

NAIC Task Force Adopts Revised “Regulatory Considerations Applicable (But Not Exclusive) to Private Equity (PE) Owned Insurers”

June 30, 2022

The National Association of Insurance Commissioners (“NAIC”) Financial Stability (E) Task Force (“Task Force”) and Macroprudential Working Group (“MWG”) jointly met on June 27, 2022 to discuss and adopt the revised list of “Regulatory Considerations Applicable (But Not Exclusive) to Private Equity (PE) Owned Insurers” (“Regulatory Considerations”), a copy of which is available as Attachment B to the joint meeting materials [here](#).¹ The most recent revisions to the Regulatory Considerations are annotations reflecting recent regulator discussions of the issues and comments submitted by interested parties.

REGULATORY CONSIDERATIONS

Background

As we discussed in the “Insurance” section of our 2021 year-end Private Equity Report [here](#), many of the Regulatory Considerations were raised and addressed years ago by enhancing disclosures and state insurance regulators’ tools; however, the interaction of private equity firms and insurers became a topic of increased focus again for U.S. state and federal regulators in 2021 in response to a growing number of complex transactions, including acquisitions of, or investments in, insurers by private equity firms. In its year-end 2020 special report, the NAIC Capital Markets Bureau noted a sizable increase in the number of insurers (particularly life insurers) acquired by private equity firms. Similarly, the Federal Insurance Office observed in its September 30, 2021 annual report the rapid increase in private equity owned life insurers in the insurance industry.

On September 30, 2021, the Task Force received a presentation regarding private equity activity in the insurance industry and discussed ways to address regulators’ questions and considerations regarding transactions involving private equity owned insurers. In

¹ Although the posted version of the Regulatory Considerations states “The proposed regulator responses are exposed for a 45-day comment period,” that notation was from before the June 27, 2022 meeting, and such comment period has passed.

response to the presentation, the Task Force charged the MWG with coordinating with state regulators and interested parties to develop the Regulatory Considerations.

The MWG prepared a draft of the Regulatory Considerations, which the Task Force voted to expose on December 7, 2021 for a 30-day comment period ending January 18, 2022. The MWG adopted the Regulatory Considerations on February 1, 2022, and the Task Force adopted the Regulatory Considerations on February 22, 2022. On April 5th, the MWG and the Task Force reported that the Regulatory Considerations had been updated following conversations with other NAIC working groups and a regulator-only discussion. On April 27th, the Regulatory Considerations were exposed for a 45-day comment period ending June 13th.

The Regulatory Considerations are summarized as follows:

- insufficient transparency to regulators of risk due to holding company contracts and affiliated or related party agreements being structured to avoid regulatory disclosures and approval requirements;
- control via means other than 10% or more voting security ownership, such as board seats and management representation, and contract rights, including non-customary minority shareholder rights or covenants;
- investment management agreements, including whether they are arm's length, the amount of investment management fees (with excessive fees to a related party suspected as essentially being unauthorized dividends), obstacles to termination (*i.e.*, onerous or costly termination provisions), or excessive control or discretion given to the investment manager over investment strategy and its implementation;
- misalignment of investment interests of owners, including owners focusing on short-term results despite the long-term nature of liabilities in life products, and being unwilling to transfer needed capital into a troubled insurer;
- operational, governance and market conduct practices of an insurer being impacted by the different priorities and level of insurance experience possessed by entrants without prior insurance experience into the insurance market, including reliance on third-party administrators, which may lead to adverse results for policyholders;
- no uniform or widely accepted definition of "private equity" and challenges in maintaining a complete list of insurers' material relationships with private equity firms;

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- the need to better identify related party-originated investments (including structured securities such as collateralized loan obligations that may create exposure to private equity portfolio companies) that may create potential conflicts of interest and excessive or hidden fees in the portfolio structure;
 - the need for enhanced insurer investment and collateral reporting, including categorization of investments (such as qualifying bonds and asset-backed securities)—regulatory disclosures may be required to identify underlying related party investments and/or collateral within structured security investments;
 - disclaimers of affiliation avoiding current affiliate investment disclosures—a new Schedule Y, Pt 3 (which is in effect for year-end 2021) will identify (i) all entities with greater than 10% ownership (regardless of any disclaimer of affiliation) and whether there is a disclaimer of control/disclaimer of affiliation and (ii) the ultimate controlling party;
 - material increases in insurer investments in privately structured securities (both by affiliated and non-affiliated asset managers), increasing credit risk and introducing other risks, such as complexity risk and illiquidity risk, and reducing transparency;
 - reliance on rating agency ratings and their appropriateness for regulatory purposes;
 - life insurers engaging in pension risk transfer (“PRT”) business and such business being supported by the more complex assets (often private equity-related) if they do not perform as the company expects, and the need for stress testing and best practices for valuation of non-publicly traded assets and the need for considering risk-based capital treatment for PRT business; and
 - insurers’ use of offshore reinsurers (including captives) and complex affiliated sidecar vehicles to maximize capital efficiency and introduce complexities into the group structure.

Additionally, the adopted Regulatory Considerations include the following regulator discussion result (which was described as essentially a 14th consideration):

[R]egulators discussed 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.

The MWG and then the Task Force adopted the Regulatory Considerations without any votes in opposition. The Regulatory Considerations include references to recent and continuing work by other NAIC task forces and working groups (such as recent details added to financial statement schedules and a currently exposed actuarial guideline) and recommendations from regulators and interested parties for referrals for further work to be done by other NAIC groups. We expect the Task Force to report its adoption of the revised Regulatory Considerations to its parent committee, the NAIC Financial Condition (E) Committee, for approval at the latter's next scheduled meeting on July 21, 2022.

Historically, referrals to other NAIC groups, such as those in the Regulatory Considerations, need not escalate with the NAIC for approval before they are made. Once a referral is made, the receiving task force or working group generally determines whether the given task fits within the task force or working group's existing charges. If it does, the group generally will take up the task unless it is determined that another task force or working group is better suited to it. If it does not, charges may need to be revised (which generally requires approval from at least the parent letter Committee level above).

Implications of the NAIC Considerations

The Regulatory Considerations highlight insurance regulators' view that they need additional information with respect to certain transactions involving insurers, including those between minority investors and insurers. States' insurance holding company acts and regulations (which are substantially similar to the NAIC models) have always provided approval, non-disapproval and notification rights regarding controlling and affiliated parties based on "control," which is generally presumed at direct or indirect ownership of 10% or more of the voting securities of an insurer, although control can also be found in other ways and based on a combination of factors (indicia of control), including by contract or otherwise. As we discussed [here](#), on April 19, 2022, the New York State Department of Financial Services issued Circular Letter No. 5 to all New York-domiciled insurers and other interested parties describing how DFS interprets "control" under the New York insurance law for transactions with insurers. The Regulatory Considerations note that the Circular Letter was distributed to MWG members and interested regulators.

CONCLUSION

The Regulatory Considerations do not present substantive rules or regulations, but rather present principles and some discussion of them for further work to be done by other NAIC working groups and task forces. Also, the inclusion of an item in the

Regulatory Considerations does not mean that the NAIC or state insurance regulators necessarily will take action on that item, and it is too early to determine whether the Regulatory Considerations will result in significant changes to current regulatory requirements and processes. Rather, the Regulatory Considerations reflect regulators' focus on the increasing complexity of transactions in recent years (including, as the document's title suggests, transactions not involving private equity) and an inquiry into whether current documentation and disclosure requirements adequately enable regulators to identify and assess risks of insurers. Such risk assessment is part of insurance regulators' role in monitoring and regulating insurer solvency.

To the extent regulatory changes are identified from further work to be done based on referrals in the Regulatory Considerations by the various NAIC groups of regulators, such changes could include amendments to the analysis handbooks regulators use, or even the development or amendment of model laws or regulations (such as the insurance holding company acts or regulations), which in turn would need to be adopted by the states to become effective. It is worth noting that any interested parties who have not had an opportunity to comment on the Regulatory Considerations will have the opportunity to comment on further work at the NAIC to carry out the referrals.

We will continue to monitor developments in this regard.

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Please do not hesitate to contact us with any questions.

NEW YORK



Marilyn A. Lion
malion@debevoise.com



Marshal L. Bozzo
mlbozzo@debevoise.com



Thomas A. DeMarzo
tademarz@debevoise.com