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Memo

To:	Elizabeth Kelleher Dwyer, Chair, Financial Condition (E) Committee
Cc:	Dan Daveline
From:	Tricia Matson, Partner and Edward Toy, Director
Date:	September 15, 2023
Subject:	RRC comments regarding the Framework for Regulation of Insurer Investments

Background

The Financial Condition (E) Committee exposed a document on August 15 for comment entitled "Framework for Regulation of Insurer Investments – A Holistic Review". RRC appreciates the opportunity to offer our comments. Should you have any questions, we would be glad to discuss our comments with you and the committee members.

RRC Comments

We begin by acknowledging several key elements.

- The investments and investment practices of U.S. insurance companies have evolved significantly over time. While bonds continue to be the predominant asset type, structures are more complicated. Other asset types have increased in importance, including different subcategories.
- The markets in which U.S. insurance companies must operate have grown increasingly complex and volatile.
- These two factors in combination, along with changes in the liability structure of insurance companies, mean significantly different risk profiles than insurance regulators needed to deal with in the past.
- It is important that the regulatory approach for oversight evolve to meet these challenges.
    - This new approach must be holistic, considering the entire portfolio of the insurance company and reflect appropriate attention to what should be the primary focus of insurance regulators, the liabilities of the insurance company and its ability to meet policyholder claims.
    - This new approach should take advantage of efficiencies that are available, including making the best use of existing resources.
    - This evolution will require new tools and new resources that may not currently be available within the NAIC or state insurance departments.

Our remaining comments are general thoughts on considerations for future enhancement, rather than specific, prescriptive suggestions on the appropriate next steps since this work is still in an early stage of development.

Reliance on Rating Agencies and the Role of the NAIC's Investment Analysis Office

The Effectiveness and Efficiency Project, resulting in Filing Exempt (FE) status for most of the industry's bond holdings, was adopted many years ago to improve on the process. The goal was to eliminate the administrative burden of translating nationally recognized statistical rating organization (NRSRO) ratings and reallocate those resources to more critical and valuable analysis.

There is a degree of judgement involved in rating investments and rating agencies can have different approaches to assessing the risk of default of a bond. Trying to make a direct interpretation across rating agencies is difficult. Because of this, we believe that it is not the best use of the NAIC's resources to focus on a relatively small number of differences in ratings for a given asset class or asset type. We encourage the NAIC instead to engage in a robust dialogue with each of the rating agencies about the process and approach that they have for each asset class. Are the procedures robust and well documented? Is there good tracking of ratings changes over time, sometimes referred to as transitions matrices, to ensure reliability? If the regulators are convinced that the process being followed is not robust or otherwise does not meet their needs, they can consider making an appropriate adjustment to the translation formula for those asset types, asset classes or for the individual rating agency. When material concerns are surfaced, regulators have tools at their disposal while a more thorough review of the rating agency's process is undertaken. The NAIC's Valuation of Securities Task Force can expose the concerns at one of its meetings and has the ability to implement an interim change in guidance until a more thoroughly vetted approach can be agreed upon.

Regulators have always retained the right to determine that a rating agency's process is not reliable. This regulatory authority must continue to be taken seriously. It should be based on robust reasoning that is well documented. We believe decisions to not follow the current formula should not be based on differences in individual ratings but on an assessment of the process. Any decision should be based on a thorough analysis of the process being employed, why it is not appropriate, and be well documented. Transparency to all insurance companies (so that problems and issues can be properly monitored and managed) and to the market is paramount to avoid confusion and disruption.

Broadening the NAIC's Analysis of Investments and Portfolios

U.S. insurance company portfolios are very different today than they were 20 or 30 years ago. For example, RRC has noted overall growth in Mortgage Loan exposures, not just among Life insurance companies, but also in the portfolios of Property & Casualty insurers. More significantly, some of that growth has not been in the more traditional lending to stabilized commercial properties but has been on residential properties and for construction loans. There has also been growth in Investments Reported on Schedule BA including, especially, Collateral Loans.

In addition, the market environments have changed. After a prolonged period of low interest rates, interest rates are much higher and may continue to be. This very likely has impacted investment strategies in ways that may not have been anticipated. There are increasing regulatory concerns about liquidity in the markets and liquidity policies and strategies of insurance companies.

We encourage the NAIC to expand guidance beyond bonds. However, we also encourage the NAIC to look beyond credit risk. Credit risk has been a historic focus. While this should always be a concern, market risk and liquidity risk have increased dramatically due to substantial changes in investment practices. Actuarial Guideline LIII is an example of steps already being taken. We also acknowledge the work of the NAIC's Statutory Accounting Principles Working Group with its Bond Definition Project and the Capital Adequacy Task Force and its creation of the RBC Risk Evaluation Ad Hoc Group. We believe further regulatory enhancements would be beneficial.

Market risk and liquidity risk are very different from credit risk. Portfolio analysis, which may be considered a combination of all three risk assessments, is entirely a different skill. We advise caution and careful consideration be given to how to deal with these tasks from a regulatory perspective. It is quite likely that these will require different people, different tools and a different approach. We strongly encourage the NAIC to engage with the appropriate experts in how this should be taken on, including potentially bringing in outside advisors to complete a top to bottom assessment of what is needed.

We commend the regulators for what has been a robust and effective process to date, resulting in minimal problems from investments within the insurance industry. However, we believe that the more recent increase in risk in insurers' investment portfolios indicates a need for improved regulatory processes and tools.

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.