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Memo

To: Commissioner Nathan Houdek, Chair, Financial Condition (E) Committee

Cc: Dan Daveline

From: Tricia Matson, Partner and Edward Toy, Director

Date: March 28, 2024

Subject: RRC comments regarding the Framework for Regulation of Insurer Investments

Background

The Financial Condition (E) Committee ("E Committee") exposed a document on August 15, 2023, for comment entitled "*Framework for Regulation of Insurer Investments – A Holistic Review*". RRC submitted a comment letter dated September 15, 2023. RRC also made oral comments in Orlando at the NAIC's 2023 Fall National Meeting.

E Committee exposed three documents on February 15, 2024, consisting of "*Memo from E Committee to Interested Parties*", "*Investment Framework as Revised E Committee*" and "*Investment Framework Workplan*". RRC was provided with the opportunity and made verbal comments at the E Committee meeting in Phoenix during the NAIC's 2024 Spring National Meeting.

RRC appreciates the opportunity to follow up with our written comments. Should you have any questions, we would be glad to discuss our comments with you and the committee members.

RRC Comments

In our previous comment letter on the Framework, we acknowledged the importance of NAIC oversight on the use of rating agency ratings as a regulatory tool. We continue to believe that having a firm understanding and comfort with respect to the methodologies employed by the individual rating agencies is critical to their use and do not have anything further to add at this time.

We also acknowledge that Bonds reported on Schedule D continue to be a majority of the insurance industry's invested assets and that, because of that, having comfort in the assignment of appropriate NAIC Designations is an important aspect of continued regulatory oversight.

Our comments in Phoenix and in this letter focus on investment risks that have evolved and that continue to evolve and grow within insurance company portfolios and in their respective investment practices. We believe that while credit risk that is represented in Bond portfolios is material, the regulatory needs there are incremental. Our greater concern lies in credit risk that exists in other parts of the insurance industry's invested assets, and in other aspects of investment risk.

We have, at different times, highlighted two specific examples where we see exposure to credit risk outside of Bond holdings. The insurance industry's exposure to Mortgage Loans that are reported on Schedule B has grown significantly in recent years. Most of that growth has been within Life insurance companies, but there has also been material increases in exposure among other insurer types. The type and tenor of Mortgage Loans have also changed. At many insurance companies this has expanded to increasing amounts of direct exposure to Residential Mortgage Loans and to Construction Loans. Growth in Commercial Mortgage Loans, which consists primarily of non-amortizing bullet loans, is creating

additional risk due to changes in markets in recent years in the Office and Retail sectors. Investments in Collateral Loans that are reported on Schedule BA have increased materially in the industry and represent a significant percentage of assets at some insurance companies. Collateral Loans are treated as fixed income instruments with a fixed income-like Risk-Based Capital factor. But the underlying assets supporting those Collateral Loans and the strategies behind them are varied.

Beyond the issue of exposure to credit risk, we are concerned about significant increases in exposure to market volatility and liquidity risk. What tools and support are available to regulators to understand and assess these risks within insurance companies? Whether it is in Bonds reported on Schedule D or in other parts of the investment portfolio, the investment portfolios are more vulnerable to changes in markets and are less liquid than they were a few years ago. The significant increase in interest rates in 2022 that continues today had a substantial negative impact on the fair value of the portfolios. With the relative calm in the markets from 2008 to 2020 that prevailed along with low interest rates, it is possible that insurance company risk management systems are not sufficient to cover this increased level of market volatility. Liquidity policies and liquidity stress testing regimes may not fully take into account fair values that in many cases are significantly below carrying value. Market volatility and liquidity risk are potentially impacted by asset concentrations in illiquid, more complex and less transparent asset classes.

The *Investment Framework Workplan* includes six Action Items as next steps. Based on our comments in this letter, there are two Action Items that we strongly endorse and encourage expedited consideration.

Action Item #5 proposes the formation of a new regulatory working group that would also support the Financial Analysis Working Group, the Valuation Analysis Working Group and other working groups. Incorporating the views of regulators that have a firsthand view into actual changes in insurance company portfolios and investment practices, and concerns on how this could impact the ability of those companies to meet policyholder claims would be extremely valuable in the discussion and in the development of regulatory priorities. We encourage the E Committee to move on this Action Item quickly.

Action Item #4 proposes the formation of centralized investment expertise with a focus on expertise that may not currently be sufficient within the NAIC. Risk-Focused Analysis and Risk-Focused Examinations encourage regulators to recognize where the risk is and where it is going, not just where it has been. It is important to not just review where past problems or issues were, but to look at prospective risks, i.e., where the next problem or issue may be. We understand that this requires discussion and the engagement of specialized resources that may not currently be available and therefore will take time to develop. We recommend that this effort begin quickly. This should include an agreed upon timeline so that regulators and other stakeholders have a clear view of the goals and progress toward those goals.

Thank you for the opportunity to provide comments on this important initiative. We can be reached at tricia.matson@riskreg.com (860) 305-0701 and edward.toy@riskreg.com (917) 561-5605 if you or other committee members have any questions.