February 9, 2024

Letter to the NAIC SAPWG regarding clarifications to SSAP No. 26R on the treatment of debt securities issued by funds

Dear Chair Bruggeman and members of the Statutory Accounting Principles (E) Working Group ("SAPWG"):

We appreciate the opportunity to comment on your exposure regarding clarifications to SSAP No. 26R on the treatment of debt securities issued by funds.[1] We support your effort to "eliminate inconsistent application between similar funds and to better align with the recently adopted definition of residual tranches through the Bond Project." We would like to share some facts to support the consistent statutory treatment for securities issued by business development companies (BDCs), closed-end funds (CEFs), and private funds.

First, as you noted in the exposure memo, that substance over form is an important principle. Under SSAP No. 26R, operations such as BDCs and CEFs, regardless of being public (or listed) or private (or unlisted), their debt issuances are treated as issuer credit obligation (ICOs). "Substance" rather than "form" dictates the ICO designation of BDCs and CEFs.

Second, we see similar substance across BDCs, CEFs, and many private funds regarding the following:

- There is a related operating entity whose primary purposes are managing assets and raising capital.
- All have a well-defined and hard-wired payment priority in the legal documents. For example, in an event of default, contractually BDCs and CEFs need to redeem senior debt first and then pay off junior obligations. Furthermore, BDCs and CEFs often have additional asset coverage tests; and if a coverage test is breached, mandatory redemption would take place such that senior debt is paid first to de-lever the capital structure. This is also how the "hardwiring" works in many rated feeder funds.
- There is no special purpose vehicle (SPV) within a typical fund construct.

Finally, rating agencies' private fund methodologies and analysis align with those for CEFs and corporate bonds (both designated as ICO) in several ways:

- Multiple rating agencies apply their CEF methodology to rate private funds.
- Rating levels and the amount of debt issued by these funds intend to right-size the risks embedded in the investment vehicle, including but not limited to prudent leverage, portfolio mix, liquidity, legal construction, and management quality.
- Funds ratings typically do not carry a structured finance (SF) subscript and are generally assigned by the Financial Institutions Group within rating agencies, not their structured finance team. An entity level anchor rating is assigned first, and that is then notched up/down to reflect security level seniority or structural subordination. Typically, rating agencies would rate no more than three-classes of debt issued by a fund. This framework aligns well with how rating agencies analyze corporate bonds overall.

In summary, we support private funds with prudent leverage to be designated as ICO, consistent with the SSAP No. 26R classification for BDCs and CEFs.

Sincerely yours,
PineBridge Insurance Solutions and Strategies

[1] SAPWG 2024-01, Bond Definition – Debt Securities Issued by Fund, https://content.naic.org/sites/default/files/inline-files/24-01%20-%20PBBD%20-%20SEC%20Funds.docx

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