To: Justin Schrader, Chair, Macroprudential (E) Working Group and Marlene Caride, Chair, Financial Stability (E) Task Force

Cc: Todd Sells (tsells@naic.org), and Tim Nauheimer (tnauheimer@naic.org)

Date: June 13, 2022

Re: UNITE HERE Comments on First Six Regulatory Considerations Applicable (But Not Exclusive) to PE Owned Insurers

Thank you for this opportunity to comment on the first six of the Regulatory Considerations Applicable (But Not Exclusive) to Private Equity (PE) Owned Insurers. We applaud the NAIC officers and staff as well as members of the Macroprudential (E) Working Group and the Financial Stability (E) Task Force for their thoughtful consideration of this complex and controversial topic.

For the most part, as regulators on both task forces have noted, the Considerations reflect concerns that are neither new nor emergent. Large private equity firms have been involved in the life and annuity business for well over a decade.

Nor is this the first time the NAIC or individual state regulators have raised concerns about how private equity firms have altered the life insurance landscape. For example, in 2013, New York Department of Financial Services Superintendent Benjamin Lawsky issued a report that raised concerns about the quality of the investments backing annuity reserves at PE-affiliated insurers and called for reforms to prevent insurers from using offshore reinsurance affiliates to “artificially inflate” their reported levels of risk-based-capital.[1]

That same year, when the Iowa Insurance Division held hearings in conjunction with Apollo’s application to purchase Aviva’s US operations, UNITE HERE provided testimony raising concerns about Apollo’s use of a Bermuda-based reinsurance affiliate and how that arrangement might affect reported RBC ratios for its US affiliates; the level and complexity of asset management fees Apollo charged its regulated insurance affiliates; and the relatively large percentage of related-party investments on those insurers’ books. We urged then-Commissioner Nick Gerhardt to require Athene to enter into a capital maintenance agreement, limit Athene’s ability to invest in Apollo-managed products and limited partnerships, and conduct on-going targeted examinations of Apollo’s investment strategies.[2]

One of our concerns (regarding Athene’s ability to continue Aviva’s “permitted practice” with respect to reserving methodologies for deferred annuities with embedded guarantees) was addressed as one of four “conditions” imposed by Commissioner Gerhart in his subsequent Order approving the acquisition.[3] The remaining three of these conditions were substantially similar to “stipulations” included in the 2013 guidance cited by the Task Force in its response to Consideration 1 (see below.) But even with these conditions/stipulations, the potential risks to annuity policyholders posed by Apollo’s “spread investing” model have, in our view, only grown larger.

Athene has become Apollo’s fastest engine of growth, essentially quadrupling its assets under management since the Aviva acquisition.[4] At yearend 2021, Athene claimed the number one market share in US fixed indexed annuities.[5] Athene has also become the largest player in the Pension Risk Transfer (PRT) market,[6] assuming responsibility for paying the monthly benefits and managing retirement assets for more than 300,000[7] workers and retirees who were beneficiaries of pension plans

sponsored by companies including J.C. Penney, Lockheed, Alcoa, and Lumen Technologies. Following these "buyout" PRT transactions, workers and retirees lose the ERISA rights and PBGC protections they previously held as pension beneficiaries.

Additionally, Apollo and or Athene has over the past decade acquired or created at least ten non-bank lender affiliates, most of which operate outside the purview of prudential regulation.[8] According to an October 2021 presentation, Apollo estimated that these "origination platforms" will generate $25 billion annually in origination volume.[9] This includes leveraged loans and commercial leases to private equity firms, small and medium sized businesses, airlines, and homebuyers around the world. Those loans and leases are then packaged into Collateralized Loan Obligations (CLOs) or other Asset Backed Securities (ABS) and sold to Apollo's state-regulated insurance units, as well as to Apollo's institutional clients, managed funds and third parties. At yearend 2021, approximately $34.9 billion or 14.8% of Athene's total assets were invested in these and other related party investments.[10] Apollo has referred to this arrangement as a "virtuous feedback loop," whereby CLOs and ABS backed by loans and leases originated by Apollo affiliates increase the firm's fee-generating opportunities and allow Apollo's insurance companies as well as its clients to "manufacture spread", i.e., garner investment spreads that Apollo says have been 100 to 200 basis points higher than those available from the broadly syndicated market.[11]

Apollo's much-touted success in fashioning Athene as a "permanent capital vehicle" for fee-generating asset management has spawned a bevy of private equity-affiliated imitators,[12] transforming what we and others once viewed as a potential retirement security concern affecting a few thousand annuity owners into a much broader macroprudential challenge. Managing the systemic risks posed by this new breed of global life insurance asset manager in our view will depend upon the coordinated efforts of state, federal and international regulators.

What follows are our specific comments on the Task Force's responses to the first six Considerations.

Consideration 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).

The Task Force's response to this consideration was to cite guidance that was added to the NAIC Financial Analysis Handbook in 2013 to assist regulatory reviews of merger and acquisition proposals (aka Form A Applications.) The 2013 guidance provided "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."

UNITE HERE supports the notion of regulators having more rather than fewer tools to monitor solvency, and we can imagine scenarios in which all of the stipulations listed by the Task Force in their response to Consideration 1 could be useful tools in the context of proposed mergers and acquisitions. We note, however, that the Financial Analysis Handbook contains voluntary guidance, not regulations with the force of law.

Moreover, it is difficult for the public to assess how effective such stipulations may be given the opacity of regulatory merger review. Since the stipulations cited by the Task Force were added to the Handbook nine years ago, it would be helpful to know the extent to which they have been used, and whether regulators believe they have proven to be useful tools for monitoring solvency and protecting policyholders. For example:

- In how many instances since 2013 were stipulations attached to merger approvals?
- Which stipulations were most commonly used?
- How often have regulators imposed stipulations that require on-going monitoring and/or reporting? Has such monitoring and reporting helped regulators detect potential problems?
- When stipulations required periodic reports from an insurer or its parent, were those reports made available to other state regulators? Were they made available to the public?

The NAIC maintains a Form A database so presumably answering these questions would not be overly time consuming. In any event, without such answers, it is difficult to evaluate whether the 2013 stipulations could be useful tools in uncovering the types of hidden risks or undisclosed related party agreements referenced in Consideration 1.

Consideration 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.

The Task Force decided to refer this item to the NAIC Group Solvency Issues (E) Working Group, and suggested that the Working Group "consider if Form B (Insurance Holding Company System Annual Registration Statement) disclosure requirements should be modified to address these considerations."

We do not have an opinion about this recommendation, other than to note that in many states Form B Annual Statements are held to be confidential documents exempt from state open records laws and procedures, making it difficult for the public to form an opinion as to whether they could be, or ever have been, effective regulatory tools.[13]

Consideration 3: The material terms of the IMA [Investment Management Agreements] 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.

The Task Force decided to refer this item to the NAIC Risk-Focused Surveillance (E) Working Group, and suggested that the Working Group "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." They

further suggested "addressing pushback on obtaining sub-advisor agreements as Form D disclosures and some optional disclosures for the Form A."

UNITE HERE has no opinion on this recommendation, other than to observe that merger applications offer a limited window during which to make inquiries and procure information about asset management arrangements entered into by life insurers. Such arrangement and agreements can and presumably do change over time. Aside from Form A reviews and routine Form D disclosures, what tools do regulators have at their disposal to monitor on an on-going basis asset management agreements, including fee arrangements and sub-advisor agreements?

Intra-company agreements within an insurance holding company or group can be particularly opaque to regulators, policyholders and the public-at-large. For example, the securities lending program that contributed to AIG's insolvency and the subsequent Federal Reserve Board bailout of AIG's life insurance units in the wake of the 2008 financial crisis was run not by personnel employed by AIG's state-regulated life insurers, but by senior executives at the parent company level.[14] Similarly, substantially all of Athene's investing activities are conducted not by employees of Athene's state-regulated insurance units in Iowa, New York or Delaware, but by El Segundo, CA-based Athene Insurance Solutions, a non-insurance subsidiary of Apollo Global Management.[15]

To the extent regulators do have access to investment management contracts, parental guarantees or other intra-company documents, we believe those documents should be made available to the public as well as to rating agencies so annuity consumers can better understand the incentive structures and/or potential conflicts that may arise pursuant to such agreements.

Consideration 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.

The Task Force noted that this topic is already under the purview of the Life Actuarial (A) Task Force (LATF) insofar as the work of that group is to help "ensure the long-term life liabilities (reserves) and future fees to be paid out of the insurer are supported by appropriately modeled assets." Regulators also recommended referring this consideration 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." The regulators suggested this Working Group should consider: what are the appropriate entities to provide capital maintenance agreements and how can such agreements be made stronger?

UNITE HERE considers the Task Force response to this consideration to be non-responsive. Consideration 4 in our view requires a historical analysis that answers the questions embedded within it. Have some insurers been focused more on short-term results which may not be in alignment with the long-term nature of liabilities in life products? Are there specific examples of investment management fees paid to an insurer's affiliate that regulators consider to be not fair or reasonable or that "effectively act as a form of unauthorized dividend"? Have there been instances when upstream owners have been unwilling to transfer capital to a troubled regulated affiliate? Without answers to these questions, it is

difficult for the public to understand whether or to what extent regulators are concerned about these issues or are interested in devising more effective tools for managing these potential risks.

Consideration 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 [third party administrators] 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.

In response to this consideration, the Task Force noted that "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)." The task Force also made various other suggestions including that regulators consider optional Form A disclosures and guidance for less experienced states.

UNITE HERE has no opinion about these recommendations except to note again that the Financial Analysis Handbook provides guidance that states can choose to follow or not, and that Form A application process provides a limited time period for monitoring TPAs or tracking actual performance of operational competencies and customer service.

Consideration 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.

The Task Force response to this consideration was that "regulators do not believe a PE definition is needed, as the considerations are activity based and apply beyond PE owners."

UNITE HERE agrees in principle that regulations and procedures should be activity based, but notes that the spread investment model perfected by Apollo and its private equity peers involves a discreet set of activities that, especially in combination, are markedly distinct from the more traditional investment practices of large life insurance groups founded prior to 2010. Private equity affiliated life insurers have engaged in four main activities that, especially in combination, set them apart from their non-private equity competitors: 1) acquiring large blocks of annuities from other life insurers; 2) replacing a portion of the acquired government and corporate bonds with less liquid asset-backed securities and alternative investments; and 3) entering into investment management agreements and/or sub-advisor agreements with noninsurance PE affiliates; and 4) reinsuring most of their acquired liabilities with Bermuda affiliates, thereby freeing up "excess capital."[16]

Managing growing macroprudential risks will require a coordinated approach

Thank you for this opportunity to provide comments on the first six of the Task Force's 13 Considerations. We look forward to your response to the remaining seven Considerations. We applaud the Task Force's attention to these important questions. Although we understand the NAIC is a deliberative body that seeks to build consensus among state regulators, industry representatives and

other interested parties when developing its model laws and procedures, we are concerned that with respect to this set of issues the process is ill-suited to the urgent task of protecting policyholders (especially group annuity beneficiaries) and the public from the growing macroprudential risks associated with private equity stewardship of life insurance companies.

These are not new risks. Regulators, lawmakers, legal scholars and other academic researchers have been drawing attention to these issues for at least a decade. Many have pointed out that the activities most contributing to that risk – particularly the regulatory and capital arbitrage,[17] and the pursuit of the "illiquidity premium" [18]- frequently take place outside the purview of state insurance regulators or indeed any prudential regulators.

For this reason, we believe that it will ultimately require state, federal and international regulators working together to protect the public from the risks of large life insurer insolvencies and/or contagion to the larger financial system to which they are interconnected.

UNITE HERE would be happy to discuss these concerns with the combined Task Force or staff. Please contact Marty Leary at 703-608-9428 if you have any questions about these comments.

ENDNOTES

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[1] New York State Department of Financial Services, (Benjamin Lawsky),"Shining a Light on Shadow Insurance, June 2013, p.2. http://02ec4c5.netsolhost.com/blog/wp-content/uploads/2013/06/NY-shadow-reinsurance-report-June-2013.pdf

[2] Testimony of Jim Baker, UNITE HERE, before the Insurance Commissioner of the State of Iowa, In the matter of application of Apollo Global Management LLC, Leon Black, Joshua Harris, and Marc Rowan for the approval of a plan to acquire control of Aviva Life and Annuity Company, Aviva of Iowa, Inc., Aviva Re Iowa II, Inc, and Aviva Re Iowa III, Inc., July 17, 2013.

[3] Findings of Fact, Conclusions of Law and Order, In the Matter of Application of Apollo Global Management, LLC, Leon Black, Joshua Harris and Marc Rowan for Approval of a Plan to Acquire Control of Aviva Life and Annuity Company, Aviva of Iowa, Inc., Aviva Re Iowa II, Inc, and Aviva Re Iowa III, Inc., Before the Insurance Commissioner of the State of Iowa, July 2013, p.9. Among the "conditions" placed on Apollo's acquisition of AVIVA were: a five year prohibition on dividends without prior approval from the IID (Condition 1); required prior approval from the IID for deviations in Athene's plan of operations (Condition 2) as well as for transactions with affiliates (Condition 3), and a reversion to Actuarial Guideline 33 for all fixed annuity contracts issued after December 31, 2013 (Condition 4).

[4] Athene Holding reported $240 billion in assets as of March 31, 2022 (see 10-Q for 1Q2022, p.8.) compared to just over $60 billion immediately following the Aviva acquisition. (See: Victor Epstein, "2.6 billion Aviva deal is complete," *Des Moines Register*, October 2, 2013.)
https://www.desmoinesregister.com/story/money/business/1/01/01/26b-aviva-deal-is-complete/2913493/

[5] Apollo Investor Day Presentation 2021, October 2021, p.158.

[6] Apollo Investor Day Presentation 2021, October 2021, p.158.

[7] "Athene Completes Significant Pension Risk Transfer Transaction with JCPenney," Athene Press Release, April 1, 2021. https://www.prnewswire.com/news-releases/athene-completes-significant-pension-risk-transfer-transaction-with-jcpenney-301261013.html

[8] These entities include MidCap, which provides leveraged loans to third party private equity firms ($15b in assets); Redding Ridge, a registered investment adviser specializing in leveraged loans and global CLO management in both the US and Europe ($15b); commercial aircraft leasing companies PK AirFinance and Merx Aviation ($8b in combined assets); Foundation Home Loans, a UK-based let-to-buy specialty lender ($4b); automobile leasing and fleet management company Donlen ($2b); Apollo Net Lease Co., which owns more than 100 triple net lease retail and industrial properties ($2B); Haydock Finance, a UK-based small business lender ($500m); Newfi, a technology-driven mortgage lender ($300m); an agreement to acquire up to 50% of Australian commercial real estate finance company MaxCap ($3B); and an agreement to purchase up to $500 million in senior secured credit facilities and securitized assets originated by Victory Park Capital to companies that aggregate third-party sellers on Amazon and other e-commerce sites. (See Apollo Investor Day Presentation 2021, October 2021, p.107.)

[9] Apollo Investor Day Presentation 2021, October 2021, p.92. "Run Rate" for platforms included on graph.

[10] 2021 Athene Holding 10-K, filed 2/25/2021, p.99.
https://www.sec.gov/ix?doc=/Archives/edgar/data/1527469/000152746922000018/ahl-20211231.htm

[11] Apollo Investor Day Presentation 2021, October 2021, p.106-108.

[12] Blackstone bought FGL in 2017 and Allstate's Life and Annuity businesses in 2020; KKR bought Global Financial Group in July 2020; Ares bought Pavonia Life in 2019 (and renamed it Aspida), and F&G Reinsurance in September 2020; Brookfield bought a 19.9% stake and entered into a strategic partnership with American Equity Investment Life in October 2020; and Sixth Street Partners (formerly an arm of TPG) bought Talcott Resolution in January 2021; see also Alwyn Scott and David French, "U.S. insurance asset sales attract new private equity players, strategies," Reuters, 2/8/2021.
"**https://www.reuters.com/article/us-insurance-m-a/u-s-insurance-asset-sales-attract-new-private-equity-players-strategies-idUSKBN2A811G**
Additionally, in July 2021, Blackstone entered into a long-term agreement with AIG to manage the assets backing AIG's life and annuity policies. Pursuant to that transaction, Apollo paid $2.2 billion for a 9.9% stake in AIG and initially assumed asset management over $50 billion in AIG's assets. See Gottfried, Miriam and Scism, Leslie, "Blackstone Enters Deal to Manage AIG Life and Retirement Assets," *Wall Street Journal*, July 14, 2021.
https://www.wsj.com/articles/blackstone-near-deal-to-manage-aig-life-and-retirement-assets-11626294156
In March 2022, AIG made an S-1 filing with the SEC to begin the process of an initial public offering of its life and retirement business, to be renamed Corebridge Financial. At the same time, AIG announced that AIG's more liquid portfolio comprised primarily of fixed income and private placement securities would be managed by BlackRock. See Masters, Brooke, Fontanella-Kahn, James, Megaw, Nicholas, and Smith, Ian, "AIG files to float its life insurance and asset management business," *Financial Times*, March 28, 2022. **https://www.ft.com/content/56b547e5-82d4-4f8a-b341-39eda8bf9bd5** In its S-1 filing, Corebridge affirmed its "strategic partnership" with Blackrock, pursuant to which Corebridge expected BlackRock to have invested more than $92 billion of the insurer's assets by 2027, "primarily in Blackstone-originated investments across a range of asset classes, including private and structured credit." See Corebridge S-1, filed 3/28/2022, p.5.
https://www.sec.gov/Archives/edgar/data/0001889539/000114036122011373/ny20001795x5_s1.htm

[13] Uniform Certificate of Authority Applications, Public Records Requirements, NAIC, 2/12/2020, found at: https://www.naic.org/documents/industry_ucaa_chart_public_records.pdf
[14] McDonald, Robert and Paulson, Ann, "AIG in Hindsight," *Journal of Economic Perspectives*, Volume 29, Number 2, Spring 2015, p.85.
https://www.aeaweb.org/articles?id=10.1257/jep.29.2.81
[15] Athene Holding 2021 10-K, filed 2/25/2022, p.13.
[16] Through the use of modified co-insurance reinsurance contracts, Athene can lower its required capitalization and thus free-up capital for reinvestment or other purposes. Here is how an Athene subsidiary describes the process: *"Due to these various reinsurance relationships, the amount of capital and surplus that AAIA* [Athene's state-regulated Iowa life insurance affiliate] *is required to maintain is less than what would be required if the insurance liabilities were not ceded to its affiliates. Therefore, AAIA may have fewer permitted assets available to make payments under its insurance liabilities in the event that the applicable account is insufficient to satisfy amounts due thereunder as the result of a default by the respective counterparty under the reinsurance arrangements."* See also: Kirti, Divya and Sarin, Natasha, "What Private Equity Does Differently: Evidence from Life Insurance," (February 14, 2020). U of Penn, Inst for Law & Econ Research Paper No. 20-17, Available at SSRN: https://ssrn.com/abstract=3538443
[17] Koijen, Ralph S.J. & Yogo, Motohiro, "Shadow Insurance," Minneapolis Fed Research, Staff Report 505, Revised May 2016. https://tinyurl.com/2p8cbwhm
See also Kirti, Divya and Sarin, Natasha, "What Private Equity Does Differently: Evidence from Life Insurance," (February 14, 2020). U of Penn, Inst for Law & Econ Research Paper No. 20-17, Available at SSRN: https://ssrn.com/abstract=3538443
See also Kim, Kyeonghee, Leverty, J. Tyler, and Schmit, Joan, "Regulatory Capital and Asset Risk Transfer," 2019, pp. 8-10. https://tinyurl.com/2p8c6tn3
[18] Upon acquiring closed annuity blocks or pension liabilities, Apollo replaces some of the lower-yielding assets that back those obligations with riskier and/or less liquid financial products, then reinsures most of the annuity obligations via affiliates incorporated and regulated in Bermuda. Unlike traditional reinsurance with third-party reinsurers, these inter-company reinsurance transactions do not actually transfer risk. But they allow Athene to lower its overall level of capital and reserves without corresponding declines in its state-regulated affiliates' reported risk-based capital (RBC) ratios. See: Foley-Fisher, Nathan, and Verani, Stepane, "Capturing the Illiquidity Premium," Authors work in the Research and Statistics Division of the Federal Reserve Board, February 2020.
https://www.californiainsurancelawyerblog.com/wp-content/uploads/sites/275/2021/02/Federal-Reserve-Board-Capturing-the-Illiquidity-Premium-February-2020.pdf