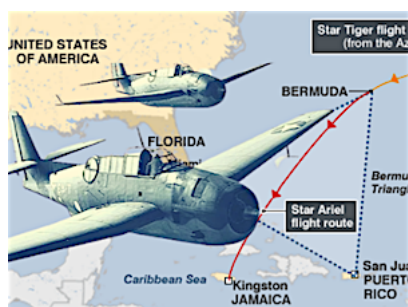


## NAIC Reassures Congress on Private Equity-Led Insurers

By Kerry Pechter     *Fri, Jun 3, 2022*

*Responding to Sen. Sherrod Brown's March inquiry, the association of state insurance commissioners gave high marks to their own oversight of PE-linked life/annuity companies. But the NAIC's 'nothing to see here' message disappointed some.*



Answering Sen. Sherrod Brown's March 2022 request for information about the impact of rising ownership of US life/annuity companies by private equity (PE) firms, the National Association of Insurance Commissioners (NAIC) Tuesday sent an 11-page response letter to Brown. Brown chairs the Senate Committee on Banking, Housing and Urban Affairs.

The NAIC is the national umbrella organization for the 50 state insurance commissioners who supervise the insurers that are domiciled in their states. While the NAIC sets certain standards of supervision, states vary significantly in their regulations and in the rigor of their oversight, with New York State often the most demanding.

In the 14 years since the Great Financial Crisis, there's been a surge of capital from powerful investment companies like Blackstone, Apollo, and KKR into the annuity business—all eager to manage the tens of billions of dollars in Americans' savings that life/annuity companies hold.

These Wall Street firms have acquired life insurers, purchased blocks of annuity assets from life insurers, and assumed liabilities of defined benefit (DB) plans from major corporations. Life insurers and DB plan sponsors, weakened by low yields on their bond investments, often welcomed the capital and the investment management expertise that the asset managers provided.

But the sometimes opaque financial and legal strategies that the asset managers use—including, for instance, the securitization of bundles of high risk loans and the transfer of liabilities to reinsurers in Bermuda—have worried some observers, including Federal Reserve economists who have published academic papers about the potential added risks.

News of those concerns recently reached the Senate Banking, Housing and Urban Affairs Committee, which Brown chairs. In March, he sent letters to the NAIC and the Federal Insurance Office asking to be briefed on the matter. The NAIC's response arrived on May

31, the deadline requested by Brown.

The NAIC replied, accurately, that it has been tracking the PE firms' influence in the life/annuity business. In its Tuesday letter to Brown, the NAIC met Brown's inquiry with assurances that, in effect, there is nothing problematic about PE investment in the life/annuity industry that the commissioners aren't already addressing or aren't capable of properly regulating.

"State insurance regulators are fully capable of assessing and managing the risks of these insurers, and there is nothing PE firms add to the playing field that changes this fact. It should provide you and the public comfort to know the state insurance regulatory system has already been working on many of the concerns that you and others have highlighted, and we possess the tools and resources to address these issues," the letter said.

NAIC CEO Michael F. Consedine, president Dean L. Cameron of Idaho and three NAIC officials signed the letter. It focuses on life/annuity company solvency as the core issue.

The question is whether PE-led life insurers, in search of yields that the Fed's low interest-rate policy has denied them, are over-investing in risky assets that could make a life insurer fail during some future financial crisis. Such failures would threaten the retirement security of millions of Americans.

The risky assets include collateralized loan obligations (CLOs), which resemble the collateralized debt obligations (CDOs) at the center of the 2008 financial crisis. The NAIC letter to Brown conceded, "Some CLOs can carry more credit or liquidity risk or have greater complexity, and as demand for CLOs has increased, there is a potential that underwriting will weaken."

But the NAIC sees no cause for alarm. "However, while the relative size of this asset class for the sector has been growing, it represents only 2.6% of total cash and invested assets at year-end 2020, and most of the investments held by the industry are of a higher quality. The NAIC has performed multi-scenario stress tests on industry CLO portfolios and closely monitors their performance."

But some followers of these matters were rankled by what they perceived as the letter's "nothing to see here" tone.

"The response is certainly no surprise," said Tom Gober, a Virginia-based forensic accountant who has documented the tens of billions of dollars of annuity liabilities that a

handful of PE-led annuity issuers have reinsured offshore, often with affiliated reinsurers. “The NAIC’s leaders apparently huddled around and threw a bunch of points at Brown that, in a vacuum, sound fine. But when you are familiar with the details, the letter is mainly fluff, and grossly inadequate.

“For instance, the letter said that collateralized loan obligations equal only 2% of the life/annuity industry’s *total assets*,” he added. “If you quoted CLO exposure as a percentage of the private equity-led companies’ *surplus*, it would knock Sen. Brown’s socks off.” The surplus is the difference between the current market value of an insurance company’s investments and the estimated present value of what it owes policyholders.

Gober, in collaboration with Pittsburgh-area insurance agent Matt Zagula, created a “Transparency, Surplus and Riskier Assets” (TSR) rating system. So far, private equity-led firms tend to show the highest TSR ratios, which Gober and Zagula consider a red flag for annuity buyers.

The letter’s reassurances have already been interpreted as a polite rebuff to potential federal encroachment on the states’ regulatory turf. A headline the online trade publication, said, “NAIC Rejects Need for Federal Help with Private Equity-Owned Life Insurers.”

The turf battle over state versus federal regulation of insurance has a long history. In 1944, the Supreme Court ruled that the insurance industry, long regulated by the states, was appropriate for federal regulation under the commerce clause. But the industry rebelled, and the NAIC proposed a compromise, which was tweaked into the McCarran-Ferguson Act of 1945.

The Act permitted the individual states to regulate the “business of insurance” within their borders. Crucially, the law also gave insurance companies exemption from federal anti-trust laws. But the act created some ambiguity by not defining the “business of insurance.” The Dodd-Frank Act of 2010 created the Federal Insurance Office to monitor the insurance sector, but not to regulate it.

The line between the insurance business and the federally regulated investment business has never been well-defined, and it is arguably even less so today. Many former mutual insurance companies have converted to federally regulated stock companies. Waves of mergers and acquisitions have concentrated the sales of life insurance and annuities within a group of giant financial services firms who do both insurance and investment business.

The line is particularly blurry in the arena where private equity-led or asset manager-led

insurers sell annuities. PE firms specialize in managing the assets of life/annuity companies—that is, the investment of policyholder savings. The savings product that PE-led life/annuity companies most often sell to the public—the fixed indexed annuity—so resembles an investment that the Securities and Exchange Commission and the Department of Labor, in 2007 and 2016, respectively, have tried to wrap some regulation around it. Both times, the life insurance lobby rebuffed their efforts.

Today, the majority of the \$73.5 billion in fixed indexed annuities sold in the US are sold by PE-led or PE-affiliated life/annuity companies like Athene, AIG, Fidelity and Guaranty Life, Global Atlantic, Sammons Financial Group, and Security Benefit Life. Their influence over the annuity industry has steadily grown.

In short, there is much more to be said about PE influence over the individual and group annuity businesses than the NAIC's letter to Sen. Brown would lead the casual reader to suspect. The letter left many important questions unexplored and unanswered.

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