What's Next for the Rules that Govern Insurers' Investments:

Developments from the NAIC's 2024 Summer National Meeting

Summer 2024

Synopsis:

At the NAIC 2024 Summer National Meeting in Chicago, regulators advanced their initiatives to refine investment guidelines in response to insurers' evolving strategies. Central to these efforts is better aligning the rules with the underlying differentiated economic risks across asset classes—a complex challenge given the significant variation in their risk characteristics and the intricate relationship between the statutory and risk-based capital frameworks. Key developments included:

- **Classification of investments**. The principles-based bond definition has been central to revising the classification of investments across varying characteristics, such as the debt of or direct investments in funds (e.g., private or SEC-registered funds).
- **Assigning Designations**. Significant concerns have been raised over the 'blind reliance' on agency ratings in NAIC Designations, which monitor insurers' debt portfolios valued in the trillions. These concerns have led to the NAIC designing procedures extending staff discretion over Designations. The challenge lies in ensuring consistent credit risk rankings despite differing methodologies and standards used by rating agencies and the increasing use of private ratings, which lack market oversight due to their confidential nature.
- **Capital differentiation**. Differentiating capital requirements for asset classes that exhibit differentiated risks, including investment vehicles and the debt and residual interest of asset-backed securities.
- **Modernizing investment oversight**. Progressing with the Financial Condition (E) Committee's long-term goal of modernizing the NAIC's investment oversight framework

This report reviews these recent developments, their potential implications for investment strategy, and what might happen next.

We hope you find this resource helpful
It is consistent with our goal of bringing value to our community

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Asset Regulatory Treatment (ART)

STANDARDS & SYSTEM is Bridgeway Analytics' machine learning-assisted platform that efficiently and effectively organizes insurers' current and proposed investment guidelines, including NAIC and state rules. Users are kept current and provided timely notifications on changes and their impacts, overcoming challenges with navigating complex regulations across jurisdictions using disparate language and varied rulemaking processes. The platform is used by insurers' investment, risk, compliance, legal, government affairs, accounting, and reporting functions and their regulators.

- **ART Newsreels** weekly emails alert users of the changes to the investment landscape, including NAIC, state investment guidelines, and global activities packaging, and deliver what matters most through timely, concise, and clear messaging.
- **ART Chronicles** are a centralized repository of recent and possible future changes to the landscape, including NAIC, state investment guidelines, and global activities. It allows you to quickly log in and find out the latest updates, next steps, and any deadlines associated with respective investment activities. The Outlook plugin will keep your calendars updated.
- **ART System** provides users access to codified state investment guidelines in a searchable and understandable format.
- **ART Investment Classification (beta)** assists with the classification of assets, which includes requirements under the principles-based bond definition, including possibly heightened reporting requirements.

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1 Executive Summary

At the NAIC 2024 Summer National Meeting in Chicago, regulators advanced efforts to refine investment guidelines in response to insurers' evolving strategies. As discussed extensively in our previous reports, noticeable shifts in insurers' investments toward private and structured assets, often with more complex characteristics, had the NAIC embark on significant multi-year updates to the statutory and risk-based capital frameworks with revisions to classification, the Designation process, reserving (e.g., actuarial guideline (AG) 53) and capital assignment (e.g., CLOs and ABS).[1] The meeting underscored the regulators' commitment to aligning the frameworks with evolving investment practices while addressing the differentiated economic risks associated with various asset classes. This task is particularly challenging due to the significant variation in risk characteristics across these classes and the intricate relationship between the statutory and risk-based capital frameworks.

Initiative	Significance	What's new?
Classification of investments	The principles-based bond definition has been central to revising the classification of investments across varying characteristics, such as the debt of or direct investments in funds (e.g., private or SEC-registered funds).	• Proposal to align the treatment of non-SEC registered funds posted for comment. • Implementation Q&A posted for comment.
Assigning Designations	Significant concerns have been raised over the 'blind reliance' on agency ratings in NAIC Designations, which monitor insurers' debt portfolios valued in the trillions. These concerns have led to the NAIC designing procedures extending staff discretion over Designations. The challenge lies in ensuring consistent credit risk rankings despite differing methodologies and standards used by rating agencies and the increasing use of private ratings, which lack market oversight due to their confidential nature.	• Proposal to extend NAIC staff discretion over agency rating-based Designations adopted by VOSTF but ratification held off by E-Committee. • Implementation Q&A posted for comment. • An update from the Technical CLO Ad hoc Group.
Capital differentiation	Differentiating capital requirements for asset classes that exhibit differentiated risks, including investment vehicles and the debt and residual interest of asset-backed securities.	• An update on the treatment of SEC-registered funds. • An update on the treatment of CLOs and ABS. • A wide range of other recent developments (e.g., residential mortgage funds and collateral loans).
Modernizing investment oversight	The Financial Condition (E) Committee has embarked on a significant initiative to modernize the NAIC's investment oversight framework.	• An updated Work Plan, Framework, and related documents were exposed for public comment. • An RFP to assist with the due diligence process for overseeing the use of agency ratings was exposed for public comment.

This report breaks down 'in play' efforts to revise guidelines and then reviews developments with the E-Committee's long-term efforts to revise the investment oversight framework. The report explores potential implications for investment strategy and what might happen next. We conclude by highlighting what we are optimistic about.

[1] See, for example, What's Next for the Rules that Govern Insurers' Investments: Developments From the NAIC's 2024 Spring National Meeting and Trends in the Ownership Structure of US Insurers and the Evolving Regulatory Landscape.

2 In-Play Efforts to Revise Investment Guidelines

We now dive into the four initiatives: (1) Classification of investments, (2) Assigning Designations, (3) Capital differentiation, and (4) Other recent developments.

2.1 Classification of Investments

2.1.1 Context

The principles-based bond definition was initially adopted at the 2023 Summer Meeting and will go live on January 1, 2025. The extensive multi-year effort covers various investments, including those under SSAP No. 26—Bonds and SSAP No. 43—Asset-Backed Securities, with ongoing subsequent SAPWG revisions. A bond is characterized, in spirit, as any security representing a creditor relationship, whereby there is a fixed schedule for one or more future payments, and which qualifies as either an issuer credit obligation or an asset-backed security. A security that possesses equity-like characteristics or represents an ownership interest in the issuer in substance does not represent a creditor relationship and is inconsistent with what is expected of bonds reported on Schedule D-1. The approach distinguishes between two types of bonds:

- **Issuer Credit Obligation (ICO).** A bond for which the general creditworthiness of an operating entity or entities through direct or indirect recourse is the primary source of repayment.
- **Asset-backed securities (ABSs)**. A bond issued by an entity (an "ABS issuer") created for the primary purpose of raising debt capital backed by financial assets or cash-generating non-financial assets owned by the ABS Issuer, for which the primary source of repayment is derived from the cash flows associated with the underlying defined collateral rather than the cash flows of an operating entity.

In addition to security investments that qualify under the principles-based definition as issuer credit obligations, certain securities, including SVO-Identified Bond ETFs and SVO-Identified Credit Tenant Loans, are also captured in the scope of this statement.

The definition for residual interests was also adopted, which are those of ABSs, as well as 'in substance' residuals held through investment vehicles (with guidance and definitions centralized under SSAP No. 21R).

Why does this matter? Debt classified as a bond generally receives preferential treatment, including lower capital charges. In addition, residuals of ABS held by life companies receive a higher interim 45% capital treatment. Equity interests of operating companies will continue to receive the 30% C-1 charge. The charge for residuals held by health and property & casualty remains at 20%, pending a more comprehensive review.

2.1.2 What's new and what's next?

The principles-based approach is, by its nature, precedence-based. With insurers' investments having a broad spectrum of characteristics, it will take time to converge on the classification of bonds and ABS, as well as the full scope of their treatment.

Proposed revisions to the bond definition – treatment of non-SEC registered funds. SAPWG proposed revisions to the bond definition and the draft issue paper, clarifying that debt issued by non-SEC registered funds would not de facto be treated as debt issued by ABS (Attachment 12). Thus, investments in the fund would not de facto be treated as residual interests of an ABS. This is significant given the 45% capital charge of residual interests held by life companies. Proposed revisions remove SEC registration requirements for debt issued by a fund to be classified as ICO.

Principles-Based Bond Project—Issue Paper adopted (Attachments 10). Issue papers are historical reference documents that detail background and discussions and are not authoritative. SAPWG adopted the proposed language that incorporates several clarifications along with refinements related to the classification of debt and equity or residual interests issued by non-SEC registered funds. A note has been added to the proposed revised issue paper with contingent

language if SAPWG does not adopt revisions to the bond definition, allowing for debt of non-SEC-registered funds to be treated as an ICO (see the discussion on the bond definition above).

Question-and-Answer (Q&A) Implementation Guide. SAPWG exposed a Q&A Implementation Guide for comment that details interpretations on how guidance should be applied to specific investment structures or characteristics (Q&A Implementation Guide—Attachment 11) through September 27, 2024. Like issue papers, the Q&A document does not represent authoritative accounting guidance (nor does Bridgeway Analytics' interpretations of those documents), and any unintended language that conflicts with statements in the SSAP should be disregarded.

2.2 Assigning Designations and the Prudent Use of Agency Ratings

A desire to move away from 'blind reliance' on agency ratings has led to several related and evolving initiatives that can have significant implications. While there is a consensus among market participants and regulators for needed improvements in governance when using agency ratings for regulatory purposes, the spectrum of proposed approaches can have broad and varied implications, with commenters at times having strong and varying views. The issues can be technical and nuanced, and we encourage interested readers to check out our report, Overseeing Designations and the Prudent Use of Agency Ratings. Let's dive in.[2]

Three related initiatives were deliberated over at the Valuation of Securities (E) Task Force (VOSTF) 2024 Summer National Meeting: **(1) Revisions to the definition of NAIC Designations, (2) Procedures for establishing criteria to permit NAIC staff discretion over agency-rating based Designations, and (3) NAIC model-based Designations for CLOs**. In parallel, the E-Committee, as part of the long-term initiative to revise the Investment Risk Framework, is petitioning for the development of an RFP to engage a consultant that would design and help implement a new process under which the NAIC develops a strong due diligence program over the ongoing use of agency ratings.

A revised definition of NAIC Designations and procedures for establishing criteria to permit NAIC staff discretion over agency-rating-based Designations were adopted by VOSTF on August 13, 2024 (Attachment Five* and Attachment Six*). The multi-year initiative concluded with industry, NAIC staff, and regulators appreciative of the heroic effort and collaboration that allowed for a final consensus formation. The E-Committee will consider ratification of the criteria that permit NAIC staff discretion over agency-rating-based Designations on August 29, 2024.

2.2.1 A Definition for NAIC Designations

Defining NAIC Designations is critical in providing regulators and market participants clarity on the risks they measure and, thus, guidance on their use and limitations. Defining a Designation is no easy task. The United States SEC, which oversees rating agencies, requires a description of credit ratings to be published. For example, Moody's Rating Symbols and Definitions describes credit ratings as opinions of ordinal, horizon-free credit risk and, as such, do not target specific default rates or expected loss rates. The definition is kept at a high level, with methodological details provided separately in technical documents.

The adopted definition and surrounding language streamline positioning and clarify that Designations consider risks beyond credit, excluding volatility/interest rate, prepayment, extension, or liquidity risk, which are reflected elsewhere within the RBC framework. Notably, the definition covers debt that does not qualify as a bond and is not eligible for agency rating-based Designations, but it is eligible for Designations the SVO assigns and filed under Schedule BA.

> *NAIC Designations represent opinions of gradations of the likelihood of an insurer's timely receipt of an investment's full principal and expected interest ("investment risk"). Where appropriate for a given investment, NAIC Designations and Designation Categories shall reflect "tail risk" and/or loss given default, the position of the*

[2] For additional discussion, see What's Next for the Rules that Govern Insurers' Investments: Developments From the NAIC's 2024 Spring National Meeting, Developments from the NAIC's Fall 2023 Meeting, Developments from the NAIC's 2023 Summer Meeting.

specific liability in the issuer's capital structure, and all other risks, except for volatility/interest rate, prepayment, extension or liquidity risk. NAIC Designations shall be identified by the NAIC 1 through NAIC 6 symbols (as modified by NAIC Designation Categories) which indicate the highest quality (least risk) to the lowest quality (greatest risk), respectively.

2.2.2 Procedures for the SVO's discretion over agency-ratings-based Designations

Broadly speaking, until now, the NAIC and state regulators have been passive consumers of ratings, whereby qualifying agencies would choose their own NAIC Designation-to-agency rating mapping, with a mechanical process of assigning a rating-based Designation to eligible securities. In this regard, there has been a "blind" reliance on agency ratings. The multi-year effort to achieve a consensus across regulators, NAIC staff, and industry involved significant considerations for issues that may bubble up as practical considerations are worked through with implementation:

- **Confidentiality.** Even in the case of publicly rated securities that are publicly rated, rating agencies have access to nonpublic information. Respecting the confidential nature of information further increases in complexity when the security is private or privately rated.
- **Due process.** The industry was keen on ensuring a mechanism exists to dispute the NAIC Investment Analysis Office (IAO) if it views a rating as unreasonable.
- **Transparency.** The industry was keen on the IAO being transparent about why it views a rating as unreasonable and about the methodologies it employs. While the final procedure requires the IAO to provide a written summary of its analysis, it will not publish its methodologies. The Chair explained that unlike rating agencies, which are required to document their methodologies, the SVO considers multiple methodologies when it assesses a security for regulatory purposes. Since the SVO relies upon the methodologies of other entities, it does not publish these methodologies.
- **Endorsement of rating agencies and their ratings**. The Chair explained in various contexts that the NAIC does not endorse rating agencies or their ratings and is instead a prudent consumer of their product. The SEC's Office of Credit Ratings, tasked with recognizing Nationally Recognized Statistical Ratings Organizations (NRSROs), does not validate or endorse rating agency methodologies or ratings, which is prohibited by law, and the NAIC is prohibited from regulating credit ratings and methodologies. The intent of extending NAIC staff discretion is purely as a consumer of ratings and the use of those ratings in insurance regulatory processes. The NAIC will not instruct rating agencies on how ratings should be determined but may choose not to use them for regulatory purposes.

The procedures adopted by SAPWG (paraphrased)**:**

1. IAO staff identifies an agency-rating-based Designation that appears to be an unreasonable assessment of investment risk.
2. IAO Credit Committee (CC) determines if it agrees and, if so, places the security "Under Review."
3. An information request is sent to invested insurers, and the investment is assigned Administrative Symbol "UR," but this symbol will not be reported on the statutory investment schedules.
4. The IAO may contact the domiciliary chief financial regulator if the information request is not responded to.
5. The IAO will perform a complete analysis of the security and coordinate with the insurer(s) to discuss the security. The authorized insurer(s) staff may invite other authorized parties that have agreed to the confidentiality provisions required by the NAIC to these discussions with the IAO. The IAO will provide a written summary of its analysis and its view of why it believes the CRP's risk assessment is an unreasonable assessment of investment risk for regulatory purposes to authorized insurers.
6. The IAO CC re-convenes to determine whether the Designation is three or more notches different than the IAO CC's opinion and, therefore, whether the SVO should proceed in requesting the removal of the agency rating-based Designation.
7. If the IAO proceeds with the removal, the IAO CC and a Sub-group of the Task Force will meet to discuss the security with the domiciliary regulators.

8. If the VOS/TF Sub-group disagrees with the Credit Committees' opinion of the NAIC Designation and the Materiality Threshold is not met, the agency rating-based Designation will remain, and the SVO Analytical Department Symbol "UR" will be deactivated, and no further action will be taken.
9. If the VOS/TF Sub-group agrees with the Credit Committees' opinion of the NAIC Designation and the Materiality Threshold is met, the IAO is authorized to block the agency rating in NAIC systems, preventing it from being used in the automated Filing Exempt Securities Process.
10. An alternate agency rating may be used at any time during the process. If there are no alternative CRP ratings, the SVO CC's assessment will be used.
11. An anonymized summary of each unique issue or situation will be published for transparency.
12. The IAO will identify when a rating-based Designation has been removed with the Administrative Symbol "ER."
13. At the Spring National Meeting, the SVO Director will summarize FE discretion actions taken during the preceding year.

The SVO expects that the process implementation will require enhancements to the NAIC's VISION and AVS+ investment data applications, and additional compliance and analytical review staff, which will require funding. As it stands, the process would be effective as of January 1, 2026, but it is acknowledged that it may require additional time.

2.2.3 NAIC model-based Designations for CLOs

VOSTF adopted the intrinsic-price modeled-based Designations with a year-end 2025 timeframe (originally 2024). The approach is outlined in Instructions for the Financial Modeling of CLOs and will follow that of CMBS and RMBS. It has authorized the CLO Modelling Ad hoc group, which includes NAIC staff, interested regulators, and key stakeholders, to work through the various issues to achieve consensus over technical modeling details. The efforts have been ongoing, and the CLO Modeling Ad-Hoc Working Group posted intermediate results from CLO Default & Recovery Scenarios that feed into the modeling framework. The scenarios are similar in spirit to those used in the NAIC CLO Stress Test Methodology. CLO tranche losses are measured across ten scenarios, with a baseline default rate and recovery scenario estimated from historical data and stressed scenarios (e.g., historical + 2 standard deviations). Several deals were analyzed and posted under CLO Preliminary Results. The probabilities/weights of each scenario will ultimately determine the total lifetime loss, which will be used in mapping to a Designation and capital.

Model performance and impact will ultimately determine the degree to which the approach will be accepted. There have been notable flags raised by commenters in this and other workstreams, questioning the benefits of CLO model-based Designations and the degree to which they are comparable or improve upon agency ratings. In Benchmarking the Treatment of CLOs, we've pointed to features of the intrinsic price approach that result in capital ultimately having characteristics that depart from those of corporate bonds, including longer-dated tranches receiving more punitive treatment; RBC is agnostic to maturity for corporate bonds.

The Ad-hoc CLO Modeling Group provided an update at VOSTF's August 13, 2024, meeting. The Ad-hoc Group has analyzed insurers' CLO holdings across the ten scenarios, with an administrative issue holding up posted results. The Group has also analyzed the methodological adjustments suggested by an interested party. The scenario probabilities associated with each scenario will also be needed to determine the total lifetime loss, which will be used in mapping to a Designation and capital.

2.3 Differentiating Capital

There have been, and continue to be, several initiatives to refine the capital treatment across a spectrum of asset classes, including residential mortgage funds, SEC-registered fixed-income funds, and collateral loans held by life companies. The notable complexity and significant growth in certain classes of asset-backed securities (ABS), collateral loan obligations (CLOs) particularly, had the Risk Based Capital Investment Risk & Evaluation (E) Working Group (RBC-IRE-WG) request the

American Academy of Actuaries explore possible differentiated capital charges for structured assets and initially focus on CLOs.

2.3.1 Differentiating capital for CLO and ABS debt and residual interests

Recognizing the inherent inconsistencies with the C-1 framework (e.g., C-1 bond factors are measured over a 10-year horizon while C-1 equity is measured over a 2-year horizon), the Academy put forth and agreed with regulators on a set of Principles for the modeling of C-1 for Structured Securities. It includes a flowchart for determining whether an asset class needs to be modeled separately and the level of modeling granularity. The principles highlight the nuanced capital framework with inconsistent components that inherently violate aspects of almost every principle that would otherwise seem reasonable. For example, Principle 3 highlights that RBC is measured net of reserves and thus should be measured consistently with an asset's accounting treatment. It observed that bond factors are calculated assuming that bonds are measured under amortized cost, which is inaccurate for impaired bonds (i.e., OTTI) that can be carried at fair value. Meanwhile, Principle 4 highlights the inherent 'arbitrage' where typical collateral of an ABS is often in the form of unrated debt (e.g., student loans), which would result in punitive RBC treatment if held directly and should not be used as a point of reference when assigning capital to the tranches that might have favorable risk characteristics.

As an interim step to differentiating capital for ABS, the RBC-IRE-WG adopted a 45% capital charge for ABS residual interests. Earlier this year, it reaffirmed the blanket 45% capital charge for all ABS residual interests held by life companies, rejecting 11th-hour compromises that would exempt some classes of residuals differentiated by comparable attributes (e.g., rating of the junior most debt tranche), which would receive a 30% charge. Notably, regulator comments at the June 27, 2024, Capital Adequacy (E) Task Force (CATF) meeting pointed to the possibility of updating the interim residual charge as the Academy assesses comparable attributes and further analyzes the differentiated risks of ABS and their residual interests. CATF also adopted the motion to maintain the 20% charge for property & casualty and health.

2.3.2 What's next?

The Academy provided an updated timeline at the RBC-IRE-WG 2024 Summer National Meeting (Agenda & Materials), where they explained that the original timeline of reviewing comparable attributes for CLO tail risk by the 2024 Fall National Meeting will need to be pushed back as they work through data collection issues. The updated timeline for reviewing comparable attributes for CLO tail risk is more likely to be in early 2025, and a proposal will likely be made in early 2025, with an update in the 2024 Fall National Meeting. The Academy had previously mapped out the following plan for their review of comparable attributes for CLO tail risk:

- Narrow comparable attributes to those that are most informative.
- Run CLOs through a range of scenarios and multiple available models to the extent possible.
- Identify candidate-comparable attributes for identifying the portfolio tail risk of CLO tranches (e.g., tranche rating).
- Once results are obtained, they can determine the set of easily identifiable attributes that explain most of the tail risk. If the set is small, it becomes a candidate for determining C-1. If the set is large and complex, modeling individual CLOs may be necessary.

2.4 Other recent developments

Since the 2024 Spring National Meeting, efforts to refine the capital treatment of several asset classes have moved forward, which may be impactful for certain investment strategies. The issues are nuanced, and we encourage you to reach out if you'd like more context:

- Investment funds on Schedule BA.
    - Residential mortgages can now be invested in through an affiliated fund with preferential look-through treatment.
    - Consolidated treatment of non-registered private funds, which will be reported under joint ventures, partnerships, or limited liability companies, starting in 2025.
- SEC-registered fixed income funds are being reviewed with aspirations of extending look through capital treatment.

- Collateral loans will be reported more granularly, and efforts will be made to further delineate reporting based on collateral, with possible downstream differentiated capital treatment.
- Tax credit structures will be expanded beyond low-income housing beginning in 2025, and possible capital differentiation will be considered.
- Derivative and derivative wrapper investments are being reviewed, and potentially significant changes to their treatment in the context of asset liability management and income-generating investments are being considered.
- A review of the overall RBC framework is being considered, along with a potential redesign of life RBC covariance and the formation of a new Risk-Based Capital Risk Research (E) Working Group (RBC-RR-WG).

3 The E-Committee's Aspirational Framework Becoming a Reality

3.1 Context

The Financial Condition (E) Committee (E-Committee) is looking to modernize investment risk oversight and has proposed a Framework for Regulation of Insurer Investments – A Holistic Review (the Framework). After multiple years of updates to the RBC and STAT frameworks ranging from asset classification (i.e., revisions to the definitions of a bond and residual interests) and Designations to the capital assignment (e.g., CLOs and ABS), the NAIC has taken stock and is looking to address the tactical nature of the updates have left essential elements of the framework disjointed. In August 2023, the E-Committee memo suggests a holistic rethink of how insurers' investments are regulated. The intervention at this highest level at the NAIC is significant. The memo discusses the need to modernize the Securities Valuation Office (SVO), creating a team of expert investment risk professionals to oversee a coherent approach to evolving capital markets. While it is suggested that the SVO "retain ability within the SVO to perform individualized credit assessment," it also describes this as a "backstop" that "would be rarely used."

3.2 What's New, and What's Next?

The E-Committee met on August 15, 2024 (Agenda & Materials), and exposed two sets of documents for public comment through October 14, 2024:

- **An update on revising the Investment Framework and related documents** (Attachment Thirteen).
- **A daft request for proposal (RFP) to assist with the due diligence process for overseeing the use of agency ratings** (Attachment Twelve).

The update on revising the Investment Framework and related documents includes regulators' responses to the most recent set of public comments, along with several notable revisions to the Work Plan and the Framework, which are intended to be a working document:

- Revisions to the Work Plan include the E-Committee's 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 overseeing the use of rating agencies, to which the E-Committee has posted a draft of (see Attachment Twelve). The Work Plan's Action Item #7 was also revised to review the appropriate incorporation of RBC recommendations, which for now entails containing a review for potential future iteration.
- Revisions to the Framework include adding the six core principles from the Work Plan, which are expected to remain in place after the work is implemented.

The daft RFP to assist with the due diligence process for overseeing the use of agency ratings includes an introductory memo. It explains the initial draft is intended to facilitate discussion and is part of developing the final RFP and requests feedback on several issues, including the RFP's clarity and completeness in several dimensions:

- Due diligence and objectives.
- RFP response requirements.
- Selection process and assessment criteria.

The draft RFP solicits proposals from third-party firms to develop a detailed quantitative and qualitative analysis that

supports the full development and implementation of the framework, which can be repeated periodically by regulators and NAIC staff. The project is to be delivered in two phases.

- Phase 1 deliverables include recommendations and considerations for accomplishing the objectives.
- Phase 2 deliverables will include developing the recommendations into an actionable framework for the NAIC to implement and maintain.

The RFP requests commentary related to key issues from the Framework and provides a sense of potential scope, including (paraphrased):

- How to best utilize and enhance the structured asset modeling capabilities of the SVO?
- What sort of governance is needed for the SVO's operations (i.e., the production and oversight of NAIC Designations)?
- How should the SVO capabilities be used to monitor the rating agency ratings on structured securities?
- How can agency ratings be compared for a given security type? Notably, the current process requires rating agencies to provide the NAIC with their own rating-to-Designation mapping, and a key objective is that ratings performance is shown to be representative of those explicitly used for NAIC Designations.
- How should securities rated by more than one rating agency and single-rated securities be analyzed?
- Should public and private credit ratings be distinguished for quantitative analysis?
- How should new investment types and emerging asset classes be considered when applying the ultimate framework?
- Define an examination process state regulators can utilize to provide oversight of the SVO in implementing this framework, its own production of Designations, and its usage of individualized challenges to agency ratings in the Designation process.

3.3 What Should We Make of Efforts Under the E-Committee and VOSTF, and How About Capital?

The NAIC has made clear its goal is to ensure that as a consumer of ratings, its use of ratings in Designations for regulatory purposes is prudent, which we wholeheartedly support. The E-Committee effort is significant, with the RFP currently in draft form, and may go through several iterations of public comment, each lasting several months. The third party may not be chosen till 2026. A lengthy timeline may be needed for data exploration, tools, and mechanisms regulators view as appropriate, with additional time needed to generate a consensus. VOSTF is targeting a tighter 2026 timeline for the rollout of procedures that would extend NAIC staff discretion over agency-rating-based Designations. With the VOSTF Chair also Chairing the Drafting Group, we expect a significant amount of iteration and convergence across the two initiatives.

Meanwhile, the E-Committee's goal of equating regulatory capital with economic risks (i.e., 'equal capital for equal risk, including tail risk') is in a more formative state. The Work Plan explains that it will continue to review the appropriate incorporation of RBC recommendations into the final Framework, qualifying that it does not include any related action items. Several initiatives to level-set capital across asset segments and their risks are underway at CATF, generally targeting specific items thus far rather than considering issues through a holistic lens. The degree to which efforts such as the formation of the RBC-RR-WG play such a role is yet to be seen.

4 What are we optimistic about?

The community remains committed to achieving the aspirational goal of equal capital for equal risk, recognizing multiple proposed paths forward, each with potentially significant implications. NAIC leadership continues to emphasize the importance of broad, thoughtful discourse around the challenges of regulating an evolving investment landscape. Despite concerns from some participants about aspects of the chosen path, regulators have shown a willingness to listen and adapt while maintaining certain non-negotiable boundaries. The recent adoption of an updated definition for Designations and the process for extending NAIC staff discretion over Designations, achieved through a commendable

and heroic consensus-building effort, underscores this commitment. As various perspectives are considered, there is much to learn, and we anticipate further refinements in thinking that will benefit the industry. We have evolved our views in response to new insights and welcome continued informed contributions to this ongoing dialogue.

Bridgeway Analytics and its product suite ART provide opinions related to the business implications of regulations and accounting standards. While Bridgeway Analytics aspires to provide accurate and timely information, the nature of distilling information to what we deem as most relevant and the evolving and subjective nature of the rules implies that the data represents our opinion of the rules and not the rules themselves. Users of ART agree to consult their legal, compliance, and accounting professionals before applying any data generated by or resulting from the use of the data in business processes. Bridgeway Analytics does not guarantee the accuracy, adequacy, completeness, timeliness, or availability of data and/or content, and is not responsible for errors or omissions (negligent or otherwise), regardless of the cause, and is not liable for any damages, costs, expenses, legal fees, or losses (including lost income or lost profit and opportunity costs) in connection with any use of the data and/or content.