

Draft Pending Adoption

Draft: 10/20/21

Financial Stability (E) Task Force Virtual Meeting September 30, 2021

The Financial Stability (E) Task Force met Sept. 30, 2021. The following Task Force members participated: Marlene Caride, Chair (NJ); Eric A. Cioppa, Vice Chair, represented by Vanessa Sullivan (ME); Alan McClain represented by Mel Anderson (AR); Ricardo Lara represented by Susan Bernard (CA); Andrew N. Mais represented by Kathy Belfi (CT); Karima M. Woods represented by Philip Barlow (DC); David Altmaier represented by Carolyn Morgan (FL); Doug Ommen represented by Carrie Mears (IA); Gary D. Anderson represented by John Turchi (MA); Kathleen A. Birrane represented by Lynn Beckner (MD); Eric Dunning represented by Justin Schrader (NE); Adrienne A. Harris represented by Bill Carmello (NY); Jessica K. Altman represented by Kimberly Rankin (PA); Raymond G. Farmer represented by Michael Shull (SC); Carter Lawrence represented by Trey Hancock (TN); and Cassie Brown represented by Jamie Walker (TX). Also participating were: Robert Wake (ME); and Cameron Piatt (OH).

1. Heard Opening Remarks

Commissioner Caride said materials for consideration and discussion for this meeting were sent by email to the member, interested state insurance regulator, and interested party distribution lists for the Task Force, but they are also available on the NAIC website in the Committees section under the Financial Condition (E) Committee.

2. Considered Adoption of its Charges

Mr. Carmello made a motion, seconded by Mr. Barlow, to adopt the Task Force's charges (Attachment 1). The motion passed unanimously.

3. Heard an Update on Private Equity

Eric Kolchinsky (NAIC) reported that private equity (PE) firms have increasingly been intertwined with insurance companies because of low interest rates and the changing PE business model. He added that the NAIC's Capital Markets Bureau (CMB) maintains a manually researched and constantly updated list of 177 companies owned or controlled by PE. He concluded that PE-owned companies focus far more on investing in asset-backed securities (ABS) than the insurance industry as a whole: 25% vs 10% of total bonds in 2020.

Mr. Kolchinsky summarized that concern about PE ownership of insurance companies has been broadly expressed but to be actionable, these concerns need to be translated into a specific characteristic or behavior that differentiates the PE ownership structure from other insurance companies. He suggested using a "first principles" approach to zero in on the concern and list potential next steps.

Mr. Kolchinsky said transactions of affiliates have been a key regulatory concern, but the current regulatory framework was developed in the context of stock companies and mutuals. He added that insurers may use dividends, salaries, or benefits to extract excessive value so regulations focus on the oversight of value extraction by, for example, gating dividends and salaries. He explained that unlike stock companies and mutuals, PE-owned insurance companies look to extract value via fees rather than primarily dividends or salaries. He noted that state insurance regulators review and approve affiliated transactions but cautioned that it is not clear if all appropriate PE transactions are captured.

Mr. Kolchinsky elaborated that PE-owned insurance companies seeking to generate fees are the ultimate risk taker, but the relationships between PE and the insurer are not always clear:

- 1st degree affiliates are structured vehicles, which are managed by the PE-owned company's asset management affiliate, but it is common for PE-owned companies to report affiliate-managed collateral loan obligations (CLOs) and other structured finance products as unaffiliated.
- 2nd degree affiliates are the debt and equity of PE-owned companies held by CLOs or collateral funding obligations that are either affiliated or unaffiliated and are held by the insurer. For example, the CMB found that for one large insurer, about 70% of its CLOs hold some exposure to the PE's portfolio companies.

In terms of next steps, Mr. Kolchinsky suggested a new definition for PE-owned insurer:

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“Financial Entity Owned Insurer is a regulated insurer, which is controlled by or has a long-term investment management agreement with an entity, which:

- 1) Derives the majority of its revenue through the management of or investment in financial assets.
- 2) Is not itself a regulated insurer.
- 3) Has some minimum amount of assets under management.”

Mr. Kolchinsky also suggested enhanced disclosures that bolster the definition of affiliate to include entities managed by an affiliate of the Financial Entity Owned Insurer:

- Fees paid or accrued to 1st and 2nd degree affiliates.
- Assets under management of all affiliates.
- Investments where there are other relationships with 1st and 2nd degree affiliates.

Ms. Belfi said considerable work goes into approving affiliate and investment manager agreements because it is an affiliate relationship. She asked if creating an investment or charging a fee is what is not currently being captured. Mr. Kolchinsky agreed and noted that, for example, for a CLO, there is no disclosure of a contract of the asset manager’s part of the trustee as the investor, but an affiliate may be receiving fees where an insurance company is an investor in the trust.

Mr. Barlow suggested that at least a 1st degree affiliate should be captured under the *Insurance Holding Company System Regulatory Act* (#440), but he asked if the new definition of a PE-owned insurer should be included. Mr. Kolchinsky responded that the company studied had good reporting, but Model #440 may not capture the new definition of a PE-owned insurer.

Ms. Mears asked if there are recommendations for the Task Force. Mr. Kolchinsky responded that he is looking for feedback and then further work would be referred to the appropriate committees. Ms. Mears asked if traditional insurers that own an asset management firm would be included. Mr. Kolchinsky responded that if the insurer owns an asset management firm, that is excluded from the definition because the insurer is already regulated. Ms. Mears asked if the presentation (Attachment 2) covers the scope of the work to be done. Mr. Kolchinsky said he views the presentation as a starting point, but there needs to be an understanding of the relationships between affiliates to determine what the solutions are and if the relationships are *de minimis*, then maybe nothing needs to be done. Ms. Mears asked if enhanced reporting would capture the traditional insurer that owns the asset manager who sponsors a CLO. Mr. Kolchinsky responded he would be open to that if the Task Force agrees on broader disclosures.

Mr. Wake said definitions would be clearer if 1st and 2nd degree affiliates are called 2nd and 3rd degree affiliates with the understanding that 1st degree affiliate is what Model #440 already defines. He added that consideration should be given to sorting out traditional insurers from these PE-owned insurer business models by defining the kind of transactions in an officially neutral way to determine the activities of asset management that are problematic and those that are not, rather than just looking if the controlling entity happens to be a financial entity. He suggested screening out traditional insurance activities that are not problematic through careful definitions and *de minimis* standards. He concluded that a traditional insurer that adopts some of those problematic practices could be included, but a PE-owned insurer that behaves like a traditional insurer could be excluded. Mr. Kolchinsky agreed.

Mr. Piatt said some state insurance regulators may have been on the Sept. 29 call regarding referral of the multistate NAIC Uniform Certificate of Authority Application (UCAA), known as Form A, when a PE-owned insurer wants to acquire an insurer. He added that the definition of a PE-owned insurer in that context is different. He asked for clarification of the definition. Mr. Kolchinsky responded that defining is a difficult task, but the focus is on fee generation.

Commissioner Caride said Todd Sells (NAIC) will receive all emails with respect to feedback to Mr. Kolchinsky’s presentation from members and interested parties.

4. Heard a Macroprudential Risk Assessment Update

Tim Nauheimer (NAIC) reported that the International Association of Insurance Supervisors (IAIS) has completed a large component of the global monitoring exercise (GME), which included analysis of data received in connection with the individual

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insurer monitoring (IIM) and the sector wide monitoring (SWM) exercises. He added that several firms were identified for follow-up action, which included a questionnaire sent to the group wide supervisor. He said the IAIS plans to release the next draft of the public consultation on liquidity metrics in mid-November, which utilizes a company's cash flow projections and more aligns with the NAIC's approach to assessing liquidity risk.

Mr. Nauheimer reported that reminders were sent to lead states of the insurers in scope of the NAIC's liquidity stress test in the event lead states wanted to follow up with their insurers' filings due Sept. 30. He added that NAIC staff will compile submitted data from lead states and present them to the Macprudential (E) Working Group. He said the Working Group will continue to develop the risk assessment framework, and a small drafting group of NAIC staff has been established to address the risk assessment details and finalize a proof of concept of the risk dashboard. The Working Group plans to use existing aggregated company data filed with the NAIC and public sources to conduct a risk assessment. The Working Group will have a call on Oct. 18 to receive the first version of the risk dashboard, and it hopes to have a first draft submitted for input by the Task Force later this year.

Stephen Broadie (American Property Casualty Insurance Association—APCIA) asked if the Oct. 18 Working Group call will be open or closed. Mr. Nauheimer responded that the initial call will be closed to get the framework for the risk dashboard in place, but some subsequent calls at the Task Force will be open.

Martin Mair (MetLife) asked what role the chief risk officer (CRO) council will play with respect to the development of the risk dashboard. Mr. Nauheimer responded that NAIC staff reached out to the CRO council for initial feedback on the risk dashboard, but he expects that NAIC staff will reach out again to collaborate.

Having no further business, the Financial Stability (E) Task Force adjourned.

2022 Proposed Charges

FINANCIAL STABILITY (E) TASK FORCE

The mission of the Financial Stability (E) Task Force is to consider issues concerning domestic or global financial stability as they pertain to the role of state insurance regulators.

Ongoing Support of NAIC Program, Products or Services

1. The **Financial Stability (E) Task Force** will:
 - A. Consider issues concerning domestic and global financial stability as they pertain to the role of state insurance regulators and make recommendations to the International Insurance Relations (G) Committee, the Government Relations (EX) Leadership Council and/or the Executive (EX) Committee, as appropriate.
 1. Analyze existing post-financial crisis regulatory reforms for their application in identifying macroeconomic trends, including identifying possible areas of improvement or gaps, and propose to the Financial Condition (E) Committee or other relevant committee enhancements and/or additions to further improve the ability of state insurance regulators and the industry to address macroprudential impacts; consult with such committees on implementation, as needed.
 - B. Consider state insurance regulators' input to national and international discussions on macroeconomic vulnerabilities affecting the insurance sector.
 1. Monitor international macroprudential activities at forums like the International Association of Insurance Supervisors (IAIS).
 2. Implement the Macroprudential Initiative (MPI) domestically, which includes enhancements to the U.S. regulatory toolkit as part of the *State Ahead* initiative.
 - C. Serve as a forum to coordinate state insurance regulators' perspectives on a wide variety of issues arising from the designation of a U.S. insurance group as "systemically important" and "internationally active" both pre- and post- designation, including:
 1. Where appropriate, develop policy recommendations and/or guidance regarding the role, responsibilities and activities of state insurance regulators in the context of consolidated supervision resulting from designation.
 2. Analyze proposed rules by the federal agencies that relate to financial stability.
 3. Analyze proposed policy measures regarding supervisory standards for global systemically important insurers (G-SIIs) and internationally active insurance groups (IAIGs).
 4. Develop comment letters on such analysis for further consideration by the International Insurance Relations (G) Committee, the Government Relations (EX) Leadership Council, and/or the Executive (EX) Committee, as appropriate.

2. The **Macroprudential (E) Working Group** will:

- A. Oversee the implementation and maintenance of the liquidity stress testing framework for 2020 data as well as future iterations.
- B. Assist with the remaining MPI projects related to counterparty disclosures and capital stress testing as needed.
- C. Continue to develop and administer data collection tools as needed, leveraging existing data where feasible, to provide the Financial Stability (E) Task Force with meaningful macroprudential information regarding how the insurance sector is navigating the prevailing market conditions.
- D. Oversee the development, implementation, and maintenance process for a new Macroprudential Risk Assessment system (i.e., policies, procedures, and tools) to enhance regulators' ability to monitor industry trends from a macroprudential perspective.
- E. Oversee the documentation of the NAIC's macroprudential policies, procedures, and tools.
- F. Provide the Task Force with proposed responses to IAIS and other international initiatives as needed.

NAIC Support Staff: Todd Sells/Tim Nauheimer

PE Owned Insurance Companies

Eric Kolchinsky
Director, Structured Securities and Capital Markets
September 30th, 2021



NATIONAL ASSOCIATION OF
INSURANCE COMMISSIONERS



PE and Insurance Companies

- Private Equity (PE) firms have increasingly been intertwined with insurance companies.
 - This trend is driven by low interest rates as well by changing PE business models.
- NAIC's Capital Markets Bureau (CMB) maintains a manually researched and constantly updated list of 177 companies owned or controlled by PE.
- We have published and will continue to publish analytical research on the holdings of those companies we identify.
 - One major take-away is that PE-owned companies focus far more on investing in asset backed securities (ABS) than the industry as whole: 25% vs 10% of total bonds in 2020.

*For more information
please see:*

[Private Equity \(PE\)
Owned U.S. Insurers as of
Year-End 2020](#)

and

[Private Equity Primer](#)



Statement of the Concern

- Concern about PE ownership of insurance companies has been broadly expressed by regulators, staff and our federal colleagues.
- However, to be actionable, these concerns need to be translated into a specific characteristic or behavior which differentiates the PE ownership structure from other insurance companies.
- Here, we attempt to use a “first principles” approach to zero in on the concern as well as listing potential next steps.



Affiliated Transactions

- Related party transactions have been a key area of concern for solvency oversight since historically this is where many issues arise.
 - Statutory accounting and reporting specifically address affiliated transactions.
 - Furthermore, state laws include provisions that require approval of certain (e.g., service agreements) affiliated agreements.
- Domiciliary regulators consider concerns when reviewing and approving Form A applications and those concerns are also addressed in NAIC committee groups such as FAWG.

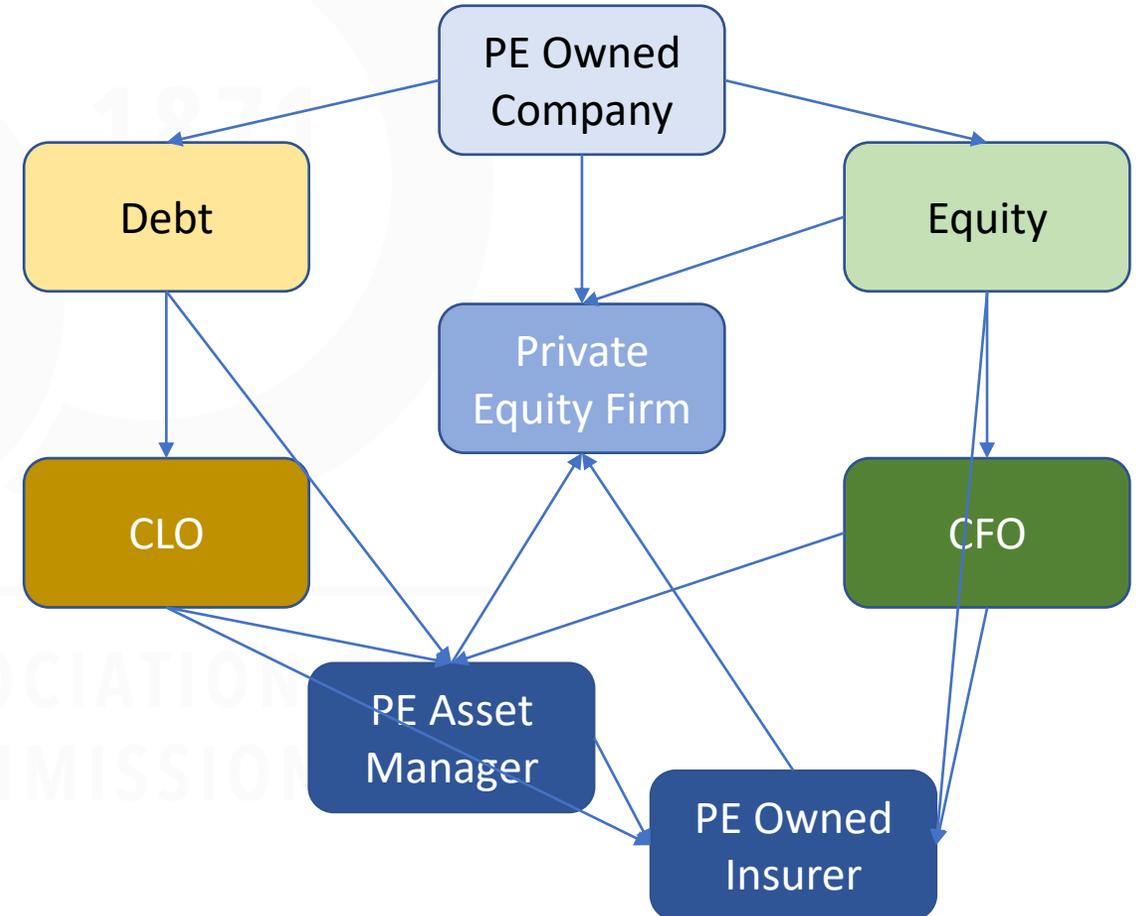


Novel Regulatory Risks

- The current regulatory framework was developed in the context of stock companies and mutuals. In these companies controlling parties use dividends and salaries / benefits to extract value for themselves, which may be excessive. Thus, regulations focus on oversight of these channels of value extraction (i.e. gating dividends and salaries in certain cases).
- Unlike stock companies and mutuals, PE-owned companies look to extract value via fees (not primarily dividends or salaries)
 - Affiliated transactions are considered by regulators, but it is not clear if all appropriate PE transactions are captured.

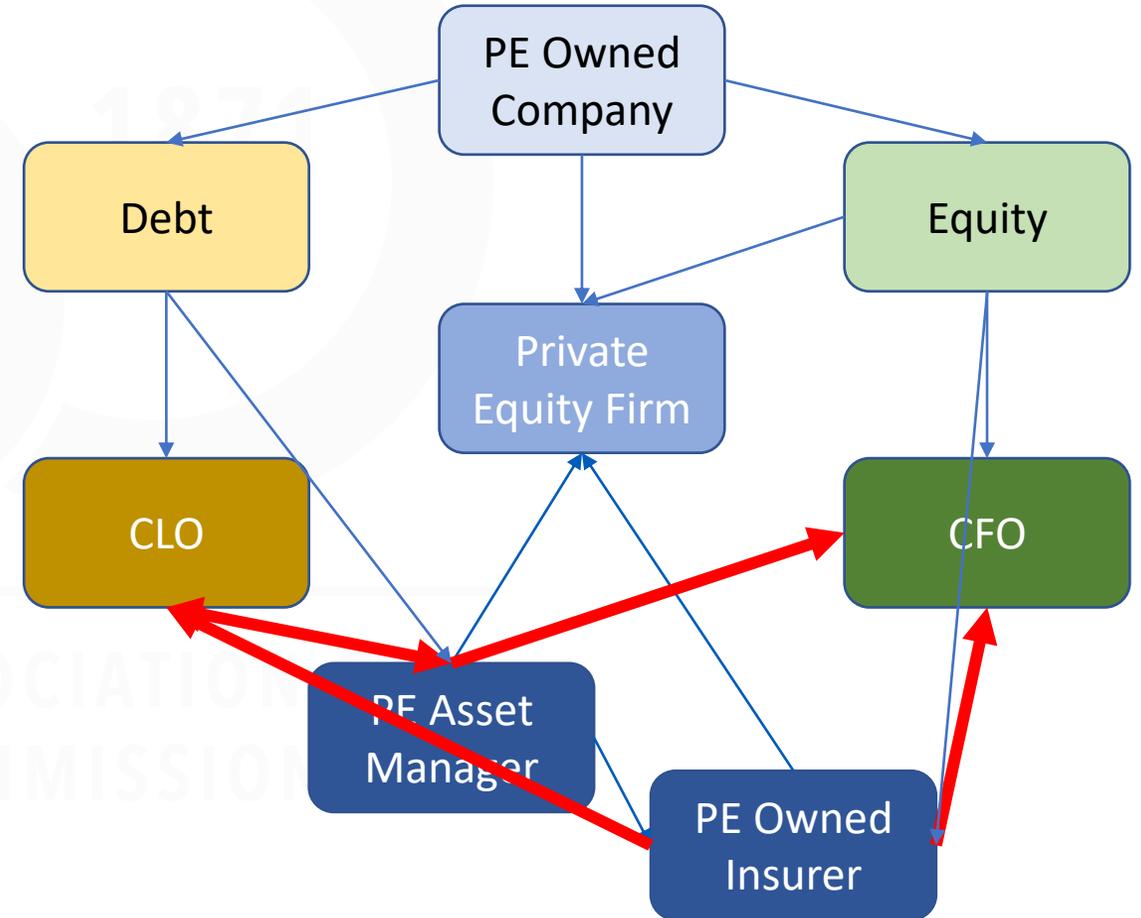
PE Business Model

- The PE business model has transitioned over the years from restructuring companies for profit to fee generation.
- PE companies seek to generate fees at every level of their investment from the underlying corporate to CLOs to managing assets for insurers.
- The PE owned insurance company stands as the ultimate risk taker for the PE pipeline.
- However, the interconnected relationships are not always clear.



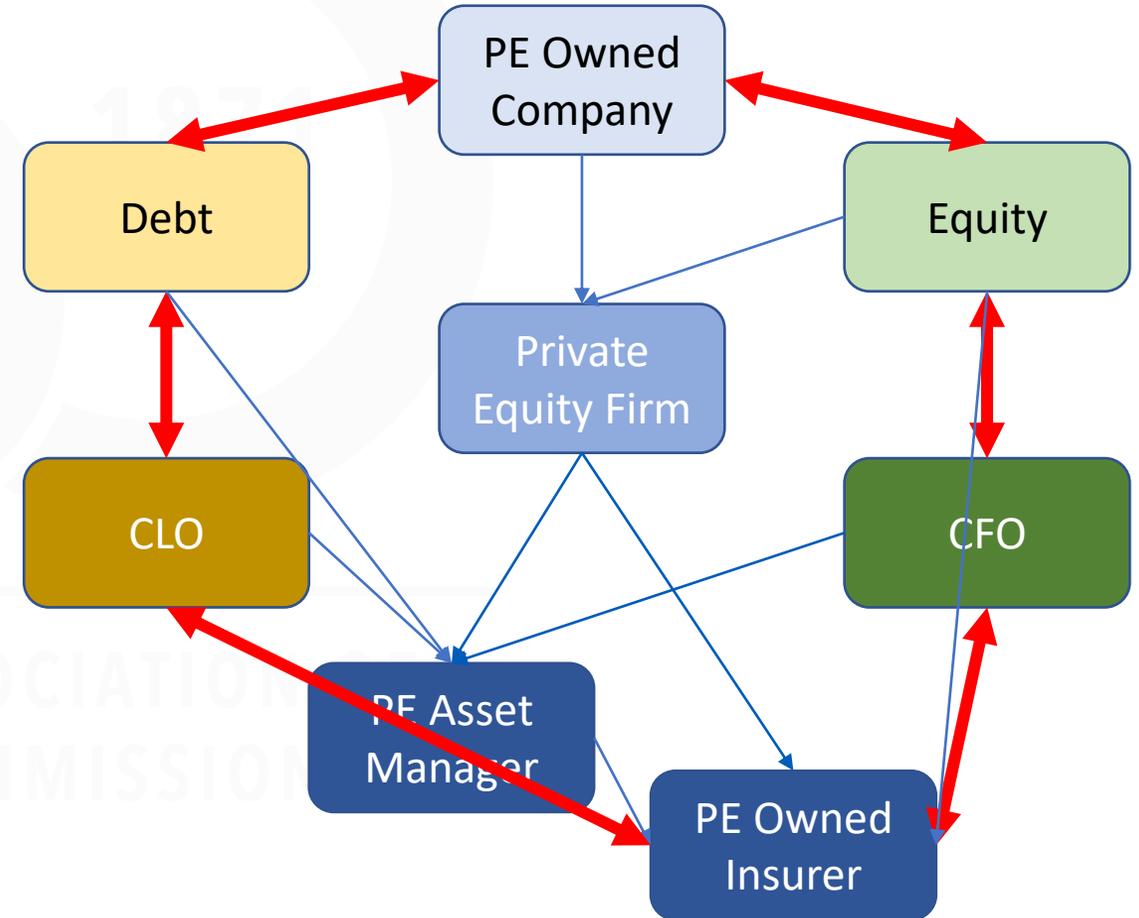
Affiliates – 1st Degree

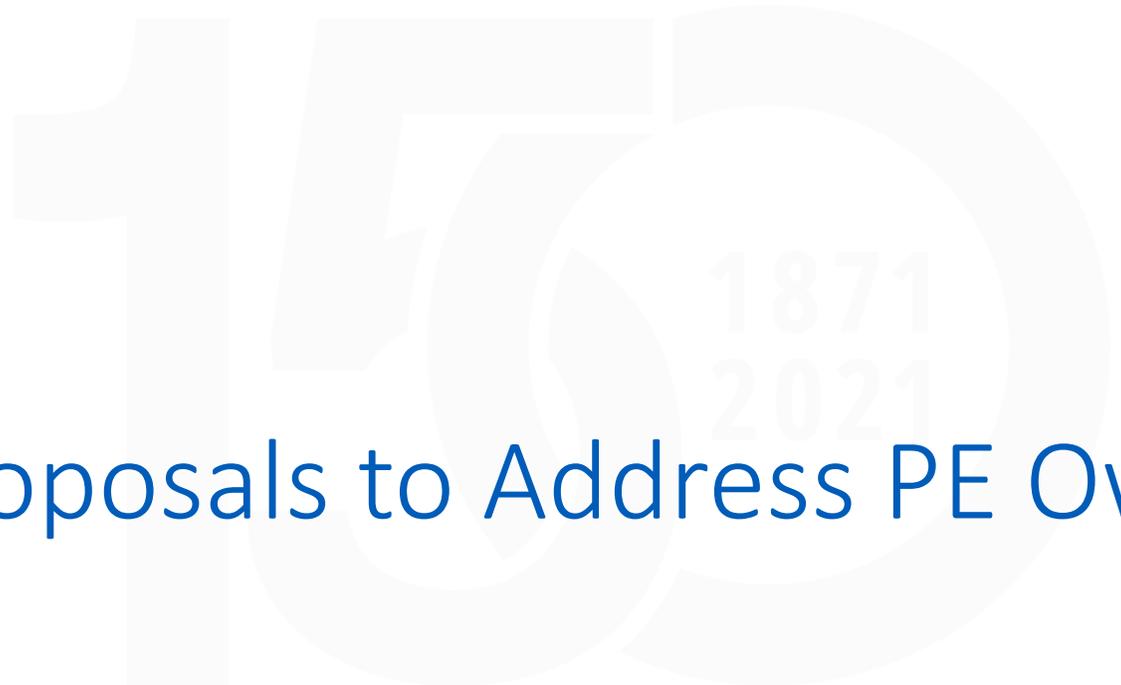
- 1st Degree Affiliates are structured vehicles which are managed by the PE firm's asset management affiliate.
- It is common for PE owned firms to report affiliated managed CLOs and structured products as “unaffiliated”.



Affiliates – 2nd Degree

- 2nd degree affiliates are the debt or equity of PE owned companies held by CLOs or CFOs (affiliated or unaffiliated) held by the insurer.
- For example, we found that for one large insurer group that approximately 70% of their CLOs hold some exposure to their portfolio companies.





Staff Proposals to Address PE Ownership

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Establish New Definition for PE Owned Insurer

- Based on the stated principles, the definition of PE revolves around the fee generation.
- “Financial Entity Owned Insurer” is a regulated insurer which is controlled by or has a long term investment management agreement with an entity which:
 1. Derives the majority of its revenue through the management of or investment in financial assets.
 2. Is not itself a regulated insurer.
 3. Has some minimum AUM.



Broaden Affiliate Reporting

- Bolster the definition of Affiliate to include entities managed by an affiliate of the “Financial Entity Owned Insurer”.
 - 1st Degree Affiliates – CLO managers
- Require that “Financial Entity Owned Insurer” reporting of affiliated entities owned by an asset in an insurer's portfolio.
 - 2nd Degree Affiliates – e.g. loans to companies owned by a CLO in an insurer’s portfolio.



Strengthen Affiliate Reporting

- More transparent disclosure of fees paid / accruing to 1st and 2nd degree affiliates.
- Disclosure of AUM of all affiliates.
- Identify investments in the investment schedules where there are other relationships with 1st or 2nd degree affiliates.
 - E.g. the investment was structured by the affiliate.