ALTERNATIVE CREDIT COUNCIL
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Philip Barlow, Chair Risk-Based Capital Investment Risk and Evaluation (E) Working Group
National Association of Insurance Commissioners (NAIC)
Via Electronic Submission

February 26, 2024

Dear Mr. Barlow:

Re: Structured Securities – Interim RBC Factor for Residual Tranches (Data Request)

The Alternative Credit Council ("ACC")[1], the private credit affiliate of the Alternative Investment Management Association Ltd ("AIMA"), welcomes the opportunity to provide the attached research conducted by Oliver Wyman in furtherance of your willingness to receive an independent third-party data-driven study on structured security residual tranches.

Over the past two years, given the emerging importance of the asset class, the NAIC and other stakeholders have examined insurance company asset-backed security (ABS) holdings, particularly ABS residual tranches. After a significant debate and under instructions to move forward rapidly, the NAIC decided on an interim basis, by YE 2024, to increase the risk-based capital charges for ABS residual tranches from 30% to 45% on an interim basis. However, we appreciate that you and several other NAIC officials, on several occasions, have publicly expressed an openness to interested parties providing credible data that could demonstrate whether or not a 45% residual capital charge is appropriate and, potentially, changing the

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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 $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.

interim charge to be consistent with that data. In response to these statements, we have engaged Oliver Wyman (OW) to conduct an independent analysis of the relative risk of ABS residual tranches and to provide such data to the NAIC for discussion.

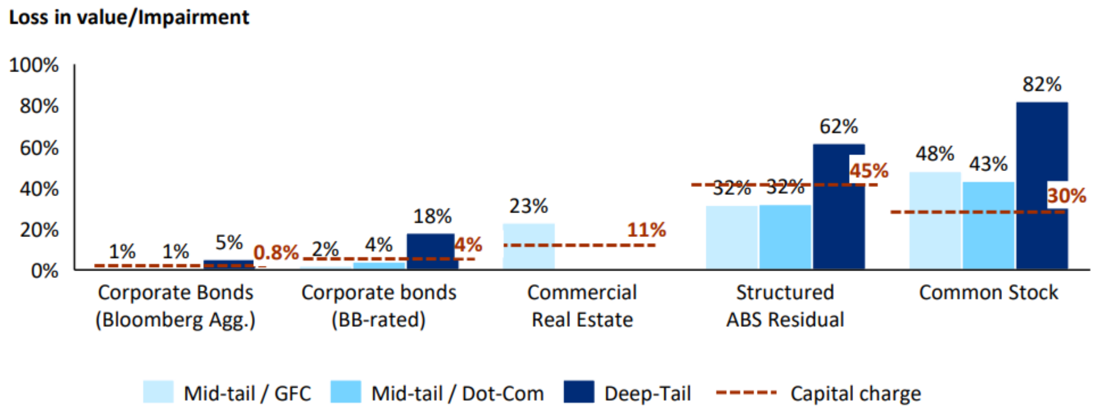
Oliver Wyman chose the methodology that it believes would result in the most accurate results consistent with how the NAIC has historically developed capital charges and that utilizes the NAIC's accounting principles. The study examines specific classes of ABS residual risk on an objective, quantitative basis using a forward-looking model and compares those results to common equity (30% risk-based capital charge). Representative samples (30 deals) were randomly selected from each of the following ABS asset classes, as these asset classes represent more than 60% of ABS total outstanding volume:

- Middle market CLOs
- Broadly syndicated loan CLOs
- Prime Auto Loan ABS
- Subprime Auto Loan ABS
- Private Student Loan ABS

In modeling residual risk in these asset classes, the study considers the significant variations in underlying assets and structures in ABS. The study also simulates the impact of adverse market conditions—including the 2008 financial crisis and the Great Depression—on the cash flow profiles and their valuation. To do so, the study uses a scenario calibrated to Value at Risk (VaR) 95%, with a Mid-Tail stress utilizing the credit losses experienced in the 2008 financial crisis and the Dot-Com bubble, relative to commonly used baseline assumptions. The study uses VaR 95% because the NAIC historically used VaR 94-96% scenarios to establish capital charges for other assets, including corporate bonds. The study also uses a Deep-Tail stress scenario based on corporate credit experience from the Great Depression reflecting an approx. 99th percentile severity to measure residual losses in an extreme scenario. While modeling this deep tail is important to demonstrate a thorough analysis, to our knowledge, no asset is calibrated to VaR 99% under RBC, and the highest calibration is currently VaR 96%.

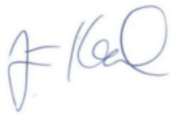
The study concludes that, on a portfolio basis, ABS residuals perform better than common equity under all modeled stress scenarios. Further, common stock losses are 30 percent higher than ABS residuals in the Deep-Tail stress scenario and 35-50 percent higher than ABS residuals in the Mid-Tail stress scenarios. This final conclusion is summarized in Figure 22 on page 30 of the Oliver Wyman research paper (copied below):

Figure 22: Capital charges compared to modeled scenario losses for selected asset classes[30]



We believe the data presented in the OW study is persuasive that the 45% interim risk-based capital charge does not reflect the actual risk when compared to the capital charges and losses of the other assets listed in Figure 23. We also believe this additional data provides ample evidence that more diligence should be done before imposing any interim capital charge, and we suggest an implementation delay to allow further consideration of any and all data put forth by interested parties. We welcome questions and dialogue on the OW study results and look forward to receiving your feedback. If you have any questions, please reach out to me or Joe Engelhard, Head of Private Credit & Asset Management Policy, Americas, at 202-304-0311 or jengelhard@aima.org.

Respectfully,



Jiří Król
Global Head of Alternative Credit Council