July 25, 2023

The Honorable Rep. Warren Davidson
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The Honorable Rep. Andy Barr
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The Honorable Rep. Bill Posey
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The Honorable Rep. Blaine Luetkemeyer
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The Honorable Rep. Scott Fitzger14(i(i)-13(t42 policyholders. The amount of risk-based capital they are required to hold, which directly impacts on their ability to pay claims, is linked to the risk of those investments. All insurer investments are given a "NAIC designation," which corresponds with a prescribed capital factor. If an investment is rated by one or more of the Nationally Recognized Statistical Ratings Organizations (NRSROs)—and roughly 80% of all insurer investments are rated—the NAIC designation is mapped directly to that rating with no further analysis or oversight by state regulators or the NAIC. These are called "filing exempt" or FE securities, in that they do not have to be filed with the NAIC's Securities Valuation Office (SVO) for review.

However, if an insurer chooses to invest in an unrated investment, the SVO provides centralized credit analysis for that security and produces the corresponding NAIC designation. This allows insurers the flexibility to go beyond traditional rated securities, while ensuring that the state regulatory system has confidence in the credit quality of those investments. Due to the vast scope of insurer investments, reliance on NRSROs provides an efficiency that we have no intention of displacing or competing with; however, because our risk-based capital system is linked directly to investment strength, this deference to NRSROs' opinions is not unconditional. It is also worth noting that the work the SVO performs on behalf of the states is for regulatory purposes only and is not released publicly or used to compete with NRSROs.

Insurers, and particularly life insurers, have long been relatively conservative, long-term investors to match the nature and duration of their long-term liabilities. However, a decade of historically low interest rates led to low yields on the traditional treasuries, municipal bonds, and high-quality corporate bonds the industry favored. This in turn compelled many insurers to seek higher yielding, but often more complex, less-liquid, and potentially riskier asset-backed securities, private placements, or other bespoke investments, which require consideration of whether a higher Risk-Based Capital (RBC) charge is appropriate due to increased risk.

In recent years, state regulators have noticed growing discrepancies between the ratings provided by competing NRSROs for the same security—in some cases, five or more notches difference in the ratings. Keeping in mind that the better the rating, the less capital an insurer is required to hold, the potential for "rating shopping" is a real concern and one with historical precedent. Indeed, because of such discrepancies for residential and commercial mortgage-backed securities, revealed during the Great Financial Crisis, we developed a separate credit analysis process for those securities that continues to this day.

In response to growing regulatory concerns with the financial engineering seen in bespoke investments today, the insurance commissioner members of the NAIC's Financial Condition (E) Committee's adopted a charge to:

[redacted]

We believe the proposal, when adopted by our membership, is an appropriate approach to ensure that insurers are holding sufficient capital based on the risk they are taking with their investments and ultimately will leave policyholders better protected. We do not anticipate any competitive imbalance for NRSROs because our work is for regulatory purposes, to arrive at appropriate capital charges, and will not be released publicly or to the broader capital markets. The materiality thresholds we have put in place ensure that challenging a CRP will only commence when a significant red flag occurs, and even then, the notice and appeal process ensures fair treatment for all parties.

While we have no intention of challenging the NRSRO's methodologies or opinions or disrupting the important role they play in our public markets, we are also under no obligation to defer to them without judgment or exception as the de facto driver of our risk-based capital framework. Past financial crises and recent banking turmoil ill Tm/o ils ation en-US clP≥ticapita cat

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