April 26, 2022

Letter to S&P regarding its insurance capital model request for comment (RFC)

Dear S&P insurance team,

We'd like to thank S&P for its efforts on updating its insurance capital model and greatly appreciate the opportunity to comment.

Our main comments are related to the proposed rating notching mechanisms. From the perspective of an asset owner and our insurance clients, the proposed notching mechanisms appear to lack an adequate analytical basis. For example, the request for comment (RFC) proposes to notch down the rating of structured securities not rated by S&P, Moody's, or Fitch to CCC. In addition, the RFC suggests lowering the rating of structured securities not rated by S&P but rated by Moody's or Fitch by two to three notches. As stated on the S&P website, "credit ratings are forward looking opinions about an issuer's relative creditworthiness. They provide a common and transparent global language for investors to form a view on and compare the relative likelihood of whether an issuer may repay its debts on time and in full." **We question whether such severe rating notching is commensurate with actual default/loss experiences, and what data S&P may have to support it.** We are also concerned about how these notching proposals may affect the insurance industry's utilization of a diverse set of rating agencies. If this notching were to be adopted, it would strongly incentivize insurers to use only S&P ratings for their investment needs. While we view S&P as a leading credit rating provider, we also believe each rating agency has its respective strengths, and some may specialize in certain asset types in which S&P may not be particularly active.

In addition to the notching proposals, we would also highlight the following:

- The "materiality" threshold for look-through treatment of an investment fund seems incredibly high at 10% impact on total company-level risk-based capital (RBC). We believe it is extremely rare for an insurer to make such oversized and concentrated investments, and we would suggest a lower or more realistic threshold. Smaller insurers are the main users of investment funds because of fund vehicles' greater operational efficiency, and thus they would be at a relative disadvantage if they must apply an equity-like risk charge to investments such as fixed income funds and commercial mortgage loan funds, given that larger insurers could invest in the underlying credits directly using separately managed accounts (SMAs) and apply look-through treatment.
- Lack of clarity around the use of S&P issuer credit ratings (ICRs) of funds in the capital model. We would expect insurers could apply the S&P's own fund ratings for S&P capital purposes.
- Lack of clarity regarding how the revised diversification framework may work for asset portfolios. An impact analysis focusing on portfolio asset risk charges before and after the RFC's proposed changes would be useful.

Thank you for your continued efforts on this important update. We hope our comments are useful in helping ensure investment risks are properly reflected in S&P's insurance capital model.

Sincerely,
Global Insurance Solutions and Strategies
PineBridge Investments

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