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Regulatory Update

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ASSET MANAGEMENT | UPDATE

Private Placements Interest Grows; Conning Managing New NAIC Requirement for Clients

By John Petchler, CFA, Director, Private Placements

Conning clients saw strong relative value in private placements in 2021 and committed nearly 50% more dollars to the asset class than in 2020. This was the second consecutive year of substantial increases from Conning clients, and as we begin 2022 we continue to see opportunities in the sector along with expectations for a more diverse issuance pipeline in February after the annual industry conference.*

One of the regulatory changes in the private placement market for 2022 that we are following closely is a new rating filing requirement by the NAIC's Securities Valuation Office (SVO). Effective 01/01/22, for any newly issued private placement that is purchased after this date, the insurance company completing the regulatory filing for this asset as lead purchaser must file with the SVO a copy of the rating agency rationale that was issued accompanying the purchase, assuming there was a private letter rating. Conning, as an experienced private placement asset manager, has always performed this service for its private placement clients when we have been lead investor on a deal and will continue to do so.

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As background, the SVO has been concerned about private letter ratings since the insolvency of Eli Global LLC (Eli Global), a highly leveraged private-equity-controlled insurance holding company that entered regulatory supervision in 2019. Eli Global had complicated inter-company financial arrangements with private letter ratings which the regulator believes obfuscated Eli Global's financial condition. The insurer's failure triggered the SVO's study of private letter ratings and the NAIC has since imposed additional disclosure requirements for inter-company transactions at an insurance company.

The SVO is reviewing requirements that it automatically accept rating agency designations for determining risk-based capital (RBC) requirements for private placements. The SVO believes rating agencies did not accurately reflect the financial risk in a substantial number of structured/MBS securities during the 2008 financial crisis. The SVO now relies on its own capital-adequacy measurement process for certain structured/MBS securities rather than the rating agency designations. The SVO is extending its review to corporate ratings, starting with private letter ratings, and comparing its ratings to those provided by select agencies as well as to how ratings vary by agency. Implied in the review is that the SVO may be re-authorized to overrule rating agency designations; until about half a dozen years ago, the SVO was allowed to overrule any agency rating on a CUSIP (public bond or private bond).

Conning will provide updates on developments on this matter as they occur. If you have any questions, please reach out to your Conning relationship contact.

RELATED CONTENT

Private Placements: Aiming for Greater Yields, Downside Protection and Customized Cash Flows

Matthew Daly, Head of Conning's Corporate and Municipal Teams, and John Petchler, Director, Private Placements, discuss how private placements may offer insurers greater yield compared to public issuance of similar quality and duration. They also discuss the sector's investor protections and how private placements may enable insurers to customize maturities to match liabilities Click here to read this Viewpoint.

John Petchler, CFA is a Director and Corporate Bond Research Analyst. Prior to joining Conning in 2016, he was a managing director at Member Capital Advisers overseeing a $2 billion private placements bond portfolio, and previously was a senior vice president at Citigroup Insurance Investments. Mr. Petchler earned a BA from Wesleyan University and an MBA from New York University. He has been president of the Private Placement Investors Association since 2013.

Risks:

Market Risk – Market, or systematic, risk is the risk that individual securities may be correlated with general market downturns regardless of the particular business conditions and outlook for the individual companies

Credit Risk – Eroding fiscal health in issuing companies resulting in inability to meet debt obligations

Inflation Risk – Inflation erodes the purchasing power of future cash flows from investments. In times of high inflation the value of securities may be reduced

Liquidity Risk – Liquidity risk can occur when market conditions do not allow transactions to be made in a quick and orderly fashion in relation to indicative market prices

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