
More Sources of 'Bermuda Triangle' Information

By Editorial Staff Thu, Feb 3, 2022

This week, McKinsey & Co. and Cerulli Associates weighed in on different aspects of the 'Bermuda Triangle' phenomenon. We provide links to and excerpts from their white papers, and from an article published last December in National Law Review.

Anyone following what *RIJ* calls the “Bermuda Triangle” strategy might be interested in three recent reports. One comes from the consulting firm Cerulli Associates, another from McKinsey & Co., and a third appeared in the *National Law Review* last December. I provide links to the full texts and excerpts from them below.

This migration to private equity and private credit is troubling. Too many investors seem to be rushing to the same side of the boat at once. Private equity firms claim that, with securitization and patience, they can achieve higher returns without going up in risk. I’m not so confident. I think the boat might tip.

[Why private equity sees life and annuities as an enticing form of permanent capital](#)

McKinsey & Co., February 2, 2022.

Permanent capital—investment funds that do not have to be returned to investors on a timetable, or at all—is, according to some, the “holy grail” of private investing. Permanent capital owes its exalted status to the time and effort that managers can save on fundraising, and the flexibility it provides to invest at times, like a crisis, when other forms of capital can become scarce.

Permanent capital can take many forms, including long-dated and open-ended fund vehicles. The balance sheet of a life and annuities company is one form of permanent capital that has drawn much attention.

In 2021, private investors announced deals to acquire or reinsure more than \$200 billion of liabilities in the United States. Such investors now own over \$900 billion of life and annuity assets in Western Europe and North America.

Assuming the pending deals close successfully, private investors will own 12% of life and annuity assets in the United States, totaling \$620 billion, and represent more than a third of US net written premiums of indexed annuities.

All five of the largest private equity (PE) firms by assets have holdings in life insurance,

representing 15 to 50% of their total assets under management. By our count, 15 alternative asset managers have entered the market, or stated their intent to do so.

Insurance carriers are also benefiting from all the attention: many of the largest insurers have sold legacy books to private buyers, typically to improve their return on equity and to free up capital for reinvestment or return to shareholders. For some public carriers, these transactions have generated near-instantaneous expansion of their price-earnings multiple.

[Shrinking Market Opportunity Spurs Interest in Private Investments for Enhanced Returns](#)

Cerulli Associates, February 3, 2022

Institutional investors with existing allocations to private markets are looking to expand from traditional private equity into growth and venture capital. "The current investing environment is characterized by complexity and shrinking opportunity," states James Tamposi, associate director, Cerulli Associates. "With rates at all-time lows and valuations at all-time highs, institutional investors are faced with a complex decision of where to deploy their portfolios. Private investments offer an avenue through which investors can, to an extent, maintain return targets," he comments.

In parallel, asset managers anticipate that mandates will change. According to Cerulli research, 80% of asset managers expect increased demand for private equity mandates and 75% expect demand for other private investment mandates. Current income (92%), diversification (85%), growth/enhanced returns (77%), and volatility dampening (54%) are the top objectives managers of private investment strategies seek to fulfill for investors.

Superior performance of private investments is credited toward illiquidity premiums. Research participants explained that illiquidity falls short as a descriptor for private investments' source of outperformance, with one saying that premiums derived from private investments would be better described as "complexity" and "access" premiums. Participants further expanded on differentiating characteristics of private investment strategies, saying that they offer investors the chance to add value at an early stage, provide potential tax benefits, and shield against volatility. "Many portfolios benefit from the smoothing effects of private investments. Because these investments are not marked to market but are instead marked at book value, having them in a portfolio helps limit volatility," says Tamposi. However, liquidity has drawbacks for different types of investors. Several participants agreed with this notion, while others said that private investments' stability made the asset class "artificially attractive," noting that private equity is subject to many of the same

market risks as public equity.

Despite the relatively strong growth in recent years, research participants believe private investments are not exempt from the lower-return outlook of other asset classes. Increased industry competition (93%), increased volatility of valuations (92%), and a lack of exit environment (75%) were cited as significant risks by firms participating in a 2021 Cerulli survey. Several research participants asserted that as investors continue to seek returns and increase allocations to private investments, the space has become more crowded and managers in the space will be forced to accept lower-yielding investments. In other words, because there is so much committed capital and firms must continuously look for ways to put this capital to work, firms may have to make deals with lower payouts.

[Turning Up the Magnification: Regulators Have Pe-Controlled Insurers Under the Microscope \(Again\)](#)

National Law Review, December 9, 2021

For much of the past 10 years, the National Association of Insurance Commissioners (NAIC) and individual state insurance regulators have highlighted their awareness of the increasing number of insurers controlled by private equity (PE) funds. The NAIC's Capital Markets Bureau publishes an annual report about those insurers it considers to be controlled by PE funds, and the year-end 2020 report can be found [here](#).

Earlier this week, during a meeting of the Financial Stability (E) Task Force (the Task Force), it became apparent that the NAIC and state regulators are about to take a deeper look, assigning the task of coordinating said project to the Task Force's subsidiary committee, the Macroprudential (E) Working Group. The Task Force is not the only NAIC committee that is looking at PE funds' ownership or the control of insurers as the list of "regulatory considerations" below indicates. While PE funds control both property-casualty and life-annuity insurers, based on discussions during recent Task Force meetings, as well as several of the regulatory considerations below, it appears that regulators are most concerned with life and annuity insurers. Regardless, any and all types of re/insurers owned or controlled by PE funds should be paying attention.

At the same meeting, Superintendent of the Maine Bureau of Insurance Eric Cioppa (the Financial Stability Oversight Council's (FSOC) insurance regulator representative) indicated in his report to the NAIC committee that the FSOC is aware that both state and federal regulators are monitoring PE fund investments in, and control of, life insurers.

The Federal Insurance Office's (FIO) Annual Report on the Insurance Industry (September

2021) confirms that the FIO has been monitoring—and will continue to monitor—the impact that PE fund control has on investment policies and practices of certain life and annuity insurers, as well as considering various management agreements with advisors of all kinds (including advisors that are fellow portfolio companies) and fee structures involved in these relationships.

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