Draft date: 3/4/25

2025 Spring National Meeting
Indianapolis, Indiana

RISK-BASED CAPITAL INVESTMENT RISK AND EVALUATION (E) WORKING GROUP
Monday, March 24, 2025
8:00 – 9:30 a.m.
JW Marriott Indianapolis—JW White River F–J—Level 1

ROLL CALL

Philip Barlow, Chair	District of Columbia	William Leung/Danielle Smith	Missouri
Thomas Reedy, Vice Chair	California	Tadd Wegner	Nebraska
Wanchin Chou	Connecticut	Jennifer Li	New Hampshire
Ray Spudeck/Carolyn Morgan	Florida	Bob Kasinow/William B. Carmello	New York
Matt Cheung	Illinois	Dale Bruggeman/Tom Botsko	Ohio
Roy Eft	Indiana	Rachel Hemphill	Texas
Carrie Mears/Kevin Clark	Iowa	Doug Stolte	Virginia
Fred Andersen	Minnesota	Steve Drutz/Katy Bardsley	Washington
		Amy Malm	Wisconsin

NAIC Support Staff: Julie Gann/Maggie Chang

AGENDA

1. Consider Adoption of its Feb. 11, 2025, and Oct. 22, 2024,Minutes—*Philip Barlow (DC*) — Attachment A, Attachment B

2. Hear an Update from the American Academy of Actuaries (Academy) on the Structured Securities Risk-Based Capital (RBC) Project —*Philip Barlow (DC)* — Attachment C

3. Receive Comments on the American Council of Life Insurers' (ACLI's) RBC Principles for Bond Funds Presentation and the NAIC's Memorandum of Bond Funds Reported in 2023 Annual Statement Filings —*Philip Barlow (DC)* — Attachment D, Attachment E, Attachment F
   A. Payden & Rygel
   B. Alternative Credit Council
   C. PineBridge Investments

4. Receive Updates from the Valuation of Securities (E) Task Force and the Statutory Accounting Principles (E) Working Group—*Philip Barlow (DC)*

5. Discuss Any Other Matters Brought Before the Working Group —*Philip Barlow (DC)*

6. Adjournment

Draft: 2/18/25

Risk-Based Capital Investment Risk and Evaluation (E) Working Group
Virtual Meeting
February 11, 2025

The Risk-Based Capital Investment Risk and Evaluation (E) Working Group of the Capital Adequacy (E) Task Force met Feb. 11, 2025. The following Working Group members participated: Philip Barlow, Chair (DC); Thomas Reedy, Vice Chair (CA); Wanchin Chou (CT); Ray Spudeck (FL); Kevin Clark and Mike Yanacheak (IA); Matt Cheung (IL); Roy Eft (IN); Fred Andersen (MN); William Leung (MO); Tadd Wegner (NE); Jennifer Li (NH); Bob Kasinow (NY); Dale Bruggeman and Tom Botsko (OH); Rachel Hemphill (TX); Doug Stolte (VA); Steve Drutz and Katy Bardsley (WA); and Amy Malm (WI).

1. Heard an Update from the Academy on the Structured Securities RBC Project

Steve Smith (American Academy of Actuaries—Academy) started by referring to the key milestones for the project (Attachment XX). Smith said the new work in 2024 and 2025 that he would like to report to the Working Group included the acquisition of collateralized loan obligation (CLO) data from Moody's Ratings (Moody's), a planned approach for modeling collaterals within the CLOs, and the use of the scenario compression approach.

Smith said Moody's database of CLOs is comprehensive. Smith highlighted the breadth of Moody's dataset, stating that it has 3,309 deals, 1,871 of which are currently owned by U.S. insurers and modeled by the NAIC's Structured Securities Group (SSG). By analyzing this dataset, the Academy's goal is to identify and assess candidate comparable attributes that can reliably predict the risks of CLOs. Smith named some examples of the attributes in the dataset, including ratings of the CLO tranches as well as ratings of the underlying collaterals, subordination, amount of leverage, etc.

Smith said there is a key difference between the SSG's modeling approach and the Academy's collateral modeling approach. The SSG's approach is used for designation assignment purposes and strives to achieve consistency in capital charges upon either ownership of a vertical slice of the CLO versus ownership of the underlying collaterals. The Academy's approach strives to achieve consistency in methodologies between corporate bonds' C-1 factors derivation and CLO's factors derivation. Smith then walked the Working Group through how the C-1 Bond model is used to produce loss distribution of the collateral pool of a CLO and how the pool-level loss distribution feeds into waterfall structure software to produce tranche-level loss distribution, which is then used to determine C-1 factors for the respective CLO tranches. Smith said one significant difference between corporate bonds and bank loans (CLO collaterals) accounted for in the modeling is that the former are unsecured while the latter are secured.

Smith continued to explain that the Academy is exploring the idea of closed-form approximation of loss distribution in order to make the collateral model as transparent, simple, and understandable as possible. The idea is to convert the stochastic model of the bond engine into a closed-form approximation (i.e., a probability distribution curve that approximates the actual output of the bond model). Smith highlighted another noteworthy aspect of the Academy's modeling approach: that the Academy is studying the time pattern of losses for the CLO debt tranches such that the model would not simply assume level losses over time.

Kristin Holzhauer (Northwestern Mutual) asked whether the Academy uses the entire CLO dataset or just the CLOs that insurers invested in to generate the closed-form approximation. Smith said the Academy will ensure the study is as relevant to the insurance industry as possible. He said if there are noticeable differences between the entire universe of CLOs versus those CLOs that insurers invested in, those differences will be reportable findings in the Academy's report.

Smith went on to explain the scenario compression approach. In the risk-based capital (RBC) framework, the standard approach to building conditional tail expectation (CTE) risk measure is to build a stochastic model that runs 10,000 scenarios. In practice, it is not feasible to run thousands of collateral loss scenarios due to waterfall structure software limitations. To overcome this, the Academy proposed to use a scenario compression approach in which tail collateral loss scenarios are grouped into discrete ranges, where the average loss of each range is used to run through the waterfall structure software. The Academy expected 15–25 scenarios generated. Should the Working Group endorse CTE 90 as a risk measure, the Academy plans to use the worst 15%–20% of loss scenarios. Yanacheak asked if the Academy plans to validate the reasonableness of the compression. Smith said the Academy plans to do so.

Smith said the work that the Academy needs to embark on in the future includes: 1) acquisition of the C-1 bond factor model; 2) parameterization of the CLO cash flow model, a step in which the Academy needs to make assumptions while using the waterfall structure software, will leverage the work of the SSG; however, Smith would not preclude potential differences between the SSG's and the Academy's parametrization; 3) analysis of the results of the conversion of tranche-specific CLO cash flows into tranche-specific base factors, through which the Academy might be able to identify comparable attributes for factor generations; 4) updating the diversification and concentration framework. Smith said considerations like the definition of "issuers," inherent diversification in collaterals within CLOs, etc., will present new considerations to update the current portfolio adjustment factor mechanism. The Academy may also need to consider asset class concentration but will develop a reasonable proposal that balances precision with parsimony.

Barlow asked if the four items presented by Smith are the only outstanding items and whether there can be a way to track progress to help the Working Group manage expectations of when a final product is available. Smith responded that the four workstreams are not necessarily dependent on one another, and some can be worked on in parallel. Smith agreed to track the progress and said he believed that once the C-1 bond factor model is obtained, the work progress is expected to be accelerated. He also cautioned that the biggest contingency is that if the collateral modeling approach does not work after acquiring the C-1 bond factor model, the other workstreams may need to rethink things, so there are still dependencies. Smith said he plans to provide another update at the Spring National Meeting in Indianapolis.

Felix Lurye (Guardian Life) asked if the Academy will expect the end results to be more like the sum-of-the-parts approach to make sure C-1 factors of the underlying bank loans are redistributed to the CLO tranches. Smith said the Academy would monitor the potential RBC arbitrage but would not intentionally apply the sum-of-the-parts approach.

Lorenzo Cupido (Prudential Financial) asked if the collateral modeling approach will differentiate between collateral types (e.g., broadly syndicated bank loans versus middle market bank loans versus private credits). Smith said his presentation only mentioned adjustment for seniority of bank loans, but collateral types should also be taken into account.

2. Discussed the Status of the Fund Review Project and Exposed the ACLI's RBC Principles for Bond Funds Presentation and the NAIC's Memorandum of Bond Funds Reported in the 2023 Annual Statement Filings

Barlow said the American Council of Life Insurers' (ACLI's) presentation (Attachment XX) resulted from the Working Group's direction to narrow the scope of the Comprehensive Fund Review to three specific types of bond funds: 1) bond exchange-traded funds (ETFs); 2) U.S. Securities and Exchange Commission (SEC)-registered bond mutual funds; and 3) private bond funds. The three types of funds are not treated equally for current RBC purposes. The ACLI's presentation included candidate guiding principles to help determine if work is needed to align the RBC treatment. To facilitate discussion, the NAIC staff put together the amount of respective fund types reported in the 2023 annual statement filing (Attachment XX).

Marc Altschull (ACLI) said that ACLI members applied the candidate principles in the presentation and concluded that the SEC-registered bond mutual funds should receive the same RBC treatment as bond ETFs and private bond funds. Specifically, they should receive a bond RBC charge based on the Securities Valuation Office's (SVO's) weighted average rating factor (WARF) methodology. Clark requested more details about the SVO's WARF methodology. Specifically, he asked if every investment within the bond funds needs to be rated in order for the SVO to apply WARF. Clark also asked whether property and casualty (P/C) insurers' trade group can weigh in on this proposal, as his understanding is that bond RBC treatment for bond funds is not currently available to P/C and health insurers.

Barlow clarified that this presentation is not a proposal itself. He said that if the Working Group desires one, a formal RBC proposal needs to be submitted for the Working Group's consideration.

Altschull said he might have already received the American Property Casualty Insurance Association's (APCIA's) position on the presentation, but he has to confirm. He also pointed out that bond mutual funds are allowed to be filed for SVO designations, but those designations would not impact RBC calculations.

Mike Reis (Northwestern Mutual) recalled that the SVO's *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual) has a robust write-up on qualifications for applying WARF methodology. He said he would follow up with the SVO to confirm the methodology for unrated underlying investments within the funds.

Barlow exposed the ACLI's presentation, and the NAIC's Memorandum of Bond Funds Reported in the 2023 Annual Statement Filings for a 24-day comment period ending March 7.

3. <u>Discussed Other Matters</u>

Barlow said the Working Group plans to meet in person at the Spring National Meeting. The meeting is scheduled for 90 minutes. It will commence with the Working Group's session, followed immediately by the Life Risk-Based Capital (E) Working Group's session.

Having no further business, the Risk-Based Capital Investment Risk and Evaluation (E) Working Group adjourned.

SharePoint/NAIC Support Staff Hub/Committees/E CMTE/CADTF/2025-1-Spring/IRE/RBCIREWG 02-11-25 Minutes TPR'd.docx

Draft: 10/23/24

Risk-Based Capital Investment Risk and Evaluation (E) Working Group
Virtual Meeting
October 22, 2024

The Risk-Based Capital Investment Risk and Evaluation (E) Working Group of the Capital Adequacy (E) Task Force met Oct. 22, 2024. The following Working Group members participated: Philip Barlow, Chair (DC); Thomas Reedy, Vice Chair (CA); Wanchin Chou (CT); Ray Spudeck (FL); Carrie Mears and Kevin Clark (IA); Vincent Tsang (IL); Roy Eft (IN); Fred Andersen (MN); Debbie Doggett and William Leung (MO); Andrea Johnson and Tadd Wegner (NE); Jennifer Li (NH); Bob Kasinow and Bill Carmello (NY); Dale Bruggeman and Tom Botsko (OH); Jamie Walker and Rachel Hemphill (TX); Doug Stolte (VA); Steve Drutz and Katy Bardsley (WA); and Amy Malm (WI).

1. Adopted its Summer National Meeting Minutes

Eft made a motion, seconded by Botsko, to adopt the Working Group's Aug. 14 minutes (*see NAIC Proceedings – Summer 2024, Capital Adequacy (E) Task Force, Attachment XX*). The motion passed unanimously.

2. Received Updates from the Valuation of Securities (E) Task Force and Statutory Accounting Principles (E) Working Group

Mears said the Valuation of Securities (E) Task Force adopted an updated definition of an NAIC designation during the Summer National Meeting. The amendment consolidated the previously disparate components of the definition that were in various areas of the *Purposes and Procedures Manual of the NAIC Investment Analysis Office* (P&P Manual). It also clarified the regulatory objective of NAIC designations moving from "credit risk" to the new concept of "investment risk." Focusing solely on credit risk limits the Securities Valuation Office's (SVO's) ability to assess if there is a risk that the insurer does not receive the payment of full principal and expected interest. The Task Force also adopted a process to permit its discretion over NAIC designations assigned through the filing exempt (FE) process. The Financial Condition (E) Committee adopted such an amendment at its Aug. 29 meeting. Mears said certain amendments were also exposed during the Summer National Meeting. The amendments mostly regarded cleaning up the document and did not introduce any new policies or procedures. One of the examples named was an amendment to remove references to "Subscript-S" and update references to "investment risk" throughout the P&P Manual. Lastly, Mears reported that the Structured Securities Group (SSG) has completed running the 10 scenarios for each eligible collateralized loan obligation (CLO) owned by insurance companies as part of its creation of CLO modeling methodology. The SSG will post the results for review on its web page and provide them to the American Academy of Actuaries (Academy) for its analysis of the risk-based capital (RBC) factors.

Bruggeman said the Statutory Accounting Principles (E) Working Group adopted the principle-based bond definition to become effective Jan. 1, 2025. He stated that corresponding adoptions by the Blanks (E) Working Group may impact the various RBC blanks and that he was aware of RBC blanks proposals underway. Debt securities that no longer qualify as bonds should be reported as non-bond debt securities on Schedule BA. With the adopted plan for reporting, no further RBC proposal is envisaged, but it is subject to the purviews of various RBC working groups.

Bruggeman said he had provided updates on tax credit investments during the Summer National Meeting. Referrals were sent to the Capital Adequacy (E) Task Force and the Life Risk-Based Capital (E) Working Group to update RBC blanks with the intent to coincide with changes adopted by the Blanks (E) Working Group.

Bruggeman said industry may request reconsideration of the RBC factors, which are under the purview of the Capital Adequacy (E) Task Force and its working groups.

Bruggeman provided an update on a new statutory accounting principle (SAP) exposure to receive details of assets involved in funds withheld and modified coinsurance (modco) agreements. It was identified that RBC reporting includes adjustments for modco assets. However, all those adjustments are based on company records, and there is no easy way for state insurance regulators to verify that the RBC adjustments are reflected properly based on the type and quality of the assets. The exposed proposal proposed new schedules so the RBC formulas will be able to directly pull the information for reflection in the RBC formulas. Although the comment deadline for this item was originally proposed for Sept. 27, it has been extended to Dec. 16 per industry's request. As such, further discussion on this item will not occur at the Fall National Meeting.

Finally, Bruggeman said that the Statutory Accounting Principles (E) Working Group received comments on its exposure on collateral loan Schedule BA reporting. NAIC staff drafted a blank proposal to be exposed in November. The proposal expands reporting on Schedule BA and asset valuation reserve (AVR) schedule to capture the type of collaterals underlying the loan, with an anticipated effective date of Jan. 1, 2026. The Statutory Accounting Principles (E) Working Group also directed notice to the Capital Adequacy (E) Task Force and its working groups, which are responsible for developing AVR and RBC factors for these collateral loans.

Barlow asked NAIC staff for a plan to address the referrals mentioned. Dave Fleming (NAIC) responded that a couple of proposals are planned for discussion by the Life Risk-Based Capital (E) Working Group in the near future.

3. <u>Heard an Update from the Academy on its Structured Securities RBC Project</u>

Steve Smith (Academy) started with a status update on comparable attributes. Smith reported that Moody's Ratings (Moody's) provided a large amount of data across all existing CLOs, both at the individual CLO tranche level and the underlying collateral level. In addition, the Academy also obtained economic scenario data from the SSG. The data allows the Academy to test candidates for comparable attributes (i.e., to compare candidate input data from Moody's against risk output data across the SSG's 10 scenarios in order to identify any attributes that are predictive of risk).

Barlow asked about the possibility of winding up with a factor- or model-based methodology. Smith responded that if the Academy was able to identify a sufficiently small number of attributes that do a good enough job of risk bucketing, individual modeling may be unnecessary. Another possibility is that the Academy concluded that the risk inside each of the CLOs is so idiosyncratic that risk bucketing is impossible. Barlow asked whether the factor-based approach can be leveraged on other types of structured securities if the former scenario pans out. Smith agreed that the work performed so far was primarily on CLOs, which have more readily available data. He said the Academy will likely make different judgment calls as it works through other asset-backed securities (ABS) in terms of setting factors and doing risk bucketing.

Tsang asked if the Academy has a targeted number of attributes. Tsang said he would prefer to limit the number because too many attributes will make the model unstable. Smith agreed that it is a judgment call and that the Academy will likely seek guidance from the Working Group if the number of attributes identified appears to be too many. He mentioned three comparable attributes were identified for commercial mortgage loan RBC factors. While this can serve as precedence, the Academy would prefer not to commit to a number of attributes at this moment.

Clark asked if the Academy considered the reliability of attributes when sourcing the comparable attributes. One example is that using Loan-to-Value (LTV) is only good if they are up-to-date or accurate. Smith said the reliability of attributes is an important consideration in the comparable attribute selection process.

Smith then gave a report on a relatively new workstream. He said the Academy started looking into portfolio adjustment factor (PAF) for structured securities. PAF is a measure of issuer-level diversification in a portfolio of assets. It became apparent that the measurement of issuer-level diversification works differently for structured securities than it does for corporate bonds. Given it is the early stage of deliberation, the Academy does not have a concrete proposal for PAF but would anticipate an adjustment to the current PAF methodology for structured securities. Smith also clarified that regardless of whether the Working Group ended up with a factor-based or modeled-based RBC methodology for structured securities, PAF consideration is needed, as it overlays the base factor within C-1.

In terms of timeline, Smith said the objective was to have a substantive update, ideally a proposal on a set of comparable attributes, in early 2025.

4. Adopted Revisions to its 2024 Working Agenda

Barlow said that apart from several minor updates, the main update to the working agenda is the addition of IR9: "Evaluate asset concentration related issues and the potential changes to the risk-based capital formulas to address the risk."

Eft made a motion, seconded by Leung, to adopt the revisions to its 2024 working agenda (Attachment XX). The motion passed unanimously.

5. Discussed the Status of the Fund Review Project

Barlow said that during the Summer National Meeting, the Working Group directed NAIC staff to collaborate with the American Council of Life Insurers (ACLI) and develop a comprehensive list of funds, which was believed to be helpful to scope and scale the project. The ACLI came back recently with concerns about the task and would like to amend the scope of the project as follows: to narrow the scope with the intent to achieve convergence in RBC treatment among three types of funds when they predominantly invest in bonds and receive SVO-assigned designations: 1) exchange-traded funds (ETFs), 2) U.S. Securities and Exchange Commission (SEC)-registered mutual funds; and 3) private funds. Barlow said the project entails the development of a set of principles that help justify the need for convergence among the three fund types. Such a principle-based framework can be extended to other fund types in the future.

Michael Reis (ACLI) supplemented this information with a historical perspective and explained what happened from 2017–2019 in the statutory accounting framework that created the divergence.

Mears said that she is fine with the refined scope but would like to confirm the three proposed fund types are exhaustive of all the vehicles in which insurers invest in bonds in fund construction. Reis said foreign jurisdiction bond funds may be left out, but the proposed scope is a reasonable starting point. Barlow believed other stakeholders in the call could also contribute to identifying any that are inadvertently left out.

A question was raised about whether collateralized fund obligations (CFOs) should be included in the project's scope. Reis and Clark agreed that debt tranches of CFOs are either classified as bonds or non-bond BA investments, and equity tranches of the CFOs are deemed residual tranches/interests. Neither the debt nor the equity tranches are within the scope of the fund review project.

With no further questions raised, the Working Group agreed to accept the refined scope proposed by the ACLI.

6. Discussed Other Matters

Barlow said the Working Group does not plan to meet at the Fall National Meeting.

Having no further business, the Risk-Based Capital Investment Risk and Evaluation (E) Working Group adjourned.

SharePoint/NAIC Support Staff Hub/Committees/E CMTE/CADTF/2024-3-Fall/RBC Investment Risk 10-22-24 Minutes TPR'd.docx

CLO C-1 Update to Risk-Based Capital Investment Risk and Evaluation (E) Working Group (RBCIRE)

March 24, 2025

Steve Smith, MAAA, FSA, CFA
Chairperson, Academy C-1 Subcommittee

American Academy of Actuaries

About the Academy

Mission:
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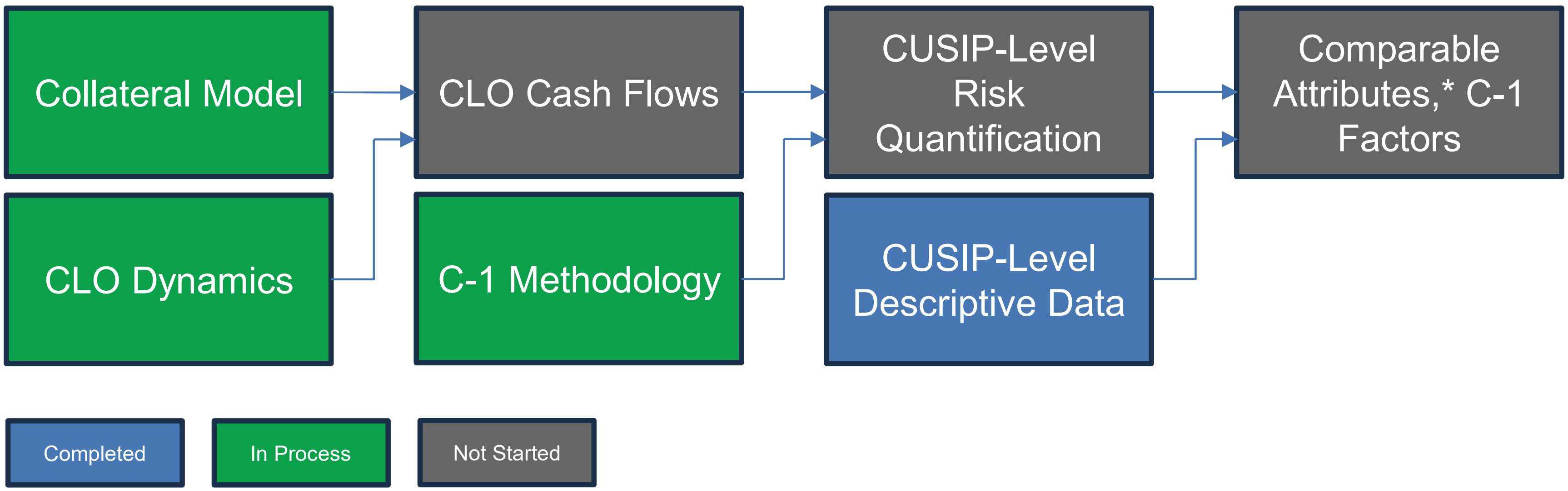
Data Flow Diagram



*This analysis is to assess the viability of comparable attributes. If deemed unviable, the result would be individual asset modeling.

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Collateral Model

- Model credit losses on the collateral pool of bank loans
- Objective: Consistency with C-1 bond factors
- Method: Use the same loss model that underlies C-1 bond factors
    - With some potential differences, e.g. secured vs. unsecured
- Status: Working with the ACLI who, with help from Moody's, developed a model that may be helpful as we explore various scenarios
- Once the model is obtained, reasonable simplifications will be explored (e.g., a closed-form approximation for credit losses)

CLO Dynamics

- Distribution of collateral losses through the CLO waterfall structure
  - Three-way agreement in place between Academy, Moody's, and NAIC for SSG to run Moody's CDOnet software on Academy's behalf
  - Establishing parameterization and settings for CDOnet
- Model to support estimation of debt and residual tranche factors

C-1 Methodology

How to use CLO cash flows to determine C-1 requirements

- Discounting
- GPVAD (greatest PV of accumulated deficiency) methodology
- Potential of inner vs. outer loops
- Risk premium
- Scenario compression
- Alignment with statutory accounting
- Treatment of PIK

American Academy of Actuaries

Key Work Completed so Far

- 2022: CLO overview
- 2023: ABS RBC principles
- 2024–2025:
  - Acquisition of Moody's CLO data
  - Collateral modeling approach
  - Scenario compression approach

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Completed: Acquisition of Moody's CLO Data

- Candidate comparable attributes
- Tranche-level data
- Deal-level data
- Collateral details
- Examples:
  - Tranche/collateral ratings (by CRP)
  - Overcollateralization
  - Tranche thickness

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Completed: Collateral Modeling Approach

- Prioritized consistency with C-1 bond factors
- Used C-1 bond model to produce loss distribution
- Adjusted for seniority of loans vs. bonds and any other known, relevant differences
- Considered closed-form approximation of loss distribution
- Stressed the timing of losses

Completed: Scenario Compression Approach

- Could not feasibly run thousands of collateral loss scenarios through CLO cash flow model
- The sole use of a single scenario could not be done, due to the cliff-shaped loss distribution of CLOs
- Instead, the tail of the collateral loss distribution will be subdivided into several discrete ranges
    - The average loss of each range will then be run through the CLO cash flow model

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Current/Remaining Work

- Acquisition of C-1 bond factor model or results, allowing for:
  - Collateral modeling specification/approximation
  - Scenario compression specification
- Parameterization of CLO cash flow model
- Conversion of CLO cash flows into losses for C-1 capital, allowing for:
  - Identification of comparable attributes
  - Development of base factors
- Diversification & concentration

American Academy of Actuaries

Questions

For more information, please contact:

Amanda Barry-Moilanen, Life Policy Project Manager

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Other Academy Resources

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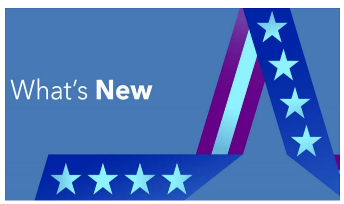
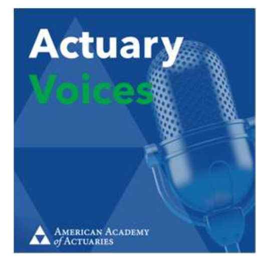
Contingencies Magazine



Policy Issue Forum

Actuarially Sound Blog



Actuary Voices Podcast

American Academy of Actuaries

Appendix. February 11, 2025 RBCIRE Update

https://www.actuary.org/sites/default/files/2025-02/Life-Presentation-CLORBCUpdate.pdf

CLO C-1 Update to Risk-Based Capital Investment Risk and Evaluation (E) Working Group (RBCIRE)

February 11, 2025

Steve Smith, MAAA, FSA, CFA
Chairperson, Academy C-1 Subcommittee

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March 5, 2025

Philip Barlow, Chair, Risk-Based Capital Investment Risk and Evaluation (E) Working Group
Members of the Risk-Based Capital Investment Risk and Evaluation (E) Working Group

Attn: Maggie Chang, NAIC – mchang@naic.org

Re: The American Council of Life Insurers' (ACLI's) RBC Principles for Bond Funds Presentation and The NAIC's Memorandum of Bond Funds Reported in 2023 Annual Statement Filings

Dear Mr. Barlow and Task Force Members,

We appreciate the opportunity to comment on the ACLI's RBC Principles for Bond Funds and The NAIC's Memorandum of Bond Funds, with a March 7, 2025 deadline.

On behalf of Payden & Rygel and our insurance clients, **we support the "Future State after Applying Principles" and the relevant changes to RBC Charge and RBC Charge Methodology outlined in the ACLI presentation**.

Payden & Rygel manages two mutual funds currently receiving NAIC Designations and listed on the NAIC Fixed Income-Like SEC Registered Funds List. In addition, US regulated insurers invest in multiple other Payden & Rygel mutual funds that do not currently receive NAIC Designations. Lastly, our clients also utilize private fund structures that have NAIC Designations from the Securities Valuation Office (SVO), and are reported on Schedule BA, but are required to take higher capital charges since they fall into the P&C RBC formula.

Each of these are examples of how the exact same portfolio of bonds or preferred stock could currently receive three different RBC charges due to being held in different legal forms. This does not reflect actual investment risk and reduces clarity for regulators to assess the Asset Risks of an insurer. We have submitted the two Fixed Income-Like SEC Registered Funds to receive NAIC Designations for the purpose of increasing clarity for insurers, as well as their policyholders, investors, counterparties, and regulators. Creating a consistent RBC methodology would likely entice additional fund submissions and improve clarity further.

Additionally, punitive RBC factors applied to bond and preferred stock mutual funds and private funds result in inefficient investments from insurers, particularly those with fewer total investable assets. Mutual funds and private funds allow for greater diversification of investment risk than many insurers can achieve with purchasing individual securities, however an RBC charge ~15x greater is an impediment. Improving investment efficiency can also improve an insurer's operations, access to liquidity, and overall financial strength.

RBC factors are already being utilized by the Life Insurance RBC formula for Schedule BA assets that have received NAIC designations from the NAIC SVO. While each RBC model should be developed separately, the Life Risk-Based Capital (E) Working Group has determined that the current RBC factors are appropriate to apply to bond funds. However, that is not currently permitted for P&C and Health companies.

In regards to the The NAIC's Memorandum of Bond Funds, an impact analysis would likely underrepresent the interest in the streamlined RBC approach. The inconsistency of the current regulatory framework favors certain ETFs and individual bonds and causes insurers to avoid less capital-favorable investments. We would refer the Working Group to studies* documenting the increase in ETF investment interest from insurance companies after they were permitted for Schedule D-1 reporting and systematic value accounting.

Thank you for your consideration and efforts towards the goal of ensuring consistent treatment for investments in funds that only hold bonds across all the schedules, for all insurer types.

Best regards,

Eric M. Hovey, CFA
Director, Payden & Rygel

* Greenwich Associates and State Street Global Advisors. "Insurance Company Investments in ETFs: Accelerating Growth Ahead." *Insurance AUM Journal.* Q1 2019: 14-19. and Stokes, Kelsey & Ganti, Anu R. "ETFs in Insurance General Accounts – 2024." *S&P Down Jones Indices*. May 2024.

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March 6, 2025

Chairman Phil Barlow
NAIC Risk-Based Capital Investment Risk and Evaluation (E) Working Group
National Association of Insurance Commissioners (NAIC)
1100 Walnut Street, Suite 1500
Kansas City, MO 64106

Via Electronic Submission

Subject: Comment Letter on the Proposed Principles for Bond Funds

Dear Chairman Barlow and Members of the RBC-IRE Working Group,

The Alternative Credit Council[1], the private credit affiliate of the Alternative Investment Management Association Ltd (AIMA), appreciates the opportunity to comment on the ACLI's proposed RBC Principles for Bond Funds ("bond fund principles").[2]

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[1] The Alternative Credit Council (ACC) is a global body that represents asset management firms in the private credit and direct lending space. It currently represents 250 members that manage over US$2 trillion of private credit assets. The ACC is an affiliate of AIMA and is governed by its own board, which ultimately reports to the AIMA Council. ACC members provide an important source of funding to the economy. They provide finance to mid-market corporates, SMEs, commercial and residential real estate developments, infrastructure, and the trade and receivables business. The ACC's core objectives are to provide guidance on policy and regulatory matters, support wider advocacy and educational efforts and generate industry research to strengthen the sector's sustainability and wider economic and financial benefits. Alternative credit, private debt or direct lending funds have grown substantially in recent years and are becoming a key segment of the asset management industry. The ACC seeks to explain the value of private credit by highlighting the sector's wider economic and financial stability benefits.

[2] National Association of Insurance Commissioners, *RBC Principles for Bond Funds* (February 2025), available at https://content.naic.org/sites/default/files/inline-files/Attn%202%20Principles%20for%20Bond%20Funds%20%201-9-2025%20%28ACLI%20revised%20deck%29.pdf.

We are writing to express strong support for the proposed bond fund principles outlined in the exposure draft. These principles address inconsistencies in the risk-based capital (RBC) treatment of bond funds, which arise due to differences in legal structures and accounting standards despite the economic risks being fundamentally similar. This initiative is commendable as it seeks to enhance regulatory consistency, economic risk alignment, and capital adequacy across bond exchange-traded funds (ETFs), SEC-registered bond mutual funds, and private bond funds.

The proposed principles emphasize that RBC should reflect the underlying economic risk of the collateral rather than the legal form or accounting method of the fund. This approach is crucial because the economic risk of a bond fund is primarily determined by the risk profile of its underlying collateral pool. The principles ensure a more consistent and accurate risk measurement by proposing a unified RBC treatment for all bond fund types compatible with the Securities Valuation Office's Weighted Average Rating Factor ("SVO WARF") methodology.

This change is necessary because the current RBC framework applies different charges to bond funds with substantially similar economic risks. For instance, bond ETFs are charged as bonds under fair value accounting, bond mutual funds face a 30% equity charge, despite investing in the same types of bonds as ETFs, and private bond funds are charged as bonds. These discrepancies disincentivize efficient capital allocation. The proposed unified treatment eliminates this disparity, ensuring that RBC charges reflect true economic risks and promote a level playing field.

The proposal's focus on the SVO WARF methodology for RBC charge calculation is appropriate. The SVO WARF framework aligns RBC charges with credit risk by considering the weighted average rating of the fund's underlying bonds. It provides consistent and transparent risk measurements, applicable across all bond fund types that meet the SVO's criteria. This methodology is well suited for bond funds as it evaluates risk at the collateral level rather than the legal structure level. By applying WARF consistently, the proposed principles ensure that RBC charges are based on actual credit risks, enhancing the accuracy and reliability of capital adequacy assessments.

The principles also emphasize that economic risk should be evaluated consistently across all bond funds, with no differentiation based on legal structure. Differences in legal structure or accounting standards (SSAPs) should not lead to inconsistent RBC charges. Specifically, the criteria for material similarity in economic risk state that all fund investors must have equal ownership status, ensuring no senior or junior tranches could skew risk exposure. It also ensures that investors' risk exposures are accurately captured in RBC charges, regardless of fund type or structure.

In conclusion, our members strongly support the adoption of the proposed RBC Principles for Bond Funds as they align RBC charges with underlying economic risks rather than legal structures. This approach reduces regulatory complexity, enhances transparency, and ensures a fair and level playing field for all market participants. It also reduces compliance burdens by simplifying RBC reporting requirements.

We encourage the RBC-IRE Working Group to adopt these principles and consider their application to other investment types facing similar inconsistencies in RBC treatment. This initiative will improve the accuracy, consistency, and fairness of the RBC framework.

We commend the Working Group for its leadership and commitment to regulatory consistency and capital adequacy. Please contact me at Jkrol@aima.org or Joe Engelhard, Head of Private Credit & Asset Management Policy, Americas, at jengelhard@aima.org if you have any questions or would like to discuss these topics in more detail.

Sincerely,

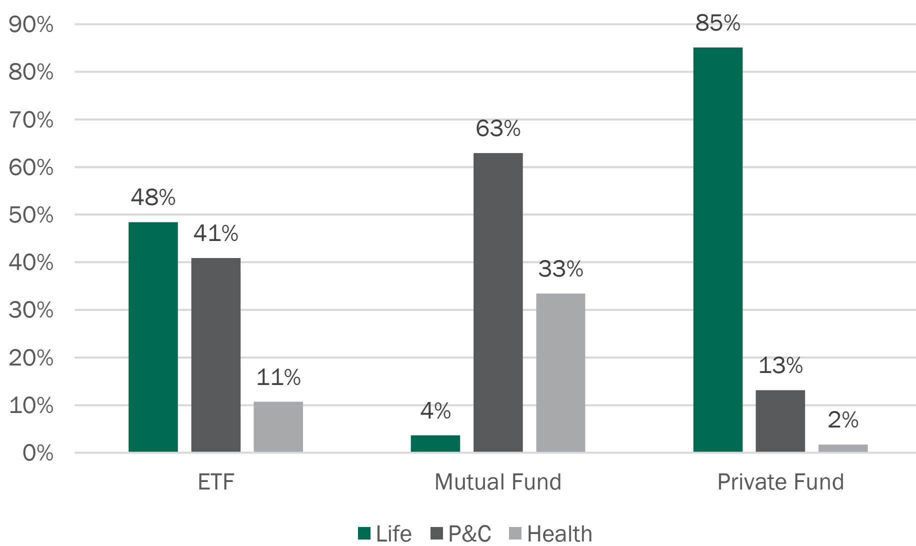
Jiří Król
Global Head of Alternative Credit Council

March 7, 2025

Dear Chair Barlow and members of NAIC Risk-Based Capital Investment Risk and Evaluation (E) Working Group:

We commend the working group for striving to create greater consistency in the risk-based capital (RBC) treatment for bond funds. We support the exposure draft for its emphasis on "substance over form" and the proposal to assign RBC charges to bond mutual funds according to Securities Valuation Office (SVO) designation. This alignment would harmonize the RBC treatment for bond mutual funds with that for bond ETFs and private funds.

The proposal, if adopted, is expected to be effective only for life insurers. However, non-life insurers, who have significantly more exposure to SVO-designated mutual funds, are currently unable to use SVO designation for RBC purposes. Moreover, for bond ETFs and private funds, non-life insurers also cannot utilize SVO designations. Overall, 96% of SVO-designated mutual funds and 45% of all SVO-designated funds (collectively across ETFs, mutual funds, and private funds) resided on non-life insurance balance sheets.[1]



Source: PineBridge Investments summary based on NAIC 2023 annual filings data on SVO-designated ETF, SEC-registered mutual funds, and private funds

We propose allowing non-life insurers to apply SVO fund designation for RBC purposes. The current inconsistent treatment (i.e., disallowing non-life insurers to use SVO fund designation) negatively impacts non-life insurers. This especially disadvantages small-to-medium non-life insurers which rely more on fund vehicles to access certain fixed income markets to diversify investment risk. Fund vehicles enable them to invest in a broader, more diverse set of fixed income assets. Disallowing non-life insurers from applying SVO fund designations subjects them to onerous RBC treatment and strongly incentivizes them to hold individual securities directly

[1] Certain Bond funds reported in 2023 Annual Statement Filings

instead. However, most smaller insurers do not have the scale or operational infrastructure to invest in this way. Fund vehicles offer a suitable alternate form of investment, where the substance of the risk is unchanged. Non-life insurers have previously supported this harmonization and submitted comment letters to NAIC working groups in June 2022 and November 2019.

Finally, we are encouraged by the recent launch of the NAIC RBC Task Force by the NAIC Executive Committee to address changes to RBC treatment designed to increase consistency. To that end, we strongly support aligning the RBC treatment for fund vehicles across both life and non-life insurers.

Sincerely yours,
PineBridge Insurance Solutions and Strategies