



167 Fleet Street, London EC4A 2EA, UK
+44 (0)20 7822 8380

info@aima.org

acc.aima.org

Doug Ommen
Iowa Insurance Commissioner
Chair, Valuation of Securities (E) Task Force
National Association of Insurance Commissioners

Via Electronic Submission

January 26, 2024

Comment letter on Revised Proposed P&P Manual Amendment Authorizing the Procedures for the SVO's Discretion Over NAIC Designations Assigned Through the Filing Exemption Process (Doc. ID: 2023-005.15)

Dear Commissioner Ommen,

The Alternative Credit Council ("ACC")¹, the private credit affiliate of the Alternative Investment Management Association Ltd ("AIMA"), appreciates the opportunity to comment on the revised proposal to authorize the Securities Valuation Office ("SVO") of the National Association of Insurance Commissioners ("NAIC") to review and potentially adjust the credit rating issued by an NAIC recognized credit rating provider ("CRP").²

The revised proposal would amend the rule adopted by the NAIC in 2004 that exempts bonds and preferred stock that have received a current, monitored rating from an NAIC-recognized CRP from the requirement to receive an NAIC designation from the SVO. Instead, the rating provided by the

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 \$1trn 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 with the view to strengthening 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 Amendment to the P&P Manual of the NAIC Investment Analysis Office Authorizing the Procedures for the SVO's Discretion Over NAIC Designations Assigned Through the Filing Exemption Process (hereinafter "SVO Rating Override Proposal"), available at <https://content.naic.org/sites/default/files/inline-files/2023-005.15%20P%26P%20SVO%20Discretion%20-%20Revised%20v4.pdf>

Alternative Credit Council (ACC)

CRP is converted to the NAIC designation and used by insurance supervisors for reporting, reserving and capital charge purposes. Under the revised proposal, there would be fifteen steps in the SVO process to review all filing-exempt ratings and determine which CRP ratings should be overridden and replaced by the SVO's own rating. (See Annex for a full description of these proposed steps, the related changes to the NAIC's Purposes and Procedures Manual of the NAIC Investment Analysis Office (the "P&P Manual") and AIMA's specific concerns.)

We appreciate the positive changes made by the Valuation of Securities Task Force ("VOSTF") and the SVO to the most recent, revised version as part of a dialogue with a variety of industry stakeholders. However, we still have substantial conceptual as well as procedural concerns about the revised proposal, including the effectiveness of the review and appeals process, the negative impact that the extra cost and time of the review process may have on an affected investment, and the potential ramifications of an SVO override of even a single type of investment on the entire asset class.

Given these concerns, which are detailed in the Annex below, we recommend that the VOSTF form a working group with industry representatives from issuers, CRPs, and insurers to discuss the conceptual and practical concerns outlined in the Annex and to discuss how to better mitigate potential negative impacts to both the specific investments and an entire asset class that may become subject to an SVO override.

Should the NAIC proceed with this proposal, we recommend the following key changes: 1) provide greater clarity on the methodology that will be used to identify which ratings will be identified for initial review, 2) allow affected insurers, issuers and credit rating providers earlier notice and greater access to the deliberations in Steps 3 through 8, 3) clarify the role of state insurance supervisors in Step 8 and ensure they have greater oversight and decision-making in the proposed SVO process, 4) require a comprehensive written record and enable access of all information to make the independent third party review more feasible, and 5) create a working group that would allow for a dialogue between issuers, rating agencies, investors, the SVO and VOSTF staff to jointly discuss the proposed process and its potential market implications. Please see the Annex for details on these recommendations.

If you have any questions, please contact me or Joe Engelhard, Head of Private Credit & Asset Management Policy, Americas, at jengelhard@aima.org or 202-304-0311.

Sincerely,

Yours sincerely,



Jiří Król

Deputy CEO, Global Head of Government Affairs

ANNEX

The revised version of the SVO Override Proposal would establish fifteen steps in the process for the SVO to review all filing exempt securities and to determine whether the rating is unreasonable for regulatory purposes:

- 1) SVO staff identifies an FE security with an NAIC Designation determined by a rating that appears to be an unreasonable assessment of risk.
- 2) SVO Senior Credit Committee (SCC) meets to determine if it agrees that the rating appears an unreasonable assessment of risk and, if so, places the security "Under Review".
- 3) If the SVO SCC votes to put the security "Under Review" an information request will be sent through VISION to insurers that hold that security in their VISION portfolio and an the SVO Administrative Symbol assigned to identify them in VISION and AVS+.
- 4) If the information request is not responded to, the SVO may reach out to the domiciliary Chief Financial Examiner.
- 5) Upon receipt of all necessary documentation through the information request, the SVO will then perform a full analysis of the security and coordinate with the interested insurer(s) on any questions or issues the SVO may have about the security.
- 6) SVO SCC re-convenes and determines, based on its full analysis of all necessary information, whether the FE NAIC Designation is three (3) or more notches different than the SCC's opinion.
- 7) If the SVO SCC opinion differs from the FE produced NAIC Designation Category by a material three (3) or more notches the specific CRP rating(s) for that security will be removed from FE.
- 8) The SCC will present its analysis to a sub-group of the Task Force to provide oversight over the FE removal process and enable the Task Force to provide feedback to the SVO.
- 9) If there are no alternative CRP ratings, the SVO SCC's assessment will be entered into VISION. If an alternative CRP rating is subsequently received, it will be incorporated into the FE process, if applicable.
- 10) If the SVO SCC assesses the issue is part of a recurring pattern, the SVO Director will inform the chair and decide if an issue paper, referral or amendment is needed.
- 11) An anonymized summary of each unique issue or situation will be published on the SVO webpage or some other insurer accessible location for transparency.
- 12) An insurer may appeal to the Task Force chair if they believe the SVO did not follow the procedures outlined in the P&P Manual.
- 13) If an insurer(s) wishes to appeal the SVO SCC's analytical assessment, it may request the NAIC's IAO to contract, at the insurer(s) expense, with an independent third-party acceptable to the NAIC IAO to perform a blind review of the security (e.g. without knowledge of the SCC's, insurers' or CRP's assessment) with the information provided through the information request. If the independent third-party review results in an NAIC Designation Category that is one (1) or less notches different from the FE produced NAIC Designation Category, then the SVO SCC's opinion will be overridden by the reinstatement

of the CRP rating(s). If the independent third-party review results in an NAIC Designation Category that is more than one (1) notch different from the FE produced NAIC Designation Category, then the SVO SCC's opinion will remain.

14) The SVO will identify through SVO Administrative Symbols when a CRP rating(s) has been removed from the Filing Exemption process for a security.

15) At the Spring National Meeting, the SVO Director will summarize FE discretion actions taken for the preceding year.³

Regarding Step 1, we have several concerns and questions, including how will the SVO staff be able to review the thousands of FE filings on a fair and impartial basis? What criteria would they use to decide that the rating "appears to be an unreasonable assessment of risk"? We believe this step requires additional study to better determine what criteria and analytical tools the SVO staff will use to identify CRP ratings that they believe may be an unreasonable assessment of risk.

In Step 2, the SCC would meet to make its own determination that the identified CRP rating may not be reasonable for regulatory purposes and, if so, should be put "under review." Paragraph 166 of the proposed update to the P&P Manual states that the SCC can consider four factors in reviewing an initial IAO staff assessment: (i) a comparison to peers rated by different CRPs, (ii) consistency of the security's yield at issuance or current market yield to securities with equivalently calculated NAIC Designations rated by different CRPs, (iii) the IAO's assessment of the security applying available methodologies, and (iv) any other factors it deems relevant.⁴ In the minutes of the VOSTF's meeting, the SVO indicated that it primarily uses "Moody's Investors Service (Moody's) and Standard & Poor's (S&P), when it reviews securities because the SVO generally [sic] finds those methodologies to be clear, reasonable, and widely accepted across financial markets."⁵ We are concerned that could lead issuers to prefer to use those two rating agencies, given that would lessen the odds that the SVO would put them under review by the SCC or that the SCC would find the rating to be unreasonable.

However, that additional information does not answer the question of under what basis the IAO staff made the initial assessment in Step 1. Given that individual staff of the IAO report to SVO senior management, one or more of whom will be members of the SCC, a reasonable course of action would be for the IAO staff to use these identified factors, but how can IAO staff obtain all of this information on the thousands of filing exempt ratings, let alone adequately analyze that information to determine whether any particular rating appears to be unreasonable?

Another concern regarding Step 2 is that there is no indication of which members of the SVO would be part of the SCC, so it would be helpful for the P&P Manual to specify this.

Regarding Step 3, only insurers that hold the relevant security will be informed that it is under review and asked to provide additional information. After the additional information is received,

³ SVO Rating Override Proposal, *supra* note 2, at pages 2-3.

⁴ *Id.* at page 8.

⁵ Minutes of VOSTF August 14, 2023 meeting, page 6 (available at https://content.naic.org/sites/default/files/national_meeting/VOSTF%20Materials%202023%20Fall%20National%20Meeting%20v7.pdf).

in Steps 6 and 7, the SVO reconvenes. If the SVO determines that the appropriate rating is three or more notches below the filing exempt rating, then that rating is removed from filing exempt status.

Not until Step 8 would any information about a particular SVO filing exempt rating review be provided to a sub-group of VOSTF members, and the language of Step 8 implies that the VOSTF-subgroup would be presented with information about this decision rather than having any ability to approve or overturn that decision. Step 8 does not contemplate any affected insurer, rating agency or issuer to be present when the SVO explains its decision to the VOSTF-subgroup.

We strongly encourage adjustments be made to Steps 3 through 8 that would allow for a greater opportunity for input from affected insurers, issuers and CRPs. Additional changes should be made to allow the VOSTF-subgroup to hear from affected parties in addition to the SCC, so that they could understand the potential impact on affected insurers, rating agencies, or issuers. Providing the VOSTF-subgroup with a wider range of information and views would better enable them to provide sufficient oversight and make informed decisions. Step 8 should be modified to provide greater clarity on the role for the VOSTF-subgroup and enable it to address any concerns raised by the affected insurers, rating agency and issuer before the SCC finalizes any decision to remove filing exempt status. To achieve this goal, we believe that the VOSTF-subgroup should have the authority to prevent the SCC from finalizing any decision to remove a rating from filing exempt status until their concerns and questions have been sufficiently resolved.

Step 8 does not currently require the SCC to provide a written record of the information gathered, the analysis it undertook, or an explanation for how it determined that its rating was three notches less than the one provided by the CRP. Requiring such a written record is critical not just for the oversight of the VOSTF-subgroup, but also for any potential appeal discussed in Step 13.

In Step 9, an insurer would be allowed to use a second CRP rating if one is or later becomes available. We are concerned that this may result in a de-facto need to obtain two credit ratings for every filing-exempt security, given the market risks to an investment that becomes subject to a failed filing-exempt rating. This would significantly increase the costs of investing and, as mentioned before, pressure issuers to utilize one or both of the two major rating agencies identified as the ones that the SVO primarily uses. Instead, this step should be delayed, and an affected insurer or issuer should be allowed to obtain a second rating before any final SVO decision is made to remove filing exempt status.

In Step 11, the SVO would publish an anonymized summary of the final results of its deliberations, but that step should be clarified to include if any decision was made to remove filing exempt status from a particular security. To avoid potential negative market impact on all securities of that asset class, the summary should also provide sufficient detail for holders of the same type of security to understand if that decision might impact them.

We have serious concerns about the viability of the proposed blind appeals process outlined in Step 13. A third-party review, to be meaningful, would need access to the original documentation, rationale, and other information that can often only be fully understood over a period of dialogue with the relevant investment parties. By depriving the blind reviewer of all the information gathered by the CRP and its analysis, along with the same information and analysis of the SCC, it would be extremely difficult, time-consuming and expensive for a third party to recreate it using their own efforts. To make the appeals process fair, an extensive written record would be

necessary, along with the establishment of a process whereby confidential information can be shared between the issuer, CRPs, the SVO and the blind reviewer.

Finally, as part of the changes suggested above, we recommend that the VOSTF create a working group with market participants, including representatives from issuers, CRPs, and insurers to consider the impact of an SVO review on the market impact of overriding the CRP rating of a specific investment. This should include a discussion of how any time delays and additional costs might affect a particular investment, as well as the broader market consequences of a particular CRP rating being overridden.