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April 29, 2022

S&P Global Ratings
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[sent via online submission]

Re: S&P Global Ratings Request for Comment on Proposed Methodology and Assumptions for Insurer Risk-Based Capital Adequacy

To whom it may concern:

The American Council of Life Insurers (ACLI)[1] is pleased to comment on S&P's Request for Comment on proposed changes to the insurer capital adequacy methodology (the "methodology" or "proposal"). We look forward to a continuing constructive dialogue between the S&P and the life insurance industry about the proposal, including its impact on the U.S. market and beyond.

ACLI recognizes S&P's need to periodically review and update its capital adequacy methodology for insurers to ensure that it appropriately reflects current calibrations, evolving accounting standards, and new products. ACLI appreciates and supports S&P's stated goal of improving the transparency and usability of S&P's risk-based capital adequacy methodology. We support S&P's proposed removal of haircuts from the Total Adjusted Capital (TAC) calculation, as well as the creation of an explicit diversification benefit, and S&P's intent to continue to use statutory financial statements in its insurance capital model.

More detailed, technical feedback and recommendations on the proposal are in the attached "ACLI Technical Comments" Appendix (Appendix). We have selected a few themes from our technical comments to highlight below.

1. **Greater transparency into the rationale for certain changes, including the calibration of required capital, is needed**

[1] The American Council of Life Insurers (ACLI) is the leading trade association driving public policy and advocacy on behalf of the life insurance industry. 90 million American families rely on the life insurance industry for financial protection and retirement security. ACLI's member companies are dedicated to protecting consumers' financial wellbeing through life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, and dental, vision and other supplemental benefits. ACLI's 280 member companies represent 94 percent of industry assets in the United States.

The methodology would benefit from additional transparency with respect to the analytical framework, particularly around the rationale for the suggested changes and calibration of required capital. More detail is needed on the rationale supporting several factors, including: the higher calibration levels; the decision to change debt and hybrid equity limits in available capital; the methodology and data used to calibrate the required capital; and the analysis used to support the changes to certain asset and liability charges and notching adjustments. In addition, the publication of variables (sector and industry variables) that affect capital and financial flexibility and the model's leverage tolerance calculations that affect capital and financial flexibility would support greater transparency of the proposal.

Greater transparency is also needed regarding the reasoning and analytics used to support certain criteria that, on their face, layer undue levels of conservatism into the model and appear excessive. For example: [2]

- Using a pre-tax result for some products, like variable annuities (VAs), appears overly conservative when the VA's long-term statutory projections provide greater certainty on the ability to get a tax offset.

- The S&P methodology does not incorporate tax offsets for risk charges, which creates inconsistency – as pre-tax capital requirements are compared to a post-tax TAC – and adds another element of conservatism.[3]

- The methodology's treatment of private equity securities appears unjustifiably conservative and unbalanced when compared against the charge for publicly traded securities.[4] While both charges seem very high, the charges for private equities are particularly excessive.

- The new confidence intervals appear to be the complements of long-term average default rates. The use of average default rates in stressed environments is very conservative, as is the use of one-year default rates with longer-term-risk assessments. It appears that the increase in confidence intervals is related to the creation of an explicit diversification adjustment.[5] While the creation of an explicit diversification benefit is positive, it appears the benefits were calculated using a conservative correlation matrix that includes an additional haircut. Without more information about the methodology used to create the diversification benefit, the haircut appears somewhat arbitrary. ACLI encourages S&P to provide stakeholders with the information needed to compare the current and proposed diversification methodologies.

2. The treatment of assets not rated by S&P and mapping of assets rated by other NRSROs[6]

Asset-risk charges should reflect a data-driven analysis of the assets' credit quality and other intrinsic factors. If adopted, the methodology's approach to notching creates a strong risk of introducing non-economic factors into the S&P model that may ultimately compromise the integrity of life insurer financial strength ratings. Furthermore, an initial third-party review of available data indicates that the proposal's

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[2] Additional areas needing further explanation, reasoning, and/or analytics include, among others: (i) Morbidity charges; (ii) Longevity charges; (iii) New pandemic charges; and (iv) Other life technical reserve risk charges.
[3] For example, risk charges are approximately 20% higher in the U.S. than appropriate, given tax offsets.
[4] For U.S. market, the proposed equity charges at the 99.99% confidence interval (AAA level) are 55% (publicly traded securities) and 66% (private).
[5] The proposal increases confidence intervals to 99.99%, 99.95%, 99.8% and 99.5%, corresponding to AAA, AA, A and BBB using S&P's rating scale.
[6] See Section 1a of ACLI's appendix for more detailed explanations and recommendations.

treatment of securities rated by competitors of S&P is not supported by empirical evidence.[7] In particular, in response to S&P's notching proposal, a large investment bank analyzed credit ratings and determined that, with respect to investment grade and high-yield corporate bonds:

- Historical, cumulative default rates indicate that investment grade and high-yield corporate bonds rated by S&P generally do not perform better than the securities rated by other NRSROs;
- The correlation between S&Ps ratings and ratings by other NRSROs is greater than 83%; and
- The notching differential between S&P and other NRSROs ranges from less than 0.1 and 1.75.[8]

With respect to structured products securities, default comparability is difficult to establish, given such securities are commonly rated by only one NRSRO. However, the aggregated statistics demonstrated that the correlation between S&P's ratings of structured products securities and ratings by other NRSROs is greater than 97%, and the notching differential ranges from 0.0 to 0.23.[9]

In its current form, the proposal would result in S&P notching large swaths of bond portfolios, and in the case of structured products not rated by the three largest NRSROs, deeming them no better than CCC. This could distort relative financial strength rating results across insurance companies if they do not align their capital strategies and portfolios with the S&P capital adequacy framework. The proposal could also cause market disruption and impact liquidity and valuations if insurers are compelled to sell or avoid investment-grade assets that carry high capital charges simply because they are not rated by S&P.[10]

The proposal potentially harms both insurers and consumers by requiring insurers to either hold artificially elevated levels of capital or to forgo yield on high-quality assets because they have been rated by one of S&P's competitors. ACLI is highly concerned that the proposal could impair competition among NRSROs, which is antithetical to the *Credit Rating Agency Reform Act's* intent to promote competition and transparency among rating agencies.[11]

With respect to mapping of securities not rated by the three largest NRSROs, it is ACLI's understanding that there is sufficient data for S&P to complete mapping rules for other NRSROs with a reasonable effort. We urge S&P to undertake this work. If S&P finds the available data lacking, S&P could consider utilizing well-accepted analytical frameworks provided by third parties that are commonly used throughout the insurance industry.

Finally, ACLI strongly recommends that S&P reconsider the methodology's treatment of securities not otherwise rated by an NRSRO and designated by the National Association of Insurance Commissioners (NAIC) Securities Valuation Office (SVO). The SVO is an established part of the U.S. regulatory framework. It is responsible for day-to-day credit quality assessments of securities owned by state-regulated insurers. The SVO also evaluates non-rated securities to assign appropriate risk-based capital charges based on NAIC designations. The methodology, however, effectively assumes that such unrated securities - almost all of which are investment grade - are equivalent to CCC risk (for structured securities) and BB (for non-financial corporate debt). Absent compelling evidence, the notching appears unwarranted.

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[7] Investment Bank Research, "Analysis of Historical NRSRO Ratings Data," received March 2022.
[8] *Id.*
[9] *Id.*
[10] It appears the proposed notching could lead to bondholders prioritizing assets rated by S&P to avoid onerous capital charges associated with non-S&P rated assets. That would encourage issuers to seek out S&P ratings, increasing S&P's market share and potentially eliminating the checks and balances created by competition in the NRSRO market.
[11] Credit Rating Agency Reform Act, Pub. L. 109-291 (2006).

3. **The methodology's potential impact on consumers and its divergence from U.S. regulatory environment merits additional evaluation**

While we understand S&P's desire to achieve global consistency, some elements of the methodology may not appropriately reflect the varying levels of conservatism in reserves that exists across different jurisdictions. The examples below demonstrate how identical treatments applied across jurisdictions – without regard for jurisdictional regulatory or accounting variations– can lead to misleading or problematic results.

- The proposed TAC calculation could significantly understate the amount of available capital in regimes where a material portion of the loss-absorbing resources reside in conservatism in reserves, such as the U.S and participating insurance product features (i.e., policyowner dividends).

- The onerous interest rate risk charges punish long duration business needed to serve unique social and economic needs that are particularly pressing in markets lacking sufficient public pension systems.

- The treatment of VAs within the proposed capital model criteria adds unnecessary complexity and will make capital management practices more difficult to manage, understand, and communicate. Removing diversification benefits from VAs would also add a punitive capital requirement and create greater misalignment between the U.S. regulatory framework and the proposal.

ACLI recommends that S&P consider the degree to which certain criteria – like the proposed interest rate risk charges – may disincentivize long-duration products. It is imperative to weigh the benefits of such criteria against the potential cost to consumers who rely on long-duration products like annuities and life insurance to provide retirement security in societies that lack government-funded pension programs.

4. **The proposed holding company debt limits are punitive[12]**

The proposed changes to debt and hybrid-funded capital appear to ignore the loss-absorbing capability of these instruments to support claims-paying capabilities in jurisdictions, such as the U.S., where there is high structural subordination. We do not see a clear rationale for materially lowering this limit as we are not aware of any indications of systemic over-leveraging relative to credit ratings. The changes could be procyclical by limiting an insurer's ability to raise capital under stress and sustain its competitive position.

Using a more restrictive measure in Adjusted Common Equity (ACE) combined with revised tolerances for senior debt and hybrids results in punitive limits (up to 33% of ACE vs. up to 35% of TAC). In stress scenarios, a company is proportionately worse off whether it raises debt or not, making it harder to fill a capital need. This reduction in capacity for senior and hybrid debt can have severe impacts on costs of capital for companies and their returns on capital in the long run. ACLI recommends that S&P recalibrate the limits, so they more closely align with general financial leverage targets.

5. **Modified duration is not an appropriate measure of interest rate risk[13]**

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[12] See Section 3d of ACLI's appendix for more detailed explanations and recommendations.
[13] See Section 4 of ACLI's appendix for more detailed explanations and recommendations.

The methodology calculates the interest rate risk charge based on duration mismatch multiplied by a rate shock that represents the extreme tail over a one-year period. This is highly concerning, given that very few U.S. companies manage interest rate risk based on a modified duration approach, as this metric assumes cash flows are fixed, whereas modern products are designed to allow the company to adjust crediting rates and policyowner dividends (for participating products) in reaction to rate changes. Furthermore, this market-based framework for interest rate risk is also inconsistent with the U.S. statutory framework in which assets are generally held at book value, which is appropriate given that policyholders are generally not able to withdraw the "market value" of their expected future policy benefits.

The proposed approach assumes the interest rate shocks are immediate and permanent, and further assumes the market shock applies to both assets and liabilities. The severity of the prescribed interest rate shocks is also excessively conservative and does not consider the current rate environment.[14] Further, using modified duration as a measure of interest rate risk for all companies could lead to inaccurate conclusions. Effective duration is a more appropriate measure of interest rate risk when dealing with cash flows that change when rates change.

6. The proposal's impact on VAs warrants greater analysis and evaluation[15]

The proposed changes to the treatment of VAs would increase the misalignment between the S&P methodology and the U.S. regulatory framework, adding unnecessary complexity to VA capital management. Additionally, conclusions drawn from changes in regulatory capital or RBC may not translate to the S&P capital model. A few examples include:

- The proposed capital ratio for VAs compares a post-tax numerator to a pre-tax denominator, rather than a post-tax denominator, as is the case at present. This represents a significant change, and it does not align with the U.S. regulatory approach, where the denominator continues to be developed on a post-tax basis.

- While the intent of the proposal appears to involve a greater capacity to reflect hedging, companies with the most robust hedge modeling (an E-factor below 25%) will continue to be penalized, even though the regulatory regime requires significant support and documentation to determine a company's E-factor.

- The proposal does not provide support for the proposal's choice of CTE level for the various rating levels.[16] Proposing higher CTE levels (*i.e.*, going further out into the tail) could create additional volatility since these CTE statistics are calculated using fewer scenarios. In addition, no single rating level in the proposal utilizes the same CTE level as the current U.S. regulatory requirement.

- The VA capital charge has the greatest need for consideration of the difference in time horizons from the one-year framework utilized by the remainder of the S&P model.[17]

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[14] For example, the down shock assumes 3.15% rates down, which would result in significantly negative rates across much of the yield curve, which is something not observed in the US, and only observed on a more limited basis in other developed economies.
[15] See Section 8a of ACLI's appendix for more detailed explanations and recommendations.
[16] S&P may wish to leverage data and analysis gathered by U.S. insurance regulators during the development of Principles Based Reserving (PBR) for VAs. U.S. regulators conducted extensive analysis to determine the appropriate CTE level for required capital (CTE98 forms the basis of C-3, Phase II required capital) and the maximum hedge credit levels (95%) for U.S. statutory regulations.
[17] Projection periods of 50 years or more are common for the statutory analyses.

- Updates to the prescribed statutory economic scenario generator (ESG) are currently under discussion at the NAIC. Refinements to the ESG model may alter the appropriateness of the proposed VA capital framework.

7. **Greater transparency around and justification for the treatment of "other than invested assets" held by U.S. insurers is needed**[18]

Life insurers' statutory balance sheets include assets that are not "invested assets" but that are important to their business function and are included in TAC. The proposal seems to suggest that these admitted assets might be subject to a 100% capital charge, regardless of their underlying risk characteristics. If so, this treatment is highly punitive. These are admitted assets, which often are material (e.g., Corporate Owned Life Insurance (COLI) and federal income tax receivables, etc.) and have real economic value – verses statutory accounting non-admitted assets with little or no value. Like other issues raised in this document an explicit and reasonable justification, along with empirical evidence, for such punitive treatment is warranted.

8. **Given the impact of the proposal, a prudent transition period is appropriate**

The S&P's request for comment states that the updated insurer risk-based capital adequacy criteria will become effective immediately upon the publication of the final criteria. We consider this to be unnecessarily accelerated for such impactful changes and we encourage S&P to either reconsider the effective date or consider offering a transition period leading up to full implementation of the criteria. The proposed changes are substantive, complex, and appear to impact almost every major input of the S&P capital model. A sudden change in the S&P capital formula could have a detrimental effect on the insurance industry and markets if not managed carefully.

A transition or grace period would allow insurers to fully assess the changes and make any necessary adjustments to avoid being unduly penalized for the need to adjust strategies to conform with the new S&P capital model requirements. A reasonable grace period would also allow insurers to make strategic changes in a more methodical and judicious manner which may potentially attenuate potential losses and market disruptions that may otherwise be associated with those changes. Depending on the feedback provided during the comment period that is incorporated by S&P into the proposal, it still may be appropriate for S&P to include a transition or grace period for the reasons noted above.

Conclusion

Thank you for the opportunity to provide these comments. ACLI's more detailed technical comments are appended to this letter. We would appreciate the opportunity to meet with you to discuss our preliminary observations in greater detail.

Sincerely,

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[18] See Section 3g of ACLI's appendix for more detailed explanations and recommendations.

Financial Security for Life

Appendix

ACLI Technical Comments

Proposed Changes to the S&P Capital Model - April 29, 2022

Table of Contents

Topic	S&P Proposal	ACLI Comments
1. Asset Charges		
1A. Increased asset charges for assets not rated by S&P (paras. 69-71 and 187)	S&P proposes to notch down or disregard credit ratings from other nationally recognized statistical rating organizations (NRSROs) and, seemingly, designations from the NAIC Securities Valuation Office (SVO) when determining the appropriate amount of risk-based capital (RBC) insurers should hold against fixed income assets on their balance sheets. *Corporate & Gov Securities:* One notch down for investment grade and two notches down for speculative grade. When the security is rated by both Moody's and Fitch, use the lowest of all the notched ratings. If the security is not rated by any major NRSRO, non-financial corporate securities will be charged as 'BB,' while sovereign/public finance and financials are rated as 'A' and 'BBB,' respectively. *Structured securities:* Two notches down if rated by both Moody's and Fitch; three notches down if rated	**(1) The capital model and its treatment of assets should accurately reflect the risk profile of the assets.** ACLI believes that the S&P capital model and its treatment of assets should be grounded in objective, demonstrable analytical rigor. Asset-charges should reflect the results of a data driven analysis of the asset's risk factors. We are highly concerned that the proposed automatic notching of non-S&P rated securities does not appear to accurately reflect a data driven analysis and, as such, introduces non-economic factors into the model. ACLI does not oppose treating an asset as lower quality than its rating by another NRSRO if the underlying economic facts, such as the probability of default, justify the notching. However, ACLI strongly disagrees that it is appropriate to notch an asset, or in the case of a structured product, apply a BB or CCC charge, solely because the product was not rated by S&P.[1] **(2) S&P's notching methodology in the proposal is not empirically supported** S&P's proposed notching methodology does not appear supported by objective evidence that S&P's credit methodology and credit ratings are more accurate or reliable than those of its competitors. In fact, evidence prepared by independent third-parties indicates that S&P's ratings of investment grade and high-yield corporate bonds generally do not perform better than the ratings of such securities rated by other NRSROs.[2] Further, recent analysis of historical cumulative default rates showed both a high level of correlation between S&P and other NRSRO ratings of these assets and low-levels of notching differentials between NRSROs.[3] In particular, analysis indicates that the correlation between S&Ps ratings and ratings by other NRSROs of such securities is greater than 83%, and the notching differential between S&P and other NRSROs ranges from less than 0.1 and 1.75.[4]

[1] S&P's definition of a "CCC" security is "[a]n obligation [that] is currently vulnerable to nonpayment, and is dependent upon favorable business, financial, and economic conditions for the obligor to meet its financial commitment on the obligation. In the event of adverse business, financial, or economic conditions, the obligor is not likely to have the capacity to meet its financial commitment on the obligation."
[2] Investment Bank Research, "Analysis of Historical NRSRO Ratings Data," received March 2022.
[3] *Id.*
[4] *Id.*

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	by one of the two (Moody's/Fitch) agencies. If the issue is not rated by any major NRSRO, 'CCC' will be assigned. _Treatment of ratings from 6 NRSROs_ S&P's proposal disregards credit ratings from six of the nine NRSROs. A fixed income product rated AAA by any NRSRO other than S&P, Moody's or Fitch would receive the same treatment as an asset rated CCC by S&P and carry a 100% asset capital charge (almost double that applied to investments in private equity). For example, one of the disregarded NRSROs could rate a fixed income product as the *highest* possible credit quality, AAA, but S&P nevertheless would assume that such security is of CCC or *junk* quality. The effect of this treatment to insurers is to ascribe no value to the asset in the S&P solvency calculation notwithstanding the very high rating provided by the competitor agency. S&P's proposal appears to disregard designations from the SVO (which serves to level set	It is difficult to establish default comparability for structured-product securities because these securities are commonly rated by just one NRSRO.[5] However, the aggregated statistics demonstrate that the correlation between S&P's ratings of structured products securities and ratings by other NRSROs is greater than 97%, and the notching differential ranges from 0.0 to 0.23.[6] **(3) S&P's proposal could impair competition among NRSROs** Considering the lack of empirical evidence justifying the proposal's automatic notching, ACLI is concerned that S&P's proposal could impair competition among NRSROs. It is widely accepted that competition amongst NRSROs is beneficial, and that conflicts of interest should be eliminated.[7] Promoting transparency and competition among NRSROs was one of the driving forces behind the *Credit Rating Agency Reform Act* enacted in 2006.[8] Similarly, state insurance regulators, through the National Association of Insurance Commissioners (NAIC) also recognize the benefits of diversification amongst NRSROs with appropriate guardrails. On its face, it appears that S&P's proposed notching could lead bondholders to prioritize S&P-rated assets to avoid the onerous capital charges associated with non-S&P rated assets. That would in turn encourage issuers to seek out S&P ratings, which would increase S&P's market share and potentially eliminate the checks and balances created by competition in the NRSRO market. Given that third-party data does not support – and appears to run counter to – S&P's notching proposal, industry must question the intent behind the notching. ACLI supports competition among NRSROs, as well as the development of processes to reconcile any significant differences in ratings between different NRSROs, where they exist. Additionally, issuers – not insurance companies as bond holders - select the NRSRO to provide ratings on their fixed income instruments. Bondholders should not have their S&P capital arbitrarily penalized because issuers do not select S&P to rate their instruments. **(4) The automatic notching of non-S&P rated assets is especially problematic because S&P does not rate some attractive assets.**

[5] Indeed, the ability of NRSROs to efficiently rate different types of structured securities varies by NRSRO. Some NRSROs have greater expertise rating certain asset classes, in particular structured securities related to consumer finance products.
[6] *Id.*
[7] On 3/5/2021, now-SEC Chair Gary Gensler wrote to the Senate Banking Committee stating that "Promoting competition in the credit ratings agencies . . . is critically important to the SEC's mission" and that "[w]eaknesses at credit rating agencies contributed to the 2008 financial crisis as the 'issuer pays' model led to conflicts and potentially misaligned incentives." Similarly, in 2016, the European Securities and Markets Authority noted that "[o]ne of the objectives of the EU's regulation of credit rating agencies . . . is to stimulate competition in the credit rating industry."
[8] Crediting Rating Agency Reform Act, Pub. L. 109-291 (2006).

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	capital charges across all US entities that are under the oversight of the SVO) whereas previously S&P utilized such designations.	In addition to the concerns listed above, ACLI is also concerned that the proposed automatic notching of other NRSROs does not fully account for circumstances when bondholders are seeking to purchase and hold specific asset classes that S&P may not have (a) dedicated criteria for specific asset types; or (b) a dedicated group that can rate these specific asset classes at scale. Some of these desired asset classes are key drivers of consumer finance and sustainable, impact investing.[9] The proposal's treatment of private placements is particularly concerning for ACLI given the industry's increasing commitments to sustainable impact investments as part of the industry's commitment to closing the racial wealth gap through prudent investments in affordable housing. **(5) The "ratings mapping" approach should communicate degrees of risk to the market – yet the proposal treats assets deemed very high quality by regulators as CCC.** As we noted above, the proposal's imposition of automatic notching does not appear empirically connected to the degree of risk within an insurer's portfolio. As a result, the conservative "ratings mapping" approach does not appear to communicate degrees of risk to the market. This disconnect is particularly evident when one considers the treatment of an insurer's bond that is not otherwise assigned a rating by an NRSRO (e.g., private placements, certain asset-backed securities, etc.) but has been subject to a rigorous analysis by the NAIC Securities Valuation Office (SVO) and received an appropriate NAIC designation. As described in the NAIC's letter to Senate Banking Chairmans Brown and Toomey: "Specifically, for those investments not otherwise assigned a rating by the NRSRO's (e.g., private placements, certain asset backed securities, etc.), the NAIC SVO staff do conduct a detailed analysis to evaluate the risk and develop an appropriate NAIC designation for use by state insurance regulators. This, coupled with investment oversight laws, give state regulators comfort to allow or disallow such investments and ensure they are backed by sufficient capital for claims paying purposes. This is a critical regulatory function that allows the insurance sector to invest its substantial resources in a diverse cross section of the U.S. economy while prioritizing the strength of insurers to pay claims. We are troubled that S&P's proposal lumps NAIC designations assigned by the SVO staff, designed by and for regulators, in with NAIC designations derived from ratings provided by S&P and its for-profit competitors, with no input from SVO staff. Doing so could disrupt a

[9] Examples include (i) Private credit in the form of private placements (Reg D) and directly sourced financing arrangements with privately owned companies or public companies that do not seek out public ratings – this category also includes the growing category of impact investments; (ii) Community banks, capital securities issued by community banks, and trust preferred (TRUP) CDOs (*i.e.*, securitizations of community bank securities); (iii) Securitizations of an ongoing stream of consumer loans originated by a given lender that might ramp up over time as loans are made according to defined set of credit rules. A large portion of the loans to U.S. consumers are financed through these vehicles; (iv) Firms that originate consumer loans through a bank partnership model (*e.g.*, Affirm, Upstart, etc.); (v) Ginnie Mae early buyouts; (vi) Certain assets supporting the clean energy transition (*e.g.*, solar or PACE assets); (vii) Whole business securitizations of restaurants and other businesses.

Topic	**S&P Proposal**	**ACLI Comments**
		critical source of diversification and investment for the U.S. insurance sector. We urge S&P to reevaluate that approach."[10] Another class of instruments that may be unrated by an NRSRO, but receives a designation from the NAIC SVO are credit default swaps (CDS). Insurance companies may write CDS protection as part of replication transactions (RSATs). In a RSAT, an insurance company may pair a derivative and cash security (the "cash component") to replicate otherwise permissible investments. In addition to single name CDS, insurers also use credit index swaps (CDX, iTraxx and other credit indices) and credit index tranche swaps as the derivative component in RSATs. The credit risk of CDS, credit index swaps, and credit index tranche swap transactions, when part of replication transactions, are evaluated by the SVO and assigned NAIC designations and corresponding capital charges. While the reference entity of single name credit default swaps are often rated by NRSROs, other credit derivatives including credit index swaps and credit index tranche swaps are not. The same concerns noted above exist for the treatment of credit index swaps and credit index tranche swaps simply because they are not normally explicitly rated by S&P or another NRSRO. Under the proposal's mapping process, a structured security that is otherwise not rated by an NRSRO and has received a Category 1 designation after a rigorous analysis and review by the SVO would receive a "CCC" capital charge.[11] A fixed interest bond designated by the NAIC SVO – but otherwise unrated by an NRSRO – would receive a BB charge. The apparent disregard for a designation process that was designed by and for U.S. insurers' primary regulators is profoundly troubling and appears unwarranted. The SVO is an established part of the regulatory framework in the U.S. and insurers are required to adhere to its designations (comparable to ratings) and set aside capital on securities based on the risk-based factors assigned to these designations. The SVO's interests align with regulators' interests of preserving insurer solvency - the SVO has no incentive to inflate the designations of these instruments. The proposal's application of CCC capital charges for instruments deemed very high quality by regulators whose primary interests are preserving the solvency of regulated insurers and protecting consumers, is counterintuitive. If S&P adopts this aspect of the methodology, ACLI would expect S&P to provide an explicit and reasonable justification, along with empirical evidence, for such an action.

[10] NAIC letter to House Financial Services Committee and Senate Banking Committee, available at https://content.naic.org/sites/default/files/government-affairs-letter-s%26p-proposed-capital-model-house-financial-services-cmte-030922.pdf (retrieved March 18, 2022).

[11] An NAIC SVO designation Category 1A has traditionally mapped to AAA.

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		(6) ACLI supports robust mapping of other NRSROs The final mapping rules for determining the rating input of bonds should be as complete as possible. ACLI strongly supports efforts by S&P to complete a mapping of ratings from the other NRSROs. We believe that sufficient data exists to allow S&P to complete this mapping with reasonable effort. For some bonds without S&P global security-level ratings, the intended mapping is unclear. To manage their portfolios, companies need to have a clear understanding of how each security will be mapped. The number of bonds in ambiguous categories is material, at least for some companies. Examples include bonds with the following ratings characteristics: • S&P global issuer rating • Moody's or Fitch global issuer rating (but not global security rating) • Moody's or Fitch National/Regional security rating (but not global security rating) In addition, paragraph 70 of the RFC instructs insurers to map S&P regional or national scale ratings back the equivalent S&P global ratings scale. However, there are multiple instances where the mapping guidance is unclear because the regional or national rating is mapped to multiple global ratings. For example: National scale mxAAA can be mapped to either "Global Scale BBB+ and above" or to BBB. Lastly, insurers would benefit from a more complete explanation of how bonds are rated under waterfall Step 2, based on "…an alternative measure of credit quality determined by S&P Global Ratings". **(7) S&P's proposed notching approach will negatively impact the integrity of financial strength ratings, credit markets, and hurt policyholders.** If the notching approach is adopted, ACLI believes it creates a strong risk of introducing non-economic factors into the S&P model and compromising the integrity of financial strength ratings. The S&P proposal would result in large swaths of bond portfolios being notched or, in the case of structured products, deemed no better than CCC. The approach would ultimately distort the relative results across insurance companies depending on ratings by S&P in the bond portfolios, or if insurers have meaningful allocations to private credit that may or may not be rated by an NRSRO. The alternative to that scenario is potential market-disruption and impacted liquidity and valuations if S&P's proposal motivates insurers to sell or avoid high-quality assets that carry high capital charges- simply because they are not rated by S&P. Below, we describe some of the potential consequences the proposal may generate.

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		• Insurers play a significant role in financing vast segments of the economy through the investment debt markets. These segments include corporate bonds and loans, residential and commercial real estate loans, and consumer credit offerings (*e.g.*, credit cards, car loans, etc.). ACLI is concerned that S&P's proposal may artificially dampen insurers' interest in assets rated by other NRSROs. This could ultimately drive higher funding costs for borrowers as the market reprices assets not rated by S&P – not because the assets are implicitly riskier, but because the higher capital these assets will consume on insurers' balance sheets. • It is likely that S&P's notching proposal may have an outsized effect on fixed income structured products, which could lead to knock-on effects. In 2021, approximately 58% of North American deal issuances of asset-backed securities and mortgage-backed securities were not rated by S&P (per Green Street here). • As noted above, S&P's proposal is likely to reduce the universe of high-quality fixed income assets that will receive appropriate capital charges, making it harder for insurers rated by S&P to achieve target yields. This creates a real risk that life insurers may have to offer less attractive long-term insurance products, or even limit product availability and offering. S&P's notching proposal could also contribute to reducing the diversification of assets held by insurers if insurers concentrate on assets and asset classes rated by S&P to avoid unduly onerous asset charges. **Recommendations:** ▪ **The S&P capital model and its treatment of assets should be grounded in objective, demonstrable analytical rigor. Asset-charges should reflect the results of a transparent, data-driven analysis of the assets risk factors.** ▪ **S&P should recognize third party NRSRO capabilities in rating asset classes and structural features, where S&P lacks similar capabilities.** ▪ **S&P should reconsider its approach to otherwise unrated assets that have received an NAIC SVO designation.** ▪ **The S&P model should be complete to ensure transparency and allow insurers to make informed investment decisions. For example, it is unclear how S&P expects to treat unrated bonds, bonds rated by an internal model, or bonds designated by the SVO.** ▪ **ACLI recommends that S&P complete a full mapping process. In the absence of data in some cases to support a mapping process, S&P should utilize well accepted analytical frameworks provided by other third parties**

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		(such as Blackrock and its Aladdin system), which are commonly used throughout the insurance industry.
1B. ASSET CHARGES FOR CERTAIN LEGACY STRUCTURED ASSETS	S&P proposes to change the methodology for determining capital charges for certain legacy residential mortgage-back securities (RMBS) and commercial mortgage-backed securities (CMBS) structured assets to a methodology that relies on solely on rating agency ratings and duration of the asset. The current methodology considers the carrying value of the asset relative to S&P's stressed recovery value.	During the financial crisis, many RMBS and CMBS were downgraded, resulting in ratings that did not accurately reflect the risk of additional losses. In recent years, S&P's approach has considered the difference between carrying value and estimated recovery value, not applying a capital charge if the carrying value of a non-agency RMBS instrument has already been impaired or written down to a level below the projected recovery value. While the rationale for reverting to a ratings-based methodology is understandable, legacy securities—particularly those issued prior to the financial crisis—may be newly burdened by unnecessarily high capital charges relative to their accounting basis and risk profile. **<u>Recommendation</u>: ACLI recommends retaining the existing methodology for certain legacy RMBS and CMBS. Alternatively, a potential compromise could be to apply a grandfathering approach that applies the new methodology only to securities issued after a specified date.**
1C. TYPE OF EXPOSURE (PARAS. 64, *ET. SEQ.)*	S&P proposes to differentiate capital charges between type of exposure (*i.e.*, secured vs. unsecured vs. subordinated vs. structured).	Although we agree credit capital charge differentiation is needed, the magnitude of differentiation does not seem appropriate in all cases. The incremental capital charges on subordinated debt are overstated because the subordinated instruments are often already rated at lower levels to reflect this subordination risk. The incremental capital charges on securitization debt vs. unsecured debt belie the conservatism embedded in the ratings on securitizations following the 2008 Financial Crisis. Other agencies consider both probability of default and loss given default in the ratings they assign to securitization and even S&P considers residual value in its analysis. **<u>Recommendation:</u> ACLI recommends that S&P reconsider the capital charges on subordinated debt, in particular, to avoid overstating the subordination risk.**
2. DIVERSIFICATION ISSUES		
2A. DIVERSIFICATION BENEFIT **(GENERAL COMMENTS)**	Diversification benefits are captured more explicitly in the new methodology by adopting a multilayered approach that allows for diversification within lines of	Given that the underlying capital charges already take into consideration the conservative confidence intervals, there is no need to further embed conservatism by haircutting the diversification benefit (and increasing such haircuts for higher capital targets). Correlation between longevity and life insurance risk should be reviewed. For example, pandemic risk increases mortality, which would then have the opposite effect on

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(para. 15)	business, within risk categories, and between risk categories. S&P proposes to employ haircuts of 10-30% on the new diversification benefit depending on the confidence interval (*e.g.*, AAA vs. AA vs. A).	longevity risk – *e.g.*, policyholders sometimes hold both life insurance policies and pensions / retirement annuities. As such, ACLI recommends S&P review the proposal's correlation between longevity and pandemic risks. Correlation between life risks (*e.g.*, longevity, mortality, etc.) and economic risks (*e.g.*, credit, market, etc.) should be reviewed. The S&P proposal may have slightly higher correlation between life risk, credit risk and market risk than some other models, which already include "tail correlation" upward adjustments. Higher correlation leads to lower diversification benefits, potentially reducing the need for the diversification benefit to be haircut. There is no credit given for geographic diversification, which ACLI believes is an unwarranted limitation. S&P should consider providing additional credit for geographic diversification. For interest rate risk, the proposal doesn't allow offsets in exposure between countries. This is especially detrimental to a group consisting of entities that have opposite exposures to interest rate movements. Product specific risks on VA do not appear to be eligible for diversification benefits. VAs are very important in meeting the retirement needs of American consumers and ACLI feels it is important that the S&P capital model treatment does not put unnecessary headwinds on the supply of this product type. **Recommendation: ACLI recommends that S&P** ▪ **Reconsiders haircutting the diversification benefit;** ▪ **Reviews the proposal's correlation between longevity and pandemic risks;** ▪ **Considers providing additional credit for geographic diversification;** ▪ **Considers allowing offsets in exposure between countries with opposite exposures in interest rate movements;** ▪ **Reconsiders the approach to diversification benefits for VA products (see comment 2b).**
2b. Diversification benefit **(VAs)**	VA added to Life Technical Risks VA product specific risks assumed to be 100% correlate with credit and market risks when assessing	*ACLI's general comments on the diversification benefits for VAs* The proposed approach does not provide much explicit diversification benefit for VAs, which embeds excess conservatism into the model. There may be some level of correlation but 100% seems very punitive and inconsistent with the U.S. statutory

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(PARAS. 176, 178)	diversification between risk categories (level 3).	framework and the other capital adequacy models. The pre-tax treatment of VAs is also concerning. *The proposal seems to understate the diversification benefits provided by VAs and is inconsistent with the treatment of VAs in the U.S. regulatory framework.* Paragraph 176 notes that the capital requirements for VAs are added to the requirements for Life Technical risks after correlation adjustments have been applied when assessing diversification within a risk category (level 2); and Paragraph 178 states that VA product-specific risks are assumed to be 100% correlated with credit and market risks when assessing diversification between risk categories (level 3). If ACLI's understanding of the VA methodology is correct, we believe the proposal understates the diversification benefits provided by VAs and is inconsistent with the treatment of VAs in other regulatory frameworks. For example, under the NAIC RBC formula, insurers split the VA capital requirements (C-3 Phase II) between interest rate and market risks, and the VA risk is treated the same way as interest rate and market risk capital requirements for other products when assessing diversification benefits (*i.e.,* covariance). **Recommendation: ACLI recommends that S&P adjust the diversification benefit to make VAs part of the market risk component of the Level 2 diversification calculation. This would be accomplished by splitting the VA capital requirements between interest rate and market (*i.e.,* equity) risks as determined by the regulatory filings. The Level 2 result could then be brought into the Level 3 calculation as part of the Life Technical component as currently proposed.**
3. TAC revisions		
3A. Calculation of TAC – Treatment of Non-Operating Holding Company Debt (NOHC) (PARAS. 38, *ET SEQ.*)	S&P's Proposal #1 Debt issued from an unregulated NOHC must be downstreamed into a regulated operating company for inclusion in TAC.	The requirement that debt must be downstreamed as equity to be eligible as debt-funded capital is difficult to monitor. The NAIC proposed a similar downstreaming requirement before abandoning it after field testing the concept, because it was nearly impossible to implement. Nevertheless, it appears that S&P is proposing that the only way a U.S. insurer can get credit for NOHC debt is if it is downstreamed into the regulated entity. Requiring debt to be downstreamed from an NOHC has disadvantages. Downstreaming debt from an NOHC means that such capital can support only a single operating company instead of multiple operating companies. In contrast, the current methodology allows debt to support multiple operating companies. The incentive created by this model assumption will likely result in companies downstreaming capital, which may lead to less fungibility of capital and therefore more complex risk management situations. In

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		addition, practical considerations and state insurance regulations, such as regulatory restrictions on upstream dividends - which vary by state - make moving capital throughout the group complex and time consuming. **Recommendations: ACLI recommends that S&P** - **Evaluates the incentives created by the model assumption relating to the downstreaming requirement; and** - **Considers whether the proposal's treatment of debt doesn't place an undue burden on a company's ability to sustain its competitive position or discourage prudent capital management across the group by decreasing the fungibility of group capital.**
	S&P's Proposal #2 Debt issued from a regulated NOHC excluded from TAC. [Bermuda situation]	While U.S. NOHCs are generally not regulated at a consolidated group level today, there is potential for certain U.S. groups to be subject to additional group-wide supervision in the future (*e.g.*, insurance groups designated as internationally active insurance groups), especially as the U.S. ramps up the implementation of the NAIC Group Capital Calculation (GCC) and the International Association of Insurance Supervisors' (IAIS) Common Framework for Insurance Supervision. This change is presumably designed to align U.S. methodology with European methodology. However, there are key differences in the U.S. market and legal frameworks that necessitate different approaches to holding excess capital, including differences in the flow of capital across regulated entities. In the EU, capital is relatively fungible across regulated operating entities. In the U.S., in contrast, moving capital across operating companies is more arduous because it is often subject to restrictions imposed by regulators across multiple states. Each state may focus on protecting the interests of local policyholders first instead of using a wider lens that focuses on optimizing capital allocation across all policyholders. U.S. insurance groups, in particular large stock insurers, often use NOHCs to account for this, and the NOHC tends to play a large role in support of its regulated entities by managing volatility, servicing debt, providing liquidity, managing capital needs in times of stress, and accessing capital markets. S&P's RFC appears to acknowledge this dynamic in paragraph 180: *"U.S. regulations are more restrictive than those in most other domiciles, limiting increases in the level of stockholder dividends by U.S. insurance operating companies. S&P considers the effect such restrictions may have on a group's ability to meet its liquidity needs in the specific legal entities where they arise. Under the U.S. rules, cash and liquid assets in an insurance operating company may not be available to its holding company to pay*

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The same restrictions cited by S&P in paragraph 180 explain why it may be imprudent for a U.S. company to hold surplus capital in a regulated entity (i.e., an insurer) and expect to be able to use that excess capital to meet the liquidity or capital needs of another regulated entity. Yet, it is likely also impractical and inefficient for large insurance groups to hold the correct amount of excess capital in each operating company to address liquidity and capital needs across the group.
U.S. holding company structural subordination is strong as evidenced by recognition of downstreamed proceeds by state regulators (and within the NAIC's GCC, subject to limits) and U.S. legal system / bankruptcy court (albeit with limited precedents of insolvency).
ACLI appreciates S&P's proposal to allow analyst discretion regarding the inclusion of holding company assets in future periods. Theoretically, this could provide a transition period for stock insurers to adjust to the new methodology. Yet there are practical impediments to this plan including:

Companies use a long-term horizon for capital planning purposes. Periodic S&P analyst changes could introduce undesirable level of uncertainty in the amount of discretion that the analyst would apply to the company's holding company assets, which complicates an insurer's ability to plan and execute long-term capital programs.
A very standardized approach to "analyst discretion" would be needed to avoid creating an unlevel playing field between different stock insurance companies. Otherwise, the application of different analytical judgments and approaches to holding company assets could skew competitive dynamics between U.S. and global carriers.

<u>Recommendations</u>: Given the unique dynamics of the U.S. state insurance regulatory framework, ACLI recommends that S&P maintain its current approach to including NOHC assets in ACE and TAC.
If the recommendation to include holding company assets in TAC is not adopted, then ACLI recommends the following:

Excluding holding company assets from required capital as well to promote consistency in S&P's approach.
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		▪ **Creating a consistent approach to S&P analyst adjustments/discretion regarding the inclusion of holding company assets on a critical facet of capital management.**
3B. Calculation of TAC – Tax (para. 5, last bullet)	The capital ratio appears to compare a post-tax numerator to a pre-tax denominator and does not incorporate tax offsets for risk charges.	Comparing a post-tax numerator to a pre-tax denominator does not align with - and runs counter to - the regulatory capital ratio, where the denominator is also developed on a post-tax basis. Not incorporating tax offsets for risk charges also adds another layer of conservatism to a proposed model that is already significantly increasing its confidence levels and corresponding risk charges. This also creates a mismatch between post-tax loss-absorbing capabilities (such as margins in reserves) and pre-tax required capital. **<u>Recommendations</u>: ACLI recommends that S&P -** ▪ **Align the denominator with the regulatory capital ratio, use a post-tax denominator, and incorporate tax offsets for risk charges; and** ▪ **Base the tax effect on TAC adjustment on whether a specific item under discussion can absorb losses on a pre-tax or post-tax basis.**
3C. Calculation of TAC- Dividend Liability (para. 21) and Statutory Life Reserves (paras. 33-35)	Eliminates the current adjustments, to statutory accounting that provide equivalence between capital assessments based on Generally Accepted Accounting Principles (GAAP)/International Financial Reporting Standards (IFRS) and Statutory Accounting Principles (SAP). Examples: S&P is proposing to fully eliminate inclusion of dividend liability (currently 50% of dividend liability is included in TAC); S&P is proposing a new capital charge on excess reserves held under statutory accounting.	ACLI believes that S&P's methodology should promote consistency between SAP and GAAP/IFRS and avoid creating disadvantages for U.S. insurers that use statutory financial statements in lieu of GAAP or IFRS. In the U.S., ACLI understands that S&P uses statutory financial statements (not GAAP) in its insurance capital model and intends to continue doing so when its new model is implemented. As noted in paragraph 16 of its proposal, while S&P may choose to use statutory financials where it finds them more fulsome, ACLI believes the ability to use either GAAP or SAP should be a company specific decision as many factors influence the appropriateness of the basis for rating capital adequacy. S&P's proposed methodology would also eliminate important adjustments to statutory accounting that previously allowed the resulting capital assessments to be on a fair footing with those based on GAAP/IFRS. These adjustments should be re-incorporated into S&P's proposal to restore equivalence to capital assessments based on GAAP/IFRS. Two examples are listed below: • **Paragraph 21-** In its current framework, S&P includes half of an insurer's dividend liability in TAC. S&P is now proposing to fully eliminate its inclusion. This proposed change is particularly problematic for U.S. mutual life insurers, whose core product is participating whole life. Eliminating half the dividend liability for U.S. mutual insurers while using statutory financials to assess them puts such insurers at a

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		significant disadvantage to insurers where S&P instead uses GAAP or IFRS financials to assess their capital adequacy. In other words, if S&P used GAAP/IFRS financials for U.S. mutual insurers, half of the dividend liability would effectively be included in TAC (since the GAAP dividend liability is 50% of the statutory dividend liability). U.S. mutual insurers should not be penalized simply because they either do not produce GAAP financials or S&P chooses to use statutory financials instead of GAAP when assessing their capital adequacy. S&P's proposed change is also at odds with the regulatory treatment of half of the dividend liability, as U.S. insurance regulators include it as TAC when calculating NAIC RBC ratios. S&P's treatment should not be more punitive than that of regulators. • **Paragraphs 33-35**- Another example is the treatment of redundant reserves where statutory accounting prescribes reserves that are much more conservative than those calculated using GAAP or IFRS accounting. Presently, S&P will include this statutory accounting reserve redundancy in TAC without a capital charge. This current treatment is reasonable and puts statutory reserves on equal footing with reserves calculated under GAAP or IFRS. However, S&P is now proposing to impose a significant capital charge on these same excess reserves held under statutory accounting. By contrast, there will be no such capital charge on the lower reserves held under GAAP or IFRS accounting. This new capital charge on excess reserves unduly penalizes all insurers for which S&P uses statutory accounting to run its capital model. **<u>Recommendation</u>: ACLI recommends that S&P -** ■ **Retain the necessary adjustments to statutory accounting currently used to ensure that the resulting capital assessments based on SAP are on a fair footing with those based on GAAP/IFRS.** ■ **Include 50% of an insurer's dividend liability in TAC to avoid penalizing insurers whose core product is participating whole life insurance and who do not produce GAAP financials (or S&P chooses to use statutory financials in a capital adequacy assessment).** ■ **Ensure that statutory reserves are on equal footing with reserves calculated under GAAP/IFRS by eliminating the proposed capital charge on statutory accounting excess reserves.**
3D. DEBT-HYBRID CAPACITY	Debt and hybrid equity tolerances will use ACE in setting limits, excluding any other forms of	*<u>Changing the debt allowability formula and limits will dramatically reduce the senior and hybrid debt available to U.S insurers</u>*

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(PARAS. 38, *ET SEQ.*) USING ACE THAT EXCLUDES OCI - INTANGIBLES	capital. ACE includes OCI and is reduced by all intangibles. Senior debt leverage ratio can be 25% of ACE. Intermediate equity content can be 33% of ACE. This excludes the amount of leverage for senior debt (*e.g.*, if senior debt is at full capacity, intermediate equity content can be 8% of ACE: 33%-25%).	• Broadly, this change reduces the senior and hybrid debt available to U.S. insurers, while there is no indication of systemic over-leveraging relative to credit ratings. • Debt issuances are long-term capital structure decisions. Historical debt decisions were made based on expectation of capital credit. A sudden change that can dramatically reduce allowability is highly punitive given that capital structure changes will take time to implement. *The limits applied to ACE are more restrictive, particularly under stress, and tolerances and have not been appropriately adjusted to compensate.* • ACE is typically much lower than capital resources used in general financial leverage, *e.g.,* ACE excludes debt resources and intangibles, which can be indicative of franchise strength. • Revised tolerances for senior debt and hybrids do not adequately compensate for using a more restrictive measure (up to 33% of ACE vs. up to 35% of TAC). • Lower amount of debt and hybrid funded capital effectively acts as a limit on holding company leverage capacity that supersedes overall leverage allowable at each rating level, which can have a severe impact on cost of capital and returns on capital over time. • A company that meets current thresholds for senior and hybrid debt could see a significant portion of that debt disallowed under the proposal. • Reductions in ACE lead to larger reductions in TAC than current approach, which will exacerbate pro-cyclicality of TAC under stress. • This could lead to an unlevel playing field that unnecessarily disadvantages US companies that still have significant overall leverage capacity. • To improve TAC and fill the potential capital hole in the short term, the only two options are to raise subordinated debt or common equity, both of which can put the company under more stress as well as significantly increase its cost of capital. • ACLI recommends revisiting the calibration of limits so that resulting debt capacity aligns more closely with general financial leverage targets. • ACLI believes the recognition of debt and hybrids should be grounded in the relevant regulatory frameworks, such as the U.S. RBC and GCC.

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		<u>*Changing the insurance framework to use ACE rather than TAC will increase the volatility risk of accounting changes.*</u> • Based on current insurance company disclosures to date, it is expected that many firms will have significant one-time unfavorable impacts to GAAP equity from the implementation of Long Duration Targeted Improvements (LDTI). This will reduce debt counted as capital despite no change to fundamental business/expected cashflows. In addition, LDTI could result in potential for ongoing equity volatility depending on company business mix. Given that debt issuances are long-term in nature, allowability volatility is inconsistent with long-term capital structure decisions. In addition, this could cause debt allowability to be pro-cyclical and amplify the impact of capital market volatility on the insurance industry (*i.e.*, debt allowability could be reduced when a company needs it the most). • Using TAC instead of ACE will reduce the volatility risk of accounting changes that impact equity (like LDTI). Using ACE as the denominator will create volatility in the double leverage tolerance ratio. TAC is a more stable denominator than ACE and TAC is more resilient to non-operational impacts. <u>*It appears that the use of ACE rather than TAC potentially increases – rather than decreases – inconsistency in S&P's methodology.*</u> • While banking RAC framework uses ACE, the S&P debt capacity framework for other financial sectors uses a total capital basis. The banking RAC framework is very conservative, yet it uses significantly lighter capital charges for securities compared to the charges in the insurance methodology. • The capital charges for insurance are also much higher than those used in the banking framework. <u>*The reduction of goodwill and intangibles from ACE penalizes diversified firms*</u> (see previous comment) • Under the proposed criteria, ACE is reduced by the amount of goodwill and intangibles to determine debt allowability, which appears to penalize diversified firms, such as those with large asset management segments that often carry significant goodwill and intangible positions on their balance sheet that may have been funded with senior debt. This is a change from the prior double leverage calculation that only deducted definite-lived intangibles. **<u>Recommendation</u>: ACLI recommends that S&P -** ■ **Uses TAC in lieu of ACE. If ACE is used, then consider recalibrating limits so that resulting debt capacity aligns more closely with general financial**

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		leverage targets or recalibrating the charge factors and other components to align with the banking RAC framework. - **Does not adjust TAC/ACE by goodwill and intangibles for determination of debt allowability to avoid unfair treatment of diversified firms.** - **Considers grandfathering allowability of debt already on the balance sheet.** - **Considers strengthening the role of coverage ratios in credit analysis to address areas where a specific credit profile warrants additional conservatism in the use of debt. This approach would more accurately identify weaker/riskier organizations where an insurer's usage of leverage is aggressive relative to operating performance and may indicate a risky pattern of subsidizing poor operating results by increasing leverage. It may also identify situations in which companies are becoming overleveraged due to the double debt tolerance capacity increase generated by issuing debt. This approach would be consistent with the notion that it is generally credit positive for financially strong companies to enhance their long-term strategic value by taking advantage of low-cost financing when it is available. It would also retain the important consistency that exists between the leverage ratio and double leverage tolerance.** - **If S&P continues to pursue the proposal's approach to debt-hybrid capacity in insurance, then ACLI recommends recalibrating the charge factors and other components to avoid taking an overly punitive approach to insurers**. <u>Other alternatives may include:</u> - Determining a long-term debt allowability for each instrument and only adjust as debt matures or there are significant business changes. - Considering whether using capital requirements as the basis for debt allowability would help eliminate the potential for pro-cyclicality created when available capital is used as the basis for debt allowability.
3E. GOODWILL AND INTANGIBLES (PARA. 25)	The proposal deducts goodwill and other intangible (G&I) assets from shareholders' equity to determine ACE. Equity is not adjusted for negative goodwill.	*<u>General comments regarding G&I:</u>* While G&I assets do raise the question of recoverability and liquidity during extreme stress scenarios, exclusion of G&I under the presumption that their value cannot be realized is not in line with the nature and historical experience of these asset types. The removal of G&I penalizes diversified firms, such as those with large asset management segments, that often carry significant G&I positions on their balance sheet that may have been funded with senior debt. Such large, diverse companies evaluate options for maximizing return on invested capital, and the tradeoffs between tangible or intangible

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ACLI believes giving capital credit in ACE and TAC for G&I up to the proposed cap is the best approach toward accurately capturing the credit profile of firms that hold these assets based on:

• The demonstrated ability within the industry to fund loss volatility through cash flows, and a foundation of liquid assets which provide meaningful time for companies to realize the value of less liquid assets such as G&I
• The characteristics of large, diverse firms that record G&I assets through actions that are constructive to the overall value and the credit profile of the company
• The emerging market for intangible asset transactions, which demonstrate the increasing ability going forward to realize the value of these asset
• The strong structural support in place to confirm the value of G&I assets as recorded on the balance sheet

ACLI recommends the S&P proposal address G&I in a way that aligns more with the current and future nature of these assets:

• Most large, diversified companies that record G&I are unlikely to be faced with the need to liquidate long-term assets, including G&I, to pay claims.
• In rare instances where such large, diverse companies are faced with liquidating assets, it is practical to assume that companies will begin with the most liquid assets, creating significant time to liquidate less-liquid assets, like G&I, if the need arises. If this occurs, G&I has been a demonstrated source of realizable value. Additionally, the economic value from many intangibles is monetizable through collateralized lending.
• The market to trade and borrow against intangible assets is evolving and growing. The proposed exclusion of these assets is more consistent with where the market has been in the last decade versus where the market will be in the next 10 years. Respected standard-setters, like the Financial Accounting Standards Board (FASB) have recognized this shift; FASB is working on a project to re-introduce the amortization of goodwill over a default period of 10 years or a period determined by the reporting entity that can extend beyond 10 years, but not beyond 20 years. The proposed standard has not been issued and there is no future effective date; however, ACLI anticipates this will occur and be effective sometime in the next several years and the result will be declining amounts of recorded acquired goodwill recorded on the balance sheet.</td></tr>
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		• S&P's new capital model should take a modernized, forward-looking view in this area by recognizing the value and ability to monetize G&I assets, subject to a reasonable cap. Therefore, ACLI supports giving capital credit to G&I assets – but would suggest S&P apply a cap for acquired goodwill. Applying a cap would address the illiquid profile of these assets: if an insurer became stressed, a cap would ensure there are sufficient assets to allow time for significant, additional capital-raising decisions. These actions could reasonably be taken by any company in extreme stress events given sufficient time for execution provided by a buffer of liquid assets. Additional reasons for giving capital credit for goodwill – up to a cap – include: • In instances where capital is deployed toward acquisitions, the goodwill generated is a fair assessment of the value generated – value which is supported both by historic trading multiples and by stringent and conservative periodic impairment testing requirements to validate the accurate representation of this value on an ongoing basis. • Acquired goodwill is supported by an arm's-length transaction and goodwill assessed for recoverability on a continuing basis.[12] • Goodwill impairment is evaluated at the reporting unit level which ensures that goodwill recoverability is assessed at the level at which an identifiable set of cash flows exists to support recoverability, which provides additional support for the continuing recoverability of the recorded asset. ACLI recommends S&P continue to give full capital credit to goodwill and introduce a cap on the amount of <u>acquired</u> goodwill that can be included in ACE TAC. ACLI recommends setting the cap for acquired goodwill at 20% of ACE or TAC (full capital credit) and no capital credit for acquired goodwill > 20% of ACE or TAC. *<u>The treatment of identifiable intangibles</u>* ACLI believes a similar logic applies to recognizing the value of identifiable intangibles in ACE and TAC. Like goodwill, the value of identifiable intangibles is supported by cash flows and their continuing value is regularly validated (at least annually or more frequently if evaluation triggers are met) and impairments are promptly recognized. We believe identifiable intangibles should not be removed from ACE or TAC, but rather

[12] Under GAAP, goodwill is assessed for recoverability on a continuing basis on a fair-value basis. Current GAAP requirements are for goodwill to be assessed for impairment at least annually or more frequently if certain impairment evaluation triggers are met. Accordingly, on off quarters between annual impairment evaluations, goodwill is evaluated to determine if a goodwill impairment trigger is met, thus requiring an interim recoverability evaluation.

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		should be treated similar to goodwill and be allowed to remain in ACE or TAC, subject to a cap. Insurers generally have two classes of identifiable intangibles: finite-lived intangibles, which are amortized with declining values over time (usually 1-10 years); and non-amortized indefinite-lived intangibles, like insurance licenses or trade names. Both finite and indefinite intangibles are continuously evaluated for impairment. Although they are both illiquid assets, their value is recognized at fair value, supported by estimated future cash flows to be earned from the operation of the acquired business and by an arm's length capital market transaction. Given the nature of finite-lived and indefinite-lived intangibles and their illiquidity profile we support giving capital credit for the unamortized balance of finite-lived intangibles but would make them subject to a cap. **<u>Recommendation: [Goodwill and Intangibles]:</u> ACLI recommends that S&P -** ▪ **Adopt a reasonably conservative cap of 25% for combined goodwill and identifiable intangibles (with the cap for goodwill remaining at 20%). In times of extreme stress, this would continue to maintain assets equivalent to 75% of ACE or TAC, which ACLI believes is more than sufficient given historical experience for severe stress events.**
3F. VALUE-IN-FORCE (VIF) – TAX AND RISK CAPITAL CHARGE ON RESERVE-RELATED TAC CREDITS (TAX EFFECT PARAS. 5, 20, 31, 35, 36; RISK CAPITAL PARA. 168-170)	S&P proposes to tax-effect all adjustments to determine ACE and TAC. S&P proposes to apply capital charges to VIF to capture the potential change in VIF in stress scenarios. The capital requirement is a measure of the potential reduction in the present value of future profits in each of the four stress scenarios. • 99.99% scenario – 65% capital charge • 99.95% scenario – 55% capital charge	The proposed tax effect and risk capital charge on credit for reserve conservatism would benefit from further analysis. A preliminary review of the tax effect raised the following concerns: • The proposal creates a mismatch between post-tax loss-absorbing capabilities and pre-tax required capital. • Charging required capital on margins in reserves is not theoretically valid; it double counts uncertainties in future cashflows which are already captured in required capital. • The approach does not differentiate margins in reserves from embedded value by vaguely putting them together in this VIF category. If adopted as proposed, this change is likely to lead to distorted capital adequacy results by insufficiently adjusting for significant conservatism in reserves under certain regulatory regime. The proposed risk capital charge to margins in reserves will materially understate an insurer's loss absorbing capabilities in regimes with more conservatism in reserves. **<u>Recommendation</u>: ACLI recommends that S&P consider using haircuts that vary depending on the certainty of loss-absorbing capabilities, instead of an arbitrary required capital charge. For example, margins in reserves are**

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	• 99.8% scenario – 45% capital charge • 99.5% scenario – 35% capital charge	**tangible resources on balance sheet and should get much higher credit than embedded value credit that realizes over a period**.
3G. TREATMENT OF OTHER THAN INVESTED ASSETS HELD BY U.S. INSURERS (PARA. 114)	In paragraph 114, admitted assets that are "not invested" assets appear to be subject to a blanket 100% capital chare, regardless of their underlying risk characteristics.	Life insurer's statutory balance sheets include assets that are not "invested assets" but that are important to their business function and are included in TAC. Paragraph 114 of S&P's proposal seems to suggest that these assets might be subject to a blanket 100% capital charge, regardless of their underlying risk characteristics. If so, this treatment is highly punitive. These are admitted assets, that often are material (e.g., Corporate Owned Life Insurance (COLI) and federal income tax receivables, etc.) and have real economic value verses statutory accounting non-admitted assets with little or no value. Like other issues raised in this document, we would have expected S&P to provide an explicit and reasonable justification, along with empirical evidence, for such punitive treatment. In regards specifically to COLI, COLI is a well-established financial strategy used by corporations, banks and insurers in the U.S. to finance (and sometimes hedge) the costs of employee benefit liabilities due to its ability to asset-liability match the long-term nature of these liabilities. When a U.S. life insurer purchases a COLI policy from another insurer, the purchaser holds an asset on its statutory balance sheet as cash surrender value under "aggregate write-ins for other than invested assets." The seller of the COLI policy books a reserve and invests the cash proceeds as it does for other life insurance policies. If S&P's proposal would ascribe a 100% capital charge to these very low risk assets, this would create a significant disincentive for insurance companies to take responsible financial actions to fund these otherwise unfunded nonqualified deferred retirement liabilities. By doing so, the proposal would also create a competitive disadvantage for S&P-rated companies in the recruitment of talent as they would be unlikely to continue to fund benefits through COLI, making them less competitive with their non-S&P-rated peers. S&P's current treatment of COLI is reasonable and consistent with regulatory capital standards. A 100% capital charge on COLI is not at all reflective of the risk of these assets and will severely impact the utilization of COLI and diminish the stability and cost effectiveness of the unfunded liabilities it is supporting. COLI is a mortality product issued by life insurers who hold reserves and capital for it. We therefore believe that S&P's current treatment of COLI is reasonable and should be maintained. Further, we believe S&P should take the requisite time to develop specific and appropriate capital charges for all other material high-quality assets that are included

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		within this category (*e.g.*, federal income tax receivables). Lastly, any other residual assets within this category should nonetheless be charged at significantly less than 100%. **<u>Recommendation:</u> ACLI recommends that S&P -** ■ **Develops specific and appropriate capital charges for all other material high-quality assets that are included within this category (*e.g.*, federal income tax receivables). Consider that any other residual assets within this category should be charged at significantly less than 100%.** ■ **Maintains S&P's current treatment of COLI. The current treatment is reasonable and consistent with regulatory capital standards. A 100% capital charge on COLI is not reflective of the risk of these assets and will severely impact the utilization of COLI and diminish the stability and cost effectiveness of the unfunded liabilities it is supporting. COLI is a mortality product issued by life insurers who hold reserves and capital for it. ACLI believes that S&P's current treatment of COLI is reasonable and should be maintained.**
4. Interest Rate Risks		
4. Interest rate risk (para. 108)	S&P proposes to compute C-3 required capital based on modified duration gap between assets and liabilities multiplied by a rate shock that represents the extreme tail over a one-year period.	The NAIC is in the process of updating the stochastic scenarios used in PBRand C-3 testing. This update will improve consistency between C-3 Phase 1 testing of fixed annuities and C-3 Phase 2 testing of VAs, enabling the use of C-3 Phase 1 as a more robust measure of interest rate risk than simple and hypothetical duration analysis, subject to adjustments for the longer time horizon. S&P's interest rate shocks are excessively conservative for the U.S. at 3.15% for the down shock (the onerous one). The magnitude of the downside rate shock should take current interest levels into consideration since when rates approach historic lows, their downside potential is likely reduced. The proposal's prescribed sizing of the shocks does not vary with the interest rate environment. In particular, the "down" shock at year-end 2020 would have resulted in an entirely negative yield curve, something not observed in the U.S., and only observed on a more limited basis in other developed economies. There is also concern with the misalignment of market-valued based exposure in the construct of a statutory capital model: • S&P's framework is more aligned with economic measures of capital, while other frameworks, including the RBC framework promulgated by the NAIC, are more

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		statutory focused. An economic framework is more sensitive to changes in market values as opposed to cashflow profiles which are the primary drivers of statutory frameworks. An economic framework can result in punitive charges for companies maintaining a strong cashflow profile. For insurers that follow statutory accounting, the impact of a downside rate shock on statutory capital that is suggested by a modified duration gap would not fully manifest for a long time - even if crediting were not adjusted, as it would require currently held assets to mature and be reinvested at the shocked down rates and current liabilities to continue at original crediting until the contracts terminate. In general, policyholders are not able to withdraw the "economic value" of their liabilities (*e.g.,* under long-term care (LTC) contracts). As such, realization of the "economic value shock" would be very long-term in nature, as it would require currently held assets to mature and be reinvested at the shocked-down rates and current liabilities to continue at original crediting until the contracts terminate. This implies that the severe rate shock would have to persist for many years, rendering the likelihood of such an event even more remote. S&P's proposal implies a one-year time horizon in the interest rate shock, but then assumes that the shock is permanent and assumes a market value shock to both assets and liabilities, which is unrealistic. Further, companies have ample opportunity between the shock and the future effect to measure, monitor, and correct for any long-term issues. Modified duration is typically not used in the insurance industry as a measure of interest rate risk for modern insurance products, as this metric assumes cash flows are fixed, whereas express product design for many products allows the insurer to adjust crediting in reaction to rate changes. ACLI agrees that interest rate risk should be incorporated into S&P's capital analysis but not considering the ability to adjust future cash flows for contracts with non-guaranteed elements (*e.g.*, participating life insurance) would overstate this risk within S&P's proposal. For U.S. life insurers, participating life insurance provides an important mechanism for managing interest rate risk. Participating policyholders share risk with the insurer and reap the rewards of their participation through policyholder dividends. Importantly, policyholder dividends do not have mandatory minimum payouts and can be reduced in times of economic stress, and there are numerous historical examples to support this. Use of company reported duration mismatch and market value of liabilities could lead to inconsistency and data quality issues • There is no standard approach to determining the fair value or duration of liabilities. The proposed approach does not consider how a company manages the interest rate risk profile; a company's measurement of liability duration could vary significantly

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		through: (1) methodologies (*e.g.*, static replication, risk-neutral stochastic valuation, simple forward curve, etc.); (2) discounting assumptions used (yield curves, spreads); and/or (3) how future premiums are reflected, either as offsets to liability flows or additions to asset flows. A simple mismatch approach can penalize companies with strong liquidity profiles that generate positive cashflow. Short interest rate positions would be strongly penalized, with no offsetting benefit for strong liquidity positioning. The approach is punitive for companies with fixed income-intensive balance sheets given both positive and negative interest rate shocks are considered in determining the stand-alone capital charge. The charges are additive for short-mismatch positioning (negative shock) and holding excess fixed income assets (positive shock). This could incentivize favoring non-fixed income assets to minimize charges for excess assets. • For a balance sheet that is entirely composed of fixed income assets, a short duration position may be "neutral" from an interest rate risk perspective, given excess fixed income assets (*e.g.*, short mismatch, but neutral DV01). • Utilizing only the mismatch can incentivize companies with total return assets to reach for yield through duration while driving significant cashflow mismatches. The default duration mismatch for foreign currency products/oversea policyholders should use the interest rate stress for the currency of the liability and the duration mismatch assumption for that currency, not that for the domestic market or where the policyholder resides. The ability to manage duration in a developed market does not depend on the location of the policy, but rather on the underlying currency and the depth of the capital market <u>Intersection of lapse related charges and interest rate charges.</u> It would be helpful if S&P clarified how the lapsed-rate related charges, noted in "Other Life Technical Risks" (paragraph 151), do not overlap with the interest rate risk related charges discussed above. **<u>Recommendation</u>: ACLI recommends that S&P:** ▪ **Uses an effective duration method, when available, because it is a more appropriate measure of interest rate risk when dealing with cash flows that change when rates change;** ▪ **Calibrates the interest rate stress using historical risk-free interest rate data applicable for the different territories, without inclusion of credit spread volatility;**

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		■ **Floors the interest rate shock to prevent an unrealistic shock in a low-interest rate environment; and** ■ **Uses a C-3 component that follows a C-3 component for VAs. An approach that represents the Present Value of a cashflow mismatch under a shock scenario or utilizing the insurer's own C-3 Phase 1 calculation could be used to determine required capital. This approach would be consistent with how market risk is captured for other products and relies on a proven framework for determine required capital**.
5. Morbidity / Mortality / Longevity Charges		
5A. Morbidity (paras. 141 *et seq.*)	S&P proposes to dramatically increase morbidity risk charges for LTC products. S&P also proposes to significantly increase morbidity factors applied to disability reserves.	The LTC morbidity risk factors are notably higher for claims and earned premiums than the factors used in the current U.S. S&P capital model, as well as the factors used in the NAIC RBC calculation. We understand that S&P's proposal was developed from a review of recent experience data. It is unclear, however, whether and how S&P has considered the ability of insurers to secure rate increases on business in force, which can limit exposures to adverse experience. Another concern relevant to the development of factors for LTC relates to the requirement for interest accretion on reserves. LTC blocks have substantial active life reserves, and interest on these reserves is a significant portion of "incurred claims" used in the calculation. Removing interest on reserves would capture the pure claims loss. The increase in active life reserves due to interest would be offset by interest earnings on the asset portfolio backing the LTC liabilities (*i.e.,* increases in reserves should be funded with returns on the assets backing the reserves). As such, the interest-driven increase in reserves should not be considered a "loss" and loss ratios would be calculated excluding interest accretion on active reserves. **<u>Recommendation:</u> ACLI recommends that S&P -** ■ **Review the LTC morbidity risk factors to ensure that they adequately reflect the potential for in-force rate increases; and** ■ **Recalculate the factors on a basis that removes interest accretion on reserves.**
5B. Mortality/ pandemic risk (paras. 138-140, 155)	*Mortality*: S&P proposes to apply capital charges to the net amount at risk ("NAR") on life products to capture the potential losses from higher-than-expected mortality in	It would be helpful to see more information about the study of the volatility of actual-to-expected (A/E) ratios since 1996 for the top 200 U.S. life companies. Discussion of the current American Academy of Actuaries recommendation to the NAIC for updates to C-2 charges is nearly complete. This analysis may offer helpful additional

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	stress scenarios. These unexpected losses could stem from volatility in the level of mortality rates, volatility around the trend, and misestimation of mortality at policy inception. To determine capital charges, S&P measured the volatility of actual mortality relative to expected mortality (the actual-to-expected-mortality ratio) since 1996 for the top 200 U.S. life companies and translated that into a percentage of the NAR. *Pandemic Risk*: S&P proposes to apply capital charges to the NAR in addition to mortality charges, designed to capture event risk, and assumes 1.5 excess deaths per 1,000 of the insured population at the 99.5% confidence level.	information and considerations, subject to the necessary adjustment for the differential in time horizons. For pandemics, 1.5/1000 seems more severe than the International Association of Insurance Supervisors (IAIS) Insurance Capital Standard's 1/1000 number that was viewed as a very conservative metric. For example, in a member's last CCAR work (2017) using Risk Management Solution's infectious disease model, the 1/200 scenario was about 0.6/1000 for a one-year event, which is typically what capital stresses. 1.5/1000 seems very conservative for a 1-year event and possibly even a 2-year event. A 1.5/1000 falls somewhere around the 99.8th percentile (1/600) based on that analysis. In both cases, mortality changes take place over time (*e.g.*, decades for general trends and 1-2 years for pandemics). Group insurance is commonly issued as short duration business which has considerably lower risk than longer duration products. The NAIC C2 applies different charges for individual vs. group business. **<u>Recommendation</u>: ACLI recommends that S&P reconsider the recommended factors considering the studies mentioned above, and consider differentiating capital charges between group and individual life products.**

5c. Longevity (paras. 148-150)	S&P proposes to apply a flat risk charge as a percentage of reserve for longevity risk based on risk category. High-risk category is defined as products with no or limited lump sum optionality (*i.e.*, immediate payout annuities, pension risk transfer). This category carries a 7% risk charge. Low-risk category is defined as products with limited and non-economic annuitization options (deferred annuities, funding agreements). This category carries a 0% risk charge. Medium-risk category is defined as all other products, which typically offer a realistic annuitization option even though a material proportion of policyholders do not annuitize (*i.e.*, income rider). This category carries a 2.1% risk charge.	The proposed longevity risk capital charges are excessive given the target calibration levels. The proposed factors (page 49) are considerably higher even relative to the NAIC's 0.7% longevity risk scaled at S&P calibration levels. The NAIC factors were formulated to the difference between the 85th and 95th percentiles, with an assumption that existing reserves already embed a level of conservatism to the 85th percentile. It is not clear how the S&P proposal views the risk level already provided for by reserves. This should be considered in the methodology. Global consistency should be interpreted as a globally consistent approach to define and calibrate risk charges, rather than a one-size-fit-all factor to risks which vary significantly across regimes. Longevity risk varies by product and further based on age of policyholders (and other factors, say for pension risk transfer business, like geographic location, occupation, and retirement status), and many capital models have charges that vary based on age (and maybe other factors). S&P should consider implementing a similar approach that varies based on age to capture the dispersion of policyholder ages and specific demographics of each company's policyholder liabilities. Also, S&P indicates that pension risk transfer business should have a higher longevity charge because of "limited lump sum optionality." For deferred populations, companies model plans with lump sum options, so another category might be necessary to avoid overstating the risk. Especially for deferred annuities, longevity changes take place over time (*e.g.*, decades for general trends). Guaranteed payout rates in deferred annuity contracts may allow much lower payments than are currently offered upon annuitization. Immediate capital requirements might not account for management actions over time, including repricing future payout annuity settlements, at rates closer to their contractual guarantees if warranted by increases in longevity. In addition, the proposal is not entirely clear as to how products are assigned to the risk categories and should be clarified to ensure that U.S. deferred annuities with very low historical annuitization rates (significantly lower than the prescribed 30%)- which the NAIC does not include in their formulation at all, and for which companies may be holding reserves above statutory minimum requirements - are not categorized in a way that significantly overstates the risk. This suggests reassessment of whether such deferred annuities properly belong in category 3. (Paragraph 150). **<u>Recommendation:</u> ACLI recommends that S&P –**

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		▪ **Considers implementing a similar approach that varies based on age to capture the dispersion of policyholder ages and specific demographics of each insurer's policyholder liabilities;** ▪ **Considers reassessing whether deferred annuities belong in category 3;** ▪ **Clarifies how the methodology addresses the longevity risk already provided for in the reserves;** ▪ **Compares the proposed longevity charges to other credible sources, in particular the NAIC longevity charges that are developed based on years of robust industry research and represent an informed and prospective view of longevity; and** ▪ **Extrapolates the NAIC charge (which is intended to fund from 85th to 95th percentile) to the intended calibration level for longevity.**
6. RISK CHARGES		
6A. EQUITY RISK CHARGES (PARA. 93)	Increasing equity risk charges across all country groupings and all confidence intervals. Equity charges for unlisted companies are greater than for listed companies.	ACLI disagrees that the charge for unlisted securities should be higher in S&P's model based on "higher leverage as well as their illiquidity". Another example of excessive conservatism appears in S&P's treatment of equity securities. For the U.S. market, the proposed equity charges at the 99.99% confidence interval (AAA level) are 55% for publicly traded securities and 66% for privates. While both capital charges are excessive, ACLI does not believe private equities should incur a higher charge than publicly traded securities. In our experience, private equities experience less—not more--price volatility than public equities. As such, ACLI recommends reducing the charge on private equities to match the public equities charge. Referring to paragraph 89 of the proposal, S&P states that they, "apply capital charges to the fair value of equity investments to capture potential losses in stress scenarios on the assumption of a buy-and-hold strategy." It is unclear what "buy and hold" means in this context. Applying a surcharge for liquidity when assuming a buy-and-hold strategy is contradictory. Liquidity risk is also captured elsewhere in S&P's methodology through the liquidity "modifier" to a firm's stand-alone credit profile, resulting in a potential double counting of this risk. It should also be noted that charges for listed securities in equity market group 1 are already 8 percentage points higher than the corresponding charge for U.S. equities in the 2010 methodology (an increase of 17%); differentials for securities in other equity market groups are even greater. It's not fully clear what data S&P used to develop its equity market volatility assumptions. To ensure S&P is not overstating the risk of this investment class, it is

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		important to consider calibrating to measures/metrics that are more focused on down-side volatility tails versus data that also incorporates positive volatility. ACLI conducted independent analysis on annual total returns of public and private equity using the S&P Total Return Index and the Limited Partners Association's (ILPA) private markets benchmark index for US/Canada Private equity. The analysis spanned 25 years from Q2 1996 to Q2 2021 and measured volatility using the standard deviation of the annual total returns. The data showed that private equity standard deviation was 14% as compared to 17% for public equity. This supports that private equity and alternatives present less volatility risk than public securities and should not draw higher charges for S&P's model. **<u>Recommendation:</u> For the reasons listed above, we recommend aligning the charges on private equities to match the charges with public equities. Alternatively, we recommend reducing the 11% surcharge on unlisted equities to a level that is more appropriate.**
6B. REAL ESTATE RISK CHARGES (PARAS. 94-96)	Charges are based on four country groupings and are differentiated between Investment and Owner-Occupied properties S&P classifies countries into the four groupings based primarily on the annual volatility observed in each country's real estate index over at least the past 15 years.	S&P's proposed approach to classifying countries for real estate risk, based primarily on one factor (*i.e.,* price index volatility over a relatively short period of time), is very simplistic, leading to some misclassifications. The simplistic approach to real estate stands in sharp contrast to the much more robust approach S&P proposes for classifying countries for equities, which is based on five factors. Price index comparisons between countries are significantly distorted by differences in national appraisal practices. For example, the U.S. has frequent (often quarterly) and robust appraisals reflected in its price indices while German appraisals are less frequent (often only every several years). This dynamic appears to be affecting country groupings in the proposal. **<u>Recommendation</u>: ACLI asks S&P to follow its example for equities and use a more robust approach in classifying countries for real estate risk. ACLI recommends basing the classifications on an expanded framework, including additional factors, such as country rating, real estate capital markets size, market liquidity, market performance benchmarks, market inclusion in global real estate benchmarks, etc.**
6C. COMMERCIAL MORTGAGE LOAN (CML) RISK (PARAS. 74-78)	The charges remove risk differentiation for the highest quality loans (<60% LTV).	ACLI has several concerns with the proposed CML risk charge, including: • The proposal does not remove expected loss, which is inconsistent with the proposed corporate credit and these losses are assessed at higher confidence intervals than previously.

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		• The CML charges are overly conservative - charges ~2x higher than "A" corporate charge; S&P has itself published various research on this subject that demonstrates low losses on insurer's CML portfolio. • It appears that the risk charges are sloped incorrectly and could provide the wrong incentive – the slope should be reviewed. • The lack of differentiation for the highest quality loans (LTV<60%) from others. • The lack of differentiation for structurally subordinated loans (mezzanine, 2nd lien) and 1st lien loans, which is also inappropriate. **<u>Recommendation</u>: ACLI recommends that S&P –** ▪ **Reassess the CML risk charges considering S&P's research on insurers loss level in CML portfolios;** ▪ **Evaluate the slope of the risk charges;** ▪ **Improve differentiation for the highest quality loans (LTV < 60%); and** ▪ **Differentiate between 2nd lien and 1st lien loans.**
6D. Agricultural mortgage risk charges (para. 78)	S&P describes agricultural mortgages as "higher risk residential mortgages" and assumes they are high-risk commercial loans and applies the risk charges for a debt service coverage ratio (DSCR) of less than 1.1x and loan-to-value (LTV) greater than 80%.	At each confidence level, the proposed approach applies a single risk charge factor to all agricultural mortgages. This approach does not recognize any differences in the relative quality of loans and is unnecessarily crude. Instead, ACLI recommends S&P vary risk charges by LTV, as it does with CMLs. Mapping all agricultural loans to the riskiest CML cell (DSCR <1.1x and LTV >80%) is inappropriately punitive and is not consistent with the loss experience of leading U.S. insurance company agricultural mortgage lenders. The historical loss performance of agricultural mortgages is very close to commercial mortgage loans loss experience, and close to corporate bonds in the A to BBB range. Despite similar loss experiences, these other asset classes have significantly lower proposed risk charges than agricultural mortgages. **<u>Recommendation</u>: ACLI recommends that S&P** ▪ **Vary its charges on agricultural mortgages by LTV as it does with CMLs** ▪ **Reconsider the overall level of charges to make them more consistent with sector loss experience;** ▪ **Use the entire CML capital table to map agricultural loans – which would require the consideration of LTV and Debt Service Coverage Ratio (DSCR).**

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6E. Other Life Technical Reserve Risk (paras. 151-154)	New risk category that captures mass lapse/lapse rate/expense risks, etc. 3 levels of risk charges, from 0.6%-2%, by product type.	*Expense risks:* The inclusion of expense charges and operational risk in this factor is not appropriate. Expense risk is generally within a firm's control and can be managed; holding capital against expense risk seems excessive. **Recommendation [Expense risk]: ACLI recommends that S&P considers excluding expense risk because it is a manageable risk controlled by the insurer and evaluates whether the mass lapse rate is duplicative or overlapping with the interest rate risk charges.** *Mass lapse risk:* Mass lapse is a liquidity risk that's already captured separately in S&P's liquidity factor. Should S&P charge have required capital on mass lapse if the most onerous interest rate risk is on a down scenario? *Lapse Risk Categories:* Additional flexibility is needed within the lapse risk categories. The proposal classifies insurance liabilities across three categories, applying higher risk charges for products with greater lapse risk. S&P may also reclassify insurance liabilities to lower risk charge categories where there are *"material risk-mitigating features embedded in the products that significantly reduce the financial impact of lapses for the insurer. For example, we may reallocate products to category 2 from category 1 where we believe the insurer has the willingness and ability to apply surrender charges or market-value adjustments to significantly reduce its potential investment losses on lapse*." **Recommendation [Lapse risk category]: ACLI recommends that S&P provides for greater flexibility when assigning lapse risk to products that have historically demonstrated low lapse risk. For example, the following are significant economic risk mitigants that should be considered when assessing lapse risk for insurance products offered by life insurers: loss of insurance protection, the uncertainty of new underwriting to obtain replacement protection, new sales costs, and tax consequences. Time restraints, based upon a company's contractual obligations, also provide a material, non-economic risk mitigator for lapse risk.**
7. Increased Confidence Levels		

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7. INCREASED CONFIDENCE LEVELS (PARA. 6, FIRST BULLET; PARA. 13)	S&P proposes to increase confidence levels driven by generally higher underlying asset / liability risk charges.	In general, the S&P proposal is excessively conservative and this manifests itself in many areas throughout the proposal. A good example is the increase in confidence intervals proposed by the agency to 99.99%, 99.95%, 99.8% and 99.5%, corresponding to AAA, AA, A and BBB using S&P's rating scale. An increase in asset and liability risk charges across the board is driven by an increase in the overall confidence intervals, which leads to a compounded impact on capital requirements for each respective calibration – effectively an increase in capital requirements from both the bottom up and top down. With 99.5% at the low-end of S&P's selected range (BBB), S&P's proposal exceeds the current regulatory capital standard for U.S. life insurers established in the NAIC RBC model. The 99.5% confidence interval should not correspond to the low-end of S&P selected range (BBB).
8. OTHER ISSUES		
8A. TREATMENT OF VA PRODUCTS (PARA. 156)	For VA products, S&P proposes to capture risks based on CTE levels of 99.75%, 98.75%, 96.5%, and 92%, which will be calibrated to the new confidence levels of four stress scenarios. Also, S&P proposes to increase in hedge credit from 50-to-75%.	The proposed changes to the treatment of VAs would increase the misalignment between the S&P methodology and the U.S. regulatory framework. Diverging from the regulatory framework adds unnecessary complexity to VA capital management. Conclusions drawn from changes in regulatory capital or RBC may not translate to the S&P capital model. *<u>VA capital ratio – post-tax numerator to a pre-tax denominator</u>* The proposed capital ratio for VAs compares a post-tax numerator to a pre-tax denominator, rather than a post-tax denominator, as is the case at present. This represents a significant change, and it does not align with the regulatory approach, where the denominator continues to be developed on a post-tax basis. The lack of tax-offsets (use of a pre-tax denominator) for VA projections seems unusually punitive because the longer-term nature of VA projections generally creates more certainty regarding an insurer's ability to secure a tax offset. As such, removing this component would be a significant change to the methodology, would result in a material increase to required capital, and would not reflect real-world results. *<u>The proposal appears to punish companies with robust hedging programs</u>* Many insurers employ effective hedge programs, which should be appropriately reflected in the capital requirements. While the intent of the proposal appears to be a greater capacity to reflect hedging, companies with the most robust hedge modeling (an E-factor below 25%) will continue to be penalized, even though the regulatory regime requires significant support and documentation to determine a company's E-factor. Further, a differing reflection of hedging in the S&P model is likely to result in differing sensitivities

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		of the capital requirements, as compared to the regulatory framework, due to economic movements. Updating the proposal to use the company-specific E factor would ensure the modeling of the hedge strategy has been robustly supported and documented, resulting in a reflection of hedge effectiveness within the capital charges that is tailored to the capabilities of individual companies and simplifies company capital management. *The proposal's increased CTE levels could create additional volatility and increases divergence between the U.S. regulatory framework.* ACLI is not aware of empirical evidence of support for S&P's adoption of more conservative CTE assumptions at the various rating levels.[13] Proposing higher CTE levels (*i.e.*, going further out into the tail) could create additional volatility since these CTE statistics are calculated using fewer scenarios. Stability of capital requirements is an important facet in managing a complex business so the potential for increased volatility unrelated to the economics of the business leading to adverse rating decisions is concerning. The increase is likely to be excessively punitive in projections with longer horizons and more extreme tails. In addition, no single rating level in the proposal utilizes the same CTE level as the current U.S. regulatory requirement, which has been a beneficial calibration point in our understanding of the current capital model. For example, the use of CTE98 without a 25% scalar in current S&P 'AA' capital suggests that this is roughly equivalent to a 400% RBC ratio in the regulatory regime. Minimizing divergence from the regulatory regime, especially with a direct link between one of the S&P capital levels and the regulatory CTE level, would aid in the understanding of the capital requirements impacting ratings. *Special care is needed to ensure that VA's decades-long projection periods does not distort VA capital requirements relative to other products.* The VA capital charge has the greatest need for consideration of the difference in time horizons from the one-year framework utilized by the remainder of the S&P model. Projection periods of 50 years or more are common for the statutory analyses. While alignment with the regulatory regime is appropriate, care should be taken that the alternate approach does not distort VA capital requirements in the S&P model relative to other lines of business. *Assessing the impact of the proposal's treatment of VAs is difficult without knowing the outcome of pending changes to the NAIC Economic Scenario Generator.*

[13] S&P may wish to leverage data and analysis gathered by U.S. insurance regulators during the development of PBR for VAs. As part of that undertaking, U.S. regulators conducted extensive analysis to determine the appropriate CTE level for required capital (CTE98 forms the basis of C-3, Phase II required capital) and the maximum hedge credit levels (95%) for U.S. statutory regulations.

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		While recommending alignment with the regulatory regime, the timing of the proposed change to the VA charge makes analysis challenging. Updates to the prescribed statutory economic scenario generator (ESG) are currently under discussion at the NAIC. While the impact and outcome of any future ESG changes is uncertain at this time, it is reasonable to believe that the refinements to the ESG model may alter the appropriateness of the proposed VA capital framework. It is difficult to provide accurate feedback on the S&P criteria without knowing the outcome of the ESG refinements. **<u>Recommendations</u>: ACLI recommends that S&P -** ▪ **Maintain the post-tax calculation of required capital for VA's and specify the rate used (such as the statutory tax rate of 21%);** ▪ **Incorporate a company's E-factor to determine the adjustment to hedge effectiveness;** ▪ **Retain CTE98 as the 'AA' calibration in the capital model; and** ▪ **Recalibrates CTE levels following the introduction of the NAIC's revisions to the ESG.**
8B. RISK ABSORPTION FEATURES NOT ACCOUNTED FOR		S&P's proposal does not account for company-specific features that provide risk absorption capacity. For example, as we noted above, participating whole life insurance sold by U.S. life insurers provides an important source of risk absorption capacity. The loss absorption capacity of policyholder dividends can either be captured in TAC or factored into the calculation of capital requirements. That is, capital requirements should be reduced to account for a U.S. mutual life insurer's ability to cut policyholder dividends under the proposed stress scenarios. Other risk absorption features include the ability to change the cost of insurance charges on universal life (UL) insurance policies, credited interest on UL and fixed annuities, and premium rates on term life insurance and long-term care insurance policies according to their contractual terms. Finally, companies may have the ability to reduce dividends as well as restructure their investment and product portfolios, reduce share buybacks (and possibly even issue shares), and exercise credit facilities, all in times of economic stress. **<u>Recommendation:</u> ACLI recommends that S&P improves the proposal's recognition of the loss absorbing capacity created by policyholder dividends, or**

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		other product features or levers that a company may use to provide risk absorption capacity in times of stress.
8c. Reserving / Consider leveraging additional modeling in VM 20 and VM21 into S&P formula		For life insurers in the U.S. that use the S&P statutory capital model, the proposed model will result in significant structural change that will create difficulties assessing the impact at a product level. The proposed model will disaggregate these reserve risks, apply gross/pre-diversification risk charges, then reaggregate by applying levels of diversification credit via correlation factors to arrive at a net required level of capital. U.S. insurance regulators have been introducing reserve processes that assess better reserve levels, like VM20, VM21 and VM-30 (asset adequacy analysis). **<u>Recommendation:</u> ACLI recommends that S&P consider leveraging this modeling to reduce the potential for multiple, redundant analyses. For example, statutory asset adequacy analysis in the form of cash flow testing could be leveraged to calculate the adjustment for VIF.**
8d. Open Questions		1. Will GAAP financials be basis for capital model going forward for public US life insurers? Does the new switch create "winners and losers" by punishing sectors of the life insurance industry whose core business model is whole life (i.e., mutual insurers & the treatment of dividend liabilities)? Why the differential treatment for excess reserves held under SAP vs. GAAP/IFRS? 2. How will the new required capital levels be incorporated into S&P's existing ratings criteria (and specifically the capital and earnings assessment)?