Regulatory Considerations Applicable (But Not Exclusive) to Private Equity (PE) Owned Insurers

A summary of currently identified regulatory considerations follows with no consideration of priority or importance (green underlined font indicates current or completed work by another NAIC committee group). Most of these considerations are not limited to PE owned insurers and are applicable to any insurers demonstrating the respective activities. Track changes notation was used for edits to the exposed version.

1. Regulators may not be obtaining clear pictures of risk due to holding companies structuring contractual agreements in a manner to avoid regulatory disclosures and requirements. Additionally, affiliated/related party agreements impacting the insurer's risks may be structured to avoid disclosure (for example, by not including the insurer as a party to the agreement).
2. Control is presumed to exist where ownership is >=10%, but control and conflict of interest considerations may exist with less than 10% ownership. For example, a party may exercise a controlling influence over an insurer through Board and management representation or contractual arrangements, including non-customary minority shareholder rights or covenants, investment management agreement (IMA) provisions such as onerous or costly IMA termination provisions, or excessive control or discretion given over the investment strategy and its implementation. Asset-management services may need to be distinguished from ownership when assessing and considering controls and conflicts.
3. The material terms of the IMA and whether they are arm's length or include conflicts of interest — including the amount and types of investment management fees paid by the insurer, the termination provisions (how difficult or costly it would be for the insurer to terminate the IMA) and the degree of discretion or control of the investment manager over investment guidelines, allocation, and decisions.
4. Owners of insurers, regardless of type and structure, ~~and asset-liability managers~~ may be focused on short-term results which may not be in alignment with the long-term nature of liabilities in life products. For example, ~~excessive~~ investment management fees, when not fair and reasonable, paid to an affiliate of the owner of an insurer may effectively act as a form of unauthorized dividend in addition to reducing the insurer's overall investment returns. Similarly, owners of insurers may not be willing to transfer capital to a troubled insurer.
5. Operational, governance and market conduct practices being impacted by the different priorities and level of insurance experience possessed by entrants into the insurance market without prior insurance experience, including, but not limited to, PE owners. For example, a reliance on TPAs due to the acquiring firm's lack of expertise may not be sufficient to administer the business. Such practices could lead to lapse, early surrender, and/or exchanges of contracts with in-the-money guarantees and other important policyholder coverage and benefits.
6. No uniform or widely accepted definition of PE and challenges in maintaining a complete list of insurers' material relationships with PE firms. (UCAA (National Treatment WG) dealt with some items related to PE.) This definition may not be required as the considerations included in this document are applicable across insurance ownership types.
7. The lack of identification of related party-originated investments (including structured securities). ~~For example,~~ This may create potential conflicts of interests and excessive and/or hidden fees in the portfolio structure, as ~~.A~~assets created and managed by affiliates may include fees at different levels of the value chain. For example, a CLO which is managed or structured by a related party. ~~Regulatory disclosures may be required to identify underlying related party/affiliated investments and/or collateral within structured security investments.~~ (An agenda item and blanks proposal are being developed by SAPWG.)

Commented [ST1]: RRC comment. *Regulators agreed.*

Commented [ST2]: ACLI comment. *Regulators attempted to address but want further comments from the ACLI.*

Commented [ST3]: RRC comment. *Regulators agreed.*

Commented [ST4]: ACLI comment. *Regulators agreed.*

Commented [ST5]: RRC comment – *Regulators believe asset liability management is included in this and other items without explicit mention needed here.*

Commented [ST6]: *Regulator comment.*

Commented [ST7]: Multiple comments agree with avoiding this definition and instead focusing on activities, risks, etc.

8. Though the blanks include affiliated investment disclosures, it is not easy to identify underlying affiliated investments and/or collateral within structured security investments. Additionally, transactions may be excluded from affiliated reporting due to nuanced technicalities. Regulatory disclosures may be required to identify underlying related party investments and/or collateral within structured security investments. This would include, for example, loans in a CLO issued by a corporation owned by a related party. (An agenda item and blanks proposal are being developed by SAPWG.)
9. Broader considerations exist around asset manager affiliates (not just PE owners) and disclaimers of affiliation avoiding current affiliate investment disclosures. (A new Sc Y, Pt 3, has been adopted and will be in effect for year-end 2021. This schedule will identify all entities with greater than 10% ownership – regardless of any disclaimer of affiliation - and whether there is a disclaimer of control/disclaimer of affiliation. It will also identify the ultimate controlling party. Additionally, SAPWG is developing a proposal to revamp Schedule D reporting, with primary concepts to determine what reflects a qualifying bond and to identify different types of investments more clearly, including asset-backed securities.)
10. The material increases in privately structured securities (both by affiliated and non-affiliated asset managers), which introduce other sources of risk or increase traditional credit risk, such as complexity risk and illiquidity risk, and involve a lack of transparency. (The NAIC Capital Markets Bureau continues to monitor this and issue regular reports, but much of the work is complex and time-intensive with a lot of manual research required. The NAIC Securities Valuation Office will begin receiving private rating rationale reports in 2022; these will offer some transparency into these private securities.)
11. The level of reliance on rating agency ratings and their appropriateness for regulatory purposes (e.g., accuracy, consistency, comparability, applicability, interchangeability, and transparency). (VOSTF has previously addressed and will continue to address this issue.)
12. The trend of life insurers in pension risk transfer (PRT) business and supporting such business with the more complex investments outlined above (**LATF has exposed questions aimed at determining if an Actuarial Guideline** is needed to achieve a primary goal of ensuring claims-paying ability even if the complex assets (often private equity-related) did not perform as the company expects, and a secondary goal to require stress testing and best practices related to valuation of non-publicly traded assets (note – LATF's considerations are not limited to PRT). Additionally, enhanced reporting in 2021 Separate Accounts blank will specifically identify assets backing PRT liabilities.) Considerations have also been raised regarding the RBC treatment of PRT business.
    a. Review applicability of Department of Labor protections resulting for pension beneficiaries in a PRT transaction.
    b. Review state guaranty associations' coverage for group annuity certificate holders (pension beneficiaries) in receivership compared to Pension Benefit Guaranty Corporation (PBGC) protection.
13. Insurers' use of offshore reinsurers (including captives) and complex affiliated sidecar vehicles to maximize capital efficiency, reduce reserves, increase investment risk, and introduce complexities into the group structure.

Commented [ST8]: ACLI suggested merging 7 and 8. *Regulators want to distinguish between fees and conflicts of interest considerations (#7) and considerations with related parties in the underlying collateral (#8).*

Commented [ST9]: RRC comment. *Regulators agreed.*

Commented [ST10]: Moved this language from #7.

Commented [ST11]: RRC comment – there are several asset classes with unique challenges due to their complexity, opaqueness, volatility, and illiquidity – both private and public. *Regulators did not opt to modify this item since it focuses on the "material increases in privately structured securities" – the dynamic for public securities is not increasing. They believe these public security concerns are already addressed in our system.*

Commented [ST12]: RRC comment. *Regulators agreed.*

Commented [ST13]: NOLHGA provided a 2016 report reviewing this issue.

Commented [ST14]: ACLI asked for more specificity on the considerations. *Regulators provided additional examples for the list.*