019	366	85%
2020	402	79%
2021	411	81%
2022	440	79%

Data: NAIC Annual Health Filings (Orange Blank) 2018–2022, for companies with established receivables
 2018 is prior year input for 2019 results, so the table begins with 2019

Collecting HCRs (Year)

Year (Rx Rebates HCR)	Company Count	Collection Ratio $\geq 100\%$
2019	0	0%
2020	0	0%
2021	0	0%
2022	-19	1%

Year (Non-Rx Rebates HCR)	Company Count	Collection Ratio $\geq 100\%$
2019	0	0%
2020	0	0%
2021	0	0%
2022	-17	0%

Difference from prior version (November 8, 2023)

Collecting HCRs (Size)

- Each company has an HCR size by year for this analysis
- HCR size “Small” if total HCR <\$1 million, “Large” if \geq \$10 million, “Medium” otherwise
- HCR <\$0 were then excluded (rare) and HCR =\$0 were excluded (common)

Size (Rx Rebates HCR)	Company Count Four-year Avg.	Collection Ratio $\geq 100\%$
Small	111	79%
Medium	214	84%
Large	257	89%

Size (Non-Rx Rebates HCR)	Company Count Four-year Avg.	Collection Ratio $\geq 100\%$
Small	57	81%
Medium	136	79%
Large	205	84%

Source: NAIC Annual Health Filings (Orange Blank) 2018–2022, for companies with established receivables

Collecting HCRs (Size)

Size (Rx Rebates HCR)	Company Count Four-year Avg.	Collection Ratio ≥ 100%
Small	-1	0%
Medium	-2	0%
Large	-2	0%

Size (Non-Rx Rebates HCR)	Company Count Four-year Avg.	Collection Ratio ≥ 100%
Small	-2	1%
Medium	-1	0%
Large	-1	0%

Source: NAIC Annual Health Filings (Orange Blank) 2018–2022, for companies with established receivables

Difference from prior version (November 8, 2023)

Tiering HCR Factors

Proposed tiered HCR factors

- Smaller HCR-sized companies hold more surplus component
- Give larger HCR-sized companies credit for observed stability (higher counts of Collection Ratios ≥ 100%)

HCR Type	Current Factor	Tier 1 Factor	Tier Cutoff	Tier 2 Factor
Rx Rebate Receivables	0.05	0.20	\$5 Million	0.03
All Non-Rx Rebate Receivables	0.19	0.40	\$10 Million	0.05

Collecting HCRs (Year Revisited)

Improved Collection Ratio (CR) by year

Year (Rx Rebates HCR)	CR ≥100% (Current Factors)	CR ≥100% (Proposed Factors)
2019	87%	91% (+4%)
2020	83%	87% (+4%)
2021	86%	89% (+3%)
2022	84%	88% (+4%)

Year (Non-Rx Rebates HCR)	CR ≥100% (Current Factors)	CR ≥100% (Proposed Factors)
2019	85%	87% (+2%)
2020	79%	81% (+2%)
2021	81%	84% (+3%)
2022	79%	82% (+3%)

Source: NAIC Annual Health Filings (Orange Blank) 2018–2022, for companies with established receivables

Collecting HCRs (Year Revisited)

Difference from prior version (November 8, 2023)

Year (Rx Rebates HCR)	CR ≥100% (Current Factors)	CR ≥100% (Proposed Factors)
2019	0%	0% (+0%)
2020	0%	0% (+0%)
2021	0%	0% (+0%)
2022	1%	0% (-1%)

Year (Non-Rx Rebates HCR)	CR ≥100% (Current Factors)	CR ≥100% (Proposed Factors)
2019	0%	0% (+0%)
2020	0%	0% (+0%)
2021	0%	0% (+0%)
2022	0%	0% (+0%)

Source: NAIC Annual Health Filings (Orange Blank) 2018–2022, for companies with established receivables

Collecting HCRs (Size Revisited)

Improved collection by HCR size

Size (Rx Rebates HCR)	CR ≥ 100% (Current Factors)	CR ≥ 100% (Proposed Factors)
Small	79%	85% (+6%)
Medium	84%	90% (+6%)
Large	89%	90% (+1%)

Size (Non-Rx Rebates HCR)	CR ≥ 100% (Current Factors)	CR ≥ 100% (Proposed Factors)
Small	81%	82% (+1%)
Medium	79%	82% (+3%)
Large	84%	85% (+1%)

Source: NAIC Annual Health Filings (Orange Blank) 2018–2022, for companies with established receivables

Collecting HCRs (Size Revisited)

Difference from prior version (November 8, 2023)

Size (Rx Rebates HCR)	CR ≥ 100% (Current Factors)	CR ≥ 100% (Proposed Factors)
Small	0%	0% (+0%)
Medium	0%	0% (+0%)
Large	0%	0% (+0%)

Size (Non-Rx Rebates HCR)	CR ≥ 100% (Current Factors)	CR ≥ 100% (Proposed Factors)
Small	1%	1% (+0%)
Medium	0%	-1% (-1%)
Large	0%	-1% (-1%)

Source: NAIC Annual Health Filings (Orange Blank) 2018–2022, for companies with established receivables

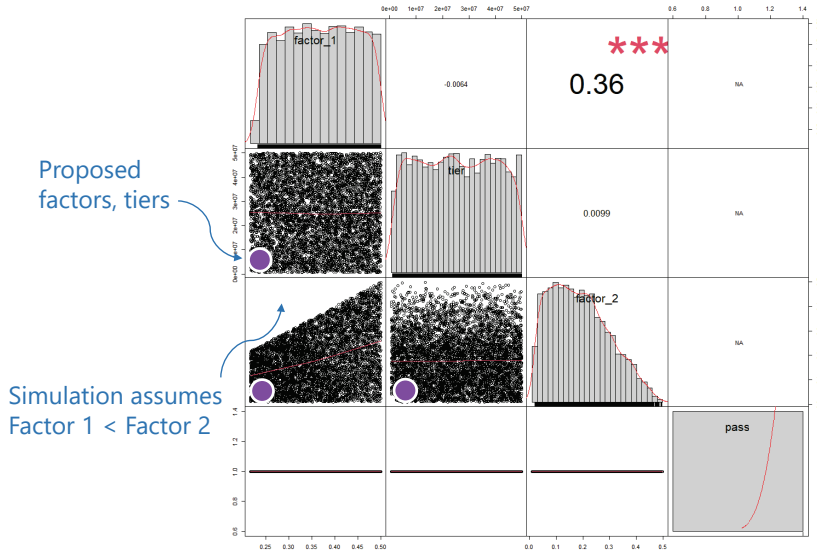
First Proposed Tier Factors

- Which combinations of factors and tier cutoffs work?
- Monte Carlo simulation

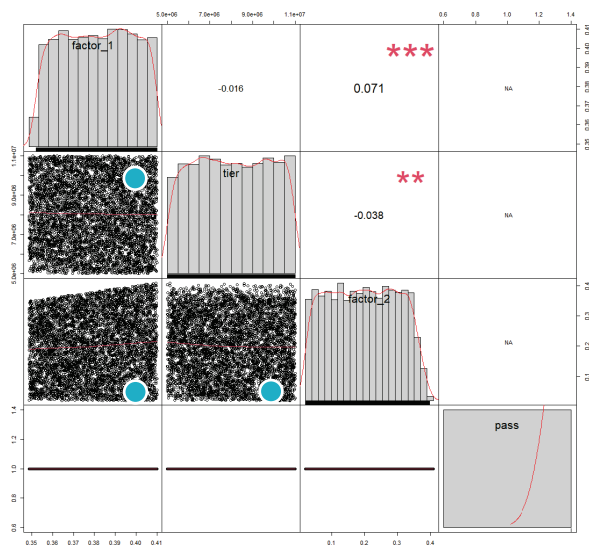
First Proposed Tier Factors

- Goal of percent of companies meeting Collection Ratios $\geq 100\%$
 - 90%–100% for Rx HCR
 - 90%–100% for Non-Rx HCR
 - For 10 or more of the 15 size and line combinations (3x sizes by 5x Non-Rx HCR types)
 - Acknowledge variance in reporting accuracy (more on this later)
- Many combinations of factors and tier cutoffs work
 - There's flexibility in the final factors and tier cutoff
 - Each black dot on the next charts is a possible solution

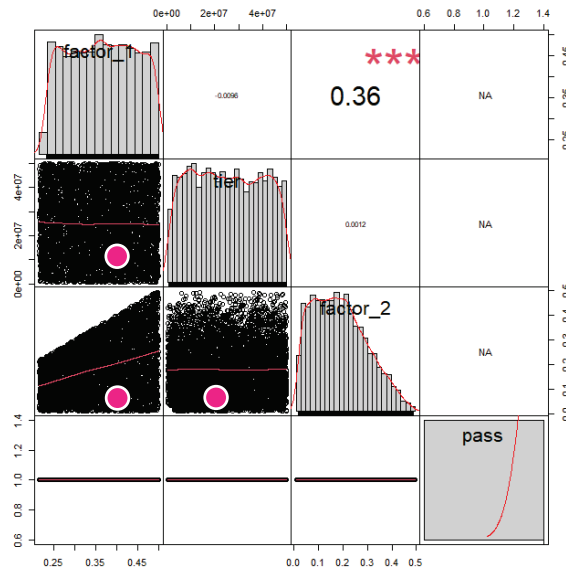
Proposed Factors and Tiers (Rx Rebate HCR)



Proposed Factors and Tiers (Non-Rx Rebates HCR)



Proposed Factors and Tiers (Non-Rx Rebates HCR)



Limitations and Considerations

- Recommendation subject to approval and comment
- Reporting Accuracy
 - Parity between prior year Exhibit 3 and current year Exhibit 3A
 - A company may establish a prior HCR but collect on it in a way not reported in Exhibit 3A
- HCR Size
 - Many combinations of tiers and tier cutoffs
 - Smaller tier threshold, higher factor
 - Proposed factors will have variable impacts on companies

Surplus Component Change in H3 (Proposal)

2022 Data

HCR Type	Co. with an Increased H3 (+)	Co. with a Decreased H3 (-)	Avg. Relative Change in H3 (+)	Avg. Relative Change in H3 (-)	Largest Magnitude Relative Change (+)	Largest Magnitude Relative Change (-)
Rx Rebate HCR	89%	11%	+241%	-19%	+300%	-38%
Non-Rx Rebates HCR	88%	12%	+106%	-29%	+111%	-70%

Source: NAIC Annual Health Filings (Orange Blank) 2018–2022, for companies with established receivables

Surplus Component Change in H3 (Proposal)

Difference from November 8, 2023

HCR Type	Co. with an Increased H3 (+)	Co. with a Decreased H3 (-)	Avg. Relative Change in H3 (+)	Avg. Relative Change in H3 (-)	Largest Magnitude Relative Change (+)	Largest Magnitude Relative Change (-)
Rx Rebate HCR	0%	0%	+1%	+1%	0%	+1%
Non-Rx Rebates HCR	-3%	+3%	+1%	-15%	0%	-1%

Source: NAIC Annual Health Filings (Orange Blank) 2018–2022, for companies with established receivables

Surplus Component Change in H3

Rx Rebate HCR (2022)

Rx Rebate HCR (\$ Millions)	H3 Surplus <i>Before Proposal</i>	H3 Surplus <i>After Proposal</i>	Difference
If an Increase (+)	\$167	\$350	\$183
If a Decrease (-)	\$484	\$351	-\$133
Total	\$651	\$701	\$50

Surplus Component Change in H3

Difference from prior version (November 8, 2023)

Rx Rebate HCR (\$ Millions)	H3 Surplus <i>Before Proposal</i>	H3 Surplus <i>After Proposal</i>	Difference
If an Increase (+)	-\$21	-\$35	-\$14
If a Decrease (-)	-\$296	-\$184	+\$112
Total	-\$317	-\$219	+\$98

Surplus Component Change in H3

Non-Rx Rebate HCR (2022)

Non-Rx Rebate HCR (\$ Millions)	H3 Surplus <i>Before Proposal</i>	H3 Surplus <i>After Proposal</i>	Difference
If an Increase (+)	\$203	\$371	\$168
If a Decrease (-)	\$750	\$369	-\$381
Total	\$953	\$740	-\$213

Surplus Component Change in H3

Difference from prior version (November 8, 2023)

Non-Rx Rebate HCR (\$ Millions)	H3 Surplus <i>Before Proposal</i>	H3 Surplus <i>After Proposal</i>	Difference
If an Increase (+)	-\$123	-\$180	-\$57
If a Decrease (-)	+\$120	+\$40	-\$80
Total	-\$3	-\$140	-\$137

Weighting Companies

Idea from public comments to use the HCR as a percent of capital and surplus as a weight (POCS)

- Hypothesis: Companies with higher POCS are more motivated to collect

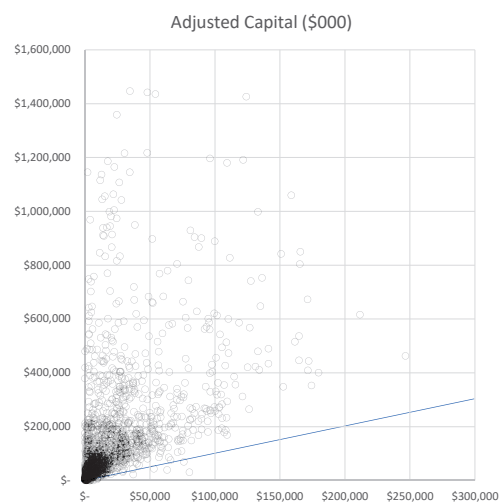
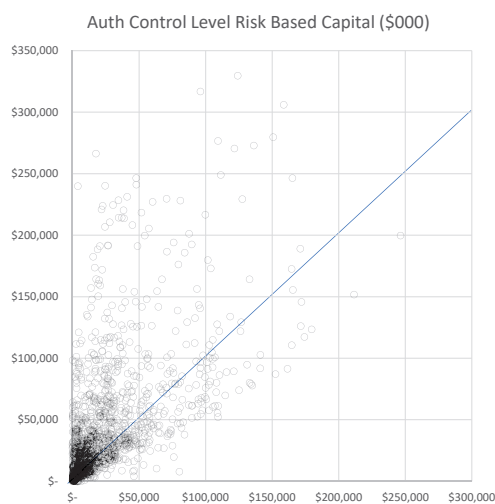
Exhibit 3, Exhibit 3A, and Underwriting and Investment (U&I) Exhibit Part 2B do not show the capital and surplus amounts

- However, U&I Part 2B has claims (row 9) and HCR amounts (row 10)
 - Use HCR as a percentage of claims as a proxy for POCS
 - Estimated Claims Reserve and Claims Liability December 31 of Prior Year (column 6)

Weighting Companies

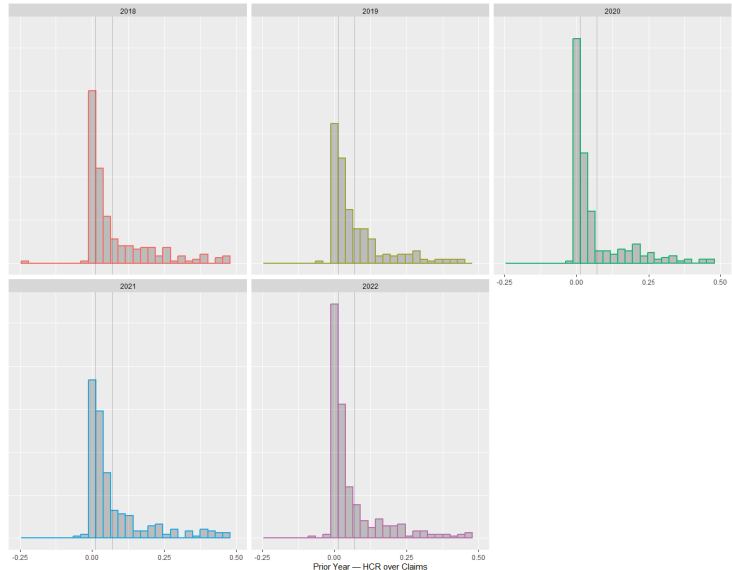
2022 SOA
 Medicaid
 Underwriting
 Margin Model

Medicaid NAIC data
 2013–2020
 (x-axis: medical loss in
 thousands)



Weighting Companies

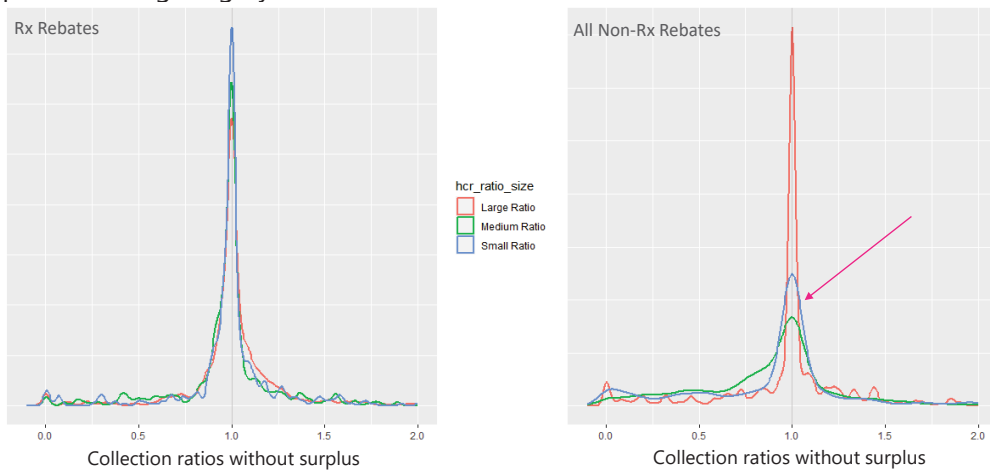
- Only Orange Blank
- **HCR dollars as percent of Claims by year**
 - x-axis
 - Net of reinsurance
- Consistent distribution by year
 - Small: 0%–1.25%
 - Medium: 1.25%–7.00%
 - Large: >7.00%



Source: NAIC Annual Health Filings (Orange Blank) 2018–2022, for companies with established receivables

Weighting Companies

- Lacks increasing collection results as HCR as a percent of claims (a POCS proxy) increases
 - Propose *not* weighting by HCR as a POCS



Source: NAIC Annual Health Filings (Orange Blank) 2018–2022, for companies with established receivables

Appendix A: Exhibit 3, Exhibit 3A Examples

EXHIBIT 3 – HEALTH CARE RECEIVABLES

ANNUAL STATEMENT FOR THE YEAR 2013

1 Name of Debtor	2 1 – 30 Days	3 31 – 60 Days	4 61 – 90 Days	5 Over 90 Days	6 Non-admitted	7 Admitted
Pharmaceutical rebate receivables						
Claim overpayment receivables						
Loans and advances to providers						
Capitation arrangement receivables						
Risk sharing receivables						
Other receivables						
Gross health care receivables					R6	R7

EXHIBIT 3A – ANALYSIS OF HEALTH CARE RECEIVABLES COLLECTED AND ACCRUED

Type of Health Care Receivable	Health Care Receivables Collected During the Year		Health Care Receivables Accrued as of December 31 of Current Year		5 Health Care Receivables in Prior Years (Columns 1 + 3)	6 Estimated Health Care Receivables Accrued as of December 31 of Prior Year
	1 On Amounts Accrued Prior to January 1 of Current Year	2 On Amounts Accrued During the Year	3 On Amounts Accrued December 31 of Prior Year	4 On Amounts Accrued During the Year		
1. Pharmaceutical rebate receivables						
2. Claim overpayment receivables						
3. Loans and advances to providers						
4. Capitation arrangement receivables						
5. Risk sharing receivables						
6. Other health care receivables						
7. Totals (Lines 1 through 6)			A3 = B1 + B3	A4 = B2 + B4		A6 = Prior Yr(R6+R7)



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Appendix B: U&I Part 2B

UNDERWRITING AND INVESTMENT EXHIBIT

ANNUAL STATEMENT FOR THE YEAR 2013

PART 2B - ANALYSIS OF CLAIMS UNPAID - PRIOR YEAR - NET OF REINSURANCE

Line of Business	Claims Paid During the Year		Claim Reserve and Claim Liability December 31 of Current Year		5 Claims Incurred in Prior Years (Columns 1 + 3)	6 Estimated Claim Reserve and Claim Liability December 31 of Prior Year
	1 On Claims Incurred Prior to January 1 of Current Year	2 On Claims Incurred During the Year	3 On Claims Unpaid December 31 of Prior Year	4 On Claims Incurred During the Year		
1. Comprehensive (hospital and medical)						
2. Medicare Supplement						
3. Dental						
4. Vision						
5. Federal Employees Health Benefits Plan						
6. Title XVIII - Medicare						
7. Title XIX - Medicaid						
8. Other health						
9. Health subtotal (Lines 1 to 8)						
10. Health care receivables (a)	B1	B2	B3	B4		B6 = Prior Yr(R6+R7)
11. Other non-health						
12. Medical incentive pools and bonus amounts						
13. Totals (Lines 9–10+11+12)						

(a) excludes _____ loans or advances to providers not yet expensed

B1 + B2 + B3 + B4 = R6 + R7 [assumes no amounts in the 10(a) footnote]



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Questions?

Thank You

For more information, please contact

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American Academy of Actuaries

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MEMORANDUM

TO: Greg Chew, Chair of Financial Analysis Solvency Tools (E) Working Group
Eli Snowbarger and John Litweiler, Co-Chairs of Financial Examiners Handbook (E) Technical Group

FROM: Steve Drutz, Chair of Health Risk-Based Capital (E) Working Group

DATE: March 22, 2024

RE: Referral for Pandemic Risk

In 2020, in light of the Covid-19 pandemic, the Health Risk-Based Capital (E) Working Group added into its working agenda an item to consider impact of COVID-19 and pandemic risks in the Health Risk-Based Capital (RBC) formula. During subsequent meetings held in 2023 and 2024, the Working Group evaluated whether RBC is the appropriate tool to capture pandemic risk. Some of the actions include:

- Looked into 2014 Health RBC interrogatories to analyze how companies allocated surplus or model for pandemic and biological risks.
- Received presentation by Texas Department of Insurance on “Pandemic Risk and Insurer Solvency – A Review of Personal Consumption Expenditures (PCE) on Healthcare Before, During, and After the COVID-19 Pandemic”.
- Reviewed RBC trends for an extended period (2015-2021).
- Considered capital requirements for pandemic risk in other jurisdictions (e.g., Solvency II).

One specific trend noted from the Texas Department of Insurance presentation was the decrease in healthcare expenditures during the pandemic, and the return to historical norms that occurred as the pandemic subsided. This appeared to increase the difficulty in adequately pricing policies post pandemic. Based on the work and findings above, the Working Group concluded that changes, resulting from pandemic risks, to the Health RBC formula are not warranted for the time being. The Working Group would like to ask the Financial Analysis Solvency Tools (E) Working Group and Financial Examiners Handbook (E) Technical Group to evaluate whether the pandemic risk is being sufficiently addressed from their perspective, and if not, the need for enhancement in the financial analysis and/or financial examination process.

If you have any questions, or would like to further discuss, please contact the Health Risk-Based Capital (E) Working Group chair or vice chair (Steve Drutz, Matthew Richard), or NAIC staff Maggie Chang (mchang@naic.org).

Cc: Julie Gann, Maggie Chang, Eva Yeung, Rodney Good, Bill Rivers, Ralph Villegas, Bailey Henning

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Growth Test Results of Queries - Based on Triggering Benchmark with an Underwriting Loss in the Following Year

Year	Baseline	
	# of Total Companies w/ an U/W Loss	% of Total Companies w/ an U/W Loss
2022	432	40%
2021	460	44%
2020	318	32%
2019	366	39%
2018	326	36%
2017	329	37%
2016	366	42%
2015	377	44%
2014	362	44%

Year	Triggering Benchmark = Current Test			Triggering Benchmark = Based on 10% MM Growth			Triggering Benchmark = Based on Reversing 10% Threshold		
	# Cos Triggering	% of Companies Triggering	Difference from Baseline	# Cos Triggering	% of Companies Triggering	Difference from Baseline	# Cos Triggering	% of Companies Triggering	Difference from Baseline
2022	73	45%	5%	151	37%	-3%	67	52%	12%
2021	50	70%	26%	148	46%	2%	98	40%	-4%
2020	33	37%	5%	73	34%	2%	34	35%	3%
2019	22	49%	10%	92	41%	2%	52	43%	4%
2018	28	44%	8%	86	38%	2%	51	41%	5%
2017	53	60%	23%	122	43%	6%	43	41%	4%
2016	53	59%	17%	147	47%	5%	60	48%	6%
2015	62	60%	16%	139	44%	0%	40	35%	-9%
2014	36	53%	9%	89	43%	-1%	36	40%	-4%

Disaggregated Results Based on Size of Company (Size band by Member Months (MM))

Year	Based on Current Test (Difference in Total is Due to 0 MM Companies)			Based on 10% MM Growth		
	# Cos Triggering (0-20K, 20K-100K, 100K-1M, >1M)	% of Companies Triggering	Difference from Baseline	# Cos Triggering (0-20K, 20K-100K, 100K-1M, >1M)	% of Companies Triggering	Difference from Baseline
2022	20, 11, 27, 10	71%, 52%, 56%, 17%	31%, 12%, 16%, -23%	56, 30, 37, 28	65%, 53%, 33%, 19%	25%, 13%, -7%, -21%
2021	23, 11, 7, 5	85%, 65%, 47%, 63%	41%, 21%, 3%, 19%	50, 36, 41, 21	68%, 67%, 39% 23%	24%, 23%, -5%, -21%
2020	12, 10, 5, 4	60%, 67%, 20%, 17%	28%, 35%, -12%, -15%	26, 20, 21, 6	54%, 56%, 29%, 11%	22%, 24%, -3%, -21%
2019	10, 4, 4, 4	63%, 50%, 44%, 40%	24%, 11%, 5%, 1%	29, 16, 22, 25	71%, 47%, 29%, 34%	32%, 8%, -10%, -5%
2018	11, 3, 10, 2	79%, 43%, 43%, 14%	43%, 7%, 7%, -22%	27, 15, 29, 15	71%, 58%, 39%, 17%	35%, 22%, 3%, -22%
2017	13, 8, 16, 12	81%, 67%, 62%, 41%	44%, 30%, 25%, 4%	23, 18, 49, 32	70%, 47%, 48%, 29%	33%, 10%, 11%, -8%
2016	15, 8, 17, 12	79%, 80%, 63%, 39%	37%, 38%, 21%, -3%	17, 22, 56, 52	57%, 58%, 56%, 35%	15%, 16%, 14%, -7%
2015	12, 19, 17, 11	67%, 70%, 59%, 46%	25%, 26%, 19%, 2%	22, 29, 46, 42	69%, 66%, 46%, 31%	25%, 22%, 2%, -13%
2014	10, 7, 7, 9	59%, 70%, 54%, 41%	15%, 26%, 10%, -3%	16, 13, 35, 25	55%, 50%, 51%, 30%	11%, 6%, 7%, -14%

Draft Pending Adoption

Attachment Four
Capital Adequacy (E) Task Force
8/14/24

Draft: 8/21/24

Life Risk-Based Capital (E) Working Group
Chicago, Illinois
August 14, 2024

The Life Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met in Chicago, IL, Aug. 14, 2024. The following Working Group members participated: Thomas Reedy, Acting Chair (CA); Ben Slutsker, Vice Chair (MN); Sheila Travis and Sanjeev Chaudhuri (AL); Wanchin Chou (CT); Vincent Tsang (IL); Mike Yanacheak and Kevin Clark (IA); William Leung and John Rehagen (MO); Margaret Garrison (NE); Jennifer Li (NH); Seong-min Eom (NJ); Bill Carmello (NY); Rachel Hemphill (TX); and Tomasz Serbinowski (UT). Also participating were: Kevin Dyke (MI); Fred Andersen (MN); Tom Botsko and Peter Weber (OH); and Diana Sherman (PA).

1. Adopted its June 18, April 19, and Spring National Meeting Minutes

The Working Group met June 18 and April 19. During these meetings, the Working Group took the following action: 1) adopted proposal 2024-15-L to address collateral loans; 2) adopted proposal 2024-17-L to add a factor for omitted Schedule BA mortgages; 3) adopted proposal 2024-04-L to add a line for total adjusted capital (TAC) adjustment for non-admitted affiliates; 4) adopted proposal 2024-05-L to add a line to Schedule BA mortgages for omitted asset valuation reserve (AVR); 5) discussed covariance; 6) discussed C-3 risk; 7) discussed proposal 2024-03-L (repurchase agreements); and 8) discussed proposal 2024-07-L (other long-term assets).

Chou made a motion, seconded by Yanacheak, to adopt the Working Group's June 18 (Attachment Four-A), April 19 (Attachment Four-B), and March 17 (*see NAIC Proceedings – Spring 2024, Capital Adequacy (E) Task Force*) minutes. The motion passed unanimously.

2. Received Updates from its Subgroups

A. Generator of Economic Scenarios (GOES) (E/A) Subgroup

Yanacheak said the Subgroup conducted a field test of a revised calibration of the GOES from April to July. He added that the Subgroup is holding meetings in regulator-to-regulator session to discuss field test results with participants and that variable annuity (VA) and life insurance model office testing have been performed alongside the field testing. He said the next steps before the Subgroup are to:

- Finish the remaining participant-to-regulator discussions and summarize the field test's key insights in the GOES (E/A) Subgroup's public meetings.
- Request the model office testing and/or analysis be evaluated against other key deliverables for the GOES project.
- Schedule a series of GOES (E/A) Subgroup calls to continue working toward implementation. Subgroup meetings will focus on building out a GOES model governance framework, improving documentation, finalizing the stochastic exclusion ratio test (SERT) scenarios, and making any adjustments to the GOES calibration after reviewing feedback from the field test.
- Make a series of recommendations to the Life Actuarial (A) Task Force and the Life Risk-Based Capital (E) Working Group for deliberation and adoption. Given where the Subgroup is in the timeline, adoption is not expected to occur and be effective sooner than 2026. However, Yanacheak made it clear that the GOES (E/A) Subgroup intends to push as hard as the Subgroup can to implement the GOES for 2026.

Draft Pending Adoption

Attachment Four
Capital Adequacy (E) Task Force
8/14/24

B. Longevity Risk (E/A) Subgroup

Eom reported that the Subgroup is currently waiting for more progress on the draft of Valuation Manual (VM)-22, Statutory Maximum Valuation Interest Rates for Income Annuities. She stated that VM-22 has been exposed and is currently being discussed. Eom stated that the Subgroup is also waiting for a field-testing follow-up of the current goals field test of VM-20, Requirements for Principle-Based Reserves for Life Products and VM-21, Requirements for Principle-Based Reserves for Variable Annuities.

C. Variable Annuities Capital and Reserve (E/A) Subgroup

Weber said the Subgroup has met twice since the Spring National Meeting, and that was the culmination of work to update the assumptions in a portion of the VM-21 reserve calculation.

3. Adopted the 2024 Life RBC Newsletter

Chou made a motion, seconded by Yanacheak, to adopt the 2024 life risk-based capital (RBC) newsletter (Attachment Four-C). The motion passed unanimously.

4. Adopted the 2023 Life RBC Statistics

Yanacheak made a motion, seconded by Andersen, to adopt the 2023 life RBC statistics (Attachment Four-D). The motion passed unanimously.

The Working Group noted Tsang's observations regarding high RBC weights on C-1 asset default risk, while fewer weights are given to C-2 insurance risk and C-3 interest rate risk as an issue that should be discussed further.

5. Discussed a Referral on Investments in Tax Credit Structures

The Working Group received a referral from the Statutory Accounting Principles (E) Working Group regarding investments in tax credit structures (Attachment Four-E) and noted the following: 1) the Statutory Accounting Principles (E) Working Group adopted changes to accounting guidance for tax credit investments; 2) the Blanks (E) Working Group adopted proposal 2024-11-BWG, which removed the federal guaranteed tax credit investments category; and 3) NAIC staff are working on an RBC proposal to accommodate the adopted blanks changes.

6. Discussed the Schedule BA Proposal for Non-Bond Debt Securities

The Working Group discussed the following updates to the Schedule BA proposal for non-bond debt securities (Attachment Four-F): 1) there are new reporting lines for non-bond debt securities; and 2) existing Schedule BA concepts where an entity can file securities that do not qualify as a bond with the Securities Valuation Office (SVO) have been incorporated, and if they receive an SVO-assigned designation, for life companies, it would then flow through the asset valuation reserve (AVR) and receive life RBC bond factors. This is expected to go into effect Jan. 1, 2025.

Draft Pending Adoption

Attachment Four
Capital Adequacy (E) Task Force
8/14/24

7. Adopted its Working Agenda

Chou made a motion, seconded by Yanacheak, to adopt the Working Group's working agenda (Attachment Seven). The motion passed, subject to edits suggested by Clark and Chou to the item regarding the Schedule BA proposal for non-bond debt securities and the item on the RBC statistics, along with the addition to the working agenda of the proposal for the separation of Schedule D into Schedules D, Part 1, Section 1 and Schedule D, Part 1, Section 2.

Having no further business, the Life Risk-Based Capital (E) Working Group adjourned.

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Draft: 8/5/24

Life Risk-Based Capital (E) Working Group
Virtual Meeting
June 18, 2024

The Life Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met June 18, 2024. The following Working Group members participated: Philip Barlow, Chair (DC); Ben Slutsker, Vice Chair (MN); Sanjeev Chaudhuri (AL); Thomas Reedy (CA); Lei Rao-Knight (CT); Carolyn Morgan (FL); Mike Yanacheak (IA); Vincent Tsang and Bruce Sartain (IL); William Leung (MO); Michael Muldoon (NE); Seong-min Eom (NJ); Bill Carmello (NY); Andrew Schallhorn (OK); Aaron Hodges (TX); and Tomasz Serbinowski (UT). Also participating was: Tom Botsko (OH).

1. Adopted Proposal 2024-15-L Collateral Loans

The Working Group considered proposal 2024-15-L to add collateral loan instructional changes and add a line reference.

Leung made a motion, seconded by Reedy, to adopt proposal 2024-15-L (Attachment One-C). The motion passed unanimously.

2. Adopted Proposal 2024-17-L BA Mortgage

The Working Group considered proposal 2024-17-L to add a factor for the line added to LR009 to specifically address line 44 of the Asset Valuation Reserve (AVR) Equity Component as part of proposal 2024-05-L.

Slutsker made a motion, seconded by Reedy, to adopt proposal 2024-17-L (Attachment One-D). The motion passed unanimously.

3. Discussed Covariance

Paul Navratil (American Academy of Actuaries—Academy) presented an update on the Academy's work on correlation. He provided background and the justification for the presentation (Attachment 1) And discussed the correlation between C-risks as well as the correlation within individual C-risks (such as within C-1o). He said the Academy is in the process of gathering data from publicly available sources and other regulatory frameworks to calibrate the top three elements (credit, interest rate, and equity markets) and would come back to the Working Group later in the year with specific recommendations. He said this is a good time to review the formula and correlation because these have not been reviewed in a while.

Tsang said risk-based capital (RBC) is not an individual company's instrument but an instrument for the entire industry. He urged regulators to keep in mind that covariance would not affect every company the same way, and therefore, they should not expect the new matrix presented to solve the problem.

Navratil responded by saying the purpose of applying RBC as a tool for individual companies is to help regulators identify companies that may be weakly capitalized, but the impact of correlation would be different across companies. However, he said his goal is to establish a guiding principle that aligns with each company's risk profile in a way that helps regulators distinguish between companies with concentrated risk exposure and little benefit from diversification of risks from companies that are well-capitalized due to diversified risks.

Barlow asked if other regulatory frameworks could be pulled together and compared side by side. Navratil said it is possible and that the Academy would provide an overview of what is done in other regulatory frameworks. This would give insights and an understanding of why and how they arrived at the correlations that they chose. Barlow said the Working Group is looking forward to additional work by the Academy, and it will assist the Academy as needed.

4. Discussed C-3 Risk

Link Richardson (Academy) presented C-3 methodology considerations and suggestions (Attachment 2) and highlighted nine key differences between C-3 Phase 1 and Phase 2 frameworks. Slutsker asked if the proposed instructions would be included in the field test for Valuation Manual (VM)-22 and asked if it would make sense to have the Academy bring the instructions to the Working Group as part of a formal process or just make them part of the field test. Richardson said that it would make sense to bring the instructions back to the Working Group for consideration.

Having no further business, the Life Risk-Based Capital (E) Working Group adjourned.

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Draft: 6/3/24

Life Risk-Based Capital (E) Working Group
Virtual Meeting
April 19, 2024

The Life Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met April 19, 2024. The following Working Group members participated: Philip Barlow, Chair (DC); Ben Slutsker, Vice Chair (MN); Thomas Reedy (CA); Wanchin Chou (CT); Hannah Howard (FL); Mike Yanacheak (IA); Vincent Tsang (IL); William Leung (MO); Lindsay Crawford (NE); Jennifer Li (NH); Seong-min Eom (NJ); Bill Carmello (NY); Andrew Schallhorn (OK); and Rachel Hemphill (TX).

1. Adopted Proposal 2024-04-L to Add a Line to TAC Adjustment for Non-Admitted Affiliates

The Working Group considered proposal 2024-04-L to add a line to “Total Adjusted Capital (TAC) Adjustment for Non-Admitted Affiliates.”

Leung made a motion, seconded by Slutsker, to adopt proposal 2024-04-L (Attachment Two-A). The motion passed.

2. Adopted Proposal 2024-05-L to Add a Line to the Schedule BA Mortgages for Omitted AVR Line

The Working Group next considered proposal 2024-05-L to add a line to the “Schedule BA Mortgages for Omitted Asset Valuation Reserve (AVR) Line,” a structural change that would be implemented in 2024.

Reedy made a motion, seconded by Schallhorn, to adopt proposal 2024-05-L (Attachment Two-B). The motion passed.

3. Exposed the ACLI’s Collateral Loan Proposal for Instructional and Line Reference Changes

The Working Group next considered the American Council of Life Insurers’ (ACLI’s) collateral loan proposal and exposed the following items for a 30-day public comment period.: 1) the ACLI’s collateral loan changes proposal; 2) a proposal for instructional change; and 3) a proposal to add a line reference change.

4. Discussed the ACLI’s Repurchase Agreement Proposal

The Working Group took the following action regarding the ACLI’s repurchase agreement proposal: 1) suspended further re-exposure of the proposal (however, the Working Group is still open to receiving any comments from the other interested groups); and 2) deferred the adoption of the proposal until 2025.

5. Discussed the Other Long-Term Assets Proposal

The Working Group took the following action regarding the other long-term assets proposal: 1) deferred proposal consideration until 2025 due to other changes being made to the statutory accounting principle (SAP); 2) agreed to monitor other work or changes regarding the proposal and whether they necessitate that the proposal be considered as a standalone proposal or that it incorporate the changes in its present form for a bigger holistic review of the proposal.

6. Discussed Other Matters

The Working Group was informed of upcoming updates from the American Academy of Actuaries (Academy) regarding matters being handled on behalf of the Working Group, which will be scheduled for a later date. The Working Group will discuss covariance during another meeting that has yet to be scheduled.

Having no further business, the Life Risk-Based Capital (E) Working Group adjourned.

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Newsletter Items for Adoption for 2024 for Life and Fraternal RBC

Date: August 2024

Volume: 30

Page 1: Intro Section:

What Risk-Based Capital Pages Should Be Submitted?

For year-end 2024 life and fraternal risk-based capital (RBC), submit hard copies of pages LR001 through LR049 to any state that requests a hard copy in addition to the electronic filing. Starting with year-end 2007 RBC, a hard copy was not required to be submitted to the NAIC. However, a PDF file representing the hard copy filing is part of the electronic filing.

If any actuarial certifications are required per the RBC instructions, those should be included as part of the hard copy filing. Starting with year-end 2008 RBC, the actuarial certifications were also part of the electronic RBC filing as PDF files, similar to the financial annual statement actuarial opinion.

Other pages, such as the mortgage and real estate worksheets, do not need to be submitted. However, they still need to be retained by the company as documentation.

Page 1+: Items Adopted for 2024:

Addition of Line to Total Adjusted Capital

The Capital Adequacy (E) Task Force adopted proposal 2024-04-L during its April 30 meeting. This proposal adds a line to LR033, Calculation of Total Adjusted Capital, to address the treatment of non-admitted insurance affiliates. This treatment was adopted as part of proposal 2022-09-CA, the revised treatment of affiliated investments. This line was omitted from the life structure change but was done for 2023 by including it in an existing line. This proposal does not change the treatment but makes the life formula consistent with the other RBC formulas.

Washington, DC 444 North Capitol Street NW, Suite 700, Washington, DC 20001-1509	p 202 471 3990	f 816 460 7493
Kansas City 1100 Walnut Street NW, Suite 1500, Kansas City, MO 64106-2197	p 816 842 3600	f 816 783 8175
New York One New York Plaza, Suite 4210, New York, NY 20004	p 212 398 9000	f 212 382 4207

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Addition of Line to Address Omitted Asset Valuation Reserve Item for Schedule BA

Mortgages

The Capital Adequacy (E) Task Force adopted proposal 2024-05-L during its April 30 meeting. This proposal adds a line to LR009 to specifically address line 44 of the Asset Valuation Reserve (AVR) Equity Component. This AVR line was not included in the LR009 changes made with the mortgage methodology change in 2013. The Task Force adopted proposal 2024-17-L during its June 28 meeting. This proposal applies a factor of 0.0068.

Collateral Loans

The Capital Adequacy (E) Task Force adopted proposal 2024-15-L during its June 28 meeting. This proposal addresses reporting changes of certain mortgage-type investments as collateral loans backed by mortgages in 2024.

Residual Tranches or Interests

The Capital Adequacy (E) Task Force adopted the Risk-Based Capital Investment Risk and Evaluation (E) Working Group’s summary report during its June 28 meeting. The Working Group met April 12, May 22, and June 21 to discuss residual tranches or interests and the 45% RBC factor in place for year-end 2024. After considering comments and a review of alternative proposals to bifurcate residual tranches or interests between 30% and 45% RBC categories, the Working Group adopted a motion to retain the 45% RBC base factor for all residual tranches or interests for year-end 2024 with the sensitivity test factor of zero.

Receivable for Securities Factor

The Capital Adequacy (E) Task Force adopted proposal 2024-13-CA during its June 28 meeting. This changes the factor for the Receivables for Securities (Line [5], Page LR012) to 0.016.

Underwriting Risk Factors - Investment Income Adjustment

The Capital Adequacy (E) Task Force adopted proposal 2024-09-CA during its June 28 meeting. This proposal updated the comprehensive medical, Medicare supplement, and dental and vision factors to include a 5.5% investment yield adjustment. The revised factors are:

	Comprehensive Medical	Medicare Supplement	Dental & Vision
\$0-\$3 Million	0.1427	0.0973	0.1143
\$3-\$25 Million	0.1427	0.0596	0.0706
Over \$25 Million	0.0832	0.0596	0.0706

Last Page: RBC Forecasting & Warning:

Risk-Based Capital Forecasting and Instructions

The Life and Fraternal RBC forecasting spreadsheet calculates RBC using the same formula presented in the *2024 Life and Fraternal Risk-Based Capital Forecasting & Instructions for Companies* (Forecasting & Instructions), and it is available to download from the NAIC Account Manager. The publication is also available for purchase in electronic format through the NAIC Publications Department. This publication is available on or about Nov. 1 each year. The User Guide is no longer included in the Forecasting & Instructions.

Warning: The RBC forecasting spreadsheet CANNOT be used to meet the year-end RBC electronic filing requirement. RBC filing software from an annual statement software vendor should be used to create the electronic filing. If the forecasting worksheet is sent instead of an electronic filing, it will not be accepted, and the RBC will not have been filed.

Last Page: 2024 National Association of Insurance Commissioners:

2024 NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

Life Risk-Based Capital Newsletter, Volume 30. Published annually or whenever needed by the NAIC for insurance regulators, professionals, and consumers.

Direct correspondence to: Kazeem Okosun, RBC Newsletters, NAIC, 1100 Walnut Street, Suite 1500, Kansas City, MO 64106-2197. Phone: 816-783-8121. Email: kokosun@naic.org.

Attachment Four-D
Capital Adequacy (E) Task Force
8/14/24

AGGREGATED LIFE RBC AND ANNUAL STATEMENT DATA
2023 Data as of 6/27/2024

	Year-End 2023	Year-End 2022	Year-End 2021	Year-End 2020	Year-End 2019	Year-End 2018
# of Companies Filed RBC	735	742	750	760	772	703
# of Companies Filed Annual Statement	749	755	766	774	786	722
% of RBC Companies	98%	98%	98%	98%	98%	97%
Company Action Level - Trend Test at 300%	1	6	8	5	7	6
Company Action Level - Trend Test at 250%		1	1	1	3	4
Company Action Level	1	2	2	2	4	2
Regulatory Action Level	2	1	0	1	0	2
Authorized Control Level	3	0	0	0	1	1
Mandatory Control Level	4	3	3	4	3	3
Total	7	12	16	12	18	18
	0.95%	1.62%	2.13%	1.58%	2.33%	2.56%
# of Companies with RBC Ratio > 10,000%	44	45	55	52	50	47
# of Companies with RBC Ratio >1000 & < 10,000%	312	298	292	306	312	275
# of Companies with RBC Ratio >500 & <1,000%	302	313	315	317	332	311
# of Companies with RBC Ratio >300 & <500%	62	69	73			
# of Companies with RBC Ratio >250 & <300%	9	9	9			
# of Companies with RBC Ratio >250 & < 500%				78	68	58
# of Companies with RBC Ratio > 200 & < 250%	1	3	2	2	4	4
# of Companies with RBC Ratio < 200% & <= 0%	5	5	4	5	6	8
# of Companies with RBC Ratio of Zero	0	0	0	0	0	0
Total	735	742	750	760	772	703
Total Adjusted Capital	733,910,634,456	696,198,240,900	710,746,904,192	635,213,337,716	606,901,270,691	540,392,904,821
Authorized Control Level RBC	84,136,361,997	81,640,007,079	80,264,014,541	74,177,610,650	70,095,026,244	64,286,923,366
Aggregate RBC %	872%	853%	886%	856%	866%	841%
Median RBC %	978%	931%	965%	972%	964%	945%
Total C-0 Asset Risk - Affiliates	34,300,788,830	33,786,700,697	32,282,896,095	27,669,014,696	25,328,213,376	23,856,057,914
Total C-1cs Asset Risk - Common Stock	57,768,527,572	54,900,737,718	55,182,980,709	45,635,935,886	42,580,467,817	36,644,436,197
Total C-1o Asset Risk - All Other	66,301,518,772	64,146,694,016	62,725,689,661	60,109,306,053	55,635,242,506	50,712,357,646
Total C-2 Insurance Risk	32,011,834,354	31,195,104,008	37,296,986,893	29,241,196,797	29,733,905,846	28,086,687,917
Total C-3a Interest Rate Risk	16,061,418,244	17,190,092,747	16,066,024,280	16,792,371,276	15,883,584,969	15,698,296,624
Total C-3b Health Credit Risk	19,114,152	18,337,840	111,552,562	104,729,771	92,196,729	88,414,538
Total C-3c Market Risk	2,342,014,491	3,529,226,438	4,295,739,257	6,181,583,664	5,209,040,590	4,036,702,207
Total C-4a Business Risk	11,797,283,285	10,224,912,322	9,240,542,060	8,816,493,013	8,678,807,068	8,042,986,598
Total C-4b Business Risk Admin. Expenses	585,932,801	583,359,049	620,386,794	680,883,943	652,941,471	679,693,954
	221,188,432,501	215,575,164,835	217,822,798,311	195,231,515,099	183,794,400,372	167,845,633,595
Net Basic Operational Risk	518,790,603					
Total C-0 Asset Risk - Affiliates	15.51%	15.67%	14.82%	14.17%	13.78%	14.21%
Total C-1cs Asset Risk - Common Stock	26.12%	25.47%	25.33%	23.38%	23.17%	21.83%
Total C-1o Asset Risk - All Other	29.98%	29.76%	28.80%	30.79%	30.27%	30.21%
Total C-2 Insurance Risk	14.47%	14.47%	17.12%	14.98%	16.18%	16.73%
Total C-3a Interest Rate Risk	7.26%	7.97%	7.38%	8.60%	8.64%	9.35%
Total C-3b Health Credit Risk	0.01%	0.01%	0.05%	0.05%	0.05%	0.05%
Total C-3c Market Risk	1.06%	1.64%	1.97%	3.17%	2.83%	2.41%
Total C-4a Business Risk	5.33%	4.74%	4.24%	4.52%	4.72%	4.79%
Total C-4b Business Risk Admin. Expenses	0.26%	0.27%	0.28%	0.35%	0.36%	0.40%
	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
Total Assets	8,915,394,823,594	8,439,367,712,664	8,832,312,765,460	8,297,856,845,231	7,697,670,761,108	6,932,444,757,225
Total Invested Assets	5,470,188,985,349	5,312,077,013,619	5,159,452,752,770	4,907,504,359,175	4,582,985,123,381	4,209,696,503,206
Reserves (Liabilities Line 1 + 2)	3,619,051,443,815	3,580,757,824,976	3,468,243,938,821	3,394,241,406,583	3,285,116,770,876	3,075,849,385,426
Surplus (Liabilities Line 37)	617,441,214,536	589,231,822,136	599,394,009,357	543,174,466,456	521,516,943,871	475,856,634,572
Premiums Earned (Page 4 Line 1)	687,761,484,264	714,406,215,905	649,749,402,737	635,918,317,202	691,912,622,389	603,752,144,878
Claims Incurred (Page 4 Lines 10 Through 13)	346,809,474,331	327,099,260,850	345,503,167,520	319,751,913,923	308,204,032,091	290,149,583,149

Source: NAIC Financial Data Repository



MEMORANDUM

TO: Tom Botsko, representing Judith L. French, Chair of the Capital Adequacy (E) Task Force
Mike Yanacheak, representing Doub Ommen, Vice-Chair of the Capital Adequacy (E) Task Force
Philip Barlow, Chair of the Life Risk-Based Capital (E) Working Group
Ben Slutsker, Vice-Chair of the Life Risk-Based Capital (E) Working Group

FROM: Dale Bruggeman, Chair of the Statutory Accounting Principles (E) Working Group
Kevin Clark, Vice-Chair of the Statutory Accounting Principles (E) Working Group

DATE: March 27, 2024

RE: SAPWG Referral for Investments in Tax Credit Structures

During the 2024 Spring National Meeting, the Statutory Accounting Principles (E) Working Group (SAPWG) adopted agenda item *2022-14: New Market Tax Credits*, a new SAP concept to replace *SSAP No. 93—Low-Income Housing Tax Credit Property Investments* with *SSAP No. 93R—Investments in Tax Credit Structures* which expands the scope of statutory guidance to include all qualifying tax credit investments regardless of structure or the underlying state/federal tax credit program. The new guidance will be effective on Jan. 1, 2025.

With this adoption, the Working Group directed NAIC staff to send a referral to both the Capital Adequacy (E) Task Force and Life Risk-Based Capital (E) Working Group to inform them of the impending changes to reporting lines. Per the Blanks (E) Working Group proposal (Ref #2024-11BWG), the reporting line, for federal guaranteed programs is proposed to be deleted because these types of tax credit investment structures were substantially eliminated by the *Historic Boardwalk Hall, LLC v. Comm of Internal Revenue* court decision in 2012. The remaining existing Low-Income Housing Tax Credit (LIHTC) Investment Asset Valuation Reserve (AVR) reporting lines are proposed to be renamed and would continue to include LIHTC investments but would also be expanded to include any type of state or federal tax credit program assuming the investment meets the criteria described in paragraph 2 of SSAP No. 93R.

As the current RBC factors were specifically developed for investments in LIHTC programs, this change may indicate the need for a review to update new RBC factors and/or reporting lines which would include new tax credit programs which are not real estate based. Attachment A summarizes both the original LIHTC investment AVR reporting lines and the proposed AVR reporting lines for tax credit investments for your reference. (see Note 1)

The Working Group appreciates your time and consideration of this referral. If you have any questions, please contact Dale Bruggeman, or Kevin Clark, SAPWG Chair and Vice Chair, with any questions.

Cc: Julie Gann, Robin Marcotte, Jake Stultz, Jason Farr, Wil Oden, Eva Yeung, Dave Fleming, Maggie Chang, Kazeem Okosun

Note 1: Attachment A summarizes proposed changes to AVR reporting lines. Note that P/C and Health RBC formulas do not use AVR reporting lines. Yet, the proposed reporting lines for Schedule BA (Ref #2024-11BWG) use the same structure as proposed AVR reporting lines. For brevity, the proposed changes to Schedule BA are omitted herein.

AVR reporting lines under SSAP No. 93—Low-Income Housing Tax Credit Property Investments

Line Number	NAIC Designation	Description	1 Book/ Adjusted Carrying Value	2 Reclassify Related Party Encumbrances	3 Add Third Party Encumbrances	4 Balance for AVR Reserve Calculations (Cols. 1+2+3)	Basic Contribution		Reserve Objective		Maximum Reserve	
							5 Factor	6 Amount (Cols. 4x5)	7 Factor	8 Amount (Cols. 4x7)	9 Factor	10 Amount (Cols. 4x9)
		LOW INCOME HOUSING TAX CREDIT INVESTMENTS										
75		Guaranteed Federal Low-Income Housing Tax Credit					0.0003		0.0006		0.0010	
76		Non-guaranteed Federal Low-Income Housing Tax Credit					0.0063		0.0120		0.0190	
77		Guaranteed State Low Income Housing Tax Credit					0.0003		0.0006		0.0010	
78		Non-guaranteed State Low Income Housing Tax Credit					0.0063		0.0120		0.0190	
79		All Other Low-Income Housing Tax Credit					0.0273		0.0600		0.0975	
80		Total LIHTC (Sum of Lines 75 through 79)					XXX		XXX		XXX	

Proposed AVR reporting lines under SSAP No. 93R— Investments in Tax Credit Structures

		INVESTMENTS IN TAX CREDIT STRUCTURES										
76		Yield Guaranteed State Tax Credit Investments					0.0003		0.0006		0.0010	
75		Qualifying Federal Tax Credit Investments					0.0063		0.0120		0.0190	
77		Qualifying State Tax Credit Investments					0.0063		0.0120		0.0190	
78		Other Tax Credit Investments					0.0273		0.0600		0.0975	
79		Total Tax Credit Investments (Sum of Lines 75 through 78)					XXX		XXX		XXX	

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MEMORANDUM

TO: Carrie Mears, Chair Representative, Valuation of Securities (E) Task Force
Tom Botsko, Chair Representative, Capital Adequacy (E) Task Force

FROM: Dale Bruggeman, Chair of the Statutory Accounting Principles (E) Working Group
Kevin Clark, Vice-Chair of the Statutory Accounting Principles (E) Working Group

DATE: August 28, 2023

RE: SAPWG Schedule BA Proposal for Non-Bond Debt Securities

The purpose of this referral is to notify the Valuation of Securities (E) Task Force and Capital Adequacy (E) Task Force of the Statutory Accounting Principles (E) Working Group’s (SAPWG) proposal to report debt securities that do not qualify as bonds on Schedule BA. A key component of this notice is to highlight that the proposal uses existing Schedule BA reporting provisions for SVO-Assigned NAIC designations in determining RBC.

As preliminary information, as part of the bond project (Ref #2019-21) the SAPWG has been working on a revised bond definition to determine the structures that qualify for bond reporting, either as an issuer credit obligation on a new Schedule D-1-1 or as an asset-backed security on Schedule D-1-2. The new definition and the resulting statutory accounting guidance in *SSAP No. 26R—Bonds* and *SSAP No. 43R—Asset-Backed Securities* was adopted during the 2023 NAIC Summer National Meeting with an effective date of January 1, 2025. Revised bond reporting schedules are currently exposed by the Blanks (E) Working Group and those are anticipated to be considered for adoption by the end of the year. Also, during the 2023 Summer National Meeting, the SAPWG exposed accounting and reporting guidance for debt securities that do not qualify as bonds in *SSAP No. 21R—Other Admitted Assets* and received direction to sponsor a blanks proposal to capture these securities in new reporting lines on Schedule BA - Other Long Term Invested Assets.

The key aspect of this referral is to highlight that the blanks proposal for the new reporting lines intends to divide the debt securities that do not qualify as bonds into separate reporting lines based on whether they have NAIC designations assigned by the SVO from those securities with NAIC designations not assigned by the SVO or that do not have designations. The intent of this reporting is to permit debt securities that do not qualify as bonds, for which the SVO has assigned an NAIC designation, to receive the RBC factor that would have been received if the security had been reported on the bond schedule with an equivalent designation. Although the debt security does not qualify for reporting as a bond due to structure, if the SVO has assessed credit quality with the issuance of an NAIC designation, then the proposed reporting allows for a fixed income RBC factor.

To illustrate an example where a debt security may not meet the bond definition but may warrant a fixed income RBC factor, one of the key principles is that, for debt securities that rely on underlying collateral for repayment,

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underlying collateral must produce meaningful cash flows to service the debt to qualify as a bond. If the debt security relies on the underlying collateral retaining its **value** to repay the debt (e.g. through sale of collateral or refinancing), then it does not qualify to be reported as a bond. For example, a debt security could be secured by non-cashflow-producing real estate at a 50% loan-to-value. While it would not qualify to be reported as a bond, its characteristics are consistent with that of a mortgage loan, and may warrant a fixed income RBC charge.

This proposal does not intend to hinder the Capital Adequacy (E) Task Force’s ability to assess these debt securities and determine the appropriate RBC factor, it simply intends to allow an avenue for certain assets to receive a fixed income factor until the Capital Adequacy (E) Task Force decides if a separate project is needed to review and assess RBC factors for these debt securities. As noted, it is only proposed to be provided for the securities that have an SVO-assigned designation, which is consistent with other Schedule BA lines for which designations influence RBC. Note also that prior to the effective date of the bond definition, these securities are reported as bonds on Schedule D and receive bond RBC factors based on NAIC designation (whether from a credit rating provider for filing exempt securities, or an SVO assigned designation). After adoption, non-qualifying debt securities with NAIC designations that are not assigned by the SVO or that do not have designations are proposed to receive the RBC factor for “other” Schedule BA assets. This is also consistent with the Schedule BA lines that have these separate reporting determinants. Since only reporting entities that file using the life blank can receive RBC reductions for reporting SVO-assigned NAIC designations on Schedule BA, this provision is intended to only apply to those entities until / unless the Capital Adequacy (E) Task Force, and related RBC Working Groups, incorporate changes to provide those capabilities to non-life entities.

The intent of this referral is to inform the Task Forces of the current reporting proposal and request the Valuation of Securities (E) Task Force to assess whether additional guidance is needed within the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* to permit or govern the assignment of SVO-Assigned NAIC Designations for debt securities that do not qualify as bonds.

The following illustrates the proposed Schedule BA reporting lines for these debt securities. A blanks proposal will be developed and exposed by the Blanks (E) Working Group to incorporate these revisions, as well as changes to the AVR with instructions that specifies the mapping from Schedule BA to the AVR for life RBC purposes.

Debt Securities That Do Not Qualify as Bonds

Debt Securities That Do Not Reflect a Creditor Relationship in Substance

NAIC Designation Assigned by the Securities Valuation Office (SVO)

Unaffiliated

Affiliated

NAIC Designation Not Assigned by the Securities Valuation Office (SVO)

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Debt Securities That Lack Substantive Credit Enhancement

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NAIC Designation Not Assigned by the Securities Valuation Office (SVO)

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Debt Securities That Do Not Qualify as Bonds Solely to a Lack Of Meaningful Cash Flows

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Affiliated

The Working Group appreciates your time and looks forward to your response. If you have any questions, please contact Dale Bruggeman, or Kevin Clark, SAPWG Chair and Vice Chair, with any questions.

Cc: Julie Gann, Robin Marcotte, Jake Stultz, Jason Farr, Wil Oden, Charles Therriault, Marc Pearlman, Eva Yeung, Dave Fleming, Crystal Brown, Maggie Chang

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/Stat Acctg_Statutory_Referrals/2023/SAPWG to VOSTF & CAPTF - Schedule BA.docx

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Attachment Five
Capital Adequacy (E) Task Force
8/14/24

Draft: 8/19/24

Property and Casualty Risk-Based Capital (E) Working Group
and the Catastrophe Risk (E) Subgroup
Chicago, Illinois
August 14, 2024

The Property and Casualty Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met in Chicago, IL, Aug. 14, 2024, in joint session with the Catastrophe Risk (E) Subgroup of the Property and Casualty Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force. The following Working Group members participated: Tom Botsko, Chair (OH); Wanchin Chou, Vice Chair (CT); Charles Hale (AL); Rolf Kaumann and Eric Unger (CO); Virginia Christy and Bradley Trim (FL); Sandra Darby (ME); Melissa Robertson (NM); and Miriam Fisk (TX). The following Subgroup members participated: Wanchin Chou, Chair (CT); Virginia Christy, Vice Chair, and Bradley Trim (FL); Rolf Kaumann (CO); Travis Grassel and Mike Yanacheak (IA); Sandra Darby (ME); Melissa Robertson (NM); Tom Botsko (OH); and Miriam Fisk (TX). Also participating were: Kevin Dyke (MI); John Rehagen and Debbie Doggett (MO); Christian Citarella (NH); and Steve Drutz (WA).

1. Adopted the Working Group and Subgroup's June 17; June 10; April 25; April 23; and Spring National Meeting Minutes

Botsko said the Working Group met June 17 and April 25. During these meetings, the Working Group took the following action: 1) adopted proposal 2023-14-P (Underwriting Risk Line 1 Factors), which it had exposed for a 30-day public comment period that ended May 25; 2) adopted proposal 2023-17-CR (Climate Scenario Analysis), which it had re-exposed for a 22-day public comment period that ended April 8 (however, the Financial Condition (E) Committee adopted proposal 2024-20-CR to replace the 2023-17-CR during its Aug. 2 meeting); 3) adopted proposal 2024-10-P (Other Health Line), which it had exposed for a 30-day public comment period that ended April 16; 4) adopted proposal 2024-11-P (Underwriting Risk Lines 4 & 8 Factors), which it had exposed for a 30-day public comment period that ended April 16; 5) discussed potential modifications in the risk-based capital (RBC) statistics; 6) discussed the study of flood risk in the Catastrophe Risk (E) Subgroup; and 7) heard updates from the American Academy of Actuaries (Academy) on its current underwriting risk projects.

Botsko said the Subgroup met June 10 and April 23. During these meetings, the Subgroup took the following action: 1) adopted proposal 2023-17-CR (Climate Scenario Analysis), which it had re-exposed for a 22-day public comment period that ended April 8; 2) exposed a referral from the Capital Adequacy (E) Task Force regarding the geographic concentration issue; 3) discussed wildfire peril impact analysis; 4) discussed CoreLogic's wildfire model review; 5) discussed the possibility of adding flood period to the Rcat component; and 6) heard an update regarding severe convective storm peril.

Darby made a motion, seconded by Grassel, to adopt the Working Group's June 17 (Attachment Five-A) and April 25 (Attachment Five-B) minutes; the Subgroup's June 10 (Attachment Five-C) and April 23 minutes (Attachment Five-D); and the Working Group and Subgroup's joint March 17 minutes (*see NAIC Proceedings – Spring 2024, Capital Adequacy (E) Task Force*). The motion passed unanimously.

2. Adopted the 2024 P/C RBC Newsletter

Botsko said the 2024 property/casualty (P/C) RBC newsletter reflects all proposals the Working Group adopted for year-end 2024. He said that since last year, the purpose of this adoption is to consider the newsletter's content,

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and the format will be revised. The final version of the newsletter will be posted to the Working Group's web page in September.

Chou made a motion, seconded by Darby, to adopt the Working Group's 2024 P/C RBC newsletter (Attachment Five-E). The motion passed unanimously.

3. Discussed 2023 RBC Statistics

Botsko said the 2023 P/C RBC statistics (Attachment Five-F) were run June 27. He said 2,546 P/C RBC filings were loaded into the NAIC database, up from 2,522 in 2022. He stated that 51 companies triggered an action level in 2023: 1) 17 were in company action level; 2) 14 were in regulatory action level; 3) four were in an authorized control level (ACL); and 4) 16 were in a mandatory control level. Also, 23 companies triggered the trend test. However, the aggregate RBC percentage decreased slightly from 586% in 2022 to 578% in 2023. Botsko also stated that last year, the interested parties suggested that adding the operational risk component would provide a complete picture of the RBC formula. The Working Group added the operational risk amount to the Year 2023 column in the RBC statistics this year. Lastly, he indicated that the statistics will only show six years of information beginning this year. Botsko said that anyone who needs historical information can contact NAIC staff.

4. Discussed its Working Agenda

Botsko summarized the following substantial changes to the Working Group's 2024 working agenda: 1) updating comments on items P1, P4, P8, P9, P10, P11, and P12; 2) providing edits to P6 to clarify R5 ex-CAT factors; and 3) adding one item for the Subgroup in the "New Item" section.

5. Discussed the Geographic Concentration Issue

Chou said, as mentioned during the June 10 meeting, the Capital Adequacy (E) Task Force asked the Subgroup to further investigate the geographic concentration issue and report findings at the national meeting. He also stated that Subgroup members had several conversations with Florida and Louisiana state insurance regulators and rating agency representatives to learn their reinsurance monitoring process. Chou said the next step would be determining whether this issue could be handled using the RBC formula or if alternative solutions must be discussed with the Reinsurance (E) Task Force. He urged all interested parties to provide feedback to the Subgroup at its next meeting.

6. Heard Updates on the Severe Convective Storm Peril

Chou said, as mentioned during the Subgroup's June 10 meeting, the Severe Convective Storm Review Ad Hoc Group planned to do the following after the completion of the severe convective storm impact analysis: 1) have another in-depth review based on the 2024 data; and 2) work with vendor modelers to re-run the impact analysis.

7. Discussed the Wildfire Peril Impact Analysis

Chou reiterated that the Subgroup will invite the modelers to conduct another in-depth analysis of wildfire peril after the CoreLogic wildfire model review is completed. Then, the modelers will share model results with the states that have signed nondisclosure agreements (NDAs). He also stated that he and NAIC staff will follow up with the previous Ad Hoc Group members to discuss the impact analysis review plan. Lastly, Chou said he anticipates that updates will be provided at the Fall National Meeting.

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8. Discussed the CoreLogic Wildfire Model Review

Christy said the Wildfire Model Review Ad Hoc Group is picking up the review of the wildfire models by reviewing the final submission from CoreLogic. CoreLogic will be reviewed utilizing the same six-phase approach done for the other commercial modelers in 2022. She also stated that CoreLogic provided its initial presentation in July, and the technical presentation is currently being scheduled. Lastly, she anticipated that the review would be completed by November and updates would be shared during the Fall National Meeting.

9. Discussed the Possibility of Adding Flood Peril to the Rcat Component

Chou said that on March 15, 2021, a referral letter from the Climate and Resiliency (EX) Task Force was received to recommend the Subgroup consider expanding the current catastrophe framework to include other perils, such as wildfire, flood, and/or severe convective storms that may experience a greater tail risk under projected climate-related trends. He stated that the Subgroup responded to the Task Force that it plans to review those perils one at a time. As of today, the wildfire and severe convective storm perils are included in the Rcat component for informational purposes. The next peril the Subgroup will focus on is flood. Chou indicated that during the June 10 meeting, Botsko expressed his concerns about the flood peril in private industry being extremely small, and while monitoring its growth is important, the Subgroup still needs to analyze whether it should move forward with including this peril in the Rcat component. He said he understood Botsko's concerns and agreed that the Working Group and Subgroup should gather more information to determine whether it should be included in the Rcat component. His preliminary plan for the information-gathering process is to encourage industry and vendor modelers to provide feedback to the Subgroup before the upcoming meetings.

10. Discussed How to Handle Flood Peril with the FCHLPM

Chou said that to gain more information to develop a better review process on flood, he invited Donna Sirmons (Florida Commission on Hurricane Loss Projection Methodology—FCHLPM) to discuss how it handles flood peril. Sirmon said FCHLPM flood standards include seven categories: 1) general standards; 2) meteorological standards; 3) hydrological and hydraulic standards; 4) statistical standards; 5) vulnerability standards; 6) actuarial standards; and 7) computer/information standards. She also stated that a model must pass all standards to be determined acceptable, and Karen Clark & Company is the only modeler approved by the FCHLPM. Sirmons also indicated that there are challenges in modeling the peril of flood, validating the modeled results, and in the FCHLPM's review of the flood models. Chou said this valuable information will give the Subgroup some basic ideas for developing the flood reviewing process. Several technical questions were raised regarding reviewing the vendor models during the meeting. As some of the questions were related to confidentiality concerns, Chou invited all interested parties to join the Ad Hoc Group to discuss this issue in depth.

11. Heard an Update from the Academy P/C RBC Committee on Current and Future Research Topics

Botsko said that during the first half of 2024, the Academy supported the Working Group in implementing the updated premium and reserve risk charges. The updated charges generally moved toward being consistent with those indicated in the P/C RBC Committee's *Update to P&C RBC Underwriting Factors and Investment Income Adjustment Factors*, published in August 2023. He also indicated that the work on diversification by line of business for premium risk and reserve risk continues and anticipates that the report will be published in 2025. Currently, the Academy is working on project planning for the rest of 2024 and 2025. Lastly, Botsko said the Academy will share a more detailed update on the project plan with the Working Group in the upcoming months.

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Botsko said the Working Group and Subgroup plan to meet in the fall to continue the discussion.

Having no further business, the Property and Casualty Risk-Based Capital (E) Working Group and Catastrophe Risk (E) Subgroup adjourned.

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Draft: 7/16/24

Property and Casualty Risk-Based Capital (E) Working Group
Virtual Meeting
June 17, 2024

The Property and Casualty Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met June 17, 2024. The following Working Group members participated: Tom Botsko, Chair, Brad Wolfenbarger, and Stewart Trego (OH); Wanchin Chou, Vice Chair, and Amy Waldhauer (CT); Eric Unger and Rolf Kaumann (CO); Virginia Christy and Trim Bradley (FL); Sandra Darby (ME); Melissa Robertson (NM); HauMichael Ying and Ni Qin (NY); Will Davis (SC); Miriam Fisk, Monica Avila, and Rebecca Armon (TX); and Adrian Jaramillo and Michael Erdman (WI). Also participating were: Adrienne Lupo (DE); Jennifer Niles (IL); Tish Becker (KS); Julie Lederer (MO); Liz Ammerman (RI); Hui Wattanaskolpant (TN); and Steven Drutz (WA).

1. Adopted Proposal 2024-14-P

Botsko said proposal 2024-14-P (Underwriting Risk Line 1 Factors) provides a routine annual update to the Line 1 premium and reserve industry underwriting factors in the property/casualty (P/C) risk-based capital (RBC) formula. He indicated that for some lines of business with smaller populations, such as the international line of business, both reserve and premium factors are driven by a handful of companies and could fluctuate or be biased by different factors. He also stated that the American Academy of Actuaries (Academy) is in the process of reviewing the Line 1 calculation methodology; recommendations will be provided soon. In addition, Botsko said the Working Group exposed this proposal for a 30-day public comment period ending May 25 during its April 30 meeting. No comments were received.

Chou made a motion, seconded by Kaumann, to adopt proposal 2023-14-P (Attachment One-F). The motion passed unanimously.

2. Discussed Potential Modification in the RBC Statistics

Botsko said that during the 2023 Summer National Meeting, the Capital Adequacy (E) Task Force mentioned some interested parties suggested that adding the operational risk component would provide a complete picture of the RBC formula. The Task Force agreed to include the operational risk amount in the 2023 RBC statistics for all lines of business. He encouraged all interested parties to submit comments to the Working Group before the Summer National Meeting if there is any additional aggregate RBC information they want to be included in the RBC statistics. Botsko said the 2023 RBC statistics will be provided at the Summer National Meeting. Chou asked whether the Working Group has a plan to review the operational risk item in the near future. Botsko said the Capital Adequacy (E) Task Force was asked to consider establishing a new working group to review different non-investment risk items, and operational risk is one of the items that will be further reviewed by either the new working group or the Task Force in the future.

3. Discussed the Study of Flood Risk in the Catastrophe Risk (E) Subgroup

Chou said that due to recent climate change, some interested parties started asking about the availability and affordability of flood insurance. He said flood peril is currently handled by the National Flood Insurance Program (NFIP) for the flood zones; however, more companies are beginning to offer their own private flood insurance, which typically includes additional coverage, lower cost, and higher limits of protection. Chou said that in order to provide a better understanding of the private flood market, he planned to invite industry members and the major flood modelers to further discuss this issue during the Catastrophe Risk (E) Subgroup's upcoming meeting.

Chou also indicated that the flood reviewing process will follow the other perils process, which will be based on *Actuarial Standard of Practice (ASOP) 38: Using Models Outside the Actuary's Area of Expertise* and *ASOP 39: Treatment of Catastrophe Losses in Property/Casualty Insurance Ratemaking*. He anticipated that the reviewing process would begin in the fall. Botsko said this is a great synopsis of the plan to approach this peril. However, he also recommended the Working Group consider: 1) continuing to monitor the exposure of flood risk to the industry, primarily through the supplemental data from the annual statement; 2) continuing to listen to comments from industry members about this issue; 3) performing different analyses; and 4) hearing from different vendors about their flood models.

4. Heard Updates from the Academy on its Current Underwriting Risk Projects

Ron Wilkins (Academy) said the Academy is currently working on the following projects: 1) diversification of line of business; 2) considering inclusion of the wildfire, severe convective storm, and flood perils in Rcat, and corresponding adjustments to R5 to avoid double counting that peril; 3) updating the calibration of premium and reserve risk charges to reflect more recent experience; and 4) considering ways to improve the efficiency of the risk charge calibration computations and the industry average computations. He also stated that the Academy plans to: 1) monitor the extent of the relationship between risk factors and interest rates; and 2) assess the growth charge. Wilkins said the Academy will provide more detailed updates on its project during the Summer National Meeting. Regarding the growth charge, Drutz said the Health Risk-Based Capital (E) Working Group looked at the risk in several different ways, and, ultimately, the Working Group found that the current formula is working reasonably well. Wilkins said the Academy will review the works from the Health Risk-Based Capital (E) Working Group before proceeding on this project. Ralph Blanchard (Retired Actuary) said he was concerned that the year 2020 data does not reflect the distortion from the COVID-19 pandemic. Wilkins agreed and said this would be a key topic for the Academy to consider.

5. Discussed Other Matters

Botsko said the Working Group plans to meet at the Summer National Meeting to continue discussing outstanding items.

Having no further business, the Property and Casualty Risk-Based Capital (E) Working Group adjourned.

SharePoint/NAIC Support Staff Hub/Member Meetings/Summer 2024 National Meeting/Task Forces/CapAdequacy/PCRBC WG/06-17propertybcwg.docx

Draft: 5/22/24

Property and Casualty Risk-Based Capital (E) Working Group
Virtual Meeting
April 25, 2024

The Property and Casualty Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met April 25, 2024. The following Working Group members participated: Tom Botsko, Chair, and Dale Bruggeman (OH); Wanchin Chou, Vice Chair, and Susan Gozzo Andrews (CT); Eric Unger and Mitchell Bronson (CO); Virginia Christy and Nicole Crockett (FL); Sandra Darby (ME); Michael Ying, Ni Qin, Rajesh Bhandula, Harriette Resnick, and Christopher Esteban (NY); Miriam Fisk and Rebecca Armon (TX); and Adrian Jaramillo (WI). Also participating were: Rabab Charafeddine (CA); Adrienne Lupo (DE); Danny Chan (HI); Jennifer Niles Tish Becker (KS); Greg Ricci (MD); Kari Leonard (MT); Julie Lederer and Danielle Smith (MO); Lindsay Crawford (NE); Liz Ammerman (RI); Trey Hancock (TN); and Jay Bruns (WA).

1. Adopted Proposal 2023-17-CR

Chou said the Catastrophe Risk (E) Subgroup met April 23 to adopt proposal 2023-12-CR (Climate Scenario Analysis). He stated that the Subgroup appreciates all the valuable comments submitted by different industry parties during the exposure period. After reviewing industry comments, the Solvency Workstream of the Climate and Resiliency (EX) Task Force and the Subgroup made the following revisions to the proposal: 1) implementing a three-year sunset clause in the instructions; and 2) updating the Line 7 question in PR027BI, PR027BII, PR027CI, and PR027CII. Chou reiterated that the intent of this proposal is to collect some useful information for state insurance regulators holding conversations with insurers that may have a greater degree of risk of these perils. He said the Subgroup and the Solvency Workstream have no desire to require reporting companies to hold capital up to specific levels based on this provided information. He also indicated that the Subgroup will re-evaluate the information in the future to determine whether further enhancement should be made to these pages.

Steve Broadie (American Property Casualty Insurance Association—APCIA) said the APCIA, the National Association of Mutual Insurance Companies (NAMIC), and the Reinsurance Association of America (RAA) (collectively, “the Associations”) appreciated the modification of including the three-year sunset clause in the proposal. He stated that the Associations came up with an alternative proposal, which they believe will be less expensive to provide state insurance regulators with information to hold discussions with insurers that may have a greater degree of indicated risk levels for hurricane and wildfire perils. Kelly Hereid (Liberty Mutual Insurance) said the alternative required insurers to calculate the Rcat charge and perform catastrophe model runs on their current books of business with: 1) a 50% increase in the frequency of major hurricanes (Category 3 and higher, and for wind only); and 2) a 50% increase in all wildfire events. Darby agreed with the latest revisions the Subgroup provided and said this toll will continue to be evaluated based on the company reporting.

Chou made a motion, seconded by Darby, to adopt proposal 2023-17-CR (Attachment Two-G). The motion passed unanimously.

2. Adopted Proposal 2024-10-P

Botsko said proposal 2024-10-P (Other Health Line) would address the current double-counting issue for companies with stop-loss premium, as the stop-loss premium is expected to be entered on Line 9 of PR019. He also stated that the Working Group exposed this proposal for a 30-day public comment period during the Spring National Meeting. No comments were received.

Darby made a motion, seconded by Unger, to adopt proposal 2024-10-P (Attachment Two-D). The motion passed unanimously.

3. Adopted Proposal 2024-11-P

Botsko said that at the Spring National Meeting, the Working Group agreed to expose proposal 2024-11-P (Underwriting Risk Lines 4 & 8 Factors) with the: 1) 50% indicated change with capped international and product liability lines in 2024, and 100% indicated change with capped international and product liability lines in 2025 for reserve factors; and 2) 50% indicated change with capped financial mortgage guaranty line in 2024, and 100% indicated change with capped financial mortgage guaranty line in 2025 for premium factors for a 30-day public comment period. No comments were received.

Chou made a motion, seconded by Christy, to adopt proposal 2024-11-P (Attachment Two-E). The motion passed unanimously.

4. Exposed Proposal 2024-14-P

Botsko said proposal 2024-14-P (Underwriting Risk Line 1 Factors) provided a routine annual update to the Line 1 premium and reserve industry underwriting factors in the property/casualty (P/C) risk-based capital (RBC) formula. He indicated that for some lines of business with smaller populations, such as the international line of business, both reserve and premium factors are driven by a handful of companies and could fluctuate or be biased by different factors. He also stated that the American Academy of Actuaries (Academy) is in the process of reviewing the Line 1 calculation methodology; recommendations will be provided soon.

The Working Group agreed to expose proposal 2023-14-P for a 30-day public comment period ending May 25.

5. Discussed Other Matters

Botsko said the Academy's Property and Casualty Risk-Based Capital Committee is currently working on: 1) researching diversification by line of business for premium and reserve risk; 2) analyzing the potential inclusion of the wildfire peril in the Rcat component and corresponding adjustments to premium risk charges to avoid double counting that peril; and 3) updating the calibration of premium and reserve risk charges to reflect more recent experience. He said he anticipates the Academy will provide another update on its projects during the Summer National Meeting.

Having no further business, the Property and Casualty Risk-Based Capital (E) Working Group adjourned.

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Draft: 7/16/24

Catastrophe Risk (E) Subgroup
Virtual Meeting
June 10, 2024

The Catastrophe Risk (E) Subgroup of the Property and Casualty Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met June 10, 2024. The following Subgroup members participated: Wanchin Chou, Chair (CT); Virginia Christy, Vice Chair, Richie Frederick, and Nicole Crockett (FL); Eric Unger (CO); Travis Grassel, Mike Yanacheak, and Kim Cross (IA); Elouisa Macias and Tim Vigil (NM); Tom Botsko (OH); Cuc Nguyen (OK); and J'ne Byckovski, Nicole Elliott, and Marianne Baker (TX). Also participating were: Chad Bennett (AK); Travis Taylor (AL); Lori Munn (AZ); Giovanni Muzzarelli, Mitra Sanadajifar, Laura Clements, and Lucy Jabourian (CA); NuDasha Fludd (DC); Jessica Luff (DE); Paula Shamburger (GA); Jennifer Niles and Julie Rachford (IL); Julie Holmes (KS); Chris Cerniauskas (LA); Jackie Horigan and Matthew Mancini (MA); Greg Ricci (MD); Paige Dickerson, Christopher Slovinski, Renee Campbell, and Chris Arth (MI); Jeana Thomas (MO); Jackie Obusek (NC); Gennady Stolyarov (NV); Shannen Logue (PA); Zachary Crandall, Vickie Trice, Devon Suttles, and Matt Mickelson (TN); Steve Drutz and David Forte (WA); and Allan L. McVey (WV).

1. Exposed a Referral from the Capital Adequacy (E) Task Force Regarding Geographic Concentration Issue

Chou said the Capital Adequacy (E) Task Force agreed to disband the Risk-Based Capital Geographic Concentration Ad Hoc Subgroup and refer its outstanding issues to the Subgroup. He also stated that the Task Force recommends the Subgroup consider: 1) further investigating all outstanding issues; 2) possibly modifying the property and casualty (P/C) risk-based capital (RBC) formula; and 3) providing updates on this project at each national meeting until its completion. Chou also indicated that the Ad Hoc Subgroup had several conference calls with Florida and Louisiana state insurance regulators and rating agency representatives to gain a better understanding of how they monitor and handle the potential geographic concentration risk exposures. He urged all interested parties to review the referral to gain a better understanding of this issue and provide feedback to the Subgroup at its next meeting.

The Subgroup agreed to expose this referral (Attachment Five-C1) for a 30-day public comment period ending July 10.

2. Heard an Update Regarding the Severe Convective Storm Peril

Chou said the Severe Convective Storm Review Ad Hoc Group was established in late 2022 to conduct a more in-depth review of various severe convective storm catastrophe vendor model assumptions, limitations, and impact analyses, following a similar process to reviewing the wildfire peril. Since late 2022, the Ad Hoc Group has met with different vendor modelers to gain a better understanding of each vendor model and ensure that the model results are within a reasonable range. He also stated that the Ad Hoc Group follows *Actuarial Standard of Practice (ASOP) No. 38—Catastrophe Modeling (for All Practice Areas)* as its guiding principles to ensure the appropriateness of the catastrophe models for the intended purposes. Chou said the vendor modelers collaborated to create a synthetic industry exposure database to perform the impact analysis in late 2023. The Ad Hoc Group identified no meaningful concerns or issues after vetting the methodology and assumptions for the impact analysis. He also stated that the severe convective storm Rcat structure was added to the RBC formula for informational purposes only during the Spring National Meeting. On April 16, the Ad Hoc Group met to conclude that there were no specific concerns related to the vendor models at that point. Chou indicated that the Ad Hoc Group planned to: 1) have another in-depth review based on the 2024 data; and 2) work with vendor modelers to re-run the impact analysis.

3. Discussed the Wildfire Peril Impact Analysis

Chou said, as mentioned during the April meeting, the Subgroup decided to invite the modelers to conduct another in-depth analysis of wildfire peril and share model results with the states that have signed nondisclosure agreements (NDAs) immediately following the Summer National Meeting. He also stated that his initial thought was to follow the previous review process, but he said he will share a more detailed review plan at the Summer National Meeting after discussing it with the vice chair.

4. Discussed CoreLogic's Wildfire Model Review

Chou said that CoreLogic was not ready for wildfire model review at the time when the Ad Hoc Group performed the reviewing process with other commercial vendors. Thus, the Subgroup decided to go through a similar process, conducting an in-depth analysis with CoreLogic soon so it can be included in the NAIC-approved third-party commercial vendor catastrophe model list. He also stated that Christy will take the lead on this process. Christy said the Model Review Ad Hoc Group will ask CoreLogic for a presentation and develop questions based on that presentation. She said that since the impact analysis for wildfire peril was only reviewed by a few state insurance regulators last year, those who signed the NDAs will be asked to help develop questions for CoreLogic in order to review and update its impact analysis by the 2025 Spring National Meeting.

5. Discussed the Possibility of Adding Flood Peril to the Rcat Component

Chou said that as the wildfire and severe convective storm perils are included in the Rcat component for informational purposes, the next peril the Subgroup will be focused on is flood. He said the flood peril will follow a similar reviewing process as the wildfire and severe convective storm perils, which will follow ASOP No. 38 as its guiding principle. Chou also stated that the Karen Clark & Company (KCC) flood model is currently the only one approved by the Florida Hurricane Commission; other commercial vendor flood models, such as Moody's Risk Management Solutions (RMS), AIR, and CoreLogic, are still under evaluation by the Florida Commission. Chou said he also planned to invite a the Florida Commission on Hurricane Loss Projection Methodology (FCHLPM) representative to discuss the flood model review process during the Summer National Meeting. Botsko commented that the flood peril in private industry is extremely small, and while monitoring its growth is important, the Subgroup still needs to analyze whether it should move forward with including this peril in the Rcat component.

Having no further business, the Catastrophe Risk (E) Subgroup adjourned.

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MEMORANDUM

TO: Wanchin Chou, Chair of the Catastrophe Risk (E) Subgroup

FROM: Tom Botsko, Chair of the Capital Adequacy (E) Task Force

DATE: April 16, 2024

RE: Risk-Based Capital Geographic Concentration Issue

Executive Summary and Recommendation

During the Spring National Meeting, the Capital Adequacy (E) Task Force agreed to: 1) disband the Geographic Concentration Ad Hoc Subgroup; and 2) refer the geographic concentration issue to the Catastrophe Risk (E) Subgroup. The Geographic Concentration Ad Hoc Subgroup heard several presentations from different rating agencies, as well as the Florida and Louisiana Departments of Insurance (DOIs), on how they measured the geographic concentration issue when hurricanes hit heavily populated regions in the past few months. Based on the findings, the Task Force believed that the Catastrophe Risk (E) Subgroup would be the appropriate group to address this issue. From the discussion at the Spring National Meeting, the Task Force agreed to forward this issue to the Catastrophe Risk (E) Subgroup and recommends that the Subgroup consider the following:

1. Further investigating all outstanding issues and possibly changing the property and casualty (P/C) risk-based capital (RBC) formula to address the risk.

We recommend that the Catastrophe Risk (E) Subgroup provides updates on this project at each national meeting until its completion. The Task Force appreciates your time and consideration of this referral. If you have any questions, please contact Tom Botsko.

Cc: Eva Yeung

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Draft: 6/10/24

Catastrophe Risk (E) Subgroup
Virtual Meeting
April 23, 2024

The Catastrophe Risk (E) Subgroup of the Property and Casualty Risk-Based Capital (E) Working Group of the Capital Adequacy (E) Task Force met April 23, 2024. The following Subgroup members participated: Wanchin Chou, Chair, Susan Gozzo Andrews, and Qing He (CT); Virginia Christy, Vice Chair (FL); Mitchell Bronson, Eric Unger, and Rolf Kaumann (CO); Travis Grassel and Kevin Clark (IA); Sandra Darby and Brock Bubar (ME); Harriette Resnick, Alexander Vajda, Rajesh Bhandula, Christopher Esteban, and HauMichael Ying (NY); Tom Botsko (OH); Will Davis (SC); and Miriam Fisk (TX). Also participating were: Giovanni Muzzarelli, Laura Clements, Mike Peterson, and Rabab Charafeddine (CA); Danny Chan (HI); Jennifer Niles (IL); Greg Ricci (MD); Danielle Smith, Cynthia Amann, and Julie Lederer (MO); Glorimar Santiago (PR); Dan Bumpus (VA); and Steve Drutz (WA).

1. Adopted Proposal 2023-17-CR (Climate Scenario Analysis)

Chou said the Working Group met April 1 and April 11 in regulator-to-regulator session and April 16 in joint regulator-to-regulator session with the Solvency Workstream of the Climate and Resiliency (EX) Task Force, pursuant to paragraph 6 (consultations with NAIC staff members related to NAIC technical guidance) of the NAIC Policy Statement on Open Meetings, to discuss proposal 2023-17-CR (Climate Scenario Analysis).

Chou said that after reviewing industry comments, the Subgroup and the Solvency Workstream of the Climate and Resiliency (EX) Task Force made the following revisions to the proposal: 1) implementing a three-year sunset clause in the instructions; and 2) updating the line 7 question in PR027BI, PR027BII, PR027CI, and PR027CII. Chou reiterated that the intent of this proposal is to collect useful information for state insurance regulators holding conversations with insurers that may have a greater degree of risk of these perils. The Subgroup and the Solvency Workstream have no desire to require reporting companies to hold capital up to specific levels based on this provided information. He also stated that the Subgroup will re-evaluate the information in the future to determine whether further enhancement should be made to these pages.

Ralph Blanchard (Retired Actuary) said there are three areas indicated in the comment letter (Attachment Five-D1) where the proposal should be modified if the data capture would remain in the current suggested format: 1) treatment of reinsurance; 2) identification of the geographic location of the risk concentration; and 3) impact of residual markets. Another modification that Blanchard suggested was removing the impact of ceded reinsurance from the current proposal for 2040 and 2050 projections, as ceded reinsurance programs are designed to fit the gross exposure and capital level existing for the period of the gross exposure. Chou said state insurance regulators decided to keep the current format during the regulator-to-regulator sessions. However, he said that Blanchard's comments deserve further review and should be considered in future enhancements.

Steve Broadie (American Property Casualty Insurance Association—APCIA) said the APCIA, the National Association of Mutual Insurance Companies (NAMIC), and the Reinsurance Association of America (RAA) (collectively, "the Associations") appreciated the modification of including a three-year sunset clause in the proposal. He stated that the comment letter (Attachment Five-D2) indicated that the Associations came up with an alternative proposal, which they believe will be less expensive to provide state insurance regulators with information to hold discussions with insurers that may have a greater degree of indicated risk levels for hurricane and wildfire perils.

Kelly Hereid (Liberty Mutual Insurance) said the alternative proposal requires insurers to use the catastrophe model they currently use to calculate the RCAT charge for hurricane and wildfire perils, using the following assumptions: 1) a 50% increase in the frequency of major hurricanes (Category 2 and higher, and for wind only); and 2) a 50% increase in all wildfire events. Eli Russo (NAIC) and Shaveta Gupta (NAIC) stated that the state insurance regulators were not in favor of performing big stress scenarios; rather, they would like to use what companies believe in the climate scenarios. Chou said there are many uncertainties on top of the assumptions. He reiterated that the intent of this proposal is to develop a tool to generate conversations between companies and state insurance regulators, and this tool will continue to be evaluated based on company reporting.

Darby made a motion, seconded by Botsko, to adopt proposal 2023-17-CR (Attachment Two-G). The motion passed unanimously.

2. Discussed Severe Convective Storm Peril Impact Analysis

Chou said that the vendor modelers ran the industry exposure database through their respective models to obtain the average annual loss (AAL) and exceedance probability (EP) curve loss output by the sub-perils such as hail, tornado, and straight-line wind. This analysis included several key geographies across the U.S. He also stated that the Model Review Ad Hoc Group met April 16 to discuss its modeling results. Chou said he received no specific concerns from its members. He said the structure of adding severe convective storms as one of the catastrophe perils for informational purposes only in the Rcat component was adopted at the Spring National Meeting. Chou also said he planned to accomplish the following tasks next year: 1) have another in-depth review based on the received data; and 2) work with vendor modelers to review and update their impact analyses.

3. Discussed Wildfire Peril Impact Analysis

Chou said, as mentioned during the Spring National Meeting, the Subgroup decided to invite the modelers to conduct another in-depth analysis of wildfire and share model results with the states that have signed nondisclosure agreements (NDAs). He also stated that he will share the review plan at the next meeting after discussing it with the vice chair.

Having no further business, the Catastrophe Risk (E) Subgroup adjourned.

SharePoint/NAIC Support Staff Hub/Member Meetings/Summer 2024 National Meeting/Task Forces/CapAdequacy/Cat Risk SG/04-23propertycatsg.docx

From: Ralph Blanchard <rsblanchardiii@gmail.com>
Sent: Monday, April 15, 2024 5:29 PM
To: Yeung, Eva <EYeung@naic.org>
Subject: Re: 03_Revised Blank - Ralph Blanchard.xlsm

CAUTION: This email originated from outside of the organization. Do not click links or open attachments unless you recognize the sender and know the content is safe.

Thanks Eva,

Those are the two columns that would be deleted. The reason for the proposal would be: *"This is a proposed modification to the current proposal, removing the impact of ceded reinsurance from the current proposal for 2040 and 2050 projections, as ceded reinsurance programs are designed to fit the gross exposure and capital level existing for the period of the gross exposure. As such, the reinsurance program in place for 2024 would likely be very different from the one in place for 2040 or 2050. Assuming no change in the reinsurance program would produce data that would be misleading (and as such should not be used)."*

Ralph

DISCLOSURE OF CLIMATE CONDITIONED CAT EXPOSURE FOR HURRICANE PR027BI
 (For Informational Purposes Only)

Climate Conditioned Modeled Losses for 2040

Hurricane	Reference	(1) Direct and Assumed	(2) Net	3 [‡] Ceded Amounts Recoverable
(1) Worst Year in 50	Company Records			
(2) Worst Year in 100	Company Records			
(3) Worst Year in 250	Company Records			
(4) Worst Year in 500	Company Records			
(5) Worst Year in 1000	Company Records			

View of climate risk used

(6) If a Climate Conditioned Catalog developed by a commercial CAT model vendor is used, provide name and version of the catalog

(7) If it is internally developed by the company, provide a brief description of assumptions/adjustments made

Lines (1)-(5): Modeled losses to be entered on these lines are to be calculated using the same commercial vendor-catastrophe model, or combination of models used to calculate the CAT Risk Charge.

~~‡ Column (3) is modeled catastrophe losses that would be ceded under reinsurance contracts. This should be associated with the Net Modeled Losses shown in Column (2).~~

 Denotes items that must be manually entered on the filing software.

**DISCLOSURE OF CLIMATE CONDITIONED CAT EXPOSURE FOR HURRICANE PR027BII
 (For Informational Purposes Only)**

Climate Conditioned Modeled Losses for 2050

Hurricane	Reference	(1) Direct and Assumed	(2) Net	(3) Ceded Amounts Recoverable
(1) Worst Year in 50	Company Records			
(2) Worst Year in 100	Company Records			
(3) Worst Year in 250	Company Records			
(4) Worst Year in 500	Company Records			
(5) Worst Year in 1000	Company Records			

View of climate risk used

(6) If a Climate Conditioned Catalog developed by a commercial CAT model vendor is used, provide name and version of the catalog

(7) If it is internally developed by the company, provide a brief description of assumptions/adjustments made

Lines (1)-(5): Modeled losses to be entered on these lines are to be calculated using the same commercial vendor-catastrophe model, or combination of models used to calculate the CAT Risk Charge.

~~† Column (3) is modeled catastrophe losses that would be ceded under reinsurance contracts. This should be associated with the Net Modeled Losses shown in Column (2).~~

 Denotes items that must be manually entered on the filing software.

DISCLOSURE OF CLIMATE CONDITIONED CAT EXPOSURE FOR WILDFIRE PR027CI
 (For Informational Purposes Only)

		<u>Climate Conditioned Modeled Losses for 2040</u>		
Wildfire	<u>Reference</u>	(1) <u>Direct and Assumed</u>	(2) <u>Net</u>	3 [†] <u>Ceded Amounts Recoverable</u>
(1) Worst Year in 50	Company Records			
(2) Worst Year in 100	Company Records			
(3) Worst Year in 250	Company Records			
(4) Worst Year in 500	Company Records			
(5) Worst Year in 1000	Company Records			

View of climate risk used

(6) If a Climate Conditioned Catalog developed by a commercial CAT model vendor is used, provide name and version of the catalog

[Redacted]

(7) If it is internally developed by the company, provide a brief description of assumptions/adjustments made

[Redacted]

Lines (1)-(5): Modeled losses to be entered on these lines are to be calculated using the same commercial vendor catastrophe model, or combination of models used to calculate the CAT Risk Charge.

~~† Column (3) is modeled catastrophe losses that would be ceded under reinsurance contracts. This should be associated with the Net Modeled Losses shown in Column (2).~~

[Redacted] Denotes items that must be manually entered on the filing software.

DISCLOSURE OF CLIMATE CONDITIONED CAT EXPOSURE FOR WILDFIRE PR027CII
 (For Informational Purposes Only)

<u>Climate Conditioned Modeled Losses for 2050</u>				
Wildfire	<u>Reference</u>	(1) <u>Direct and Assumed</u>	(2) <u>Net</u>	3† <u>Ceded Amounts Recoverable</u>
(1) Worst Year in 50	Company Records			
(2) Worst Year in 100	Company Records			
(3) Worst Year in 250	Company Records			
(4) Worst Year in 500	Company Records			
(5) Worst Year in 1000	Company Records			

View of climate risk used

(6) If a Climate Conditioned Catalog developed by a commercial CAT model vendor is used, provide name and version of the catalog

[Redacted]

(7) If it is internally developed by the company, provide a brief description of assumptions/adjustments made

[Redacted]

Lines (1)-(5): Modeled losses to be entered on these lines are to be calculated using the same commercial vendor catastrophe model, or combination of models used to calculate the CAT Risk Charge.

† Column (3) is modeled catastrophe losses that would be ceded under reinsurance contracts. This should be associated with the Net Modeled Losses shown in Column (2).

[Redacted] Denotes items that must be manually entered on the filing software.

PR027CII



April 8, 2024

Ms. Eva Yeung
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Re: Proposal 2023-17-CR (Climate Scenario Analysis)

Dear Ms. Yeung:

The American Property Casualty Insurance Association (APCIA)¹, the National Association of Mutual Insurance Companies (NAMIC)², and the Reinsurance Association of America (RAA)³ (collectively, “the Associations”), appreciate the opportunity to comment on the exposed proposal to require property casualty insurers to perform scenario analysis of their hurricane and wildfire exposure through a catastrophe model’s “Climate Conditioned Catalog”.

The exposed proposal is subject to almost all of the flaws that we addressed in a joint January 18 comment letter to the Solvency Workstream of the Climate and Resiliency (EX) Task Force. That letter is attached to our comments here, and we will not reiterate them except to say that, based upon discussions with our members and two of the catastrophe modelers that offer climate conditioned catalogs, the data produced by the proposal will be of little or no benefit to regulators in assessing an insurer’s current or likely future financial condition, at great cost to the companies that would be required to use those catalogs.

The Associations propose a different approach, which is detailed in the attached draft RBC proposal form. Under our approach, as part of their annual RBC filing, companies would be required to use the catastrophe model they currently use to calculate the RCAT charge for hurricane and wildfire perils, using the following assumptions:

- A 50% increase in the frequency of major hurricanes (Category 3 and higher, and for wind only), and
- A 50% increase in all wildfire events.

¹ APCIA is the primary national trade association for home, auto, and business insurers. APCIA promotes and protects the viability of private competition for the benefit of consumers and insurers, with a legacy dating back 150 years. APCIA members include companies of all sizes, structures, and regions—protecting families, communities, and businesses in the U.S. and across the globe.

² NAMIC has more than 1,500-member companies representing 40 percent of the total U.S. property/casualty insurance market. NAMIC member companies serve more than 170 million policyholders and write more than \$323 billion in annual premiums. Our members’ direct written premiums account for 67 percent of homeowners’ insurance and 55 percent of automobile insurance. Through NAMIC advocacy programs it promotes public policy solutions that benefit NAMIC member companies and the policyholders they serve and fosters greater understanding and recognition of the unique alignment of interests between management and policyholders of mutual companies

³ The RAA is a national trade association representing reinsurance companies doing business in the United States. RAA membership is diverse, including reinsurance underwriters and intermediaries licensed in the U.S. and those that conduct business on a cross-border basis. The RAA also has life reinsurance affiliates and insurance-linked securities (ILS) fund managers and market participants that are engaged in the assumption of property/casualty risks. The RAA represents its members before state, federal and international bodies.

Under our proposal, companies would report the same PMLs (probable maximum losses) that are required in the current RCAT instructions (1/50-year, 1/100-year, 1/250-year, and 1/500-year).

Regulators have expressed their concerns about being able to assess insurers' risk concentrations for hurricanes and wildfires, and NAIC staff have expressed their need for data that is comparable with the current RBC PMLs, and that is comparable across companies. Our proposal accomplishes the goals that the exposure is seeking to meet but in a manner that is significantly less resource-intensive for companies. Our proposal also provides the following benefits:

- Major hurricanes cause 80%+ of historical economic losses (likely a greater percentage of insured losses), and scientific evidence for their increase is the strongest, making a targeted frequency adjustment scientifically valid that prioritizes their impact.
- Similarly, wildfires have seen an accelerating increase due to changes in temperature driving increased evaporation, making a large single scenario plausible and capturing the direction of risk changes.
- Explicitly selecting a tail scenario that causes portfolios to break, and examining how that happens, provides insight into potential financial impacts on insurers and is most protective of solvency – small percentage changes may just lead to dismissal of risk.
- A single, defined scenario maximizes comparability and aggregation across insurers.
- A single flat frequency change is highly accessible for small insurers and can also be rapidly implemented by vendor models.
- This approach excludes water impacts of hurricanes given the limitations of available tools to model impact and for the purpose simplifying assumptions for smaller insurers. However, hurricane water risk is less likely to be a solvency risk than wind, given that such risk is excluded from most policies and is instead covered by the National Flood Insurance Program.

We also suggest that, after two or three years, the Subgroup assess the data this proposal produces and determine whether modifications are necessary or whether such data provides useful insight into the potential solvency impacts from climate scenarios. This reevaluation should be included in the RBC instructions to ensure that the regulators' goals are enshrined so that the benefits to regulators and insurers can be measured and adjusted as necessary.

The Associations look forward to discussing our proposal with the Subgroup. Please do not hesitate to contact us if you have any questions or would like more information.

Sincerely,



Stephen W. Broadie
Vice President, Financial & Counsel
American Property Casualty Insurance Association



Colleen W. Scheele
Public Policy Counsel and Director of Financial and
Tax Policy
National Association of Mutual Insurance
Companies



Dennis C. Burke
Vice President, State Relations
Reinsurance Association of America



Newsletter Items for Adoption for 2024 for Property and Casualty RBC:

Date: August 2024

Volume: 28.2

Page 1: Intro Section:

What Risk-Based Capital Pages Should Be Submitted?

For year-end 2024 property/casualty (P/C) risk-based capital (RBC), hard copies of pages PR001-PR035, as well as pages PR038 and PR039, should be submitted to any state that requests a hard copy. Beginning with year-end 2011 RBC, a hard copy was not required to be submitted to the NAIC, but a portable document format (PDF) file representing the hard copy filing is part of the electronic filing with the NAIC.

Page 1+: Items Adopted for 2024:

Underwriting Risk

Pet Insurance

The Capital Adequacy (E) Task Force adopted proposal 2023-14-P during its March 17 meeting. This proposal removed pet insurance from the inland marine line of business and added a separate new line for pet insurance. This change is consistent with the change in the annual statement. However, the RBC charges calculation for pet insurance will still be included in the inland marine line of business.

Schedule P Short Tail Lines

During its March 17 meeting, the Capital Adequacy (E) Task Force adopted proposal 2024-01-P, which: 1) changed all the company record data to vendor link data for all RBC Schedule P short-tailed exhibits as the result of the adoption of the annual statement blanks proposal 2023-16BWG

Washington, DC 444 North Capitol Street NW, Suite 700, Washington, DC 20001-1509 p | 202 471 3990 f | 816 460 7493

Kansas City 1100 Walnut Street NW, Suite 1500, Kansas City, MO 64106-2197 p | 816 842 3600 f | 816 783 8175

New York One New York Plaza, Suite 4210, New York, NY 20004 p | 212 398 9000 f | 212 382 4207

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MOD; and 2) removed PR301 through PR306.

Underwriting Risk Factors Lines 4 and 8

As a result of the adoption of proposal 2024-11-P by the Capital Adequacy (E) Task Force during its April 30 meeting, Lines 4 and 8 factors were based on the 2023 American Academy of Actuaries' (Academy's) *Update to Property and Casualty Risk-Based Capital Underwriting Factors and Investment Income Adjustment Factors* report. During the Property and Casualty Risk-Based Capital (E) Working Group's April 25 meeting, the Working Group decided to use 50% indicated change with capped international and product liability lines for reserves and 50% indicated change with capped financial mortgage guaranty line for premium for 2024 reporting.

PR017 Underwriting Risk - Reserves				PR017 Underwriting Risk - Reserves			
Proposed Line (4), Industry Loss & Expense RBC Factors				Proposed Line (8), Adjustment for Investment Income			
Col.	Line of Business	2024 Factor	2023 Factor	Col.	Line of Business	2024 Factor	2023 Factor
(1)	H/F	0.220	0.213	(1)	H/F	0.945	0.938
(2)	PPA	0.192	0.179	(2)	PPA	0.933	0.928
(3)	CA	0.318	0.276	(3)	CA	0.919	0.911
(4)	WC	0.363	0.344	(4)	WC	0.807	0.830
(5)	CMP	0.485	0.494	(5)	CMP	0.887	0.876
(6)	MPL Occurrence	0.327	0.383	(6)	MPL Occurrence	0.863	0.865
(7)	MPL Claims Made	0.224	0.276	(7)	MPL Claims Made	0.890	0.883
(8)	SL	0.353	0.304	(8)	SL	0.887	0.890
(9)	OL	0.514	0.531	(9)	OL	0.858	0.852
(10)	Fidelity/Surety	0.479	0.371	(10)	Fidelity/Surety	0.924	0.940
(11)	Special Property / Pet Insurance Plan	0.259	0.246	(11)	Special Property / Pet Insurance Plan	0.960	0.966
(12)	Auto Physical Damage	0.146	0.155	(12)	Auto Physical Damage	0.977	0.976
(13)	Other (Credit A&H)	0.223	0.220	(13)	Other (Credit A&H)	0.952	0.967
(14)	Financial/Mortgage Guaranty	0.163	0.179	(14)	Financial/Mortgage Guaranty	0.921	0.926
(15)	INTL	0.514	0.359	(15)	INTL	0.878	0.874
(16)	REIN. P&F Lines	0.367	0.415	(16)	REIN. P&F Lines	0.907	0.901
(17)	REIN. Liability	0.626	0.656	(17)	REIN. Liability	0.816	0.838
(18)	PL	1.014	0.802	(18)	PL	0.843	0.841
(19)	Warranty	0.363	0.371	(19)	Warranty	0.951	0.940

PR018 Underwriting Risk - Premiums			
Proposed Line (4), Industry Losses & Loss Adjustment Expense Ratio			
Col.	Line of Business	2024 Factor	2023 Factor
(1)*	H/F	0.933	0.936
(2)	PPA	0.970	0.969
(3)	CA	1.012	1.010
(4)	WC	1.041	1.044
(5)*	CMP	0.878	0.883
(6)	MPL Occurrence	1.531	1.668
(7)	MPL Claims Made	1.138	1.130
(8)*	SL	0.908	0.922
(9)	OL	1.003	1.013
(10)	Fidelity/Surety	0.756	0.854
(11)*	Special Property/Pet Insurance	0.829	0.863
(12)	Auto Physical Damage	0.836	0.836
(13)	Other (Credit A&H)	0.931	0.935
(14)	Financial/Mortgage Guaranty	1.805	1.598
(15)*	INTL	1.355	1.234
(16)*	REIN. P&F Lines	1.072	1.170
(17)*	REIN. Liability	1.253	1.322
(18)	PL	1.229	1.263
(19)	Warranty	0.920	0.854

PR018 Underwriting Risk - Premiums			
Proposed Line (7), Adjustment for Investment Income			
Col.	Line of Business	2024 Factor	2023 Factor
(1)*	H/F	0.960	0.954
(2)	PPA	0.931	0.925
(3)	CA	0.897	0.890
(4)	WC	0.836	0.839
(5)*	CMP	0.909	0.896
(6)	MPL Occurrence	0.781	0.767
(7)	MPL Claims Made	0.845	0.827
(8)*	SL	0.911	0.898
(9)	OL	0.827	0.816
(10)	Fidelity/Surety	0.913	0.904
(11)*	Special Property/Pet Insurance	0.953	0.949
(12)	Auto Physical Damage	0.975	0.971
(13)	Other (Credit A&H)	0.953	0.947
(14)	Financial/Mortgage Guaranty	0.888	0.884
(15)*	INTL	0.915	0.905
(16)*	REIN. P&F Lines	0.906	0.893
(17)*	REIN. Liability	0.794	0.777
(18)	PL	0.788	0.774
(19)	Warranty	0.938	0.904

New Industry Average Risk Factors - Annual Update

During its June 28 meeting, the Capital Adequacy (E) Task Force adopted the annual update of industry average development factors:

PR017 Underwriting Risk - Reserves			
Line (1), Industry Development Factors			
Col.	Line of Business	2024 Factor	2023 Factor
(1)	H/F	1.020	0.999
(2)	PPA	1.061	1.047
(3)	CA	1.115	1.106
(4)	WC	0.882	0.873
(5)	CMP	1.024	1.026
(6)	MPL Occurrence	0.910	0.906
(7)	MPL Claims Made	0.996	0.984
(8)	SL	0.996	0.994
(9)	OL	0.993	0.969
(10)	Fidelity/Surety	0.875	0.852
(11)	Special Property / Pet Insurance	0.989	0.983
(12)	Auto Physical Damage	0.999	1.016
(13)	Other (Credit A&H)	0.942	0.946
(14)	Financial/Mortgage Guaranty	0.493	0.674
(15)	INTL	2.168	2.414
(16)	REIN. P&F Lines	0.930	0.924
(17)	REIN. Liability	1.054	1.024
(18)	PL	0.882	0.874
(19)	Warranty	0.991	0.995

PR018 Underwriting Risk - Net Written Premiums			
Line (1), Industry Average Loss and Expense Ratios			
Col.	Line of Business	2024 Factor	2023 Factor
(1)*	H/F	0.695	0.679
(2)	PPA	0.799	0.791
(3)	CA	0.787	0.777
(4)	WC	0.646	0.651
(5)*	CMP	0.684	0.671
(6)	MPL Occurrence	0.752	0.767
(7)	MPL Claims Made	0.828	0.815
(8)*	SL	0.583	0.578
(9)	OL	0.649	0.641
(10)	Fidelity/Surety	0.375	0.363
(11)*	Special Property / Pet Insurance	0.559	0.550
(12)	Auto Physical Damage	0.733	0.727
(13)	Other (Credit A&H)	0.711	0.702
(14)	Financial/Mortgage Guaranty	0.158	0.209
(15)*	INTL	1.153	1.136
(16)*	REIN. P&F Lines	0.587	0.578
(17)*	REIN. Liability	0.760	0.743
(18)	PL	0.594	0.597
(19)	Warranty	0.641	0.652

* Cat Lines

Catastrophe Risk

Interrogatory on Catastrophe Risk Reinsurance Program (PR027INTA)

Given the recent catastrophe-related insolvencies and increasing cost of catastrophe reinsurance coverage, state insurance regulators have identified a need to collect additional detail from insurers on the structure of their catastrophe reinsurance programs on an annual basis. As such information could be viewed as confidential and proprietary and is closely related to the existing PR027 Rcat charge, the collection of additional information on an insurer's catastrophe reinsurance program is being proposed through a series of questions added to the PR027 Catastrophe Risk Interrogatories. The Capital Adequacy (E) Task Force adopted proposal 2023-13-CR during its March 17 meeting, which added page PR027INTA to the P/C RBC blanks.

Convective Storm Structure in Rcat for Informational Purposes Only (PR027D)

The Capital Adequacy (E) Task Force adopted proposal 2023-15-CR during its March 17 meeting to add severe convective storm as one of the catastrophe perils for informational purposes only in the Rcat component. While the Catastrophe Risk (E) Subgroup reviewed the possibility of expanding the current catastrophe framework to include other perils that may experience a greater tail risk under projected climate-related trends, the severe convective storm has been identified as a catastrophe peril in the Rcat component.

Climate Scenario Analysis (PR027D)

As a result of the adoption of proposal 2023-17-CR MOD during the Financial Condition (E) Committee's August 2 meeting, the disclosure of climate-conditioned catastrophe exposure for hurricane and wildfire, which reflect adjusted frequency and severity for years 2040 and 2050, was added to the P/C RBC blanks. This information is intended to be useful for domestic regulators holding conversations with insurers who may have a greater degree of risk for these perils.

Affiliated Investments

Modification to the Affiliated Investment Blanks (PR003)

The Capital Adequacy (E) Task Force adopted proposal 2024-08-CA during its April 30 meeting to remove the "R0 Component" reference from the Column 12 heading on page PR003. The "R0"

references are misleading because only affiliate types 1, 2, 5, and 6 flow into R0, while affiliate types 3, 4, 7, 8, and 9 flow into R2.

In addition, the Task Force adopted proposal 2023-12-CA during its Dec. 2, 2023, meeting to adopt an editorial change made to remove the word “Common” in the heading of Column (13) of PR003 Details for Affiliated Stocks. A corresponding change was made to PR007 Unaffiliated Preferred and Common Stock and PR031 (Calculation of Total Risk-Based Capital After Covariance) by removing the word “Common” in line “Market Value in Excess Affiliated Stocks.” This line includes the affiliated amounts for both preferred and common stock.

Accident and Health Business

Underwriting Risk Factors (PR020)

The Capital Adequacy (E) Task Force adopted proposal 2024-09-CA during its June 28 meeting. This proposal updated the comprehensive medical, Medicare supplement, and dental and vision factors to include a 5.5% investment yield adjustment. The revised factors are:

	Comprehensive Medical	Medicare Supplement	Dental & Vision
\$0-\$3 Million	0.1427	0.0973	0.1143
\$3-\$25 Million	0.1427	0.0596	0.0706
Over \$25 Million	0.0832	0.0596	0.0706

Other Health Line (PR019)

During its April 30 meeting, the Capital Adequacy (E) Task Force adopted proposal 2024-10-P, which: 1) added “in part” to the Line 25 annual statement source; and 2) updated Column 1, Line 25 to “Company Record.” These changes eliminated the double-counting issue for those companies that have stop-loss premium.

Receivable for Securities Factor

The Capital Adequacy (E) Task Force adopted proposal 2024-13-CA during its June 28 meeting, which updated the factor for the Receivables for Securities (Line (1), Page PR009) from 0.020 to 0.025.

Modification of Other Long-Term Assets (PR008) Structure for Residual Tranches or Interests

The Capital Adequacy (E) Task Force adopted proposal 2024-02-CA during its April 30 meeting to add a line in PR008 to include the total of residual tranches or interests on a stand-alone line with no factor proposed and, hence, deemed as structural change only.

Residual Tranches or Interests Factor

The Capital Adequacy (E) Task Force adopted proposal 2024-18-CA during its June 28 meeting to adopt a 20% factor for residual tranches or interests in PR008.

Last Page: RBC Forecasting and Warning:

Risk-Based Capital Forecasting and Instructions

The P/C RBC forecasting spreadsheet calculates RBC using the same formula presented in the *2024 NAIC Property & Casualty Risk-Based Capital Report Including Overview & Instructions for Companies*. The entire RBC publication, including the forecasting spreadsheet, can be downloaded from the [NAIC Account Manager](#) through the NAIC Publications Department. This publication is available for purchase on or about Nov. 1 each year. The User Guide is no longer included in the RBC publications.

WARNING: The RBC forecasting spreadsheet CANNOT be used to meet the year-end RBC electronic filing requirement. RBC filing software from an annual financial statement software vendor should be used to create the electronic filing. If the forecasting worksheet is sent instead of an electronic filing, it will not be accepted, and the RBC will not have been filed.

Last Page: 2023 National Association of Insurance Commissioners:

2024 NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

Property and Casualty Risk-Based Capital Newsletter Volume **28.2**. Published annually or whenever needed by the NAIC for state insurance regulators, professionals, and consumers.

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Address corrections requested. Please mail the old address label with the correction to: NAIC Publications Department, 1100 Walnut St., Suite 1500, Kansas City, MO 64106-2197. Phone: 816-783-8300. Email: prodserv@naic.org.

Attachment Five-F
Capital Adequacy (E) Task Force
8/14/24

Summary: Aggregate P/C RBC Results By Year

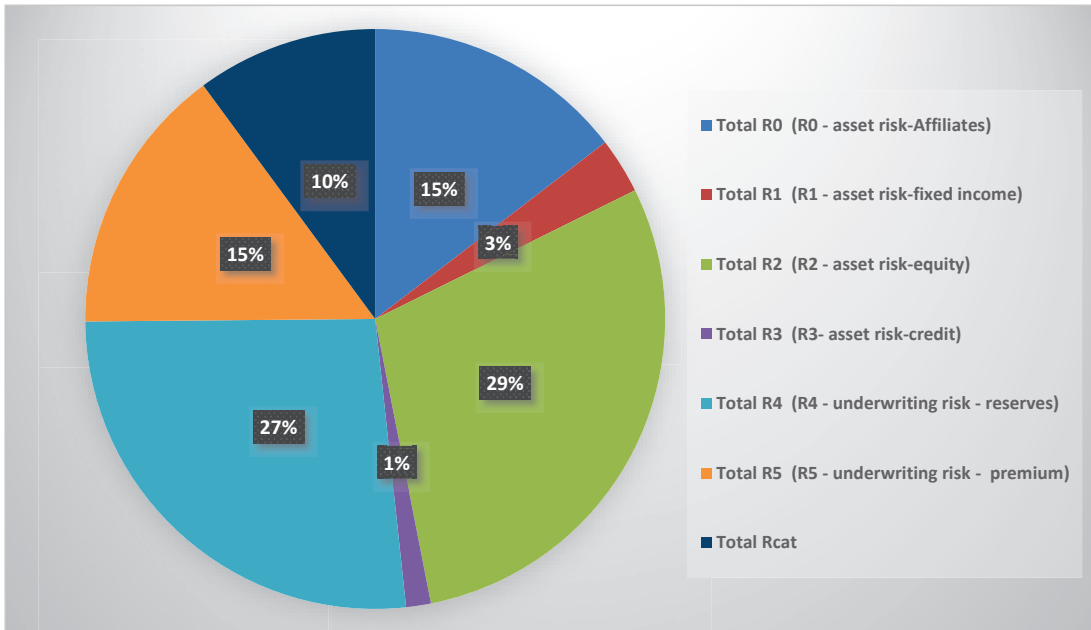
AGGREGATED P&C RBC DATA
2023 Data as of June 27, 2024

	YR2023	YR2022	YR2021	YR2020	YR2019	YR2018
# OF COMPANIES FILED RBC	2,546	2,522	2,511	2,477	2,490	2,465
# OF COMPANIES FILED AST	2,634	2,626	2,626	2,599	2,593	2,607
% OF RBC COMPANIES	97%	96%	96%	95%	96%	95%
GRAND TOTAL OF CO'S AT AN ACTION LEVEL						
LEVEL						
TREND TEST	1	23	19	17	24	17
COMPANY ACTION LEVEL	1	17	27	8	15	14
REGULATORY ACTION LEVEL	2	14	7	3	4	8
AUTHORIZED CONTROL LEVEL	3	4	3	6	3	2
MANDATORY CONTROL LEVEL	4	16	17	18	20	22
TOTAL	51	54	35	42	38	48
% OF ACTION LEVEL COMPANIES	2.00%	2.14%	1.39%	1.70%	1.53%	1.95%
RRG'S AT AN ACTION LEVEL						
LEVEL						
RRG'S TREND TEST	1	5	5	8	9	4
RRG'S AT COMPANY ACTION LEVEL	1	9	11	4	5	4
RRG'S AT REGULATORY ACTION LEVEL	2	6	4	2	2	3
RRG'S AT AUTHORIZED CONTROL LEVEL	3	0	1	1	2	0
RRG'S AT MANDATORY CONTROL LEVEL	4	4	7	5	6	4
TOTAL RRG'S AT AN ACTION LEVEL	19	23	12	15	11	18
TOTAL RRG'S	248	249	225	225	225	224
% OF RRG'S AT AN ACTION LEVEL	7.66%	9.24%	5.33%	6.67%	4.89%	8.04%
TOTAL CO'S AT A LEVEL EXCLUDING RRG'S						
LEVEL						
TREND TEST	1	18	14	9	16	13
COMPANY ACTION LEVEL	1	8	16	4	10	5
REGULATORY ACTION LEVEL	2	8	3	1	2	5
AUTHORIZED CONTROL LEVEL	3	4	2	5	1	2
MANDATORY CONTROL LEVEL	4	12	10	13	14	15
TOTAL CO'S AT AN ACTION LEVEL EXCL. RRG'S	32	31	23	27	27	30
TOTAL CO'S EXCLUDING RRG'S	2298	2273	2286	2252	2265	2241
% OF ACTION LEVEL COMPANIES	1.39%	1.36%	1.01%	1.20%	1.19%	1.34%
# OF COMPANIES WITH RBC RATIO > 10000%	395	378	364	542	540	525
# OF COMPANIES WITH RBC RATIO > 1,000 & < 10,000%	949	1,007	1,037	832	836	836
# OF COMPANIES WITH RBC RATIO > 500 & < 1,000%	628	611	634	620	627	682
# OF COMPANIES WITH RBC RATIO > 300 & < 500%	423	380	359			
# OF COMPANIES WITH RBC RATIO > 250 & < 300%	55	55	46			
# OF COMPANIES WITH RBC RATIO < 500% > 250%				418	420	409
# OF COMPANIES WITH RBC RATIO > 200 & < 250%	45	37	36	23	29	35
# OF COMPANIES WITH RBC RATIO < 200 & <= 0%	51	54	35			
# OF COMPANIES WITH RBC RATIO OF ZERO	0	0	0			
TOTAL	2,546	2,522	2,511			
TOTAL ADJUSTED CAPITAL	1,305,188,051,389	1,211,723,945,518	1,295,396,441,237	1,147,914,269,354	1,073,407,595,862	931,224,541,048
AUTHORIZED CONTROL LEVEL RBC	225,770,759,221	206,730,000,454	209,812,119,487	186,945,420,616	171,329,036,103	151,112,834,048
AGGREGATE RBC %	578%	586%	617%			
MEDIAN RBC %	1097%	1145%	1167%			
Total R0 (R0 - asset risk-subsidary insurance companies)	92,893,237,492	82,520,919,036	84,025,196,294	76,046,027,452	68,455,409,790	58,785,678,885
Total R0A (R0A - asset risk-subsidary insurance companies)	N/A	N/A	N/A	N/A	N/A	N/A
Total R1 (R1 - asset risk-fixed income)	19,763,201,704	19,282,260,346	19,509,016,149	9,673,549,747	8,753,606,104	8,046,031,430
Total R1A (R1A - asset risk-fixed income)	N/A	N/A	N/A	N/A	N/A	N/A
Total R2 (R2 - asset risk-equity)	186,251,584,606	174,361,118,092	192,082,618,520	161,553,769,065	144,697,616,270	119,069,344,182
Total R2A (R2A - asset risk-equity)	N/A	N/A	N/A	N/A	N/A	N/A
Total R3 (R3 - asset risk-credit)	8,800,279,481	8,287,161,773	11,388,107,162	10,387,430,318	9,357,397,726	9,301,202,060
Total R3A (R3A - asset risk-credit)	N/A	N/A	N/A	N/A	N/A	N/A
Total R4 (R4 - underwriting risk - reserves)	169,235,693,704	154,267,900,707	145,492,505,595	130,302,138,858	123,165,959,122	114,979,409,018
Total R4A (R4A - underwriting risk - reserves)	N/A	N/A	N/A	N/A	N/A	N/A
Total R5 (R5 - underwriting risk - net written premium)	95,802,981,865	88,254,096,856	81,117,342,335	78,327,294,222	74,813,906,575	75,532,307,468
Total R5A (R5A - Unerwriting Risk - net written premium)	N/A	N/A	N/A	N/A	N/A	N/A
Total R6 (R6 - Catastrophe Risk for Earthquake)	N/A	N/A	N/A	N/A	N/A	N/A
Total R7 (R7 - Catastrophe Risk for Hurricane)	N/A	N/A	N/A	N/A	N/A	N/A
Total Rcat	64,358,508,354	56,443,376,138	54,458,108,356	55,405,268,158	53,740,016,069	52,510,292,783
Net Basic Operational Risk	13,033,528,133					

Source: NAIC Financial Database

Att03_SUM2023_062724.xlsx 1

Total R0 (R0 - asset risk-Affiliates)	92,893,237,492
Total R1 (R1 - asset risk-fixed income)	19,763,201,704
Total R2 (R2 - asset risk-equity)	186,251,584,606
Total R3 (R3- asset risk-credit)	8,800,279,481
Total R4 (R4 - underwriting risk - reserves)	169,235,693,704
Total R5 (R5 - underwriting risk - premium)	95,802,981,865
Total Rcat	64,358,508,354



Draft Pending Adoption

Attachment Six
Capital Adequacy (E) Task Force
8/14/24

Draft: 8/20/24

Risk-Based Capital Investment Risk and Evaluation (E) Working Group
Chicago, Illinois
August 14, 2024

The Risk-Based Capital Investment Risk and Evaluation (E) Working Group of the Capital Adequacy (E) Task Force met in Chicago, IL, Aug. 14, 2024. The following Working Group members participated: Philip Barlow, Chair (DC); Thomas Reedy, Vice Chair (CA); Wanchin Chou (CT); Carolyn Morgan and Nicole Crockett (FL); Carrie Mears and Kevin Clark (IA); Vincent Tsang (IL); Roy Eft (IN); Fred Andersen (MN); Debbie Doggett (MO); Tadd Wegner (NE); Jennifer Li (NH); Bob Kasinow and Bill Carmello (NY); Dale Bruggeman and Tom Botsko (OH); Jamie Walker and Rachel Hemphill (TX); Doug Stolte (VA); Steve Drutz and Katy Bardsley (WA); and Amy Malm (WI).

1. Adopted its June 21, May 22, April 12, and Spring National Meeting Minutes

The Working Group met June 21, May 22, and April 12. During these meetings, the Working Group took the following action: 1) discussed a review of year-end 2023 data reported for residual tranches; 2) heard a presentation from the Structured Securities Group (SSG); 3) discussed comment letters received on Oliver Wyman's residual tranche risk analysis; 4) discussed comment letters received on a memorandum requesting additional feedback from industry stakeholders to substantiate their request for an additional one-year delay in implementing the 45% risk-based capital (RBC) factor for residual tranches; 5) discussed comment letters received on proposal 2024-19-I and other potential alternative proposals; 6) discussed the American Council of Life Insurers' (ACLI's) survey data on residual ownerships by life insurers; and 7) voted to retain the original adoption of the 45% charge to be applied to all residuals.

Chou made a motion, seconded by Drutz, to adopt the Working Group's June 21 (Attachment Six-A), May 22 (Attachment Six-B), April 12 (Attachment Six-C), and March 17 (*see NAIC Proceedings – Spring 2024, Capital Adequacy (E) Task Force*) minutes. The motion passed unanimously.

2. Received Updates from the Valuation of Securities (E) Task Force and Statutory Accounting Principles (E) Working Group

Mears said the Valuation of Securities (E) Task Force met Aug. 13 and adopted an updated definition of an NAIC designation. The significant changes included: 1) the addition of "Regulatory Objective;" and 2) broadening the scope from credit risk-oriented to investment risk assessment to allow a broader application (e.g., designations for funds, certain types of non-filing-exempt [FE] assets, and bonds that no longer meet the definition of a bond and get moved to Schedule BA). The Task Force also adopted a process to permit its discretion over NAIC designations assigned through the FE process. Lastly, Mears provided an update on the collateralized loan obligation (CLO) modeling project led by the SSG.

Bruggeman said the Statutory Accounting Principles (E) Working Group adopted the principle-based bond definition to become effective Jan. 1, 2025. A corresponding adoption by the Blanks (E) Working Group may impact the Working Group as the Schedule D, Part 1 Bond Schedule will be broken into two schedules, one for issuer credit obligations and one for asset-backed securities (ABS). Bruggeman highlighted revisions adopted for Schedule BA that allow non-bond debt securities held by life insurers to receive bond factors if the investments have a designation assigned by the Securities Valuation Office (SVO). Non-bond debt securities without an SVO-

Draft Pending Adoption

Attachment Six
Capital Adequacy (E) Task Force
8/14/24

assigned designation or those held by property and casualty (P/C) or health insurers are not afforded bond factors. Bruggeman said no further RBC proposal is anticipated to effect the changes described, but the Capital Adequacy (E) Task Force and its working groups have full purview over RBC and can further assess the RBC framework for non-bond debt securities.

Bruggeman said another project adopted by the Statutory Accounting Principles (E) Working Group with an effective date of Jan. 1, 2025, is the revision to state and federal tax credit and tax credit investment guidance in *Statement of Statutory Accounting Principle (SSAP) No. 93—Low-Income Housing Tax Credit Property Investments* and *SSAP No. 94R—Transferable and Non-Transferable State Tax Credits*. Broadly, the accounting guidance was revised to remove the specific guidance for low-income housing tax credits (LIHTCs) and instead establish guidance for all qualifying investments in state and federal tax credits, regardless of tax credit program or if they are in the form of debt or equity. Related blanks changes were also adopted. One key reporting change was the removal of the guaranteed federal tax credit reporting line. It was removed, as the concept of a yield-guaranteed federal tax credit investment is no longer permitted under the Internal Revenue Service's (IRS's) tax credit rules. Bruggeman said the following feedback received from the comment process may impact RBC working groups: 1) industry commented that if the investments do not meet the criteria for reporting under the qualifying tax credit investment reporting lines, the current RBC factors may be too high and not commensurate with risk; and 2) with the broadening of the scope of SSAP No. 93 and No. 94 to encompass all types of tax credit investments, the current RBC factors may not be appropriate, as they were developed using real estate historical data.

Bruggeman said the Statutory Accounting Principles (E) Working Group exposed a proposal to affect changes to the reinsurance schedules such that more details are disclosed for assets involved in funds withheld and modified coinsurance (modco) arrangements. Such revisions, if adopted, facilitate the direct pull of data from the annual statement and will enhance transparency.

Finally, Bruggeman said that the Statutory Accounting Principles (E) Working Group exposed a proposal to have more granular reporting of collateral loans based on the underlying collaterals, with an anticipated effective date of Jan. 1, 2026. The Capital Adequacy (E) Task Force and its working groups have been encouraged to look into any potential instruction and/or factor changes resulting from this revision.

3. Heard an Update from the Academy on a CLO Risk Bucketing Proposal

Steve Smith (American Academy of Actuaries—Academy) said the timeline for a proposal developed for identifying which comparable attributes would be used for CLO risk bucketing needs to be revised from the upcoming Fall National Meeting into early 2025. The Academy is working through some issues in accessing the data needed. Smith said there was great collaboration with the SSG; therefore, the Academy should be able to use the NAIC's software license to perform runs once all the permissions and legal formalities are ironed out.

Botsko asked if the Academy plans to provide a status update during the Fall National Meeting. Smith responded that a status update will be provided, including information such as the nature of the data received and the work performed by the Academy up to that point.

4. Discussed Referrals Related to Funds

Barlow said several items on the Working Group's working agenda related to funds and he would like to tackle them holistically. He said NAIC staff developed and shared a memorandum with Working Group members prior

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to the meeting. NAIC staff will continue to refine the document until it is ready for broader circulation and can be used to guide the Working Group's discussions. Barlow then asked if any interested parties were willing to work with NAIC staff to compile a comprehensive list of all funds that should be subjected to the Working Group's review. Brian Bayerle (ACLI) volunteered to work with NAIC staff on this project.

Chou referred to page two of Attachment E and asked where the Working Group stands regarding investments in exchange-traded funds (ETFs) that are not captured in the SVO listing. He said ETFs are different from common stocks and may warrant further deliberation. Barlow responded that this topic could be a candidate for the funds review project discussed earlier.

5. Adopted its 2024 Working Agenda

Barlow said that apart from several updates on dates, the main update to the working agenda is the addition of IR9: Develop a structure and factors proposal to reflect the split of the Annual Statement Schedule D, Part 1 into two schedules for all lines of business.

Botsko asked about the status of the asset concentration referral from the Capital Adequacy (E) Task Force to the Working Group. Barlow responded that the topic would be added to the Working Group's working agenda during its next meeting.

Botsko made a motion, seconded by Chou, to adopt its 2024 working agenda (Attachment Seven). The motion passed unanimously.

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

SharePoint/NAIC Support Staff Hub/Committees/E CMTE/CADTF/2024-2-Summer/RBC Investment Risk 08-14-24 Minutes TPR'd.docx

Draft: 7/9/24

Risk-Based Capital Investment Risk and Evaluation (E) Working Group
Virtual Meeting
June 21, 2024

The Risk-Based Capital Investment Risk and Evaluation (E) Working Group of the Capital Adequacy (E) Task Force met June 21, 2024. The following Working Group members participated: Philip Barlow, Chair (DC); Thomas Reedy, Vice Chair (CA); Wanchin Chou (CT); Carrie Mears and Kevin Clark (IA); Vincent Tsang (IL); Roy Eft (IN); Fred Andersen (MN); William Leung and Debbie Doggett (MO); Lindsay Crawford (NE); Jennifer Li (NH); Bob Kasinow and Bill Carmello (NY); Tom Botsko (OH); Rachel Hemphill (TX); Doug Stolte (VA); Steve Drutz (WA); and Amy Malm (WI).

1. Discussed Comment Letters (Attachment Six-A1) Received on Residual Proposal 2024-19-I

Barlow said the 45% charge for residuals was adopted last year, so there is no absolute necessity to adopt proposal 2024-19-I. He said that should there be adoption, the vendors had suggested a few tweaks to the instructions. He said only the simple majority is needed for adoption at the working group level, whereas supermajority is needed at the task force level, given the timing of the exposure. Barlow emphasized that the proposal cannot be adopted “as is” and that the purpose of the meeting was to discuss the potential changes.

Joe Engelhard (Alternative Credit Council—ACC) presented a comment letter. He said the ACC expressed support of the proposal for the most part, except that it recommended the addition of residuals backed by real estate (e.g., commercial real estate [CRE] collateralized loan obligations [CLOs] and commercial mortgage-backed securities [CMBS]) to the 45% bucket, as suggested by the Structured Securities Group (SSG). The ACC disagreed with the SSG in that middle-market CLOs performed similarly to broadly syndicated loan (BSL) CLOs. Engelhard said the ACC believes the former is safer based on the historical default data of the Standard & Poor’s 500 index (S&P 500). He said the ACC also agreed with some commenters that not all residuals are equal in terms of risk. He stated that the ACC said Oliver Wyman’s report demonstrated a correlation between certain attributes (e.g., the thickness of the residual tranche and ratings of the next most junior tranche) and level of losses for CLOs only, not other types of asset-back securities (ABS) residuals. Engelhard said that given the American Academy of Actuaries (Academy) is conducting a holistic review of comparable attributes across a wide variety of ABS assets, the ACC recommended against, for interim solution purposes, applying selective rigor(s) in determining charges.

Clark disagreed with the ACC’s comment that there is no observed correlation between risks and ratings for auto and student loan ABS. Clark observed that in Oliver Wyman’s report, the samples taken for prime auto loans were primarily investment grade, and the samples for subprime auto loans were primarily below investment grade. He said that Oliver Wyman’s report pointed out a difference in risk between the two categories.

Steve Smith (Academy) presented a comment letter. He pointed out that one issue with the proposal is the use of a single attribute (i.e., collateral type) as the determinant of charges. He said the proposal to give a lower charge to middle-market CLOs compared to BSL CLOs is caused by confusing correlation for causation. He said the Academy expects that, given that all else is equal for the structure, a middle-market CLO would have more risk than a BSL CLO. Smith said the Academy concurred with the ACC’s recommendation to avoid the application of selective rigor(s) for the interim solution.

Bryan Bashur (Americans for Tax Reform—ATR) presented a comment letter. He said ATR is supportive of the proposal but concerned that the blanket application of a 45% charge on residuals would raise the cost of life and annuities products. Bashur said ATR also expressed concern that the 45% charge will significantly reduce the

availability of middle-market CLOs, student and credit card loans, and other financial products that are typically securitized.

Mike Consedine (Athene) presented a comment letter. He said Athene believed the application of 45% across all ABS residuals is overly conservative and, therefore, is in support of a two-bucket approach as in the proposal. Athene's comment letter laid out factors to consider when middle-market CLOs should or should not be exempted. Finally, Consedine said Athene commended the alternative proposal the Iowa Insurance Division (IID) put forth as a simple, balanced, and thoughtful approach.

Consedine noted that Athene suggested the possibility of allowing stakeholders to submit a more detailed analysis in 2025 to further refine the proposal. Barlow welcomed the idea.

Patrick Reeder (Everlake) presented a comment letter. Reeder said Everlake continues to stand by the use of collateral type as the sole determinant of residual charges. Chou inquired if Everlake would make a compromise to the original proposal by removing the middle-market CLOs from the "Exempted" list. Reeder said Everlake consented.

Jeff Johnson (Global Atlantic Financial Group—Global Atlantic) presented a comment letter. He said Global Atlantic supported a bifurcated approach to assessing capital charges. Johnson said the proposal needs to be further refined to include residual tranche thickness in determining whether residuals qualify for "exemption." According to Global Atlantic, the following residuals are qualified for a 30% capital charge: middle-market CLOs and BSL CLOs with residual thickness greater than or equal to 15%, prime loans ABS with residual thickness greater than or equal to 5%, and ABS backed by hard assets with residual thickness greater than or equal to 10%. Tsang asked how the 15% is being selected as the threshold and whether 15% should be measured at origination or as of reporting date. Johnson responded that 15% is based on Figure 19 of Oliver Wyman's report and that the percentage should be determined at origination. Tsang asked whether the CLO should continue to be qualified for "exemption" if the securitization performs poorly after origination and the residual thickness declines below 15%. Johnson said Global Atlantic believes this issue should be dealt with using a long-term solution. Clark said Tsang's concern illustrated the advantage of using the rating of the next lowest tranche as rigor because any defaults/credit deterioration of the underlying collaterals will likely trigger a downgrade of the next most junior tranche, causing a factor reconsideration event.

Sarah Williams (Guardian Life) presented a joint comment letter. Williams said the letter proposed using residual thickness as the sole rigor for interim purposes. Specifically, 20% of residual thickness is chosen. Williams said that although this rigor has proven more relevant for CLOs, CLO is a representative asset class among the residuals, attaining 75% coverage per the American Council of Life Insurers (ACLI) survey. Besides ease of application, Williams said she believed this rigor will avoid the unintended consequences of incentivizing increased leverage in the securitization structure. It was noted that 20% is a bit more conservative than what is supportable by the Oliver Wyman report.

Francisco Paez (MetLife) presented a joint comment letter. The signors of the joint letter continued to support the adoption of a 45% charge for all residuals without delay. Paez reacted to other proposals that centered around the use of residual thickness or rating of the next most junior tranche as a sole determinant of capital charge. He said restructuring mechanisms (collapsing residual tranche with the next junior most tranche) could easily be used to circumvent the spirit of the rule, giving reprieve in charges without an actual reduction in risk. In addition, Paez cautioned against conclusions that rely solely on specific loss estimates in the Oliver Wyman report, as gaps are observed. Finally, Paez said none of the proposals thus far are based on analysis credibly aligned with insurers' actual holdings and conditional tail expectation risk measure approach.

Barlow called upon Doug Farren (National Center for the Middle Market—NCMM) to present a comment letter. No representative spoke on the comment letter.

Gordan Gray (Pinpoint Policy Institute) presented a comment letter. He said Pinpoint supported proposal 2024-19-I. Gray expressed concern, however, that the broad application of a 45% charge would reduce access to capital, specifically for the middle-market sector.

Barlow called upon Paul Stephen (Resolution Life) and Karen Kerrigan (Small Business & Entrepreneurship Council) to present comment letters. No representative spoke on the comment letters.

2. Discussed the ACLI Survey Data

Mariana Gomez-Vock (ACLI) said the ACLI was appreciative of the opportunity to provide additional insight to the Working Group (Attachment Six-A2). She and her colleague stood ready for questions. No further questions were posted.

3. Discussed Proposal 2024-19-I

Barlow asked if any Working Group members felt strongly about whether middle-market CLO residuals should be afforded 30% versus 45% capital charge. Andersen responded that the 45% appeared appropriate as middle-market CLOs are not less risky than BSL CLOs. Stolte concurred. He thought 45% was supportable per the Oliver Wyman report. Clark stated that even though the Oliver Wyman report appears to demonstrate lower risk for middle-market CLOs, he thought the sample of middle-market CLOs selected by Oliver Wyman was meaningfully different than those reported as held by life insurers in the ACLI's survey in terms of credit quality of the next most junior tranche. As such, Clark said he is inclined to put middle-market CLO residuals in the 45% bucket. That said, Clark advocated for a bifurcated approach and said he believed certain other residuals qualify for lower than a 45% charge. Chou agreed with Clark.

Barlow invited Clark to present the memorandum and recommendations put together by the IID. Clark said Iowa's memorandum weighed the pros and cons of the proposals presented thus far. The use of the credit rating provider (CRP) rating of the next most junior tranche has been Iowa's most favored approach. Clark clarified, however, that Iowa would likely also support other proposals, including Everlake's, if middle-market CLOs are moved to the 45% bucket. Stolte said the issue with the use of CRP rating as rigor is the created dependency on CRP ratings. He said he can foresee "rating shopping." He was also concerned about the incentives created for insurers to structure securitizations to circumvent the spirit of the rule. Stolte also had an issue with Everlake's proposal, which incorporated an element of "permitted practice" by the domiciliary state, which is not meant to be allowable under model law. Clark agreed and suggested removal from the proposal if it were to be considered for adoption.

Stolte made a motion, seconded by Kasinow, to uphold the original adoption of the 45% charge broadly applied to all residuals.

Chou, Walker, and Clark disagreed with the broad application of the 45% charge and volunteered to make a motion for a "modified" version of Everlake's proposal, which Clark said he would second if the opportunity was presented.

Andersen said the use of two buckets incentivized the restructuring of securitization structures and reshuffling of assets, rendering bifurcation based on structures and collateral type meaningless. As such, he said he would support Stolte's motion. Reedy concurred. Mears clarified that the modified Everlake proposal was purely based on collateral type for bifurcation and, therefore, the circumvention concern raised by Andersen and Reedy likely

could not be played out. Walker clarified that Texas is more supportive of Iowa's proposal than the modified Everlake proposal, as the former is more risk-based. Tsang thought that there should not be significant differences given the composition of insurers' holdings, regardless of which proposal is finally adopted.

Kay Noonan (NAIC) clarified a procedural question Barlow had raised. The Working Group was asked to vote on Stolte's motion as it came first and was seconded by Kasinow.

A roll call vote was taken. The motion passed, with nine members voting "yes" and six voting "no." The 45% charge will be applied broadly across the residuals, effective 2024, as an interim solution.

4. Discussed Other Matters

Mears inquired about the next agenda item the Working Group would consider. Specifically, she asked whether the comprehensive fund proposal will be discussed next. Barlow said it would, but he did not have a chance to review the topic. He said he planned to discuss this with NAIC staff and come up with a plan for future meetings.

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

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

Via Electronic Submission

June 13, 2024

Dear Chairman Barlow:

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

The Alternative Credit Council ("ACC")¹, the private credit affiliate of the Alternative Investment Management Association Ltd ("AIMA"), appreciates the opportunity to provide comments on Proposal 2024-19-I² and the presentation by the NAIC's Structured Securities Group ("SSG")³. Given the focus on middle-market collateralized loan obligations ("MM CLOs"), we suggest a definition to distinguish between MM CLOs and broadly syndicated CLOs ("BSL CLOs") and present additional data analysis that demonstrates the relative safety and outperformance of MM CLOs compared to BSL CLOs.

-
- ¹ The Alternative Credit Council (ACC) is a global body that represents asset management firms in the private credit and direct lending space. It currently represents 250 members that manage over \$1trn of private credit assets. The ACC is an affiliate of AIMA and is governed by its own board which ultimately reports to the AIMA Council. ACC members provide an important source of funding to the economy. They provide finance to mid-market corporates, SMEs, commercial and residential real estate developments, infrastructure, and the trade and receivables business. The ACC's core objectives are to provide guidance on policy and regulatory matters, support wider advocacy and educational efforts and generate industry research with the view to strengthening the sector's sustainability and wider economic and financial benefits. Alternative credit, private debt or direct lending funds have grown substantially in recent years and are becoming a key segment of the asset management industry. The ACC seeks to explain the value of private credit by highlighting the sector's wider economic and financial stability benefits.
- ² RBC-IRE Proposal 2024-19-I ("the ABS Residual Proposal"), which updates the Risk-Based Capital ("RBC") instructions for "other long-term assets, Form LR008 (5/17/2024) at https://content.naic.org/sites/default/files/inline-files/2024-19-I%20ResidualCombined_Updated.pdf
- ³ SSG Presentation, which lists five concerns about the ABS Residual Proposal (5/17/2024) at <https://content.naic.org/sites/default/files/inline-files/IRE%20RBC%20Note.pdf>

Alternative Credit Council (ACC)

The ACC is the private credit affiliate of the Alternative Investment Management Association Limited (AIMA)
AIMA is registered in England as a Company Limited by Guarantee, No. 4437037. VAT Registration no. 577 5913 90. Registered Office as above.





Executive Summary

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

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

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

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

We welcome the opportunity to provide supplementary comments and additional data analysis. From our perspective, there are now only two data-driven analyses available to the NAIC, both of which demonstrate that a single 45% charge on ABS residuals would not correspond to the actual levels of risk. If you have any questions about this new





information, please reach out to me or Joe Engelhard, Head of Private Credit & Asset Management Policy, Americas, at 202-304-0311 or jengelhard@aima.org.

Respectfully,

A handwritten signature in blue ink, appearing to read "J Król".

Jiří Król
Global Head of Alternative Credit Council

Appendix

Distinguishing MM CLOs from BSL CLOs

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

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

Definition of a MM CLO

A middle-market CLO can be defined as one where the underlying collateral consists of a loan where the key lenders directly negotiate the loan without the intermediation of a bank and develop a bespoke loan contract that forms the basis of a long-term



relationship with the borrower and that allows for greater management control during the course of the loan.

Historical Data Shows MM CLOs Default Less Than BSL CLOs

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

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

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

The Oliver Wyman ABS Study

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

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

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

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





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

Table 8: CLO summary statistics

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

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

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

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

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

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





June 13, 2024

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

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

Dear Mr. Barlow,

On behalf of the American Academy of Actuaries¹ C1 Subcommittee, I am providing comments on the [exposed interim residual tranche proposal](#) by Everlake Life Insurance Company.

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

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

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

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

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

Sincerely,

Stephen Smith
Chairperson, C1 Subcommittee
American Academy of Actuaries



June 13, 2024

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

Dear Chair Barlow:

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

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

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

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

¹ ATR is a nonprofit, 501(c)(4) taxpayer advocacy organization that opposes all tax increases and supports limited government, free market policies. In support of these goals, ATR opposes heavy regulation and taxation of financial services. ATR was founded in 1985 at the request of President Ronald Reagan.

² <https://content.naic.org/sites/default/files/inline-files/Oliver%20Wyman%20Residual%20Tranche%20Report.pdf>.



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

ATR remains concerned that the NAIC’s RBC charge increase is a result of pressure from intergovernmental organizations³ and foreign banking regulators.⁴ The proposed bank capital requirements arbitrarily punish securitizations by doubling the p-factor.⁵ The increase in the p-factor fails to take into consideration the varying riskiness of different types of underlying collateral—just like the NAIC’s proposal to increase the RBC charge to 45 percent.

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

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

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

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

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

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

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

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

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

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

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

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



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

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

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

* * * *

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

Sincerely,

Americans for Tax Reform

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

Submitted via electronic mail

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



June 13, 2024

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

Via email: dfleming@naic.org

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

Dear Mr. Barlow:

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

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

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

During the last Working Group call, there was significant debate regarding which assets should be classified as "Exempted Residual Tranches or Interests." The Working Group could adopt the "Exempted Residual Tranches or Interests" line and spend the rest of the year gathering detailed analysis from stakeholders about which asset classes should be

included. This would enable implementation by the end of 2024 and provide a more Framework-consistent approach to reaching interim decisions. Alternatively, the Working Group could decide on the list of asset classes now but allow stakeholders to submit more detailed analysis throughout the next year on which asset classes to include in the “Exempted Residual Tranches or Interests” line for year-end 2025.

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

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

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

Sincerely,

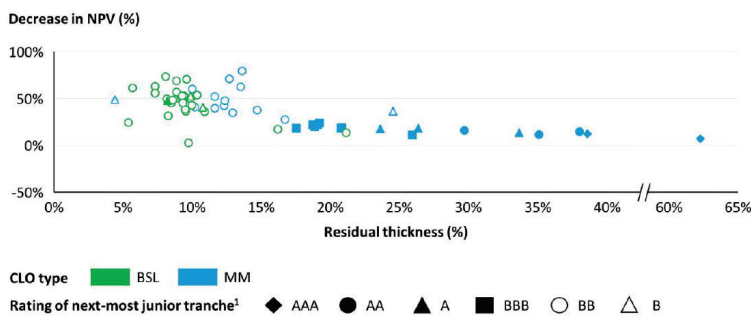


Michael Consedine
Executive Vice President
Head of US Government Relations & Regulatory Affairs

Appendix

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

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



Regardless, MM CLOs have consistently performed better than BSL CLOs. The lower loss/default for rated tranches means lower loss to equity as well. See the table below¹.

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

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

(i)Original rating counts as of June 30, 2023. (ii)CLO tranche default counts as of August 31, 2023. Source: S&P Global Ratings.

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

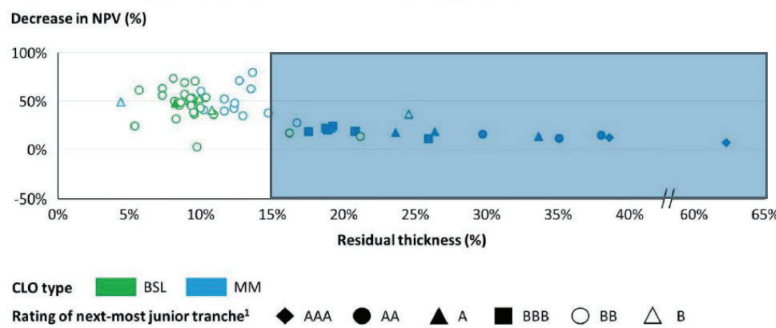
Moreover, the application of a 45% capital factor to the equity tranche regardless of the thickness of the equity or the rating of the next rated tranche, may change current practices and result in the creation of thinner equity tranches for MM CLOs.

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

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

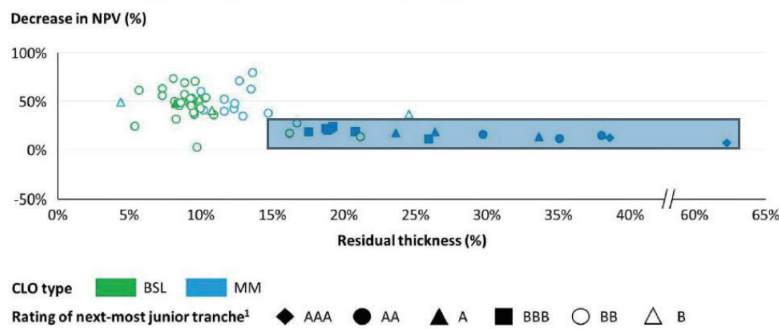
- Narrower screen test: Make the regulatory capital for equity sensitive to the risk, requiring at least 15% tranche thickness to support 30% equity capital. The Working Group could build in excess conservatism (e.g., 18% or 20%) if preferred.

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



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

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





June 13, 2024

VIA E-mail

Philip Barlow, Chair of the Risk-Based Capital Investment Risk and Evaluation (E) Working Group and Associate Commissioner for Insurance, District of Columbia
Department of Insurance, Securities and Banking
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1000
Kansas City, MO 64106-2197

Everlake Life Insurance Company
3100 Sanders Road, Suite 303
Northbrook, IL 60062
847.665.9930

everlakelife.com

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

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

Dear Mr. Barlow:

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

Executive Summary

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

Following feedback given by regulators at the previous RBC IRE meeting, we removed several items from the original list of residual tranche types that would be subject



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to a 30% charge; we do retain Middle Market (“MM”) Collateralized Loan Obligations (“CLOs”) as being subject to a 30% charge.

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

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

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

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

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

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

¹ “US CLO Market Review”, Fitch Ratings (15 Feb 2024),

² Lawrence Carrel, “Middle Market Companies See Revenue Growth, Hiring Challenges”, March 1, 2024.

³ U.S. Chamber of Commerce, “Small Business Data Center”, May 20, 2024.

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

⁵ “Scenario Analysis: How Resilient Are Middle-Market CLO Ratings (2023 Update)?” S&P Global, 16 October 2024

(<https://www.spglobal.com/ratings/en/research/articles/231016-scenario-analysis-how-resilient-are-middle-market-clo-ratings-2023-update-12884065>).

See also, Mark Adelson, The Journal of Structured Finance, Fall 2022.



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

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

Middle Market CLOs – Strong Performance and Structural Protections

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

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

⁶ See, generally regarding CLO structures, Shohini Kundu, "The anatomy of corporate securitizations and contract design," *Journal of Corporate Finance*, Volume 81 (2023).

⁷ Moody's Private Credit Conference, May 14, 2024 (<https://events.moodys.com/2024-05-miu22814-private-credit-conference/resources>).

⁸ "U.S. BSL & MM CLO Spotlight – February 2024", March 15, 2024, Fitch Ratings, Inc.

⁹ As a comparison, most business lending originated by banks that ends up in BSL CLOs through syndication.

¹⁰ All CLOs, by their nature, generally have strong structural protections. "[. . . The] fundamentals of the CLO structure protecting the noteholders, especially for the senior CLO tranches, and shows that middle-market CLOs can withstand comparable defaults with less rating impact than BSL CLOs. "Scenario Analysis: How Resilient Are Middle-Market CLO Ratings (2023 Update)?" S&P Global, 16 October 2024

(<https://www.spglobal.com/ratings/en/research/articles/231016-scenario-analysis-how-resilient-are-middle-market-clo-ratings-2023-update-12884065>)



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

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

OW Study and Middle Market CLOs

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

The OW Study Loss Analysis is Not Equivalent to RBC Charges

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

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

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

¹² Oliver Wyman, 1.

¹³ Oliver Wyman, 30, Fig 22.



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

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

II. SSG Presentation - MM CLO Residual Thickness

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

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

Conclusion

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



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

We appreciate your efforts and consideration of this request.

Very truly yours,

/s/ Patrick C Reeder

Patrick C Reeder
Chief Government Affairs Officer

/s/ Theresa M. Resnick

Theresa M. Resnick
Senior Vice President and Actuary

cc: Dave Fleming, Senior Life RBC Analyst, NAIC



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Appendix 1A

Suggested Changes to Proposal 2024-19-I

“Exempted Residual Tranches and Interests” are:

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



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Appendix 1B

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

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



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Appendix 2

Analytical Support for Appendix 1B

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

Broadly Syndicated Loan CLO Residuals

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

Middle Market Loan CLO Residuals

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

Consumer Loan Residuals

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

Aircraft and Equipment Loan/Lease Residuals

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



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

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Feeder Funds, CFOs or Other ABS Residuals

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

CRE CLOs and RMBS Residuals

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





June 13, 2024

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

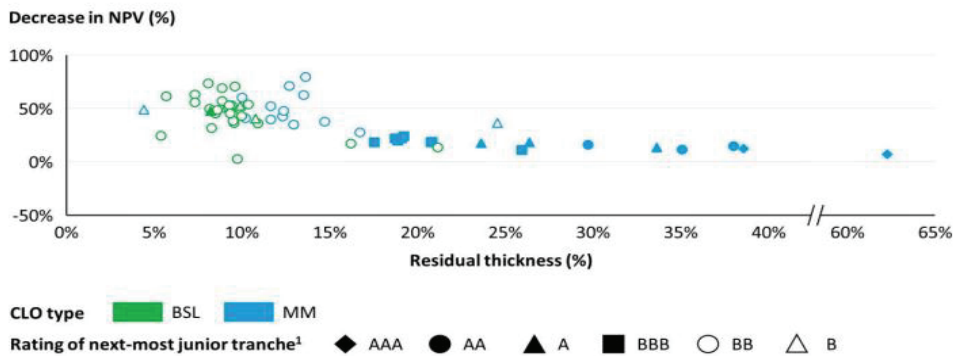
Re: Exempted Residual Tranches and Interests (RBC IRE Working Group Proposal 2024-19-I)

Dear Mr. Barlow:

Global Atlantic¹ appreciates the opportunity to comment on Proposal 2024-19-I which proposes to set the Risk Based Capital (“RBC”) charge at 45% for all residual tranches except those specifically identified as exempted.

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

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



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

Recommendation

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

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

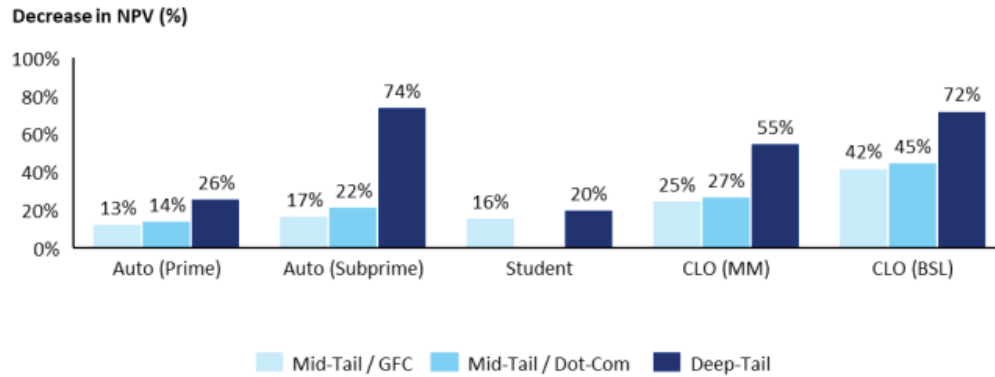
- Middle Market Loans (MML) and BSL CLOs where the size of the residuals is greater than, or equal to, 15% of the structure's collateral pool
- Transactions backed by loans or leases to prime consumers where the size of the residuals are greater than, or equal to, 5% of the structure's collateral pool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

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

Additional Rational

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

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



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

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

Sincerely,

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

June 13, 2024

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

Via e-mail: dfleming@naic.org

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

Dear Mr. Barlow:

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

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

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

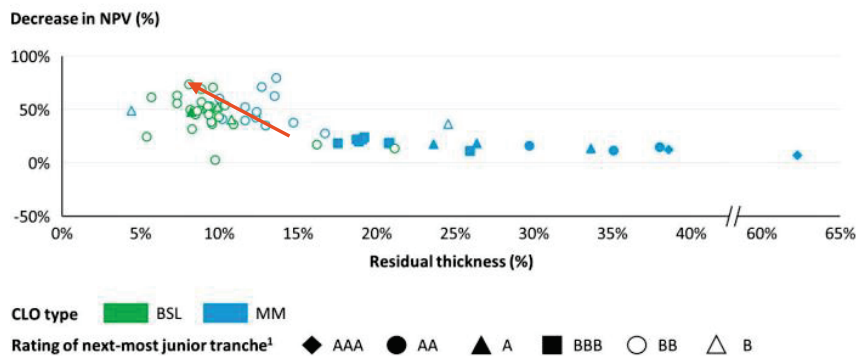
- Easily observable input avoiding need for controversial assumptions
- Directionally increases capital for most aggressive structures benefiting from capital arbitrage
- Dissuades unintended consequences of further increasing leverage in structures
- Provides a risk-based approach to capture the potential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

Mr. Philip Barlow
 June 13, 2024
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Risk of Loss Strongly Correlated with Leverage in the Structure

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

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



Exemption Based on a Conservative Level of Residual Thickness

Informed by the OW Report, we propose two criteria that must both be satisfied to determine eligibility for an exemption:

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

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

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

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

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

Table 2: Scenario-level parameters for CLOs

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

Alignment with NAIC Guidance

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

- 1) The proposal is credibly aligned with actual holdings of residuals by insurers, with middle-market loans and broadly syndicated loans being the most prevalent underlying collateral in ACLI members' ABS residual holdings. (See ACLI letter dated May 15, 2024, Table 2.0 copied below); and
- 2) The OW Report GFC and Dot-Com stress scenarios are of approximately 95th percentile severity, which is approximately equivalent to the CTE90 that the American Academy of Actuaries is applying in its work on CLOs.

Mr. Philip Barlow
 June 13, 2024
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Table 2.0 Allocation by Dollar Amount, Sector, Percentages – survey responses

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

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

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

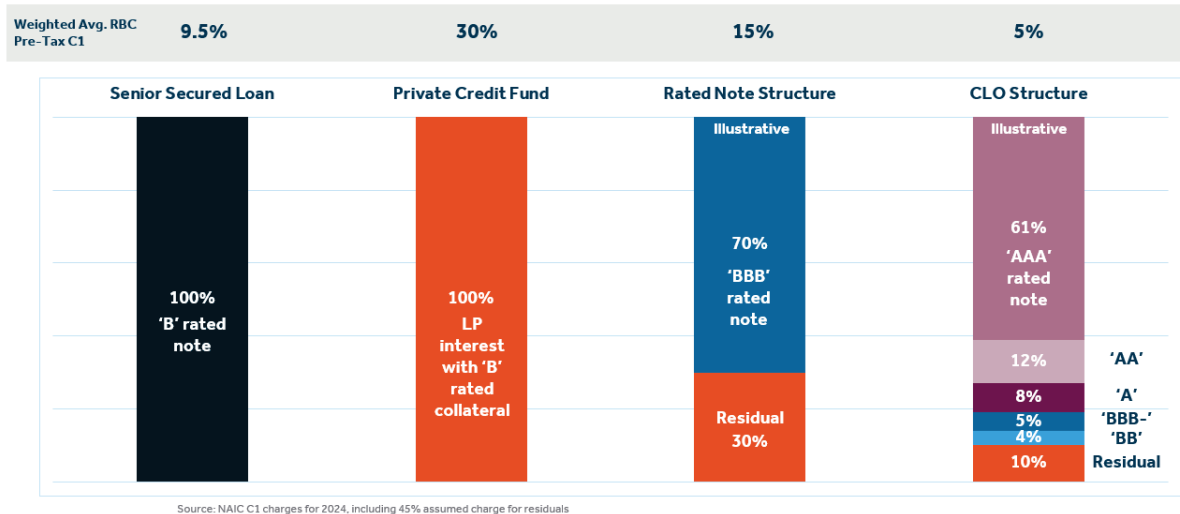
* Other ABS* = ACLJ requested data on 14 different sectors. Companies could also enter sectors into an other category if the sector was not one of the 14 sectors ACLJ asked about. In this category, members reported: Aircraft Loan ABS; Commercial Loans; Equity – other, Infrastructure Debt, Powerplant,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

Risk of Residuals Varies Widely Across Structures

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

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

Mr. Philip Barlow
 June 13, 2024
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Practical to Implement

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

$$\text{Thickness} = (\text{Par Value of Collateral Pool} - \text{Par Value of Debt Outstanding}) / \text{Par Value of Collateral Pool}$$

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

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

Mr. Philip Barlow
June 13, 2024
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We look forward to the opportunity to discuss our proposed solution and answer any questions you may have.

Sincerely,



Sarah Williams
Chief Risk Officer
The Guardian Life Insurance Company



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

June 13, 2024

Via email

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

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

Dear Mr. Barlow:

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

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

While a significant portion of the Oliver Wyman report on residual tranche risk analysis (the “OW Report”) presented by the Alternative Credit Council in its February 26 letter to the Working Group focused on residuals minimally held by insurers (i.e. Subprime Auto ABS, Prime Auto ABS, and Student Loan ABS,) it did offer helpful insights on the impact that higher risk collateral can have on residual tranche losses in adverse scenarios. The OW Report shows that when residual tranche thickness is low and the underlying collateral for that residual is of higher risk (like the middle market and broadly syndicated leveraged loans considered in the OW Report,) the residual tranche losses

1

can be high under adverse scenarios and an RBC factor of 45 percent or higher is therefore appropriate. The OW Report shows that this relative thinness of residual tranches can be easily identified by looking at the rating of the next junior-most tranche above the residual in a securitization. Residuals that are followed by a relatively low rated subordinate tranche tend to be thin (i.e., they represent less than 25 percent of a securitization's capital structure.)

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

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

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

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

Importantly, we advise against having such an exemption framework be open to state regulator override as suggested by the Exemption Proposal. Such flexibility would

amount to an embedded “permitted practice” for RBC that may lead to an uneven competitive playing field based on state of domicile.

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

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

Respectfully Submitted,

Equitable
MetLife
Pacific Life
Western & Southern

June 13, 2024

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

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

Dear Mr. Barlow:

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

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

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

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

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

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

Sincerely,

Doug Farren

Managing Director

National Center for the Middle Market, The Ohio State University Fisher College of Business

Cc: Capital Adequacy Task Force

Financial Condition (E) Committee



June 11, 2024

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

Dear Mr. Barlow:

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

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

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

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

subject to the onerous capital charge are not material to insurer solvency and there is no negative performance history even through several business cycles.

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

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

Sincerely,

A handwritten signature in black ink, appearing to read 'Gordon Gray', with a long horizontal flourish extending to the right.

Gordon Gray
Executive Director
Pinpoint Policy Institute



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

June 6, 2024

Re: Proposal 2014-19-I

Dear Mr. Barlow:

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

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

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

Sincerely,

Paul Stephen

Paul Stephen
Chief Accounting Officer
Resolution Life U.S.



June 13, 2024

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

Dear Mr. Barlow:

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

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

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

In addition to this strong performance under a forward-looking model in the Oliver Wyman study, middle market companies themselves have proven to be remarkably resilient and continue to experience growth. Middle market companies of all sizes and across nearly all industry

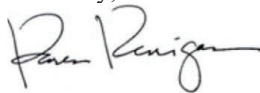
segments reported strong growth over the last year, and these businesses outperformed through the last financial crisis, adding 2.2 million jobs.^[1] The rate of year-over-year revenue growth for middle market businesses reached a new all-time high in 2023 with 55% of companies experiencing double-digit growth compared to 2022.^[2]

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

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

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

Sincerely,



Karen Kerrigan
President & CEO

^[1] National Center for the Middle Market: [Year-End 2023 Middle Market Indicator](#)

^[2] National Center for the Middle Market: [Year-End 2023 Middle Market Indicator](#)

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Protecting Small Business, Promoting Entrepreneurship

Table 1 (6-4-2024 Update)

Aggregate Totals for Residual Tranches Survey Responses

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

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

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

Draft: 6/4/24

Risk-Based Capital Investment Risk and Evaluation (E) Working Group
Virtual Meeting
May 22, 2024

The Risk-Based Capital Investment Risk and Evaluation (E) Working Group of the Capital Adequacy (E) Task Force met May 22, 2024. The following Working Group members participated: Philip Barlow, Chair (DC); Thomas Reedy, Vice Chair (CA); Wanchin Chou (CT); Ray Spudeck (FL); Doug Ommen, Carrie Mears, and Kevin Clark (IA); Vincent Tsang (IL); Roy Eft (IN); Fred Andersen (MN); William Leung and Debbie Doggett (MO); Lindsay Crawford (NE); Jennifer Li (NH); Bob Kasinow and Bill Carmello (NY); Judith L. French, Tom Botsko, and Dale Bruggeman (OH); Cassie Brown and Rachel Hemphill (TX); Doug Stolte and Dan Bumpus (VA); Steve Drutz (WA); and Amy Malm (WI).

1. Discussed Comment Letters Received on the Memorandum

Barlow said that even though a couple of comment letters were received, they did not directly respond to the memorandum that was exposed (Attachment Six-B1). This might suggest that the analysis effort was exhausted, at least in the short term.

Mariana Gomez-Vock (American Council of Life Insurers—ACLI) presented a comment letter (Attachment Six-B2). Gomez-Vock said ACLI sought to be responsive to questions raised on the last call, specifically, “What exactly life insurers were holding with respect to residuals?” ACLI surveyed its members and summarized the findings in the comment letter. Gomez-Vock said 19 members responded to the survey, and these members owned about \$6.3 billion in residuals (compared to an industry total of about \$11 billion). She called out a couple of prevalent residual types, such as middle market (MM) collateralized loan obligations (CLOs) and broadly syndicated loan (BSL) CLOs, which accounted for 36% and 11% of the surveyed assets, respectively.

Barlow asked if ACLI could share the identity of the life insurers that responded to the survey. Gomez-Vock said she needs to obtain consent from the respondents and will follow up with an answer. Barlow compared ACLI’s survey results with Oliver Wyman’s report. He noted out of the five residual types in Oliver Wyman’s report, three of them (specifically prime auto asset-backed securities [ABS], subprime auto ABS, and student loan ABS) accounted for less than 2% of overall holdings per ACLI’s survey result. He questioned why they were chosen in Oliver Wyman’s study. Gomez-Vock responded that Oliver Wyman’s selection was based on the largest sectors of ABS deals in the United States by volume. The selection was neither insurer-specific nor residual-specific, and this may cause the difference observed by Barlow.

Barlow asked whether the holdings of the life insurers that did not respond to ACLI’s survey could vary significantly from ACLI’s findings. Gomez-Vock declined to answer due to a lack of information but offered to follow up after the meeting. Clark asked if ACLI collected further information about the collateral types of the feeder fund sector, and Gomez-Vock responded that ACLI did collect information about the underlying collateral being commercial real estate credit; equity investments, including limited partnership (LP) stakes in private equity (PE) funds; MM credits; other leveraged credit; and other loans and fixed-income-like assets, such as real estate equity. ACLI also obtained similar information for collateralized fund obligations (CFOs). However, ACLI did not summarize the values and percentages of ownership by underlying collateral types due to time constraints and, therefore, was not able to show which collateral type is the most prominent.

Patrick Reeder and Theresa Resnick (Everlake Life) presented a comment letter and proposal (Attachments Six-B3 and Six-B4). Reeder said Everlake Life’s proposal is an alternative interim solution that is both responsive to regulators’ concerns and is supported by data. Reeder also said the proposal, though viewed as an interim solution,

did not specify a sunset provision. Resnick said the foundational concept when deliberating charges for emerging investments is to have robust calibration and internal consistency with existing C-1 charges. Though historical loss data is lacking for residuals, data of the underlying collaterals is available, and through modeling techniques, one can still arrive at the right answer. Resnick believed Oliver Wyman's report is informative and supports Everlake Life's proposal, which is that the null hypothesis at 45% is the right interim charge, with an alternative hypothesis that 45% is too high and not consistent with existing C-1 charges for certain residual types. Resnick concluded with her preference to see the exposure of Everlake Life's proposal, which would allow more time to reflect on the reasonableness and consistency of the proposed factors. She also believed Everlake Life's proposal helps avoid the cliff or volatility (e.g., when the interim charge is too high and is adjusted to a lower permanent charge).

Reeder said the gist of Everlake Life's proposal is that the collateral type in the securitization or feeder fund structure drives the factors: equity collaterals receive 45% while debt, and physical asset-backed debt collaterals receive 30%. Barlow said the proposal appeared to be more than an instructional change. It entailed a change from a direct pull of annual statements to company self-reporting. He invited comments on the feasibility of implementing such a change during the exposure period.

Barlow asked Eric Kolchinsky (NAIC) to comment on the proposed subset of residuals that are exempted from 45%. Kolchinsky interpreted the proposal as assigning a 45% charge to BSL CLO only, and a 30% charge to everything else. He thought that was counterproductive. Reeder clarified that Everlake Life's original intent was to have residuals of CFOs, BSL CLOs, and equity-backed feeder funds assigned a 45% charge. Upon Kolchinsky's request, Reeder clarified that MM CLO residuals fall into the 30% bucket in the proposal. Barlow argued that per Oliver Wyman's report, MM CLOs do not appear to be low risk. Kolchinsky agreed. He explained that MM CLO losses appear comparatively low in Oliver Wyman's report due to the thickness of the MM CLO residual tranches as well as the comparatively higher-rated, next most junior tranches within the structures, e.g., BBB, A, and sometimes even AA or AAA. Kolchinsky said, however, MM CLO residuals held by the insurers do not have that kind of thickness and/or that high of a rating for the next most junior tranches. He made use of Schedule BA disclosures in the annual statements and concluded that the next most junior tranches of the MM CLO residuals owned by the insurers are mostly BB-. He said going back to Oliver Wyman's report, the loss rate modeled for these insurer-owned MM CLOs is very comparable, if not higher, than the loss rate of BSL CLOs. Kolchinsky also pointed out that MM CLOs have lower S&P Index ratings.

Gomez-Vock said ACLI also collected data on tranche thickness but did not have time to sanitize it for public presentation. Kolchinsky commented that it is counterintuitive to have lower charges for MM CLOs and feeder fund structures. They are less transparent as to underlying collaterals and have much greater liquidity risk. Given the current downturn for commercial real estate (CRE) properties, Kolchinsky said it is not a great time to benefit from CRE CLOs and commercial mortgage-backed securities (CMBS) by assigning them a lower charge. Lastly, Kolchinsky pointed out that there are no set definitions for MM CLOs and BSL CLOs, which is likely causing enforcement issues (e.g., one may put 5-10% MM loans into the securitization to qualify for MM CLOs charge, if lower). He said the Structured Securities Group (SSG) can help, upon a regulator's request, to categorize residuals by referring to the prospectus and/or help define categories by working with the industry.

Kolchinsky also presented a slide that surveyed the credit structured finance investment outstanding as of 2021, sourced from the Securities Industry and Financial Markets Association (SIFMA). CMBS and residential mortgage-backed securities (RMBS) made up about half of the market, while collateralized debt obligations (CDOs) and CLOs accounted for a quarter. BSL CLOs are the most prevalent type within the CDOs/CLOs sector, accounting for 80-90%. The consumer sector is primarily made up of auto loans and credit card loan securitizations. Kolchinsky said the other sector is up for discussion as a lot can go into it.

Upon Clark's request, Kolchinsky clarified that the SIFMA survey is sourced from market issuance and is not necessarily representative of insurers' holdings.

Stolte said Virginia supports retaining the adopted 45% interim solution for ABS residuals. He said the Working Group already delayed implementation for a year. The industry failed to rebut the 45% interim charge, and the Working Group voted against an additional year of delay. A memorandum was exposed to solicit commitment to perform additional analysis. Everlake Life's proposal reacted to the solicitation but failed to satisfy the specific requirements laid out in the memorandum. Stolte said that if the Working Group wishes to consider the proposal, he would have significant concerns with it. The first concern is that pages 10 through 15 of Oliver Wyman's report did not support a lower risk charge for MM CLOs, which have higher peak default rates across stress scenarios. The obligors of the MM loans have lower credit ratings, and the projected losses are in excess of 45%, much comparable with BSL CLO losses. In addition, ACLI's survey presented in the meeting shows that 36% of the surveyed residuals are MM CLOs, when compared to 11% in BSL CLOs. Based on this information, Stolte said the Working Group should not carve out MM CLOs from the 45% charge.

Andersen agreed with Kolchinsky and Stolte. He said carving out MM CLOs and CRE-related assets will likely incentivize investment in risky assets. He also said that he believes all the analysis performed so far appears to solidify the 45% charge.

Chou supported the exposure and anticipated further investigations needed (e.g., feasibility studies to implement the change, potentially more work by the industry, and the SSG to follow up on the discussions, etc.).

Clark also supported the exposure. He said the 45% charge was originally developed based on assumptions that the BSL CLO residuals were the most prevalent among insurers. With new information presented in the meeting, he said the Working Group would need time to reevaluate and digest it. Clark suggested exposing the SSG's presentation along with Everlake Life's proposal.

Malm agreed with Virginia and Minnesota about MM CLOs. She appreciated more time given through the exposure process.

Tsang said Everlake Life has a steep curve to climb to justify the charges for MM CLO residuals, especially in a short period of time.

Brown made a motion, seconded by Eft, to expose Everlake Life's proposal and the SSG's presentation, for a 21-day public comment period, ending on June 13, 2024. A roll call vote was taken with 10 members voting "Yes" to the motion and six members voting "No." The motion passed.

Barlow said the Working Group will seek comments on what should be included/excluded in the residual buckets, preferably with some analytical support.

Barlow said that because the timing of the exposure is outside of the standard procedures, it would require a supermajority two-thirds vote for adoption by the Capital Adequacy (E) Task Force. Likewise, the timing of the exposure might present challenges to vendors, and he said those need to be addressed as well.

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

SharePoint/NAIC Support Staff Hub/Committees/Committee Folders/E CMTE/CADTF/2024_Summer/RBCIRE/RBC Investment Risk 5-22-24 Minutes.docx



MEMORANDUM

TO: Members, Interested Regulators and Interested Parties of the Risk-Based Capital Investment Risk and Evaluation (E) Working Group

FROM: Philip Barlow, Chair of the Risk-Based Capital Investment Risk and Evaluation (E) Working Group

DATE: April 16, 2024

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

The Risk-Based Capital Investment Risk and Evaluation (E) Working Group will meet May 22, 2024, to consider additional feedback to be provided by those industry stakeholders requesting a 1-year delay. In order to be considered by the Working Group, this feedback needs to include and shall be limited to, a detailed plan describing:

- (1) Who is accepting responsibility for conducting the additional analysis. Note that this cannot require the dedication of American Academy of Actuaries' (Academy) resources which are already dedicated to long-term projects commissioned by the Working Group. If the responsible party also needs the cooperation of other sources, please confirm the willingness and ability of those parties to provide the necessary data/analysis in the timeframe identified.
- (2) A specific timeline of when deliverables will be provided, in order to allow adequate time for the Working Group to conduct its review. This should include touchpoints with the Chair of the Working Group regarding progress, with a final proposal to be provided no later than January 31, 2025.
- (3) Any analysis provided must be credibly aligned with the actual holdings of residuals by insurers and should be based on a Conditional Tail Expectation (CTE) risk measure approach.
- (4) While the Working Group presumes that a long-term factor will be based on attributes of holdings, likely resulting in multiple factors, an interim factor is anticipated to be singular in nature. If industry anticipates it will request multiple factors be used for an interim step, the structure and design of the interim proposal must be received by November 30, 2024, to ensure an adequate time to review before a structure change. Note that any proposal involving multiple factors must be supported by additional CTE-based risk measure analysis. As evidenced by the vote taken during the April 12, 2024, meeting, a majority of the working group does not believe a 1-year delay for the sole purpose of allowing multiple interim factors is warranted.

Washington, DC 444 North Capitol Street NW, Suite 700, Washington, DC 20001-1509

p | 202 471 3990

Kansas City 1100 Walnut Street, Suite 1500, Kansas City, MO 64106-2197

p | 816 842 3600

New York One New York Plaza, Suite 4210, New York, NY 10004

p | 212 398 9000

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- (5) Acknowledgement that the Working Group will not reassess the interim factor if information is received after the agreed timelines. Any information provided after those dates may be considered in the context of ongoing work as a long-term factor.



Mariana Gomez-Vock
Senior Vice President, Prudential Policy & International
American Council of Life Insurers
Marianagomez-vock@acli.com

May 15, 2024

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

[Via email: dfleming@naic.org]

Re: Allocation of residual tranche holdings, by sector

Dear Mr. Barlow:

ACLI appreciates the opportunity to follow up on a request that emerged from discussions about the recent Oliver Wyman (OW) study. On the last Working Group call, several regulators discussed the study's findings on Bank Syndicated Loan (BSL) CLOs. Regulators noted that the current statutory reporting for residuals does not include sector-specific disclosure for Asset Backed Securities (ABS) residuals and asked ACLI to collect this data for YE 2023. ACLI developed a voluntary survey to gather information from our members on Asset Backed Securities (ABS) residual holdings.

Executive Summary of Findings:

- Our survey indicates that approximately **10.9% are BSL CLOs**.
- ACLI identified the top 32 holders of residuals who collectively held 95% of the aggregate amount of residuals ABS in the life industry. Of the 32 group holders, 27 were ACLI members. ACLI did not survey non-members.
- ACLI received data from 19 life insurance groups out of the 27 surveyed, which represented **54% or \$6.4 billion** of the total aggregated residuals in YE 2023.

Additional information about the survey, its participants and findings are below.

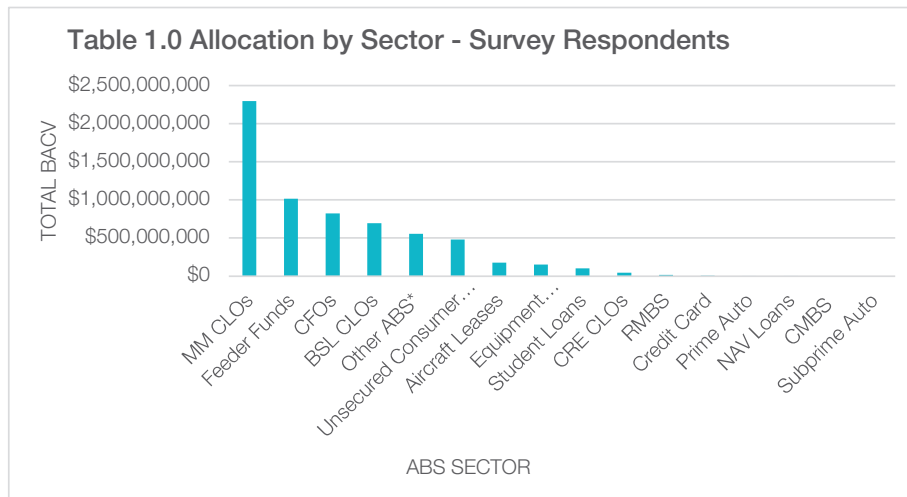
American Council of Life Insurers | 101 Constitution Ave, NW, Suite 700 | Washington, DC 20001-2133

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

acli.com

About the survey

- Survey asked about allocations for 15 specific sectors / collateral type, there was also space to identify and report other categories of ABS. Respondents were asked to identify the “other” ABS sector.
- Respondents also submitted the definitions their company used for each sector, ACLI reviewed the definitions to ensure that each sector was homogeneous.
- Respondents were also asked to identify the underlying collateral for “feeder funds” and “CFOs.”
- ACLI calculated the percentage of asset allocation for the 19 groups reporting. Thus, the survey represents the percentages, based on book adjusted carrying value (BACV) for each sector, for the 19 groups.
- Each survey participant provided ACLI with a signed attestation regarding the completeness and accuracy of the data submitted.



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

Sample Representativeness

- ACLI first identified the top 32 holders of residual tranches. These 32 life insurance groups held 95% of the total residual tranches reported in YE 2023 (\$11.5 billion).
- ACLI excluded non-members and surveyed the remaining 27 insurance groups.
- ACLI received data from **19** life insurance groups.
- The 19 responses represents **54%** or **\$6.4 billion** of the total aggregated residuals reported in YE 2023.

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

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

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

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

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

Summary of ACLI Survey Findings

Top Five ABS sectors reported to ACLI

- MM CLOs - **36.1%** (\$2.3 billion)
- Feeder Funds - **16%** (\$1 billion)
- CFOs – **13%** (\$822 million)
- BSL CLOs - **10.9%** (\$694 million)
- Other ABS¹ – **8.7%** (\$554 million)

¹ ACLI requested data on 14 different sectors. Companies could also enter sectors into an “Other” category if the sector was not listed. In this category, members reported: Aircraft Loan ABS; Commercial Loans; Equity – other, Infrastructure Debt; Powerplant; Prime Borrower Unsecured Borrower; Prime Home Improvement Loans; Solar; Utility Scale Solar.⁹ The Oliver Wyman reported discussed BSL CLOs, MM CLOs, Prime Auto and Subprime Auto, Student Loan ABS.

Comparing actual holdings with the sectors analyzed in the OW Report²

- Subprime Auto – **0%** (\$0)
- Prime Auto – **0.00014%** (\$897,163)
- Student Loan ABS – **1.6%** (\$101.5 million)
- BSL CLOs – **10.9%** (\$694 million)
- MM CLOs – **36.1%** (\$2.3 billion)

Note about the asset classes/sectors selected by OW to review:

- OW's selected its subclasses based on the four largest sectors of outstanding ABS deals in the U.S., by volume.
- The data was not specific to insurers or life insurers, who have different investment needs than other institutional investors.
- ACLI's data demonstrates that insurers' holdings of residuals do not align with the total market share of all outstanding ABS deals in the U.S.

Thank you for the opportunity to provide this data. We hope that it is useful as the Working Group continues its work on RBC factors for structured securities.

Sincerely,



Mariana Gomez-Vock
Senior Vice President, Prudential Issues & International

Appendix

Table 1 (5-15-2024 Update)

Aggregate Totals for Residual Tranches Survey Responses

SECTOR	Book/Adjusted Carrying Value	percent distribution of BACV
MM CLOs	\$2,294,231,501	36.1
Feeder Funds	1,014,183,088	16.0
CFOs	822,598,092	13.0
BSL CLOs	694,225,569	10.9
Other ABS ¹	554,251,226	8.7
Unsecured Consumer Loans ABS	480,105,560	7.6
Aircraft Leases ABS	175,105,871	2.8
Equipment Lending/Leases ABS	151,683,102	2.4
Student Loans ABS	101,539,282	1.6
CRE CLOs	43,187,227	0.7
RMBS	14,015,686	0.2
Credit Card ABS	4,930,996	0.1
Prime Auto ABS	897,163	0.0
NAV Loans	189,521	0.0
CMBS	-	-
Subprime Auto ABS	-	-
TOTAL	6,351,143,883	100.0

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

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

ACLI Comment Letter
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Appendix, cont.

Table 2 (5-15-2024 Update)

Percent Distribution of Responses for Book/Adjusted Carrying Value Holdings, By Sector

Groups with Residual Holdings of \$230 million and Above (9 Groups)	Percent distribution of BACV	Groups with Residual Holdings Below \$230 million (10 Groups)	Percent distribution of BACV
SECTOR		SECTOR	
MM CLOs	41.6	Feeder Funds	38.2
CFOs	14.9	BSL CLOs	33.4
Feeder Funds	10.9	MM CLOs	12.1
Other ABS ¹	9.5	Other ABS ¹	5.2
Unsecured Consumer Loans ABS	8.7	CFOs	4.3
BSL CLOs	5.8	Aircraft Leases ABS	3.0
Equipment Lending/Leases ABS	2.9	Unsecured Consumer Loans ABS	2.8
Aircraft Leases ABS	2.7	RMBS	0.9
Student Loans ABS	2.0	CRE CLOs	-
CRE CLOs	0.8	NAV Loans	-
Credit Card ABS	0.1	CMBS	-
RMBS	0.1	Credit Card ABS	-
Prime Auto ABS	0.0	Prime Auto ABS	-
NAV Loans	0.0	Subprime Auto ABS	-
CMBS	-	Student Loans ABS	-
Subprime Auto ABS	-	Equipment Lending/Leases ABS	-
TOTAL	100.0	TOTAL	100.0

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

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

ACLI Comment Letter
 5/15/2024

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May 15, 2024

VIA E-mail

Philip Barlow, Chair of the Risk-Based Capital Investment Risk and Evaluation (E) Working Group and Associate Commissioner for Insurance, District of Columbia
Department of Insurance, Securities and Banking

National Association of Insurance Commissioners
1100 Walnut Street, Suite 1000
Kansas City, MO 64106-2197

Everlake Life Insurance Company
3100 Sanders Road, Suite 303
Northbrook, IL 60062
847.665.9930

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

Dear Mr. Barlow:

Thank you for the work that you and the Risk-Based Capital Investment Risk and Evaluation (E) Working Group (“Working Group”) have done on this important matter. This letter is in response to your memo dated April 16, 2024. That memo was issued in response to the April 12, 2024 meeting of the Working Group, during which a one-year delay in implementation of the interim RBC factor for all residual tranches was considered. Upon further consideration of the matter, including the stated concerns of the regulatory community to take swift action to address the concerns about the residual tranches of collateralized loan obligations (“CLOs”), and taking into account the available data, we suggest an alternative path forward.

Executive Summary

We propose that the Working Group apply a 45% interim RBC charge to residual tranches of all structured securities EXCEPT those listed below that are (1) demonstrated as high-performing based on data and analysis, and (2) supported by data that demonstrates the performance in a tail scenario warrants a 30% charge (“Exempted Residual Tranches and Interests”). Exempted Residual Tranches and Interests would be subject to a 30% RBC charge during this interim period until the long-term ABS RBC project is completed. This proposal could be implemented on an interim basis, starting at the end of 2024 and would involve a change to the RBC instructions and not the RBC blank.



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To implement this proposal, the Working Group could change the RBC instructions clarifying that residual tranches of structured securities (other than Exempted Residual Tranches and Interests) would be reported on line 51 while Exempted Residual Tranches and Interests would be reported on line 49.2.

We have suggested specific language that could be included in the NAIC RBC Proposal Form in Appendix 1.

Background

Concerns About Performance of Residual Tranches

The interim 45% charge originated in 2021 due to concerns raised by the SVO and NAIC staff regarding residual tranches and the potential for regulatory capital arbitrage. The issue was discussed in the Valuation of Securities (E) Task Force before being referred to the Working Group.¹ Specific concerns about tail risk and other issues have been raised by the Working Group² and stakeholders regarding certain types of residuals, most notably Broadly Syndicated Loan (“BSL”) CLO equity as well as other fund structures such as feeder funds backed by equity linked instruments and collateralized fund obligations (“CFO”).³

Data Is Being Collected and Shared with the Regulatory Community

We understand that the Working Group will receive data from the ACLI showing the residual tranche holdings, broken down by sector or type of collateral by a number of life insurance companies. Everlake Life participated in this survey.

This data collected by the ACLI will be helpful to demonstrate to the Working Group that the majority of the residuals owned by respondents to the ACLI survey are not BSL CLO equity or CFOs / feeder funds backed by equity linked instruments. Instead, they are largely backed by structures that are more resilient due to higher levels of enhancement and / or collateral that is more fixed income like in nature such as loans and leased cashflow streams.

¹ VOSTF adopted an amendment to the Purposes and Procedures Manual of the NAIC Investment Analysis Office to remove residual tranches from receiving an NAIC Designation. VOSTF December 12, 2021, meeting minutes

² Working Group Meeting Minutes (February 28, 2022) (9-454 NAIC Proceedings – Spring 2022), at 2. In discussing the background of residual project for Working Group Members, Ms. Mears (IA) recognized the complexity of the issue, noting that initial risk assessment “may also be easier for residuals of collateralized loan obligation (CLO), which have underlying collateral that is rated and may be more difficult for other structures that have underlying collateral that is not rated or does not fit within the existing RBC framework.”

³ Joint Working Group and Financial Condition (E) Committee Meeting Minutes (January 12, 2022). Commissioner White supported a request “to solicit if members of the industry, and perhaps consultants that follow the NAIC work, have views on possible methodologies that could achieve the objective of capturing the tail risk on CLOs.” See also, regulator comments on March 4, 2024, Working Group meeting suggesting that the Oliver Wyman Study supports a 45% for BSL CLOs. See also recent observations from interested parties in written comments for April 12, 2024, Working Group meeting suggesting that BSL CLOs make up approximately 80% of insurance holdings of ABS.



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Changes to RBC Must Be Data Driven

The Working Group began this project with the goal of focusing “on setting RBC charges that correlate with the risk insurers are undertaking and ensure that the risk the RBC is addressing is commonly understood.”⁴ As this Working Group has acknowledged, the increased charge was introduced based on limited data.⁵ The most substantive data presented to the Working Group to date regarding ABS residuals was the March 2024 Oliver Wyman study.⁶ That study provided detailed data modeling performance of residuals under significant historical stress scenarios – the dotcom bubble and the Great Financial Crisis. The importance of modeling those two events in assessing asset risk was acknowledged by the SVO, which initial report noted “historical performance of CLOs has been excellent weathering three economic downturns - dotcom bubble, GFC and COVID.”⁷

To date the Oliver Wyman study is the most and only comprehensive data that has been produced by any party on this issue.

The Oliver Wyman study utilized a methodology that will be vital in addressing the open RBC factor the Working Group is addressing. The foundation of this methodology is described in Appendix 2 (the “Residual Performance Assessment Methodology”). We respectfully request that the Working Group adopt the Residual Performance Assessment Methodology to evaluate assets other than those listed below for inclusion as an Exempted Residual Tranche or Interest during this interim evaluation period. The process we outline would facilitate such additions during the period between now and a final charge being adopted via the Academy workstream.

The Oliver Wyman study demonstrated far superior performance of prime auto ABS, subprime auto ABS, middle-market CLOs and student loan ABS, as compared, for example, to common stock equity and BSL CLO equity.⁸ These types of structured securities along with similar ABS form the basis for defining the population of Exempted Residual Tranches and Interests.

In light of the above, we propose the RBC instruction changes, as described below, to address regulator concerns through an interim capital charge based on this initial analysis for certain residual tranches, with an understanding that these charges will be adjusted through the RBC IRE WG project led by the Academy, informed by the Oliver Wyman Study and the Residual Performance Assessment Methodology. For the interim period, we recommend the Working Group deem the following ABS investments as “Exempted Residual Tranches and Interests”.

⁴ Working Group Meeting Minutes (February 28, 2022) (9-454 NAIC Proceedings – Spring 2022), at 2.

⁵ Draft: 8/9/23 Risk-Based Capital (RBC) Investment Risk and Evaluation (E) Working Group Virtual Meeting June 14, 2023

⁶ <https://content.naic.org/sites/default/files/inline-files/Oliver%20Wyman%20Residual%20Tranche%20Report.pdf>

⁷ https://content.naic.org/sites/default/files/national_meeting/VOSTF%20Materials%208.11.2022%20v7.pdf (page 155).

⁸ The types of ABS chosen in the Oliver Wyman study represent nearly 50% of the ABS market.



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“Exempted Residual Tranches and Interests” are:

- Middle market and commercial real estate CLO residuals whether in feeder fund format or CLO;⁹
- CMBS and RMBS residuals;
- Residuals secured by:
 - Consumer assets including but not limited to consumer loans, credit card receivables, student loans, auto loans and leases, solar loans and leases, home improvement loans and other prime consumer assets;
 - Cashflows from leases secured by, but not limited, to data centers, fiber and wireless infrastructure, renewable energy projects backed by power purchase agreements, and loans and leases secured by physical assets, solar and other energy related projects backed by power purchase agreements, transportation assets such as railcars, containers and aircraft and engines, equipment, commercial and residential real estate;
 - Other loans and fixed income like cashflows including but not limited to residential and commercial PACE assets, insurance policy payments, commercial & industrial solar contracts, whole business securitizations, timeshares, royalties, intellectual property, tax liens, small business loans inventory finance, supply chain finance and accounts receivable finance; and
- any other category of residual tranche or interest or specific residual investment identified by a domiciliary regulator as appropriately receiving a 30 percent charge under the RBC calculations of insurers domiciled in that state. Such review will be based on the characteristics specific to the asset or analysis of the asset class under any methodology deemed appropriate by the domiciliary regulator.

Collaborative Process Moving Forward

We understand the regulatory community’s need for data-driven, consumer-protective decision making and are prepared to collaborate with the regulatory community broadly and our domestic regulators specifically as well as our industry colleagues. Everlake Life is willing to continue to engage to move this project forward in a data-driven, consumer-protective manner.

Working Group Procedural Matters

We request this proposal be adopted by the Working Group no later than June 30 of this year, and adoption by the Capital Adequacy Task Force (CATF) by July 30 of this year, per existing NAIC procedures, or through a one-time amendment to the Capital Adequacy Task Force’s Procedures for Proposed Amendments to the Risk-Based Capital Blanks and Instructions timing requirements for an instruction change, which would allow the proposal to be effective for year-end 2024.



⁹ Private credit backed feeder fund residuals may be included based on the nature of collateral which would be determined based on full look through to the final collateral.

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Everlake Life is submitting this proposal in an effort to directly address regulator concerns regarding CLO residual tranches. We are making every effort to be responsive and utilize the best and most up to date data with a solution that will allow regulators to implement their interim solution for year end 2024 and focus on data-driven analysis as part of a permanent solution moving forward.

We appreciate your efforts and consideration of this request.

Very truly yours,

/s/ Patrick C Reeder

Patrick C Reeder
Chief Government Affairs Officer

cc: Dave Fleming, Senior Life RBC Analyst, NAIC



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Appendix 1 – Language for RBC Proposal Form

Description/Justification for Changes

The proposed change would add instructions for lines 51 and 49.2 in the life RBC formula clarifying that for reporting year 2024, residual tranches of structured securities (other than Exempted Residual Tranches and Interests) should be reported under line 51 while the residual tranches for Exempted Residual Tranches and Interests should be reported under line 49.2. The proposal includes a footnote to line 51 stating 'Include residual tranches of structured securities (other than Exempted Residual Tranches and Interests) per the instructions,' and a footnote to line 49.2 stating 'Include residual tranches for Exempted Residual Tranches and Interests per the instructions.'

Under this proposal, Line 51 has a 45% charge that would apply to the residual tranches of structured securities (other than Exempted Residual Tranches and Interests) to be listed on that line. AVR Equity Component, for Exempted Residual Tranches and Interests, would be reported on existing line (49.2). Line 49.2 was added new lines for year-end 2022 reporting to Schedule BA and the AVR Equity Component to capture amounts related to residual tranches or interest. For year-end 2022 life RBC reporting, AVR Equity Component, Column 1, Line 93 was included in Line (49.2).

Amendment Language

Amendment to “Other Long-Term Assets” (page 25 of Instructions)

Specific instruction for Line (51): Parties should report the residual tranches of structured securities (other than Exempted Residual Tranches and Interests) on Line 51. Parties should add a footnote to indicate if their overall RBC changes by 10 percent or more from their 2023 RBC based on this reporting change. Exempted Residual Tranches and Interests” are:

- Middle market and commercial real estate CLO residuals whether in feeder fund format or CLO;
- CMBS and RMBS residuals;
- Residuals backed by:
 - Consumer Assets including but not limited to consumer loans, credit card receivables, student loans, auto loans and leases, solar loans and leases, home improvement loans and other prime consumer assets;
 - Cashflows from leases secured by, but not limited, to data centers, fiber and wireless infrastructure, renewable energy projects backed by power purchase agreements, and loans and leases secured by physical assets, solar and other energy related projects backed by power purchase agreements, transportation assets such as railcars, containers and aircraft and engines, equipment, commercial and residential real estate;



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- Other loans and fixed income like cashflows including but not limited to residential and commercial PACE assets, insurance policy payments, commercial & industrial solar contracts, whole business securitizations, timeshares, royalties, intellectual property, tax liens, small business loans inventory finance, supply chain finance, and accounts receivable finance; and
- and any other category of residual tranche or interest or specific residual investment identified by a domiciliary regulator as appropriately receiving a 30 percent charge demonstrated using a methodology acceptable to the domiciliary regulator.

Amendment to “Other Long-Term Assets” (page 25 of Instructions)

Line (49.2) For year end 2024 Life RBC reporting, AVR Equity Component, Column 1, line 93 will be included in line (49.2), except for broadly syndicated loan collateralized loan obligation residual tranche investments which are to be captured in line (51).



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APPENDIX 2

Residual Performance Assessment Methodology [Fundamental Steps / High Level Concepts]

1. A random sampling of US deals large enough to represent a statistically representative sample of the asset class at issue (the "Target Asset") would be selected.
2. Analyst would conduct a comparison of the sample in #1 above to average characteristics and deals, editing the sample with new random selection of deals where initial selection produces outliers that would inappropriately skew the sample set.
3. The relative risk of the sample of ABS residuals would be measured utilizing a scenario-based approach, utilizing a simulated base and three stress scenarios (a base scenario and two "mid-tail" stress scenarios based on the 2008 Financial Crisis and the "Dot Com" bubble of 1995-2000) (collectively, the "Stress Scenarios") as well as a "deep-tail" scenario. The analyst would apply the Stress Scenarios to the underlying collateral of the assets with calculation of potential default and underperformance rates. The analyst would also consider a "deep tail" scenario modeled after a 1-in-100 excess defaults event, i.e., the Great Depression, and intended to reflect a roughly 99 percentile severity.
4. The analyst would utilize assumptions regarding each asset class that reflect the characteristics of that asset class as observed in available historical periods (e.g., active management of loans, prepayment and discount purchases as have occurred historically in downturns).
5. Any insurer seeking to apply the Performance Assessment Methodology to any Target Asset would be required to have the analysis certified by [A Date Certain].



**Capital Adequacy (E) Task Force
RBC Proposal Form**

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| <input type="checkbox"/> Capital Adequacy (E) Task Force | <input type="checkbox"/> Health RBC (E) Working Group | <input type="checkbox"/> Life RBC (E) Working Group |
| <input type="checkbox"/> Catastrophe Risk (E) Subgroup | <input type="checkbox"/> P/C RBC (E) Working Group | <input type="checkbox"/> Longevity Risk (A/E) Subgroup |
| <input type="checkbox"/> Variable Annuities Capital. & Reserve (E/A) Subgroup | <input type="checkbox"/> Economic Scenarios (E/A) Subgroup | <input checked="" type="checkbox"/> RBC Investment Risk & Evaluation (E) Working Group |

	DATE: <u>5/17/24</u>																																				
CONTACT PERSON: _____ TELEPHONE: _____ EMAIL ADDRESS: _____ ON BEHALF OF: _____ NAME: <u>Patrick Reeder</u> TITLE: <u>Chief Governmental Affairs Officer</u> AFFILIATION: <u>EverLake Life Insurance Comany</u> ADDRESS: _____ _____	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <th colspan="2" style="text-align: center;">FOR NAIC USE ONLY</th> </tr> <tr> <td style="width: 50%;">Agenda Item # <u>2024-19-1</u></td> <td style="width: 50%;"></td> </tr> <tr> <td>Year <u>2024</u></td> <td></td> </tr> <tr> <th colspan="2" style="text-align: center;">DISPOSITION</th> </tr> <tr> <td colspan="2">ADOPTED:</td> </tr> <tr> <td><input type="checkbox"/> TASK FORCE (TF)</td> <td>_____</td> </tr> <tr> <td><input type="checkbox"/> WORKING GROUP (WG)</td> <td>_____</td> </tr> <tr> <td><input type="checkbox"/> SUBGROUP (SG)</td> <td>_____</td> </tr> <tr> <td colspan="2">EXPOSED:</td> </tr> <tr> <td><input type="checkbox"/> TASK FORCE (TF)</td> <td>_____</td> </tr> <tr> <td><input type="checkbox"/> WORKING GROUP (WG)</td> <td>_____</td> </tr> <tr> <td><input type="checkbox"/> SUBGROUP (SG)</td> <td>_____</td> </tr> <tr> <td colspan="2">REJECTED:</td> </tr> <tr> <td><input type="checkbox"/> TF <input type="checkbox"/> WG <input type="checkbox"/> SG</td> <td>_____</td> </tr> <tr> <td colspan="2">OTHER:</td> </tr> <tr> <td><input type="checkbox"/> DEFERRED TO</td> <td>_____</td> </tr> <tr> <td><input type="checkbox"/> REFERRED TO OTHER NAIC GROUP</td> <td>_____</td> </tr> <tr> <td><input type="checkbox"/> (SPECIFY)</td> <td>_____</td> </tr> </table>	FOR NAIC USE ONLY		Agenda Item # <u>2024-19-1</u>		Year <u>2024</u>		DISPOSITION		ADOPTED:		<input type="checkbox"/> TASK FORCE (TF)	_____	<input type="checkbox"/> WORKING GROUP (WG)	_____	<input type="checkbox"/> SUBGROUP (SG)	_____	EXPOSED:		<input type="checkbox"/> TASK FORCE (TF)	_____	<input type="checkbox"/> WORKING GROUP (WG)	_____	<input type="checkbox"/> SUBGROUP (SG)	_____	REJECTED:		<input type="checkbox"/> TF <input type="checkbox"/> WG <input type="checkbox"/> SG	_____	OTHER:		<input type="checkbox"/> DEFERRED TO	_____	<input type="checkbox"/> REFERRED TO OTHER NAIC GROUP	_____	<input type="checkbox"/> (SPECIFY)	_____
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<input type="checkbox"/> DEFERRED TO	_____																																				
<input type="checkbox"/> REFERRED TO OTHER NAIC GROUP	_____																																				
<input type="checkbox"/> (SPECIFY)	_____																																				

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

- | | | |
|--|---|---|
| <input type="checkbox"/> Health RBC Blanks | <input type="checkbox"/> Property/Casualty RBC Blanks | <input checked="" type="checkbox"/> Life and Fraternal RBC Blanks |
| <input type="checkbox"/> Health RBC Instructions | <input type="checkbox"/> Property/Casualty RBC Instructions | <input checked="" type="checkbox"/> Life and Fraternal RBC Instructions |
| <input type="checkbox"/> Health RBC Formula | <input type="checkbox"/> Property/Casualty RBC Formula | <input checked="" type="checkbox"/> Life and Fraternal RBC Formula |
| <input type="checkbox"/> OTHER _____ | | |

DESCRIPTION/REASON OR JUSTIFICATION OF CHANGE(S)

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

Additional Staff Comments:

**** This section must be completed on all forms.**

Revised 2-2023

OTHER LONG-TERM ASSETS
LR008

Basis of Factors

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

Specific Instructions for Application of the Formula

Line (49.1)

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

Line (49.2)

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

Line (51)

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

Exempted Residual Tranches and Interests’ are:

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

Line (57)

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

Company Name	Confidential when Completed	NAIC Company Code				
OTHER LONG-TERM ASSETS (CONTINUED)		(1)	(2)	(3)	(4)	(5)
<u>Annual Statement Source</u>		<u>Book / Adjusted Carrying Value</u>	<u>Unrated Items ‡</u>	<u>RBC Subtotal †</u>	<u>Factor</u>	<u>RBC Requirement</u>
<u>Schedule BA - All Other</u>						
(48.1) BA Affiliated Common Stock - Life with AVR	AVR Equity Component Column 1 Line 67	_____				
(48.2) BA Affiliated Common Stock - Certain Other	AVR Equity Component Column 1 Line 68	_____				
(48.3) Total Schedule BA Affiliated Common Stock - C-1o	Line (48.1) + (48.2)	_____		X 0.3000	=	_____
(49.1) BA Affiliated Common Stock - All Other	AVR Equity Component Column 1 Line 69	_____				
(49.2) Total Sch. BA Affiliated Common Stock - C-1cs and Exempted Residual Tranches or Interests as described in the instructions.	Line (49.1) + AVR Equity Component Column 1 Line 93, in part	_____			X 0.3000	=
(50) Schedule BA Collateral Loans	Schedule BA Part 1 Column 12 Line 2999999 + Line 3099999	_____			X 0.0680	=
(51) Total Residual Tranches or Interests - Other	AVR Equity Component Column 1 Line 93, in part	_____			X 0.4500	=
(52.1) NAIC 01 Working Capital Finance Notes	AVR Equity Component Column 1 Line 94	_____			X 0.0050	=
(52.2) NAIC 02 Working Capital Finance Notes	AVR Equity Component Column 1 Line 95	_____			X 0.0163	=
(52.3) Total Admitted Working Capital Finance Notes	Line (52.1) + (52.2)	_____				
(53.1) Other Schedule BA Assets	AVR Equity Component Column 1 Line 96	_____				
(53.2) Less NAIC 2 thru 6 Rated/Designated Surplus Notes and Capital Notes	Column (1) Lines (23) through (27) + Column (1) Lines (33) through (37)	_____				
(53.3) Net Other Schedule BA Assets	Line (53.1) less (53.2)	_____			X 0.3000	=
(54) Total Schedule BA Assets C-1o (pre-MODCO/Funds Withheld)	Lines (11) + (21) + (31) + (41) + (48.3) + (50)+ (52.3) + (53.3)	_____				_____
(55) Reduction in RBC for MODCO/Funds Withheld Reinsurance Ceded Agreements	Company Records (enter a pre-tax amount)	_____				_____
(56) Increase in RBC for MODCO/Funds Withheld Reinsurance Assumed Agreements	Company Records (enter a pre-tax amount)	_____				_____
(57) Total Schedule BA Assets C-1o (including MODCO/Funds Withheld.)	Lines (54) - (55) + (56)	_____				_____
(58) Total Schedule BA Assets Excluding Mortgages and Real Estate	Line (47) + (49.2) + (51) + (57)	_____				_____
† Fixed income instruments and surplus notes designated by the NAIC Capital Markets and Investment Analysis Office or considered exempt from filing as specified in the <i>Purposes and Procedures Manual of the NAIC Investment Analysis Office</i> should be reported in Column (3). ‡ Column (2) is calculated as Column (1) less Column (3) for Lines (1) through (17). Column (2) equals Column (3) - Column (1) for Line (53.3). § The factor for Schedule BA publicly traded common stock should equal 30 percent adjusted up or down by the weighted average beta for the Schedule BA publicly traded common stock portfolio subject to a minimum of 22.5 percent and a maximum of 45 percent in the same manner that the similar 15.8 percent factor for Schedule BA publicly traded common stock in the Asset Valuation Reserve (AVR) calculation is adjusted up or down. The rules for calculating the beta adjustment are set forth in the AVR section of the annual statement instructions.						
# Did the reporting entity experience a 10% or more change from their 2023 ACL RBC based on the 2024 RBC changes.					Yes []	No []
_____ Denotes items that must be manually entered on the filing software.						

LR008

NAIC Company Code

Company Name

Confidential when Completed

CALCULATION OF AUTHORIZED CONTROL LEVEL RISK-BASED CAPITAL

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

Denotes items that must be manually entered on the filing software.

LR031

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

† Excluding affiliated preferred and common stock

Denotes items that must be manually entered on the filing software.

#REF!

LR039

Draft: 5/21/24

Risk-Based Capital Investment Risk and Evaluation (E) Working Group
Virtual Meeting
April 12, 2024

The Risk-Based Capital Investment Risk and Evaluation (E) Working Group of the Capital Adequacy (E) Task Force met April 12, 2024. The following Working Group members participated: Philip Barlow, Chair (DC); Thomas Reedy, Vice Chair (CA); Wanchin Chou (CT); Ray Spudeck (FL); Doug Ommen, Carrie Mears, and Kevin Clark (IA); Vincent Tsang (IL); Roy Eft (IN); Fred Andersen (MN); Debbie Doggett (MO); Lindsay Crawford (NE); Jennifer Li (NH); Bob Kasinow and Bill Carmello (NY); Judith L. French and Dale Bruggeman (OH); Rachel Hemphill (TX); Doug Stolte and Dan Bumpus (VA); Steve Drutz (WA); and Amy Malm (WI).

1. Discussed a Review of Year-End 2023 Data Reported for Residual Tranches

Julie Gann (NAIC) presented an NAIC staff review of the 2023 data reported for residual tranches (Attachment Six-C1). She said staff completed a review of the residual reporting on schedule BA and noted that the count of the residuals included in the memorandum includes any reported residual, regardless of whether they had a zero book adjusting carrying value (BACV). She stated that the increase in residual shown from 2022 to 2023 may not be from 2023 acquisitions but could be from a move to the residual line. Gann noted key elements of the data review shown on page one of the report. She highlighted the reporting by type of residual based on the underlying collateral for each line of business shown on pages two and three of the report, followed by a chart showing residuals by acquisition date. She noted additional information included in the report providing detail on the movement in 2023 reporting to residual lines. She highlighted the last chart shown on page six and the impact of the 45% risk-based capital (RBC) factor across the reporting entities with residuals. She stated that the result of each individual company calculation was done by removing the impacts of the 30% factor on the risk component totals going into the covariance adjustment and replacing them with the results of a 45% factor. She stated the results show that only five companies would have a percentage change of 5% with the application of a 45% RBC factor. She noted that there are 19 companies that would fall between 1% and 5% overall RBC decline and then the rest would have less than a 1% change to RBC. None of the companies reviewed would have triggered any additional regulatory oversight as a result of the change. Drutz asked if the results of the recalculation were crosschecked with the sensitivity test. Gann said that some companies did not flow through the residual amount that was reported on schedule BA through either the LR008 line or the sensitivity test. As such, NAIC staff did not rely on either of those reporting metrics in recalculating the RBC but instead used the schedule BA information that was reported for residuals and used the information to recalculate at the 45% factor.

2. Heard a Presentation from the NAIC's SSG

Eric Kolchinsky (NAIC) presented the Structured Securities Group's (SSG) report (Attachment Six-C2). He said the SSG was tasked to replicate some of the results in an Oliver Wyman report titled, "Residual Tranche Risk Analysis." Acknowledging there were two critical pieces of information missing in the analysis (slide 2), Kolchinsky walked through how the SSG overcame the limitations by: 1) reconstructing the cumulative default rates (slides 3–4); and 2) using common benchmarks to understand the loss to the investment. Kolchinsky commented that Oliver Wyman's default rate is too high, and discount rates are too low. He gathered from market participants that a constant default rate of 2%, a discount rate between 14%–18%, and a 20% constant prepayment rate (CPR) are more reasonable baselines for the analysis (slides 5–6). With these replication efforts, SSG was able to replicate losses for six proxy deals that SSG is currently modeling (slides 7–8). SSG's observations from this benchmarking exercise were summarized in slide 9.

Upon Clark's request, Kolchinsky summarized his presentation into two key takeaways: 1) the stress scenarios, namely the global financial crisis (GFC) and the dot-com bubble, were not extreme enough to represent severe tail-risk events; and 2) the Oliver Wyman analysis understated the potential risk/loss to broadly syndicated loan (BSL) collateralized loan obligations (CLOs).

Upon Tsang's request, Kolchinsky went deeper into the results (slide 8), which summarize the losses under two stress scenarios: historic + one standard deviation and historic + two standard deviations. Barlow clarified that for RBC purposes, the latter scenario is more relevant. Looking at the results, Tsang wondered if the 45% charge was too generous. Kolchinsky said he needed more parameters to answer that question. Barlow clarified that the SSG's work presented is only for residual tranches of CLOs. That said, CLO residuals are the most commonly owned residuals among the insurers according to information reported in annual statements, per the SSG. Tsang asked whether the CLO deals that the SSG selected were representative of the asset class. Kolchinsky said the selection was arbitrary with a deliberate effort to have varied credit performance and vintages. Apart from that, Kolchinsky said he could not comment on how representative the samples were. While SSG did not solicit public comment in the selection process, the selected CLO deals are subject to public discussion during the modeling phase, and no objection was received. Tsang inquired if the results in this presentation were vetted in the SSG's ad hoc group, and Kolchinsky confirmed that they were not. He said the ad hoc group's focus is not on CLO equity, but he is at the regulators' disposal. Mears reiterated that the ad hoc group is focused on modeling for designations of CLOs and, therefore, only rated tranches of CLOs are in scope. Kolchinsky reported that the ad hoc group is going to model the entire universe of CLOs, and therefore, a broader dataset will be available in the future.

Tom Sullivan (Sullivan Strategy and Advisory Services LLC) suggested the Working Group give Oliver Wyman the opportunity to respond and/or expose the SSG's report for public comment. Barlow reminded the Working Group that the purpose of the meeting was to receive feedback on the Oliver Wyman report and deemed no further action as necessary.

3. Discussed Comment Letters (Attachment Six-C3) Received on the Oliver Wyman Report

Bryan Bashur (Americans for Tax Reform—ATR) presented a comment letter. He said ATR is in favor of the 30% RBC charge for residuals and, therefore, would like to delay the 45% capital charge by at least one year. ATR is concerned that the blanket application of a 45% charge on residuals would raise the cost of life and annuities products. ATR also expressed concern that the proposed 45% charge appears to stem from pressure to align the insurance industry's capital requirement with federal banking regulations and/or international capital requirements, neither of which is justifiable given the U.S. state-based insurance regulation framework.

Barlow called upon Julio Fuentes (Florida State Hispanic Chamber of Commerce), Doug Dean (former Colorado Insurance Commissioner), Max Carter (Nevada State Assembly), Cesar Aguilar (Arizona House of Representatives), Rea S. Hederman (The Buckeye Institute), and Tom Swatzell (South Carolinians for Responsible Government) to present their comment letters. No representatives spoke on these comment letters.

Isaac Schick (American Consumer Institute—ACI) presented a comment letter. ACI expressed concern about the affordability of insurance policies resulting from the proposal's adoption. It also believed the Oliver Wyman report supports a 30% charge, not a 45% charge.

Colleen Scheele (National Association of Mutual Insurance Companies—NAMIC) presented a comment letter. NAMIC is supportive of a one-year delay in the implementation of the 45% charge to allow for a more thorough assessment of the data (e.g., data in the Oliver Wyman report, the SSG's presentation, and the American Academy of Actuaries' [Academy's] work). Scheele pointed out that the analysis could look different for property/casualty (P/C) insurance companies than for life companies. Chou reminded the Working Group that a year was already

given to the industry to evaluate the proposal. Chou asked NAMIC whether it can guarantee needed progress if another year is granted. No guarantee was made by NAMIC.

Barlow asked Rebekah Goshorn Jurata (American Investment Council—AIC) to present a comment letter. No representative spoke on the comment letter.

Amnon Levy (Bridgeway Analytics) presented a comment letter. He said by submitting a comment letter, Bridgeway would like to advocate for a thoughtful, long-term solution for asset-backed securities (ABS) and its residuals. The comment letter details Bridgeway's assessment of the Oliver Wyman report, and Levy highlighted two key observations. The first observation is that Oliver Wyman's methodology departed from that used to estimate C1 charges for bonds, equities, and other asset classes by not considering portfolio concentration/diversification effects. Bridgeway believes that Oliver Wyman failed to recognize the diversification benefit in CLOs. The second observation was that back-testing was omitted in the report. Rather than a negative 45% potential loss, residuals performed exceptionally well through the GFC, with double-digit annualized returns recorded over the life of CLOs. Levy would like to see the Academy leverage Bridgeway's detailed empirical assessment of the Oliver Wyman report, particularly assessing the "comparable attributes" that would allow the identification of differentiated risks and, thereby, align capital charges to the risks/economics of different residual types.

Francisco Paez (MetLife) presented a comment letter. MetLife interpreted the Oliver Wyman report as supportive of a 45% or higher interim RBC charge. MetLife also offered recommendations to strengthen Oliver Wyman's analysis, each of which is anticipated to result in materially higher losses than presented in the Oliver Wyman report. The recommendations are: (i) include residential mortgage-backed securities (RMBS) and commercial mortgage-backed securities (CMBS) deals in order to result in selections that are representative of insurers' holdings; (ii) include only residuals that are truly available for investment by insurance companies; (iii) fine-tune modeling assumptions, as the current assumptions for extreme tail-risk scenarios are overly optimistic; and (iv) apply a modeling technique that fully evaluates the spectrum of tail-risk scenarios and captures the binary loss nature of residuals. Upon Clark's request, Paez clarified that upward of 90% of holdings studied by Oliver Wyman are BSL CLOs, both debt and residual tranches. Clark pointed out that regulators do not currently have information on what types of residuals (BSL, middle market loans, or other) insurers owned and that information is more relevant for the discussion. Paez said he did not have specific data to shed light on that but inferred that insurers' residual holdings resembled overall holdings, based on the availability of residuals for purchase. (BSL CLO residuals are readily available for purchase in the market.)

Mike Consedine (Athene) presented a comment letter. Athene refrained from commenting on specific details and findings in the Oliver Wyman report or the appropriateness of the factor proposed. Athene recommended that the Working Group delay implementation of the 45% factor until an informed decision, backed by data-driven expert analysis, can be made under the holistic framework for the regulation of insurer investments, as adopted by the Financial Condition (E) Committee.

Richard Goldberger (Equitable) presented a comment letter. Equitable interpreted Oliver Wyman's report as a justification for at least a 45% capital charge for residuals. As a result, any further delay in adopting the 45% charge as an interim solution is not justifiable.

Steve Broadie (American Property Casualty Insurance Association—APCIA) presented a comment letter. APCIA echoed NAMIC's and the American Council of Life Insurers' (ACLI's) recommendation to support a one-year delay in implementing a 45% charge. APCIA interpreted the Oliver Wyman report as 45% being not supportable. APCIA believes that further study is needed to deliberate an increase in residuals' charges for P/C and health insurers.

Barlow clarified that the deliberation for the P/C and health sectors is being analyzed by the Capital Adequacy (E) Task Force and, therefore, was not a focus for the meeting.

Kevin Howard (Western & Southern Financial Group) presented the comment letter. Western & Southern believe the Oliver Wyman report supports a 45% capital charge for residual.

Barlow called upon Briscoe Cain (Texas House Committee on Insurance) and Robert Harms (The Harms Group) to present a comment letter. No representative spoke on the comment letters.

Joe Engelhard (Alternative Credit Council—ACC) presented a comment letter. ACC noted a heightened interest in BSL CLO residuals, and it echoed Bridgeway’s recommendation to encourage back testing. Engelhard pointed out that syndicated loans had a great track record of performance per a Federal Reserve study that covers a period from 1997 to 2021. He attributed the great record to various features of CLOs (e.g., reinvestment options, closed-end structure, liquidity management tools, etc.). He asked the Working Group to consider this historical track record. Separately, ACC noted that a 45% charge is too punitive for certain non-BSL CLO residuals (e.g., residuals of commercial property assessed clean energy [C-PACE] loan ABS). Barlow stated that the RBC process is designed to assist regulators in identifying potentially weakly capitalized companies and is by no means meant to be “punitive.” He discouraged the use of the word “punitive” when describing RBC charges. Barlow also reiterated that RBC is a blunt regulatory tool that is not intended to be granular. Further fine-tuning of the RBC charges for different types of residuals may not be warranted. Mears heard that the residuals owned by insurers are predominantly BSL CLOs but acknowledged there was a struggle to verify this information. She asked if ACC could confirm this information. ACC could not opine on it but said, through industry outreach, it realized a great variety of ABS are owned by insurers. ACC volunteered to assist with the due diligence. Mears then questioned whether the Oliver Wyman report factored in the historical track record of CLOs, as recommended by the ACC. Engelhard said the Oliver Wyman report was conservative in many regards and did not factor in certain competitive advantages of CLOs, such as active management by CLOs managers.

Mariana Gomez-Vock (ACLI) said the ACLI was aware that non-industry stakeholders have made claims to media that are untrue, unfair, and/or malicious. The ACLI condemned these activities. Gomez-Vock presented a comment letter, which requests a one-year delay in implementing the 45% charge, which would allow additional time for regulators and stakeholders to evaluate the charge in the context of: 1) work by the Academy; and 2) actual and potential accounting and reporting changes (e.g., the new principle-based bond definition and resulting changes to accounting and measurement of carrying value of residuals). Clark clarified that all definitional changes for residuals have been adopted as of the date of the meeting, and no further deliberations are anticipated. Commissioner Ommen commented that the Academy is at capacity and questioned if the ACLI can be specific on its expectation of the Academy’s involvement. Gomez-Vock clarified that her remark referred to the Academy’s work on comparable attributes, and the ACLI did not mean to suggest the Academy take on additional work. Upon Clark’s request, Gomez-Vock clarified that the ACLI did not mean to suggest scraping the interim solution altogether and waiting until the Academy completed its study. Barlow stated that should the Academy’s comparable attributes study be leveraged, the resulting proposal could be more complicated than a single factor for all residuals. Gomez agreed and said it would not preclude the possibility that a more complicated proposal is the right solution.

Steve Smith (Academy) presented a comment letter. The Academy completed a high-level review of the Oliver Wyman report, focusing on determining if Oliver Wyman’s analysis is consistent with the ABS RBC principles that the Working Group endorsed at the 2023 Fall National Meeting. The overall observation is that the Oliver Wyman report is not fully consistent with all the principles. Specifically, the Oliver Wyman report heavily relied on the comparison of risks of residuals versus the risk of common stocks, and that comparison is not supported by the principles. The Academy disagreed that risks of residuals are comparable with risks of common stocks and stated

that the shape of loss distributions between the two are very different. Smith reported that the Academy's work on comparable attributes is still underway, and the goal is to present an update during the Summer National Meeting. Clark inquired if the planned report is relevant for deliberation of residual factors capital requirement. Smith said he believed so and expects the study to address both residual and debt tranches of ABS. However, he cannot commit to a timeline for finalization and endorsement of the comparable attributes. Even if finalized, further time is needed to use the attributes to deliberate factors, and therefore, a lengthy process is expected.

Barlow called upon Sen. Paul Bailey (TN-R) to present a comment letter. No representative spoke on the comment letter.

Barlow thanked the presenters and stated that some of the comment letters received were responsive to the Working Group's request to provide constructive feedback. Barlow expressed his opinion, based on all the information and presentations received, that a 45% RBC charge for residuals is appropriate. Carmello agreed and said that a higher-than-45% charge is perhaps warranted. He also questioned why residuals are admitted assets, as they are more akin to speculative derivatives, which are non-admitted under statutory accounting guidance. Chou also advocated for a 45% charge now until any analyses would suggest otherwise. Andersen said timely regulation is warranted, and there is no reason to further delay the 45% charge. He noted exponential growth in residuals ownership and believed the current charge is understated. He interpreted the Oliver Wyman report as supportive of a 45% charge and does not believe the report accurately reflects the risks of residuals. Tsang also supported a 45% charge but is willing to leave the door open for future adjustments based on future findings or analyses. Bumpus said Virginia is in support of a 45% charge without delay. Bumpus said the reading of the Oliver Wyman report supports a 45% charge.

Director French was in favor for an additional one-year implementation delay. Commissioner Brown echoed and supported Director French's position. Director French made a motion, seconded by Eft, to move the interim 45% charge on ABS residuals from 2024 to 2025.

A roll call vote was taken with 11 members voting "No," four members voting "Yes," and one member abstaining. The motion did not pass.

Commissioner Ommen said he was concerned that there was a lack of specific deliverables, and he believed more work and considerations are needed on the Oliver Wyman report. He would like to give all parties another 30 days for this work.

In light of Commissioner Ommen's concern and the desire to have additional discussions, Barlow directed NAIC staff to work with Iowa state insurance regulators to draft a solicitation of comments, which is going to be exposed for a 30-day public comment period. A public call will be scheduled later in May after the conclusion of the comment period.

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

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MEMORANDUM

TO: Members of the RBC Investment Risk and Evaluation (E) Working Group
Members of the Statutory Accounting Principles (E) Working Group

FROM: NAIC Staff

DATE: April 1, 2024

RE: Aggregated Residual Data – Year-End 2023

This memo has been developed to provide information on the reporting of residuals by life, P/C & health companies on Schedule BA for year-end 2023. Summaries of information are provided for the following aspects:

- Residual by Reporting Line
- Residual Acquisition Date
- 2023 Movement to Residual Reporting – Life Entities
- Residuals with NAIC Designations Reported
- Residual Investments Involving Related Parties
- Impact of 45% RBC Factor – Refreshed for 2023 Riling Results.

Residuals By Reporting Line:

Total Residuals	2023 Count	Reported BACV	% of Total	2022 Count	Reported BACV	% of Total
Life Entities	1,248	11,630,554,475	86.13%	874	5,742,324,464	81.86%
P/C Entities – 2022 Revised	419	1,551,970,807	11.49%	355	1,049,516,959*	14.96%
Health Entities	99	317,688,548	2.35%	80	220,517,642	3.14%
Title Entities	2	2,637,903	0.02%	2	2,799,992	0.04%
Total Residuals	1,768	13,502,851,733		1,314	7,015,159,057	

Notes: 1) The counts include any instance in which an investment is reported, regardless of if it had a BACV.

2) The increase in residuals may not be from 2023 acquisitions but could be a move to the residual reporting line. See the chart on page 4 for residual movement detail for life companies.

* In 2022 it was noted that \$4.5B of this was likely misreported as residuals. This company did not include that amount in the 2023 residual reporting. The amount has been removed for comparison purposes.

Key Elements:

- Life entities make up the significant majority (86%) of residual interests across the entire industry. Residuals reported on Schedule BA for life entities has doubled in BACV from 2022, from \$5.7B to \$11.6B.
- Residuals are predominantly classified as either fixed income or other. This is consistent with 2022.
- 48% of all residuals held by life entities involve a related party in some form. A much lower percentage of related party involvement exists for P/C and Health Entities.
- 25 life entities hold residuals that reflect 83% of the life industry BACV total. (8 companies represent 47% and 10 companies represent 55%.)
- Per the detail of largest residuals held, several are reported at an amount greater than cost. This will not be permitted for residuals acquired after Jan. 1, 2025, per the new measurement guidance in SSAP No. 21R.

Life Entities: Residuals reported on Schedule BA has doubled in BACV from 2022, from \$5.7B to \$11.6B. The number of residuals has increased in all categories, except for “Other-Affiliated,” which reported an approx. count decrease of 100 and 51% decline in BACV. Although the count of residuals is significantly greater with unaffiliated investments, the BACV is evenly split between unaffiliated and affiliated.

Life Reporting Entities					
Unaffiliated	2023 Count	Reported BACV 2023	2022 Count	Reported BACV 2022	% Change in BACV '22 to '23
Fixed Income – Unaffiliated	651	3,829,582,270	428	1,717,933,527	122.92%
Common Stock - Unaffiliated	31	459,991,247	20	151,745,564	203.13%
Preferred Stock – Unaffiliated	9	15,559,571	6	4,999,986	211.19%
Real Estate - Unaffiliated	3	12,321,798	0	0	100%
Mortgage Loans - Unaffiliated	30	69,675,196	9	2,757,688	2426.58%
Other – Unaffiliated	163	1,423,560,678	147	682,127,139	108.69%
Total Unaffiliated	887	5,810,690,760	610	2,559,563,904	127.02%
Percent of Life Residual Total	71%	50%	70%	45%	
Affiliated					
Fixed Income - Affiliated	217	3,200,982,913	94	1,438,200,802	122.57%
Common Stock – Affiliated	85	1,503,564,184	30	110,512,247	1260.54%
Preferred Stock – Affiliated	1	0	0	0	100%
Real Estate - Affiliated	5	276,320,282	0	0	100%
Mortgage Loans – Affiliated	5	45,959,496	0	0	100%
Other – Affiliated	48	793,036,840	140	1,634,047,511	-51.47%
Total Affiliated	361	5,819,863,715	264	3,182,760,560	82.86%
Percent of Life Residual Total	29%	50%	30%	55%	
Life Residual Total	1,248	11,630,554,475	874	5,742,324,464	102.54%

P/C Entities: Residuals reported on Schedule BA has increased about 50% from 2022. Although it appears that the affiliated residuals have decreased significantly, four investments totaling \$4.5B were misreported by one company as residuals in 2022. As those investments were not misreported in 2023, those investments represent the bulk of the decrease in affiliated. For P/C entities, a significant majority are unaffiliated investments.

Property / Casualty Reporting Entities					
Unaffiliated	2023 Count	Reported BACV 2023	2022 Count	Reported BACV 2022	% Change in BACV '22 to '23
Fixed Income – Unaffiliated	280	880,698,427	237	631,189,758	39.53%
Common Stock - Unaffiliated	83	293,210,673	69	132,695,423	120.97%
Preferred Stock – Unaffiliated	3	15	1	65,550	-99.98%
Real Estate - Unaffiliated	2	4,608,460	0	0	100%
Other – Unaffiliated	16	70,461,810	24	65,938,165	6.86%
Total Unaffiliated	384	1,248,979,385	331	829,888,896	50.50%
Percent of P/C Residual Total	92%	80%	92%	15%	
Affiliated					
Fixed Income - Affiliated	31	292,249,580	26	4,756,630,624	-93.86%
Common Stock – Affiliated	1	0	0	0	0
Other – Affiliated	3	10,741,842	1	15,239,928	-29.52%
Total Affiliated	35	302,991,422	27	4,771,870,552	-93.65%
Percent of P/C Residual Total	8%	20%	8%	85%	
P/C Residual Total	419	1,551,970,807	358	5,601,759,448	-72.29%

Health Entities: The increase in residuals reported on Schedule BA is for health is 44%, which is similar to the increase in P/C entities. Also similar to P/C entities, a significant majority are unaffiliated investments.

Health Reporting Entities					
Unaffiliated	2023 Count	Reported BACV 2023	2022 Count	Reported BACV 2022	% Change in BACV '22 to '23
Fixed Income – Unaffiliated	93	\$300,528,301	64	\$198,916,262	51.08%
Preferred Stock – Unaffiliated	1	2,323,187	0	0	100%
Other – Unaffiliated	2	705,038	12	3,584,975	-80.33%
Total Unaffiliated	96	303,556,526	76	202,501,237	49.90%
Percent of Health Residual Total	97%	96%	95%	92%	51.08%
Affiliated					
Fixed Income - Affiliated	2	\$14,132,022	4	\$18,016,405	-21.56%
Other – Affiliated	1	0	0	0	0
Total Affiliated	3	14,132,022	4	18,016,405	-21.56%
Percent of Health Residual Total	3%	4%	5%	8%	
Health Residual Total	99	317,688,548	80	220,517,642	44.06%

Title Entity – There is one title company that holds two residuals for a BACV of \$2.6M in 2023. These investments were held in 2022 with a \$2.8M BACV.

Residual Acquisition Dates

A vast majority of life entities (76% in 2023 vs. 83% in 2022) reported that their residuals (in BACV) were acquired in the most recent three years. Similar observations are noted for P/C and Health, with 78.2% and 80.7% of residuals BACV acquired in the most recent three years respectively. *(The count includes all reported investments, including those with 0 BACV.)*

Year Acquired	Life			P/C			Health		
	Count	Reported BACV	% of BACV	Count	Reported BACV	% of BACV	Count	Reported BACV	% of BACV
2023	247	2,810,468,654	24.2%	70	255,611,788	16.5%	26	86,522,773	27.2%
2022	345	3,591,694,216	30.9%	111	508,120,920	32.7%	51	163,729,104	51.6%
2021	246	2,467,916,903	21.2%	123	448,965,412	29.0%	13	6,214,651	2.0%
2020	89	1,048,139,934	9.0%	33	123,193,438	7.9%	-	-	-
2019	51	569,343,237	4.9%	30	72,359,962	4.7%	-	-	-
2018	52	127,519,073	1.1%	10	19,082,086	1.2%	1	14,033,114	4.4%
2017	49	60,369,061	0.5%	9	1,988,026	0.1%	-	-	-
2016	33	122,340,118	1.1%	7	20,667,734	1.3%	-	-	-
2015	6	7,323,326	0.1%	1	0	0.0%	1	694,655	0.2%
2014	93	323,179,676	2.8%	1	41,773	0.0%	-	-	-
2013	3	665,006	0.0%	5	1,208,799	0.1%	1	98,908	0.0%
2012	1	0	0.0%	3	99,561,943	6.4%	1	118,711	0.0%
2011	1	70,044	0.0%	1	809,408	0.1%	-	-	-
2010 or earlier	7	(1)	0.0%	6	242,224	0.0%	3	41,081,461	13.0%
No Date	25	501,525,228	4.2%	9	117,294	0.0%	2	5,195,171	1.6%
Total	1,248	11,630,554,475	100%	419	1,551,970,807	100%	99	317,688,548	100%

2023 Movement to Residual Reporting – Life Entities:

In 2022 it was known that residuals were under-reported as residual investments in LLCs were often retained within the LLC Schedule BA reporting line and not moved to the residual reporting line until explicitly directed. The detail below illustrates that residuals (in all categories except for “Other”) were held in 2022 but not reported on the Schedule BA residual reporting line. This information is in aggregate count only. It would require a comparison of each insurance company’s Schedule BA for 2023 and 2022 to identify the specific residuals and BACV that were held in 2022 and reported elsewhere. *(This review was completed for life companies only.)*

Life Entities	Total Count 2023	Acquired 2023	Acquired 2022 or earlier per 2023 Data	Total Count 2022	Difference in 2022 #'s
Fixed Income – Unaffiliated	651	131	520	428	92
Fixed Income Affiliated	217	37	180	94	86
Common Stock – Unaffiliated	31	14	29	20	9
Common Stock - Affiliated	85	14	71	30	41
Preferred Stock – Unaffiliated	9	2	7	6	1
Preferred Stock – Affiliated	1	0	1	0	1
Real Estate - Unaffiliated	3	1	2	0	2
Real Estate - Affiliated	5	2	3	0	3
Mortgage Loans - Unaffiliated	30	3	27	9	18
Mortgage Loans – Affiliated	5	3	2	0	2
Other – Unaffiliated	163	47	116	147	(31)
Other – Affiliated	48	5	43	140	(97)
Total Counts	1248	334	1001	874	

Note – Items that were not reported with an acquisition date were assumed to be acquired prior to 2023.

Residuals with NAIC Designations Reported

Life Entities: Residuals most commonly do not have designations, either SVO assigned or from CRPs. The information reported for year-end 2023 had 195 investments reported with an NAIC designations (as compared with 76 in 2022). The vast majority (in count and percentage of BACV) are not reported with a designation, or if reported, reflected an NAIC 6. Although designations can be reported for residuals, they have no impact on RBC. The reporting for P/C and Health companies is in line with the expectation that residuals would not have designations.

Designation	Life			P/C			Health		
	Count	Reported BACV	% BACV	Count	Reported BACV	% BACV	Count	Reported BACV	% BACV
NAIC 1	5	715,013,572	6.2%	-	-	-	-	-	-
NAIC 2	9	2,961,703	0.0%	-	-	-	-	-	-
NAIC 3	-	-	-	1	2,630,803	0.2%	-	-	-
NAIC 4	-	-	-	-	-	-	-	-	-
NAIC 5	18	110,531,073	1.0%	-	-	-	3*	9,762,289	3.1%
NAIC 6	163	968,700,137	8.3%	174	372,616,456	24.0%	3	60,615,371	19.1%
0 or None	1,053	9,833,347,990	84.5%	244	1,176,723,548	75.8%	93	247,310,888	77.8%
Total	1,248	11,630,554,475	100%	419	1,551,970,807	100%	99	317,688,548	100%

Note: For the life entities, all the NAIC 1s for life entities are reported as FE. For the NAIC 5, 8 of them are reported as 5GI with aggregate BACV of \$1.2M

Residual Investments Involving Related Parties:

As shown, close to half (48% vs. 62% in 2022) of residuals owned by life entities involved related parties in some form (related party code 1 to 4). Most of these are from securitizations (or similar structures) with less than 50% of the underlying collateral in direct credit exposure (code 3).

Life				
Related Party Code		Count	Reported BACV	% of BACV
1	Direct credit exposure.	8	138,580,178	1.2%
2	Securitization with related party with 50% or more of the underlying collateral in direct credit exposure.	34	1,723,845,683	14.8%
3	Securitization with related party with less than 50% of the underlying collateral in direct credit exposure.	330	3,688,578,763	31.7%
4	Securitization where structure reflects an in-substance related party transaction, but does not involve a related party as sponsor, originator, manager, servicer, etc.	5	13,070,500	0.1%
5	Investment is identified as related party, but the role is a different arrangement from the prior options.	2	44,082,179	0.4%
6	Investment does not involve a related party.	855	6,022,397,172	51.8%
No Entry		14	0	0.0%
Total		1,248	11,630,554,475	100%

Unlike life entities, the majority of residuals held by P/C (86%) and Health (94%) do not involve a related party.

P/C				
Related Party Code		Count	Reported BACV	% of BACV
1	Direct credit exposure.	7	15,584,624	1.0%
3	Securitization with related party with less than 50% of the underlying collateral in direct credit exposure.	17	111,499,671	7.2%
4	Securitization where structure reflects an in-substance related party transaction, but does not involve a related party as sponsor, originator, manager, servicer, etc.	1	7,096,432	0.5%
5	Investment is identified as related party, but the role is a different arrangement from the prior options.	3	83,133,797	5.4%
6	Investment does not involve a related party.	384	1,334,656,283	85.9%
No Entry		7	-	-
Total		419	1,551,970,807	100%

Health				
Related Party Code		Count	Reported BACV	% of BACV
1	Direct credit exposure.	5	20,388,739	6.4%
5	Investment is identified as related party, but the role is a different arrangement from the prior options.	1	98,908	0.0%
6	Investment does not involve a related party.	92	297,200,901	93.6%
No Entry		1	-	-
Total		99	317,688,548	100%

Note: Codes with zero entries were excluded from the P/C and Health Schedules above.

Impact of 45% RBC Factor – Refreshed for 2023 Riling Results.

Although company specific information cannot be shared publicly, estimated (@) individual company calculations of ACL RBC ratio, after removing the impacts of the 30% factor on the risk component totals going into the covariance adjustment and replacing them with the results of a 45% factor, was noted to have the following impact:

Percentage Change, in absolute term*	Number of Companies
> 5.0%	5
1.0% ≤ Percentage change <5.0%	19
0.5% ≤ Percentage change <1.0%	14
0.2% ≤ Percentage change <0.5%	19
0.1% ≤ Percentage change <0.2%	16
<0.1%	37
Total	110

@ The estimate does not take into consideration the effect of MODCO Reinsurance Adjustments, potential concentration factor/consideration and non-admittance of residual investments (if any).

* “Percentage Change in absolute term” is calculated by determining the percentage change in 2023 reported and estimated (@) ACL RBC ratios. For example, if a company reported an 860% ACL RBC Ratio and the application of the 45% factor within the estimation decreased ACL RBC to 859%, this would represent a 0.12% percentage change, in absolute terms | (859%-860%)/860%|. This exercise was completed for 110 of the life entities that reported ownership of residuals in Schedule BA as of March 13, 2024.

NAIC Staff also noted that none of the 110 companies analyzed above would trigger additional regulatory oversight prescribed for action levels such as Company Action Level, Regulatory Action Level, Authorized Control Level or Mandatory Control Level RBC, as a result of implementation of 45% factors. Coupled with the fact that over 95% of the companies experienced a less than 5% change in ACL RBC Ratio (as seen in analysis above), it was concluded that the 45% factor has inconsequential impact to the insurers’ 2023 RBC.

Benchmarking BSL CLO Equity

Eric Kolchinsky

April 8, 2024



STRUCTURED SECURITIES

Executive Summary

- This report attempts to benchmark the results presented in the Oliver Wyman (OW) Residual Tranche Risk Analysis date February 24, 2024.
- We focused on the results related to BSL CLOs as this constitutes our core expertise. In addition, it is not clear what is the total insurance company exposure to the other sectors.
- We sought to re-create the OW analysis using our 6 proxy CLO deals. The OW report was missing two critical pieces of information:
 - The total defaults (Cumulative Default Rates) for the portfolio in each of their scenarios. We attempt to reconstruct these.
 - The "Reference case" cash flows for the CLO Equity. This is the assumed carrying value of Equity on the insurance company balance sheet.

 **STRUCTURED SECURITIES**

Overview

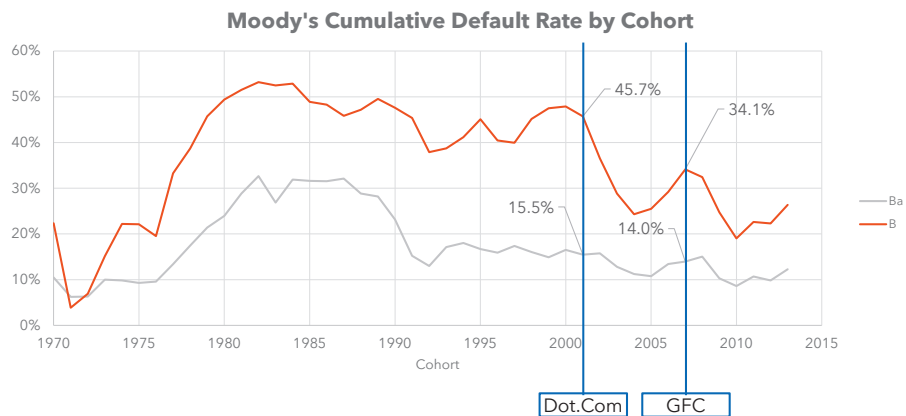
Below is a simplified procedure we employed to place the two scenarios (Dot.Com and GFC) within the context of our 10 scenarios:

1. Used Exhibit 47 of the 2023 Moody's Corporate Default Study: the 1/1/01 cohort for the Dot-Com bubble; and the 1/1/07 cohort for the GFC.
2. Cohort data is combined into rating categories by weights stated in the OW Paper.
3. Applied the portfolio weights to NAIC Default scenarios
4. Compared the two values at the 10-year level. The GFC scenario is analogous to the historical base case and the Dot.Com is analogous to the NAIC + 1 σ .

Scenario	CDR
GFC Cohort	31.4%
NAIC Hist	31.6%
Dot.Com Cohort	40.2%
NAIC+1 σ	40.4%
NAIC+2 σ	49.3%

 **STRUCTURED SECURITIES**

Historical Moody's Cohort Cumulative Default



Source: Moody's Global Annual default study 2023; Exhibit 47



Reference Comparison

- Next step is to understand the loss to the investment. CLO Equity does not have a par value and does not promise the return of principal. Equity has a notional par, but that it is unrelated to any cash flows.
- To measure the risk of loss to the holder, a reference level for BACV needs to be assumed. In their analysis, OW calculates a value based on a constant default rate of 2.6% (approx. 23% over 10-yrs) and a discount of 12%. The actual assumed BACV is not provided.
 - NAIC staff believes that the base default rate used is too high and the discount rate is too low as market benchmarks. Nevertheless, it is difficult to understand the full impact of the decision without seeing the underlying cashflows.
- To overcome this limitation, we used a few common benchmarks to understand the losses.



Reference Benchmarks

- We used four benchmarks for the carrying value.
 - Two are less severe, NAIC default scenarios (Base and Hist -1).
 - We also used the simple rubric of Assets less Liabilities which marks the Equity "to book".
 - Lastly, we looked at the historical reporting for tranches identified as CLO Equity when they were reported on Schedule D. We used the ratio of BACV to Par Value for YE 21 to calculate an average 58 dollar price.

Scenario	Description
Hist. -1	NAIC historical default rates less 1 sd
Base	NAIC historical default rates
A-L	Assets minus liabilities
Schedule D	Historical reporting calculated as BACV over Par.



STRUCTURED SECURITIES

Results

- We used the previously generated cash flows from our 6 proxy deals available on our CLO website. (<https://content.naic.org/sites/default/files/industry-ssg-clo-cashflow-20231208.xlsb>)
- We compared the total Equity cash flows in the two stress scenarios (Historical plus +1σ and +2σ) against the various carrying value benchmarks.
 - Historical recoveries are used in these scenarios.
- Lastly, we take the minimum of the losses for each scenario.
- The Dot.Com cohort closely resembles the Hist +1σ scenario. As discussed before, the GFC corporate defaults were not significantly different from the base case. The Hist +2σ scenario is further provided as a reference.



STRUCTURED SECURITIES

Results

Hist+1σ

	ANCHC17	ARES LII	Carlyle	MAGN27	OHA3	Strata II
Sched D	80%	84%	70%	73%	80%	77%
A-L	83%	88%	80%	81%	76%	84%
Hist-1	88%	91%	78%	83%	82%	87%
Base Scen	60%	84%	45%	53%	58%	76%
Min Loss	60%	84%	45%	53%	58%	76%

Hist+2σ

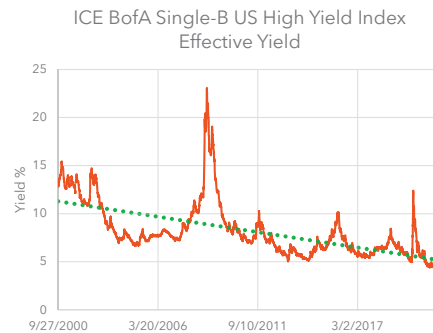
	ANCHC17	ARES LII	Carlyle	MAGN27	OHA3	Strata II
Sched D	90%	89%	81%	84%	92%	89%
A-L	91%	92%	87%	89%	90%	92%
Hist-1	93%	94%	86%	90%	92%	94%
Base Scen	79%	89%	66%	72%	83%	89%
Min Loss	79%	89%	66%	72%	83%	89%



STRUCTURED SECURITIES

Discussion

- Based on our benchmarks, the OW paper understates the potential risks to BSL CLO Equity.
- The Dot.Com did see a spike in defaults in speculative grade issuers. However, CLOs were able to avoid a direct impact partially because the Federal Reserve lowered rates in response to the 9/11 attacks.
 - This helped floating rate issuers by reducing the cost of funds.
 - However, CBOs - backed by fixed rate bonds - imploded.
- The GFC did not materially impact the speculative default rate.



Note that the trendline above underestimates the cost of capital since very few issuers, issue at the spread peak.

Source: ICE BofA via FRED



April 4, 2024

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

Re: Oliver Wyman Report: *Residual Tranche Risk Analysis*

Dear Mr. Barlow:

Americans for Tax Reform (ATR)¹ appreciates the opportunity to comment on the National Association of Insurance Commissioners' (NAIC) proposed increase to the risk-based capital (RBC) charge for residual tranches and interests of asset-backed securities (ABS). ATR also appreciates the opportunity to comment on Oliver Wyman's (OW) report analyzing the risk of losses to the residual tranches and interests of ABS under certain stress scenarios.² **ATR requests that the NAIC delay the implementation of the 45 percent RBC charge by at least one year. If the NAIC fails to delay the implementation of the 45 percent capital charge, then the NAIC should vote to establish the interim charge for residuals at 30 percent.**

The NAIC is arbitrarily increasing regulations on life insurance companies that invest in residual tranches and interests of ABS.³ It appears that the NAIC's goal is to push life insurance companies out of residual tranches without any quantitative analysis to justify this change. The implementation of the proposed regulations will disincentivize life insurance companies from investing in residual ABS tranches, which could increase the cost of Americans' life insurance and annuities. **ATR is deeply concerned the NAIC will deter financial companies from keeping life insurance and annuity products affordable for Americans.**

Third-party data and analysis provide evidence that NAIC's proposed regulations go too far. The OW report finds that common stock losses are higher than losses on residual ABS tranches on a portfolio level. The NAIC's proposed equity capital increase from 30 percent to 45 percent for residual ABS tranches is not commensurate with the residual tranche risk observed within the OW report. Meanwhile, the common stock charge is 30 percent. The OW report offers support for a 30 percent capital charge, not a 45 percent charge.

¹ ATR is a nonprofit, 501(c)(4) taxpayer advocacy organization that opposes all tax increases and supports limited government, free market policies. In support of these goals, ATR opposes heavy regulation and taxation of financial services. ATR was founded in 1985 at the request of President Ronald Reagan.

² <https://content.naic.org/sites/default/files/inline-files/Oliver%20Wyman%20Residual%20Tranche%20Report.pdf>.

³ <https://content.naic.org/about>.



Notably, another paper analyzing collateralized loan obligations (CLOs) found that “CLO equity exhibits a great deal of resilience to market volatility.”⁴

ABS residuals offer significant returns to life insurance and annuities. Residuals are a “great return enhancer and fundamental diversifier.”⁵ These tranches and interests can also “play an effective role in generating return while keeping portfolio risk constant.”⁶ Increasing the RBC charge to 45 percent would limit life insurance companies’ exposure to residuals, hamper returns, and increase costs for annuities that rely on those enhanced returns. Ultimately, American workers and retirees will bear the brunt of the increased RBC charge.

The NAIC’s proposed regulations should be delayed by at least one year. If the NAIC fails to delay the implementation of the 45 percent RBC charge, then the charge should remain at 30 percent. This is more than reasonable considering the NAIC has not conducted a comprehensive cost-benefit analysis for increasing the RBC charge to 45 percent. Moreover, the OW report clearly shows the NAIC’s proposed regulations are gratuitous. To date, no substantive quantitative analysis has been conducted to justify the NAIC’s proposed 45 percent RBC charge for residuals.

Additionally, NAIC’s proposed RBC charge should not be implemented simply to create parity with federal regulators’ implementation of the Basel III Endgame bank capital requirements.⁷ These bank regulations were originally formed by unelected bureaucrats in Basel, Switzerland. The NAIC should not implement rules for life insurance companies that will align with heavy-handed European-based regulations.

The proposed bank capital requirements arbitrarily punish securitizations by doubling the p-factor.⁸ The increase in the p-factor fails to take into consideration the varying riskiness of different types of underlying collateral. So, the p-factor treats credit card debt and commercial paper as equally risky. Adding the NAIC’s arbitrary RBC charge to residuals would unnecessarily, and without empirical evidence, label ABS as too risky for life insurance. The higher capital charges from the NAIC and the bank regulators will disincentivize banks and life insurance companies from adding exposure to securitizations. Life insurance companies will be forced to increase the cost of annuities, making them less attractive to American workers and retirees. Businesses “tend to pass on cost increases far more quickly than cost reductions.”⁹ Government-mandated capital controls will likely force life insurance companies to pass down these costs through annuities. It is widely observed that “[o]utput prices tend to respond faster to input increases than to decreases” in the producer and consumer goods markets.¹⁰ Similarly, the cost of annuities will increase more quickly if the RBC charge for residuals increases to 45 percent.

⁴ <https://w4.stern.nyu.edu/finance/docs/pdfs/Seminars/CLO-Performance.pdf>.

⁵ <https://www.thornburg.com/article/think-abs-residuals-to-improve-your-risk-reward-trade-off/>.

⁶ Id.

⁷ <https://docs.house.gov/meetings/BA/BA20/20240131/116775/HHRG-118-BA20-Wstate-BashurB-20240131.pdf>.

⁸ <https://www.federalregister.gov/d/2023-19200/p-564>.

⁹ <https://www.cuna.org/content/dam/cuna/advocacy/priorities/documents/True-Impact-of-Interchange-Regulation-CornerstoneAdvisors-June-2023.pdf>.

¹⁰ <https://www.jstor.org/stable/10.1086/262126>.



NAIC’s proposed regulations will force annuity providers to hold significantly more cash on hand. **Essentially, this will raise costs for consumers—acting as a *de facto* tax increase.** This is especially harmful to Americans considering the guaranteed lifetime income that annuities provide.¹¹

The NAIC should not arbitrarily and capriciously increase the RBC charge for residual ABS tranches without a proper quantitative analysis. Since insurance is primarily regulated at the state level, state regulators wield significant power over the insurance industry. Although the NAIC is not subject to the *Administrative Procedure Act* (APA),¹² as a matter of proper due process, the NAIC should consider abiding by the APA’s principles and allow for a structured notice-and-comment process that considers and analyzes hard data. Today, the NAIC possesses no hard evidence to suggest that raising the capital charge for residuals to 45 percent would provide any material benefits to life insurance companies or their clients.

One key element of ABS special purpose vehicles (SPVs)¹³ is that they benefit from bankruptcy remoteness. Bankruptcy remoteness possesses advantages such as:

*(i) the ability to segregate the assets to be financed such that they are held solely for the benefit of specific creditors and (ii) avoiding bankruptcy risks, costs, and delays including cram-down risk, the suspension of payments to creditors, and the limitations on enforcement actions against the [SPV] for nonpayment due to the automatic stay taking effect upon the filing of a bankruptcy case.*¹⁴

Legally isolating the securitized assets acquired by a SPV also gives ABS an advantage over corporate bonds and other non-securitized instruments. The “true sale” of assets creates a legal isolation between the SPV and the entity that originated the assets.¹⁵ This structure “allows creditors financing the assets to focus on the credit quality of the assets rather than the credit quality of the originator, resulting in better financing terms for the issuer/borrower.”¹⁶ The “economic benefits” of bankruptcy remoteness “can significantly lower borrowing costs.”¹⁷ Increasing the RBC charge for residuals to 45 percent is more likely to worsen financing terms for annuities, not improve them.

The level of riskiness observed in ABS is further delineated by the NAIC itself. The NAIC has previously stated that “[a]sset-backed securities have proven over the years to be stable investments.”¹⁸

The NAIC should avoid hindering American families from maximizing their nest eggs. Increasing the RBC charge for residuals to 45 percent would increase costs on annuities—effectively increasing costs on retirement options for American workers and retirees. Currently, there is no quantitative evidence to substantiate this RBC charge increase. **Consequently, ATR requests the 45 percent RBC charge on ABS residuals be delayed and remain at 30 percent.**

¹¹ <https://www.actuary.org/sites/default/files/2022-08/IB.SECUREact.8.22.pdf>.

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

¹³ <https://am.credit-suisse.com/content/dam/csam/docs/articles/2022/cig-white-paper-collateralized-loan-obligations.pdf>.

¹⁴ <https://www.choate.com/images/content/1/0/v2/104168/Bankruptcy-Remoteness-A-Summary-Analysis.pdf>.

¹⁵ Id.

¹⁶ Id.

¹⁷ https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4178280.

¹⁸ <https://content.naic.org/cipr-topics/asset-backed-securities>.



* * * *

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

Sincerely,

Americans for Tax Reform

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

Submitted via electronic mail

Mr. Tom Botsko
Chair, Capital Adequacy (E) Task Force (CATF)
Via email: Eva Yeung (eyeung@naic.org)

Philip Barlow
Chair, Life Risk-Based Capital (E) Working Group (RBC IRE WG)
Via email: Dave Fleming (dfleming@naic.org)

Dear Mr. Barlow and Mr. Botsko:

As the President and CEO of the Florida State Hispanic Chamber of Commerce, I have always supported economic growth and free market principles to ensure success for all residents in our state. The strength of Florida's economy can be attributed to its free market practices. Following the recent National Association of Insurance Commissioners (NAIC) meeting, it seems the organization is seeking to stamp out competition that allows the free market to thrive. I find the precedent being set by the Risk-Based Capital Investment Risk and Evaluation Working Group (RBC IRE WG) and the Capital Adequacy (E) Task Force (CATF) troublesome. Both the RBC IRE WG's and CATF's decision to disregard objective, third-party data that they requested is concerning, and the findings should mandate a reexamination of the proposed 45% capital charge on residual tranches.

We've recently learned that many of the initiatives pushed by the NAIC are done so behind closed doors and not open to public input. However, this aggressive attempt at suppressing competition in the insurance market is open to public comment, and we'd like our voice to be heard. In the past, the NAIC has valued research and used data to drive its decisions, but now it seems like a lack of oversight has allowed the organization to run astray and be influenced by individual priorities and politics. The recent independent study conducted by Oliver Wyman provides validated data that demonstrates that asset-backed security (ABS) residuals don't have a higher risk, making the 45% charge in question unnecessary.

If the NAIC continues pursuing this charge, it would confirm that its real goal is to drive competition out of insurance markets, including life insurance and annuity markets. A frivolous 45% charge would clearly have an adverse effect on the market. The life insurance and annuity industry is critical to Florida's retirees, a community that primarily operates on a fixed income and would not be able to handle the impact of this proposed charge, which could reduce the number of affordable policies.

Further, this charge is also being proposed for property and casualty insurance companies, which would further increase costs in that market. As you know, Florida is experiencing an unprecedented crisis in the availability and affordability of homeowners insurance. Floridians are already leaving the state in droves because of skyrocketing insurance costs.¹ This is the

¹ <https://www.newsweek.com/florida-faces-exodus-insurance-costs-cause-residents-leave-state-1838206>

absolute worst time for regulators to arbitrarily raise costs. The effect of such increased costs will hit Hispanic communities particularly hard given that Hispanics are already substantially less likely to have homeowners insurance than the general population.² When insurers are prevented from investing in high-returning assets, they will be forced to minimize their offerings, which will lead to higher costs.

Unfortunately, the NAIC's recent actions are seemingly guided by political agendas rather than sound policymaking. The NAIC should be forging new ways to lower costs and provide more options for consumers, especially in states like Florida, not working to suppress the free market. I ask the NAIC to act in favor of data and in favor of consumers and vote in support of the one-year delay.

Sincerely,
Julio Fuentes
President and CEO of the Florida State Hispanic Chamber of Commerce

² <https://consumerfed.org/wp-content/uploads/2024/03/Exposed-UninsuredHomes-1.pdf>

Mr. Philip Barlow

Chair, Life Risk-Based Capital and Investment Risk and Evaluation Working Group

Dear Mr. Barlow:

As a former insurance commissioner who was active in leadership positions at the NAIC, as well as a former state legislator who served as Colorado House Majority leader and Speaker of the House, I have followed recent NAIC activity on structured securities very closely. Specifically, I write to support a one-year delay or a lowering of the risk charge to 30% until the data and full implications and potential unintended consequences of the “interim” 45% charge on residuals are better understood.

I have always sought to support substantive, innovative, and equitable policies that help maintain the health of the insurance market as governed by the states and state constitutions and support a diverse choice of insurance options for consumers. I am greatly concerned about the precedent being set by the Risk-Based Capital Investment Risk and Evaluation Working Group (RBC IRE WG). Recently published, objective, third-party data necessitates a delay and reconsideration of the implementation of the 45% capital charge on residual tranches.

The NAIC has historically maintained an approach that’s underpinned by data as it works to drive agreement on policy that impacts all 50 states. A data-driven approach is especially important in areas of significant controversy around risk-based capital (RBC) charges – the nature of the accreditation system means that many state legislatures do not directly vote on policy changes that affect their state’s policyholders.

In this case, rather than funding and conducting its own independent research, the NAIC asked for industry to fund and produce data regarding the proposed capital charge for residual tranches to inform a path forward. The recent study conducted by Oliver Wyman is the best response to this request the NAIC could have hoped for – the study provides a comprehensive third-party analysis demonstrating that asset-backed security (ABS) residuals don’t represent a higher risk than other assets with a lower charge, which indicates that a 45% charge is too high. Should the NAIC forge ahead despite this analysis, the body would set a poor precedent for disruptive and frequent changes to the currently stable, long-term capital framework unsupported by data. I am concerned that such a move directly undermines the credibility of the NAIC and should in no way serve as a template for any future capital charge.

Given that the charge is likely to be permanent or long-term, it’s vital to ensure that policy is decided carefully. It’s not hard to imagine the cascading implications a 45% charge will have for stakeholders in the market. If insurers are blocked or dissuaded from investing in high-return and performing assets, insurers will likely have to shrink their offerings of affordable life insurance and retirement options to consumers.

This process has been accelerated due to ballooning fears of outsized risks that aren’t substantiated. For example, the American Academy of Actuaries has stated that CLOs do not

present a material solvency risk to the insurance industry.¹ In light of the Oliver Wyman study, I support the request by the American Council of Life Insurers (ACLI) that the NAIC postpone the implementation of the 45% charge for at least one additional year. During this time, regulators and stakeholders can carefully assess data in the Oliver Wyman study and any alternative proposals that account for the complexity of the asset in question.

Regulators should be accountable to consumers. It's unfortunate that the NAIC's recent actions seem to be guided by personal agendas and outside political pressure rather than sound policymaking. I implore the NAIC to do the right thing, maintain its credibility, and vote for a one-year delay so a data-driven result can be achieved.

Sincerely,

Doug Dean

Former Colorado Insurance Commissioner

¹ [American Academy of Actuaries C1 Work Group's \(C1WG\) December 14, 2022 presentation to the NAIC's RBC IRE](#). Slide 12: "In the C1WG's view, CLOs do not present a material risk to the aggregate solvency of the life insurance industry currently."

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State of Nevada
Assembly
Eighty-Second Session

Mr. Philip Barlow
Chair, Life Risk-Based Capital and Investment Risk and Evaluation Working Group

Mr. Barlow:

I find the RBC IRE Working Group's recent work on structured securities very troubling. As a member of the Nevada State Assembly, I understand the importance of deliberative, transparent, and informed policymaking. From what I've seen, the working group's actions are not indicative of the kind of rulemaking process my constituents and others across the country deserve. In fact, it seems unprecedented and in violation of the NAIC's standard operating procedures when making changes to risk-based capital (RBC).

Many people don't realize the broad impact the policies your organization put forward can have on their insurance options, livelihoods, and financial security. The NAIC was built around the idea that all state regulators should work together to develop the policies that fall under their jurisdiction, but the organization is now transferring that rulemaking authority to a small set of staff members and regulators pursuing agendas that clearly do not benefit consumers or protect markets from risk. Pushing through regulatory changes that don't reflect genuine consensus and the collective, informed preferences of all state regulators is a reckless way to make policy.

The working group has failed to follow standard NAIC practice in its efforts to change the risk factor for residual tranches. Specifically, the working group has already publicly signaled that it will mischaracterize and/or disregard reputable data related to the change, and it has failed to give the public an appropriate amount of time to provide public comment on that data. All of this has been done through a rushed process that only seems to be growing in breadth to include additional asset classes.

In fact, to many, it seems like your decision was already made — long before any calls for supporting data — and the process is now just a damn-the-torpedoes race to the finish line. This change will affect families, consumers, and businesses across the country, and it deserves the proper, responsible review it hasn't received. Unfortunately, it has also created a sense of doubt regarding the NAIC's credibility in this area. As a legislator, I take this very seriously, given that the policymaking done by the NAIC would otherwise rightly be in the purview of state legislatures and governments.

My hope is that the NAIC will change course and adhere to a credible process that allows for informed outside data and opinions and gives those it will affect the most an opportunity to understand and speak out against what is happening behind closed doors. Providing a one-year delay is one way the NAIC could do that, and I hope you take the opportunity to do just that.

Assemblyman Max Carter
Nevada State Assembly District 12

CC: RBC IRE Working Group.

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DISTRICT 26

Arizona House of Representatives
Phoenix, Arizona 85007

Mr. Philip Barlow
Chair, Life Risk-Based Capital and Investment Risk and Evaluation Working Group

Dear Mr. Barlow:

I believe strongly in the need for policies that are pro-consumer, pro-competition, and backed by data as a proud member of the Commerce Committee of the Arizona State House of Representatives. I am concerned about the NAIC Risk-Based Capital Working Group's (RBC IRE WG) insistence on implementing a 45% capital charge on the equity portion of asset-backed securities. Not only does the policy inhibit consumer choice and the competitive landscape of the life insurance and annuities market, but the process leading to this recommendation will set a dangerous standard for how the NAIC approaches policymaking. I am also concerned by the proposal pending in the Capital Adequacy Task Force to impose this increase on property and casualty and health insurers.

Historically, the NAIC has used a measured and researched-back approach to generate consensus when crafting insurance-related policies and guidelines. However, a handful of regulators, who certainly do not speak for the Arizona legislature or Arizona consumers, have abandoned this analytical and data-driven method to greatly accelerate the policymaking timeline with their attempt to quickly finalize a 45% capital charge. Now, research performed by a respected outside consultant, Oliver Wyman, demonstrates that asset-backed security (ABS) residuals don't carry higher risk. We have the exact data necessary to declare a 45% charge to be ill-advised and not needed, research that the NAIC should conduct itself before making major policy changes.

Not only has the RBC IRE working group failed to follow standard NAIC processes and give the public enough time to comment as it advances a change to the risk factor for residual tranches, but it has also failed to consider the negative effects this policy will bring about for consumers. If higher costs are to be tacked on to asset-backed securities, insurers will be dissuaded from investing in these reliable and high-return assets. I am very concerned that this change will hinder important markets, such as student loans, credit cards, lending to small businesses, and lending to finance the energy transition. These are all critical priorities, nationally, in Arizona, and among my constituents. In addition to restricting lending, in the wake of restricted insurer investment returns, the availability of premium insurance product offerings will be reduced, while costs for consumers soar.

The effect on the availability and affordability of life insurance and retirement products is of particular concern for my state and others with similar demographics. More than 17% of Arizonans are of retirement age, putting us at 12th in percent of the population aged 65 years and older in the U.S.¹ Hard-working Americans who are trying to plan for their futures deserve a wide array of retirement and financial planning options. It is unfortunate that a handful of regulators are poised to take this away from them with a misguided approach.

I implore the RBC IRE working group to change course and delay the implementation of the 45% capital charge on residual tranches for at least one year. The opportunity is before you to not only rectify the policy at hand to be more consumer and competition-friendly but also to restore credibility to the NAIC in its policymaking process. I sincerely hope you seize it.

Sincerely,

A handwritten signature in black ink, appearing to read "Cesar Aguilar".

Representative Cesar Aguilar (D-26)
Arizona House of Representatives
CC RBC IRE Working Group

Maricopa Association of Governments: "Age Friendly Arizona and Older Adult Demographics"



THE BUCKEYE INSTITUTE

April 5, 2024

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

Via email: dfleming@naic.org

Dear Mr. Barlow:

As an independent research and educational institution advancing free-market public policies in the states, **The Buckeye Institute** works to **reform regulatory codes and cut burdensome red tape**. The Buckeye Institute's recommendations have helped eliminate or relieve the burdens of more than 50 occupational licenses and have stricken hundreds of unnecessary regulatory restrictions from the Ohio Administrative Code.

With respect to the current proposal from the National Association of Insurance Commissioners (NAIC) to increase the risk charge for residuals, The Buckeye Institute recommends caution and joins the industry and other interested parties in calling for NAIC to allow more time to collect additional data. Without comprehensive data collection, new requirements of this magnitude could inflict unintended harms if implemented prematurely.

NAIC is right to protect insurance consumers from unsound corporate practices, especially as insurers acquire larger shares of opaquely structured securities. But such investments in a properly balanced portfolio also earn higher returns for insurers, which can help reduce consumer costs and premiums. Consequently, insurers and regulators must appropriately balance the risks and rewards of regulating insurer investment portfolios and strategies.

The Buckeye Institute has reviewed the report conducted by the management consulting firm Oliver Wyman (OW) and recently submitted to your office by the Alternative Credit Council. The well-designed study examined multiple risk scenarios for various asset classes and determined that residuals carried lower risk than equity in common stock. The OW study should not be dispositive, but it does challenge the prudence of rapidly increasing the current equity capital requirement from 30 percent to 45 percent. At the very least, it supports the call for more evidence that higher capital requirements will improve consumer safety. Without additional evidence, the proposed jump to 45 percent appears arbitrary and deviates from NAIC's typically data-driven approach to modifying risk charges.

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Imposing higher risk charges and cash-on-hand requirements too fast and with insufficient supporting data will likely stifle innovation in the life insurance market and compel insurers to charge higher premiums to offset lower investment returns—an unintended harm to consumers. And given the credible data undermining the rationale for the proposed changes and the industry’s request for further study, adopting the new requirements without reconsideration will weaken the industry’s faith in the regulatory process as it questions NAIC’s motives for proceeding unabated—another unintended harm.

Rather than risk these outcomes, NAIC should temporarily pause its proposal for one year to solicit further input and collect additional data on the risk-profile of residuals. That will allow NAIC to best calibrate the risk charges and achieve the right balance of risk and reward. A temporary pause will enhance rule-making transparency and reassure the regulated industry that NAIC makes important decisions prudently, methodically, and fully supported by hard evidence.

Sincerely,
Rea S. Hederman Jr.
Vice President of Policy
The Buckeye Institute

Mr. Philip Barlow
Chairman
Life Risk-Based Capital (E) Working Group

Dear Mr. Barlow:

A functioning, vibrant free market is the heart of the American economy. Competition drives innovation and ultimately gives consumers various options at fair prices for the goods and services they seek. This principle should apply across all sectors of the economy, including the life insurance and annuities market. These products represent valuable tools that Americans from all backgrounds and income levels can use to plan for retirement, provide for their families, and incorporate into their long-term financial planning.

The recent moves by the National Association of Insurance Commissioners (NAIC), particularly the Risk-Based Capital Working Group, demonstrate a fundamental disregard for the importance of innovation in the marketplace. The proposed 45% capital charge on asset-backed securities would do a great disservice to consumers by shrinking the offerings of life insurance and annuity policies available to them while raising the costs of those that are offered.

The proposed charge is even more troubling because it appears to not only be misguided but also predetermined. The working group has received a public study conducted by an independent researcher demonstrating that the risk the proposed charge attempts to address is nonexistent. Per Oliver Wyman, the assets in question actually carry less risk than other assets commonly held by insurers, which are not subject to a higher charge.

The research is decisive and available for all to see. It is troubling that the working group continues to press forward with a punitive measure aimed at risk that does not exist in the data. If the higher charge is adopted, the NAIC will not only embrace a policy that ultimately hurts consumers, but it will undermine its own credibility.

I ask that the Risk-Based Capital Working Group and the NAIC follow the data that is readily available. The proposed 45% capital charge is not only unnecessary, but it's harmful to consumers and markets. The NAIC should put a stop to it before its effects can be felt.

Thank you,

Tom Swatzel
Founder
South Carolinians for Responsible Government



April 8, 2024

Philip Barlow
Chair, Risk-Based Capital and Investment Risk and Evaluation Working Group
National Association of Insurance Commissioners

Re: Oliver Wyman Study on Residual Tranches and Interests

Dear Mr. Barlow:

The American Consumer Institute is honored to present the National Association of Insurance Commissioners (NAIC) with comments on its proposal to raise the risk-based capital (RBC) charge for residual tranches and interests of asset-backed securities (ABS) from 30 percent to 45 percent for life insurance companies. The effects of limiting financial options on life insurance policyholders are of great concern to us, particularly because the proposal will limit the availability and affordability of such a vital resource.

Life insurance provides financial solace for those who hold these policies and can be integral in supporting families after the passing of a household's primary breadwinner. The difference in feelings of financial security between those with and without life insurance is stark.¹ While nearly 70 percent of those with life insurance feel financially secure, less than half of those without insurance can say the same.

Furthermore, after just six months, nearly half of Americans say they feel the financial burden of losing their household's primary wage earner. Life insurance helps to provide families with the cushion they need to stave off the inevitable financial burdens of a loss. Even if a policy is never used, the peace of mind that it grants is still immeasurable to working families.

There is little debate that life insurance policies are beneficial. However, rules that limit investment opportunities for life insurance policyholders threaten to limit availability and affordability. Similar to the proposal from the Federal Reserve to impose "Basel Endgame"² requirements on banks, this sharp increase in RBC charges would

¹ Michael Jones, "Life Insurance Statistics and Industry Trends to Know in 2023," Annuity, January 24, 2024, <https://www.annuity.org/life-insurance/statistics/#:~:text=About%252050%2525%2520of%2520Americans%2520do.compared%2520to%252046%2525%2520of%2520women>.

² "Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity," Federal Register, September 18, 2023,

4350 North Fairfax Drive, Arlington, VA, Suite 725, 22203

functionally limit the investments into residual tranches and ultimately hinder ABS.³ These investments are high-performing and can offer life insurance holders greater access to financial markets. High RBC charges amount to cash-on-hand requirements, limiting investment capital which earns interest, and helping life insurers cover customers.

The report by Oliver Wyman on the risk of losses to residual tranches and interest of ABS under various stress tests does not lend support for a 45 percent RBC charge.⁴ Instead, the Wyman report indicates that a 30 percent RBC charge would best satisfy risk, making the proposed 45 percent charge unsubstantiated by testing. For the NAIC to continue implementing the current proposal would essentially create an arbitrary RBC charge that would unnecessarily limit life insurance policyholders' access to financial options.

The NAIC should not implement this rule change. At a minimum, the NAIC should hold off on rule implementation for at least a year and conduct further risk-based testing to substantiate the increase in RBC charges to 45 percent, or the charge should be set at 30 percent as the Wyman report concludes. Anything else would endanger Americans' access to valuable financial tools which could be the difference between having or not having access to health insurance.

Based on our analysis of the proposal, we conclude that consumers would be harmed in two major ways. First, the increase in RBC charges would drive the costs of life insurance and annuities up because the charge would artificially reduce insurer investment returns. As a result, insurers would have to pass this cost on to consumers. This is happening at the very time that more Americans are facing retirement insecurity and need to protect their families.

Second, the increase in RBC charges would hinder the origination of lending to consumers, because many originators of consumer loans require securitization to finance such lending. Thus, making these securitization structures/investments less attractive by jacking up the risk charge would significantly reduce demand and make consumer loans more expensive.

Considering life insurance provides benefits both in peace of mind and financial ease following losses, it is incumbent upon policymakers to not unnecessarily limit its

<https://www.federalregister.gov/documents/2023/09/18/2023-19200/regulatory-capital-rule-large-banking-organizations-and-banking-organizations-with-significant>

³ Bill Hulse, "How New Banking Rules Might Harm Your Business," U.S. Chamber of Commerce, November 6, 2023, <https://www.uschamber.com/finance/how-new-banking-rules-might-harm-your-business#:~:text=As%20a%20whole%2C%20increasing%20capital,by%20more%20than%2020%20percent>.

⁴ "Oliver Wyman Residual Tranche Report," Alternative Credit Council, February 26, 2024, <https://content.naic.org/sites/default/files/inline-files/Oliver%20Wyman%20Residual%20Tranche%20Report.pdf>.

availability through the implementation of RBC charges that are higher than what is supported through stress testing.

If you have any questions, we can be reached on 703-282-9400.

Respectfully submitted,

Steve Pociask
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April 8, 2024

Mr. Philip Barlow, Chair
Chair, Risk-Based Capital Investment and Evaluation (E) Working Group
National Association of Insurance Commissioners
c/o Dave Fleming
Via Email: dfleming@naic.org

Mr. Tom Botsko
Chair, Capital Adequacy (E) Task Force
National Association of Insurance Commissioners
c/o Eva Yueng
Via Email: eyeung@naic.org

RE: Oliver Wyman Residual Tranche Risk Analysis and Proposal 2024-02-CA

Dear Mr. Barlow and Mr. Bostko,

Thank you for the opportunity to comment on the Oliver Wyman Residual Tranche Risk Analysis and Proposal 2024-02-CA. The following is submitted on behalf of the member companies of the National Association of Mutual Insurance Companies (NAMIC).

NAMIC has more than 1,500-member companies representing 40 percent of the total U.S. property/casualty insurance market. NAMIC member companies serve more than 170 million policyholders and write more than \$323 billion in annual premiums. Our members' direct written premiums account for 67 percent of homeowners' insurance and 55 percent of automobile insurance. Through NAMIC advocacy programs it promotes public policy solutions that benefit NAMIC member companies and the policyholders they serve and fosters greater understanding and recognition of the unique alignment of interests between management and policyholders of mutual companies.

NAMIC is writing to express our support for an additional one-year implementation delay of the increased 45% capital charge on asset-backed security (ABS) residual tranches and interests.



As noted by the American Council of Life Insurers (ACLI) at the March National NAIC meeting, the insurance industry is aligned that regulators and stakeholders must thoroughly assess new data and discuss and evaluate all residual tranche charges to ensure that they align with the actual risk. Aligning risk with capital is also consistent with a foundational principle of the recently proposed Holistic Framework – equal capital for equal risk.

We believe that providing an additional year will allow additional analysis, including by the Academy of Actuaries, to help the regulatory community arrive at an informed decision and produce specific recommendations that are based on fact, and specific to individual types of assets. This additional year can provide an opportunity for understanding the impact to property and casualty companies, as opposed to assuming the risk is the same as the life industry. Unlike the life risk-based capital calculation, there is no current mechanism for assigning a property/casualty Schedule BA asset charge by investment type. Such a change in charge is significant and should be supported by a holistic review of the treatment of property/casualty Schedule BA investment types in general, rather done in isolation for one specific investment type, such as residual tranches. This concern also supports the need for additional analysis.

Thank you for your consideration of our views and your support for a process that provides consistent rigor and standards when evaluating insurance company investments for purposes of changing RBC.

Sincerely,

A handwritten signature in blue ink that reads "Colleen W. Scheele".

Colleen W. Scheele, Public Policy Counsel and Director of Financial and Tax Policy
National Association of Mutual Insurance Companies



April 8, 2024

VIA ELECTRONIC SUBMISSION

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

Re: RBC Factor for Asset-Backed Security Residual Tranches – Oliver Wyman Report

Dear Mr. Barlow,

The American Investment Council (“AIC”)¹ appreciates the opportunity to comment on the Risk-Based Capital Investment Risk and Evaluation (E) Working Group (“RBCIRE”) exposure of Oliver Wyman’s *Residual Tranche Risk Analysis* (“OW Report”) that was released for public comment on March 17, 2024. As always, we appreciate the RBCIRE’s willingness to receive input from interested parties on its important workstreams.

The OW Report is responsive to the RBCIRE’s request for interested parties to provide data regarding whether the “interim” 45% RBC charge for asset backed securities (“ABS”) residual tranches is a reasonably conservative factor.² The OW Report evaluates the potential for losses in the residual tranches of commonly-held types of structured assets and assesses how they compare with the historical losses for other asset classes. Among other things, the OW Report concludes that ABS residual tranche investments realize lower losses on a portfolio-level than common stock under corresponding stress levels. This conclusion, and others noted in the OW Report, appear to be consistent with other reputable studies that analyze similar issues.³

Taken together, these materials support a conclusion that the current 30% RBC charge is likely a more “reasonably conservative factor” for residual tranche investments than the 45% charge that is

¹ The AIC is an advocacy, communications, and research organization established to advance access to capital, job creation, retirement security, innovation, and economic growth by promoting responsible long-term investment. The AIC’s members include the world’s leading private equity and private credit firms, many of which partner with insurers to achieve their long-term investment objectives and ensure the continued success of insurers and their policyholders. Among other things, by adopting appropriate, risk-adjusted investment strategies, our members are committed to helping secure the retirement of millions of pension holders and to policyholder protection. For further information about the AIC and its members, please visit our website at <http://www.investmentcouncil.org>.

² The “interim” 45% RBC charge for residual tranches was adopted by the RBCIRE in 2023 for the 2024 reporting year. As adopted, the amendment will result in a 50% (or 15 percentage point) increase to the RBC charge applicable to ABS residual tranches as so reported on Schedule BA of the Annual Statement for life insurance companies and fraternal benefit societies.

³ See e.g., our letter to the RBCIRE dated May 12, 2023 entitled *Comments regarding Risk-Based Capital Investment Risk and Evaluation (E) Working Group 2023-09-IRE Residual Factor Proposal*, which is memorialized in the NAIC 2023 Summer National Meeting Minutes at pages 2057-2059, available at: <https://naic.soutrnglobal.net/Portal/Public/en-US/DownloadImageFile.ashx?objectId=10416&ownerType=0&ownerId=26573>.

AMERICAN INVESTMENT COUNCIL

currently slated to take effect for the 2024 reporting year. Stated differently, **we interpret the OW Report as establishing that the 45% charge is unreasonably conservative.** At minimum, the RBCIRE should afford itself and interested parties additional time to assess the valid issues raised by the American Council of Life Insurers (“ACLI”) and other interested parties during the March 17 meeting, including obtaining additional information from Oliver Wyman and considering whether it is inappropriate to apply a single RBC factor to all ABS residual tranches. We urge the NAIC and RBCIRE to consider the differences between ABS categories and the adverse effect that an unreasonably conservative single residual RBC factor could have on lenders’ willingness to originate loans and the real economy more broadly.

In light of the foregoing, **we respectfully request that the RBCIRE retain the current 30% RBC factor for ABS residual tranche investments for an additional year in order to give regulators and interested parties time to evaluate whether a 45% charge is unreasonably conservative relative to other equity RBC factors.** We welcome the opportunity to serve as a resource to the RBCIRE as it considers both “interim” and “long-term” regulatory frameworks for ABS and would be pleased provide insight into our members’ perspective on these issues.

Sincerely,

/s/ Rebekah Goshorn Jurata
General Counsel
American Investment Council

cc: Mr. Dave Fleming
Senior Life Risk-Based Capital Analyst
National Association of Insurance Commissioners (via email)



Amnon Levy
Bridgeway Analytics
Amnon.Levy@BridgewayAnalytics.com

April 8, 2024

Risk-Based Capital Investment Risk and Evaluation (E) Working Group
National Association of Insurance Commissioners
110 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

RE: Oliver Wyman Residual Tranche Report

Dear Associate Commissioner Barlow,

On behalf of Bridgeway Analytics, I am grateful for the opportunity to comment on the Oliver Wyman Residual Tranche Report. Our objective for submitting this comment should be interpreted as advocating for a thoughtful, long-term solution for the treatment of asset-backed securities (ABS) and their residuals, and we do not suggest using our analysis, in its current form, for quantitative inferences regarding a C-1 charge for corporate equity or CLOs across the rating spectrum. While the content in this document is informed by extensive discussions with our client base, the broader industry, NAIC staff, and state regulators and may contain analysis that Bridgeway Analytics had conducted as part of a commercial engagement and retains the right to reuse, the views in this document are solely those of Bridgeway Analytics and are based on an objective assessment of data, modeling approaches, and referenced documentation, that in our judgment and experience, are viewed as appropriate for the analysis at hand. For additional context, analysis in our comments includes Bridgeway Analytics research that may have elements that originated with commercial engagements that have *never been shared with a client as part of a paid engagement*.

Our comment letter has two sections:

- A review of the Oliver Wyman study in the context of the C-1 framework. We focus entirely on the technical aspects of the approach. While we do not dismiss valuable lessons from the study, the methods depart from those used to estimate C-1 charges for bonds, equity, and other assets in several dimensions, including a lack of consideration for portfolio concentration and diversification effects. In addition, the study takes on the significant effort of assessing past experience and estimating baseline and stress loss scenarios across different markets, which is no easy task and requires a heavy dose of professional judgment. We conclude that differences in approaches can result in significant differences in risk assessments.
- Our own analysis of data to differentiate the risks of CLO residuals and those of other asset classes. We hope the American Academy of Actuaries and the broader community can leverage the analysis to expedite their long-term efforts to differentiate the RBC C-1 treatment of structured assets and possibly other asset classes. We draw two conclusions from our analysis:
 - Not all corporate equity or CLO residual interests exhibit the same risks, and ‘comparable attributes,’ defined by the American Academy of Actuaries in their *Principles for Structured Securities RBC* presentation in [Attachment C](#), can help identify those risks.
 - The patterns are consistent across different lenses, suggesting differentiated tail risks of CLO residuals can be estimated for C-1.

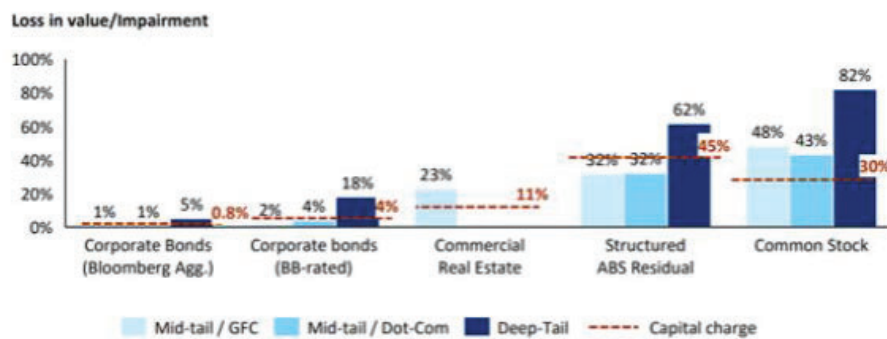
In our opinion, a more thorough set of empirical calibrations and an assessment of other classes of ABS residuals needs to be conducted. A more thorough analysis of tail risks would require calibrated simulation methods that

consider diversification and concentration risks across ABS residuals, which we discuss in *Section 2.2.2*. In addition, our results have us strongly support the Academy’s approach to identifying ‘comparable attributes’ when differentiating risks of asset classes broadly, beyond ABS debt and their residuals.

1 A Review of the Oliver Wyman Study in the Context of the C-1 Framework

The [Oliver Wyman study](#) analyzes a random sample of ~30 residuals for several classes of ABS, including CLOs, auto loans, and student loans. Losses were estimated along tail scenarios designed for each class of ABS (e.g., loan default rates for CLO). The study concludes that, on a portfolio basis, ABS residuals perform better than common equity under all modeled stress scenarios. The study finds that losses on corporate equity (82% and 43-48%) are higher than ABS residuals (averaging 62% and 32% across ABS residuals) in the Deep-Tail and Mid-Tail stress scenarios, as represented in Figure 22 from the study, which we reproduce.

Figure 22: Capital charges compared to modeled scenario losses for selected asset classes³⁰



The letter argues that the study provides ample evidence that more diligence should be done before imposing the 45% interim capital charge, with delayed implementation of changes to allow for further consideration of data put forth by interested parties.

1.1 Useful Insights

The study shares several insightful observations that we hope the community can incorporate into their understanding of ABS residual risks.

- Characteristics that affect the potential losses on residual tranches.** The study finds residual tranche thickness and the rating of the next-most junior (i.e., the junior-most rated tranche) tranche can help differentiate losses on residuals, where thicker tranches are often associated with lower expected losses. To their credit, the study segments the residual tranche thickness by ABS class, which is critical given the significant heterogeneity in collateral risk characteristics across classes. However, risk characteristics within a class can also exhibit significant variation, resulting in inherent challenges in its use within this context. Meanwhile, agency ratings consider both thickness and collateral risk, which provides a measure that is normalized across ABS classes, in aspiration at least. This is an important point in the context of differentiating RBC C-1 using ‘comparable attributes,’ which we explore at greater length in *Section 2* below.
- Analyzing risks across classes of ABS.** The study takes on the significant effort of assessing past experience and estimating baseline and stress loss scenarios across different markets, which is no easy task. We note limitations with our analysis, which focuses only on CLOs and does not attempt to take on this effort. Assessing a baseline default rate for corporates alone, for example, can lead one to significantly different conclusions depending on the market segment (e.g., broadly syndicated loans versus corporate bonds) and sample period; S&P provides useful context in [A Tale of Two Markets: Credit Dispersion Characterizes U.S. Leveraged Finance](#)

in 2024. Choosing comparable baseline and tail scenarios across, say, corporate credit, auto loans, and student loans requires a heavy dose of professional judgment. Notice, for example, that the study estimates loss on common stock for a scenario argued to be comparable to 95% at well over 40%, rather than the 30% that represents the 94% 2-year loss on the S&P 500 between 1960 and 1991 which was used to estimate C-1. That being said, the study highlights the wide-ranging performance across ABS classes and the wide-ranging risk factors that drive performance, which speaks to the possible diversification benefits of investments across different classes of ABS.

1.2 Additional Needed Analysis

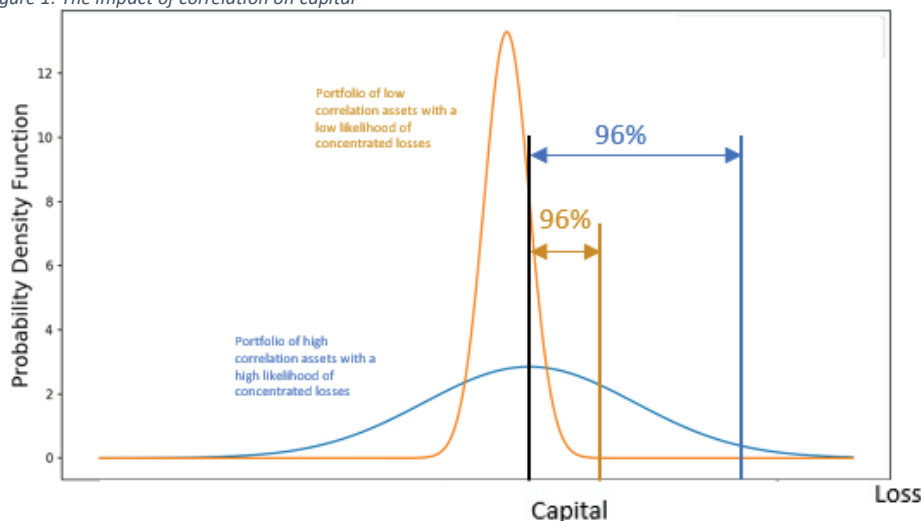
We now point to areas requiring additional analysis for the study to more closely align with approaches used to estimate C-1 charges for bonds, equity, and other assets.

1.2.1 Considerations for concentration and diversification when assessing portfolio tail risk

The study applies the same scenario to all residuals within a class of ABS, implying that the loss rates on the collateral pool are the same across all deals for each scenario. The loss rates would only be identical across the deals if the performance of the collateral pools were perfectly correlated, which could only be the case if all CLOs hold the same collateral loans - they don't. This departs from the RBC C-1 framework, where diversification and concentration effects are considered. C-1 bond factors measure the expected tail loss on a large portfolio of bonds and attribute that loss to a bond with a particular rating (e.g., A-rating), with considerations for their correlation and diversification, providing an assessment of the likelihood of concentrated loss. Similarly, the C-1 common stock factor is estimated using the S&P 500, which by its nature incorporates the correlation and diversification associated with its constituents, assessing the likelihood of concentrated loss. For context, the annual volatility on the S&P 500 is in the order of 20%, while the annual volatility on any single corporate is generally in the order of 60%-90%.

Visually, a portfolio of highly (low) correlated assets can lead to a higher (lower) likelihood of concentrated losses, as depicted in blue (orange), and should be assigned a higher (lower) capital.

Figure 1: The impact of correlation on capital



The challenge partly stems from the market convention of CLOs and ABS, which are generally analyzed using scenario analysis in the spirit of the study. Unfortunately, those scenario-based tools are not designed to capture concentration diversification and concentration risks of CLO or ABS residual portfolios.

1.2.2 The framework should aspire to backtest and represent observed dynamics experienced historically

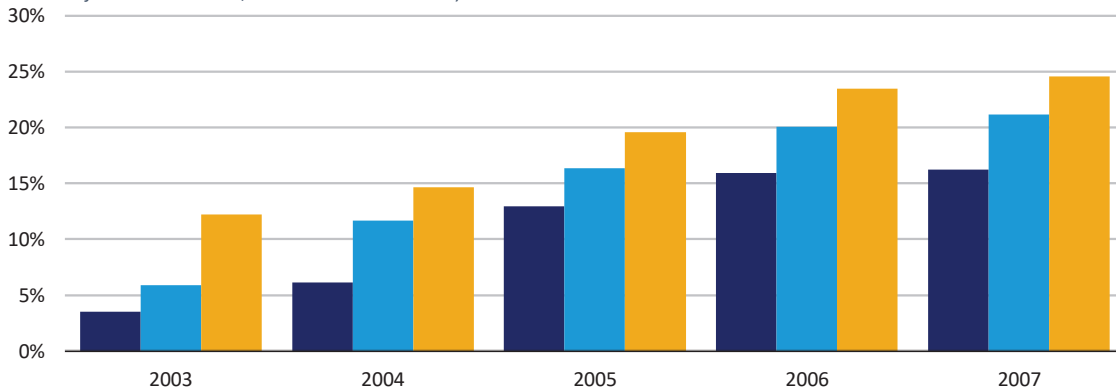
The study finds that ABS residuals experience broad performance in the mid-tail scenarios, ranging from the low teens to 45% (Table 7, reproduced from the Oliver Wyman study). For broadly syndicated loan (BSL) CLOs, an important asset class for insurers, average losses for residuals through the Great Financial Crisis (GFC) are estimated at ~45%.

Table 7: Portfolio average losses for all modeled assets across stress scenarios

Scenario Severity	Scenario	CLOs (BSL)	CLOs (MM)	Student loans	Subprime auto loans	Prime auto loans
95 th percentile	Dot-Com	-45%	-27%	-	-	-
	GFC	-42%	-25%	-	-17%	-13%
	Mid-tail	-	-	-16%	-	-
	Long Mid-tail	-	-	-	-22%	-14%
99 th percentile	Deep-tail	-72%	-55%	-20%	-74%	-26%

The 45% contrasts sharply from what transpired. A recent study by Bank of America Securitized Products Research, [2024 Year Ahead Outlook \(CLO\) CLO Outlook: A Tale of two CCCs](#), includes the lifetime profitability of residual interests of redeemed deals that originated just prior to the GFC and experienced the actual GFC; few deals originated through the crisis, with volume picking up in 2011. The Bank of America study highlights the significant positive lifetime annualized internal rate of return (IRR) (Figure 2 reproduces parts of Exhibit 146 from the study). Another reference can be seen on the right-hand side of Figure 3 below, which demonstrates that over 50% of CLO residuals maintained a positive return over 2-year windows straddling the GFC. While some residuals experienced losses over this period, the Bank of America analysis demonstrates they generally recovered, generating significant profits over their life. A formal statistical analysis demonstrating the strong performance of residuals through the GFC can be found in [CLO Performance](#).

Figure 2: Annualized lifetime IRR for CLO residuals of redeemed deals by vintage – median, 25% and 75% (Source: BofA Global Research, U.S. Securitized Products)



While the study acknowledges the modeled losses differ from the observed performance of CLO residual tranches during the GFC, pointing to several factors, including simplified modeled assumptions (see footnote 25 in the study), the significant difference between the modeled outcome and the actual performance (i.e., model backtesting) raises the question over the degree to which quantitative inference can be extracted from the ~45%.

2 Data to Differentiate Residual Risks

In this section, we present an assessment of CLO residual data that may be used to estimate their risks in the context of the C-1 framework, recognizing nuances such as the need to consider portfolio diversification/concentration effects. As explained above, we believe that the analysis supports the American Academy of Actuaries to expedite the long-term efforts to differentiate the RBC C-1 treatment of structured assets and, in the process, provide insights to the broader community on the risks associated with the asset class. In its current form, we do not intend our analysis to be used to infer an appropriate interim charge for ABS residual interests.

We draw two conclusions from our analysis:

- Not all corporate equity or CLO residual interests exhibit the same risk, and ‘comparable attributes’ (as defined by the American Academy of Actuaries in [Attachment C](#)) can help differentiate those risks.
- The patterns are consistent across different lenses, suggesting differentiated tail risks of CLO residuals can be estimated for the purpose of C-1.

As referenced in the introduction above, we believe a more thorough set of empirical calibrations and an assessment of other classes of ABS residuals are needed. A more thorough analysis of tail risks would require calibrated simulation methods, which we discuss in *Section 2.2.2*.

2.1 Assessing Data to Differentiate Portfolio Risks

Two core elements of our approach allow us to arrive at the conclusions we outline above:

- **Comparable attributes.** We use the rating of a CLO’s most junior tranche as an identifier of the risk of its residual interest. In spirit, the risk profile of operating company equity or ABS residual interests is determined by the predictability of cash flow generated by the respective business model and leverage to which those interests are junior claimants. The likelihood that the junior most tranche is impaired represents the same likelihood that the residual incurs a significant loss.¹
- **Measuring risk in the context of the C-1 framework.**
 - We assess the data for estimating residual risks following the approach used for estimating C-1 for common stocks, in spirit. There are several motivating factors:
 - Classifying an investment fund as an equity interest (i.e., common stock) of an operating company or residual interest of an ABS under the bond definition is determined, in part, by how the fund is structured (e.g., its capital structure). For example, Business Development Companies (BDCs) face leverage restrictions by the SEC and are classified as common stock, while CLO residuals tend to be more heavily leveraged and are classified as those of ABS. In

¹ The approach can be formalized through a structural economic framework developed by Merton, Hull, and White ([Merton’s Model, Credit Risk, and Volatility Skews](#)) and Vasicek ([Modeling Default Risk](#)). Intuitively, the framework would build off of the three main elements that determine the likelihood of a residual tranche experiencing loss:

1. The value of underlying collateral.
2. Risk or uncertainty with the value and predictability of cash flows of the underlying collateral.
3. Leverage, represented by the contractual liabilities.

Notice that the value of the underlying collateral and leverage represents tranche thickness, which is a key determinant of the risk of a residual. Agencies ratings generally also consider the risk profile of the underlying assets, which is equally critical in assessing the risk of residuals.

- that regard, the consideration for the relative capital treatment of equity and residuals should be tied to considerations with their classification.
- The accounting treatment under scenarios where residuals are incurring a loss, which is the region of interest, has them receive statutory treatment similar to common stock.²
 - An important limitation is unavoidable and tied to the C-1 framework, which is inherently inconsistent with horizons over which capital for debt and equity is measured (10 and 2 years, respectively) and target probabilities (96% and 94% loss, respectively). These inconsistencies necessarily result in any approach leading to some form of arbitrage.

Assessing the loss distribution of CLO residual portfolios in the spirit of the C-1 equity factor requires an assessment of the actual variation in the performance of portfolios of CLO residuals over time or using simulation methods. The C-1 equity charge was estimated using total returns from the S&P 500, which includes the return from price fluctuations, generally the primary driver of return variation, and cash disbursements. Meanwhile, CLO residuals are not actively traded, which means that fluctuations in their value would need to be modeled, complicating the analysis.³ Instead, we explore the return on equity (ROE), which measures the cash return, whether by an operating company or a CLO, that aspires to be comparable across corporates and CLOs.^{4,5} We do so across the rating spectrum. We also explore the total return risk of corporate equity across the issuer ratings to benchmark the use of ratings as ‘comparable attributes’ for corporate equity within the context of the C-1 framework.

ROE performance for corporates and CLOs is presented in *Figure 3*. Portfolios are constructed across S&P issuer and junior most tranche ratings at the beginning of each two-year window. The two-year ROE is measured up to the reporting period and is computed for every firm and CLO. The left-hand (right-hand) plots the cross-sectional median and the 25% and 75% of corporates (CLOs) across issuer (junior most) rating, with BBB on top and below investment grade (IG) on the bottom. Inference for CLOs whose junior tranches are rated above BBB is limited

² The NAIC adopted revisions to the valuation of residuals that will now be reported at the lower of “adjusted cost” or fair value. It incorporates the “Effective Yield with a Cap” along with the “Cost Recovery Method,” whereby cash flows shall be treated as a return of principal, reducing the adjusted cost. Under the “Cost Recovery Method,” distributions are not recognized as interest or investment income until the residual tranche has a book adjusted carrying value (BACV) (adjusted cost basis) of zero, which is not standard and more conservative but is less onerous than the “Effective Yield with a Cap,” which is argued to require extensive non-automation work. Under the “Effective Yield with a Cap,” BACV represents the acquisition cost, net of distributions in excess of the Allowable Earned Yield. Allowable Earned Yield, established at acquisition, is the discount rate that equates the initial best estimate of the residual’s cash flows to its acquisition cost and other-then-temporary impairments (OTTI).

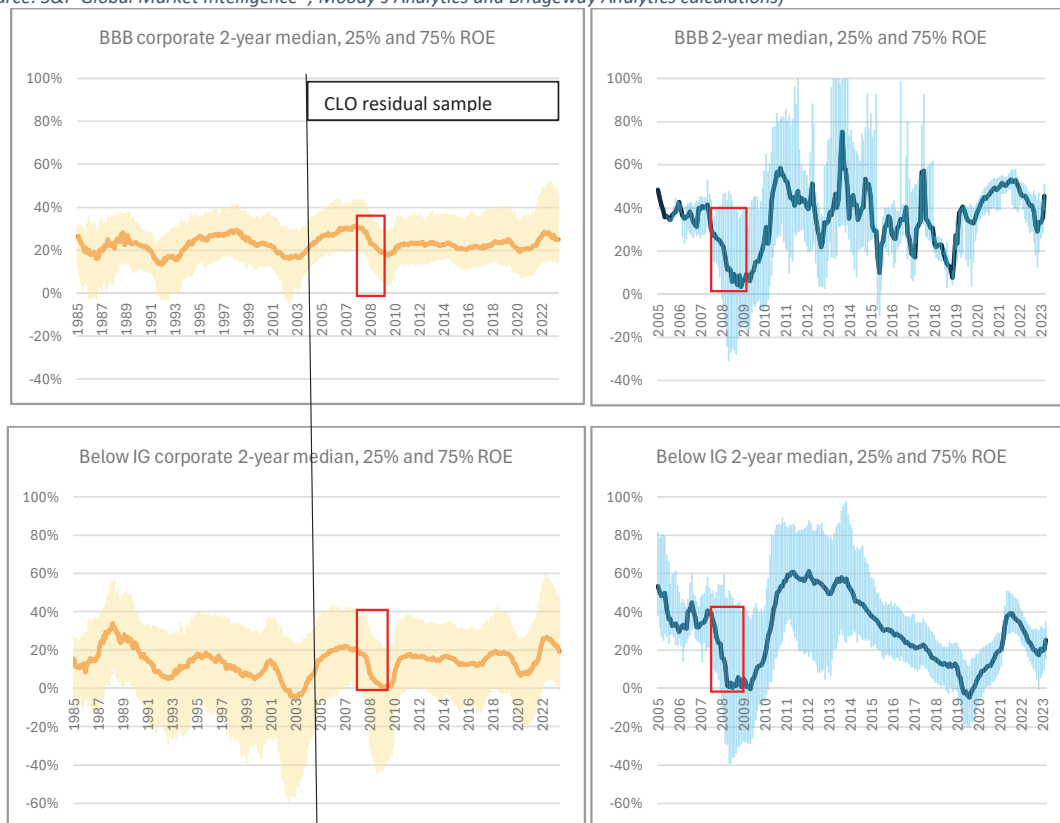
³ Other differences needing consideration include residual interests having finite lives and designed to produce high yields, whereas corporate equity generally does not have contractual termination and often has the majority of its value driven by growth prospects.

⁴ For corporate equity, ROE is measured using sales minus direct and indirect costs, depreciation and amortization, and taxes. It is intended to capture how much money is available to the equity holders of a firm after suppliers, employees, debt holders, and the government have been paid and asset decay. Notice that the measure includes funds that are reinvested in order to be comparable to CLOs, which generally do not attempt to grow their asset base. ROE is normalized by corporate book equity.

⁵ For CLOs, earnings are measured as distributions to residual tranches, which include interest income and change in the book value of the residual. ROE is normalized by the par value of the residual at origination less payment principle against the residual.

given the limited sample and is excluded. While two-year windows are reported, results for longer horizons were explored and are broadly consistent with performance improving with the horizon. This pattern partly motivated C-1 equity to be measured over 2 years rather than 10 years, which is used for C-1 bonds and would result in an unacceptably low or possibly negative C-1 charge (see also *Figure 6*).

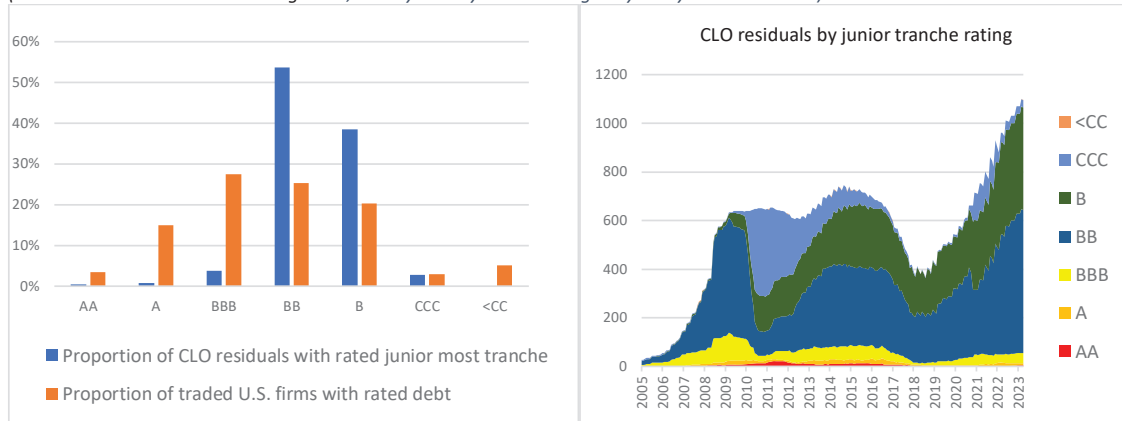
Figure 3: Corporate and CLO ROE dynamics
 (Source: S&P Global Market Intelligence*, Moody's Analytics and Bridgeway Analytics calculations)



There are several notable visual patterns:

- There is significant variation in cross-sectional performance for corporate and CLOs.
- The performance of median CLO residuals tends to be higher than corporates for the BBB and below IG samples.
- The 25% worst performers in each period of the below IG sample tend to be worse for corporates than CLOs.
- The strong, positive performance will result in ROE volatility for CLO residuals appearing inflated compared to ROE volatility for corporates.
- BBB CLO performance is significantly noisier, partly driven by the limited number of transactions over varying periods (see yellow highlighted series on the right-hand side of *Figure 4*). Notice that the sample size drops with deteriorated performance, often associated with downgrades.
- CLO performance of the BBB and below IG sample in the second half of the sample is less varied, which might be driven by the shift to CLO 2.0s after the GFC (see [CLO Performance](#)).

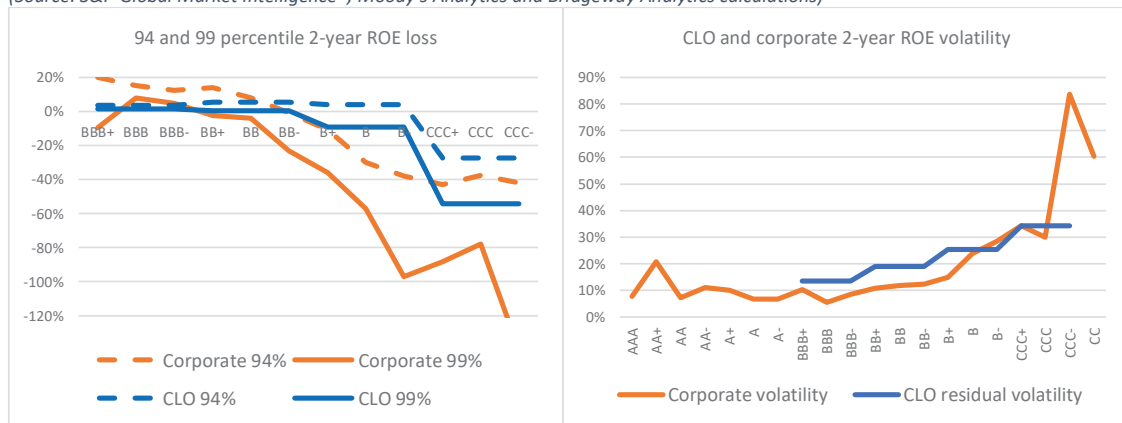
Figure 4: S&P rating composition of U.S. traded corporate and junior most tranche of CLO residuals
 (Source: S&P Global Market Intelligence*, Moody's Analytics and Bridgeway Analytics calculations)



The left-hand side of Figure 5 presents the 94% (dashed) and 99% (solid) worst ROE for CLO (blue) and corporate (orange) portfolios across the S&P rating spectrum. Similarly, the right-hand side presents ROE volatility for CLO (blue) and corporate (orange) portfolios across the S&P rating spectrum. With some exceptions, losses become more negative, and volatility increases monotonically along the rating spectrum, confirming potential benefits for their use as 'comparable attributes.' Notably, risks are higher in the below IG, particularly in the B and CCC range.

The two 94% dashed lines stratal each other, with the corporate performing better in the BBB and CLOs performing better in the B and CCC range. BBB and BB CLOs and corporates exhibit similar losses at 99%, with B and CCC CLOs exhibiting higher ROE than corporates. Notice that higher performance for CLOs on the upside, as seen in Figure 3, has higher BBB and BB CLO volatility than equally rated corporates. However, the BBB CLO series is visibly more volatile, as discussed above.

Figure 5: CLO residual and corporate equity risk across the S&P junior most tranche/issuer rating spectrum
 (Source: S&P Global Market Intelligence*, Moody's Analytics and Bridgeway Analytics calculations)⁶



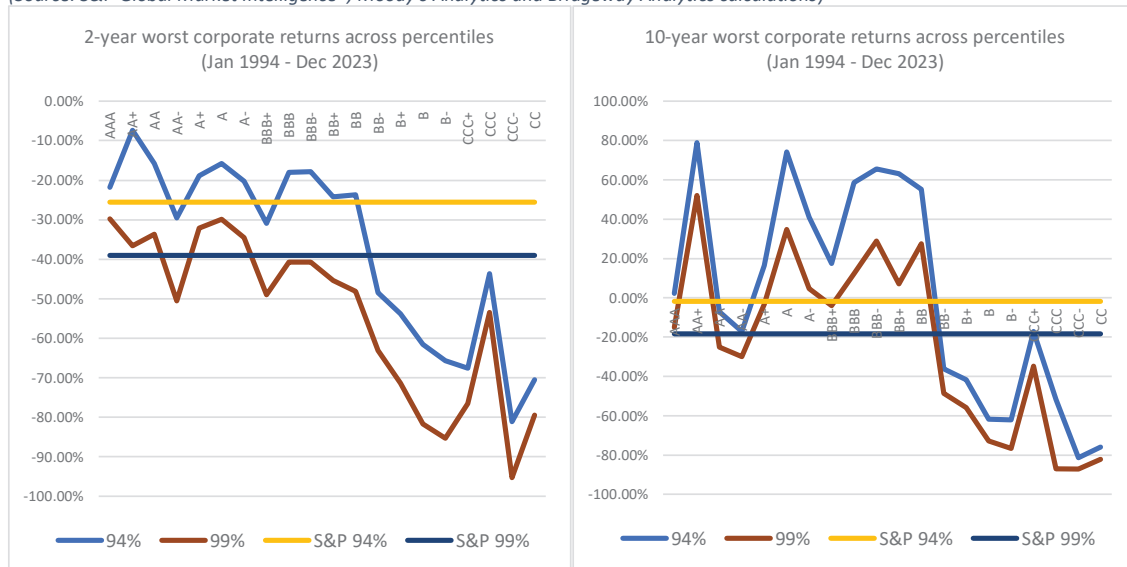
⁶ Percentile losses are calculated using a time series of weighted average ROE, where the weights are book equity. The observed variation in volatility across adjacent ratings is likely due to small samples within each category.

We now shift our attention to an analysis of 2-year total return on corporate equity portfolios constructed across S&P issuer ratings to benchmark the use of ratings as ‘comparable attributes’ within the context of the C-1 framework. The left-hand side of *Figure 6* presents the 94% (blue) and 99% (brown) 2-year cumulative total returns on corporate equity portfolios reconstructed each month using their beginning period issuer ratings. The yellow (dark blue) line represents the 94% (99%) loss on the S&P 500. The 94% loss is slightly lower than the 30% obtained from the original 1960-91 study. Similar to the ROE analysis, the risk increases below IG and, noticeably, in the B and CCC range. The right-hand side represents the 10-year total return, which can produce close to zero or negative losses, which we reference above as a motivating factor of setting the C-1 common stock charge to be measured over 2 years.

We remind the reader that we do not suggest using *Figure 5* or *Figure 6* for quantitative inferences regarding a C-1 charge for corporate equity or CLOs across the rating spectrum. Additional analysis related to sample characteristics needs to be thoughtfully incorporated into the study, with smoothing techniques needing to be applied, possibly similar to the ones used in [Revisions to the RBC C-1 Bond Factors](#). Rather, in its current form, our analysis allows us only to confirm that:

- There are potential benefits for using agency ratings as ‘comparable attributes’ of CLO residuals and corporate equity within the C-1 framework.
- At the lower end of the spectrum, CLO residuals and corporate equity exhibit higher risks and properties in the tail that have some similarities over the analyzed sample periods.

Figure 6: Total return on corporate equity portfolios
 (Source: S&P Global Market Intelligence*, Moody’s Analytics and Bridgeway Analytics calculations)



2.2 Limitations and Additional Needed Analysis

The analysis presented in this comment letter suggests potential benefits for using agency ratings as ‘comparable attributes’ of CLO residuals and corporate equity within the C-1 framework and that there are data and methods that can be used to estimate differentiated C-1 charges. However, there are known limits, and additional analysis is needed, which we now review at a high level.

2.2.1 There are known limits to our study

Several known limitations with our analysis need to be acknowledged and possibly addressed if it is to be extended and used to support a proposed refinement to C-1 charges:

- Although our results suggest the overall methodology of using the lowest rated tranche or issuer rating as a risk proxy applies broadly, an analysis of ABS residuals beyond CLOs needs to be conducted.
- The S&P 500 was used for estimating C-1 equity and had relatively few firms rated below BBB- and argued to be representative of insurers' equity portfolios. The analysis in this presentation uses a broader set of corporates to understand the risks across the rating spectrum better. Application within the C-1 equity framework should consider the following:
 - Aligning 30% with a representative portfolio (e.g., using S&P weights).
 - Derive monotonic and smooth representation of risk across ratings using techniques similar to [Revisions to the RBC C-1 Bond Factors](#).
- The sample periods over which corporate equity and CLO residuals were presented differ.
- ROE risk needs to be linked with total return risk on the common stock, which was used to estimate C-1 equity.
- Further assessments of the sensitivity of measurement and accounting variation resulting in differences between ROE measured for corporates and those of residual interests.
- Other limitations that need to be considered:
 - S&P ratings are credit risk opinions with broad limitations.
 - Variation in rating standards, the types of firms and industries represented across the credit spectrum change over time.
 - The economic risks captured may not align with economic risks that reflect the historical experience of life insurers' holdings.
 - No statistical assessment of robustness has been performed.

2.2.2 Additional analysis of tail risks

Beyond the limitations of our empirical analysis discussed above, tail risks would require calibrated simulation methods that consider diversification and concentration risks across ABS residuals. For example, assessing the risk of CLO residual portfolios would ideally consider correlation across the underlying collateral pools and overlapping counterparties across CLOs.⁷ That sort of analysis is challenging for reasons similar to those discussed in the Oliver Wyman study review in Section 1.2. Level-setting parameters across classes of ABS that face different risk factors are challenging; baseline and tail scenarios for collateral loan default scenarios for CLOs behave very differently from those of home prices and interest rates for RMBS.

Our analysis of CLO residuals and corporate equity suggests that we may efficiently leverage agency ratings to assess the stand-alone risk of a residual interest. Along with assessing correlation across ABS collateral, a parsimonious model can provide guidance on the likelihood of significant losses on a portfolio of residuals and an appropriate C-1 risk charge. Ideally, the approach would have generic components that allow the analysis to be extended to the broad classes of ABS.

3 Conclusions and Thank You

While, in their current form, neither the Oliver Wyman study nor our assessment of data to differentiate residual risks can provide quantitative guidance on the appropriate C-1 charge(s) for CLO residuals, both provide valuable insights which we summarize:

⁷ This issue was raised in a comment letter from [Equitable](#), dated October 9, 2023.

- **Conclusions from our analysis of the Oliver Wyman study**
 - The study finds residual tranche thickness and the rating of the next-most junior (i.e., the junior-most rated tranche) tranche can help differentiate losses on residuals, which is important in the context of differentiating RBC C-1 using ‘comparable attributes.’
 - Level setting baseline and stress loss scenarios across different markets face significant challenges, and the study takes the first step at attempting to do so, demonstrating significant variation in the performance of residuals across classes of ABS.
 - Considerations that we view as critical when estimating C-1 charges were abstracted from and should be considered in future studies:
 - Consistency with C-1 framework for bond, equity, and other asset classes requires considerations for portfolio diversification and concentration effects, which the study departs from in its current form.
 - The framework should aspire to backtest and represent observed dynamics experienced historically, which the study, in its current form, does not.
- **Conclusions from our assessment of data to differentiate residual risks**
 - Not all corporate equity or CLO residual interests exhibit the same risk.
 - There are potential benefits for using agency ratings as ‘comparable attributes’ of CLO residuals and corporate equity within the C-1 framework.
 - At the lower end of the spectrum, CLO residuals and corporate equity exhibit higher risks and properties in the tail that have some similarities over the analyzed sample periods.
 - The empirical patterns are consistent across different lenses, suggesting differentiated tail risks of CLO residuals can be estimated for C-1.
 - **With notable limitations that include**
 - An analysis of ABS residuals beyond CLOs needs to be conducted. However, our results suggest the overall methodology of using the junior most tranche or issuer rating as a risk proxy applies broadly.
 - The sample periods over which corporate equity and CLO residuals were presented differ.
 - ROE risk, which our study focuses on, needs to be linked with total return risk on the common stock, which was used to estimate C-1 equity.
 - Tail risks would require calibrated simulation methods that consider diversification and concentration risks across ABS residuals.

Bridgeway Analytics was founded with a mission to support insurers and their regulators in navigating capital markets and their regulatory landscape. We often gravitate toward the most complex and dividing issues and aspire to form consensus by framing issues objectively and through data-driven analysis that can be easily understood. We are grateful for the opportunity to contribute to this process and look forward to engaging further.

Sincerely,



Amnon Levy
Founder and Chief Executive Officer

Bridgeway Analytics supports the investment and regulatory community work to optimize the design, organization, and utility of regulations surrounding the management of insurance company portfolios. While the content in this document is informed by extensive discussions with our client base, the broader industry, NAIC staff, and state regulators and may contain analysis that Bridgeway Analytics had conducted as part of a commercial engagement and retains the right to reuse, the views in this document are solely those of Bridgeway Analytics and are based on an objective assessment of data, modeling approaches, and referenced documentation, that in our judgment and experience, are viewed as appropriate in articulating the landscape. Methodologies are available to the public through an email request at support@bridgewayanalytics.com. For more information visit www.BridgewayAnalytics.com.

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April 8, 2024

Mr. Philip Barlow
Chair
Risk-Based Capital Investment Risk and Evaluation Working Group
National Association of Insurance Commissioners

Transmitted via email to Dave Fleming at dfleming@naic.org

Re: Oliver Wyman Residual Tranche Report

Dear Chair Barlow:

This letter is submitted on behalf of MetLife, Inc. ("MetLife"). MetLife appreciates the opportunity to comment on the technical features of the Oliver Wyman "Residual Tranche Risk Analysis" report ("the Report") exposed for comment at the March 17 meeting of the Risk-Based Capital Investment Risk and Evaluation (E) Working Group meeting. As requested by Chair Barlow, this letter offers some recommendations on ways to enhance the analysis behind the Report.

Overview

The general approach of modeling structured security residuals based on the forecast performance of underlying collateral assets that the study followed is the industry standard approach to estimating the potential loss sensitivity of these investments. We have two recommendations to improve the analysis. The first recommendation is regarding the selection of individual securities to make the findings of the study more relevant to the actual holdings of residuals in life insurers' portfolios. Second, we recommend adjustments to modeling techniques to improve estimations of loss levels to be consistent with the RBC C-1 framework and appropriate to measure the binary loss behavior of subordinated structured securities such as residuals.

Our recommendations, if implemented, will result in significantly higher average losses among a relevant sampling of deals than what the Report currently shows. Despite the need for a more robust modeling technique, the portion of the Report's analysis most relevant to life insurer holdings leads us to conclude that an RBC factor of at least 45 percent for residuals is fully justified. Specifically, the subset of residuals of BSL CLOs is the only significant category presented in which life insurers invest. For this subset,

results in adverse scenarios in the Report, even absent a fuller analysis of tail events, indicate loss sensitivities that are at least equal to the 45 percent interim factor.

The remainder of this letter explores these recommendations in further detail.

Relevant Sample Set

There are two important shortcomings in the deals selected for the study:

1. Only some of the sectors studied are relevant to the actual holdings of structured securities in life insurers' portfolios.
2. Only some of the residual structures included in the study are typically offered in the market and available for life insurer investment.

The Report selected three classes of structured securities based on the share of each class to total outstanding ABS volume, but notably excluded RMBS and CMBS from consideration. According to a recent industry benchmarking study, only about 4 percent of life insurers' holdings of all non-agency structured securities are in auto and student loan ABS transactions, while CLOs, RMBS, and CMBS comprise 78 percent of these holdings¹. We would strongly recommend including RMBS and CMBS in a potential new iteration of the study. Given the well documented weak performance of these transactions in the Global Financial Crisis, we would fully expect that their inclusion will result in relatively higher loss expectations under appropriate stress scenarios.

In general, there are two underlying drivers of securitization – risk disposition and asset funding. A risk disposition securitization creates numerous debt-like tranches and a relatively thin first-loss residual tranche. All of these tranches are typically sold into the market, and these thinner residuals comprise the bulk of residuals readily available for insurer investment. Typically, in such structuring, the next junior-most tranche in the transaction is rated below investment grade – usually in the B or BB categories. Conversely, in an asset funding securitization the issuer intends to maintain exposure to the underlying collateral while seeking a funding stream for further credit creation. The issuer retains relatively thick funding residuals while offering for sale a few tranches of higher credit quality. The Report shows that the study included many of these funding-type residuals that were unlikely sold into the market – see for example the number of Middle-Market CLOs on Figure 19 of the Report, where the rating of the next junior-most tranche after the residual was single-A, BBB, or even AAA. Including these funding-type residuals, which are not typically held by insurers, results in an artificially low estimate in the Report of the average modeled losses for residuals actually held by insurers.

¹ As reported in BlackRock peer study using S&P Global Market Intelligence data of insurers' holdings as of 12/31/2022.

Modelling Calibration Consistent with C-1 Framework

The modeling technique shown in the Report seems to select certain scenarios that it classifies as either 95th or 99th percentile scenarios. We would strongly encourage properly calibrating the scenarios, and applying a technique that analyzes the behavior of residuals across a spectrum of tail scenarios.

With a proper calibration of scenarios, certain key assumptions would likely need some important fine-tuning. For example, the recovery rate for defaulted leveraged loans in a real “deep-tail” scenario would unlikely be higher than the recovery rate we’ve seen in recent months – the Report shows a 55.9 percent recovery rate in this scenario vs. levels around 40 percent seen in instances in the past several months amid a generally benign environment. Similarly, prepayment rates are unlikely to be of any significance in a true “deep-tail” scenario, and the 10 percent assumed prepayment rate in the Report may prove overly optimistic. These and other assumptions likely need enhanced calibration, which again is likely to result in higher modeled losses than currently shown in the Report.

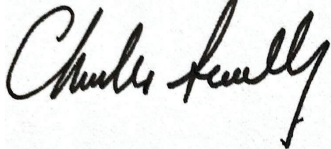
Perhaps more importantly, a study of residuals and other subordinated tranches of securitizations would benefit from a deeper analysis across a broader spectrum of tail scenarios to properly determine the prudent amount of capital necessary to back these types of investments. Such an analysis is a common best practice in assessing risk in structured products, and would show that, unlike more traditional investments like corporate bonds, residuals and other subordinated structured securities exhibit a binary loss behavior where losses go from low to exceedingly high in a step-like function after a given point of the loss curve. This contrasts with the incremental loss rates exhibited by more traditional investments in tail scenarios and highlights the need for a differentiated approach to determine RBC for subordinated structured securities like residuals. If applied to this study, a technique like the one we recommend will again show a more pronounced loss behavior for residuals than those currently shown in the Report.

Conclusion

While the general approach of modeling residuals shown in the Report sensibly analyzes the performance of the underlying assets in securitizations, the study will likely benefit from important adjustments to the sample studied and to the modeling technique used. Nonetheless, the more relevant findings in the Report seem to justify, at a minimum, the adopted interim RBC of 45 percent for residuals. We believe that the enhancements to the study we recommend above would only make more evident that the 30 percent factor historically applied to residuals is insufficiently conservative, and that a factor above 45 percent may need to be considered as part of a more fulsome permanent solution.

We reiterate MetLife's sincere appreciation for the opportunity to offer our recommendations for enhancing the study behind the Report. If you have any questions regarding the present letter, please contact Ben Cushman, Head of Global Regulatory Policy, via email at ben.cushman@metlife.com.

Sincerely,

A handwritten signature in black ink that reads "Chuck Scully". The signature is written in a cursive style with a prominent initial "C".

Chuck Scully
Executive Vice President and CIO
MetLife Insurance Investments



April 8, 2024

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

Re: Oliver Wyman Residual Tranche Report

Dear Mr. Barlow:

On behalf of Athene Holding (“Athene”) we appreciate the opportunity to comment on the Oliver Wyman report offered during the 2024 Spring National Meeting.

Rather than offering a view on the methodology employed by Oliver Wyman or the appropriateness of the .45 interim factor, we believe the continuing debate around both offers the NAIC an opportunity at a critical juncture of the Framework’s¹ implementation to embrace its principles in order to reach a resolution based on the application of sound data and expert analysis. As such, we support ACLI’s request to delay implementation of the interim residual factor for a year, or until such time as NAIC members can make informed decisions on the appropriate outcome. We also recommend that the working group, as part of the Framework implementation and in consultation with the Academy, articulate the longer-term plan for developing permanent factors for the broad spectrum of ABS residuals.

The working group approved the .45 interim factor with an express commitment to apply a different factor (or factors) if stakeholders provided data demonstrating a different factor was more appropriate (i.e., a charge that reflects the risks associated with holding residual interests in ABS). At that time, working group members indicated a willingness to review information from stakeholders supporting a charge other than .45. Similarly, the American Academy of Actuaries (“Academy”) agreed to review any such information and provide its feedback to the working group.

The Oliver Wyman report announces a modeling framework indicating that a lower charge may be warranted; we do not have comments on that. However, we observe that the debate around its findings further underscores the need for additional analysis. We anticipate NAIC members may receive a variety of stakeholder input with differing views on the Oliver Wyman report. This type of ongoing uncertainty is exactly why additional analysis is required to determine a reliable modeling framework for RBC to ensure we have reasonably accurate and consistent factors across asset classes. Fortunately, there is already a process underway in this area with the Academy that will allow the NAIC to do just that.

¹ *Framework for Regulation of Insurer Investments – A Holistic Review, as amended* (the “Framework”)

We believe that the Academy work should continue, and we encourage the NAIC to maintain the current interim factor (30% and 15% sensitivity) until such time as NAIC members can make an informed decision based on that expert analysis. It is far more important for this process and NAIC credibility that its decisions be the right ones, not expedient ones.

We appreciate the ongoing thoughtful and transparent engagement afforded by the NAIC and the working group throughout this process and we commit to providing continued constructive input.

Sincerely,

A handwritten signature in black ink that reads "Michael Consedine". The signature is written in a cursive, flowing style.

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



Aaron J. Sarfatti
Chief Strategy Officer &
Head of Institutional Businesses and
New Ventures

April 8, 2024

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

Via email: dfleming@naic.org

Re: Oliver Wyman report on residual tranches

Dear Mr. Barlow-

Equitable is pleased to provide the following comments on the Oliver Wyman report titled "Residual Tranche Risk Analysis" that was exposed for comment by the RBC Investment Risk & Evaluation (E) Working Group (the "Working Group") on March 17, 2024 (the "Report").

At the outset, we note that one of the stated objectives of the Report was to "[provide] data to help inform the calibration of the capital charge of residual equity tranches." The Report goes on to conclude that an analysis of the data so provided demonstrates that "the losses for the modeled residual tranches of structured products are lower than equities" – the implicit presumption being that the recently adopted interim RBC factor of 45% for the residual tranches of structured securities was unwarranted.

Our commentary is intended to support two principal assertions:

1. Acceding to the eleventh-hour request for a delay in implementation of the 45% residuals charge would thwart the intent of regulators in adopting an interim solution
2. The Report, despite several technical limitations that create a bias toward lower loss estimates for ABS residuals, nevertheless lends support for an increased residuals factor

Our comments are constrained by the incomplete data made available for scrutiny by the Report and its authors. We anticipate further technical limitations will be identified upon a more complete release of the Report's underlying data, assumptions and extrapolations.

A. Acceding to the eleventh-hour request for a delay in implementation of the 45% residuals charge would thwart the intent of regulators in adopting an interim solution

In arriving at the decision to prescribe a higher RBC charge for residuals on an interim basis, regulators at the NAIC engaged in a thorough, deliberate and transparent process in which extensive industry input was invited and provided. For the following reasons we urge regulators to ignore calls from some parties for a last-minute delay:

- **The 45% charge for residuals is explicitly intended to be *interim*.** Regulators have been clear that the 45% charge is being adopted as a temporary measure while work continues on permanent updated charges for both residual and debt tranches of structured securities. The contents of the Report may be worthy of consideration as part of the longer term project to set permanent charges, but nothing in the Report justifies delaying this much-needed interim measure. Indeed, we think it likely that regulators will conclude that charges higher than 45% are needed for all or many categories of ABS residuals.
- **The rationale for expeditiously adopting an interim 45% charge for residuals has not changed.** Regulators identified a significant flaw in the RBC framework as applied to CLOs and other structured securities and, as an initial step to stem growing instances of associated RBC arbitrage resulting from a well-documented marked increase in such holdings by life insurers, put in place a *temporary* increase in the capital charge for the equity tranches of those securities. This decision, while only impacting one subcategory of structured securities investments by life insurers, sent an important message to the marketplace that regulators are taking ABS-related investment risk issues – and the attendant potential adverse impacts on policyholders – seriously. Delaying implementation of the higher charge for residuals at this late stage would serve only to undermine this message and, by extension, regulator credibility.¹
- **Consideration of newly emerging “alternative” solutions is not practical in the context of an interim fix that is needed now.** In recent weeks, some industry participants have been floating alternatives to a single 45% charge for all residual tranches held by all insurers – for example, applying a lower charge to insurers whose overall RBC level exceeds a preset threshold or setting varying charges for residuals of different categories of structured securities. These proposals lack the crucial quality desirable for an interim solution that the single 45% charge embodies: *simplicity*. Analysis of the merits – and complexities – of any alternative solutions will inevitably generate extensive debate that should be left to permanent solution discussions and not used as a pretext for delaying implementation of the interim measure.

¹ We applaud the NAIC’s commitment to continuing its work on investment risk regulatory reform “without delay or pause” as expressed in the E Committee’s recently updated *Framework for Regulation of Insurer Investments – A Holistic Review*.

B. The Report, despite numerous technical limitations that create a bias toward lower loss estimates for ABS residuals, nevertheless lends support for an increased residuals factor

In this section we provide a high-level description of what in our view are meaningful flaws in the Report’s methodology, awareness of which are pertinent for assessments of charges for residual tranches as well as any other ABS tranches. In addition, we explain why we think the analytics contained in the Report, notwithstanding these limitations, support a 45% charge.

1. The proffered data does not adequately reflect “equal capital for equal tail risk.”

We note that the 95th percentile stress scenarios for leveraged loans utilized by the Report are based on data from the Global Financial Crisis (“GFC”). Yet the high yield default rates observed during the GFC were materially lower than the default rates that occurred during the credit crunch of the early 1990s and 2000s. Indeed, current NAIC C-1 bond factors are derived from credit stresses more severe than those of the GFC. Analyzing the performance of CLO collateral at a lower standard represents a deviation from the principle of equal capital for equal risk.

This anomaly arises because the Report’s primary leveraged loan data source is the US LSTA 100, which only tracks data for the largest 100 leveraged loans between 1999-2021. That index therefore does not include data from the early 1990s credit crisis, and is skewed toward a more favorable rating distribution than present in current CLO collateral. For example, in 2007, less than 5% of the US LTA 100 was rated below 'B+' compared to more than 50% today.

2. The Report doesn’t appropriately consider tail risk.

For modeling tail losses of residual tranches, the Report utilizes self-constructed stress scenarios and a Value at Risk severity measure that, among other flaws, are based on incomplete data and rely substantially on inferences for key parameters such as Loss Given Default (“LGD”). As a result, the extent of predicted tail losses is materially understated in the Report. A more thorough analysis would deploy a Conditional Tail Expectation risk measure – as endorsed by the American Academy of Actuaries (the “Academy”) – that captures the significant cliff loss potential (i.e., sudden 100% loss of value) inherent in ABS residual tranches.

3. The Report draws on incomplete historical performance data.

Crucially, the historical analysis of ABS performance in the Report omits consideration of CMBS/RMBS. The GFC, during which CMBS/RMBS experienced deep and rapid losses, provided a practical illustration of how an extreme tail event (low probability but high impact) can unfold during a time of profound credit stress. While this type of event has not yet occurred with, for example, CLOs - due largely to their limited 20-year history of mainstream market penetration – it would be irresponsible to assume that residual tranches of CLOs and other ABS are incapable of experiencing deep losses in a credit crisis or other major tail event.

In addition, the time periods examined in the Report inexplicably omit the stagflation years of the late 1970s to early 1980s. Stagflation, characterized by high and rising interest rates along with low economic growth, present hostile conditions for the performance of the collateral backing the preponderance of ABS. Including this period is imperative for a credible assessment of ABS historical losses.

Moreover, the Report uses LGD assumptions for CLO collateral that are derived from the 2019-2021 data, a period of generally favorable markets. While the recency of this LGD data captures *part* of the recent weakening in debt covenants that is characteristic of the present universe of leveraged loans, recovery rates can be expected to decline precipitously in a stress environment when equity values are lower.

4. The comparison of ABS residual tranches to US equities is fundamentally flawed.

The Report purports to show that the performance of structured security residuals is similar to that of public US equities. However, several assumptions used in drawing this comparison are inappropriate – for example:

- Stress losses projected in the Report are based on changes in “fair value”, whereas RBC charges for US equities are based on changes in market value;² and
- The discount rates used to establish fair value do not vary by stress scenario; the Report assumes a 12% constant discount rate for residuals, whereas, for example, spreads on CCC and lower-rated US debt peaked at over 35% during the GFC - properly reflecting the increased risk to investors. Incorporating the change in risk premium within the discount rate would sharply amplify the measured loss in a “fair value” that is more comparable to market value.

5. The Report uses prepayment assumptions that are overly generous.

The Report uses assumed prepayment rates under all stress scenarios, including deep stress scenarios, that are (a) material and positive and (b) fail to adjust for the observed positive correlation of borrower health and loan prepay rates. To put it bluntly, prepayment assumptions should reflect the reality that companies on the brink of default do not prepay loans. This behavior must be represented in projected cumulative loss rates in any objective analysis of ABS performance. Adjusting for this outcome in the Report will materially increase cumulative ABS losses, with particularly substantial increases to residual tranche losses.

6. Notwithstanding these criticisms, there are important elements of the Report that show that a minimum 45% RBC charge for residual tranches of CLOs is appropriate.

- For Broadly Syndicated Loan CLOs, which according to the Report represent roughly 90% of outstanding CLOs, losses presented for the residual tranches of those securities are in the 40-

² The Academy has observed that calibrating a marked-to-market asset, such as the residual tranche of a structured security, needs to incorporate the market value or the volatility of that asset.

45% range for the mid-tail scenarios (~95th percentile per the Report) and over 70% in a deep-tail scenario. This result alone suggests a 30% RBC factor is too low.³

- The appropriate RBC level for CLOs would be shown to be well above 45% if the data in the Report was analyzed with a CTE risk measure, given the heavy-tail nature of CLOs (as discussed above).
- 90% of US Life Insurer holdings of the asset classes studied in the Report are CLOs, and given that RBC is a blunt instrument, extending the 45% charge for residuals to other ABS is both pragmatic and reasonable.

We would welcome the opportunity to discuss these comments with you in greater detail.

Sincerely,



Aaron Sarfatti
Chief Strategy Officer &
Head of Institutional Businesses and New Ventures

³ We also note that the calibration of collateral losses in the Report was understated. Correcting for this anomaly would provide further support for a higher RBC factor for residuals.



April 8, 2024

Mr. Tom Botsko
Chair, NAIC Capital Adequacy (E) Task Force
Via email: Eva Yeung (eyeung@naic.org)

Mr. Philip Barlow
Chair, Risk-Based Capital Investment Risk and Evaluation (E) Working Group (RBC IRE WG)
Via email: Dave Fleming (dfleming@naic.org)

Re: Proposal 2024-02-CA (Residual Structure PC & Health)
Oliver Wyman Residual Tranche Report

Dear Mr. Botsko and Mr. Barlow,

The American Property Casualty Insurance Association¹ (APCIA) appreciates the opportunity to express our views on the Oliver Wyman study of the performance of residuals relative to other asset classes, exposed by the RBC IRE WG. We are also responding to the Capital Adequacy (E) Task Force's (CATF) proposal to impose a 45 percent interim risk-based capital (RBC) charge on residual tranche of asset-backed securities (residuals) held by property casualty insurers. We do not believe a sufficient basis has been demonstrated for this increase and agree with the American Council of Life Insurers (ACLI) that the NAIC should delay the implementation of an increased RBC charge on residuals by an additional year for all insurance lines.

Last year, the NAIC appropriately delayed imposition of a 45 percent charge on residuals on life insurers and sought industry data to conduct additional study. While we believe that any significant change in RBC charges, whether "interim" or not, should be underpinned by careful analysis conducted by the NAIC, regulators now have access to a thoughtful and credible study prepared by Oliver Wyman. In our opinion, the study does not justify a 45 percent charge on residuals. It does support the need for additional analysis in establishing an interim capital charge that is reflective of risk.

Moving forward with the 45 percent charge would be inappropriate in light of the new data. Oliver Wyman is a highly credible firm that the NAIC has appropriately relied on over the years to analyze important aspects of solvency regulation. The study constitutes compelling evidence that regulators should take additional time and analysis before making major changes to RBC. The NAIC has required substantially more rigor in the analysis underpinning every prior increase in RBC. We are concerned that failure to do so here would be inappropriate, especially insofar as applying this interim charge to property casualty and health insurers was only proposed at the March 2024 NAIC meeting.

¹ APCIA is the primary national trade association for home, auto, and business insurers. APCIA promotes and protects the viability of private competition for the benefit of consumers and insurers, with a legacy dating back 150 years. APCIA members represent all sizes, structures, and regions—protecting families, communities, and businesses in the U.S. and across the globe.

We are also concerned that this charge appears to be designed to align with the “Basel III Endgame” banking capital rules proposed by the Federal Reserve Board. For many years, the insurance industry and insurance regulators have rightly pointed out that banking capital rules cannot and should not be applied to insurance companies. The two business models are quite different, as property casualty insurers do not hold demand deposits and the terms of our liabilities do not subject insurers to a run on the bank, i.e., are not runnable. The Basel III Endgame proposal, whether it is appropriate or inappropriate for structured securities held by banks, should not translate to state insurance regulation. The charge of state regulators is to set insurance-specific rules that protect policyholders, not to adopt global banking rules that do not reflect the best available data.

Finally, we would like to point out that, unlike the life RBC formula, there is no current mechanism for assigning property casualty Schedule BA asset RBC charges by investment type. Assigning a different charge to one particular investment type currently within Schedule BA is a significant change and should be supported by a more holistic review of the treatment of property casualty Schedule BA investments in general. This consideration further supports ACLI’s call for a one-year extension of the implementation date.

Thank you for the opportunity to convey our views and your continued commitment to ensuring that RBC changes reflect analysis and consistent standards of review by regulators. We hope that you will seriously consider our request to delay the implementation of this charge by an additional year to ensure that an appropriate charge is developed and adopted.

Sincerely,



Stephen W. Broadie
Vice President, Financial & Counsel



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Cincinnati, OH 45202-3341
Tel: 513-361-6675
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Kevin.Howard@wslife.com

April 8, 2024

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

Via email: dfleming@naic.org

Re: Comments on Oliver Wyman Report

Dear Mr. Barlow:

Western & Southern Financial Group, Inc. (“W&S”) appreciates the opportunity to comment on the Oliver Wyman report titled “Residual Tranche Risk Analysis” (the “Report”) that was exposed for comment by the RBC Investment Risk & Evaluation (E) Working Group.

W&S’s review of the Report reveals that it actually *supports* the interim 45% RBC factor for the residual tranches of asset-backed securities. The Report notes that Broadly Syndicated Loans (“BSLs”), which W&S’s proprietary life insurance industry peer study estimates as comprising 87% of the industry’s CLO exposure, would experience losses of 42-45% in a moderate loss (95th percentile) scenario, and losses of 72% in a deep-tail (99th percentile) scenario. (See Table 7 of the Report.) While there are several problems with the methodology used and assumptions made by the Report, its findings on the risks associated with BSL CLOs alone is enough to maintain the 45% interim charge on ABS residual tranches.

Even as the Report supports a 45% charge, it still has several critical biases and flaws as discussed below.

1) The comparison to US Equities is flawed.

The Report’s conclusion that the 45% charge is too high is entirely dependent on a comparison to US Equities’ 30% charge vs. projected losses. ABS residuals are, however, fundamentally different from US Equities. First, ABS residuals are the first loss position on a portfolio of assets, which is different from a diversified portfolio of US Equities. It is entirely plausible for an ABS residual to take 100% losses, as the ABS residual exists to take all losses before the rated tranches. Second, ABS residuals are expected to take losses in the baseline scenario and those losses tend to be permanent, whereas equity mark-to-market losses tend to be transient. Third, while some ABS residuals benefit from a reinvestment window that gives the investment manager time to wait out a market downturn, US Equities have an even longer time horizon to wait out a market downturn because there is no maturity date. In other words, the supposed liquidity and holding-period advantages cited for certain ABS residuals also exist for US Equities at an even greater level. Fourth, the US Equities market has hundreds of years of data to better

calibrate loss distribution models with tail risk, while ABS residuals have just a couple of decades of data. Finally, a CLO residual tranche is underfunded on day 1 due to deal expenses and interest reserve accounts (typically by 10% or more), and then default losses are expected over the life of the securitization, further eroding principal recovery—that’s how the investment is structurally designed—which is very unlike US Equities.

- 2) The Report uses Value-at-Risk (VaR), which is not a coherent risk metric.

It is widely recognized that VaR is not a coherent risk measure because it fails the subadditivity property. The subadditivity property implies that two separate risks cannot get worse if they are pooled together (i.e., diversification is beneficial). The reason VaR fails the subadditivity property is because VaR looks at the loss at a specific probability (e.g., 95th percentile), but it is completely blind to the loss beyond that probability. For example, an investment could take zero loss at the 95th percentile but a full loss starting at the 96th percentile. In this example, the VaR at the 95th percentile would be zero, implicitly implying very low risk. VaR does a particularly poor job of assessing risk where significant “cliff risk” exists, which is the key risk with ABS residual tranches: losses can increase very quickly as the residual tranche absorbs all of the losses of the investment pool.

This shortcoming of VaR is well understood by sophisticated investment managers that are VaR-constrained, which has led these investment managers to take additional risk not seen by VaR. The shortcomings of VaR likely exacerbated the Great Financial Crisis, as the risk of the CDO market was unseen by VaR.

Because of this, we highly recommend using Conditional Tail Expectation (CTE) to calibrate risk charges. CTE is similar to VaR; however, it is a coherent risk measure. CTE looks at the average loss beyond the probability event, meaning it can see the cliff risk that is present in ABS residuals.

- 3) We cannot replicate the findings of the Report.

The Report relies on a myriad of assumptions, some of which are provided, but many other key assumptions are not shared. Moreover, the Report only shows projected losses from three scenarios. As a result, it is impossible to fully assess and appropriately critique the shortcomings of the Report. And related to the VaR point above, we are unable to see if there is tail risk beyond the scenarios chosen.

For comparison, W&S’s CLO modeling shows a base case of the following: assuming a base case scenario of 20% CPR, 1% CDR and 50% Recovery rate, the loan portfolio would then be sold in the open market via a competitive bidding process when the CLO Equity holder calls the deal (approximately year seven). If the loan portfolio achieves a 98 average sale price (which is 67th percentile for performing loans since 2010), the residual tranche would experience a 45% principal loss. The 45% loss our modeling projects is in the base case, reflecting a greater loss than the 42% shown for the GFC scenario for BSL CLOs in the Report.

W&S strongly supports a data-driven solution to determine an appropriate capital charge for ABS residuals. We believe that the interim charge of 45% is appropriate given the diverse risks of the many asset classes employed in ABS residual tranches. Some of these asset classes merit a lower charge than 45%, and others may warrant an even higher charge; however, W&S believes that the temporary interim charge of 45% best represents the binary cliff risks that ABS residual tranches (and most notably BSL CLOs) present. We note that a 45% charge represents a level where the investment becomes a non-admitted asset for most insurance companies, and so a charge higher than 45% may not be necessary.

W&S recognizes that the many perspectives on an appropriate capital charge for ABS residuals is in part the result of the variability and complexity of ABS asset classes. We support a single charge for the interim solution, but anticipate that at least two charges will be necessary for the permanent solution.

It is important to remember that the *interim* charge of 45% is just that—it's a temporary stopgap until a long-term solution can be developed. Until the Academy and other objective commentators weigh in with appropriate data-driven proposals to achieve a permanent solution, we believe that preserving the "Texas compromise" previously agreed upon by regulators and the industry is important to maintain consistency and credibility.

Thank you again for the opportunity to comment on this important issue; please let us know if we can be of further assistance.

Sincerely,



Kevin L. Howard
Vice President, Deputy General Counsel
& Head of Government Affairs



TEXAS HOUSE *of* REPRESENTATIVES

Briscoe Cain
District 128

CHAIR, HOUSE COMMITTEE ON AGRICULTURE & LIVESTOCK
MEMBER, HOUSE COMMITTEE ON INSURANCE

April 8, 2024

Mr. Philip Barlow
Chair, Life Risk-Based Capital and Investment Risk and Evaluation Working Group

Mr. Barlow:

Insurance industry regulations must strike a careful balance. They must protect consumers and ensure the integrity of markets while also fostering competition and a wide array of affordable policy options. To strike this balance, policymakers must make a sober assessment of the risks assumed by insurers who invest premiums into varying assets in order to achieve returns strong enough to cover their obligations to consumers. Recently, the NAIC's Risk-Based Capital Investment Risk and Evaluation Working Group (RBC IRE WG) has discarded this careful balance and vastly overstated the risks of certain assets.

The NAIC is at its most effective when it uses data, research, and real-world information to develop pragmatic solutions and build consensus among its members. My experience as a member of the Texas House Insurance Committee has informed my belief in pragmatic, responsible insurance policy that puts consumers first. However, the RBC IRE WG's proposed 45% charge for asset-backed securities falls short on every front.

Unlike previous recommendations, the recommendation to tighten rules specifically around these securities was crafted without data. There was little consensus, as the recommendation was initially delayed when some policymakers expressed concern that the NAIC was moving forward with the higher capital charges without having any demonstrated reason to do so.

When the NAIC asked for data, they received it. An independent, third-party consultant delivered a thorough research report demonstrating that the 45% charge was unjustified and unnecessary. The RBC IRE WG dismissed this critical research and is hastily advancing its predetermined policy prescription with a limited window for public review and comment.

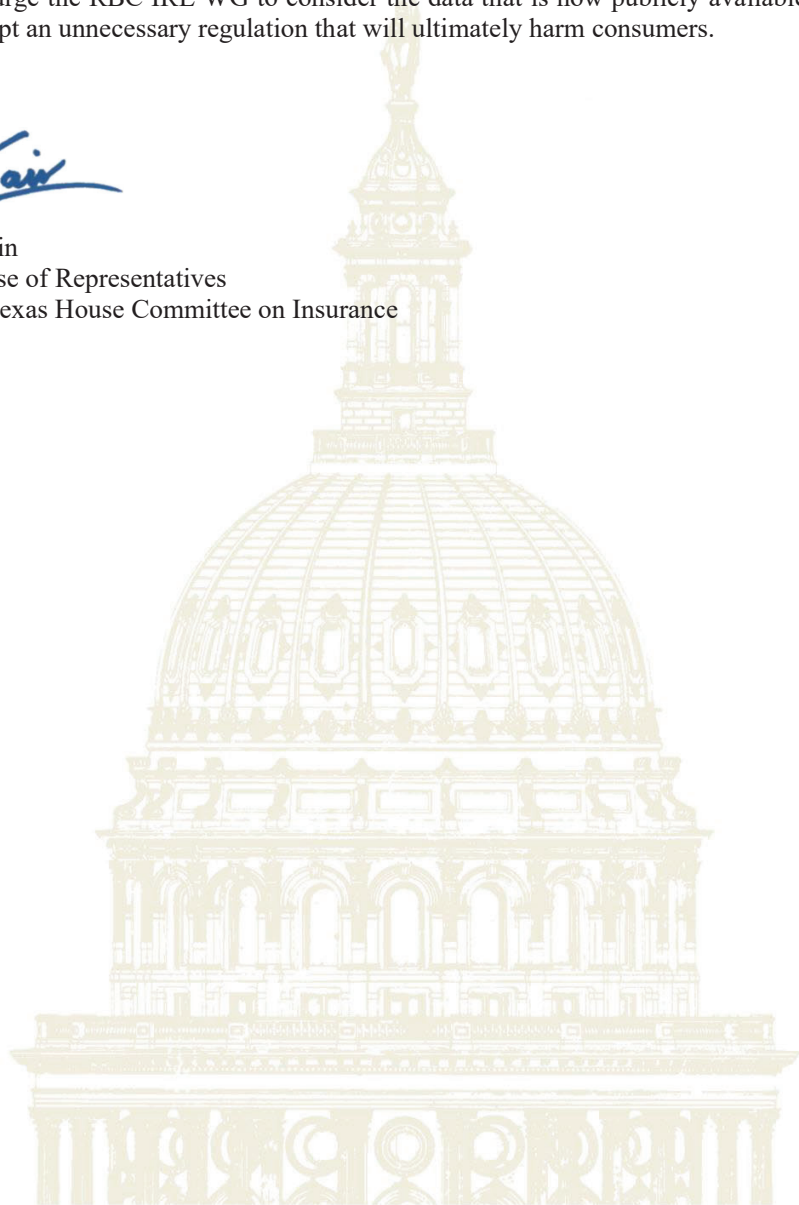
Consumers deserve strong protections against risk, especially when it comes to financial planning tools like life insurance and annuities. The RBC IRE WG's proposed measures do them a disservice by overstating, if not entirely misrepresenting, the risks associated with asset-backed securities. These securities are a critical asset class that allows insurers to offer competitive products that protect consumers.

The NAIC and the RBC IRE WG must be thoughtful and intentional about protecting consumers, maintaining competitive markets, and letting the data guide policy recommendations. The process behind the recommended increase in capital charges for certain securities falls short on every front. I strongly urge the RBC IRE WG to consider the data that is now publicly available and halt its rush to adopt an unnecessary regulation that will ultimately harm consumers.

Sincerely,



Briscoe Cain
Texas House of Representatives
Member, Texas House Committee on Insurance





April 8, 2024

Attn: Mr. Philip Barlow
Chair, Life Risk-Based Capital and Investment Risk and Evaluation Working
Group

Commissioner Jon Godfread
North Dakota Insurance Department

Dear Commissioner Godfread,

As a staunch advocate of free market competition, I am concerned by the recent developments within the National Association of Insurance Commissioners (NAIC), concerning the Risk-Based Capital Working Group.^[1] Mandating a 45% capital charge on asset-backed securities, after being confronted with third-party data that disproves the need for such a proposal, is a disservice to the market and the public.

The proposed capital charge is unnecessary and detrimental to consumers and the overall vitality of the life insurance and annuities market. Imposing this mandate on insurance providers will fragment the market and force providers to drive up costs. As a result, this action limits consumer choice and contradicts the spirit of a free and competitive market.

The NAIC has been criticized before because of its closed-door agreements.^[2] NAIC has ignored independent research in the consideration of the proposed rule around residual tranches. That research has demonstrated that the perceived risks associated with these asset-backed securities are unfounded. Nonetheless NAIC insists on pushing forward with a policy that is not grounded in data.

As someone who is familiar with the insurance industry and has a record of public service in North Dakota, I understand the need for transparency and accountability in policymaking. I implore the Risk-Based Capital Working Group and the NAIC to prioritize evidence-based decision-making and consumer welfare. If we hope to uphold the state regulatory system and respect the NAIC, then the organization must honor the principles of transparency and

^[1] <https://www.insurancebusinessmag.com/us/news/breaking-news/naic-accused-by-atr-of-bending-to-bidens-will-482877.aspx>

^[2] <https://www.insurancebusinessmag.com/us/news/breaking-news/congressional-republicans-take-naic-to-task-over-proposal-452948.aspx>

accountability, especially when proposing measures that could significantly impact consumers and the market.

I strongly encourage you to reconsider the 45% capital charge and to instead focus on policies that promote competition and consumer choice within the life insurance and annuities market. Thank you for your attention to this matter. I trust that you will carefully consider the concerns raised and take appropriate action to ensure that the interests of consumers and market participants are safeguarded.

Sincerely,

A handwritten signature in blue ink that reads "Robert W. Harms". The signature is written in a cursive style with a large initial "R".

Robert W. Harms, JD

Robert W. Harms Box 2732 Williston, ND 58802 Robert@harmsgroup.net



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Philip Barlow
Chair, Risk-Based Capital Investment Risk and Evaluation (E) Working Group ("RBC-IRE")
NAIC
via email to Dave Fleming (dfleming@naic.org)

April 8, 2024

Dear Chair Barlow:

Re: Proposal 2024-02-CA; Oliver Wyman Residual Tranche Report

The Alternative Credit Council ("ACC")¹, the private credit affiliate of the Alternative Investment Management Association Ltd ("AIMA"), appreciates the opportunity to provide a few additional comments to supplement the RBC-IRE committee's discussion of the Oliver Wyman ("OW") analysis of asset-backed securities ("ABS") residuals. In addition, we would like to present new data analysis that further demonstrates the relative safety and outperformance of CLO equity tranches compared to common stock.

Claims of 100% cliff losses versus historical track record

One concern raised by regulators is whether ABS residual tail losses during periods of market stress could be 100% in absolute terms and much greater in comparison to public equities. However, Larry Cordell, an economist at the Federal Reserve Bank of Philadelphia, along with Professor Michael Roberts of the Wharton School at the University of Pennsylvania, performed a detailed analysis of CLO residuals from 1997 to 2021. The results of their analysis were published in the Journal of Finance and found

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

Alternative Credit Council (ACC)

The ACC is the private credit affiliate of the Alternative Investment Management Association Limited (AIMA). AIMA is registered in England as a Company Limited by Guarantee, No. 4437037. VAT Registration no. 577 5913 90. Registered Office as above.





that CLO equity outperformed the S&P 500 during that time period.² Their study also found that on a risk-adjusted basis, CLO equity outperformed equity “against a variety of public benchmarks.”³ A key finding of this study was the relative stability of CLO equity during two periods of significant market instability, namely the 2001 dot-com bubble and the 2008 Great Financial Crisis. The authors noted that CLOs’ “equity performance highlights the resilience of CLOs to market volatility.”⁴ The authors attributed the outperformance of CLO equity to several of the structural features of CLOs, including “their closed-end structure, long-term funding, and embedded options to reinvest principal proceeds.”⁵

The Cordell study provides a clear historical track record that CLO residuals do not suffer complete losses during periods of financial stress. In addition to the reasons cited above, residuals are priced well below par (unlike corporate bonds), reflecting both the high discount rates and an expectation of some credit losses. As a result, the interest payments are a meaningful contributor to the overall value--again, unlike corporate bonds. Even in a severe stress, both the Cordell and OW studies demonstrate that CLO equity investors can still expect to receive cash flows.

CTE 90 vs VAR 95-99 percentile

Some RBC-IRE members have asked about the difference between contingent tail exposure (“CTE”) 90 and Value at Risk (“VaR”) at the 95th or 99th percentile. While CTE represents the average probability-weighted loss above a certain probability level, VaR represents the loss at a specific probability level. The American Academy of Actuaries is using a CTE approach, so if the CTE 90 level is what becomes adopted, that would calculate the average of losses above the 90th percentile. The OW study examined losses at both the 95th and 99th percentiles. Those are both specific percentile points of the loss distribution but are at the higher end of the CTE 90 average range. This difference can also be explained by the fact that the OW study used stress tests during three different periods of financial stress, which is not compatible with the kind of Monte Carlo simulation used to calculate CTE. Also, the purpose of the OW study was to compare the interim capital charge for ABS residuals to that of established NAIC capital charges for similar assets, and the NAIC has historically used a 94-96th percentile VaR to establish capital charges.

BSL residuals vs the other ABS residuals in the OW study

The OW study clearly demonstrates that all three analyzed types of ABS equity outperformed common stock during periods of market stress, including the 2001 dot-

2 Cordell, R, and Schwert, M, CLO Performance, Journal of Finance, 2023. <https://doi.org/10.1111/jofi.13224>

3 *Id.* at 2. “Our central finding is that CLO equity tranches provide statistically and economically significant abnormal returns, or “alpha,” against a variety of public benchmarks...”

4 *Id.* at 20.

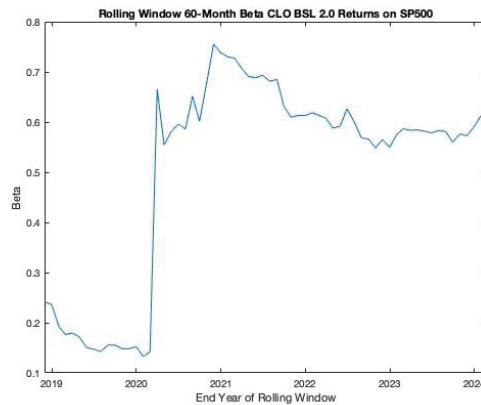
5 *Id.* at 1. See also Jeff Helsing, Can CLO Equity Outperform if the Economy Tips into Recession?, September 26, 2022, [Can CLO Equity Outperform If the Economy Tips Into Recession? | Western Asset](#)





com bubble, the 2008 Great Financial Crisis, and the 1930s Great Depression. However, given that the equity of one sub-type of collateralized loans (“CLOs”), namely broadly syndicated loans (“BSLs”), performed better overall than common stock but similar in the two medium-tail stresses, we asked finance Professor Daniel Svogun to perform a beta analysis to determine whether or not BSL equity has lower volatility than common stock.⁶⁶

Professor Svogun was able to use time series data from Bank of America on CLO BSLs monthly median equity prices to calculate BSL equity beta using the NAIC’s formula for measuring monthly volatility over a 60-month rolling window. The results of Professor Svogun’s analysis (see chart below) demonstrate that the 60-month rolling beta of BSL equity is well below 1 (any beta result lower than 1 indicates less volatility relative to the S&P 500). This beta analysis compared the monthly CLO equity price change to the S&P 500 index performance each month. The beta of the full period studied (Dec 2013 - Feb 2024) with over 750 BSL CLOs included is .4989, which is well below the NAIC’s .75 beta threshold for the lowest charge of 20%. The chart shows the 60-month rolling average beta following the NAIC’s formula. During that time period, the beta of BSL equity remains below the .75 threshold in all but one month, where it reaches .7564. Note the time indicated in the x-axis is the ending period of the 60-month rolling beta. As a result, to be consistent with the principle of equal capital for equal risk, it would be more appropriate for the NAIC RBC charge for BSL equity to be adjusted to 20% using the NAIC’s formula to adjust the equity capital charge according to its level of volatility compared to the S&P 500.



Bank of America CLO data; calculations from finance professor Daniel Svogun, Ph.D., Busch School of Business, CUA

⁶⁶ Professor Daniel Svogun is a professor of finance at the Busch School of Business, Catholic University of America, whose research specializes in the “time value of money, ratio analysis, [and] the valuation of stock and bonds.” <https://business.catholic.edu/faculty-and-research/faculty-profiles/svogun-daniel/index.html>





This finding that BSL equity is less volatile than the S&P 500 should not be a surprise because it is consistent with the results of both the OW study and the Cordell CLO equity research paper. Furthermore, it provides additional evidence of the relative outperformance of BSL CLO equity compared to common stock.

The punitive nature of a single ABS residual charge

In response to regulators' requests, we were able to anecdotally confirm that insurers invest in CLOs, investment-grade auto loan and student loan ABS residuals. However, several of our insurance and investment members noted that they invest in other types of ABS as well and expressed concerns about the inequity of a single residual C-1 charge of 45% for all ABS regardless of the type or quality of the underlying collateral.

One specific example where a 45% residual C-1 factor would be unwarranted is for Commercial Property Assessed Clean Energy (C-PACE) ABS⁷. C-PACE ABS are backed by loans to U.S. commercial property owners that finance energy efficiency, water conservation and renewable energy projects. C-PACE loans are high-quality, super senior to a mortgage loan on a property, given that the loans are repaid as a benefit assessment on the property tax bill. However, it is uneconomic and unfeasible to rate or invest in individual C-PACE loans at scale due to the relatively small average ticket size. As a result, these loans are aggregated in a securitization or structured product so that insurers can invest in the C-PACE asset class. However, the 45% C-1 charge on the residual tranche, even if it is a small part of the structure, can negatively impact the capital-adjusted risk-return profile of a C-PACE ABS. Insurance investors in C-PACE ABS are already subject to higher capital charges compared to investing directly in the underlying, so the interim 45% residual charge makes it even harder to justify the relative risk-reward analysis for an insurance investment. Investors are aware that the 45% residual charge is meant to be an interim one, but the reality is that it may be in place for many years, particularly for smaller ABS asset classes. This would, in effect, significantly disincentivize insurers from investing in high-quality and sustainable C-PACE assets.

Conclusion

At a high level, the OW analysis and findings demonstrate that expected losses in stress scenarios can vary depending on the underlying collateral and structure, which makes a 45% residual charge inappropriate. As more information is gained on insurers' residual exposure, it is very likely that there are other types of ABS beyond the ones in the OW study and C-PACE ABS for which a 45% charge would not be appropriate based on their specific level of risk. As a result, we respectfully request the NAIC to reconsider

⁷ C-PACE loans are used by commercial property owners to finance climate and environment-related projects, including climate resiliency, renewable energy, and water and energy efficiency improvements. *See generally*, "Credit FAQ: ABS Frontiers: The C-PACE Space Explained, (2024) at <https://www.spglobal.com/ratings/en/research/articles/231213-credit-faq-abs-frontiers-the-c-pace-space-explained-12943764>.





imposing the highest capital charge level in its history until the impact of this charge on all ABS residuals is better understood and determined to be appropriate. In addition, since the only two available empirical studies demonstrate that CLO equity outperforms common stock during periods of financial distress—and we now have evidence that BSLs have a lower beta—we respectfully urge the NAIC to maintain the 30% charge until additional analysis can be performed on what ABS residuals insurers actually hold on their balance sheet and whether a 45% charge would be appropriate.

We welcome the opportunity to discuss these supplementary comments and additional data analysis. From our perspective, there are now only two data-driven analyses available to you, both of which demonstrate that a single 45% charge on ABS residuals would not correspond to the actual levels of risk. If you have any questions about this new information, please reach out to me or Joe Engelhard, Head of Private Credit & Asset Management Policy, Americas, at 202-304-0311 or jengelhard@aima.org. The ACC will provide a similar comment letter to the Capital Adequacy Task Force, given that they have proposed a 45% charge for ABS residuals for the property casualty and health insurance RBC formulas.

Respectfully,

A handwritten signature in blue ink, appearing to read "J. Król".

Jiří Król
Global Head of Alternative Credit Council





Mariana Gomez-Vock
Senior Vice President, Policy Development
American Council of Life Insurers
Marianagomez-vock@acli.com

April 8, 2024

Mr. Philip Barlow
Chair, NAIC Risk Based Capital (RBC) Investment Risk and Evaluation Working Group
National Association of Insurance Commissioners
[via e-mail to dfleming@naic.org]

Re: Exposure of Oliver Wyman Residual Tranche Report

Dear Chair Barlow,

The American Council of Life Insurers (ACLI) is pleased to submit these comments responding to the RBC Investment Risk and Evaluation Working Group's ("the Working Group") exposure of the Oliver Wyman ("OW") Residual Tranche Report. ACLI's 280 member companies represent 94 percent of the life insurance industry's assets. We are writing to you today on behalf of a broad coalition of life insurers – large, small, stock and mutuals, private-equity and non-private equity.

Since the emergence of the "Texas Compromise"¹ in June 2023, ACLI has worked diligently on residual tranche issues. The project has been complex and challenging. While ACLI is not as far along as we had originally planned, there has been significant progress – ACLI's Principles of Consensus on the C-1 Framework for Structured Securities, were adopted unanimously by the ACLI Board in September 2023. The Principles were labor intensive and took several months to develop but were necessary before ACLI attempted to undertake an analytical review of residual tranches. ACLI remains committed to finding a consensus-based solution to this issue.

ACLI is respectfully asking for a one-year deferral of the 45% factor, allowing time for regulators and stakeholders to consider the factor within the context of the Academy's work and the impact of recent changes in accounting treatment and reporting standards. With multiple workstreams engaged to develop fact and risk-based information, a finite deferral of one additional year will advance the objective of implementing a data-informed interim factor.

1. ACLI supports regulators' efforts to proactively evaluate and address concerns about particular asset classes – including residual tranches.

As noted in our testimony at the March 17 meeting of the Working Group, ACLI is supportive of the Working Group's efforts in this area. It is regulators' prerogative to proactively evaluate any investment

¹ Texas Department of Insurance, June 9, 2023 comment letter in Attachment 2 of rbcire-6-14-23-materials, "TDI supports a compromise that would set the residual tranche base factor at 30% and a sensitivity test factor at 15% for the 2023 risk-based capital formula. Then, in 2024 the base factor would move to 45% and the sensitivity test factor would drop to 0%."

they believe merits greater scrutiny, including structured securities and residual tranches. Investments evolve over time – and regulations must evolve alongside them. We appreciate that the Working Group has strived to maintain a transparent process and that the Chair has created opportunities for stakeholders to share their views on this complex topic.

2. *ACLI supports further study on the potential drivers of risk within the residual tranches to determine appropriate interim RBC factors.*

Considering the brief exposure period and in a desire to avoid duplicative efforts, the American Academy of Actuaries (“the Academy”) is the appropriate body to conduct a technical review of the OW study. While ACLI is not submitting comments on the study itself, we do believe it raises a relevant question on whether the variations of the residual tranche structure or specific attributes are driving risk.² For example, the OW study looked at residual tranche thickness and collateral types.

The forthcoming Academy analysis, expected this summer, will identify comparable attribute candidates to appropriately capture the major drivers of tail risk. The Academy’s work should provide additional insights on this matter and help regulators determine the best approach for determining C-1 charges, for both Broadly Syndicated Loan Collateralized Loan Obligations (“BSL CLOs”) and non-CLO Asset Backed Securities (“ABS”). Additional analysis on industry holdings and the risk drivers within the residual tranches across different types of asset classes would be useful to ensure that regulators have the most appropriate approach for the interim RBC factors in place. This analysis may also help avoid unintended consequences that may occur when the charge is applied to BSL CLOs and other types of securitizations, especially those that have not been specifically evaluated by regulators or the Academy. It is possible that the interim factor (45%) could potentially incentivize structures with lower equity subordination (higher leverage) rather than structures with higher equity subordination (lower leverage).

3. *It is important for stakeholders to understand the cumulative impact of recent regulatory changes impacting residual tranches.*

Since 2021, regulators have made multiple changes impacting the disclosure, reporting, and treatment of residual tranches and interests. First, these changes will increase the consistency in reporting by clarifying that residuals in substance should be treated as residuals and disclosed on Schedule BA. The changes mean that some assets that may have previously been disclosed on Schedule D-1, will be reported on Schedule BA and receive a higher RBC factor. Second, further changes are likely under the Principles Based Bond Definition (“PBB”), which becomes effective in YE 2025. At this point, it is still unclear which assets will be classified as ABS (thus impacting residuals of those ABS) under the PBB. It is possible that additional analysis and calibration of the ABS residual risk charges may be needed after understanding exactly which assets are classified as ABS under the new definition in 2025.

² Other regimes, including Basel III have identified multiple risk drivers for securitization, including maturity, seniority level, tranche thickness, and final ratings. Tranche thickness and maturity were added to reduce the importance of external ratings and enhance risk sensitivity. See Moody’s Analytics, *Capital calculations under the revised securitization framework* 3-5 (2017) (describing the inclusion of additional risk drivers to reduce dependence on external ratings and increase risk sensitivity), available at <https://www.moodyanalytics.com/-/media/whitepaper/2017/capital-calculations-under-the-revised-securitisation-framework.pdf>; See also Basel III Document: Revisions to the Securitization Framework 9-12 (2016) (describing the inclusion of additional risk drivers into the external-ratings based approach (ERBA) for securitizations).

The adoption of the PBBD will change the carrying value of residuals and as noted by one of the [Academy's RBC principles](#) for structured securities, the accounting must be considered when determining an appropriate RBC factor.³ ACLI believes that consideration is appropriate for all factor changes, whether it is interim or not. Specifically, the new residual tranche accounting likely will result in carrying values broadly across the industry to be lower than fair values. As a result, any RBC factor developed using fair value loss RBC could potentially overstate exposure to loss broadly across all companies, especially in cases where companies account for residuals using the practical expedient. The carrying value accounting and the use of fair value as the loss metric should both be considered when determining whether an RBC factor is reasonably conservative and reflective of risk.

In 2023, there was a significant increase in the aggregate amount of residuals (\$11.6B) reported by life insurers on Schedule BA, although the acquisition data indicates that reclassification of assets was the primary driver of increased exposure to Schedule BA residuals.⁴ While the reporting changes make an accurate year-over-year analysis somewhat imperfect, the data demonstrates that life insurers' acquisition of residuals declined by 28% between 2022 and 2023.

The 2023 sensitivity test results give regulators the data they need to identify and mitigate potential solvency concerns now. The 2023 sensitivity test data also provides additional insight into the impact of the 45% charge on 110 life insurance entities. Five companies (5%) would see a change of at least 5% in Authorized Control Level RBC. The remainder of life companies examined (95%) would have less than a 5% change in Authorized Control Level RBC if the charge is applied. Around 33% of life companies examined would have a change of <0.1%.

The 2023 reclassification data, the ability to evaluate companies at both the 30% and 45% RBC charge through the 15% sensitivity test in place for YE 2023, and the consideration of the January 1, 2025 accounting changes are potentially material to the judgement of an appropriate interim RBC factor. It is prudent to review each of these concepts thoroughly prior to establishing an interim RBC factor which may be in place for several years.

4. ACLI respectfully requests a one-year deferral to better understand emerging data and research by the Academy.

In June 2023, regulators opted to impose a 45% interim RBC charge for residuals as of YE 2024 while the NAIC Structured Securities Group ("SSG") develops a more sophisticated approach for BSL CLOs.⁵ However the 45% charge applies to all structured securities irrespective of their risk. The 45% factor is often described as a reasonably conservative solution for an interim RBC charge that would apply until the SSG's modeling work was done. However, the SSG has been focusing on BSL CLO debt. There is no apparent timeline for modeling asset-backed securities, nor is it clear that the SSG will model all classes of

³ Principles 3 states that "C-1 requirements should generally reflect the impact of risk on statutory surplus. Changes in accounting treatment will affect RBC." The Academy noted that "all else equal, assets that are marked to market ("MTM") may have higher C-1 requirements because C-1 on MTM assets incorporates price fluctuations in addition to credit losses. In practice, this means that C-1 for residual tranches would consider price fluctuations, whereas C-1 for unimpaired rated debt tranches only considers credit losses."

⁴ NAIC Year-End 2023 Aggregated Residual Data, *available at* https://content.naic.org/sites/default/files/call_materials/2023%20Residual%20Aggregated%204-1-24.pdf.

⁵ The initial modeling excludes Commercial Real Estate CLOs, asset-backed securities, resecuritizations, Collateralized Debt Obligations (CDOs), Trust Preferred CDOs, and Middle Market CLOs.

ABS or other types of residual tranches. Accordingly, the interim solution may be more enduring for certain types of ABS.

ACLI acknowledges that some regulators feel urgency about the work. ACLI is not suggesting regulators pause the workstream or abandon the inquiry into the appropriate treatment of residual tranches and structured securities. We are respectfully asking for a temporary, one-year deferral, allowing time for regulators and stakeholders to consider the RBC factor within the context of the Academy's work on comparable attributes and the impact of recent changes in accounting treatment. Regulators continually strive to "get it right". Spending a bit more time on this will help to ensure that a true data-informed RBC factor for residual tranches is adopted.

For the reasons cited above, ACLI respectfully requests an additional one-year deferral.

5. Conclusion

Thank you for the opportunity to share these views. We would be pleased to discuss this letter with you in further detail, at your request.

Sincerely,

A handwritten signature in cursive script that reads "Mariana Gomez-Vock".

Mariana Gomez-Vock
Senior Vice President, Policy Development



April 8, 2024

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

Re: Review of Oliver Wyman study on ABS residual tranches

Dear Chair Barlow,

Oliver Wyman has conducted a study on Asset-Backed Securities (ABS) residual tranche risk (OW study) that was presented to the Risk-Based Capital Investment Risk and Evaluation Working Group of the NAIC (RBCIRE) at the 2024 Spring National Meeting. Working Group members asked the American Academy of Actuaries¹ C1 Subcommittee (subcommittee) to review and comment on the OW study. This letter focuses on the OW study's consistency with the six ABS RBC principles [presented by the subcommittee](#) to RBCIRE at the 2023 Fall National Meeting. A full technical review of the OW study is outside the scope of this letter.

The table below provides a summary of this review's conclusions, with detailed explanations provided throughout the remainder of this letter.

Principle #1	Partially consistent
Principle #2	Consistent
Principle #3	Consistent
Principle #4	Partially consistent
Principle #5	Partially consistent
Principle #6	Inconsistent

Principle #1: The purpose of RBC is to help regulators identify potentially weakly capitalized insurers, therefore changes that have a small impact on RBC ratios may not justify a change to the RBC formula.

Principle #1 includes two complementary elements. The first is that RBC is intended to highlight for regulators potential solvency issues with insurers. In other words, if an insurer is exposed to a

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

risk, then its RBC ought to reflect that. The second is a materiality consideration where enhancements with the highest potential impact on RBC should be prioritized over potential changes that may increase precision but not materially impact RBC.

Regulators have identified residual tranches as a material risk warranting a change to the RBC formula. Therefore, the OW study, providing data on residual tranches, is consistent with Principle #1.

However, the subcommittee disagrees with the implicit suggestion from the OW study that C-1 for residual tranches can be informed by comparing risk of residual tranches to the risk of common stock (other sections of this letter also reference the comparison to common stock, which we believe is implied although not explicitly stated in the OW study). The subcommittee's view is based on the following:

- While leveraging existing C-1 factors from other asset classes may be a reasonable approach under some circumstances, the use of this approach should be predicated on similar risk characteristics or having insufficient data to support risk modeling (see Appendix 1 for the C-1 modeling flowchart that was introduced by the subcommittee at the 2023 NAIC Summer National Meeting).
- In the subcommittee's view, the risk characteristics for residual tranches (especially in the tail) are significantly different from common stock. Therefore, assessing the C-1 factor for residual tranches using the existing C-1 factor for common stock may lead to inappropriate conclusions.
- The C-1 factor for residual tranches should not be informed by the C-1 factor for common stock because statutory accounting for these two asset classes is different. Accounting for common stock is on a mark-to-market basis whereas SSAP 21R provides an option for residual tranches to be valued on a discounted cash flow basis (further discussed under Principle #3 below).

Principle #2: Emerging investment risks create concerns for regulators, and existing regulatory tools can be considered alongside RBC for addressing these newer risks—but RBC needs to be considered when there are material solvency issues.

Regulators have generally identified ABS as an emerging risk that could impact solvency. Residual tranches, specifically, are an emerging risk. By providing new data and analysis to explore the risk of residual tranches, the OW study is consistent with Principle #2.

In addition, emerging investment risk can arise in circumstances where the C-1 factor for an asset class is not commensurate with the underlying investment risk. The OW study brings to light material differences in risk characteristics across different types of residual tranches and therefore the potential need for differentiated C-1 factors. This is a helpful insight and is consistent with Principle #2.

Principle #3: C-1 requirements should generally reflect the impact of risk on statutory surplus. Changes in accounting treatment will affect RBC.

Statutory accounting for residual tranches is impacted by the recently adopted SSAP 21R where residual tranche valuations are not directly subject to mark-to-market volatility. SSAP 21R allows insurers to use a discounted cash flow approach to residual tranche valuation (an approach

that was adopted after the development of the OW study). Under this approach, a discount rate for each residual tranche is determined at purchase and remains unchanged. The asset is impaired if the present value of cash flows is less than book value.

The OW study uses a fixed discount rate in assessing potential loss exposure for residual tranches, which in effect excludes potential mark-to-market exposure under a stress scenario. This approach is largely consistent with SSAP 21R and Principle #3.

Principle #4: C-1 requirements for a given tranche should align with that tranche's risk, to the extent practical.

Principle #4 addresses the idea that C-1 should reflect the level of risk in each tranche, rather than being constrained by requirements that C-1 on ABS equals C-1 on collateral. On this point, the OW study is consistent with Principle #4 where the exposure analysis of residual tranches is based on projected performance of the underlying collateral.

The subcommittee's view is that residual tranches and common stock have different risk characteristics, so the study's reference to C-1 factors for common stock may be inconsistent with Principle #4. Further, since the OW study assumes sufficient data to support modeling the risks, the C1 modeling flowchart would not end with using existing C-1 factors, whether for common stock or some other asset class, unless residual tranches are impractical to model individually. An assessment of individual asset modeling's practicality is outside the scope of the OW study and of this letter.

Principle #5: C-1 requirements on ABS should treat the collateral as a dynamic pool of assets, incorporating future trading activities that are reasonable and vary appropriately by economic scenario.

Principle #5 clarifies that no assumption should be made for reduced risk through better-than-market credit selection, which is consistent with the OW study.

Principle #5 also suggests that trading activity subject to or mandated by the structure's legal documents should be incorporated as part of the risk modeling in determining C-1 requirements. Specific to collateralized loan obligations (CLOs), the OW study does not incorporate trading activity in the form of reinvestments within the collateral pool. This simplification is inconsistent with Principle #5 and may potentially bias the results in a conservative direction, which the OW study acknowledges.

Principle #6: Each C-1 factor is based on the asset class's risk profile. However, the risk profile for ABS differs from the risk profile for bonds. Therefore, C-1 requirements for ABS should be calibrated to different risk measures where appropriate.

Principle #6 suggests that ABS and corporate bonds need not use the same risk measure and that a conditional tail expectation (CTE) risk measure is likely more appropriate than percentile for ABS to capture tail risk. The OW study is based on percentiles, which would be inconsistent with Principle #6 because percentiles may struggle to capture tail risk for ABS. While not using CTE explicitly, the OW study does include percentile results under a deep-tail scenario. This provides a potential upper bound for a CTE risk measure.

The C1 Subcommittee appreciates your attention to the issues raised in this letter and looks forward to discussing them further with you. Should you have any questions or comments in

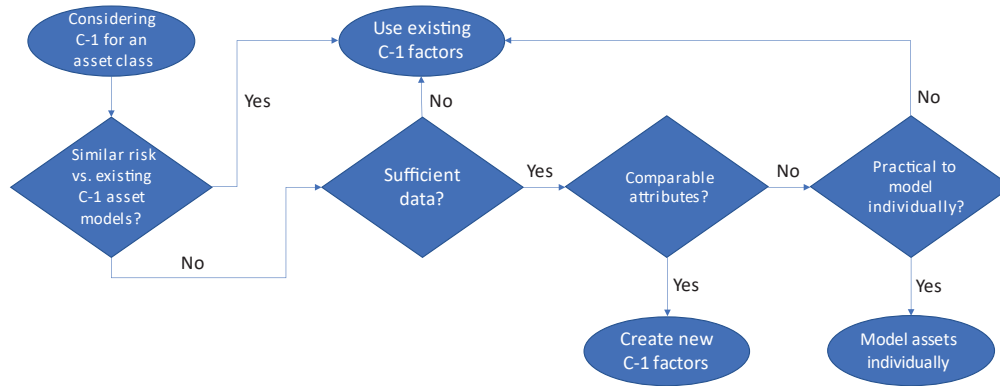
response to this letter, please contact Amanda Barry-Moilanen, life policy analyst
(barrymoilanen@actuary.org).

Sincerely,

Stephen Smith
Chairperson, C1 Subcommittee
American Academy of Actuaries

Appendix 1

C-1 Modeling Flowchart



SENATOR PAUL BAILEY

CORDELL HULL BUILDING
425 REP JOHN LEWIS WAY N
SUITE 736
NASHVILLE, TENNESSEE
37243
(615) 741-3978

State of Tennessee
NASHVILLE

MEMBER OF COMMITTEES
Chairman of Commerce and Labor
Transportation

April 8, 2024

Dear Mr. Barlow:

The life insurance and annuities market boasts a complex collection of products that provide hardworking Americans from all socioeconomic backgrounds with the crucial tools they need to get ahead in planning and saving for retirement. Given the important yet delicate nature of this market, I'm concerned by the NAIC Risk-Based Capital Investment Risk and Evaluation (RBC IRE) Working Group's recent conduct in moving forward on a 45% capital charge on asset-backed securities.

When drafting insurance rules, regulators should adhere to data and consider the costs and benefits of any changes. This is particularly important given the NAIC's unique role in guiding consensus for insurance policymaking across the entire country. However, this is not the path the NAIC has been following recently. Independent and verified data in the form of the Oliver Wyman study clearly demonstrates that asset-backed security (ABS) equity is less risky than other securities with a 30% charge. This demonstrates that a 45% capital charge on residual tranches is disproportionately high relative to other insurer investments. This study is thorough and uses a sophisticated analysis. Some regulators are misstating that the study supports a 45% charge. This is untrue and regulators should seek clarification from the study sponsors and authors if they have questions about the research conclusions.

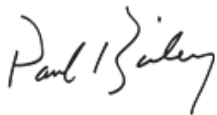
Beyond being unnecessary, I worry that a 45% capital charge on ABS equity would be extremely burdensome for the life insurance and annuities market and, by extension, for American consumers. In my role as the Chair of the Commerce and Labor Committee in the Tennessee State Senate, I remain committed to safeguarding consumers and market competition. If ABS equity is saddled with a 45% capital charge, insurers will be dissuaded from investing in these assets. This would reduce investment returns, steer insurers into less appropriate investments, and reduce or eliminate options for consumers who need help protecting their families and saving for retirement.

Hardworking people across the Volunteer State deserve to know that rules affecting their insurance policies are made in full sunlight and with their best interests at heart. Therefore, it is concerning to see the NAIC forge ahead in such an unprecedented and thoughtless manner, despite data and research, to pursue this misguided policy proposal. I am concerned that this move undermines the credibility of the NAIC itself, and calls into question the wisdom of states permitting standard-setting by the organization.

Legislators like myself are questioning what ill-founded policy moves might be next, given that the NAIC seems willing to ignore data and harm our citizens.

Before it's too late, I encourage the RBC IRE working group to delay the implementation of the 45% capital charge on residual tranches. Regulators ought to review the data and adopt a more consumer- and competition-centric approach. The life insurance and annuities market is an integral facet of the American economy. I hope the NAIC sees things the same way.

Sincerely,

A handwritten signature in black ink that reads "Paul Bailey". The signature is written in a cursive style with a large, stylized initial "P".

Paul Bailey

Chairman of Commerce & Labor

15th District of Tennessee

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

**CAPITAL ADEQUACY (E) TASK FORCE
WORKING AGENDA ITEMS FOR CALENDAR YEAR 2024**

2024 #	Owner	2024 Priority	Expected Completion Date	Working Agenda Item	Source	Comments	Date Added to Agenda
Ongoing Items – Life RBC							
L1	Life RBC WG	Ongoing	Ongoing	Make technical corrections to Life RBC instructions, blank and /or methods to provide for consistent treatment among asset types and among the various components of the RBC calculations for a single asset type.			
L2	Life RBC WG	1	2023-2024 or later	1. Monitor the impact of the changes to the variable annuities reserve framework and risk-based capital (RBC) calculation and determine if additional revisions need to be made. 2. Develop and recommend appropriate changes including those to improve accuracy and clarity of variable annuity (VA) capital and reserve requirements.	CADTF	Being addressed by the Variable Annuities Capital and Reserve (E/A) Subgroup	
L3	Life RBC WG	1	2023-2024 or later	Provide recommendations for the appropriate treatment of longevity risk transfers by the updated longevity factors and consider expanding the scope to include all payout annuities.	New Jersey	Being addressed by the Longevity (E/A) Subgroup	
L4	Life RBC WG	1	2023-2024 or later	Monitor the economic scenario governance framework, review material economic scenario generator updates, key economic conditions, and metrics, support the implementation of an economic scenario generator for use in statutory reserve and capital calculations and develop and maintain acceptance criteria		Being addressed by the Generator of Economic Scenarios (GOES) (E/A) Subgroup	
Carryover Items Currently being Addressed – Life RBC							
L5	Life RBC WG	1	2023-2024 or later	Update the current C-3 Phase I or C-3 Phase II methodology to include indexed annuities with consideration of contingent deferred annuities as well	AAA		
L6	Life RBC WG	1	2023-2024 or later	Review companies at action levels, including previous years, to determine what drivers of the events are and consider whether changes to the RBC statistics are warranted. <u>Deliberate the relevant weights assigned to various risk components.</u>			
L7	Life RBC WG	1	2023 or later	Work with the Academy on creating guidance for the adopted C-2 mortality treatment for 2023 and next steps.			
New Items – Life RBC							
<u>L7</u>	<u>Life RBC WG</u>	<u>1</u>	<u>2024 or later</u>	<u>In light of SAPWG INT to permit admittance of negative IMR, SAPWG requested CADTF to consider:</u> <u>1. The elimination of any admitted net negative IMR from Total Adjusted Capital (TAC).</u> <u>2. Sensitivity testing with and without negative IMR.</u>	<u>CADTF</u>		
<u>L8</u>	<u>Life RBC WG</u>	<u>1</u>	<u>2024 or later</u>	<u>Develop a structure proposal to reflect the split of the Annual Statement, Schedule D, Part 1 into two schedules pursuant to the SAPWG adopted bond project.</u>	<u>CADTF</u>		
<u>L9</u>	<u>Life RBC WG</u>	<u>1</u>	<u>2024 or later</u>	<u>Consider SAPWG Referral for Investments in Tax Credit Structures</u>	<u>SAPWG</u>		

L10	Life RBC WB	1	2024 or later	<u>Consider possible structural changes to account for reporting changes for collateral loans addressed through instructional changes for 2024 with the adoption of proposal 2024-15-L</u>			
2024 #	Owner	2024 Priority	Expected Completion Date	Working Agenda Item	Source	Comments	Date Added to Agenda
Ongoing Items – RBC IR & E							
Carryover Items Currently being Addressed – RBC IR & E							
IR1	RBC IRE	2	2023-2024 or later	Supplementary Investment Risks Interrogatories (SIRI)	Referred from CADTF Referral from Blackrock and IL DOI	The Task Force received the referral on Oct. 27. This referral will be tabled until the bond factors have been adopted and the TF will conduct a holistic review all investment referrals.	1/12/2022 11/19/2020
IR2	RBC IRE	2	2023-2024 or later	NAIC Designation for Schedule D, Part 2 Section 2 - Common Stocks Equity investments that have an underlying bond characteristic should have a lower RBC charge. Similar to existing guidance for SVO-identified ETFs reported on Schedule D-1, are treated as bonds.	Referred from CADTF Referral from SAPWG 8/13/2018	10/8/19 - Exposed for a 30-day Comment period ending 11/8/2019 3-22-20 - Tabled discussion pending adoption of the bond structure and factors.	1/12/2022 10/11/2018
IR3	RBC IRE	2	2023-2024 or later	Structured Notes - defined as an investment that is structured to resemble a debt instrument, where the contractual amount of the instrument to be paid at maturity is at risk for other than the failure of the borrower to pay the contractual amount due. Structured notes reflect derivative instruments (i.e., put option or forward contract) that are wrapped by a debt structure.	Referred from CADTF Referral from SAPWG April 16, 2019	10/8/19 - Exposed for a 30-day Comment period ending 11/8/2019 3-22-20 - Tabled discussion pending adoption of the bond structure and factors.	1/12/2022 8/4/2019
IR4	RBC IRE	2	2023-2024 or later	Comprehensive Fund Review for investments reported on Schedule D Pt 2 Sn2	Referred from CADTF Referral from VOSTF 9/21/2018	Discussed during Spring Mtg. NAIC staff to do analysis. 10/8/19 - Exposed for a 30-day comment period ending 11/8/19 3-22-20 - Tabled discussion pending	1/12/2022 11/16/2018

2024 #	Owner	2024 Priority	Expected Completion Date	Working Agenda Item	Source	Comments	Date Added to Agenda
New Items – RBC IR & E							
IR5			2023-2024 or later	Evaluate the appropriate RBC treatment of Asset-Backed Securities (ABS), including Collateralized Loan Obligations (CLO), collateralized fund obligations (CFOs), or other similar securities carrying similar types of tail risk (Complex Assets).	Request from E Committee, SAPWG, VOSTF	Per the request of E Committee comments were solicited asking if these types of assets should be considered a part of the RBC framework.	1/12/2022
IR6			2023-2024 or later	Evaluate the appropriate RBC treatment of Residual Tranches.	Request from E Committee, SAPWG, VOSTF	Per the request of E Committee comments were solicited asking if these types of assets should be considered a part of the RBC framework.	1/12/2022
IR7			2025 or later	Phase 2 Bond analysis - evaluate and develop an approach to map other ABS to current bond factors following the established principles from Phase I where the collateral has an assigned RBC. This project will likely require an outside consultant and the timeline could exceed 2-3 years.	Request from E Committee	Per the request of E Committee comments were solicited requesting the need for outside review.	1/12/2022
IR8	RBC IRE		2023-2024 or later	Address the tail risk concerns not captured by reserves for privately structured securities.	Referral from the Macroprudential (E) Working Group		8/11/2022
New Items – RBC IR & E							
<u>IR9</u>	<u>RBC IRE</u>		<u>2024 or later</u>	<u>Develop a structure proposal to reflect the split of the Annual Statement, Schedule D, Part 1 into two schedules pursuant to the SAPWG adopted bond project for all lines of business.</u>	<u>CADTF</u>		
Ongoing Items – P&C RBC							
P1	Cat Risk SG	1		Continue development of RBC formula revisions to include a risk charge based on catastrophe model output:			
			Year-end 2024 or later	a) Evaluate other catastrophe risks for possible inclusion in the charge - determine whether to recommend developing charges for any additional perils, and which perils or perils those should be.	Referral from the Climate and Resiliency Task	12/2/23 Proposal 2023-15-CR (Convective Storm for Informational	4/26/2021

					Force. March 2021	Purposes-Only Structure) was exposed for a 60-day comment period at the Joint P/C RBC and Cat Risk SG meeting. 03/17/24 Proposal 2023-15-CR was adopted by the Subgroup, Working Group, and the Task Force during the Spring National Meeting 4/23/24 Proposal 2023-17-CR was adopted during April 23 interim Cat Risk SG meeting. 4/25/24 Proposal was adopted during the April 25 PCRBC WG interim meeting.	
P2	PCRBCWG	1	Ongoing	Review and analyze the P/C RBC charges that have not been reviewed since developed.			3/23/2023
Carryover Items Currently being Addressed – P&C RBC							
P3	P&C RBC WG	1	Year-end 2025 or later	Evaluate a) the current growth risk methodology whether it is adequately reflects both operational risk and underwriting risk; b) the premium and reserve based growth risk factors either as a stand-alone task or in conjunction with the ongoing underwriting risk factor review with consideration of the operational risk component of excessive growth; c) whether the application of the growth factors to NET proxies adequately accounts for growth risk that is ceded to reinsures that do not trigger growth risk in their own right. <i>Referral to the Academy:</i> https://naiconline.sharepoint.com/teams/FRSRBC/PRBC/2018%20Calls%20-%20PRBC/PCRBC/06_14/attC01_Growth%20Risk%20Referral%20to%20Academy.pdf	Referral from Operational Risk Subgroup	1) Sent a referral to the Academy on 6/14/18 conference call.	1/25/2018
P4	P&C RBC WG	1	2024 Summer Meeting or later	Continue working with the Academy to review the methodology and revise the underwriting (Investment Income Adjustment, Loss Concentration, LOB UW risk) charges in the PRBC formula as appropriate.		11/16/23 The Academy provided a presentation on their Underwriting Risk Report at the Joint	6/10/2019

						<p>PCRBC And Cat Risk SG meeting. <u>3/17/23 Proposal 2024-11-P was exposed for a 30-day public comment period during the Spring National Meeting.</u> <u>4/25/24 Proposal 2024-11-P was adopted during the PCRBCWG interim meeting.</u></p>	
P5	P&C RBC WG	1	2025 Summer Meeting or later	Evaluate the Underwriting Risk Line 1 Factors in the P/C formula.			7/30/2020
P6	Cat Risk SG	1	2025 Spring Meeting	Quantify the R5 Ex-cat Factors for wildfire peril (for informational purposes only) Evaluate the possibility of adding PR018A to determine the R5 including <u>excluding</u> the wildfire peril <u>in additional to earthquake, and hurricane.</u>			3/21/2023
P7	Cat Risk SG	2	2025 Spring Meeting	Evaluate the impact of flood peril to the insurance market			3/21/2023
P8	PCRBCWG	1	2024 Spring Meeting	Adding pet insurance line in the RBC PR017, 018, 035 and RBC Schedule P, parts due to the adoption of the Annual Statement Blanks proposal 2023-01BWG.		<p>12/2/23 Proposal 2023-14-P (Pet Insurance) was exposed for a 60-day comment period at the Joint P/C RBC and Cat Risk SG meeting. 2/21/24 Proposal 2023-01BWG was adopted at the BWG Interim Meeting. <u>3/17/24 Proposal 2023-14-P was adopted by the Subgroup, Working Group, and the Task Force during the Spring National Meeting</u></p>	7/27/2023

P9	Cat Risk SG	1	2024 Summer Meeting	Create a new disclosure to collect more information of insurers catastrophe reinsurance programs. Referral from Reinsurance (E) Task Force: https://naiconline.sharepoint.com/teams/FRSRBC/PRBC/2024%20Calls%20-%20Joint/03_17_NM/Att2c_%20Referral%20from%20RTF%20to%20PCRBCWG%20(1).doc x	Referral from Reinsurance (E) Task Force	<u>11/16/23 Received a referral and proposal from RTF.</u> <u>12/2/23 Proposal 2023-13-CR (Cat Risk Insurance Program Interrogatory) was exposed for a 60-day comment period at the Joint PCRBC and Cat Risk SG meeting.</u> <u>3/17/24 Proposal 2023-13-CR was adopted by the Subgroup, Working Group, and the Task Force during the Spring National Meeting.</u>	2/20/2024
P10	PCRBCWG	1	2024 Summer Meeting	Update PR019, Line 25 Annual Statement Source and the Statement Value to avoid double-counting on Stop-Loss premium.		<u>3/17/24 Proposal 2024-10-P was exposed for a 30-day public comment period during the Spring National Meeting.</u> <u>4/25/24 Proposal was adopted during 4/25 PCRBCWG interim meeting.</u>	2/20/2024
P11	Cat Risk SG	1	2024 Summer Meeting	Create additional Rcat pages to collect commercial Cat modelers product information known as “Climate Conditioned Catalogs”, which would provide an estimate of climate change for hurricane and wildfire.	From Solvency Workstream of the Climate & Resiliency (EX) Task Force	<u>1/29/24 Proposal 2023-17-CR was exposed for a 30-day public comment period at the Cat Risk SG Interim Meeting on Jan. 29.</u> <u>3/17/24 Proposal 2024-10-P was re-exposed for a 22-day public comment period during the</u>	1/29/2024

						Spring National Meeting.	
P12	PCRBWGW	1	2024 Spring Meeting	Change the RBC Schedule P short-tail lines to vendor link, which will pull directly from the Annual Statement, Schedule P short-tail lines as the adopted blanks proposal 2023-16BWGW modified the Schedule P short-tail lines to show 10 years of data beginning in 2024.		2/21/24 Blanks Proposal 2023-16BWGW was adopted at the BWGW meeting 3/17/24 Proposal 2024-01-P was adopted by the Subgroup, Working Group, and the Task Force during the Spring National Meeting.	
New Items – P&C RBC							
P13P10	Cat Risk SGPCRBCWGW	21	2025 Fall Meeting 2024 Summer Meeting	<u>Consider:</u> 1) further investigating all geographic concentration related issues, possibly modifying the property and casualty (P/C) risk-based capital formulasUpdate PR019, Line 25 Annual Statement Source and the Statement Value to avoid double-counting on Stop-Loss premium.		6/10/24 Exposed a referral from the Tas Force for a 30-day comment period ending July 10.	2/20/2024
2024 #	Owner	2024 Priority	Expected Completion Date	Working Agenda Item	Source	Comments	Date Added to Agenda
Ongoing Items – Health RBC							
X1	Health RBC WG	Yearly	Yearly	Evaluate the yield of the 6-month U.S. Treasury Bond as of Jan. 1 each year to determine if further modification to the Comprehensive Medical, Medicare Supplement and Dental and Vision underwriting risk factors is required. Any adjustments will be rounded up to the nearest 0.5%.	HRBCWGW	Adopted 2022-16-CA (YE-2023) Exposed 2024-09-CA (YE-2024) Adopted 2024-09-CA (YE-2024)	11/4/2021
X2	Health RBC WG	3	Ongoing	Continue to monitor the Federal Health Care Law or any other development of federal level programs and actions (e.g., state reinsurance programs, association health plans, mandated benefits, and cross-border) for future changes that may have an impact on the Health RBC Formula.	4/13/2010 CATF Call	Adopted 2014-01H Adopted 2014-02H Adopted 2014-05H Adopted 2014-06H Adopted 2014-24H Adopted 2014-25H Adopted 2016-01-H Adopted 2017-09-CA Adopted 2017-10-H The Working Group will continually evaluate any changes	

						to the health formula because of ongoing federal discussions and legislation.	1/11/2018
						Discuss and monitor the development of federal level programs and the potential impact on the HRBC formula.	
Carryover Items Currently being Addressed – Health RBC							
X3	Health RBC WG	2	Year-End 2025 RBC or Later	Consider changes for stop-loss insurance or reinsurance.	AAA Report at Dec. 2006 Meeting	(Based on Academy report expected to be received at YE-2016) 2016-17-CA Adopted proposal 2023-01-CA	
X4	Health RBC WG	2	Year-end 2025 RBC or later	Review the individual factors for each health care receivables line within the Credit Risk H3 component of the RBC formula.	HRBC WG	Adopted 2016-06-H Rejected 2019-04-H Annual Statement Guidance (Year-End 2020) and Annual Statement Blanks Proposal (Year-End 2021) referred to the Blanks (E) Working Group Adopted 2024-12-H (MOD)	
X54	Health RBC WG	1	Year-end 2025 RBC or later	Work with the Academy to perform a comprehensive review of the H2 - Underwriting Risk component of the health RBC formula including the Managed Care Credit review. (Item 18 above) Review the Managed Care Credit calculation in the health RBC formula - specifically Category 2a and 2b. Review Managed Care Credit across formulas. As part of the H2 - Underwriting Risk review, determine if other lines of business should include investment income and how investment income would be incorporated into the existing lines if there are changes to the structure.	HRBCWG	Review the Managed Care Category and the credit calculated, more specifically the credit calculated when moving from Category 0 & 1 to 2a and 2b.	4/23/2021 12/3/2018

X6	Health RBC WG	1	Year-end 2025 or later	Review referral letter from the Operational Risk (E) Subgroup on the excessive growth charge and the development of an Ad Hoc group to charge.	HRBCWG	Review if changes are required to the Health RBC Formula	4/7/2019
X75	Health RBC WG	3	Year-End 2025 or later	Discuss and determine the re-evaluation of the bond factors for the 20 designations.	Referral from Investment RBC July/2020	Working Group will use two- and five-year time horizon factors in 2020 impact analysis. Proposal 2021-09-H - Adopted 5/25/21 by the WG	9/11/2020
New Items – Health RBC							
2024 #	Owner	2024 Priority	Expected Completion Date	Working Agenda Item	Source	Comments	Date Added to Agenda
Ongoing Items – Task Force							
CA1	CADTF	2	2023	Affiliated Investment Subsidiaries Referral Ad Hoc group formed Sept. 2016	Ad Hoc Group	Structural and instructions changes will be exposed by each individual working group for comment in 2022 with an anticipated effective date of 2023. Proposal 2022-09-CA was adopted at the 2022 Summer Meeting. Proposal 2022-09-CA MOD was adopted at the 2023 Spring Meeting. Proposal 2023-12-CA was adopted at the 2023 Fall Meeting. Editorial Proposal 2024-08-CA will be exposed on 3/17/24 for a 30-day public comment. Proposal 2024-08-CA was adopted at the	

						2024 Spring National Meeting. Proposal adopted during 4/30 TF interim meeting.	
CA2			Ongoing	All investment related items referred to the RBC Investment Risk & Evaluation (E) Working Group		Proposal 2024-02-CA (Residual Structure PC & Health) was exposed for comment ending Mar. 2. 3/17/24 – the TF exposed this proposal for a 30-day public comment period. 4/30/24- the RG adopted this structure proposal. 6/28/24-the TF adopted proposal 2024-18-CA to retain 20% charge for the	1/12/2022

							<u>Total Residual Tranches or Interests.</u>	
CA3	CADTF	3	Ongoing	Receivable for Securities factor			Consider evaluating the factor every 3 years. (2024, 2027, 2030 etc.) Factors will be exposed for comments in April 2024. <u>6/28/24 - the TF adopted proposal 2024-13-CA.</u>	
CA4	CADTF	1	2026 or later	Established the Risk Evaluation Ad Hoc Group to: b) Evaluate the RBC factors. c) Potentially develop an evaluating process. d)a) Prioritize those factors that require reviewing.			<u>7/26/23 – the Risk Evaluation Ad Hoc Group established 3 Ad Hoc Subgroup to focus on different issues: 1) RBC Purposes & Guidelines Ad Hoc Subgroup; 2) Asset Concentration Ad Hoc Subgroup; and 3) Geographic Concentration Ad Hoc Subgroup.</u>	<u>03/23/2023</u>
CA54	CADTF	1	Ongoing	Update the annual investment income adjustment to the comprehensive medical, medicare supplement, and dental and vision factors.			<u>4/30/24 – the TF exposed proposal 2024-09-CA for a 30-day public comment period.</u> <u>6/28/24 – the TF adopted the proposal.</u>	<u>4/30/2024</u>
CA5	CADTF	2	2024 or later	Evaluate if changes should be made in the RBC formula to reflect the split of the Annual Statement, Schedule D, Part 1 into two sections. <i>Referral:</i> SCDPT1	Blanks WG and SAPWG		<u>12/2/23 – the TF agreed to send a referral to the RBCIREWG to continue reviewing this issue.</u>	<u>12/2/2023</u>
CA6	CADTF	2	2024 or later	Evaluate if changes should be made in the RBC formula to reflect the possible changes in the Annual Statement, Schedule BA proposal for non-bond debt securities <i>Referrals:</i> SCBAPT1	Blanks WG and SAPWG		<u>12/2/23 – the TF received a referral from SAPWG regarding the possible</u>	<u>12/2/2023</u>

						Annual Statement reporting for debt securities that do not qualify as bonds on Schedule BA. TF agreed to forward the referral along with the ACLI comment to the RBCIREWG.	
CA7CA65	CADTF	2	2024-2025 or later	Evaluate if changes should be made in the RBC formula to reflect the possible changes in Schedule BA Collateral Loan reporting, including structural changes to RBC blanks and forecasting and changes of risk charges that commensurate with underlying collateral type. <i>Referral from Statutory Accounting Principles (E) Working Group:</i> https://naiconline.sharepoint.com/teams/FRSRBC/Capital%20Adequacy%20CapAd%20Task%20Force/2024%20Calls/03_17NM/Att14Collateral%20Loan%20Memo%20to%20Multiple%20Groups.docx		1/23/24 – the TF received a referral from SAPWG regarding collateral loan reporting changes 3/26/24 – the TF exposed this referral for a 45-day public comment period. 6/28/24 – the SAPWG provided updates on this project.	1/23/2024
CA8CA76	CADTF	2	2024 or later	Review the proposal from the ACLI to modify the treatment of repurchase agreements in the Life RBC formula to determine whether its possible application to P/C and Health formulas. <i>Referral from Life Risk-Based Capital (E) Working Group:</i> Att16_2024-06-CA Repurchase Agreements P&C and Health.pdf	Life RBC WG	1/25/24 – the TF received a referral from LRBCWG. Proposal 2024-06-CA (Repurchase Agreements PC & Health) was exposed for comment ending Mar.2. 3/17/24 – the TF exposed this referral for a 30-day public comment period.	1/25/2024
CA9	CADTF	2	2024 or later	Establish a long term approach for the issue of the negative interest maintenance reserve (IMR) <i>Referrals:</i> Negative IMR	SAPWG	12/2/23 – the TF agreed to forward the referral to LRBCWG.	12/2/2023
Carryover Items Currently being Addressed – Task Force							

New Items –Task Force							
CA87	CADTF	1	2024 or later	<p><u>Review the possibility of establishing a new Working Group to evaluate the non-investment risk issues.</u></p> <p>a) <u>Review the possibility of removing the TAC and ACL amounts I the annual statement’s five-year historical data page.</u></p> <p>b) <u>Re-evaluate some of the missing non-investment risks to determine whether the Task Force should include them in the RBC calculation or if it should appropriately handle those risks utilizing other regulatory methods.</u></p> <p>c) <u>Review those non-investment factors and instructions that have not been reviewed since being developed to determine if modifications should be made.</u></p>			4/30/2024
CA98	CADTF	2	2025 or later	<u>Review the RBC Preamble to determine whether additional modification is required to clarify and emphasize the purposes and intent of using RBC.</u>	RBC Purposes & Guidelines Ad Hoc Subgroup		4/30/2024
CA109	CADTF	2	2025 or later	<u>Evaluate if changes should be made in the RBC formula to reflect the possible changes in the existing low-income housing tax credit investment lines in the RBC formulas to allow the expansion of including any type of state or federal tax credit program.</u>	SAPWG	4/30/24 – the referral was exposed for a 30-day public comment period. 6/28/24 – the SAPWG provided updates on this project.	4/30/2024

Historical Comments:

P1:

- 4/26/21 - The SG exposed the referral for a 30-day period.
- 6/1/21 - The SG forwarded the response to the Climate and Resiliency Task Force.
- 2/22/22 - The SG adopted proposal 2021-17-CR (adding the wildfire peril for informational purposes only). The SG continues reviewing other perils for possible inclusion in the Rcat.
- 8/11/22 – The TF adopted Proposal 2022-04-CR (2013-2021 Wildfire Event Lists)
- 9/26/22 – The SG formed an ad hoc group to conduct review on severe convective storm models.
- 7/18/23-The SG is finishing reviewing the following SCS vendor models: RMS, Verisk, KCC, and Corelogic.
- 12/2/23-Proposal 2023-15-CR (Convective Storm for Informational Purposes Only Structure) was exposed for a 30-day comment period at the Joint P/C RBC and Cat Risk SG meeting.

CA1:

1. Structural and instructions changes will be exposed by each individual working group for comment in 2022 with an anticipated effective date of 2023.
2. Proposal 2022-09-CA MOD was adopted at the 2023 Spring Meeting.
3. Proposal 2023-12-CA was adopted at the 2023 Fall Meeting.
4. Editorial Proposal 2024-08-CA will be exposed on 3/17/24 for a 30-day public comment.

**PROCEDURES OF THE FINANCIAL CONDITION (E) COMMITTEE'S
CAPITAL ADEQUACY TASK FORCE IN CONNECTION WITH PROPOSED AMENDMENTS TO RISK-BASED
CAPITAL BLANKS AND INSTRUCTIONS**

The following establishes procedures and rules of the Financial Condition (E) Committee's Capital Adequacy Task Force (Task Force) and its Working Groups with respect to proposed amendments to the NAIC RBC Forecasting (blanks) and Instructions.

1. The Task Force may consider relevant proposals to change the RBC blanks and instructions at the national meeting or designated interim meeting as scheduled by the Task Force.
2. All proposals for suggested changes and amendments shall use NAIC Proposal Forms and shall be stated in a concise and complete manner and include the appropriate blank and instruction modifications. The Proposal Form and its instructions are available online under related documents and resources at https://content.naic.org/cmte_e_capad.htm. All interested party proposals should be emailed to the appropriate NAIC staff support with a completed proposal form and mocked-up changes.

The following guidelines apply:

- Although proposal shall be exposed throughout the year to allow ample time for consideration, any proposals that affect an RBC blank (e.g. all pages after LR001, PR001, XR001) must be exposed by the Task Force or its Working Groups no later than March 31 of the effective year of the change. - The proposal must be adopted by the Task Force no later than May 15 of the effective year of the change.
- Any proposal that only affects the instructions or factors must be exposed by the Task Force / Working Group by May 15 and adopted by the Task Force by June 30 of the current year.
- Only the Task Force may extend the June 30th adoption deadline for previously considered proposals upon a -two-thirds- consent of the Task Force members present where such extension can be no later than July 30th of the current year. This would be considered only in rare circumstances where urgency of such adoption is high and implementation by the RBC software vendors is feasible. The two-thirds consent applies only in the instance of a Task Force vote that is outside of the standard RBC adoption deadlines (May 15 and June 30).

An illustration of the proposed change to the RBC blank, factors, or instructions should accompany the Proposal Form. In addition, an impact analysis is preferred for any factor change. If another NAIC Committee, Task Force or Working Group is known to have considered this proposal, that Committee, Task Force or Working Group should provide any relevant information.

The Task Force/Working Groups will review the proposal and determine whether to receive the proposal and expose for public comment (initial exposure of at least 30-days to ensure adequate time to provide comment on any structural change, unless a shorter exposure is approved by the Task Force or Working Groups) or to reject the proposal. The comment period shall end at least 3 business days prior to the next designated national or interim meetings of the Task Force/ Working Group. The Task Force/Working Group will consider comments received on each proposal at its next meeting. Proposals under consideration may be deferred by the Task Force/Working Group if the proposal has merit but warrants additional work or input. The Task Force may also refer proposals to other NAIC groups due to their technical expertise or for additional review. If a proposal has been referred to another NAIC group it will be considered again after comments/recommendations are received. The Task Force will review and adopt the working agenda at each National Meeting, if necessary, to ensure all items designated as a priority 1 are being addressed, to add or delete items that have been addressed or to reprioritize the remaining items on the working agenda.

3. Interested Party proposals filed with the appropriate NAIC staff support shall be considered at the next regularly scheduled meeting of the Task Force/Working Group if the proposal is filed at least fifteen business days prior to the meeting.
4. The NAIC staff support shall prepare the meeting materials including all suggested proposals. Interim meeting

materials will be posted no later than three business days prior to the scheduled meeting on the NAIC website. Initial national meeting materials will be posted ten business days before the first day of each National Meeting on the NAIC website. Materials posted ten business days in advance of the National Meeting will not be printed for distribution.

5. At each meeting, the Task Force/Working Group will review comments that were received by the comment exposure due date for suggested proposals.
6. NAIC staff support will incorporate any editorial changes discovered in the annual updates of the RBC formulas e.g., reference changes due to new SSAPs or annual statement references. NAIC staff support may also request that the Task Force/Working Group reconsider items adopted, if these items contain substantial -modifications.
7. The Task Force/Working Group may, when deemed necessary, appoint an Ad Hoc Group to study proposals and/or certain issues.
8. The NAIC will publish the RBC Forecasting and Instructions for the next subsequent year on, or about November 1 each year. The following documentation will be posted to the NAIC Web site:
 - RBC Proposals adopted by the Task Force (after each interim and National Meeting)
 - Annual RBC Newsletters (after Summer National Meeting)
 - Annual RBC Statistics (after Summer National Meeting)
 - Working Agenda (after each National Meeting)
 - Any subsequent corrections to these publications (as needed)

Draft: 8/14/24

Adopted by the Executive (EX) Committee and Plenary, Dec. xx, 2024

Adopted by the Financial Condition (E) Committee, Dec. xx, 2024

Adopted by the Capital Adequacy (E) Task Force, TBD

2025 Proposed Charges

CAPITAL ADEQUACY (E) TASK FORCE

The mission of the Capital Adequacy (E) Task Force is to evaluate and recommend appropriate refinements to capital requirements for all types of insurers.

Ongoing Support of NAIC Programs, Products, or Services

1. The **Capital Adequacy (E) Task Force** will:
 - A. Evaluate emerging “risk” issues for referral to the risk-based capital (RBC) working groups/subgroups for certain issues involving more than one RBC formula. Monitor emerging and existing risks relative to their consistent or divergent treatment in the three RBC formulas.
 - B. Review and evaluate company submissions for the schedule and corresponding adjustment to total adjusted capital (TAC).
 - C. Evaluate relevant historical data and apply defined statistical safety levels over appropriate time horizons in developing recommendations for revisions to the current asset risk structure and factors in each of the RBC formulas.

2. The **Health Risk-Based Capital (E) Working Group, Life Risk-Based Capital (E) Working Group, and Property and Casualty Risk-Based Capital (E) Working Group** will:
 - A. Evaluate refinements to the existing NAIC RBC formulas implemented in the prior year. Forward the final version of the structure of the current year life and fraternal, property/casualty (P/C), and health RBC formulas to the Financial Condition (E) Committee by June.
 - B. Consider improvements and revisions to the various RBC blanks to: 1) conform the RBC blanks to changes made in other areas of the NAIC to promote uniformity; and 2) oversee the development of additional reporting formats within the existing RBC blanks as needs are identified. Any proposal that affects the RBC structure must be adopted no later than ~~April 30~~ May 15 of the reporting year, and any proposal that affects the RBC factors and/or instructions must be adopted no later than June 30 of the reporting year. Adopted changes will be forwarded to the Financial Condition (E) Committee by the next scheduled meeting or conference call. Any adoptions made to the annual financial statement blanks or statutory accounting principles that affect an RBC change adopted by June 30 and result in an amended change may be considered and adopted by July 30, where the Capital Adequacy (E) Task Force votes to pursue by ~~super-majority (two-thirds)~~ consent of members.
 - C. Monitor changes in accounting and reporting requirements resulting from the adoption and continuing maintenance of the revised *Accounting Practices and Procedures Manual* (AP&P Manual) to ensure that model laws, publications, formulas, analysis tools, etc. supported by the Task Force continue to meet regulatory objectives.
 - D. Review the effectiveness of the NAIC’s RBC policies and procedures as they affect the accuracy, audit ability, timeliness of reporting access to RBC results, and comparability among the RBC formulas. Report on data quality problems in the prior year RBC filings at the summer and fall national meetings.

3. The **Variable Annuities Capital and Reserve (E/A) Subgroup** of the Life Risk-Based Capital (E) Working Group

and the Life Actuarial (A) Task Force will:

- A. Monitor the impact of the changes to the variable annuities (VA) reserve framework and RBC calculation and determine if additional revisions need to be made.
 - B. Develop and recommend appropriate changes, including those to improve the accuracy and clarity of VA capital and reserve requirements.
4. The **Longevity Risk (E/A) Subgroup** of the Life Risk-Based Capital (E) Working Group and the Life Actuarial (A) Task Force will:
- A. Provide recommendations for the appropriate treatment of longevity risk transfers by the new longevity factors.
5. The **Catastrophe Risk (E) Subgroup** of the Property and Casualty Risk-Based Capital (E) Working Group will:
- A. Recalculate the premium risk factors on an ex-catastrophe basis, if needed.
 - B. Continue to update the U.S. and non-U.S. catastrophe event list.
 - C. Continue to evaluate the need for exemption criteria for insurers with minimal risk.
 - D. Evaluate the RBC results inclusive of a catastrophe risk charge.
 - E. Refine instructions for the catastrophe risk charge.
 - F. Continue to evaluate any necessary refinements to the catastrophe risk formula.
 - G. Evaluate other catastrophe risks for possible inclusion in the charge.
6. The **RBC Investment Risk and Evaluation (E) Working Group** will:
- A. Perform a comprehensive review of the RBC investment framework for all business types, which could include:
 - i. Identifying and acknowledging uses that extend beyond the purpose of the *Risk-Based Capital (RBC) for Insurers Model Act* (#312).
 - ii. Assessing the impact and effectiveness of potential changes in contributing to the identification of weakly capitalized companies; i.e., those companies at action levels.
 - iii. Documenting the modifications made over time to the formulas, including, but not limited to, an analysis of the costs in study and development, implementation (internal and external), assimilation, verification, analysis, and review of the desired change to the RBC formulas and facilitating the appropriate allocation of resources.
7. The **Generator of Economic Scenarios (GOES) (E/A) Subgroup** of the Life Risk-Based Capital (E) Working Group and the Life Actuarial (A) Task Force will:
- A. Monitor that the economic scenario governance framework is being appropriately followed by all relevant stakeholders involved in scenario delivery.
 - B. Review material economic scenario generator updates, either driven by periodic model maintenance or changes to the economic environment and provide recommendations.
 - C. Regularly review key economic conditions and metrics to evaluate the need for off-cycle or significant economic scenario generator updates and maintain a public timeline for economic scenario generator updates.
 - D. Support the implementation of an economic scenario generator for use in statutory reserve and capital calculations.
 - E. Develop and maintain acceptance criteria that reflect history as well as plausibly more extreme scenarios.

NAIC Support Staff: Eva Yeung



TO: Nathan Houdek (WI), Chair of the Financial Condition (E) Committee
Michael Wise (SC), Co-Vice Chair of the Financial Condition (E) Committee
Cassie Brown (TX), Co-Vice Chair of the Financial Condition (E) Committee

FROM: Tom Botsko (OH), Chair of the Capital Adequacy (E) Task Force

DATE: July 31, 2024

RE: Request for a New Working Group

The Capital Adequacy (E) Task Force, along with the RBC working groups, are requesting a new working group be appointed to review non-investment related factors that affect the RBC formula. When necessary, other groups will be contacted for their expertise. This new working group, the Risk-Based Capital Risk Research (E) Working Group, would be charged with performing a comprehensive review of the RBC framework for all business types, which could include: 1) identifying and acknowledging uses that extend beyond the purpose of the *Risk-Based Capital (RBC) Model Act* (#312); 2) assessing the impact and effectiveness of potential changes that would contribute to the identification of weakly capitalized companies (i.e., those companies at action level); and 3) documenting the modifications made over time to the formulas, including, but not limited to an analysis of the costs in:

- Study and development.
- Implementation (internal and external).
- Assimilation.
- Verification.

Since the inception of the RBC formulas in the early 1990s, many of the risk factors have not been evaluated/updated for the appropriateness of the initial risk charge.

We believe that a regularly scheduled analysis of these risk charges is necessary to maintain the accuracy of the formula and to stay current with economic conditions. We also understand that the Insurance Core Principles (ICPs) speak to the periodic review of the solvency framework. This proposed working group would work in parallel with these principles to review and maintain appropriate RBC charges.

Another important aspect of this working group would be to maintain documentation of the analysis and the background of the charge. At various times, the RBC working groups have reached out to the original members of the group that created the RBC formulas to better understand the thought process/reasons for some of the original charges.

As the proposals are discussed and adopted by this new group, they will move up to the Task Force for further discussion. The Task Force will then decide if this should be discussed and adopted at the Task Force level or be sent down to the individual RBC working groups. Each proposal will have different circumstances and will be handled accordingly.

As the insurance environment evolves both domestically and internationally, it is imperative that our organization stays current. The development of group capital within the NAIC is an indicator that our organization needs to maintain appropriate and current methodology.

Thank you for taking the time to review this request. We are available to discuss this with you at your convenience.

Please contact Eva Yeung, NAIC staff support for the Capital Adequacy (E) Task Force, at with any questions.

Cc: Dan Daveline; Eva Yeung; Maggie Chang; Kazeem Okosun Derek Noe; Dave Fleming; Julie Gann