Draft date: 8/5/24

2024 Summer National Meeting
Chicago, Illinois

RISK-BASED CAPITAL INVESTMENT RISK AND EVALUATION (E) WORKING GROUP
Wednesday, August 14, 2024
8:00 – 9:00 a.m.
McCormick Place Convention Center—S105—Level 1

ROLL CALL

Philip Barlow, Chair	District of Columbia	Tadd Wegner	Nebraska
Thomas Reedy, Vice Chair	California	Jennifer Li	New Hampshire
Wanchin Chou	Connecticut	Bob Kasinow/Bill Carmello	New York
Ray Spudeck/Carolyn Morgan	Florida	Dale Bruggeman/Tom Botsko	Ohio
Vincent Tsang	Illinois	Rachel Hemphill	Texas
Roy Eft	Indiana	Doug Stolte	Virginia
Carrie Mears/Kevin Clark	Iowa	Steve Drutz/Katy Bardsley	Washington
Fred Andersen	Minnesota	Amy Malm	Wisconsin
William Leung/Debbie Doggett	Missouri		

NAIC Support Staff: Dave Fleming/Julie Gann

AGENDA

1. Consider Adoption of its June 21, May 22, April 12, and Spring National Meeting Minutes—*Philip Barlow (DC)* — Attachments A–D

2. Receive Updates from the Valuation of Securities (E) Task Force and the Statutory Accounting Principles (E) Working Group—*Philip Barlow (DC)*

3. Hear an Update from the American Academy of Actuaries (Academy) —*Philip Barlow (DC)*

4. Discuss Referrals Related to Funds—*Philip Barlow (DC)* — Attachments E–G

5. Consider Adoption of its Working Agenda—*Philip Barlow (DC)* — Attachment H

6. Discuss its Next Steps—*Philip Barlow (DC)*

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

8. Adjournment

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 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 (Attachment 1). 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 (Attachment 2). 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 (Attachment 3). 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 (Attachment 4). 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 (Attachment 5). 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 (Attachment 6). 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 (Attachment 7). 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 (Attachment 8). 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 (Attachment 9). No representative spoke on the comment letter.

Gordan Gray (Pinpoint Policy Institute) presented a comment letter (Attachment 10). 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 (Attachment 11 and Attachment 12, respectively). 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. 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.

SharePoint/NAIC Support Staff Hub/Committees/Committee Folders/E CMTE/CADTF/2024_Summer/RBCIRE/RBC Investment Risk 6-21-24 Minutes.docx

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 1). 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 2). 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 3 and 4). 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 insures 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 (RBMS) 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 Virgina 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.

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 1). 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 2). 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. <u>Discussed Comment Letters Received on the Oliver Wyman Report</u>

Bryan Bashur (Americans for Tax Reform—ATR) presented a comment letter (Attachment 3). 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 (Attachment 4, Attachment 5, Attachment 6, Attachment 7, Attachment 8, and Attachment 9). No representatives spoke on these comment letters.

Isaac Schick (American Consumer Institute—ACI) presented a comment letter (Attachment 10). 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 (Attachment 11). 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 (Attachment 12). No representative spoke on the comment letter.

Amnon Levy (Bridgeway Analytics) presented a comment letter (Attachment 13). 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 (Attachment 14). 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 (Attachment 15). 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 (Attachment 16). 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 (Attachment 17). 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 (Attachment 18). 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 (Attachment 19 and Attachment 20). No representative spoke on the comment letters.

Joe Engelhard (Alternative Credit Council—ACC) presented a comment letter (Attachment 21). 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 (Attachment 22), 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 (Attachment 23). 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 (Attachment 24). 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.

SharePoint/NAIC Support Staff Hub/Committees/Committee Folders/E CMTE/CADTF/2024_Summer/RBCIRE/RBC Investment Risk 4-12-24 Minutes.docx

Draft Pending Adoption

Draft: 4/1/24

Risk-Based Capital Investment Risk and Evaluation (E) Working Group
Phoenix, Arizona
March 17, 2024

The Risk-Based Capital Investment Risk and Evaluation (E) Working Group of the Capital Adequacy (E) Task Force met in Phoenix, AZ, March 17, 2024. The following Working Group members participated: Philip Barlow, Chair (DC); Thomas Reedy, Vice Chair (CA); Wanchin Chou (CT); Carolyn Morgan and Jane Nelson (FL); Carrie Mears and Kevin Clark (IA); Vincent Tsang (IL); Roy Eft (IN); Fred Andersen (MN); Debbie Doggett (MO); Lindsay Crawford and Andrea Johnson (NE); Jennier 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 (WA); and Amy Malm (WI). Also participating was: Andrew Schallhorn (OK).

1. <u>Adopted its 2023 Fall National Meeting Minutes</u>

Eft made a motion, seconded by Botsko, to adopt the Working Group's Dec. 2, 2023, minutes (*see NAIC Proceedings – Fall 2023, Capital Adequacy (E) Task Force, Attachment*). The motion passed unanimously.

2. <u>Received Updates from the Valuation of Securities (E) Task Force and Statutory Accounting Principles (E) Working Group</u>

Mears said the Valuation of Securities (E) Task Force exposed revisions to its proposal, which describes the process the Securities Valuation Office (SVO) should utilize when identifying potential issues with individual ratings on the securities reviews. This has been referred to as the discretion proposal and as part of the investment framework from the Financial Condition (E) Committee. The Task Force received comments in January that included additional constructive feedback it would like to incorporate into the final amendment. The Task Force discussed key thematic responses to comments and staff recommendations on how some can be addressed as they prepare another revision. The Task Force reiterated to interested parties that insurers would receive full transparency into any analysis done by the SVO in its review. It also reiterated that the discretion proposals were meant to provide an avenue for the SVO when identifying individualized issues and not to address broader asset class issues, as they already have mechanisms for those purposes.

In relation to this current proposal, the Task Force also supports the current request from the Financial Condition (E) Committee to draft a request for proposal (RFP) as the first step in establishing a broader due diligence process when rating agencies apply to be a credit rating provider (CRP). The Task Force anticipates this process to be a primary mechanism to inform its reliance on CRPs, and the discretion proposal in place would be used in conjunction with that. Some commenters noted they should defer the discretion proposals as they work through aspects of the framework before the Task Force. It noted in its materials that it is a reasonable consideration but also noted that establishing the discretion process will take approximately one to two years before it can be implemented. Therefore, it expects to move forward with that process and concur with the framework discussions at the Financial Condition (E) Committee.

Mears said the current road map is for the state insurance regulators to walk through the constructive feedback received in the last round of comment letters and work with staff to expose a final draft before the Summer National Meeting. They also received an update on the collateralized loan obligation (CLO) modeling process from a structured security group at the Task Force's meeting. Eric Kolchinsky (NAIC) noted that they have been working diligently with interested parties and getting feedback on the process. They hope to run a set of stress scenarios based on some of this feedback. In addition, they have been working very closely with the American Academy of Actuaries (Academy). Mears said the timeline will be extended to year-end 2025.

Bruggeman said the Statutory Accounting Principles (E) Working Group adopted revisions to *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.* Additionally, revisions in *SSAP No. 21R—Other Admitted Assets* were adopted to incorporate a new measurement method for residual interests. Revisions to update SSAP No. 97 were also adopted. One blanks proposal is upcoming in May for approval with regard to some Schedule BA items. Revisions to *SSAP No. 26R—Bonds* were re-exposed to expand the transparency of reporting for collateral loans on Schedule BA to allow for quick identification of the type of collateral that supports admittance of collateral loans and define debt issued by funds operations.

3. <u>Heard an Update from the Academy on its Workstreams and Planned Review of the Oliver Wyman Residual Tranche Study</u>

Stephen Smith (Academy) discussed three current workstreams with comparable attributes: a review of rating methodologies from rating providers and a review of the residual tranche study. Hemphill asked Smith about the Oliver Wyman report and the Academy's conclusions. Smith said the review will be structured into six sections (one for each principle). Whether C-1 is relevant depends on how much the study aligns with the principles. Assumptions or methodology will be noted within the context of alignment with principles. Tsang asked Smith to expand on the comparable attribute candidates of CLOs. Smith said comparable attributes can be used to compare different securities within an asset class. The comparable attribute that risk-based capital (RBC) uses is an NAIC Designation for corporate bonds. The RBC system assumes that if one corporate bond is rated A and another is rated BBB, it is enough information to determine the capital charge. Another example Smith provided is commercial mortgage loans. They are based on two comparable attributes: the loan-to-value and the debt-to-service coverage ratio.

Tsang asked how many attributes there are. Smith said it would start with as many comparable attributes as possible, and then a rule of parsimony is applied to reduce it until as few as possible. It is unknown whether a small number of comparable attributes would still be useful for differentiating risk. Tsang asked about the timing of the Academy's review of the Oliver Wyman report. Smith said the Academy would provide something in early to mid-April.

Mears asked Smith to clarify whether the Academy is reviewing the methodology of the CLO or that of broader asset-backed securities (ABS). Smith said the Academy is trying to get that of the CLO right first, and hopefully, it can expand that as needed later.

4. <u>Discussed Residual Tranche Risk Analysis</u>

Kathy Belfi (Alternative Credit Council—ACC) and David Altmaier (ACC) presented highlights of the residual tranche risk analysis conducted by Oliver Wyman regarding the appropriateness of a residual interim capital charge of 45% for 2024. They asked the Working Group to consider whether an existing 30% charge remains reasonably conservative.

Joe Engelhard (Alternative Investment Management Association—AIMA) provided some context for the analysis. He said a 30% charge is considered reasonably conservative. Stolte asked if Belfi and Altmaier represent a coalition of the U.S. insurers. Altmaier said he represents Nassau Financial Group. Belfi said she represents Talcott Financial Group. Stolte asked whether these two companies are private equity controlled. Belfi said Nassau Financial Group is. Altmaier said he is not 100% certain about the ownership structure. Stolte asked Engelhard about AIMA's members. Engelhard said AIMA is a trade association with over 2000 members and includes private equity firms, private credit firms, hedge funds, some insurance members, and other companies. Stolte said RBC is a regulatory tool for state insurance regulators to identify weakly capitalized companies. He strongly believes it is incumbent upon state insurance regulators to have a reasonably conservative charge. Stolte said that in his opinion, ABS residuals act much differently than common stocks.

Clark asked what work was done to determine whether this represents what insurers hold. Engelhard said there were changes to how insurers are supposed to report their holdings of ABS residuals; therefore, it is very hard to determine that.

Carmello expressed his concern regarding a complete loss of value on the residuals. Some companies told him a 100% charge was used in their internal target surplus models. Carmello asked whether the probability of losing all value was part of the study. Engelhard said the answer is yes, and the major point of the study was to study the cash flows over time, subject to very conservative severe stress tests.

Reedy asked for more details about the study's reliance on the experience of corporate bonds during the Great Depression. Engelhard said Oliver Wyman is better positioned to provide a detailed technical answer. He said he would be glad to have Oliver Wyman follow up and explain in much greater detail.

Mears asked how results can be interpreted from a conditional tail expectation (CTE) perspective for structured securities. Hemphill said the same point in the tail for two asset classes should be looked at when the performance of one is compared to the other because they might not have the same scenarios representing the same percentiles. However, she did not see a discussion on this in the report. Engelhard said his understanding is that most NAIC charges were not determined by the three worst stress scenarios based on a very long-term time series. He said Oliver Wyman looked at the length of the study very closely and that it would be best for them to follow up and provide a more detailed answer.

Mariana Gomez-Vock (American Council of Life Insurers—ACLI) said that given the emergence of recent research by Oliver Wyman, the NAIC holistic framework, the complexities associated with ABS, and the potential for multiple RBC factors in just a few years, the ACLI respectfully requests that the Working Group consider granting a temporary, one-year delay in the implementation of the 45% factor for residual tranches. She said the factor is likely to be relatively permanent or at least very long-term for most residual ABS classes that are non-CLOs. Given the permanency of these factors, it is important to get it done right. The delay would give ACLI members more time to collaborate with state insurance regulators and the Academy to ensure that whatever proposal is put forth addresses state insurance regulators' concerns. Issuing a delay would also give time to ensure that the residual factor aligns with the Academy's principles that C-1 requirements for a given tranche should align with that tranche's risk to the extent practical. Similarly, the holistic framework includes a foundational principle that there should be equal capital for equal tail risk. Gomez-Vock said it appears that the Oliver Wyman report may show that the tranche risk can vary considerably across ABS classes.

Barlow said the Working Group determined that the 45% factor is reasonably conservative, and its implementation was delayed at the request of industry last year. He said the Oliver Wyman report does a good job of justifying the 45% factor. He said the RBC factor is a blunt tool that will not be precise for everything. It needs to be reasonably conservative, but there is no intent to punish any type of investment. Barlow said he does not think that the Working Group would consider another deferral of the implementation of the 45% factor.

Gomez-Vock said the Oliver Wyman report might justify the 45% for CLOs, but it was unclear that it justified the factor for the other ABS.

Clark said the original exposure for the interim factor last year contemplated the ability to assign three different charges. He said that he believes it was the ACLI's comment letter that supported a single factor. He said it seems to him that the reason for the other delay is that a further break out of the factor is needed.

Gomez-Vock said her understanding of the basis of the comment was that the ACLI was unsure about the process for bifurcating the tranches into different buckets. This was part of the concern and why the ACLI suggested an aggregate factor.

Barlow said he believes the Working Group is interested in continuing to look at this. The Working Group agreed to expose the Oliver Wyman report for a 21-day public comment period.

5. Discussed its Next Steps

Barlow noted a memorandum on projects the Working Group intends to tackle next. A meeting will be scheduled to discuss this further. He said NAIC staff have begun to put together some statistics based on the information in the 2023 annual statements related to the residual tranches. As was done last year, there will be a state insurance regulator version of that report. A version of the report, which does not have company-specific information, will be posted publicly on the website to make it publicly available.

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_1Spring/RBCIRE/RBC Investment Risk 3-17-24 Minutes.docx

National Association of Insurance Commissioners
& The Center for Insurance Policy and Research

MEMORANDUM

To: David Altmaier, Chair, Capital Adequacy (E) Task Force

From: Kevin Fry, Chair, Valuation of Securities (E) Task Force

Cc: Robert Carcano, Senior Counsel, NAIC Investment Analysis Office
Julie Gann, Senior Manager, NAIC Financial Regulatory Services Division

Date: September 21, 2018

Re: Referral to the Capital Adequacy Task Force - Comprehensive Fund Proposal

---

1. Introduction – In mid-2017, the SVO and FRS asked for an instruction to draft guidance for the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) to clarify eligibility of fund investments for assignment of NAIC Designations. The SVO explained that many funds are excluded from designation eligibility but are structurally identical to those permitted under the P&P Manual and the Accounting Practices and Procedures Manual (AP&PM). On Sept. 27, 2017, the Valuation of Securities (E) Task Force (VOS TF) directed NAIC staff to develop a comprehensive proposal to ensure consistent treatment for investments that involved funds that invest in bond portfolios.

2. Background – The VOS TF has permitted more appropriate treatment to funds that invest in bonds and possess other defined characteristics since 1991, as summarized below:

- 1991 – Money market mutual funds that hold short-term U.S. Treasuries - exempted from reserve.[1]
- 1992 – Funds holding U.S. direct and full faith and credit obligations - exempted from reserving
- 1992 – Funds holding high quality corporate bonds & U.S. Government obligations - reserve as NAIC 1 bonds[2].
- 1995 – Short-term bond funds - holding high quality corporate & U.S./GSO obligations) - Schedule D; market value & reserved as bonds for AVR and RBC[3].
- 2003 – Exchange Traded Funds that held bonds – report as bonds.[4]
- 2005 – BA assets with fixed income characteristics can be assigned NAIC Designations.[5]
- 2017 – SVO authorized to assign NAIC Designations to private Schedule BA funds, joint ventures or partnership interests if underlying investments are fixed-income like to align with Annual Reporting Instruction.[6]

Significant efforts have also been made to align guidance in the P&P Manual and the AP&PM for this investment, as summarized below:

- Investments in money market mutual funds are reported as cash equivalents under SSAP No. 2R without an NAIC Designation.
- SVO-Identified Bond ETFs are reported as bonds under SSAP No. 26R with an NAIC designation as assigned by the SVO.
- SVO-Identified Preferred Stock ETFs are reported as preferred stock under SSAP No. 32 with an NAIC designation as assigned by the SVO.

[1] NAIC Proceedings 1991 Vol I-A pages 505, 520, 531
[2] NAIC Proceedings, 1993 Vol 1B, page 770; and Nov. 9, 1992 minutes of the IMR/AVR Study Group
[3] NAIC Proceedings, 1995 2Q, pages 419, 437, 467 – 472
[4] NAIC Proceedings 2003 1Q, page 730; 2003 2Q, pages 810 - 813; 4Q page, 1859
[5] NAIC Proceedings, 2001 3Q, page 802, 834, 841 and 845; 4Q Vol II, page 1302 and 2005, 4Q page 2067.
[6] See the minutes of the Valuation of Securities (E) Task Force conference call held November 13, 2017

- Investments in ETFs (not captured on an SVO listing) are reported as common stock under SSAP No. 30 without an NAIC designation.
- SVO-Identified Bond Mutual Funds are reported under SSAP No. 26R with an NAIC 1 designation.
- All other mutual funds (regardless of what they hold, if they are not on an SVO listing) are reported under SSAP No. 30 without an NAIC designation.
- Under a current initiative related to a review of SSAP No. 30 the SAP WG is considering whether all investments in a registered investment company should be captured in scope of SSAP No. 30. (This would expand the current reference to "mutual funds" to also include closed-end funds and unit investment trusts within scope of SSAP No. 30.) *(A related initiative is discussed in this footnote.[7])*
- Guidance for non-SEC registered funds is not explicit within the AP&PM, but industry has reported such investments as joint ventures pursuant to *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*. These investments are captured on Schedule BA, with an NAIC designation permissible for fixed-income investments held by life and fraternal companies.

The Comprehensive Fund Proposal would unify guidance for all fund investments in a new section in the P&P Manual. All existing procedures for fund investments developed by the VOS TF since 1991 would be retained.[8] The proposal would expand existing policy to funds issued by an investment company that is a closed end fund or a unit investment trust type registered with and regulated by the U.S. SEC. This tracks the SAPWG's proposed expansion of SSAP No. 30 discussed above and the blanks initiative discussed in footnote 7. The policy that fund investments are not eligible for filing exemption would be extended to the new fund procedure and to private (Schedule BA) funds. Analytical definitions, criteria, methodology and instructions are modernized. Greater detail on analytics provides enhanced transparency to insurers.

3. Referral – The VOS TF refers to the CAD TF a recommendation that it conduct a comprehensive review of all funds (as described above) that can be assigned NAIC Designations by the SVO and consider how those NAIC Designations should be included into the RBC calculation; specifically, for the CAD TF to consider what RBC changes they would like to make once NAIC Designations are added to Schedule D-2-2. Currently, bond ETFs and private funds receive different RBC treatment than other similarly structured funds. Equalizing the RBC treatment for assets with similar credit risk, represented by the SVO assigned NAIC Designation, when joined with the proposed changes in the P&P Manual and those made in the AP&PM over the last several years would provide a consistent and uniform NAIC process consistent with regulatory needs for an asset that has experienced significant evolution since 1991.

G:\DATA\Vos-tf\Meetings\2018\October\Task Force 2018 Referral To CAD TF Re Fund Proposal.docx

[7] In furtherance of its consideration of SSAP No. 30, on August 15, 2018, the SAP WG sent a referral to the Capital Adequacy (E) Task Force, Valuation of Securities (E) Task Force and the Blanks (E) Working Group noting support for the consideration of revisions to permit NAIC designations on Schedule D-2-2 – Common Stock. As detailed within that referral, the SAPWG defers to each of the noted groups in determining whether it is appropriate and feasible to incorporate the revisions.

[8] In each of the above assignments, if the SVO confirms that criteria and characteristics specified by the VOS TF are met, it places the name of the fund on a published List. An insurer can purchase any fund on the List and then files the fund shares with the SVO for an NAIC Designation. If the criteria and characteristics have not changed in the interim, the SVO assigns an NAIC Designation to the fund and annually reviews the Designation.

National Association of Insurance Commissioners & The Center for Insurance Policy and Research

To: Commissioner David Altmaier, Chair of the Capital Adequacy (E) Task Force
Kevin Fry, Chair of the Valuation of Securities (E) Task Force
Jake Garn, Chair of the Blanks (E) Working Group

From: Dale Bruggeman, Chair of the Statutory Accounting Principles (E) Working Group

Date: August 13, 2018

Re: NAIC Designations for Schedule D, Part 2 – Section 2 – Common Stocks

The purpose of this referral is to communicate the Statutory Accounting Principles (E) Working Group's support for the consideration of reporting revisions to permit NAIC designations for SEC registered funds (mutual funds, closed end funds and unit investment trusts), in scope of *SSAP No. 30—Unaffiliated Common Stock* (reported on Schedule D, Part 2 – Section 2 – Common Stock (D-2-2)), if determined appropriate based on the underlying holdings of the fund. (It is presumed that such NAIC designations would only be permitted for SEC registered funds that are comprised of bond or qualifying preferred stock investments.)

This referral was developed in response to requests to move equity investments that have underlying bond investments from the scope of SSAP No. 30 to the scope of *SSAP No. 26R—Bonds* in order to obtain more appropriate risk-based capital (RBC) charges. In reviewing the request, the Statutory Accounting Principles (E) Working Group has concluded against moving these equity investments to SSAP No. 26R for the following reasons:

- SEC registered funds in scope of SSAP No. 30 are not bonds, and do not represent a creditor relationship whereby there is a fixed schedule for one or more future payments.
- The long-term bond schedule (Schedule D-1) is not conducive to the reporting of funds, and questions often arise on the proper completion of Schedule D-1 for the limited equity investments already captured in scope of SSAP No. 26R. (For example, several columns on Schedule D-1 are not applicable for funds including interest rate, par value, maturity date, etc.)
- Existing guidance that allows SVO-Identified ETFs to be reported in scope of SSAP No. 26R, on Schedule D-1, has historically resulted with inconsistent reporting for similar investments. Companies may not identify that they have investments permitted for reporting on Schedule D-1 and continue to report these investments on Schedule D-2-2, or companies may infer the limited SSAP No. 26R provisions to additional investments that do not qualify for Schedule D-1 reporting.
- The desire for equity investments to be within scope of SSAP No. 26R is driven by RBC charges and not the investment structure or the measurement method for the investment.

Although the Statutory Accounting Principles (E) Working Group supports the consideration of revisions to permit NAIC designations on Schedule D-2-2, the Statutory Accounting Principles (E) Working Group defers to each of the identified groups in determining whether it is appropriate and feasible to incorporate these revisions. The ability to report NAIC designations on Schedule D-2-2 would require revisions that would include, at a minimum, the following assessments:

1. Blanks (E) Working Group – Consider a new column for NAIC designations on Schedule D-2-2.
2. Valuation of Securities (E) Task Force – Consider and establish a methodology for reviewing equity investments with underlying bond investments and in determining the appropriate NAIC designation.

3. Capital Adequacy (E) Task Force – Consider and determine the extent, if any, the reported NAIC designation for the SEC registered investment should be factored into the RBC calculation.

Although the Statutory Accounting Principles (E) Working Group has previously communicated that they do not plan to entertain future requests to reclassify investments to be in scope of a different SSAP when the key driver is an RBC charge, this issue was raised as part of the Statutory Accounting Principles (E) Working Group's current project to review SSAP No. 30 under the investment classification project. Going forward, if future requests are received, the Working Group intends to direct inquirers to the appropriate NAIC group for RBC assessment.

A referral response is not expected, as there will be no statutory accounting impact regardless of the ultimate decision. As noted, the Statutory Accounting Principles (E) Working Group has previously concluded against moving these equity investments from the scope of SSAP No. 30 to SSAP No. 26R.

Please contact NAIC staff of the Statutory Accounting Principles (E) Working Group with any questions.

Cc: Julie Gann, Robin Marcotte, Fatima Sediqzad, Jake Stultz, Charles A. Therriault, Robert Carcano, Mary Caswell, Calvin Ferguson, Jane Barr, Lou Felice

G:\DATA\Stat Acctg\1. Statutory\E. Referrals\2017\SAPWG to CADTF VOSTF Blanks - mutual funds.docx

NAIC National Association *of* Insurance Commissioners

The CENTER *for* INSURANCE POLICY *and* RESEARCH

To: Commissioner David Altmaier, Chair of the Capital Adequacy (E) Task Force

From: Dale Bruggeman, Chair of the Statutory Accounting Principles (E) Working Group

Date: August 12, 2019

Re: SIRI – Line 13: Equity Interests

This referral provides notification of a current Statutory Accounting Principles (E) Working Group exposure and requests comments. The comment deadline for the public exposure is October 11, 2019, but the Working Group can give additional time to the Task Force to review and provide comment.

As historical background, revisions have been incorporated, in effect for year-end 2019, to clarify what should be captured in the Supplemental Investment Risk Interrogatory (SIRI) for *Line 2: 10 Largest Exposures to a Single Issuer / Borrower / Investment.* The revisions clarify that reporting entities do not need to "look-through" diversified funds to aggregate exposures in determining the 10 largest exposures. However, reporting entities shall look-through non-diversified funds to aggregate exposures held in the fund with other exposures in determining the 10 largest exposures. Ultimately, this guidance ensures consistency in practice when assessing diversified and non-diversified funds and prevents use of non-diversified funds in shielding exposures from identification as one of the 10 largest exposures. (A diversified fund is one that is diversified in accordance with the Investment Company Act of 1940.)

With the adopted revisions to SIRI Line 2, the Working Group is considering similar revisions to SIRI *Line 13: 10 Largest Equity Interests.* The proposed edits follow the same concepts as those adopted to Line 2, in which a reporting entity would not be required to look-through a diversified fund in identifying individual equity exposures, but a non-diversified fund would require a look-through to aggregate exposures held in the fund with other equity exposures in determining the 10 largest equity interests. The revisions also clarify that an equity interest, whether diversified or not, that individually qualifies as one of the largest equity interests shall be reported. Lastly, the revisions propose to expand funds excluded from Line 13 to include SVO identified Bond ETFs and SVO-Identified fund investments with underlying equity interests from the scope of the listing. (SVO identified Bond Mutual Funds (government funds) and Money Market Mutual Funds are already excluded from the listing.)

The entire agenda item has been provided as a supplement to this referral, and comments from the Task Force are welcome on all aspects, but comments are specifically requested on whether the proposed revisions will have inadvertent impact to risk-based capital charges.

Please contact NAIC staff of the Statutory Accounting Principles (E) Working Group with any questions.

Cc: Julie Gann, Robin Marcotte, Fatima Sediqzad, Jake Stultz, Jim Pinegar, Jane Barr, Lou Felice

G:\DATA\Stat Acctg\1. Statutory\E. Referrals\2017\SAPWG to CADTF VOSTF Blanks - mutual funds.docx

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 – 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

						adoption of the bond structure and factors.	
IR5	RBC IRE		~~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	RBC IRE		~~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	RBC IRE		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 no captured by reserves for privately structured securities.	Referral from the Macroprudential (E) Working Group		8/11/2022
New Items – RBC IR & E							
IR9	RBC IRE		2024 or later	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.	CATF		