ACLI Verbal Testimony
House Financial Services Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets
“A notch above? Examining the bond rating industry”
May 11, 2022

Good morning, thank you Chairman Sherman and Ranking Member Huizenga for having me here today.

My name is Mariana Gomez-Vock and I’m proud to appear on behalf of the American Council of Life Insurers. Before I dive into the details, I’m going to briefly touch on the big picture because I think it really demonstrates why we care so much about this issue.

The big picture is that 90 million families nationwide – people you represent - depend on the life insurance industry to protect their financial future. Life insurance, annuities, disability insurance, paid medical leave and other products make certain they can care for themselves and their loved ones in good times and bad.

Our policies often stay with families for decades. Our promise to them is we will be there no matter what. And we are.

When the pandemic hit, life insurers were there. The pandemic hit many industries hard – airlines, retail, restaurants. But we were the industry that was writing checks and paying out to families. We were there when the worst came for too many. Benefits paid in 2020 were the highest in history. The industry paid over $90 billion in life insurance benefits.

Our long-term investments are the bedrock of our commitments to be there when we’re called. We invest $7.4 trillion in the U.S. economy – that’s $572 million every day. That makes life insurers one of the largest sources of investment capital in the nation.

And our investments do more than protect policyholders. They drive economic growth in every corner of the country. Steady, slow-growth investments make it possible for us to keep our promises, while providing business owners, farmers, school systems and communities with the working capital they need to open their doors, fund infrastructure, and grow their workplace

That’s the big picture, now let’s dig deeper.

Insurer capital models – like the one proposed by S&P - are so critical that insurers will often shape their long-term investment and capital management strategies to align with them.

When a rating agency “notches” an investment it’s signaling that it believes the asset may have a higher risk of default – or loss – so the insurer should hold more capital against it.

S&P had proposed to notch, and in some cases disregard, credit ratings from competitors and the NAIC Securities Valuation Office. In some cases, the notching would assign a 100% capital charge to an investment grade asset - without any clear reason for the notching, other than it was rated by an S&P competitor. We appreciate S&P's decision to revisit that part of their proposal.

Notching assets just because they are rated by a competitor could disrupt competition.

That's a bad outcome for consumers and the American economy.

Before I conclude, I would like to make three points:

The first is that ACLI supports robust competition

Competition and diversity among NRSROs, benefits the insurance industry, the economy and ultimately consumers.

The second point is that automatic notching is not harmless.

It creates a fundamental disconnect between the assets value and the assets charge. Large swaths of insurers' bond portfolios would have been notched, and structured products rated by competitors would be treated as "junk" under the S&P original proposal.

We look forward to exchanging views with S&P on the appropriate treatment of NAIC-designated securities. The proposal's disregard of these designations is counterintuitive given that the NAIC designations are designed for and overseen by state regulators. Their mission is to preserve the solvency of insurers and protect consumers. There is no conflict of interest there.

Automatic notching essentially inflates asset-charges. It would force insurers to choose between holding artificially inflated levels of capital or avoid high-quality, high yield assets, just because they were rated by a competitor. Both outcomes are bad.

The third point addresses the proposal's impact on the competitive global insurance market

Some of the proposed changes were designed to promote global consistency, an understandable goal. However, some elements of the proposal appear to penalize different accounting and regulatory American regimes. This

could disadvantage U.S.-provided long term financial security products to American consumers, such as variable annuities and whole life. We look forward to continuing the dialogue on this issue.

[Conclusion]

One final observation. Much of this is highly technical, but the details matter. They matter because individuals and families all across this country are seeking certainty. And we are in the business of providing certainty. *W*e are there for our policyholders when they need us. We are there for communities who rely on our economic investments in our towns, suburbs, and cities, so they can fuel America's commerce and ingenuity. A change by the world's largest rating agency *will* have impact. These changes should be transparent and supported by data. We urge you to think of these details and the impact they'll have. Thank you for this opportunity share our views. I look forward to answering any questions you may have.