The Implications of a National Association of Insurance Commissioners' ("NAIC") Designation on the AAF First Priority CLO Bond ETF, ticker symbol 'AAA'

Key Takeaways:

- **Ticker symbol 'AAA' receives a 1.A Designation Category from the NAIC**
- **A 1.A Designation is the highest classification issued by the NAIC, which implies that credit risk is at its lowest and the issuer's credit profile is stable[1]**
- **This classification means that 'AAA' can be characterized as a fixed income like asset, which materially eases capital charges from a regulatory standpoint for insurance companies investing into this exchange-traded-fund ("ETF")**

The Significance of a NAIC 1.A Designation

The history of the National Association of Insurance Commissioners dates back to the late 1800s, when insurance commissioners from each of the individual states sought the need to establish a national regulatory framework to guide the insurance industry soundly beyond state lines. Today, the NAIC plays an important role across the insurance industry to uniformly "establish standards and best practices, conduct peer review, and coordinate their regulatory oversight"[2]. While the NAIC is not a regulatory body, the organization helps to form broader consensus at the national level around insurance regulations and policies, including accounting standards, market practices and operating procedures.

In particular, the Securities Valuation Office ("SVO") division of the NAIC plays an integral part in analyzing credit and other risks associated with fixed income-related investments held by the insurance industry. The SVO provides a "Regulatory Treatment Analysis Service" ("RTAS"), with the purpose of specifically examining credit-like features embedded in any type of security and calibrating these underlying risks to a systematic rating system that defines credit quality and determines risk-based capital charges from a regulatory perspective. In short, the RTAS serves as a mechanism to sensibly permit apples-to-apples comparisons of different types of securities that share the same underlying risks.

According to the NAIC guidelines, an ETF that tracks a credit product may be treated as a bond if it meets specific conditions, namely that the ETF will consistently generate fixed income like cash flows and the principal will be repaid based on contractual agreements. As a point of reference, a 1.A Designation is the highest classification issued by the NAIC (see Table 1). A 1.A Designation explicitly suggests that the underlying securities share the same characteristics with the soundest credit issuer.

Bond-like Capital Charges

From a practical standpoint, a 1.A Designation implies that if an insurance company purchases an ETF like 'AAA', as an example, the SVO will include this investment as "eligible for the most favorable treatment provided under the NAIC Financial Regulation Standards and Accreditation Program"[3]. In other words, this type of asset will incur the lowest regulatory capital charge, in effect easing any incremental burden on balance sheet usage. This is significant as any investment grade, credit-focused ETF without a NAIC 1 designation would be regularly treated by the SVO as preferred or common stock from a risk assessment standpoint despite the fact that the underlying assets share more in common with credit products. (Note, according to the NAIC regulatory treatment calculations, a general 1 Designation is subject to a risk-based capital ("RBC") of just 0.4% on a pre-tax basis for every US$1 of investments. At the other extreme, a 6 Designation would impose a 30% RBC factor.)

Table 1: NAIC Risk Designations

NAIC Designation	NAIC Designation Modifier	NAIC Designation Category
1	**A**	**1.A**
1	B	1.B
1	C	1.C
1	D	1.D
1	E	1.E
1	F	1.F
1	G	1.G
2	A	2.A
2	B	2.B
2	C	2.C
3	A	3.A
3	B	3.B
3	C	3.C
4	A	4.A
4	B	4.B
4	C	4.C
5	A	5.A
5	B	5.B
5	C	5.C
6		6
6		6
6		6
6		6
6		6
6		6
6		6

Use Cases

In light of receiving a 1.A Designation from the NAIC, we believe the potential demand for an ETF like 'AAA' should increase from all segments of the insurance industry.

More specifically, mid-sized and smaller insurers, in theory, should be able to wholly enjoy the merits of an ETF like 'AAA' as it offers: i) exchange-traded access to AAA-rated CLOs (Colateralized Loan Obligations) ii) ease of use without a significant investment in a large, professional team of CLO experts iii) a relatively low expense ratio of 25 bps iv) immediate liquidity with a NYSE-listed ETF with no need to transact in the over-the-counter bond market and v) a NAIC 1.A Designation providing for the most favorable regulatory capital treatment.

Contact Information:

Todd Themistocles
Email: tthemistocles@altacfunds.com
Phone: 917-535-5737

The fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The prospectus contains this and other important information about the investment company, and once available a copy may be obtained without charge, by calling the Fund at 1-800-617-0004. Read it carefully before investing.

Investing involves risk. Principal loss is possible. Shares of any ETF are bought and sold at market price (not NAV), may trade at a discount or premium to NAV, and are not individually redeemed from the funds. Brokerage commissions will reduce returns.

The Fund is also subject to the following risks: Collateralized Loan Obligations (CLOs) are generally backed by a pool of credit-related assets that serve as collateral. Accordingly, CLO securities present risks similar to those of other types of credit investments, including default (credit), interest rate and prepayment risks. In addition, CLOs are often governed by a complex series of legal documents and contracts, which increases the risk of dispute over the interpretation and enforceability of such documents relative to other types of investments. An increase in interest rates may cause the value of fixed-income securities held by the Fund to decline. The Fund may be subject to a greater risk of rising interest rates due to the current period of historically low rates and the effect of potential government fiscal policy initiatives and resulting market reaction to those initiatives. The Fund's income may decline if interest rates fall.

The Fund is a recently organized, diversified management investment company with no operating history. Additionally, the investment adviser has not previously managed a registered fund, which may increase the risks of investing in the Fund.

Preliminary NAIC Designations are the intellectual property of the National Association of Insurance Commissioners (NAIC) and are redistributed here under License. A Preliminary NAIC Designation is an opinion of the NAIC Securities Valuation Office (SVO) of the probable credit quality designation that would be assigned by the SVO to an investment if purchased by an insurance company and reported to the SVO. A Preliminary NAIC Designation is only one of the regulatory factors considered by the SVO as part of its analysis of probable regulatory treatment under the Regulatory Treatment Analysis Service (RTAS). A full discussion of such other regulatory factors is set forth in the RTAS Letter provided to Alternative Access Funds, LLC. A Preliminary NAIC Designation cannot be used to report the ETF to state insurance regulators. However, the purchasing insurance company may obtain an NAIC Designation for the ETF by filing the security and final documents for the ETF with the SVO. The indication of probable regulatory treatment indicated by a Preliminary NAIC Designation is not a recommendation to purchase the ETF and is not intended to convey approval or endorsement of the ETF Sponsor or the ETF by the NAIC.

NAIC Designations are the intellectual property of the National Association of Insurance Commissioners (NAIC) and are redistributed here under License. An NAIC Designation is a proprietary symbol used by the NAIC Securities Valuation Office (SVO) to denote a category or band of credit risk (i.e., the likelihood of repayment in accordance with a written contract) for an issuer or for a security. NAIC Designations may be notched up or down to reflect the position of a specific liability in the issuer's capital structure and/or the existence of other non-payment risk in the specific security. Under NAIC reporting rules, shares of an ETF are presumed to be reportable as common stock. The SVO may classify an ETF as a bond or preferred stock and assign it an NAIC Designation if it meets defined criteria. For a discussion of these criteria please call the SVO or refer to the *Purposes and Procedures Manual of the NAIC Investment Analysis Office*. The assignment of an NAIC Designation is not a recommendation to purchase the ETF and is not intended to convey approval or endorsement of the ETF Sponsor or the ETF by the NAIC.

Investment grade indicates that a bond has a relatively low risk of default.

The AAF First Priority CLO Bond ETF is distributed by Quasar Distributors, LLC.

[1] NAIC Designation Letter dated November 10, 2020.
[2] https://content.naic.org/index_about.htm.
[3] NAIC Designation Letter dated November 10, 2020.