March 29, 2022

Standard & Poor's Global Ratings ("S&P") via email
criteriacomments@spglobal.com

RE: December 6, 2021 request for comment on Insurer Risk-Based Capital Adequacy—Methodology and Assumptions publication: PPIA response to proposed S&P Capital Model changes

Dear Standard & Poor's Global Ratings:

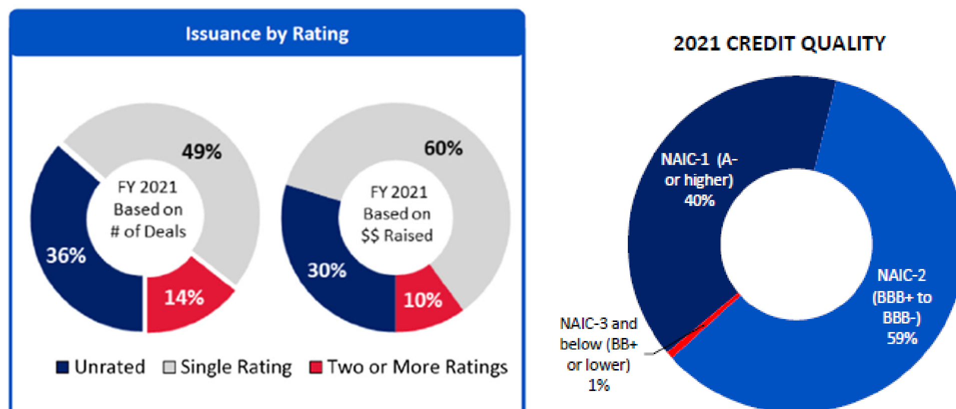
The Board of Directors of the Private Placement Investors Association[1] ("PPIA") appreciates the opportunity to comment on S&P's proposed changes to its proprietary capital model for analyzing the risk-based capital adequacy of insurance companies ("Capital Model"). While the proposed Capital Model changes are comprehensive in nature, we will limit our comments to the proposed changes in ratings treatment for privately placed debt securities that S&P does not rate. Specifically, we are referring to debt securities issued in the traditional U.S. private placement market that are exempt from registration under the Securities Act of 1933, as amended ("US Private Placements").[2]

The PPIA acknowledges that the asset-level ratings adjustment practice proposed by S&P is a single component of S&P's proposed Capital Model revisions and may not necessarily translate to a direct, material impact for many insurers' credit ratings. However, these changes will result in ratings changes for certain insurers. In addition, it is important to understand that many insurance companies manage capital with specific S&P credit ratings or claims paying ability ratings targets in mind. As such, changes to investment ratings assumptions within the Capital Model can have material and tangible implications for insurers' investment strategies and for capital markets activity generally. This is especially true for US Private Placements, the ratings of which we believe would be disproportionately and adversely affected by the proposed Capital Model changes.

The US Private Placement debt market is an estimated $750+ billion market with more than $100 billion in annual issuance, purchased primarily by insurance companies. This market is predominantly an investment-grade space, with about one-third of the debt issued bearing an A- or higher credit risk profile, and two-thirds bearing credit ratings profiles ranging from BBB+ to BBB-. Below investment grade securities constitute a *de minimis* portion of the market (typically only 1-2% of issuance in any given year—see charts on page 2).

The US Private Placement market is an important source of investment for insurers and has proven to be a valuable asset class from a risk management perspective. It is not uncommon for life insurance or annuity companies to invest as much as 15-20% of their general account portfolios in these securities. Debt issued within this market offers geographic, industry and name diversification, which can provide substantial benefit to insurers and their policyholders in terms of reduced investment risk and enhanced long-term returns. These securities also typically provide structural protections such as maintenance-based financial covenants, event risk covenants and priority debt limitations, and/or collateral, resulting in better credit loss experience vs. comparably rated public bonds.[3] As such, the PPIA would encourage S&P to take a thoughtful approach when making changes to its Capital Model, in order to avoid unintended consequences, such as diverting investment away from, or discouraging issuance activity in, the US Private Placement debt market.

A significant portion of debt securities issued in the US Private Placement market are assigned a rating by one or more Nationally Recognized Statistical Rating Organizations ("NRSROs"). Those securities which are unrated by an NRSRO receive credit risk designations assigned directly by the Securities Valuation Office ("SVO") of the National Association of Insurance Commissioners ("NAIC"). For these unrated securities, insurers file deal materials, financial information, and legal documents (along with the insurer's internal credit analysis) with the SVO. The SVO then undertakes an independent, detailed analysis of the securities to evaluate the risk and develop an appropriate NAIC credit risk designation for use by state insurance regulators. According to data produced annually by Bank of America Securities, approximately one-third of transactions issued in the US Private Placement market do not carry NRSRO ratings and instead receive NAIC designations directly from the SVO.[4] SVO personnel have repeatedly stated, correctly in our view, that the SVO takes a conservative approach when assigning such designations. Though nearly all SVO designations for US Private Placements are the equivalent of an investment grade rating, the proposed Capital Model changes would assign BB ratings (for non-financial corporate debt) and CCC (for structured securities) to these assets. The PPIA believes this is an overly punitive outcome for a large portion of insurers' investment portfolios, which are already subject to conservative credit risk analysis and designations from the SVO.



The left chart above shows the ratings composition of debt issued in the US Private Placement market during the year ended December 31,2021. Unrated securities must be filed for a designation. The right chart above shows 2021 US Private Placement market issuance by NAIC designation. The US Private Placement Market is predominantly an investment grade market. Source: Bank of America Securities 2021 USPP Market Snapshot, Issued January 2022

Likewise, a meaningful portion of the US Private Placement debt market bears a credit rating from an NRSRO other than S&P, Moody's or Fitch. The Securities and Exchange Commission has recognized the importance of diversification in credit rating providers, and there are practical considerations for selecting NRSROs, including: issuer relationships, ability and willingness to act in a timely manner, cost considerations, and expertise with respect to certain types of transactions. Because the US Private Placement market is primarily an investment-grade market, we believe it is overly punitive to assign BB ratings (for non-financial corporates) and CCC ratings (for structured securities) to these transactions. Moreover, US Private Placements may constitute as much as 15-20% of a life and annuity insurer's assets. Modeling insurers' portfolios, presuming that 15-20% of their assets are invested in below investment grade securities, would not be consistent with insurers' actual risk.

In light of these considerations, the PPIA makes two requests of S&P regarding its Capital Model:

1) That S&P conducts a mapping of its credit ratings against **all** NRSROs' credit ratings **and** against the SVO's assigned credit risk designations. We believe that sufficient data exists to perform such a mapping. Every NRSRO is required to file transition matrices with the SEC annually; therefore, it should be possible to garner default information from these matrices and perform a mapping of S&P's ratings vs. other NRSROs' ratings. Furthermore, the SVO has expressed an interest in measuring how its assigned credit risk designations have performed vs. comparable credit ratings assigned by NRSROs. The SVO may be amenable to working with S&P to supply the data necessary to perform a mapping analysis.

2) That S&P offer transparency into its mapping process and results. Only limited information has been provided regarding the methodology used for mapping to Moody's and Fitch ratings. The PPIA would like to better understand how that mapping was performed and study granular data supporting S&P's decision to notch Fitch and Moody's corporate ratings by one notch and structured securities ratings by two notches. Likewise, details for any future mappings to other NRSRO ratings, or to SVO designations, should also be shared broadly.

The PPIA understands that it will take time to develop a comprehensive mapping system. In the interim, the PPIA asks that S&P maintains its current approach of deferring to the ratings designations or equivalents that are used by the NAIC for the purposes of determining insurers' risk-based capital. As a feasible double-check, S&P could ask insurers to provide portfolio data, using insurers' own internal ratings assessments as a basis of comparison. Most insurers assign internal credit ratings to their debt and loan securities, and their ratings processes are reviewed by internal and external auditors. Indeed, for privately placed securities, ratings are a critical component of the securities valuation process, which is also reviewed and validated by external auditors as part of an insurer's annual audit.

The PPIA believes that a comprehensive mapping system, subjected to the rigors of public scrutiny and input, would result in a Capital Model that is more robust and better reflects each insurer's specific capital position than the approach currently proposed by S&P. The PPIA is concerned that S&P's proposed Capital Model changes would result in ratings and Capital Model charges that are inaccurate relative to the underlying credit quality and historical performance of the majority of US Private Placement debt issuance. We further believe that a potential consequence of S&P's proposal would be to reduce both the issuance and purchase of these securities, thereby reducing the diversification and resilience of insurers' portfolios. For this reason, the PPIA strongly encourages S&P to consider the alternative approaches that we have proposed.

The PPIA would be happy to discuss these ideas further. Feel free to contact us if you have questions.

Sincerely,

John Petchler

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FOOTNOTES

1. The Private Placement Investors Association "PPIA' is a business association of 66 insurers and other institutional investors (and their affiliates) that actively invest in the primary market for privately placed debt instruments. While our membership invests in a variety of privately marketed debt instruments, including ABS, bank loans, municipal debt, and direct lending transactions, a majority of our investable universe consists of investment grade corporate notes, infrastructure debt and project finance debt issued within the US Private Placement debt market. Collectively, PPIA membership comprises most of the invested funds within the investment grade US Private Placement debt market. The PPIA seeks to develop and promote best practices and increase issuer interest in, and access to capital within, the UP Private Placement debt market and provides an important discussion forum for its member companies.

2. Private placement debt is a broad term that encompasses a variety of different transaction types or asset classes. For the purposes of this letter, the PPIA uses the term US Private Placement debt to refer to traditional debt transactions that are marketed privately (either through direct placement activities or through agent banks) under Rule 4(a)(2), Regulation D, or Rule 3(a)(6) of the Securities Act of 1933, as amended. Such debt transactions include, but are not limited to, infrastructure and project finance debt, privately issued municipal, hospital or university debt, corporate debt (including credit tenant leases, equipment trust certificates and enhanced equipment trust certificates), bank loans, royalty securitizations, future flows transactions, and certain ABS transactions. These transactions are purchased by insurance companies, pension funds or other qualified institutional buyers and typically are market-clearing transactions, purchased by investors that are not affiliated with the issuer or guarantor of the debt. The term US Private Placement is not intended to include affiliated transactions and/or artificial contrivances aimed at risk-based capital arbitrage.

3. See April 2006 Society of Actuaries report entitled "1986-2002 Credit Risk Loss Experience Study: Private Placement Bonds" and April 2019 Society of Actuaries report entitled "2003-2015 Credit Risk Loss Experience Study: Private Placement Bonds."

4. In fact, an even higher portion of US Private Placement investments are assigned SVO designations. Bank of America Securities' chart considers issuance to be rated, either if a debt security carries a CUSIP-specific NRSRO rating, or if the issuer of that debt security carries a general corporate issuer rating. However, <u>any</u> debt security without a CUSIP-specific NRSRO rating must be filed to receive an NAIC designation, even if an NRSRO rates the issuer of that security.