

April 5, 2024

Commissioner Nathan Houdek (WI)  
Chair of the Financial Condition (E) Committee  
National Association of Insurance Commissioners

**Re: Response to Written Comments on Holistic Framework on Insurers Investments**

Dear Mr. Houdek,

The Structured Finance Association (SFA) appreciates the opportunity to provide feedback to the memorandum from the Financial Condition (E) Committee regarding its “Response to Written Comments on Holistic Framework on Insurers Investments,” dated February 14, 2024 (the “Memo”).

In gathering feedback to respond to the Memo and associated “Investment Framework Recommended Work Plan For The Financial Condition (E) Committee” (the “Work Plan”), SFA engaged with various market participants, including insurance companies, asset managers, credit rating agencies, law firms, and others who may be directly and/or indirectly impacted by the changes to the Framework recommended by the drafting group to address the comments previously received on the Framework for Regulation of Insurer Investments – A Holistic Review (the “Framework”).

While the Memo and Work Plan demonstrate progress in the development of the Framework, the new workstreams, especially as they relate to the Request for Proposal (RFP) and due diligence framework for credit rating providers (“CRPs”), have generated additional questions and comments from market participants. The recommendations and questions in this comment letter will focus on “Drafting Group Members Views on Comments Related to Recommendation 1” (“Recommendation 1”) of the Memo, and “Action Item #2” of the Work Plan, specifically as they relate to the preparation of the RFP, the identification and credentialing of the “independent consultant”, and the preparation and processes of the due diligence framework. SFA also requests clarification about the change in terminology of “Equal capital for equal risk” to “Equal capital for equal tail risk” as it relates to future revisions to risk-based capital (RBC) factors.

**I. Credit Rating Provider Due Diligence Framework and Independent Consultant Definition**

- i. Recommendation 1 states: “Drafting Group Members are also supportive of engaging a consultant to develop the due diligence framework. In furtherance of its views, the Drafting Group Members developed a memorandum to the Executive (EX) Committee that once

discussed and if approved, may result in a Request for Proposal (RFP) to be submitted for further consideration.” In addition, the first paragraph of Action Item #2 states “The Committee will request approval from the NAIC Executive (EX) Committee to develop a request for proposal (RFP) to hire an independent consultant to provide recommendations for a due diligence framework for CRPs.”

SFA views the Memo to the Executive Committee as the foundation of the CRP due diligence process that will likely define the scope of the RFP. The RFP will have far-reaching implications for market participants, so it is critical that the problems it aims to solve are well defined and the ultimate goals are clear. As such, we believe it is important that the views of market participants from various sectors of the industry are considered, including those from investors, rating agencies, and insurance companies. As addressed in detail below, SFA and its members would welcome the opportunity to review and comment on the draft RFP prior to its submission to the Executive Committee.

The SFA’s membership represents most, if not all, sectors of the securitization industry that will be impacted by the final RFP. Importantly, any advocacy efforts undertaken by SFA must be based on the consensus of its broad membership. As such, any feedback provided by SFA regarding the RFP will represent a thoughtful compromise position of our industry membership. SFA believes that early engagement in the RFP drafting process between the NAIC and industry would be helpful. The opportunity to receive feedback from our CRP members, which each have unique approaches to the ratings process and bespoke methodologies, would seem especially useful. A collaborative approach should result in a more comprehensive RFP that ultimately generates a more meaningful analysis.

- ii. The first bullet point of Action Item #2 states: “If approved, the drafting group will work in concert with the NAIC Securities Valuation Office (SVO) to create a robust RFP proposal with consultant independence as a priority. We note that the selection of a consultant needs to consider potential conflicts with CRPs or industry.”

SFA agrees that consultant independence is paramount to ensure the impartiality and accuracy of the CRP evaluation methods defined and applied under the RFP. However, members have questioned how the SVO will define “consultant independence” given how interwoven CRPs and consulting firms are in the financial markets. Some specific member questions regarding independence include:

- a. By design, CRPs are large organizations with diverse operations and extensive global relationships. If a consulting firm carries ratings from certain CRPs, or is a subsidiary of a firm that is rated by one or more CRPs, how will the SVO view this in terms of independence?

- b. Many consulting firms have a global presence, with their mandates cutting across industries. Will consulting firms be required to disclose all direct or indirect mandates at CRPs? If CRP mandates do exist, will information walls within a consulting firm be considered a mitigating factor?
- c. Will the criteria for determining independence also consider whether a consultant is on a rotational basis for certain mandates at a CRP, such as financial auditing?
- d. Will individuals at the independent consultant or the NAIC with prior CRP experience be viewed as potentially conflicted or will that be looked upon favorably?
- e. Which working group or task force within the NAIC will ensure the true independence of the consultant? Will the independent consultant have to attest to their independence prior to receiving a mandate? If the due diligence process will be continuous, will the independent consultant also periodically be evaluated for independence?
- f. Regardless of the criteria chosen to determine independence, will they be shared with the industry for comment before being made final?

SFA also believes it would be prudent for the individual employees at the consultancy responsible for conducting the CRP due diligence, as well as individuals within the NAIC that are tasked with drafting the RFP and determining consultant independence, be evaluated for any potential conflicts that may affect their impartiality. When establishing eligibility criteria for evaluating consultant independence, SFA and its members believe a comprehensive and conservative approach will lessen the likelihood that the RFP and the due diligence results of the consultant are later called into question.

Equally as important as establishing independence will be confirming that a consultant has the technical prowess and relevant experience to prepare a due diligence framework for evaluating CRPs. For both criteria, members have questioned which specific benchmarks the SVO will reference to determine whether a consultant is qualified. Given the evolving nature of the structured finance market, our members have inquired if the RFP will require the due diligence framework to have an “initial” phase as well as an “ongoing” phase, the latter being used for a) newly emerging asset classes and b) ongoing reviews of CRP performance. Members have also inquired if the RFP/due diligence framework will make available an appeal process for CRPs that are not deemed to be acceptable for either phase.

SFA appreciates that the NAIC has been transparent about the fact that the development of the RFP is in its early stages. However, our members have raised questions about the anticipated structure of the RFP, including whether it will provide the independent consultant a highly structured and detailed “roadmap” of the due diligence process, or only define broad parameters with the expectation that the process will be fully designed by the consultant. Additionally, in designing the due diligence framework, given the acknowledgement by the NAIC that there are potential differences in transparency between public and private ratings, does the NAIC anticipate

creating separate processes and standards for evaluating CRPs as it relates to private versus public ratings? Members have also inquired about how the results of the due diligence process will be applied. Does the SVO anticipate mandating the independent consultant to perform a firmwide assessment of each CRP where, after assessment, the ratings from that CRP will or will not be eligible regardless of sector? Or will the due diligence process be performed on an asset-class, sector, or other specified basis, where certain ratings from a specific CRP may be eligible while other ratings from the same CRP may not? If some or all of a CRP’s ratings are deemed ineligible, how often will that decision be reevaluated?

Again, the SFA strongly believes the draft RFP should be made available to the industry for review and comment prior to being finalized, as incorporating the views of the broader market will result in a more comprehensive final RFP.

iii. The second bullet point of Action Item #2 states: “The consultant would deliver a comprehensive recommendation/request for the Committee to consider.”

Members have inquired as to the amount of time the independent consultant will have to respond to the RFP and, once returned, how the work product will be validated and which working group or task force of the NAIC will conduct the review. The current language references the “[Drafting] Committee to consider”. Given the decision will impact regulators in all states, will the Drafting Committee elicit input from state regulators as well as other resources (internal or external)?

Members have asked for clarification as to the expected frequency of CRP reviews to be conducted by the independent consultant. Some questions include:

- a. Will the due diligence be conducted periodically to capture changes in CRP performance?
- b. Would the independent consultant develop a framework for periodic monitoring and the objective measures on which it will be based?
- c. Will such a framework consider new asset classes or material changes in methodologies that may render past performance moot? Regardless, will such work be conducted by independent consultants once the recommendation is implemented, or would that fall on NAIC staff?

iv. The third bullet point of Action Item #2 states: “The Committee would expose this communication for industry comment, including encouraging CRPs to comment.”

SFA and its members fully support exposing the work of the independent consultant to the industry as soon as it is practical. However, we caution that it would be less efficient and effective to do so without also engaging with the industry earlier in the process, as outlined above.

## **II. Revision of “Equal Capital for Equal Risk” to “Equal Capital for Equal Tail Risk”**

With the release of the Memo, the NAIC noted the change in the language regarding future revisions to RBC Risk Factors from “Equal Capital for Equal Risk” to “Equal Capital for Equal Tail Risk”. While the NAIC has stated that this change was not meant to be material, and the two terms are used interchangeably within the NAIC, differing opinions exist within our membership as to which term is more appropriate. Some members believe that “Equal Capital for Equal Tail Risk” is consistent with the RBC framework where capital factors should be calculated by evaluating the tail risks specific to the assets in question. Other members have proposed restoring “Equal Capital for Equal Risk” as the operative term, but for its first instance adding an appended clause as follows: “Equal Capital for Equal Risk, noting that the full distribution of risk that includes tail risk should be considered.” SFA requests that the definition and its intended use be clarified.

## **III. Conclusion**

SFA believes that the RFP and CRP due diligence framework being in their nascent stages afford the NAIC the opportunity to engage early with the industry and provide clarity on the methodology and the assumptions applicable to the independent consultant and CRP due diligence processes. It also provides the NAIC the ability to leverage the broad experience of the industry to refine the associated documentation and workstreams, and ultimately develop a more robust and broadly accepted methodology. Finally, the industry asks for guidance on whether “Equal Capital for Equal Risk” or “Equal Capital for Equal Tail Risk” should be the operative term as it relates to futures revisions of RBC factors.

We again thank the NAIC for the opportunity to share these views and look forward to continuing our engagement with the NAIC on this issue.

Sincerely,



**Michael Bright, CEO, Structured Finance Association**