May 31, 2022

The Honorable Sherrod Brown
Chairman
U.S. Senate Committee on Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Brown:

Thank you for your interest in the growth of alternative asset management companies, private equity (PE) firms among them, in the life insurance sector, and in particular, the impact on pension risk transfers (PRT). Before delving into the insurance aspects of your inquiry, your focus on the demise of pensions and why those retirement obligations are increasingly transferred to life insurers deserves some attention and context. As Chairman of the Banking Committee, you know well the long decline of private defined benefit plans as a pillar of American retirement security. The reasons for this decline are complex but have been well documented by others and explored by Congress.

For the purposes of your inquiry however, we can use the hypothetical example of a large national employer that is in financial trouble, trending toward bankruptcy, with a large, diverse workforce f gr gpf kpi ''qp''vj cv''go r nq{ gtøu''r gpukqp''r ncp''cu''vj g''r tgf qo kpcpv''uqwteg''qh''vj gkt''tgvktgo gpv''kpeqo g0'' Too often in this scenario, the pension plan is underfunded, managed by a company treasurer or CFO whose attention is focused on a broad array of competing corporate interests, with little expertise in assessing credit and market risk decades into the future or managing the longevity risk of a workforce spread across the country. If the company fails or if the plan is too underfunded to sustain, it can be transferred to the Pension Benefit Guaranty Corporation (PBGC) where almost certainly plan participants will see significant benefit reductions. Even if the company is in good health and the plan is well-funded, as retirees live longer, they draw benefits for longer, and if coupled with a workforce that shrinks or stagnates due to automation, globalization, or other factors, the company may recognize the unsustainable trajectory of the plan and the demands of managing it placed on its management team.

While a hypothetical, this scenario is not hard to imagine and has indeed played out across the country as defined benefit plans are now an option for just 16% of private sector employees compared to 60% just a few decades ago, according to the U.S. Bureau of Labor and Statistics. Regardless of the reasoning or rationale, when a company exits its defined benefit plan, it will

either offer a lump sum to its retirees or turn to the one sector with experience managing longevity risk: life insurers.

To be clear, we are not attempting to defend or rationalize the demise of traditional pensions, and we can certainly appreciate the apprehension of those retirees or future retirees when they see their retirement security being transferred from their employer to an insurance company they might have no relationship with. What we can say for certain, however, is that if a life insurer steps in, state regulators step up, and subject that insurer to a full suite of solvency monitoring tools and requirements to ensure that it will be there to honor those commitments, regardless of its ownership structure.

Life Insurance Regulatory Approach

Turning more specifically to insurance regulation, it is important to remember that any insurer, regardless of its ownership struc

Life Insurance Ownership Transactions with Private Equity Firms

With this overview of relevant regulatory practices in mind, we can turn more specifically to the growth of PE ownership of life insurers. Life insurers are long term investors who aim to match the duration of their invested assets with their liabilities, typically investing in high quality fixed income securities. Life insurers must produce enough yield from their investments to keep pace with benefits and obligations embedded in policies that can stretch out decades into the future, while not running afoul of the financial conservatism regulators expect to preserve solvency. This task has been made more challenging over the past decade due to the prolonged low interest rate environment, particularly for the very securities life insurers tend to favor, putting pressure on the whole sector regardless of ownership structure.

Life insurers have taken different approaches to mitigating this pressure, but the two main options are either raising premiums, which can put lifetime income protection out of reach for some consumers, or taking on more risk in their investment portfolios in a search for yield, which can create new pressures and regulatory scrutiny on their business. One other option is to shrink or exit from either more capital intensive or less profitable blocks of business. It is in part this reality that is driving PE and alternative asset manager interest in the sector ó

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.

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 the 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.

Over time, as transactions were reviewed and regulators had discussions with the board and management of these firms, some of our initial concerns were reduced as PE firms either retained or brought on long-tenured insurance finance professionals and demonstrated they were in this industry for the long-term. NAIC members agreed that the additional stipulations should be included in the NAIC Financial Analysis Handbook for consideration of future PE acquisitions. The NAIC Financial Analysis Handbook is a process manual used by every state insurance regulator when performing periodic, regular analyses of insurers as well as for special purpose reviews when dealing with a group that may have a greater amount of credit, market, or liquidity risk as a result of its investment strategy.

Regulators have been paying close attention to the increase in credit, market, and liquidity risk in

The long-term nature of typical life insurance products increases the regulatory concerns around

Vj g"HUVHøu"eqpegtpu"hqewu"qp"vj g"tkumu"vj g"dtqcder economy can pose to the insurance industry cu"y gm"cu"vj g"r qvgpvkcn"hqt"qwi qkpi "tkumu"htqo "vj g"kpuwtcpeg"kpf wuvt{."J qy gxgt."õuj cf qy "dcpmkpi ö" is a much broader universe of activity. For this reason, the Financial Stability Oversight Council (FSOC) pulls together the regulatory community to direct attention at these activities and the impact on the broader economy. The State Insurance Commissioner Representative to FSOC also serves a leadership role in the NAIC FSTF. In this manner, the state insurance rgi wncvqt{ "u{ uvgo øu" macroprudential agenda at FSTF stays engaged in the concerns of the broader economy and eqpvtkdwvgu"kpuwtcpeg"tgi wncvqt{ "kpuki j vu"cpf "gzr gtvkug"vq"HUQEøu"y qtm0

4. In cases of pension risk transfer arrangements, what is the impact on protections for pension plan beneficiaries if plans are terminated and replaced with lump-sum payouts or annuity contracts? Specifically, how are protections related to ERISA and PBGC insurance affected in these cases?

The National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) 2016 tgr qtv"vkvngf ."õEqpuwo gt"Rtqvgevkqp"Eqo r ctkuqp"ó The Federal Pension System and the State Kpuwtcpeg"U{ uvgo .ö"ur gcmu"f ktgevn{ "vq" vj ku"s wguvkqp0"Vj g"Gzgewvkxg"Uwo o ct{ "qh"vj ku"tgr qtv" indicates that consumer protections for affected individuals shift from the pension system to the insurance system when an employer purchases annuity contracts to fund its pension plan. It goes on to say:

> Even though both systems focus on payer solvency, insurance regulation generally holds life insurance companies to stricter financial standards and more intensive oversight than are applied by pension regulation to single-employer pension plans. As one significant difference, although ERISA places the ultimate funding responsibilkv{ "qp"c"r gpukqp"r ncpøu"ur qpuqtkpi "go r nq{ gt." ERISA gives pension regulators no control over the financial condition of the sponsoring employer. Pension plan funding is often, but not always, consistent y kvj "vj g"r ncp"ur qpuqtøu"hkpcpekcn"eqpf kvkqp."cpf "hqt"uome purposes pension plan funding levels may fall to as low as 80% of plan liabilities before triggering certain adverse consequences under federal law. ERISA plan sponsors are not meaningfully regulated for solvency, whereas constant solvency regulation is the primary focus of insurance regulation.

Specific to the failure resolution processes and on the financial safety nets provided under each of the two systems, the report says:

> In the pension system, the PBGC guarantees pension benefits, within statutory limits. The PBGC receives its funding from insurance premiums charged to active pension plans, investment income, the assets of insolvent plans it takes over, and some additional recoveries against plan sponsors. It receives no direct funding from general tax revenues, and its obligations are not backed by the full faith and credit of the United States. In the insurance system, each state has created a guaranty association (GA) under state law to protect annuity and life insurance benefits for its residents (within statutory limits) as part of a comprehensive insolvency process for failed insurers that allocates a failed kpuwtgtøu"tgo ckpkpi "cuugvu"vq"vj g"I Cu"cpf "vq"vj g"r qnke{ j qnf gtu"*hqt"dgpghkvu"pqv"

covered by the GAs) as priority creditors on the same priority level. . . . Like the PBGC, the GAs are not directly funded by tax dollars and are not backed d{"cp{"uvcvgøu"hwnn"hckvj"cpf"etgfkv0

The safety net mechanisms differ in significant respects from system to system,

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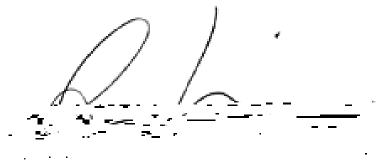
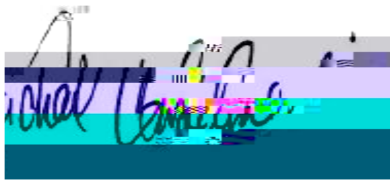


Andrew N. Mais (He/Him/His)
NAIC Vice President
Commissioner
Connecticut Insurance Department

Jon Godfread
NAIC Secretary-Treasurer
Commissioner
North Dakota Insurance Department



Michael F. Consedine
Chief Executive Officer
National Association of Insurance Commissioners