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ANALYTICS

Supporting the investment and regulatory community to navigate increasingly complex capital markets

What's next for the rules that govern insurers' investments:

Developments from the NAIC's 2023 Fall National Meeting

December 2023

Synopsis:

This report reviews the 2023 NAIC Summer Meeting, which brought progress on several initiatives to revise guidelines with potentially far-reaching implications for insurers' investment strategy and capital markets:

- Classification of investment vehicles, including debt and residual interest of structured products.
- Potential revisions to the designation process, which determines capital for debt instruments.
- Efforts to revise the capital framework to differentiate structured assets.

In addition, the Financial (E) Committee (E-Committee), whose working group's mandate includes overseeing many of these initiatives, met to explore the Committee's Framework for Regulation of Insurers Investments further. As a reminder, the Framework proposes a modernization of investment risk oversight, which is significant.

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 the multitude of complex regulations across jurisdictions that use disparate language, with varied rulemaking processes. The platform is used by insurers' investment, risk, compliance, legal, government affairs, accounting, and reporting functions, as well as their regulators.

- **ART System** provides users access to codified state investment guidelines in a searchable and understandable format.
- **ART Newsreels** alert users of the changes to the investment landscape, including NAIC and state investment guidelines, packaging, and delivering 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 and state investment guidelines. Our Chronicles consolidate Newsreels in a distilled and easy-to-navigate format.
- **ART Heatmaps** provide a visualization of the varying investment limits that govern asset classes across states.
- **ART Investment Classification (beta)** assists with the classification of assets, which includes requirements under the proposed principles-based bond definition which consists of possible heightened reporting requirements.

Contents

1 Executive summary

Much progress was made at the 2023 NAIC Summer Meeting to move agendas forward and revise guidelines on several fronts with potentially far-reaching implications for insurers' investment strategy and capital markets:

- Classification of investment vehicles, including debt and residual interest of structured products; classification ultimately determines an asset's treatment (e.g., bonds generally receive favorable treatment).
- Potential revisions to the definition of a designation and oversight of ratings-based designations used to rank credit risk and help determine capital requirements.
- Efforts to revise the capital framework to differentiate Collateral Loan Obligations (CLOs) and structured assets more broadly.

Discussed extensively in our previous reports,[1] noticeable shifts in insurers' investment strategies toward private and structured assets, often with more complex characteristics, had the NAIC embark on significant multi-year updates to the RBC and STAT frameworks with revisions to classification (i.e., bonds and residual interests), the designation process, reserving (e.g., Actuarial Guideline (AG) 53) and capital assignment (e.g., CLOs and ABS).

In addition, the Financial (E) Committee (E-Committee), whose Task Forces oversee many of these initiatives, met to hear oral responses from commenters to the Committee's Framework for Regulation of Insurers Investments. As a reminder, the Framework, outlined in their memo proposes a modernization of investment risk oversight, which is significant.

This report reviews these recent developments, their potential implications for investment strategy, and what might happen next. We begin by breaking down 'in play' efforts to revise guidelines; we then review developments related to the E-Committee memo and conclude by highlighting what we are optimistic about.

2 In-play efforts to revise investment guidelines

We now dive into four initiatives: (1) Classification and accounting treatment of investment vehicles, including bonds and residual interest of ABS; (2) Revisions to the definition and oversight of ratings-based designations; (3) Revisions to the capital framework to potentially differentiate Collateral Loan Obligations (CLOs) and structured assets more broadly; and (4) efforts to review the oversight of asset concentration risk.

2.1 Classification and Accounting Treatment of Bonds and Residual Interest of ABS

2.1.1 Context

The principles-based bond definition was adopted at the 2023 Summer Meeting and will go live on January 1, 2025. The extensive multi-year effort covers a broad spectrum of investments, including those under SSAP No. 26R—Bonds, and SSAP No. 43R—Asset-Backed Securities (ABS). 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 principles-based approach avoids references to legal structure in the classification process and distinguishes between two types of bonds:

- **Issuer Credit Obligations** - a bond for which the general creditworthiness of an operating entity or entities through direct or indirect recourse is the primary source of repayment.

[1] See, for example, Developments from the NAIC's 2023 Summer Meeting, The changing rules governing US insurers' investments: Capital requirements and the role of agency ratings, or Trends in the Ownership Structure of US Insurers and the Evolving Regulatory Landscape.

- **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 specific instruments are also captured in the scope of this statement, including SVO-Identified Bond ETFs and SVO-Identified Credit Tenant Loans.

The definition for residual interests was also recently adopted in SSAP 48, which aims to clarify that residuals are those of ABSs, as well as 'in substance' residuals held through investment vehicles.

2.1.2 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 will receive the more punitive interim capital treatment of 45% beginning year-end 2024 unless the industry proposes an alternative that regulators view as more appropriate; equity interests will continue to receive the 30% C-1 charge. Capital charges for ABS held by non-life companies are expected to be updated accordingly. The capital charges are interim in that they are expected to be overridden as the Academy progresses with a long-term solution for treating structured assets.

2.1.3 What's still open?

There are several open issues to keep an eye out for:

- **The principles-based approach is precedence-based by its nature.** 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 treatment of their full scope.
    - **The bond definition Issue Paper** provides additional context, and case studies were posted for comments to be discussed at the 2023 Fall National Meeting; no comments were received. With ongoing discussions on SSAP No. 21R, that covers valuation of residual interests and provides guidance on 'non-bond' debt, and interested parties' collaborating to reconcile issues across SSAP, to achieve clarification and/or consistency, **NAIC staff recommended not to adopt the paper yet** but rather update the issue paper to reflect developments with the treatment of residual interests.
    - **The classification of debt and equity or residual interests issued by non-SEC registered funds** faces several open questions. While the bond definition and issue paper go through various cases to set a foundation for the treatment across various characteristics, possible areas are open for interpretation, notably:
        - Non-SEC registered funds are not specifically mentioned in *SSAP No. 26—Bonds*, which covers guidance for ICOs.
        - The bond issue paper doesn't speak directly to the broad class of non-SEC registered funds; the language suggests they would be classified as ABS de facto. Specific references include:
            - Debt issued by CFOs is possibly classified as ABS when the pool of funds is highly diversified and overcollateralized. (19 and 32c)
            - Bonds issued by business development corporations, closed-end funds, or similar operating entities registered under the 1940 Act classified as ICOs. It proceeds to qualify that the intent of classifying them as ICOs is specific to bonds issued from SEC-registered entities. (32c)
            - NAIC staff noted, while "It would also not be expected that private funds that issue debt would constitute residual tranches... calling something a fund is not sufficient to be excluded from residual reporting; it would have to be based on the substance of the investment."
- **The treatment of debt that does not comply with the bond definition**.
    - **Schedule BA proposal for Non-Bond Debt Securities.** SAPWG proposes new reporting lines that separate debt securities that do not qualify as bonds based on whether they have NAIC designations. The intent is to permit

debt securities assigned an NAIC designation to receive RBC factors that would have been received if the security had been reported on the bond schedule with an equivalent designation. An example is provided of a debt security that relies on the underlying collateral retaining its value to repay the debt (e.g., through the sale of collateral or refinancing), may not qualify to be reported as a bond such as non-cashflow-producing real estate at a 50% loan-to-value. While it would not qualify to be reported as a bond, its characteristics are consistent with that of a mortgage loan and may warrant a fixed income RBC charge.

    - **It is noteworthy that only life companies would receive RBC reductions** for reporting debt with SVO-assigned NAIC designations on Schedule BA, and the provision is intended to apply only to those entities until/unless the Capital Adequacy (E) Task Force (CATF) and related RBC Working Groups, incorporate changes to provide those capabilities to non-life entities. In that same vein, debt with NAIC designations not assigned by the SVO (e.g., rating agency-based designations) or that do not have designations are proposed to receive the more punitive RBC factor for "other" Schedule BA assets.
- **Revisions to the valuation of residual interests** (SSAP No. 21R) are being explored, with NAIC staff and industry converging. Under the proposal, residuals would be reported at the lower of "adjusted cost" or fair value.[2] The proposal incorporates the "Effective Yield with a Cap" along with the "Cost Recovery Method," whereby cash flows shall be treated as a return of principal, reducing the adjusted cost. Under the "Cost Recovery Method," distributions are not recognized as interest or investment income until the residual tranche has a book adjusted carrying value (BACV) (adjusted cost basis) of zero, which is not standard and more conservative but is less onus than the "Effective Yield with a Cap," which is argued to require extensive non-automation work. Under the "Effective Yield with a Cap," BACV represents the acquisition cost, net of distributions in excess of the Allowable Earned Yield. Allowable Earned Yield, established at acquisition, is the discount rate that equates the initial best estimate of the residual's cash flows to its acquisition cost and other-then-temporary impairments (OTTI).

What's Next?

The proposed updated accounting treatment of residual tranches was exposed for comment through January 22, 2024. Industry comment was also requested to help define further and provide examples for the investments captured as non-registered private funds, joint ventures, partnerships or limited liability companies, or residual interests and reported based on the underlying characteristics of assets through January 22, 2024.

2.2 Revisions to the definition of designations and oversight of agency ratings

Discussed extensively in [Developments from the NAIC's 2023 Summer Meeting](), a desire to move away from blind reliance on agency ratings has resulted in several related and evolving initiates, including (1) **an update to the definition of NAIC designations** and (2) **procedures for establishing criteria to permit staff's discretion over agency-ratings based designations**. Both dovetail with the Financial Condition (E) Committee's [memo]() on the Framework for Insurer Investment Regulation.

2.2.1 Updated definition of NAIC designations

As part of efforts to set standards over designations, VOSTF has been working with its Securities Valuation Office (SVO) to appropriately define designations and articulate the risks that are intended to be captured.

- **Feedback from the last round of deliberations** included:
    - A request to remove the application of Subscript S for instruments that exhibit 'other non-payment risks,' where NAIC staff would be allowed discretion over notching their designation. For context, it has been argued that features, such as payment-in-kind (PIK) interest, pose additional risks that may not be captured in some agency ratings.
    - Having the definition be concise, which it very much is, along with the definition being consolidated across the Purposes & Procedures Manual.

[2] Reductions in fair value below adjusted cost reported as an other-than-temporary impairment (OTTI).

- Incorporate 'tail risk' and/or loss given default.

- **The updated proposed definition is indeed concise**. NAIC designations represent opinions of gradations credit quality 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, and which reflect the likelihood of timely and full payment of principal and scheduled periodic interest, in accordance with the regulatory objectives explained above, and the likelihood of principal and/or interest payment default. Where appropriate for a given investment, NAIC Designations shall reflect "tail risk" and/or loss given default. NAIC Designations and Designations Categories shall reflect the position of the specific liability in the issuer's capital structure and other non-payment risks or non-payment mitigants. NAIC Designations do not measure other risks or factors that may affect repayments, such as volatility/interest rate, prepayment, extension, or liquidity risk.
- **A note on tail risk**. The current proposal includes, but does not define, 'tail risk.' The previous version included an example of 'tail risk' as the probability that a security's payment default will be more than three standard deviations from the mean, which is greater than what is shown by a normal distribution. At the time, concerns were raised over how 'tail risk' is defined and the extent to which it causes a deviation between ratings and designation, which may complicate the comparability between a rating and designation. We've previously explored different notions of tail risk, given the concept has been discussed increasingly, including Brett's unusually weedy ART Newsreel | August 10, 2023, In the Weeds. Regulators are rightly worried about the impact of extreme events on insurers, but several concepts often get conflated. In particular, the use of agency ratings, which in spirit rank order stand-alone expected credit risk, in the context of RBC, which is calculated based on the 96% loss (roughly 90% CTE). Agency ratings undoubtedly account for extreme events (e.g., AAA or AA defaults are extremely rare, with frequencies measured in single or fractional basis points). The rank order of stand-alone credit risk does not generally change if one focuses more on extreme tail events; AAA-rated corporate bonds will continue to be safer than those rated A. However, this is not to say that tail risk is the same across different asset classes with the same designation, given differences in correlation, concentration, and recovery risks. Those differences are generally captured in the capital framework, as is the case with Solvency II and Basel, which permit the use of agency ratings.

There was limited reaction to the proposed definition of designations when it was presented at the National Meeting.

What's next? The proposed definition is exposed for public comment through January 26.

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

This latest proposal has evolved considerably, with early versions restricting agency ratings in NAIC designations of debt issued by investment vehicles, including feeder notes, with arguments favoring the use of NAIC model-based designations to address concerns over arbitrage. SAPWG Chair introduced this latest version of the proposal by noting that in their opinion, "most regulators at this point feel [the proposal] is very fair and reasonable with the appropriate levels of feedback and oversight," acknowledging that "designations ultimately... fall under the purview of regulators and are used solely within the insurance regulatory framework itself. Credit rating providers provide an invaluable service given the number of securities and efficiencies gained by the NAIC, and... there's absolutely no intention of displacing or competing with them... we're empowering the SVO staff to take action through a very well-defined process when necessary in supporting the NAIC regulators in this responsibility."

The proposed procedure involves:

- **SVO discretion**
  - The formation of an SVO Senior Credit Committee (SCC) that determines whether a rating appears unreasonable and placed "Under Review," along with an information request informing insurers holding the security.
  - If the SCC views the rating-based designation as three or more notches different from its own opinion (i.e., Materiality Threshold), the rating will not be eligible for use in designations.
  - If an alternative agency rating is available or subsequently received, it will be incorporated into the designation process. Otherwise, the SCC's assessment will be used.

- **Reporting**
    - An anonymized summary of each unique issue or situation will be published.
    - SVO Administrative Symbols will identify ratings that have been removed for security.
    - An annual summary of actions will be provided at the Spring National Meeting.
- **Oversight by VOSTF**
    - The SCC will discuss the basis for removing an agency rating from the designation process as long as the VOSTF chair deems it necessary.
- **The right to appeal**
    - An insurer may appeal if they believe the SVO did not follow the procedures
    - An insurer may request the NAIC's IAO to contract, at the insurer(s) expense, with an independent third party acceptable to the NAIC IAO.

Commenters reacted orally to several aspects of the proposal, mostly related to transparency and the appeals process, which the Chair encouraged formalizing through written submission:

- **Commenters questioned the kind of information that would be available to insurers**, noting that the proposal places no requirement for the SVO to produce a report explaining their analytical process to the investor, similar to what is done by rating agencies, making it difficult to for an appeal to be effective if the insurer was not informed of what went into the analysis.
    - The Chair provided an initial reaction indicating the intent of providing transparency to the insurer but pointing to the potential confidential nature of some investments, the possibility of multiple insurers investing in a deal, and control over the distribution of a written report.
- **Commenters also questioned the appeals process through an independent third party** acceptable to the NAIC staff. In particular, efficacy in light of requirements for the party to act blindly, with restricted access to material related to the agency rating or that which was produced by NAIC staff, along with considerations for potential limits to access non-public information.

For a comprehensive discussion of our views on this matter, see our report, Overseeing Designations and the Prudent Use of Agency Ratings.

What's next? The proposal is exposed for public comment through January 26. If adopted, the procedures would go into effect on January 1, 2025.

2.2.3 NAIC model-based designations for CLOs

The VOSTF adopted intrinsic-price modeled-based designations with a year-end 2024 timeframe. 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.

What's new?

In a move to place closure on the modeling framework, the CLO Modeling Ad-Hoc Working Group posted preliminary results from CLO Default & Recovery Scenarios that would 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 associated with each scenario will ultimately determine the total lifetime loss, which will be used in mapping to a designation and capital.

What's next?

While the methodology is progressing as planned, 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, including reactions to the E-Committee's Framework for Investment Risk Oversight and the RBC-IRE-WG's effort to differentiate capital for CLOs, 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. To their credit, NAIC staff have made clear that the January 2024 timeline is a placeholder, with an acknowledgment of the possible need for additional time. In the words of the Chair, "It's not done until it's done."

2.3 Differentiating capital for CLOs and structured assets

We now explore recent developments with efforts to differentiate capital for structured assets, which we break down into two initiatives: (1) a broad effort to design a capital framework for structured assets and (2) interim capital charges for of residual interests.

2.3.1 Designing a capital framework for structured assets

The Risk Based Capital Investment Risk & Evaluation (E) Working Group (RBC-IRE-WG) has requested the American Academy of Actuaries explore possible differentiated capital charges for structured assets and initially focus on CLOs. The Academy presented the latest candidate principles (see meeting Materials). The Academy is proposing a flowchart to determine whether an asset class needs to be modeled separately and the level of modeling granularity that is needed. 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, Candidate 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 under the assumption that bonds are measured under amortized cost, which is inaccurate for impaired bonds (i.e., OTTI) that can be carried at fair value. Meanwhile, Candidate Principle 4 highlights that collateral of structured assets is often in the form of unrated debt (e.g., student loans), which would result in punitive RBC treatment if held directly, which should not be used as a point of reference when assigning capital to the tranches that might have favorable risk characteristics.

What's next?

While not formally exposed for comment or adopted, the Working Group gave the Academy the, 'go ahead' to use a slightly tweaked version of the candidate principles.

2.3.2 Interim capital of 45% for residual interests of ABS

RBC-IRE-WG adopted interim charges to the treatment of structured assets tranche residuals held by life companies:

- For 2023, the charge will remain at 30% with a 15% sensitivity test; absent a detailed and evidence-driven alternative proposal from the industry, the charge will automatically increase to 45% in 2024 (with a 0% sensitivity).
- The adoption was a compromise, with strong and differing views expressed by a bifurcated industry and with some regulators questioning the urgency and need for an interim change, considering the longer-term and broader initiative of updating the treatment of structured assets and the need for more analysis. Others question whether life insurers should hold residual interests.

The capital charges are interim in that they are expected to be overridden as the Academy progresses with a long-term solution for the treatment of structured assets. While the adopted changes are interim, posted comment letters and discussions highlighted the strong and varying views. Residual interest capital charges for property and casualty, and health companies are expected to follow a similar direction to life eventually.

What's new?

At their Fall National meeting, the Chair of RBC-IRE-WG spoke to the 45% interim charge, which is scheduled to go into effect unless the industry proposes a data-driven alternative that regulators find convincing. Given timelines for when changes go into filings, the only change possible for 2024 would have the 45% be modified to an alternative value, with a more comprehensive change that may differentiate residuals with varying risk characteristics only possible within the 2025 timeframe. With precedence still being set under the bond definition for assets that constitute an ABS and thus their residual interests, we expect this highly contentious issue will continue to receive significant attention.

2.4 Asset concentration risk

The regulatory toolbox overseeing investment risk is broad. While RBC receives significant attention, it is designed to be a blunt tool, deliberately avoiding complexity. Notably, RBC does not attempt to measure solvency, as with, say, Solvency II or the S&P insurance solvency model. Rather, it is designed to help identify weakly capitalized companies. With that in mind, regulators in the U.S. rely on other tools, such as Liquidity Stress Testing, cash flow tests, state investment limits, reporting, reserving, and the list goes on.

The Capital Adequacy (E) Task Force and its Working Groups oversee RBC. The Task Force set up a Risk & Evaluation Ad hoc Asset Concentration Subgroup (AH-ACSG) this year to understand better how asset concentration risk should be overseen. The group provided an update on the state of the Concentration Flowchart, which provides guidance on when and where concentration risk should be accounted for in the investment risk oversight framework and the Concentration Risk Inventory.[3]

Interestingly, this group predates the E-Committee memo but fits firmly into thinking broadly about the NAIC investment framework and how best to use regulatory tools to protect insurers' solvency.

What's next? The Subgroup expects to inventory concentration elements using the flowchart to assess how the risk should be accounted for. It expects to have an additional meeting before year-end.

3 A long-term aspirational vision – the E-Committee memo

The Financial Condition (E) Committee (E-Committee), whose Task Forces oversee RBC, SAP, the designation process, and other key aspects of the investment oversight toolbox, invited commenters of the Framework for Regulation of Insurers Investments to speak for 2 minutes. As a reminder, the Framework, outlined in their memo proposes a modernization of investment risk oversight, which is significant. Oral comments, including our own, were very much in line with the posted public comments.[4] In general, commentators were overwhelmingly supportive of the initiative. However, several raised questions about funding and implementation, and there were some differing viewpoints on whether and how current work streams should progress, including proposals that would allow discretion over agency rating-based designations and efforts related to NAIC model-based CLO/RMBS/CMBS designations. The Chair has clarified that all existing investment risk-related workstreams will march on - for now, at least**.** With much nuance, we break down critical themes from commenters:

- **Governance, oversight, and efficient use of resources.** There was consensus on the need for heightened governance and oversight of the overall process that should apply to rating agencies and NAIC staff/models. There was also general acknowledgment of the need to ensure "not to duplicate existing resources if they cannot be proven to produce better results," as one commentator phrased it.

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[3] Two forms of concentration risk are captured within the C-1 bond framework. The portfolio adjustment factor (PAF) provides a diversification capital offset that increases with the number of counterparties and the doubling of capital for the top ten largest counterparty exposures, excluding those with NAIC-1 designations or categories that assign the maximum factor, such as common stock.

[4] We certainly had a lot to share, considering 37 of the 119 pages of comments came from Bridgeway Analytics, where we propose a framework for Investment Risk Oversight and Overseeing Designations and the Prudent Use of Agency Ratings.

- **Designations.** There were two themes featured heavily in discussions of designation:
  - **CLO model-based designations.** With some exceptions, there was support for abandoning the NAIC's CLO model-based designation efforts, with several suggestions for repurposing the initiative to support the Academy's design of a CLO capital framework. The Academy has taken the stance that CLO designations should rely on agency ratings since they have sufficient 'comparable attributes.' They argue that CLO-specific capital factors are sufficient since "most CLOs are rated by [rating agencies], and those ratings can reasonably sort each CLO security into a risk bucket," eliminating the need for individual modeling of CLOs.
  - **NAIC discretion of agency rating-based designations.** Several commenters also discussed the proposal for NAIC staff to have discretion over agency ratings. There is strong consensus on the need for rating agency oversight, which includes comments from one rating agency. Several commenters, including state regulators, also advocated for better SVO oversight, with many noting the need for heightened oversight and transparency if the SVO is extended discretion over rating-based designations.
- **Primary areas of concern regarding investment risk.**
  - One rating agency pointed to privately rated credit as most concerning, given the inherent lack of market oversight. It is often argued that market participants question rating agencies when their ratings are not appropriately rank-ordered, forcing discipline that would not be the case with private ratings. This is coupled with the potential conflict of interest whereby a rating agency may be influenced to determine more favorable (i.e., higher) ratings than warranted to retain the issuers as clients and obtain new issuer clients, which the SEC acknowledges.
  - Several commenters pointed to features of structured assets as cause for concern, noting the rapid expansion of the asset class. One letter raised concerns over structured assets exhibiting higher concentration risks and proposed introducing additional concentration charges. While we agree that structured assets exhibit correlations and tail risks that are different from corporate bonds and have advocated for differentiated capital charges across asset classes (see ART Newsreel | August 10, 2023), we found the evidence presented to suggest the need for more research but insufficient for providing conclusive guidance on prudent policy design. We've advocated for data-driven guidelines, deliberately considering materiality thresholds and avoiding duplicitous workstreams.

What's next? The Chair indicated we will see 'something' from the Committee in January.

4 What are we optimistic about?

The NAIC and regulators are embarking on significant much needed efforts to revise investment risk oversight. The NAIC's communal approach to policy design is unique in that parties provide public and varied perspectives over possible considerations and concerns. While we observe contentious but mutually respectful debates and apparent disagreements over policy design, the ongoing collegiate approach is proving to be robust as regulators continue to work closely with the industry while advocating for policyholders. This alone is cause for optimism, which is reinforced by observing we are at a time when the U.S. insurance industry is in good health. We look forward to supporting all sides as this initiative develops.

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