

January 26, 2024

Carrie Mears
Chair, Valuation of Securities (E) Task Force
National Association of Insurance Commissioners

Re: SVO Discretion and Appeals Process

Dear Ms. Mears,

The Structured Finance Association (SFA) appreciates the opportunity to provide feedback to the Valuation of Securities (VOS) (E) Task Force (VOS TF) on the exposure draft for the Amendment to the P&P Manual of the NAIC Investment Analysis Office Authorizing the Procedures for the SVO's Discretion Over NAIC Designations Assigned Through the Filing Exemption Process (SVO Discretion Exposure Draft).

In gathering feedback to respond to the proposal, 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 SVO Discretion Exposure Draft.

SFA has also engaged in dialogue with the American Council of Life Insurers (ACLI), with which we have many common members. As we discuss below, many of our members are supportive of the ACLI letter, particularly as it relates to creating a more robust initial rating reconsideration process that takes place prior to any appeals process. While we support ACLI's position, at the same time we acknowledge the vital importance of the structured finance market in providing liquidity to the real economy, with issuers securing over \$1.5 trillion in loans to support businesses, households, and communities in 2023 alone. The investors that provide the liquidity to this market, including many insurance companies, do so largely because of the stability of the market and predictability of returns on investment. Any proposal that introduces uncertainty into this market also runs the risk of impacting the future flow of liquidity to it. As such, SFA has elected to submit our own response to focus on questions and issues most directly impacting structured finance market participants.

We will first raise some questions aimed at seeking clarity about where and how the SVO will focus its attention when exercising its discretionary authority to remove a rating from the filing exempt process (FE). We will then move to raising issues and providing suggestions about the initial reconsideration process as currently constituted. Finally, we will share feedback on the proposed appeals process, particularly as it relates to the role and responsibilities of the neutral third party.

I. Scope of SVO Discretion

At the December 2023 annual meeting of the NAIC, VOS TF publish a historical record of the SVO's ability to exercise authority over the suitability of securities for insurance company investment. Notwithstanding the existence of the NAIC's authority, we believe that it may be beneficial for the NAIC SVO to set forth a more refined scope and/or limits around how the SVO's authority will be applied as this new process is initially implemented.

While we appreciate that the SVO would not seek to irrevocably limit their authority to review any security, an acknowledgment or statement from the NAIC clarifying specific types of securities, or concerns about specific approaches to ratings that will be the initial focus of the SVO would provide a measure of certainty to market participants. Such certainty would be welcomed across the market during this transition period. Federal regulators frequently make use of commentary, guidance, FAQs, and interpretive publications that provide clear guidelines for how they will exercise their investigative and regulatory authorities. We believe that the NAIC should consider doing so here.

II. Initial Reconsideration Process

As noted above, many of our members share the views enumerated by the ACLI, particularly on the importance of the SVO building out a more robust initial reconsideration process. It is of paramount importance that this process appropriately balances the interests of all affected parties while helping ensure that the NAIC VOSTF continues to fulfil its obligations. We will highlight a few issues raised by our members that should be addressed.

A. Due Process Considerations

As currently envisioned, the insurance companies most directly impacted by the reconsideration of a rating would be excluded from direct involvement in the re-rating process. While a rating from a credit rating agency is an important part of an investment decision, it is not the only consideration. Indeed, insurance companies are sophisticated investors who perform their own analysis, which may differ from the analysis of a rating agency in some respects. We appreciate that the proposed process would allow impacted insurers to submit additional information or analysis in support of their views, but that limited opportunity falls short in comparison to the level of detail that would be available if impacted insurers were permitted to have direct representation before the Senior Credit Committee and VOSTF. Moreover, Section 168 leaves it up to the discretion of the Investment Analysis Office ("IAO") to coordinate with impacted insurers prior to undertaking their full analysis. Excluding insurance companies from "being in the room" during the initial reconsideration process would necessarily exclude the very investment views that led to the purchase of that security in the first place. As a result, the review process could unfairly deprive these sophisticated investors the opportunity to explain why a given rating should be considered a reasonable assessment of the relevant risk.

SFA believes that a more objective approach would be to establish an initial reconsideration process that offers the option of direct participation by impacted insurance companies, a dialectical approach that is more likely to yield the appropriate outcome. Doing so would allow insurers directly to explain and justify the views that informed their investment decision. Should the insurance company choose to participate, they should have the option to also have their investment advisor in attendance at any proceedings. Such views are especially relevant in the context of a rating that—in the view of the SVO—does not reasonably reflect the underlying credit risk. In most adjudicative proceedings, due process typically requires direct representation by the parties most proximately impacted by that decision. A final recommendation would be for the NAIC to directly notify the credit rating agency(s) whose ratings are subject to reconsideration, along with the rationale for that reconsideration. Given the role of credit rating agencies in the marketplace, direct notification from the NAIC will help align the views of the rating agencies with that of the regulators as the NAIC pursues the goals underlying the proposed changes.

B. Questions on Process and Approach

Our members have raised some questions and concerns around the approach and process that would be employed during the initial reconsideration. We believe that any method employed to remove a rating from FE must be at least as robust, replicable, and statistically sound as those used by credit rating agencies. Moreover, the specific assumptions that factor into a removal from FE must be clearly enumerated and understood.

Our members have also raised specific questions and issues on the process as outlined in the exposure draft. These questions include:

- a.* In Section 81 of the revised P&P Manual, what is the basis upon which a determination of “reasonable assessment of regulatory risk” will be made for the initial reconsideration? What parameters or guardrails will define the limits of “reasonableness”?
- b.* While there are timing requirements for insurers to respond to an IAO request for information (45 days, not to exceed 90 days), there are no requirements for the IAO to notify an insurer that a security is Under Review. We recommend explicit timing requirements for IAO to notify insurers that a security is Under Review.
- c.* The “materiality threshold” in Section 171 is three notches. Upon what basis was the materiality threshold determined?
- d.* Given that IAO would be allowed to consider post-issuance performance of the security, what impact (if any) would ongoing surveillance from a CRP have, especially when that surveillance results in a credit downgrade? How will the differences between the assumptions and methodology of an initial rating and assumptions and process of ongoing surveillance factor into the IAO reconsideration process?

- e. When the IAO determines that a security remains eligible for the Filing Exempt Process, what are the timing requirements for them to inform the insurer that the security is no longer Under Review?

III. Appeals Process and Neutral Third-Party

As stated above, we believe that the current focus should be on improving the initial reconsideration process. If the process is appropriately robust and well-considered, it will reduce the instances where parties feel compelled to appeal reconsideration decisions. Nevertheless, there will always be a need for an appeals process, and we offer some member views on that process as outlined in the exposure draft.

The involvement of a neutral third-party is at the core of the proposed appeals process. We believe that it would be constructive for NAIC to provide more detail about the roles, responsibilities, and function of the neutral third-party, and how precisely it will meet their obligations. Additionally, given the role and responsibilities as laid out in the exposure draft, it would be helpful if NAIC indicated which existing capital market participants, if any, it views as able to perform the neutral third-party duties. SFA members have also questioned whether the NAIC envisions maintaining a list of approved neutral third-parties by asset class or will the NAIC review and approve a neutral third party on a case-by-case basis.

IV. Conclusion

SFA believes that the NAIC should consider applying a narrow scope for the reconsideration of ratings for specific securities, especially to provide additional market certainty as this process is implemented. We also recommend that NAIC provide clarity on the approach and assumptions applicable to the initial rating reconsideration process and improving due process. Finally, the market would welcome additional details on the roles and responsibilities of the neutral third party, including whether and how credit rating providers can serve in this role.

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