May 12, 2023

Letter to the RBC IRE WG regarding proposed interim RBC solution for residual interests in April 2023

Dear Chair Barlow, Mr. Fleming, and members of Risked-Based Capital Investment Risk and Evaluation (E) Working Group (the “Working Group”):

We appreciate the opportunity to comment on the proposed interim Risk-Based Capital (“RBC”) solution for residual interests exposed by the Working Group in April 2023. We believe a more thorough process is needed before adopting the proposed 45% RBC for CLO equity, even on an interim basis. Additionally, robust analysis is desirable to provide a sound basis to revise the RBC treatment broadly for other asset classes.

We recommend allowing the NAIC CLO Ad Hoc working group to complete its detailed analysis and modeling process for CLOs prior to implementing an interim change to CLO equity RBC. A comprehensive analysis would provide a sound basis. We support the analytical work undertaken by the NAIC. In fact, PineBridge has been actively participating in the modeling efforts led by the NAIC CLO Ad Hoc working group. We expect CLO equity loss rates to be driven by a variety of factors such as collateral composition, leverage, and manager profile. We believe active collateral management, portfolio diversification, and structural protections have all contributed to the strong track record of CLOs as stated in our July 15, 2022 response letter to the NAIC.

Given that the analytical work to date has been largely focused on CLOs, we are concerned that assigning the CLO equity risk charge (to be determined), or the proposed interim RBC of 45%, to the residual interests of other types of structured assets is unsupported. CLOs are not necessarily comparable to other securitizations. As seen in other comment letters and prior modeling work for other securitized products (e.g., CMBS and RMBS), there are significant differences in deal structure and performance across structured assets. CMBS, RMBS, and sub-prime autos experienced more severe losses during times of extreme stress such as the 2008 global financial crisis as compared to CLOs. A logical sequencing for determining appropriate RBC treatment for other asset classes is to continue the NAIC’s analytical efforts on CLOs (including the modeling work led by the NAIC CLO Ad Hoc working group). After the CLO results have been thoroughly analyzed, we would recommend applying a consistent framework regarding cashflow analysis and stress testing to determine an appropriate solution for other structured asset classes.

We support having a sound basis for any RBC revision and do not believe that it is prudent to increase RBC for residual interests broadly due to the NAIC’s concern around capital arbitrage, which was cited as one of the primary reasons for the proposed RBC increase. While it is possible certain residual interests could warrant RBC factors greater than 45% due to capital arbitrage or other reasons, not all structures create capital arbitrage. In our February 2023 comment letter to the Valuation of Securities Task Force (“VOSTF”), we shared a framework to help fret out adverse cases. Below is an example of a structure held by various insurers demonstrating that some structures are not aimed at achieving RBC arbitrage, and in fact, they may have higher RBC than that for the underlying assets, i.e., the sum can be greater than the parts.

In conclusion, we strongly recommend allowing the working groups to collaborate with industry and properly model CLO residuals first, and then apply a consistent modeling framework to other structured assets, before implementing any changes to residual interest RBC broadly.

Sincerely yours,
PineBridge Insurance Solutions and Strategies, CLO team, Leveraged Finance team

Global Disclosure Statement