Memo

To:	Justin Schrader, Chair, Macroprudential (E) Working Group
From:	Tricia Matson, Partner and Edward Toy, Director
Date:	May 20, 2022
Subject:	RRC comments regarding Regulatory Considerations Applicable (But Not Exclusive) to PE Owned Insurers

Background

The Macroprudential (E) Working Group (MWG) exposed a document on April 27 for further comment on Regulatory Considerations Applicable (But Not Exclusive) to Private Equity (PE) Owned Insurers (Considerations). RRC appreciates the opportunity to offer our comments. Should you have any questions, we would be glad to discuss our comments with you and the MWG members.

RRC Comments

- We have the following general comments on the Considerations:
    - We applaud these efforts. Overall, we agree with the considerations listed, and have encountered nearly all of them in our work with regulators reviewing insurer complex investments, PE acquisitions, captive formations, ownership changes, and use of offshore reinsurance.
    - We also agree with and encourage considerations that are as much as possible activities based and not specific to PE owned insurers or specific types of transactions or investments.
- We have the following specific comments on the continuing discussions:
    - In a Form A transaction, whether the owner of the insurer is a PE fund or another type of investor, expectations and structures behind insurer ownership may have changed. Because of that, RRC believes that the stipulations, either limited time or continuing, should protect against adverse policyholder outcomes resulting from that change in dynamic.
        - The regulatory expectation is that owners of insurers should have a long, if not indefinite, time horizon. It is not uncommon for PE funds in general and other similar investment vehicles to have a limited time frame because they are specifically structured investment vehicles such as limited partnerships. For example, requiring that limited partnerships should not have a specific end date would bring that ownership vehicle into line with regulatory expectations.
        - While there are typically no guarantees of additional funding in any ownership situation, having a structure that allows for backstop capital in the event that a need arises should be considered. This could be achieved through a parental guarantee or a capital maintenance agreement.
        - With regards to dividends, even if dividends are permitted, it may be advisable to

structure a claw back period. This could be effectuated with allowing dividends to the limited partnership structure but requiring that the funds not be paid out to the partners for some period of time to ensure that the availability is not short-lived.

- In a limited partnership structure, the limited partners may be considered passive investors and arguably should not be subject to the typical expectations of owners. However, additional understanding and restrictions on the interest of the general partner would be appropriate.
- In the event that the Form A includes transfer of business to offshore entities, requiring continued maintenance of capital levels similar to those in place prior to the transaction, and ongoing reporting to the U.S. regulator that is in line with the Statutory reporting framework, to ensure that there are no adverse implications to policyholders.
- Ensuring that corporate governance appropriately balances the desire for strong returns with the need to protect policyholders. For example, the Board and senior management should include members with appropriate background and knowledge of insurance laws and operations. In addition, risk and compliance functions should have appropriate reporting and communication lines to the Board.
- Policyholder non-guaranteed elements, such as credited rates and dividends, should not be inappropriately reduced from existing levels.

- With respect to an Investment Management Agreement (IMA), RRC encourages an approach that includes a thorough review of the IMA to ensure that it is fair and reasonable to the insurer. In addition to the specific items noted for consideration,
  - Are there detailed and reasonable investment guidelines?
  - Is there sufficient expertise at the insurer and on the insurer's Board to properly assess the performance and compliance of the investment manager?
  - Is the investment manager registered as such under the Investment Advisers Act of 1940, and recognizes the standard of care as a fiduciary?
- The exposure cites collateralized loan obligations (CLOs) several times as a source of concern and therefore a focus for additional disclosure. While there has been a continuing level of concern about CLOs in general, RRC encourages the working group to take a broader view as well. As a general matter, investments in CLOs are at least subject to disclosure and conflicts of interest standards under various securities laws and regulations. On the other hand, there are other potentially problematic investments that do not benefit from that regulatory oversight.
  - Private funds – Some of the issues noted with respect to concerns about overlapping interests in CLOs may also be prevalent in various kinds of funds, especially privately placed funds that are reported on Schedule BA. Such investment vehicles may have significant areas that have the potential for a conflict of interest that would not be captured by securities laws. Such investment vehicles may also include substantial management fees for management of the fund.
  - Collateral Loans – The U.S. insurance industry's reported exposure to Collateral Loans that are reported on Schedule BA has grown substantially in the last ten years. In addition to the same potential conflicts, it may be appropriate to revisit valuation and reporting guidance.

- The exposure also cites “privately structured securities which introduce other sources of risk or increase traditional credit risk, such as complexity risk and illiquidity risk, and involve a lack of transparency”.
  - While the lack of available public data does present a significant issue and does mean there is in theory a lower degree of liquidity, we caution at being overly concerned about the private nature of such transactions.
    - Any highly structured transaction is going to lack liquidity.
    - The NAIC had at one time a disclosure for Structured Notes. This allowed regulators to see when that represented an excessive risk. We encourage the reinstitution of that disclosure.
  - A potential consideration related to complex asset structures would be to incorporate this risk factor into the criteria for additional liquidity risk analysis outlined in the NAIC 2021 Liquidity Stress Test Framework (Framework). Considering the amount of effort spent on developing the Framework, it may be helpful to leverage its requirements for situations in which significant complex securities are used to back insurer liabilities.

The exposure references the work by the Life Actuarial Task Force (LATF) on requirements for modeling complex assets within asset adequacy testing, as a mechanism to address the increased risk associated with complex assets. We agree that this work will support improved capture of the risk; however, we also recognize that reserving is not intended to capture tail risk. Some of the complex assets in question may not present significant risk in a reserving analysis (which is focused on moderately adverse conditions). We also suggest referencing regulatory review of capital requirements for such complex assets so their tail risks are captured in RBC, since new owners may rely on shifting investments into complex asset structures with relatively low RBC charges as a way to increase RBC ratios and remove “excess” capital at deal inception. The NAIC’s RBC Investment Risk and Evaluation Working Group has recently begun a holistic review of this, and their work could be referenced in the document.

Thank you for the opportunity to provide comments on this important initiative. We can be reached at tricia.matson@riskreg.com/(860) 305-0701 and edward.toy@riskreg.com/(917) 561-5605 if you or other MWG members have any questions.

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June 9, 2022

Re: Comments Regarding NAIC Macroprudential (E) Working Group exposed "Regulatory Considerations Applicable (but not exclusive to) Private Equity Owned Insurers"

Thank you for the opportunity to provide additional comments regarding the NAIC Financial Stability Task Force (FSTF) and Macroprudential (E) Working Group (MWG) exposure, "Regulatory Considerations Applicable (But Not Exclusive) to Private Equity (PE) Owned Insurers" (hereafter, "Regulatory Considerations"). The MWG exposed the document to allow stakeholders to comment on the addition of the regulatory process summaries, as well as the results of regulator discussions on how to move forward with respect to each Consideration.

As noted in our January 18, 2022, comment letter, ACLI supports efforts to ensure that the insurance regulatory framework continues to provide robust consumer protection and safeguards. The U.S. state regulatory system fosters the life insurance industry's ability to provide financial protection and promote financial security to the 90 million Americans who count on us to plan for tomorrow, so they can live confidently today. We appreciate and support the decision to appoint the MWG as a coordinator for the Regulatory Considerations and new workstreams. Coordination and collaboration between different NAIC working groups and FSTF is key to maintaining a coherent process that provides maximum relevance and transparency to regulators.

We are appreciative of regulators' thoughtful and deliberative approach to each Consideration. In general, ACLI supports the MWG's proposed referrals and agrees with the MWG's determination to take an activities-based approach to the Regulatory Considerations rather than focusing on a particular type of ownership structure. ACLI also supports the regulators' efforts to leverage existing

NAIC workstreams and promote the enhancement of existing tools to protect consumers and preserve financial stability.

The Regulatory Considerations document, dated April 27, 2022, made several referrals that are intended to improve transparency into insurer operations and investments. It also recommended providing additional training opportunities for state regulators. ACLI is generally supportive of these efforts, which will better enable regulators to identify and address potential risks and/or potential conflicts of interest. ACLI looks forward to working with the NAIC and regulators as these efforts progress and is willing to provide additional support and assistance with the development of the training resources.

The Regulatory Considerations document also reflects several issues that regulators would like to better understand, like the applicability of Department of Labor protections for pension beneficiaries in a Pension Risk Transfer (PRT)[1] transaction, as well as certain reinsurance transactions. With respect to the latter, regulators deferred specifying action on this item and noted a desire to gather additional information from industry representatives and non-U.S. regulators. This appears to be a reasonable approach – and ACLI welcomes the opportunity to assist with this engagement, upon request.

Thank you for the opportunity to provide these comments. ACLI looks forward to continuing to work with regulators and other interested parties on these issues. ACLI welcomes the opportunity to provide additional assistance as needed.

Sincerely,

Kristin Abbott
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[1] In No. 12(b), regulators discussed directing NAIC legal staff to review the applicability of DOL protections for pension beneficiaries in a PRT transaction. The 2016 American Academy of Actuaries Issue Brief, “Pension Risk Transfer” may provide a useful starting point for this research. https://www.actuary.org/content/pension-risk-transfer-0#:~:text=KEY%20POINTS%3A,unique%20perspectives%20on%20these%20transactions.

To: Justin Schrader, Chair, Macroprudential (E) Working Group and Marlene Caride, Chair, Financial Stability (E) Task Force

Cc: Todd Sells (tsells@naic.org), and Tim Nauheimer (tnauheimer@naic.org)

Date: June 13, 2022

Re: UNITE HERE Comments on First Six Regulatory Considerations Applicable (But Not Exclusive) to PE Owned Insurers

Thank you for this opportunity to comment on the first six of the Regulatory Considerations Applicable (But Not Exclusive) to Private Equity (PE) Owned Insurers. We applaud the NAIC officers and staff as well as members of the Macroprudential (E) Working Group and the Financial Stability (E) Task Force for their thoughtful consideration of this complex and controversial topic.

For the most part, as regulators on both task forces have noted, the Considerations reflect concerns that are neither new nor emergent. Large private equity firms have been involved in the life and annuity business for well over a decade.

Nor is this the first time the NAIC or individual state regulators have raised concerns about how private equity firms have altered the life insurance landscape. For example, in 2013, New York Department of Financial Services Superintendent Benjamin Lawsky issued a report that raised concerns about the quality of the investments backing annuity reserves at PE-affiliated insurers and called for reforms to prevent insurers from using offshore reinsurance affiliates to "artificially inflate" their reported levels of risk-based-capital.[1]

That same year, when the Iowa Insurance Division held hearings in conjunction with Apollo's application to purchase Aviva's US operations, UNITE HERE provided testimony raising concerns about Apollo's use of a Bermuda-based reinsurance affiliate and how that arrangement might affect reported RBC ratios for its US affiliates; the level and complexity of asset management fees Apollo charged its regulated insurance affiliates; and the relatively large percentage of related-party investments on those insurers' books. We urged then-Commissioner Nick Gerhardt to require Athene to enter into a capital maintenance agreement, limit Athene's ability to invest in Apollo-managed products and limited partnerships, and conduct on-going targeted examinations of Apollo's investment strategies.[2]

One of our concerns (regarding Athene's ability to continue Aviva's "permitted practice" with respect to reserving methodologies for deferred annuities with embedded guarantees) was addressed as one of four "conditions" imposed by Commissioner Gerhart in his subsequent Order approving the acquisition.[3] The remaining three of these conditions were substantially similar to "stipulations" included in the 2013 guidance cited by the Task Force in its response to Consideration 1 (see below.) But even with these conditions/stipulations, the potential risks to annuity policyholders posed by Apollo's "spread investing" model have, in our view, only grown larger.

Athene has become Apollo's fastest engine of growth, essentially quadrupling its assets under management since the Aviva acquisition.[4] At yearend 2021, Athene claimed the number one market share in US fixed indexed annuities.[5] Athene has also become the largest player in the Pension Risk Transfer (PRT) market,[6] assuming responsibility for paying the monthly benefits and managing retirement assets for more than 300,000[7] workers and retirees who were beneficiaries of pension plans sponsored by companies including J.C. Penney, Lockheed, Alcoa, and Lumen Technologies. Following these "buyout" PRT transactions, workers and retirees lose the ERISA rights and PBGC protections they previously held as pension beneficiaries.

Additionally, Apollo and or Athene has over the past decade acquired or created at least ten non-bank lender affiliates, most of which operate outside the purview of prudential regulation.[8] According to an October 2021 presentation, Apollo estimated that these "origination platforms" will generate $25 billion annually in origination volume.[9] This includes leveraged loans and commercial leases to private equity firms, small and medium sized businesses, airlines, and homebuyers around the world. Those loans and leases are then packaged into Collateralized Loan Obligations (CLOs) or other Asset Backed Securities (ABS) and sold to Apollo's state-regulated insurance units, as well as to Apollo's institutional clients, managed funds and third parties. At yearend 2021, approximately $34.9 billion or 14.8% of Athene's total assets were invested in these and other related party investments.[10] Apollo has referred to this arrangement as a "virtuous feedback loop," whereby CLOs and ABS backed by loans and leases originated by Apollo affiliates increase the firm's fee-generating opportunities and allow Apollo's insurance companies as well as its clients to "manufacture spread", i.e., garner investment spreads that Apollo says have been 100 to 200 basis points higher than those available from the broadly syndicated market.[11]

Apollo's much-touted success in fashioning Athene as a "permanent capital vehicle" for fee-generating asset management has spawned a bevy of private equity-affiliated imitators,[12] transforming what we and others once viewed as a potential retirement security concern affecting a few thousand annuity owners into a much broader macroprudential challenge. Managing the systemic risks posed by this new breed of global life insurance asset manager in our view will depend upon the coordinated efforts of state, federal and international regulators.

What follows are our specific comments on the Task Force's responses to the first six Considerations.

Consideration 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).

The Task Force's response to this consideration was to cite guidance that was added to the NAIC Financial Analysis Handbook in 2013 to assist regulatory reviews of merger and acquisition proposals (aka Form A Applications.) The 2013 guidance provided "examples of stipulations, both limited time and continuing, regulators could use when approving the acquisition to address solvency concerns, as well as for use in ongoing solvency monitoring."

UNITE HERE supports the notion of regulators having more rather than fewer tools to monitor solvency, and we can imagine scenarios in which all of the stipulations listed by the Task Force in their response to Consideration 1 could be useful tools in the context of proposed mergers and acquisitions. We note, however, that the Financial Analysis Handbook contains voluntary guidance, not regulations with the force of law.

Moreover, it is difficult for the public to assess how effective such stipulations may be given the opacity of regulatory merger review. Since the stipulations cited by the Task Force were added to the Handbook nine years ago, it would be helpful to know the extent to which they have been used, and whether regulators believe they have proven to be useful tools for monitoring solvency and protecting policyholders. For example:

- In how many instances since 2013 were stipulations attached to merger approvals?
- Which stipulations were most commonly used?
- How often have regulators imposed stipulations that require on-going monitoring and/or reporting? Has such monitoring and reporting helped regulators detect potential problems?
- When stipulations required periodic reports from an insurer or its parent, were those reports made available to other state regulators? Were they made available to the public?

The NAIC maintains a Form A database so presumably answering these questions would not be overly time consuming. In any event, without such answers, it is difficult to evaluate whether the 2013 stipulations could be useful tools in uncovering the types of hidden risks or undisclosed related party agreements referenced in Consideration 1.

<u>**Consideration 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.**</u>

The Task Force decided to refer this item to the NAIC Group Solvency Issues (E) Working Group, and suggested that the Working Group "consider if Form B (Insurance Holding Company System Annual Registration Statement) disclosure requirements should be modified to address these considerations."

We do not have an opinion about this recommendation, other than to note that in many states Form B Annual Statements are held to be confidential documents exempt from state open records laws and procedures, making it difficult for the public to form an opinion as to whether they could be, or ever have been, effective regulatory tools.[13]

<u>**Consideration 3: The material terms of the IMA [Investment Management Agreements] 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.**</u>

The Task Force decided to refer this item to the NAIC Risk-Focused Surveillance (E) Working Group, and suggested that the Working Group "consider training and examples, such as unique termination clauses and use of sub-advisors with the potential for additive fees, and strategies to address these." They further suggested "addressing pushback on obtaining sub-advisor agreements as Form D disclosures and some optional disclosures for the Form A."

UNITE HERE has no opinion on this recommendation, other than to observe that merger applications offer a limited window during which to make inquiries and procure information about asset management arrangements entered into by life insurers. Such arrangement and agreements can and presumably do change over time. Aside from Form A reviews and routine Form D disclosures, what tools do regulators have at their disposal to monitor on an on-going basis asset management agreements, including fee arrangements and sub-advisor agreements?

Intra-company agreements within an insurance holding company or group can be particularly opaque to regulators, policyholders and the public-at-large. For example, the securities lending program that contributed to AIG's insolvency and the subsequent Federal Reserve Board bailout of AIG's life insurance units in the wake of the 2008 financial crisis was run not by personnel employed by AIG's state-regulated life insurers, but by senior executives at the parent company level.[14] Similarly, substantially all of Athene's investing activities are conducted not by employees of Athene's state-regulated insurance units in Iowa, New York or Delaware, but by El Segundo, CA-based Athene Insurance Solutions, a non-insurance subsidiary of Apollo Global Management.[15]

To the extent regulators do have access to investment management contracts, parental guarantees or other intra-company documents, we believe those documents should be made available to the public as well as to rating agencies so annuity consumers can better understand the incentive structures and/or potential conflicts that may arise pursuant to such agreements.

Consideration 4: Owners of insurers, regardless of type and structure, 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, 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.

The Task Force noted that this topic is already under the purview of the Life Actuarial (A) Task Force (LATF) insofar as the work of that group is to help "ensure the long-term life liabilities (reserves) and future fees to be paid out of the insurer are supported by appropriately modeled assets." Regulators also recommended referring this consideration to the NAIC Risk-Focused Surveillance (E) Working Group, "as it is already looking at some of this work related to affiliated agreements and fees." The regulators suggested this Working Group should consider: what are the appropriate entities to provide capital maintenance agreements and how can such agreements be made stronger?

UNITE HERE considers the Task Force response to this consideration to be non-responsive. Consideration 4 in our view requires a historical analysis that answers the questions embedded within it. Have some insurers been focused more on short-term results which may not be in alignment with the long-term nature of liabilities in life products? Are there specific examples of investment management fees paid to an insurer's affiliate that regulators consider to be not fair or reasonable or that "effectively act as a form of unauthorized dividend"? Have there been instances when upstream owners have been unwilling to transfer capital to a troubled regulated affiliate? Without answers to these questions, it is difficult for the public to understand whether or to what extent regulators are concerned about these issues or are interested in devising more effective tools for managing these potential risks.

Consideration 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 [third party administrators] 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.

In response to this consideration, the Task Force noted that "the NAIC Financial Analysis Handbook includes guidance specific to Form A consideration and post approval analysis processes regarding PE owners of insurers (developed previously by the Private Equity Issues (E) Working Group)." The task Force also made various other suggestions including that regulators consider optional Form A disclosures and guidance for less experienced states.

UNITE HERE has no opinion about these recommendations except to note again that the Financial Analysis Handbook provides guidance that states can choose to follow or not, and that Form A application process provides a limited time period for monitoring TPAs or tracking actual performance of operational competencies and customer service.

Consideration 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.

The Task Force response to this consideration was that "regulators do not believe a PE definition is needed, as the considerations are activity based and apply beyond PE owners."

UNITE HERE agrees in principle that regulations and procedures should be activity based, but notes that the spread investment model perfected by Apollo and its private equity peers involves a discreet set of activities that, especially in combination, are markedly distinct from the more traditional investment practices of large life insurance groups founded prior to 2010. Private equity affiliated life insurers have engaged in four main activities that, especially in combination, set them apart from their non-private equity competitors: 1) acquiring large blocks of annuities from other life insurers; 2) replacing a portion of the acquired government and corporate bonds with less liquid asset-backed securities and alternative investments; and 3) entering into investment management agreements and/or sub-advisor agreements with noninsurance PE affiliates; and 4) reinsuring most of their acquired liabilities with Bermuda affiliates, thereby freeing up "excess capital."[16]

Managing growing macroprudential risks will require a coordinated approach

Thank you for this opportunity to provide comments on the first six of the Task Force's 13 Considerations. We look forward to your response to the remaining seven Considerations. We applaud the Task Force's attention to these important questions. Although we understand the NAIC is a deliberative body that seeks to build consensus among state regulators, industry representatives and other interested parties when developing its model laws and procedures, we are concerned that with respect to this set of issues the process is ill-suited to the urgent task of protecting policyholders (especially group annuity beneficiaries) and the public from the growing macroprudential risks associated with private equity stewardship of life insurance companies.

These are not new risks. Regulators, lawmakers, legal scholars and other academic researchers have been drawing attention to these issues for at least a decade. Many have pointed out that the activities most contributing to that risk – particularly the regulatory and capital arbitrage,[17] and the pursuit of the "illiquidity premium" [18]- frequently take place outside the purview of state insurance regulators or indeed any prudential regulators.

For this reason, we believe that it will ultimately require state, federal and international regulators working together to protect the public from the risks of large life insurer insolvencies and/or contagion to the larger financial system to which they are interconnected.

UNITE HERE would be happy to discuss these concerns with the combined Task Force or staff. Please contact Marty Leary at 703-608-9428 if you have any questions about these comments.

ENDNOTES

[1] New York State Department of Financial Services, (Benjamin Lawsky),"Shining a Light on Shadow Insurance, June 2013, p.2. http://02ec4c5.netsolhost.com/blog/wp-content/uploads/2013/06/NY-shadow-reinsurance-report-June-2013.pdf
[2] Testimony of Jim Baker, UNITE HERE, before the Insurance Commissioner of the State of Iowa, In the matter of application of Apollo Global Management LLC, Leon Black, Joshua Harris, and Marc Rowan for the approval of a plan to acquire control of Aviva Life and Annuity Company, Aviva of Iowa, Inc., Aviva Re Iowa II, Inc, and Aviva Re Iowa III, Inc., July 17, 2013.
[3] Findings of Fact, Conclusions of Law and Order, In the Matter of Application of Apollo Global Management, LLC, Leon Black, Joshua Harris and Marc Rowan for Approval of a Plan to Acquire Control of Aviva Life and Annuity Company, Aviva of Iowa, Inc., Aviva Re Iowa II, Inc, and Aviva Re Iowa III, Inc., Before the Insurance Commissioner of the State of Iowa, July 2013, p.9. Among the "conditions" placed on Apollo's acquisition of AVIVA were: a five year prohibition on dividends without prior approval from the IID (Condition 1); required prior approval from the IID for deviations in Athene's plan of operations (Condition 2) as well as for transactions with affiliates (Condition 3), and a reversion to Actuarial Guideline 33 for all fixed annuity contracts issued after December 31, 2013 (Condition 4).
[4] Athene Holding reported $240 billion in assets as of March 31, 2022 (see 10-Q for 1Q2022, p.8.) compared to just over $60 billion immediately following the Aviva acquisition. (See: Victor Epstein, "2.6 billion Aviva deal is complete," *Des Moines Register*, October 2, 2013.)
https://www.desmoinesregister.com/story/money/business/1/01/01/26b-aviva-deal-is-complete/2913493/
[5] Apollo Investor Day Presentation 2021, October 2021, p.158.
[6] Apollo Investor Day Presentation 2021, October 2021, p.158.
[7] "Athene Completes Significant Pension Risk Transfer Transaction with JCPenney," Athene Press Release, April 1, 2021. https://www.prnewswire.com/news-releases/athene-completes-significant-pension-risk-transfer-transaction-with-jcpenney-301261013.html
[8] These entities include MidCap, which provides leveraged loans to third party private equity firms ($15b in assets); Redding Ridge, a registered investment adviser specializing in leveraged loans and global CLO management in both the US and Europe ($15b); commercial aircraft leasing companies PK AirFinance and Merx Aviation ($8b in combined assets); Foundation Home Loans, a UK-based let-to-buy specialty lender ($4b); automobile leasing and fleet management company Donlen ($2b); Apollo Net Lease Co., which owns more than 100 triple net lease retail and industrial properties ($2B); Haydock Finance, a UK-based small business lender ($500m); Newfi, a technology-driven mortgage lender ($300m); an agreement to acquire up to 50% of Australian commercial real estate finance company MaxCap ($3B); and an agreement to purchase up to $500 million in senior secured credit facilities and securitized assets originated by Victory Park Capital to companies that aggregate third-party sellers on Amazon and other e-commerce sites. (See Apollo Investor Day Presentation 2021, October 2021, p.107.)
[9] Apollo Investor Day Presentation 2021, October 2021, p.92. "Run Rate" for platforms included on graph.
[10] 2021 Athene Holding 10-K, filed 2/25/2021, p.99.
https://www.sec.gov/ix?doc=/Archives/edgar/data/1527469/000152746922000018/ahl-20211231.htm
[11] Apollo Investor Day Presentation 2021, October 2021, p.106-108.
[12] Blackstone bought FGL in 2017 and Allstate's Life and Annuity businesses in 2020; KKR bought Global Financial Group in July 2020; Ares bought Pavonia Life in 2019 (and renamed it Aspida), and F&G Reinsurance in September 2020; Brookfield bought a 19.9% stake and entered into a strategic partnership with American Equity Investment Life in October 2020; and Sixth Street Partners (formerly an arm of TPG) bought Talcott Resolution in January 2021; see also Alwyn Scott and David French, "U.S. insurance asset sales attract new private equity players, strategies," Reuters, 2/8/2021.
"**https://www.reuters.com/article/us-insurance-m-a/u-s-insurance-asset-sales-attract-new-private-equity-players-strategies-idUSKBN2A811G**
Additionally, in July 2021, Blackstone entered into a long-term agreement with AIG to manage the assets backing AIG's life and annuity policies. Pursuant to that transaction, Apollo paid $2.2 billion for a 9.9% stake in AIG and initially assumed asset management over $50 billion in AIG's assets. See Gottfried, Miriam and Scism, Leslie, "Blackstone Enters Deal to Manage AIG Life and Retirement Assets," *Wall Street Journal*, July 14, 2021.
https://www.wsj.com/articles/blackstone-near-deal-to-manage-aig-life-and-retirement-assets-11626294156
In March 2022, AIG made an S-1 filing with the SEC to begin the process of an initial public offering of its life and retirement business, to be renamed Corebridge Financial. At the same time, AIG announced that AIG's more liquid portfolio comprised primarily of fixed income and private placement securities would be managed by BlackRock. See Masters, Brooke, Fontanella-Kahn, James, Megaw, Nicholas, and Smith, Ian, "AIG files to float its life insurance and asset management business," *Financial Times*, March 28, 2022. **https://www.ft.com/content/56b547e5-82d4-4f8a-b341-39eda8bf9bd5** In its S-1 filing, Corebridge affirmed its "strategic partnership" with Blackrock, pursuant to which Corebridge expected BlackRock to have invested more than $92 billion of the insurer's assets by 2027, "primarily in Blackstone-originated investments across a range of asset classes, including private and structured credit." See Corebridge S-1, filed 3/28/2022, p.5.
https://www.sec.gov/Archives/edgar/data/0001889539/000114036122011373/ny20001795x5_s1.htm

[13] Uniform Certificate of Authority Applications, Public Records Requirements, NAIC, 2/12/2020, found at: https://www.naic.org/documents/industry_ucaa_chart_public_records.pdf

[14] McDonald, Robert and Paulson, Ann, "AIG in Hindsight," *Journal of Economic Perspectives*, Volume 29, Number 2, Spring 2015, p.85.
https://www.aeaweb.org/articles?id=10.1257/jep.29.2.81

[15] Athene Holding 2021 10-K, filed 2/25/2022, p.13.

[16] Through the use of modified co-insurance reinsurance contracts, Athene can lower its required capitalization and thus free-up capital for reinvestment or other purposes. Here is how an Athene subsidiary describes the process: *"Due to these various reinsurance relationships, the amount of capital and surplus that AAIA* [Athene's state-regulated Iowa life insurance affiliate] *is required to maintain is less than what would be required if the insurance liabilities were not ceded to its affiliates. Therefore, AAIA may have fewer permitted assets available to make payments under its insurance liabilities in the event that the applicable account is insufficient to satisfy amounts due thereunder as the result of a default by the respective counterparty under the reinsurance arrangements."* See also: Kirti, Divya and Sarin, Natasha, "What Private Equity Does Differently: Evidence from Life Insurance," (February 14, 2020). U of Penn, Inst for Law & Econ Research Paper No. 20-17, Available at SSRN: https://ssrn.com/abstract=3538443

[17] Koijen, Ralph S.J. & Yogo, Motohiro, "Shadow Insurance," Minneapolis Fed Research, Staff Report 505, Revised May 2016. https://tinyurl.com/2p8cbwhm
See also Kirti, Divya and Sarin, Natasha, "What Private Equity Does Differently: Evidence from Life Insurance," (February 14, 2020). U of Penn, Inst for Law & Econ Research Paper No. 20-17, Available at SSRN: https://ssrn.com/abstract=3538443
See also Kim, Kyeonghee, Leverty, J. Tyler, and Schmit, Joan, "Regulatory Capital and Asset Risk Transfer," 2019, pp. 8-10. https://tinyurl.com/2p8c6tn3

[18] Upon acquiring closed annuity blocks or pension liabilities, Apollo replaces some of the lower-yielding assets that back those obligations with riskier and/or less liquid financial products, then reinsures most of the annuity obligations via affiliates incorporated and regulated in Bermuda. Unlike traditional reinsurance with third-party reinsurers, these inter-company reinsurance transactions do not actually transfer risk. But they allow Athene to lower its overall level of capital and reserves without corresponding declines in its state-regulated affiliates' reported risk-based capital (RBC) ratios. See: Foley-Fisher, Nathan, and Verani, Stepane, "Capturing the Illiquidity Premium," Authors work in the Research and Statistics Division of the Federal Reserve Board, February 2020.
https://www.californiainsurancelawyerblog.com/wp-content/uploads/sites/275/2021/02/Federal-Reserve-Board-Capturing-the-Illiquidity-Premium-February-2020.pdf

Northwestern Mutual®

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June 13, 2022

Mr. Justin Schrader
Chair, NAIC Macroprudential Working Group

Mr. Todd Sells
Director, Financial Regulatory Policy & Data

Re: Regulator Responses to List of MWG Considerations - April 27, 2022

Dear Messrs. Schrader and Sells:

Northwestern Mutual appreciates the opportunity to submit comments on the Regulator Responses to List of MWG Considerations, also referred to as the Regulatory Considerations Applicable (But Not Exclusive) to Private Equity (PE) Owned Insurers (MWG Considerations). Northwestern Mutual, headquartered in Milwaukee, Wisconsin, was founded in 1857 and today is the country's largest direct provider of individual life insurance. Our company continues to earn the highest financial strength ratings awarded to any U.S. life insurer from Moody's, A.M. Best Company, Fitch Ratings, and Standard & Poor's. We engage in solvency-related regulatory issues, such as those listed in the MWG Considerations, with the goal of maintaining the stability and vibrancy of the life insurance marketplace in the United States.

We agree with the Macroprudential Working Group (Working Group) that the critical issue presented by the MWG Considerations is not the nature of a company's ownership structure. Rather, it is the potential for gaps in the existing solvency regulatory system to be exploited to the potential detriment of consumers, the life insurers that compete in our national marketplace and, ultimately, the integrity and stability of the state insurance regulatory system itself. Therefore, we strongly support the work of the Working Group to develop and address the MWG Considerations. We recognize and commend the progress made and referrals proposed for many of the 13 items listed in the MWG Considerations.

As the Working Group holds further discussions on each of the MWG Considerations, Northwestern Mutual would like to offer three core concepts of insurance regulation that should form the basis for future NAIC activity: uniformity; transparency; and strong reserving and capital standards.

- Uniformity. Solvency regulation should be uniform across the states to maintain the protection of policyholders in the United States. Companies should not have to establish complex and costly structures and rely on disparate solvency standards across jurisdictions to compete on a level playing field.
- Transparency. Transparency should allow both regulators and interested parties, without excessive effort, to be able to understand the impact of key transactions on the reported financial condition and solvency of the ceding company. Without transparency, market discipline fails and consumer confidence dwindles, increasing risks to policyholders, the industry, and the state-based regulatory and guaranty systems.
- Strong Reserving and Capital Standards. Life insurance should have strong, appropriately conservative reserve and capital requirements for the long-term promises made to policyholders. Industry and regulatory credibility could be questioned if a transaction involving a block of business could meaningfully reduce the total reserve and capital requirements while the risks associated with that business remain substantively the same.

Notably, regulator discussion has not yet led to substantial progress on item #13 which pertains to insurers' use of offshore reinsurance structures. Reinsurance transactions can and often do serve a valuable function by reallocating risk. However, offshore reinsurance can also result in lower total reserves and capital, reduced state regulatory oversight, and diminished stakeholder transparency from what would be required by the statutory accounting and risk-based capital requirements the NAIC has established to protect policyholders in the United States.

Without progress and action on the item pertaining to offshore reinsurance, the Working Group's progress on other MWG Considerations could further incentivize even more utilization of offshore reinsurance transactions and undercut the NAIC's efforts to close other solvency regulatory gaps domestically. In the long run, a system that encourages companies to transfer business to a related offshore entity in order to alter their reserves and capital from uniform standards diminishes the strength of reserve and capital regulation in the United States. If capital standards are deemed to be too conservative in the US, they should be addressed transparently and uniformly through the NAIC and not through the alternate means of offshore reinsurance.

As the Working Group advances in addressing each of the MWG Considerations, we encourage efforts to refine and to strengthen state insurance regulatory levers and to overcome any perceived obstacles on this issue, so that offshore reinsurance does not undermine the outcomes on the other MWG Considerations.

We appreciate the efforts of the Working Group thus far to coordinate NAIC activities related to the MWG Considerations.

Sincerely,

Andrew T. Vedder
Vice President – Enterprise Risk Management

June 13, 2022

VIA ELECTRONIC SUBMISSION
Justin Schrader
Chief Financial Examiner
Nebraska Department of Insurance
Chair, NAIC Macroprudential (E) Working Group

Todd Sells
Director, Financial Regulatory Policy & Data
National Association of Insurance Commissioners

Aida Guzman
Senior Administrative Assistant, Government Affairs
National Association of Insurance Commissioners

Re: Comments Regarding NAIC Macroprudential (E) Working Group Exposed *"Regulatory Considerations Applicable (but not exclusive to) Private Equity Owned Insurers"*

The American Investment Council ("AIC")[1] is pleased to have the opportunity to provide additional comments regarding the National Association of Insurance Commissioners ("NAIC") Financial Stability (E) Task Force ("FSTF") and Macroprudential (E) Working Group ("MWG") exposure, "*Regulatory Considerations Applicable (But Not Exclusive) to Private Equity (PE) Owned Insurers*" ("Exposure Document"). As the advocacy, communications, and research organization for the world's leading private equity and private credit firms, which have substantial experience assisting insurers with their investment needs, we believe we are well-positioned to share an important perspective with the NAIC.

As noted in our January 18, 2022 comment letter, the AIC commends the FSTF and MWG for seeking to further understand the longstanding and mutually beneficial

[1] The American Investment Council, based in Washington, D.C., is an advocacy, communications, and research organization established to advance access to capital, job creation, retirement security, innovation, and economic growth by promoting responsible long-term investment. In this effort, the AIC develops, analyzes, and distributes information about private equity and private credit industries and their contributions to the U.S. and global economy. Established in 2007 and formerly known as the Private Equity Growth Capital Council, the AIC's members include the world's leading private equity and private credit firms which have experience with the investment needs of insurance companies. As such, our members are committed to growing and strengthening the companies in which, or on whose behalf, they invest, to helping secure the retirement of millions of pension holders and to helping ensure the protection of insurance policyholders by investing insurance company general accounts in appropriate, risk-adjusted investment strategies. For further information about the AIC and its members, please visit our website at http://www.investmentcouncil.org.

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relationship between private equity firms, asset managers, the insurance industry and the policyholders they serve. In particular, we applaud the NAIC for taking a deliberative and transparent approach to determining what additional work, if any, should be undertaken to address state insurance regulators' concerns pertaining to the ongoing shift in insurer investment strategies in a persistent low interest rate environment. We also appreciate the recognition by the NAIC in its May 31, 2022, letter to Senate Banking Chairman Sherrod Brown that: (i) many of the Exposure Document's considerations are not unique to one particular category of investors or insurers; (ii) a number of related considerations are currently, or were recently, the subject of deliberation of other NAIC working groups unrelated to private equity, and (iii) notwithstanding the recent attention on the subject, a wide range of insurers have been utilizing alternative investment strategies under the supervision of state insurance regulators for some time. We agree, as you note in the letter, that state insurance regulators are fully capable of assessing and supervising any insurance activity, regardless of ownership structure.[2]

We welcome the opportunity to discuss any questions or comments that FSTF or MWG members may have regarding the Exposure Document or the role of private equity and alternative asset managers in insurance generally, and we would like to call particular attention to the following four Exposure Document Considerations.

Consideration 1 (Disclosure)[3]

We appreciate the recognition by FSTF/MWG that there is no "one size fits all" approach to regulatory disclosures and that this issue is not limited to one category of investors or one sub-set of insurers. To that end, we encourage the FSTF and MWG to extend these fundamental considerations to the entirety of the Exposure Document workstream and to continue to focus on specific *activities*, rather than a particular type of investor or insurer.

As a general matter, we understand that a regulator may need to request that affiliated/related party agreements be submitted as part of certain insurance holding company act review processes, but would request that those materials receive customary confidential treatment. In addition, if and when the Group Solvency Issues (E) Working Group ("GSWG") takes this Consideration up for discussion, we believe it would be

[2] Like insurers, private fund advisers are also subject to significant oversight and regulation. For example, private fund advisers are registered as investment advisers under the Investment Advisers Act of 1940 with the U.S. Securities and Exchange Commission ("SEC"). The SEC seeks to administer and enforce legal obligations on alternative asset managers through an active examination and oversight program, including with an announced focus on conflicts. Insurance companies advised by private fund advisers also receive the benefits of this oversight.

[3] Consideration 1 states: "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)."

helpful for the GSWG to assess, among other items: (i) the need to provide regulatory certainty *vis a vis* when and on what basis additional disclosures could be required; and (ii) whether the additional disclosures would extend approval timelines. We believe such items are critical to insurers being able to access the capital markets effectively and efficiently.

We also note that there are legitimate business reasons why investors enter into agreements with insurer parent companies or other affiliates that are unrelated to regulator disclosure considerations. Investors enter into these arrangements with insurer affiliates to ensure that those parties support and otherwise refrain from undermining the commitments made at the insurer legal entity level in connection with engaging an alternative manager for services, particularly where the investment manager has made an equity investment in the parent company. These mutually beneficial arrangements ensure that long-term equity investments made in an insurer by an investment manager support the insurer's operations, validate the potential growth of the insurer to other potential investors, and provide alignment between the investment manager and the insurer as a means to ensure the investment manager acts in the interest of the insurer and its policyholders.

Consideration 2 ("Control")[4]

The NAIC *Insurance Holding Company System Regulatory Act* (#440) ("Model Act") defines "control" and provides that control is presumed to exist "if any person, directly or indirectly, owns, controls, holds with the power to vote, or holds proxies representing, ten percent (10%) or more of the voting securities of any other person."[5] To be sure, the Model Act also provides state insurance regulators with the discretionary authority to determine "that control exists notwithstanding the absence of a presumption [of control]."[6]

An established standard as to the facts and circumstances under which control is presumed – and the well-established practices and conventions so associated – is an essential component to providing insurers and investors with regulatory certainty. The need for a clear and predictable presumption to remain in place is critical in order for insurers to effectively and efficiently access capital with predictability, while balancing

[4] Consideration 2 states: "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."
[5] *See* Model Act Section 1(C).
[6] Per the Model Act, such a determination is subject "furnishing all persons in interest notice and opportunity to be heard and making specific findings of fact to support the determination [of control]."

the need for state insurance regulators to have the necessary discretionary authority to effectively supervise insurer transactions.

Moreover, we believe that the Model Act's current definition of "control" continues to be the proper determinant for actual control. Absent traditional indicia of control, contractual arrangements relating to service agreements – including investment management agreements – should not be viewed as providing an indicia of control. Stated differently, contractual terms contained in service agreements that are negotiated on an arm's length basis are not sufficient to convey the power to direct or cause the direction of an insurer, so long as they are subject to the ultimate supervision and control by the insurer through general oversight of the service provider and other customary contractual provisions. To conclude otherwise would impose undue uncertainty on contractual arrangements between insurers and their counterparties, and would likely have a chilling effect on the ability of insurers to enter into agreements that are in the best interest of their policyholders.

Consideration 3 (Investment Management Agreements)[7]

Conflict of Interest

As a general matter, the terms of a contractual agreement should not be viewed as giving rise to a conflict of interest when the agreement is negotiated on an arm's length basis. Notwithstanding the foregoing, current law provides an established process to address potential conflicts (for example, requirements to appoint independent directors and traditional corporate law processes to ensure fairness and, under certain circumstances, review of transactions by regulators pursuant to Form D filings). Accordingly, investments sourced and allocated by alternative asset managers on behalf of insurance company clients should not, absent other factors, be viewed as presenting a potential conflict of interest, particularly where insurers retain full control over asset allocation (for example, insurers retain control over the asset classes in which they invest, as well as the amounts and periods of time over which such asset exposure is achieved).

Fees

Importantly, as an initial consideration, any fees paid to investment managers cannot be considered in isolation, rather they should be considered on a "net" basis – i.e., on the basis of total return (after fees are taken into account). Sophisticated institutional investors (including insurers) have a successful history of investing in a range of

[7] Consideration 3 states: "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."

strategies despite certain investment products generally having higher fees than other available investment opportunities. On a net basis, private equity has consistently outperformed more traditional asset classes such as publicly traded stocks and public mutual funds[8] Net-of-fees private debt funds have also consistently outperformed bond and equity market benchmarks.[9] Insurers continue to recognize the value of investment opportunities that outperform when considered on a net basis.[10] This approach has enabled the consistent delivery of industry leading investment results, which ultimately leads to a high level of financial strength.

<u>Termination</u>

Asset managers often dedicate extensive resources at the outset of a new arrangement in support of managing an insurer's general account assets (e.g., dedicating or reassigning existing personnel, hiring new employees, investing in information technology systems, expanding office space, further enhancing compliance and regulatory processes). As such, and because, in our experience, insurers have the right to terminate their investment management agreements (e.g., upon 30 days' notice), the desire for external asset managers to seek contractual protections (subject to arms' length negotiations) should an insurer decide to terminate the arrangement earlier than was originally anticipated by the parties is entirely appropriate.

[8] *See e.g.,* Hamilton Lane data (February 2021) available at: https://www.investmentcouncil.org/wp-content/uploads/deck-pe-outperformance-aic-2022.02.02.pdf.

[9] Private debt funds outperformed versus investment grade, high yield, and S&P 500 benchmarks by 8 percentage points, 6 percentage points and 6 percentage points, respectively. *See* Private Debt Fund Returns, Persistence, and Market Conditions (Böni and Manigart, April 2022), available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3932484. Additionally, this report observed the average (median) private debt fund provided an internal rate of return of 9.2 (8.5) percent net of fees to limited partners. Moreover, there was a relatively equal outperformance for distressed debt, mezzanine and special situations funds of 8 to 10 percentage points, while direct lending funds outperformed the market by 4 percentage points.

[10] For example, insurers currently comprise approximately 12% of the invested capital in private equity funds. *See e.g.,* Global Private Equity & Venture Capital Report (Preqin, 2021) available at: https://www.preqin.com/insights/global-reports/2021-preqin-global-private-equity-and-venture-capital-report. The attractiveness of the net returns offered by private equity investments is also evidenced by the extent to which institutional investors will be increasing or maintaining their allocation to such investments in the next year. *See* LP Perspectives 2021 (Private Equity International, December 2020) available at: https://www.investmentcouncil.org/wp-content/uploads/deck-pe-outperformance-aic-2022.02.02.pdf.

<u>Consideration 10 (Privately Structured Securities)</u>[11]

As you are aware, insurance company asset managers are tasked with producing enough yield from their investments to keep pace with benefits and obligations embedded in policies that often stretch years into the future, while not running afoul of state insurance investment laws. These obligations have been challenging as of late due to the persistent low interest rate environment, leaving insurers with two essential choices: (i) take more risk along the yield curve in search of higher rates of return; or (ii) seek other types of debt instruments that provide for more attractive returns without incremental credit risk. This set of circumstances is increasingly driving insurers to seek the services of alternative asset managers with significant asset origination capabilities and private credit expertise to manage a portion of their assets, which provide a number of benefits to the insurer and their policyholders. Those benefits include:

- A natural alignment between the long-dated insurance liabilities and the long-term investment approach taken by alternative asset managers, including in the private credit space;
- Alternative asset managers have the ability to source, underwrite and execute private credit transactions that require skill sets, experience, and scale that many insurance companies do not possess in-house;
- Private equity and private credit firms also provide an opportunity for smaller and midsized insurers to access these asset classes, which historically have been the primary purview of large insurers that have the scale to afford in-house asset management functions that can originate these assets, making the industry more competitive to the ultimate benefit of policyholders;
- Engaging asset managers with differentiated capabilities can be more cost efficient than making significant investments in an internal asset management function. By availing themselves of these advantages, insurers can benefit from cost-effective sourcing and origination capabilities in attractive asset classes, resulting in enhanced long-term adequacy margins for policyholders, increased

[11] Consideration 10 states: "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.)"

spread/earnings, and more competitive product pricing that inures to the benefit of policyholders;

- Asset-backed security default rates are substantially similar to corporate investment grade debt default rates while CLO default rates are substantially lower than corporate default rates[12];
- The focus on private investments is belied by the fact that institutions with higher allocations to private investments have outperformed (with less volatility) those with less.[13]

We welcome the opportunity to serve as a resource to the NAIC as it continues to address this important matter.

Respectfully submitted,

Rebekah Goshorn Jurata

Rebekah Goshorn Jurata
General Counsel
American Investment Council

[12] *See* Analysis of Historical NRSRO Ratings Data (Morgan Stanley, February 2022), available at: https://mcusercontent.com/65ee38c99561aeba4a1f82919/files/ff9650b4-dfa7-2815-f41a-fa7a60d85fbf/Final_Morgan_Stanley_Report_18_.pdf.

[13] *See e.g.,* Cambridge Associates data (August 2021) available at: https://www.investmentcouncil.org/wp-content/uploads/deck-pe-outperformance-aic-2022.02.02.pdf. In fact, prominent institutional investors believe that the inclusion of private investment can produce high returns with lower risk. *See* Yale Endowment Report (2019) available at: https://static1.squarespace.com/static/55db7b87e4b0dca22fba2438/t/5ebbf53c4b59573668cd85cf/1589376317984/2019+Yale+Endowment.pdf.

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. A summary of the regulatory process has been added to this document since it is being used by individuals less familiar with the state insurance regulatory system, and the results of regulator discussions on how to move forward have been added to specific considerations in blue font. The proposed regulator responses are exposed for a 45-day comment period.

State insurance regulators monitor the solvency of each legal entity insurer, including assessing risks from the broader holding company when an insurer is part of a group, making use of routinely required disclosures, both public, such as the statutory financial statements, and confidential, such as the Risk-Based Capital (RBC) supplemental filing and Holding Company form filings. Regulators also use many analysis and examination tools and procedures for each insurer and/or insurance group. Regulatory responses to the analysis and examination work depend upon the results of those reviews. One specific area of solvency monitoring work focuses on potential acquisitions of a US legal entity insurer, involving a Form A filing. In 2013, guidance was added to the NAIC Financial Analysis Handbook for Form A reviews when a private equity owner was involved, although these considerations are not limited to PE acquisitions. The guidance provides examples of stipulations, both limited time and continuing, regulators could use when approving the acquisition to address solvency concerns, as well as for use in ongoing solvency monitoring. Examples follow:

Limited Time Stipulations:

- Requiring RBC to be maintained at a specified amount above company action level/trend test level. Because capital serves as a buffer that insurers use to absorb unexpected losses and financial shocks, this would better protect policyholders.
- Requiring quarterly RBC reports rather than annual reports as otherwise required by state law.
- Prohibiting any dividends, even ordinary.
- Requiring a capital maintenance agreement or prefunded trust account.
- Enhancing the scrutiny of operations, dividends, investments, and reinsurance by requiring material changes in plans of operation to be filed with the commissioner (including revised projections), which, at a minimum, would include affiliated/related party investments, dividends, or reinsurance transactions to be approved prior to such change.
- Requiring a plan to be submitted by the group that allows all affiliated agreements and affiliated investments to be reviewed, despite being below any materiality thresholds otherwise required by state law. A review of agreements between the insurer and affiliated entities may be particularly helpful to verify there are no cost-sharing agreements that are abusive to policyholder funds assessment.

Continuing Stipulations:

- Requiring prior commissioner approval of material arms-length, non-affiliated reinsurance treaties or risk-sharing agreements.
- Requiring notification within 30 days of any change in directors, executive officers or managers, or individuals in similar capacities of controlling entities, and biographical affidavits and such other information as shall reasonably be required by the commissioner.
- Requiring filing of additional information regarding the corporate structure, controlling individuals, and other operations of the company.

- Requiring the filing of any offering memoranda, private placement memoranda, any investor disclosure statements or any other investor solicitation materials that were used related to the acquisition of control or the funding of such acquisition.
- Requiring disclosure of equity holders (both economic and voting) in all intermediate holding companies from the insurance company up to the ultimate controlling person or individual but considering the burden on the acquiring party against the benefit to be received by the disclosure.
- Requiring the filing of audit reports/financial statements of each equity holder of all intermediate holding companies but considering the burden on the acquiring party against the benefit to be received by the disclosure.
- Requiring the filing of personal financial statements for each controlling person or entity of the insurance company and the intermediate holding companies up to the ultimate controlling person or company. Controlling person could include for example, a person who has a management agreement with an intermediate holding company.

Among many other concepts, regulators are considering the need for any additional stipulations, if there are some stipulations that should be required instead of used subjectively, and use of some stipulations beyond the Form A acquisition process (e.g., for insurers acquired in the past).

RRC Comments "In a Form A transaction" (7 bullet points) – Suggest including these in the referrals to the NAIC Group Solvency Issues (E) Working Group and the NAIC Risk-Focused Surveillance (E) Working Group for consideration when addressing Consideration numbers 1, 2, 4 and 5.

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).

   Regulator discussion results:
   - Refer this item to the NAIC Group Solvency Issues (E) Working Group. Items discussed:
     - Instead of requiring for all Form A acquisitions to provide additional disclosures, structure an optional disclosure requirement that can be used when unresolved regulatory concerns exist with the acquisition. For example:
       - Disclosures to allow regulators to assess the goal of the potential owner in acquiring the insurer, how the potential owner will be paid and in what amounts, and the ability of the potential owner to provide capital support as needed.
       - Copies of disclosures provided to the potential owner's investors.
     - Provide training as needed to states with less experience reviewing complex Form A transactions and refer those states to more experienced states for live help.
       - These options include highlighting the need to use external expertise for complex transactions, especially to understand non-U.S. affiliations and when assessing multiple complex Form A applications, and at the expense of the Form A applicant.

   AIC Comment (recommended 2 items) – Suggest including this recommendation in the referral to the NAIC Group Solvency Issues (E) Working Group for its work on Consideration #1.

- Recommendation: The Working Group should assess, among other items: (i) the need to provide regulatory certainty *vis a vis* when and on what basis additional disclosures could be required; and (ii) whether the additional disclosures would extend approval timelines. We believe such items are critical to insurers being able to access the capital markets effectively and efficiently.

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.

Regulator discussion results:
- Refer this item to the NAIC Group Solvency Issues (E) Working Group. Regulators recognized the integral connection of the first two considerations. Items discussed:
    - An emphasis on training and providing detailed examples to address the complexity and creativity involved in some of these Form A agreements and holding company structures.
    - It is not practical to get copies of operating agreements from every entity in a group to assess control impacts to the insurers. Consider ways of better targeting the pertinent agreements to assess, including a potential list of questions about less than 10% owners for use when considering Form A applications and/or ongoing analysis.
    - Consider if Form B (Insurance Holding Company System Annual Registration Statement) disclosure requirements should be modified to address these considerations.

AIC Comment (2 primary concerns) – Suggest asking the AIC to follow the work of the NAIC Group Solvency Issues (E) Working Group on Consideration #2 and make comments on specific recommendations if needed.
- Concerns: The 10% presumption of control needs to remain; and contractual terms contained in service agreements that are negotiated on an arm's length basis are not sufficient to convey the power to direct or cause the direction of an insurer, so long as they are subject to the ultimate supervision and control by the insurer.

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.

Regulator discussion results:
- Refer this item to the NAIC Risk-Focused Surveillance (E) Working Group. Regulators recognized similar dynamics to the first two considerations, but this Working Group was selected because it is already currently focused on a project involving affiliated agreements and Form D filings. Items discussed:
    - Consider training and examples, such as unique termination clauses and use of sub-advisors with the potential for additive fees, and strategies to address these.

        - This included addressing pushback on obtaining sub-advisor agreements as Form D disclosures and some optional disclosures for the Form A.
    - Given the increasing prevalence of bespoke agreements, does it make sense to tie this work in to the work of the NAIC Valuation of Securities (E) Task Force and/or the NAIC Securities Valuation Office? If yes, how best to do so?
    - Surplus Notes and appropriate interest rates given their special regulatory treatment, including whether floating rates are appropriate; follow any Statutory Accounting Principles (E) Working Group projects related to this topic and provide comments needed.

RRC Comments "With respect to an Investment Management Agreement (IMA" (3 bullet points) - Suggest including these in the referral to the NAIC Risk-Focused Surveillance (E) Working Group for Consideration #3.

AIC Comments on "Conflict of Interest, Fees, Termination" (3 individual comments) – Suggest including these comments in the referral to the NAIC Risk-Focused Surveillance (E) Working Group for its work on Consideration #3.

4. Owners of insurers, regardless of type and structure, 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, 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.
    a. Life Actuarial (A) Task Force (LATF) work addresses this – helping to ensure the long-term life liabilities (reserves) and future fees to be paid out of the insurer are supported by appropriately modeled assets.

Regulator discussion results:
- In addition to LATF's work, refer this item to the NAIC Risk-Focused Surveillance (E) Working Group, as it is already looking at some of this work related to affiliated agreements and fees. Items discussed:
    - Capital maintenance agreements, suggesting guidance for the appropriate entities to provide them and considering ways to make them stronger.

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.
    a. The NAIC Financial Analysis Handbook includes guidance specific to Form A consideration and post approval analysis processes regarding PE owners of insurers (developed previously by the Private Equity Issues (E) Working Group).

Regulator discussion results:
- Regulators considered referring this consideration to the NAIC Risk-Focused Surveillance (E) Working Group but opted to keep developing more specific suggestions for now. Items discussed:

- Consider optional Form A disclosures and guidance for less experienced states; review EU conduct of business language and consider if similar concepts would help target the optional use.
- Consider more detailed guidance for financial examinations.
- Besides just inexperience, the consideration also includes intentional actions that ignore known concerns to achieve owner's results; might need to consider Market Conduct group(s).

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.

Regulator discussion results:
- Regulators do not believe a PE definition is needed, as the considerations are activity based and apply beyond PE owners.

7. The lack of identification of related party-originated investments (including structured securities). This may create potential conflicts of interests and excessive and/or hidden fees in the portfolio structure, as 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.
   a. An agenda item and blanks proposal are being re-exposed by SAPWG. Desire for 2022 year-end reporting to include disclosures identifying related-party issuance/acquisition.

Regulator discussion results:
- Regulators are comfortable the SAPWG's work is sufficient as a first step since it involves code disclosures to identify various related party issues. They also recognize that existing and/or referred work at the Risk-Focused Surveillance (E) Working Group may address some items in this consideration. Once regulators work with these SAPWG disclosures and other regulatory enhancement, further regulatory guidance may be considered as needed.

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.
   a. An agenda item and blanks proposal are being re-exposed by SAPWG. The concept being used for investment schedule disclosures is the use of code indicators to identify the role of the related party in the investment, e.g., a code to identify direct credit exposure as well as codes for relationships in securitizations or similar investments.

Regulator discussion results:
- Like the previous consideration, regulators are looking forward to using these code disclosures to help target areas for further review. However, specific to CLO/structured security considerations, regulators support a referral to the Examination Oversight (E) Task Force. Specific items discussed include:

- Since investors in CLOs obtain monthly collateral reports, regulators should consider asking for such reports when concerns exist regarding a company's potential exposure to affiliated entities within their CLO holdings.
- Regulators would like to have more information regarding the underlying portfolio companies affiliated with a CLO manager to help quantify potential exposure between affiliates and related parties.
- Regulators request NAIC staff to consider their ability to provide tools and/or reports to help regulators target CLOs/structured securities to consider more closely.

RRC Comments on "collateralized loan obligations (CLOs)" (2 bullets) – Suggest including these in the referrals to the NAIC Examination Oversight (E) Task Force and the NAIC Risk-Focused Surveillance (E) Working Group for Consideration numbers 7, 8 and 9, but also sending to the NAIC Statutory Accounting Principles (E) Working Group for its existing work related to these Considerations.

9. Broader considerations exist around asset manager affiliates (not just PE owners) and disclaimers of affiliation avoiding current affiliate investment disclosures. A new Schedule Y, Pt 3, has been adopted and is 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.
    a. Additionally, SAPWG is developing a proposal to revamp Schedule D reporting, with primary concepts to use principles to determine what reflects a qualifying bond and to identify different types of investments more clearly. For example, D1 may include issuer credits and traditional ABS, while a sub-schedule of D1 could be used for additional disclosures for equity-based issues, balloon payment issues, etc. This is a much longer-term project, 2024 or beyond.

Regulator discussion results:

- Regulators recognize the new Schedule Y, Part 3, will give them more insights for owners of greater than 10%, but it does not provide insights for owners of less than 10%. However, regulators also recognize that existing and/or referral work of the Risk-Focused Surveillance (E) Working Group may help with some of this dynamic. Additionally, since the SAPWG 2022 code project and its longer-term Schedule D revamp project will help provide further disclosures that will assist with this consideration, regulators are comfortable waiting to see if further regulatory guidance is needed after using the resulting disclosures and other enhancements from these projects.
    - Specific to owners of less than 10%, regulators discussed the April 19, 2022, Insurance Circular Letter No. 5 (2022) sent by the New York Department of Financial Services to all New York domiciled insurers and other interested parties. This letter highlights that avoiding the levels deemed presumption of control, e.g., greater than 10% ownership, does not create a safe harbor from a control determination and the related regulatory requirements. The circular letter was distributed to all MWG members and interested regulators.

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.)

a. LATF's exposed AG includes disclosure requirements for these risks as well as how the insurer is modeling the risks.
b. SVO staff have proposed to VOSTF a blanks proposal to add market data fields (e.g., market yields) for private securities. If VOSTF approves, a referral will be made to the Blanks WG.

Regulator discussion results:

- Regulators focused on the need to assess whether the risks of these investments are adequately included in insurers' results and whether the insurer has the appropriate governance and controls for these investments. Regulators discussed the potential need for analysis and examination guidance on these qualifications.
- To assist regulators in identifying concerns in these investments, regulators expressed support for the VOSTF proposal to obtain market yields to allow a comparison with the NAIC Designation. Once such data is available, regulators ask NAIC staff to develop a tool or report to automate this type of initial screening. Also, regulators again recognized the SAPWG Schedule D revamp work will help in identifying other items for initial screening.
- The regulators discussed LATF's exposed AG, noting the Actuarial Memorandum disclosures that would be required for these privately structured securities along with the actuarial review work, and recognizing how those would be useful for analysts and examiners when reviewing these investments. Additionally, the Valuation and Analysis (E) Working Group would be able to serve as a resource for some of these insights for states without in house actuaries.
- As a result of the above discussions, regulators agreed to a referral to the Examination Oversight (E) Task Force to address the disclosures that will be available from LATF's exposed AG. They agreed to wait for any further work or referral until they have an opportunity to work with the results of the VOSTF proposal and the SAPWG Schedule D revamp project.

RRC Comments on "privately structured securities" (2 bullets, 1 with 2 sub-bullets) – Suggest including these in the referral to the NAIC Examination Oversight (E) Task Force for Consideration #10 but also sending to the NAIC Valuation of Securities (E) Task Force for its existing work related to this Consideration.

AIC Comment on "Privately Structured Securities" (6 bullets) – Suggest asking the AIC to follow the work of the NAIC Examination Oversight (E) Task Force and the NAIC Valuation of Securities (E) Task Force and provide comments on specific recommendations if needed.

RRC Comment on the work by the NAIC Life Actuarial (A) Task Force (LATF) – Suggest adopting this recommendation as an addition to the Regulatory Discussion results and sending the referral.

- Recommendation: Since reserves are not intended to capture tail risk, refer this item to the NAIC RBC Investment Risk and Evaluation (E) Working Group and monitor the Working Group's progress.

11. The level of reliance on rating agency ratings and their appropriateness for regulatory purposes (e.g., accuracy, consistency, comparability, applicability, interchangeability, and transparency).
    a. VOSTF has previously addressed and will continue to address this issue. A small ad hoc group is forming (key representatives from NAIC staff, regulators, and industry) to develop a framework for assessing rating agency reviews. This will be a multi-year project, will include discussions with rating agencies, and will include the inconsistent meanings of ratings and terms.

Regulator discussion results:

- Regulators agreed to monitor the work of the ad hoc group in lieu of any specific recommendations at this time. Recognizing this will likely be a multi-year project, regulators reserve the right to raise specific concerns that may arise as the various NAIC committee groups work to address this list of considerations.

12. The trend of life insurers in pension risk transfer (PRT) business and supporting such business with the more complex investments outlined above. (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. **LATF has exposed an Actuarial Guideline** 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). Comment period for the 2nd exposure draft ends on May 2.

    Regulator discussion results:

    - Regulators focused on the need to have disclosures on the risks to the General Account from the Separate Account PRT business – for guarantees but also reporting/tracking when the Separate Account is not able to support its own liabilities. Regulators noted the need to address the differences between buy in PRT transactions and buy out.
    - Regulators are comfortable LATF is addressing the reserve considerations. To address the disclosure considerations, regulators support sending a referral to the Statutory Accounting Principles (E) Working Group since regulators suggested it be an item in the Notes to Financial Statements. (Regulators noted it might help to discuss such disclosure concepts with LATF's Valuation Manual 22 (A) Working Group.)
        - While the exposed AG is not limited to PRT, and general disclosures may be helpful, regulators recognized additional and/or more specific disclosures may be needed for PRT business.

    b. Review applicability of Department of Labor protections resulting for pension beneficiaries in a PRT transaction.

    Regulator discussion results:

    - Regulators discussed concerns regarding potential differences between the pension benefit and the group annuity benefit in the PRT transaction.
    - Regulators directed NAIC staff to further research this item for the MWG to address in the near future, including potential discussions with Department of Labor representatives.

    c. Review state guaranty associations' coverage for group annuity certificate holders (pension beneficiaries) in receivership compared to Pension Benefit Guaranty Corporation (PBGC) protection.
        i. NOLHGA provided 2016 study of state guaranty fund system vs. PBGC.

    Regulator discussion results:

    - Regulators recognized the difficulty in comparing the state guaranty system to the Pension Benefit Guarantee Corporation, as detailed in the NOLHGA study. However, they agreed policyholders should appreciate the benefit of having solvency regulators actively monitoring and working with the insurance companies in an attempt to prevent the need for any guaranty fund usage, as standard corporations holding pension liabilities have significantly less regulatory oversight.

- Regulators found the NOLHGA study responsive to this consideration, thus they suggested no further action.

d. "Considerations have also been raised regarding the RBC treatment of PRT business."
Regulator discussion results:
- Regulators recognized the work of the Longevity Risk Transfer (LRT) Subgroup of the Life Risk-Based Capital (E) Working Group covers PRT business. A new LRT charge was included in the 2021 Life Risk-Based Capital (LRBC) formula. Regulators agreed the results of this new charge should be monitored.
- While regulators agreed to follow the work of the LRT Subgroup, they suggested no further action at this time.

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.
    a. LATF's exposed AG was modified to require the company to provide commentary on reinsurance collectability and counterparty risk in the asset adequacy analysis memorandum. The original concept of requiring life insurers to model the business itself even if it uses these mechanisms to share/transfer risk was deferred to allow time to consider and address concerns over potential violations with EU/UK covered agreements and the 2019 revisions to NAIC Models 785 and 786.

Regulator discussion results:
- Regulators held candid conversations about the need to understand why insurers are using these types of offshore reinsurers. If there are problems in the U.S. regulatory system that are driving insurers to utilize offshore reinsurers (e.g., "excess" reserves), we should know of those problems so we can consider if there are appropriate changes to make.
- If there are other drivers, per the common theme in the regulators' review of this list of considerations, there isn't a presumption that the use of these transactions is categorically bad. Rather, there is a need to understand the economic realities of the transactions so the regulators can effectively perform their solvency monitoring responsibilities.
    - Regulators discussed the potential concept of additional Holding Company Act requirements if these are affiliated reinsurers, disclosing the insurer benefits (reserves, capital, etc.).
- Regulators deferred specifying action on this item at this time, instead noting the desire to have meetings with industry representatives using these transactions and regulators from some of the offshore jurisdictions to gain more insights.

Northwestern Mutual Comment (2 cautions) – Suggest including these cautions as part of the MWG's future discussions and work for this Consideration.
- Caution: Reinsurance transactions can and often do serve a valuable function by reallocating risk. However, offshore reinsurance can also result in lower total reserves and capital, reduced state regulatory oversight, and diminished stakeholder transparency from what would be required by the statutory accounting and risk-based capital requirements the NAIC has established to protect policyholders in the United States.

- Caution: Without progress and action on the item pertaining to offshore reinsurance, the Working Group's progress on other MWG Considerations could further incentivize even more utilization of offshore reinsurance transactions and undercut the NAIC's efforts to close other solvency regulatory gaps domestically. In the long run, a system that encourages companies to transfer business to a related offshore entity in order to alter their reserves and capital from uniform standards diminishes the strength of reserve and capital regulation in the United States. If capital standards are deemed to be too conservative in the US, they should be addressed transparently and uniformly through the NAIC and not through the alternate means of offshore reinsurance.

- **Additional regulator discussion result:**
  - Similar to the result of discussions for the 13th consideration, regulators expressed a desire to meet with various industry representatives to discuss the incentives behind private equity ownership of insurers and conversely the concerns other industry members may have with such ownership. Regulators believe the insights from these conversations will benefit their ability to monitor and, when necessary, contribute to the work occurring in the various NAIC committee groups regarding these considerations.