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CLIENT ALERT

Private Credit Rated Investments – NAIC's SVO Proposes Updates for Rating Agency Rationale Report Requirements

June 18, 2025

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Ongoing developments in the NAIC's Securities Valuation Office (the "SVO") continue to influence the relationship between private credit asset managers and insurance company investors seeking to invest in rated private credit securities. As described in more detail below, the SVO has proposed to the NAIC's Valuation of Securities (E) Task Force ("VOSTF") that insurance company investors submit a sufficiently substantive credit rating rationale report (a "Rationale Report") in order for rated private credit securities to remain filing-exempt. Typically, the asset manager, not the insurance company, interfaces with the rating agency and drives both the timing and substance of the Rationale Report. Given the importance of the Rationale Report to asset managers' insurance company investors, it behooves asset managers to familiarize themselves with the requirements for a Rationale Report as an investor relations matter.

The Rationale Report is typically provided as part of the credit ratings process for a private credit security. The SVO has proposed to the VOSTF that the Rationale Report "be no less comprehensive" than the report that a rating agency would produce for a similar publicly rated security, "and always include sufficient analytical content to enable an independent party to form a reasonable opinion of the basis for the [rating agency]'s assessment of investment risk."

Private credit rated investments using investment fund or NAV rating methodologies continue to grow in 2025. For example, several of the largest collateralized fund obligation (CFO) issuances to date have been launched in the last few months and the NAIC President has made favorable comments about the potential benefits that "carefully designed" CFOs provide to insurance company investors.[1]

When structuring CFOs, rated note feeder funds or other bespoke private credit-rated investments, asset managers are often designing the investment with a view that the relevant financial instrument is intended to be reported by the insurance company investor as a filing-exempt bond on Schedule D, which can result in a more favorable NAIC Designation and corresponding risk-based capital charge for the insurance company investor as compared to the typical risk-based capital charge for equity investments in private funds. An NAIC Designation may be obtained by filing an investment with the SVO, but many securities are exempt from filing when rated by a rating agency.

As we have previously discussed here, insurance company investors are now required by the Purposes and Procedures Manual of the NAIC Investment Analysis Office to submit a Rationale Report issued by the rating agency for newly acquired securities and for each calendar year thereafter, and with any changes in rating, in order for a privately rated security to be exempt from filing with the SVO for assessment and assignment of an NAIC Designation.

At its most recent meeting on June 4, 2025, the VOSTF discussed two proposals that the SVO has put forth to clarify the requirements for Rationale Reports. First, the SVO proposed that it must receive a Rationale Report no later than 90 days following the date of an annual rating update or any rating change—otherwise, the SVO will mark the security as ineligible for filing exemption until it receives the Rationale Report. Second, the SVO proposed that the Rationale Report "shall be no less comprehensive" than the report that a rating agency would produce for a similar publicly rated security, "and always include sufficient analytical content to enable an independent party to form a reasonable opinion of the basis for the [rating agency]'s assessment of investment risk." The SVO also provided an anonymized sample of an insufficient Rationale Report.[2] If the SVO determines that a Rationale Report

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1 https://www.bloomberg.com/news/articles/2025-05-23/private-funds-are-turning-to-complex-bonds-to-tackle-cash-crunch?srnd=phx-fixed-income.

2 "The confirmation by CPR XYZ is based on the following rating rationale and analytical considerations: 1) The transaction assumptions consider CRP XYZ's baseline macroeconomic scenarios for rated sovereign economies, available in its published commentary. These baseline macroeconomic scenarios replace CRP XYZ's moderate and adverse COVID-19 pandemic scenarios, which were first published in 2020. 2) Transaction capital structure and credit enhancement level are sufficient for the current rating. 3) Credit enhancement is in the form of overcollateralization, reserve account, and excess spread. 4) Credit enhancement level is sufficient to support the CRP XYZ's expected default and loss severity assumptions under various stress scenarios. 5) Collateral performance is within expectations and cumulative defaults remain low." https://communications.willkie.com/138/3013/uploads/vostf-materials-2025-06-04.pdf.

does not satisfy minimum expectations, the SVO would request further information from the insurance company investor, and if that request is not fulfilled, the SVO could reject the filing.

These developments are relevant to both asset managers and insurance company investors as the two parties negotiate reporting covenants and other terms with respect to investments in rated private credit securities Generally speaking, asset managers undertake to use commercially reasonable efforts to obtain the annual rating letter and Rationale Report; asset managers typically do not promise to provide a rating letter and Rationale Report to insurance company investors because such deliveries are prepared by rating agencies that are unrelated to and not controlled by the asset managers. Undertakings made by the asset manager to the insurance company investor are typically built into the investment documentation directly, or into side letters or similar agreements between the issuer and insurance company investor. These new proposals may result in additional details on the timing and substance of these reporting covenants and other terms being negotiated between insurance company investors and asset managers.

In offering documentation, asset managers are often mindful of not offering any firm assurances or guarantees that any particular rating will be obtained, and such offering documentation typically includes risk factors or other disclosures related to a credit rating not ultimately being obtained or maintained. Despite these disclosures, it behooves asset managers to be familiar with these ongoing obligations on their insurance company investors so that there is greater understanding and a clearer delineation of the relevant roles, responsibilities and duties of each party and to ensure expectations are understood at the outset and met throughout the term of investment.[3] The new proposals are also relevant to asset managers with closed and fully invested private credit rated notes because, if adopted, these requirements will apply to all privately rated securities currently held by insurers, regardless of when the investment was made or purchased or where it is in its life cycle.

The consequences for the insurance company investor of a private credit-rated investment failing to remain filing-exempt could include having to affirmatively file the investment with the SVO to obtain a unique NAIC Designation and a different risk-based capital charge. Asset managers and insurance company investors alike stand to benefit from avoiding such consequences and developing productive reporting processes that are responsive to the proposed requirements.

These proposed requirements are reflective of the NAIC's continued attention to privately rated securities this year, including the NAIC's creation of a new task force, the Risk-Based Capital Model Governance (EX) Task Force, launched in February, and a proposal that is currently exposed for comment by the Financial Condition (E) Committee until July 21, 2025 that would reorganize VOSTF and form new subgroups specifically focused on analysis of investment risks and credit rating-provider matters.

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3 For example, a submitted comment to an earlier proposal noted that: "Many issuers do not proactively send annual ratings reviews and rationale updates to insurers. Instead, insurers must often reach out to those issuers to obtain [Rationale Reports] on an after-the-fact basis." https://communications.willkie.com/138/3013/uploads/vostf-materials-2025-06-04.pdf.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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