STRUCTURED FINANCE ASSOCIATION

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Via Electronic Mail:* *jren@naic.org*, *dgenao1@naic.org

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Re: NAIC - CRP Due Diligence Framework

Dear Ms. Ren and Ms. Genao:

The Structured Finance Association ("SFA") appreciates the opportunity to provide comments on the NAIC's proposed Credit Rating Provider ("CRP") Due Diligence Framework (the "Framework").

SFA is a consensus-driven trade association representing participants across the structured finance market, including issuers, investors, insurance companies, credit rating agencies, broker-dealers, law firms, service providers, and other market participants. These comments reflect the views of SFA's NAIC Task Force, with input from our Credit Rating Provider members. However, it may be the case that individual members have different views than those reflected in this letter; in such cases, individual members may communicate their views directly to the NAIC.

At the outset, SFA supports the NAIC's objective of developing a thoughtful, risk-based framework to better understand credit rating processes and evaluate the role of Credit Rating Providers within the insurance regulatory system. Given the importance of credit ratings within the NAIC designation framework, we appreciate regulators' efforts to promote confidence in credit ratings used for regulatory purposes while ensuring appropriate oversight.

SFA recognizes that the growing diversity of credit ratings providers, asset classes, and market structures presents legitimate challenges for regulators seeking to ensure that ratings incorporated into the NAIC designation framework continue to serve as reliable indicators within the NAIC designation framework and broader assessment of investment risk. We appreciate the NAIC's efforts to develop a more transparent and consistent oversight framework in response to these developments.

As the Framework continues to develop, SFA respectfully offers the following observations and recommendations.

I. Preserving Methodological Independence and Diversity of Opinion

The Framework places significant emphasis on concepts such as "alignment," "equivalency," and "consistency" among CRP ratings. We presume that the Framework intends to review the alignment, equivalency, and consistency of a CRP's ratings with its mapping to NAIC designations, while respecting the differentiation in opinions and methodologies that do and should exist.

Since differences in credit rating outcomes across CRPs are an expected feature of CRPs with differences in analytical opinions and methodologies, we do not believe that differences between individual ratings are necessarily inappropriate, nor do we believe that the existence of such differences equates to a lack of comparability.

CRPs employ different methodologies, analytical assumptions, surveillance practices, and rating philosophies. As a result, variation in credit rating outcomes may reflect differing but analytically valid approaches to assessing credit risk rather than evidence of inconsistency or weakness in certain credit rating outcomes.

Methodological diversity and independent analytical judgment among credit rating agencies are important strengths of the U.S. capital markets. This principle is reflected in the post-Global Financial Crisis U.S. regulatory framework, as Congress, through Dodd-Frank, sought to promote competition and diversity of analytical viewpoints among CRPs. The availability of multiple analytical perspectives has contributed to market depth, innovation, and resilience. Accordingly, SFA encourages the NAIC to ensure that the Framework does not unintentionally encourage credit rating convergence, standardization of credit rating outcomes, or homogenization of CRP methodologies.

We are encouraged that the NAIC's Questions and Responses for the Proposed Credit Rating Provider Due Diligence Framework ("NAIC Questions and Responses") published on June 26 speaks to this issue by committing to respect the methodological diversity among CRPs[1]. SFA believes that credit rating equivalency should not be interpreted as ratings uniformity. Differences in analytical approaches can coexist with a shared objective of providing independent credit rating opinions on rigorous methodologies, and the Framework should preserve space for legitimate methodological differences while promoting confidence in CRP processes.

II. Coordination with Existing Regulatory Oversight

SFA encourages the NAIC to coordinate closely with supervisory authorities responsible for oversight of credit rating agencies and avoid creating duplicative or potentially inconsistent oversight obligations.

CRPs already operate within extensive regulatory frameworks, including oversight by the SEC's Office of Credit Ratings and, in many cases, international supervisory authorities. While findings from these regulators may provide useful context in certain limited circumstances, SFA believes additional clarity

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[1] *Questions and Responses for the Proposed Credit Rating Provider Due Diligence Framework*, 10. Available at https://content.naic.org/sites/default/files/inline-files/questionsresponsescrpduediligenceframeworkproposal_1.pdf

would be required regarding how such information would be evaluated, contextualized, and incorporated into the Framework.

We are encouraged that the NAIC Questions and Responses speaks to this issue by characterizing the NAIC's role as a consumer of ratings that is considering how to adjust its own regulatory reliance, rather than an external supervisor of CRPs[2]. At the same time, we note that the NAIC in this context is unique in its role as the consumer of ratings, and the Framework should avoid practices that inadvertently result in reducing the diversity of perspectives and methodologies that currently exists among CRPs. We reiterate that the Framework should seek to avoid duplicative requests for information, governance reviews, methodology assessments, or supervisory inquiries that are already addressed through existing regulatory processes.

III. Confidentiality and Information Governance

The Framework contemplates the collection and review of significant amounts of CRP information. Some information--including ratings data—may be shared by CRPs, subject to the NAIC providing additional clarity regarding cybersecurity safeguards, information segregation controls, retention policies, access controls, and protections applicable to submitted materials.

However, when seeking other categories of information—including supervisory materials and examination findings—a more appropriate path would be for the NAIC to first seek such materials directly from the respective supervisor or regulator, subject to limitations outlined above in Section III. CRPs may be subject to restrictions on selectively sharing confidential supervisory findings with users of ratings, and encourages the NAIC to provide additional clarity regarding the circumstances under which such information may be requested, shared, or relied upon, including cooperation with existing supervisory authorities.

We welcome the NAIC's confirmation that access to CRP data submissions and confidential diligence information will be limited to U.S. state insurance regulators and NAIC staff. To give that commitment full effect, we seek confirmation that all reasonable administrative, technical, and organizational safeguards will be maintained to protect this information against unauthorized access or disclosure, and that any onward sharing will occur only with the submitting CRP's consent. We welcome the opportunity to further engage on the specific mechanisms for such information sharing, including formal arrangements between regulators and the NAIC. [3]

IV. Remediation Actions and Due Process Protections

SFA appreciates the NAIC's efforts to establish a structured governance process and remediation framework. However, the proposal contemplates a range of potentially significant remediation actions, including translation matrix adjustments, additional rating requirements, removal of filing-exempt treatment, and CRP de-admittance.

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[2] Ibid., 10, 19-20
[3] Ibid., 19-20

Given the potentially significant market implications associated with these actions, SFA believes the Framework would benefit from additional procedural safeguards and greater clarity regarding the standards supporting remediation decisions.

At a minimum, CRPs should receive timely notice of concerns, access to the information and analyses supporting proposed findings, and a meaningful opportunity to respond prior to the implementation of materially adverse actions. Additional clarity regarding the criteria, evidentiary standards, and decision-making process supporting remediation actions would help market participants better understand how the Framework will be implemented in practice. SFA also encourages the NAIC to establish a transparent process for reassessment of remediation measures, including clarity regarding review cycles, duration, and the circumstances under which remedial actions may be modified, lifted, or reversed based on new information or CRP's corrective actions.

We are encouraged by the specific actions proposed in the NAIC Questions and Responses that an affected CRP will receive a confidential and detailed explanation, along with the opportunity to present its case in a regulator-only session. The 3 to 6-month notice period is directionally appropriate to mitigate adverse market impacts as well.[4] However, we reiterate that NAIC must develop and publish clear objective thresholds for the basis of an action taken against a CRP.

Because ratings are deeply embedded within investment mandates, capital frameworks, and portfolio management practices, significant remediation actions may have implications beyond the affected CRP. SFA encourages the NAIC to consider potential market impacts when designing implementation timelines and remediation procedures.

V. Considerations for Private Market Securities

SFA supports the NAIC's efforts to develop a data-driven framework while recognizing the unique characteristics of private market securities.

Many privately rated securities are highly customized and frequently rated by only a single CRP. Structured finance and private market transactions often involve highly bespoke structures, collateral pools, legal features, and transaction-specific considerations that may limit the usefulness of broad statistical comparisons across securities.

As a result, direct comparisons across different securities may not always provide a reliable basis for assessing rating equivalency or methodological consistency. However, private market securities should not be presumed to present data insufficiency concerns solely because they may lack extensive historical performance records. The Framework should instead focus on whether the CRP has appropriate methodologies, governance, surveillance practices, and analytical processes in place to evaluate available information, including the use of relevant proxy data where appropriate.

[4] Ibid. 13-15

The Framework would benefit from additional consideration of these factors when developing quantitative testing approaches, escalation criteria, and equivalency assessments. We encourage the NAIC to focus on ensuring that CRP ratings are mapped appropriately to NAIC designations and, where relevant to its designation function, on analytical rigor, governance, and methodological quality.

VI. Considerations for Emerging Asset Classes

SFA encourages the NAIC to recognize that limited historical performance data is often an inherent characteristic of emerging asset classes, which will likely limit the usefulness of historical-data-based risk assessments and make it difficult to draw reliable sector-wide conclusions regarding rating equivalency, consistency, or relative performance across CRPs.

The absence of extensive performance history should not, by itself, be treated as evidence of deficient rating quality or elevated risk. Emerging asset classes frequently develop more quickly than the historical datasets available to evaluate them. A more relevant consideration is whether sufficient data exists—either historical or proxy—to support a reasoned credit assessment in a particular asset class. Determinations regarding the sufficiency of such information are inherently analytical judgments and may reasonably differ across CRPs. Accordingly, to the extent the Framework evaluates CRPs in this area, it should focus on whether CRPs maintain robust frameworks, controls, and governance for making such determinations, consistent with the NAIC's designation function and without duplicating existing CRP regulatory oversight, rather than on reassessing the specific data and analytical judgments reached through those processes.

The NAIC Questions and Responses appears to contemplate this dynamic, noting that an initial default to a "High Risk" classification is not an adverse finding or a declaration of deficiency. Instead, it is a calibration tool to determine the sample size and scope of Detailed Testing. We are further encouraged by confirmation that the NAIC will factor in analytical conservativism—such as haircuts and stress assumptions—when proxy data is used in emerging asset classes.[5]

SFA encourages the NAIC to ensure that escalation criteria and review processes appropriately account for these realities and place appropriate weight on analytical rigor, methodology development, governance, and surveillance practices, and we welcome further engagement as the Framework evolves,

Conclusion

SFA appreciates the NAIC's efforts to develop a structured and risk-based framework for evaluating Credit Rating Providers. We support the objective of enhancing confidence in ratings used for regulatory purposes while preserving methodological independence, diversity of opinion, analytical rigor, and competition among rating providers.

SFA believes the NAIC can achieve its objective of strengthening confidence in ratings used for regulatory purposes while preserving the diversity of analytical approaches that has long characterized

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[5] Ibid. 4-6, 7-9.

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the U.S. ratings market. We encourage the NAIC to continue engaging with market participants as the Framework evolves and appreciate the opportunity to contribute to that dialogue, including future opportunities to comment on revisions and enhancements to the framework.

We would welcome the opportunity to discuss these comments further and facilitate additional engagement with structured finance market participants.

Sincerely,

Dallin Merrill
Head of Policy
Structured Finance Association