sifma

asset management group

August 29, 2024

National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197
Attn: Rodney Good & Ralph Villegas

Re: Financial Analysis Solvency Tools Working Group (E) – Complex Ownership Structures

<u>Submitted Via Email</u>

Dear Mr. Good and Mr. Villegas:

The Asset Management Group of the Securities Industry and Financial Markets Association ("SIFMA AMG")[1] appreciates the opportunity to provide comments to the National Association of Insurance Commissioners ("NAIC") on the Financial Analysis Handbook Exposure Draft.

The NAIC recently published an exposure draft of potential changes to the NAIC Financial Analysis Handbook ("Handbook") and requested public comment. The proposed changes are part of a broader initiative to address "Regulatory Considerations Applicable (But Not Exclusive) to Private Equity (PE) Owned Insurers."

SIFMA AMG members span a wide range of asset management firms. The proposed changes to the Handbook could have indirect implications for asset managers to the extent they have made investments in, or manage money for, state-regulated insurance companies. We recognize the policy objective of being able to identify situations where a party with partial ownership exercises control over an insurance company. We also recognize the challenge of writing guidance that will be useful across a wide range of circumstances.

Asset managers are a source of long-term stable capital for insurers and continued insurer access to affordable capital should remain a priority. We are particularly concerned, however, that the proposed section titled "Disclaimer of Control/Affiliation"

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[1] SIFMA's Asset Management Group brings the asset management community together to provide views on U.S. and global policy and to create industry best practices. SIFMA AMG's members represent U.S. and global asset management firms that manage more than 50% of global AUM. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds. For more information, visit http://www.sifma.org/amg.

could create ambiguities, conflict with other regulatory structures, or have practical aspects that make them infeasible. Guidance with specific fact patterns in mind might have unintended consequences by applying unsuitable conditions or criteria to disclaimer applicants with different facts and without associated control risks.

Asset managers invest on behalf of their clients directly and indirectly in the equity of insurance companies and may also be retained to manage money for insurance companies. The heading for the changes reference Private Equity but also suggests the considerations are not limited to private equity. The vast majority of asset managers invest for the purpose of pursuing economic returns for their clients and investors and not for the purpose of becoming involved in the management or day-to-day control of the companies in which they invest.

Given that background, we offer the following observations and suggestions:

1) The proposed guidance states that some contracts may convey an element of control:

> Consideration should be given to situations where a disclaiming party may exert influence or control over the insurer such as: …any non-voting arrangement or contract that may convey an element of control (e.g., ***investment management***, reinsurance, administrative service, employment); (emphasis added)

   The presence of an investment management agreement is not a per se indicia of control. Investment management agreements that are negotiated at arm's length and include customary terms do not implicate control. Language should be amended to clarify that only contracts that include non-customary terms that implicate control or the intent to control are relevant to disclaimer assessments, such as onerous termination provisions, excessive control given over the insurance company's strategy and implementation, or risks associated with non-arm's length affiliated arrangements. This is consistent with prior work of the Risk-Focused Surveillance (E) Working Group.

   We suggest the following revised text:

> Consideration should be given to situations where a disclaiming party may exert influence or control over the insurer such as: …any non-voting arrangement or contract that may convey an element of control (e.g., investment management <u>***agreements with non-customary terms that extend beyond advisory services and into broader influence over the insurer's business such as termination provisions that would be onerous and implausible in practice, authority over the insurer's strategy and implementation for managing its assets, or an affiliated adviser becoming intertwined in the insurer's business operations***</u>, reinsurance, administrative service, employment);

2) Accumulating a position of an insurance company's outstanding equity is typically an investment decision rather than a mechanism to obtain and exercise control. Applicable Securities and Exchange Commission regulations under Section 13 of the Securities Exchange Act of 1934 require public disclosure of positions held by institutional investment managers, as well as public disclosure by beneficial owners that own more than 5% of a public company. These regulations require distinct disclosure for those that own more than 5% of a public company if they purchase or hold shares with the purpose or effect to change or influence control of a company. Handbook guidance should look to these filings as a reliable source of authority if appliable.

3) The proposed guidance states that "actions and activities" of investment companies may be relevant:

> Consideration should be given to situations where a disclaiming party may exert influence or control over the insurer such as:… passive investment companies with more than 10% ownership of voting shares within funds they manage, where the ***actions and activities*** do not support the investment company's assertion that it does not exert control. (emphasis added)

   This text is ambiguous and risks creating confusion regarding what "actions and activities" are viewed as indicia of control. This language should be clarified or augmented to avoid any implication that ordinary course stewardship, engagement and proxy voting by an asset manager or investment company constitutes exerting control.

   We suggest the following text to be added at the end of the paragraph:

> Actions asset managers take in the ordinary course of their advisory services, such as engagement with management and proxy voting, should not be viewed as actions and activities that indicate exerting influence or control for these purposes.

4) The proposed guidance lists a variety of measures and considerations as "best practices." The "Best practices" heading may inadvertently endorse measures that may not be appropriate in all fact patterns. The heading should be amended to better show the subsequent bullet points as "alternatives depending on the circumstances" rather than a checklist of "best practices" that may be viewed as recommended and applicable across all scenarios.

5) Asset managers buy, sell and hold investments on behalf of their clients. They make ongoing investment determinations and vote proxies in the same manner for insurance company holdings as holdings of other issuers and in the same

manner as any other shareholder. They and the funds and accounts they manage are subject to their own regulatory frameworks and requirements. Several of the suggested required conditions run afoul of these constructs. Handbook guidance should ensure flexibility to recognize these business models and avoid imposing conditions that will be inapplicable or infeasible and otherwise frustrate the investment process. Examples:

a. “Consider state laws that require limitations on investments (e.g., three-year waiting period)”

   The objective and implications of this language are not clear. Imposing minimum waiting periods to invest, minimum holding periods, and other limits on investment timing will hamper potential investments into insurers, interrupting the flow of capital to these companies. For example, index funds may be unable to trade shares of insurers as needed to track their respective indices, limiting or preventing index funds from investing in the insurance industry.

   Holdings may be viewed as impaired or illiquid which have implications for financial statements and investment guidelines and will deter investment. Restrictions on the ability of an asset manager to exit investments in insurance companies would have an adverse impact on the market for those instruments and increase costs for an insurance company to raise capital.

   The Handbook text should avoid any implication that passive owners whose disclaimers have been approved must re-apply for disclaimers every three years. We suggest that this text be omitted altogether.

b. “Require 30-day notice to the Department if a “passive owner” is acting counter to management recommendations for proxy voting.”

   Requiring advance notice of proxy voting is infeasible and impractical for most public equity proxy votes. Decisions are often made close to the meeting date and disclosing voting intentions may disclose material non-public information or voting strategy. Asset managers have a responsibility to vote in the best interests of the funds they manage and therefore decisions must be made thoughtfully and carefully, often involving reviews of company disclosures and engagement with company management to understand the company's disclosures and corporate governance practices. The responsibility to vote can result in votes for or against management recommendations, but that should not be viewed as a per se control indicator. Insurance companies with public equity are no different than any other public issuer in this respect, and shareholders must be free to vote in their interests regardless of management recommendations.

If voting transparency is an issue, proxy votes for mutual funds, exchange traded funds and other funds registered under the Investment Company Act of 1940 are publicly available on Form N-PX on an annual basis.

c. "Post-Disclaimer Considerations: The disclaiming person/entity should:
   - Provide notice before taking action on any of the rights and privileges of the non-voting shares.
   - Provide notice before transferring non-voting shares.
   - Provide notice before taking any position at the insurer or its affiliates."

   Requiring advance notice by an asset manager for ordinary investment decisions is infeasible and impractical. Investment management decisions are made on a daily basis and such investments could extend to non-voting instruments (depending on the terms of the instruments the insurance company has issued to the public). Requiring advance notice for ordinary course trading that has no impact on a control determination or disclaimer serves no purpose and raises the risk of administrative reporting violations.

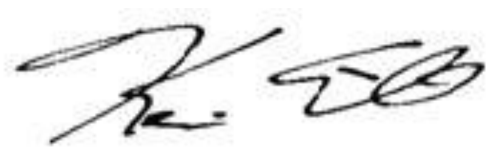
   In general, ongoing notice requirements should be avoided. Adding requirements creates impediments to investment and anything that deters the flow of capital is not in the interests of insurers. A notice requirement should only be an option if there is a is a compelling reason to believe there is an active question regarding control intentions.

6) The proposed changes replace objective standards based on ownership with more subjective standards based on ambiguous indicia of control. Introducing too many subjective standards risks reducing predictability and putting those considering disclaimer requests in awkward positions of making their own determinations. Ambiguity also puts prospective applicants including asset managers that typically buy and sell public equity on a daily basis on behalf of their clients, in the position of not knowing how a determination will be made. The changes could frustrate one of the primary objectives of the Insurance Holding Company System Regulatory Act (#440) - to promote consistency and uniform treatment among and between companies and states.

Handbook changes that impose new substantive requirements that change how asset managers invest in and do business with insurance companies warrant caution. The assessment of disclaimer applications and potential conditions for approval should be approached carefully to avoid imposing new requirements or requirements that impair access to capital for insurance companies.

SIFMA AMG appreciates NAIC's consideration of these comments and would be pleased to discuss any of these views in greater detail if that would assist deliberations on this issue. Please feel free to contact me via email at kehrlich@sifma.org.

Sincerely,



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