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

-Plan adopted by FSTF/MWG on June 27, 2022

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. Interested party comments are included in purple font and are followed by the regulators' decision on how to address the comments.

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) – These bullet points will be included 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) – These two items will be included 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) – Regulators asked 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) – These bullet points will be included 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) – These comments will be included 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 bullet points) – These bullet points will be included 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 sent 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.
- 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. (Regulators adopted this recommendation from the RRC comment letter.)

RRC Comments on "privately structured securities" (2 bullet points, 1 with 2 sub-bullets) – These bullet and sub-bullet points will be included in the referral to the NAIC Examination Oversight (E) Task Force for Consideration #10 but also sent 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) – Regulators asked 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.

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) – These cautions will be included 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.