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July 18, 2024

Ms. Carrie Mears

Chair, Valuation of Securities (E) Task Force (VOSTF)
National Association of Insurance Commissioners (NAIC)
110 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

Re: Revised Proposed P&P Manual Amendment to Update the Definition of an NAIC Designation

Dear Ms. Mears:

The undersigned (ACLI, PPIA, and NASVA) appreciate the opportunity to comment on the exposure referred to above that was released for comment by the VOSTF on June 18, 2024. As noted in our previous letter, dated January 26, 2024, on this topic, and as often stated by both industry and regulators, the P&P Manual is often difficult to navigate, and includes conflicting and confusing language. Therefore, we agree with the premise to clearly and concisely define an NAIC Designation in a single uniform location (i.e., not in both Part 1 and Part 2 of the P&P Manual).

The undersigned are also appreciative of the VOSTF for giving serious consideration to our comments / concerns expressed in our previous letter – specifically:

- Providing appropriate clarification and addressing concerns surrounding the VOSTF's role in assessing the ability of insurers to pay claims and the underlying related regulatory assumption, and
- Beginning cleanup work (which may continue as lingering references are identified) to remove the Subscript S language, a significant source of confusion for both regulators and industry.

The remainder of our letter will focus on the latest proposed Definition of an NAIC Designation from the exposure. The undersigned believe that in the vast majority of circumstances, the NAIC Designation represents the credit quality of the investments, with somewhat limited exceptions. We do not believe the exceptions should drive the definition, without clear articulation of that fact. Our comments are expressed in more detail below. The exposure includes the following changes to the definition of an NAIC Designation.

American Council of Life Insurers | 101 Constitution Ave, NW, Suite 700 | Washington, DC 20001-2133

The American Council of Life Insurers (ACLI) is the leading trade association driving public policy and advocacy on behalf of the life insurance industry. 90 million American families rely on the life insurance industry for financial protection and retirement security. ACLI's member companies are dedicated to protecting consumers' financial wellbeing through life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, and dental, vision and other supplemental benefits. ACLI's 280 member companies represent 94 percent of industry assets in the United States.

NAIC Designations represent opinions of gradations credit quality of the likelihood of an insurer's timely receipt of an investment's full principal and expected interest. Where appropriate for a given investment, NAIC Designations and Designation Categories 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 and all other risks or factors that may affect repayment, such as, except for volatility/interest rate, prepayment, extension or liquidity risk.~~ [Editing Note: moved from Part One, para. 37] 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, 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.

Specifically, the focus of our comments will be on the first sentence as well as subsequent references to "credit risk" in the P&P Manual being changed to "investment risk". The explanation in the exposure for this change is as follows:

Creation of a concise definition of an NAIC Designation which focuses on the likelihood that an insurer will receive full and timely principal and expected interest. This change reflects a departure from the term "credit risk" which focuses on the ability of an issuer to make payments in accordance with contractual terms. Credit risk alone may, at times, be too narrow a concept for NAIC purposes. For example, the performance component of a principal protected security (PPS) may produce no return and, therefore, the PPS could pay no interest with no event of default by the issuer. As such, focusing solely on credit risk could limit the SVO's ability to assess the risk of the performance component of a principal protected security.

The undersigned understand the rationale for this change, as the credit risk which focuses on the ability of an issuer to make payments in accordance with contractual terms may be too narrow for NAIC purposes in limited situations such as with Principal Projected Securities or when the NAIC applies their WARF methodology to SVO designated funds. However, credit risk assessment is still the overall fundamental and predominant determinant of what an NAIC designation represents. As the new term "investment risk" is not defined, it is imperative the P&P Manual have some explanatory language. Given the importance of this need, perhaps in a paragraph immediately following the definition of an NAIC designation, this should be codified. The undersigned suggest the following and are willing to work with the VOSTF/SVO to refine, if needed, as appropriate.

Creation of a concise definition of an NAIC Designation focuses on the likelihood that an insurer will receive full and timely principal and expected interest (i.e., "investment risk"). This change reflects a departure from the term "credit risk" which focuses on the ability of an issuer to make payments in accordance with contractual terms. Credit risk alone may, at times, be too narrow a concept for NAIC purposes. For example, the performance component of a principal protected security (PPS) may produce no return and, therefore, the PPS could pay no interest with no event of default by the issuer. Similarly, the SVO designates certain funds using its Weighted Average Rating Factor (WARF) methodology where the fund does not pay in accordance with contractual terms. As such, while credit risk is the overall fundamental and predominant determinant of what an NAIC designation represents, it would limit the SVO's ability to assess the risk of the performance component

of a PPS or certain funds appropriately for regulatory purposes. While credit risk is the overall fundamental and predominant determinant of what an NAIC designation represents, for both CRP ratings used in the filing exempt process and SVO internally developed NAIC designations, the concept of credit risk has been changed to investment risk. Instances where credit risk alone is not appropriate include:

- *Principal Protected Securities, and*
- *NAIC designated funds.*

As part of the process of the SVO identifying other instances of investment risk outside of credit risk, including through the process of discretion over CRP ratings with a thematic occurrence (e.g., per paragraph 173 of proposed amendments to the P&P Manual authorizing the procedures for the SVO's discretion over NAIC Designations assigned through the filing exemption process), when such instances are identified, they will be added to this list.

Sincerely,



Mike Monahan
ACLI



Tracey Lindsey
NASVA



John Petchler
on behalf of PPiA Board of Directors

cc: Charles Therriault, Director, Securities Valuation Office
Eric Kolchinsky, Director, Structured Securities Group