Memo

To:	Justin Schrader, Chair, Macroprudential (E) Working Group Marlene Caride, Chair, Financial Stability (E) Task Force
From:	Tricia Matson, Partner and Edward Toy, Director
Date:	January 3, 2022
Subject:	RRC comments regarding Regulatory Considerations Applicable (But Not Exclusive) to PE Owned Insurers

Background

The Macroprudential (E) Working Group (MWG) and Financial Stability (E) Task Force (FSTF) exposed for comment a set of 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 and/or FSTF 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 that the considerations are not unique to PE owned insurers, and most, if not all, of the considerations could also apply to a non-PE owned insurance entity.
- We have the following specific comments on individual Considerations:
  - Regarding items 2 and 3, there has been significant growth in the reliance of insurers on investment managers outside of the insurance legal entities. Those investment managers may be unaffiliated, affiliated through a holding company, or formerly affiliated through a prior owner. In addition to the concerns expressed in your Considerations, there may be inadequate protections for the insurer, and therefore the policyholders, against various conflicts of interest or the investment manager engaging in investment practices that are not in the best interest of the insurer. This includes inappropriate or excessive trading, and cross trading with the investment managers other clients.
  - Regarding item 4, we agree with the consideration, and suggest also explicitly mentioning asset-liability management. We have found in some cases that increasing short term yields has resulted in insufficient consideration of longer-term management of asset and liability cash flows and economic characteristics (such as duration).

- Regarding item 6, we generally agree that a PE definition may not be required since the considerations should apply beyond PE owned insurers. We also believe that attempts to define a PE relationship or focus on only a narrow group of transaction types would only lead to efforts to work around the definition or migrate to other transaction types. A more principles-based approach would serve to mitigate this possibility.
- Regarding item 8, we have experienced situations where parties have argued that transactions are not affiliated by relying on highly nuanced technicalities. We suggest that the guidance could be revisited to ensure that it is principles-based and encompasses all intended transactions.
- Regarding item 10, we note that there are several asset classes that present unique challenges due to their complexity, opaqueness, volatility and illiquidity. This includes both private and public securities; structured securities and structured notes, investments reported on Schedule BA, and different kinds of mortgage loans. While these complex investments can provide benefits to the insurer and the policyholder (typically in the form of higher yields), it is critical that the reserves and capital supporting the business appropriately take the additional risk exposures into account.
- Regarding item 12, we agree with the commentary but note that the exposed LATF comments regarding an Actuarial Guideline may cover the issue of complex investments and their treatment in reserves across multiple product lines, and not just pension risk transfer. We believe it is appropriate to develop guidance on the treatment of complex assets in reserving for all products, as we have seen the use of private investments and structured securities in a wide range of product types, and the risk associated with them is not always captured in determining if reserves are adequate.

- We have the following potential additional considerations that the MWG and FSTF may wish to incorporate into the work:
  - Corporate governance may be structured such that decision making resides in a small number of individuals, whose interest may conflict at times with policyholder interests. For example, if Board members have a narrow background that does not adequately cover insurance (including insurance company investments) knowledge, or if there is not an adequate ability for second line (ERM) and third line (internal audit) to effectively review and challenge management, decisions may focus on short term earnings rather than long term policyholder interests.
  - Conditions that are placed on buyers of insurance businesses during the regulatory review process are sometimes confidential, making it challenging for regulators to achieve consistency across states/deals/companies in the mechanisms used to maintain policyholder protection during the Form A review process.
  - Strategic asset allocations may be designed to maximize yield while minimizing required capital charges, resulting in increased risk without a commensurate increase in capital held to protect against the risk. For example, public equity or lower quality bonds (which have relatively high capital charges for the risk) may be exchanged for more complex assets that may not have capital charges appropriate for the risk. Asset classes and types that have not been significant investments among insurers may not have a long enough history to enable management to truly understand the risk. Additionally, long-dated or illiquid (and therefore higher yielding) investments may be used that result in asset-liability mismatch, a risk that is also not well captured in RBC.

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 or FSTF members have any questions.