Retirement Income
JOURNAL

Goldman Touches the FIA Market

By Kerry Pechter *Fri, Oct 4, 2013*

A Bermuda domicile is just one of Global Atlantic Financial Group's competitive edges. Last week, the former Goldman Sachs Reinsurance Group added Forethought, which markets variable, fixed and fixed indexed annuities, to its stable of insurance businesses, which includes Commonwealth Annuity.

Bermuda-based Global Atlantic Financial Group, a multiline insurer and reinsurer whose principal owner is Wall Street powerhouse Goldman Sachs, is expanding its footprint in the life insurance industry by acquiring privately-held Forethought Financial Group Inc., which offers variable annuities, fixed annuities and fixed indexed annuities, as well as funeral insurance.

By buying Houston-based Forethought, Global Atlantic, which until last April 30 was Goldman Sachs Reinsurance Group, captures The Hartford’s former annuity business; Hartford stunned the industry by selling its once-vaunted life and annuity business to Forethought in 2012.

Global Atlantic also owns Commonwealth Annuity and Life (the former Allmerica Life), which Goldman Sachs bought in 2005. And, just two days ago, regulators approved Commonwealth’s acquisition of $10 billion in Aviva USA life insurance assets from Athene Re (not Aviva Life and Annuity in its entirety, as the box below misstates).

The Aviva and Forethought deals prompted the rating agency A.M. Best to affirm Commonwealth’s A-minus (Excellent rating) and removed the insurer from “under review with negative implications.”

Goldman Sachs, a partnership that went public in the late 1990s and morphed into a bank holding company during the financial crisis, acquired Bermuda-based Ariel Re in 2012, which is now part of Global Atlantic’s property-casualty segment. These transactions give Global Atlantic total assets of about $31 billion. Its chairman and CEO is Allan Levine (right), former CEO of Goldman Sachs Reinsurance Group. Forethought’s CEO, John Graf, will join Global Atlantic’s board as a non-executive vice-chairman of the life and annuity business.

In response to an inquiry by *RIJ*, Mark Kollar of Global Atlantic's public relations firm, Prosek Partners, said Global Atlantic wasn't yet giving interviews on the deal. It could not be confirmed if ownership of Epoch Securities, the small Massachusetts-based broker-dealer that distributes Commonwealth Annuity's variable annuities, has transferred from Goldman Sachs to Global Atlantic.

Fixed indexed annuity due next year

Forethought already has at least two fixed indexed annuity contracts (Bonus Advantage and Forethought Income 125) and Commonwealth expects to introduce one. Goldman Sachs owns a reported 23% (this is anecdotal but the source was in a position to know) of Global Atlantic Financial Group. The companies are said to be still working out how Forethought and Commonwealth will fit into Global Atlantic's structure.

"The acquisition [of Aviva's life insurance business] will provide Global Atlantic with new sources of earnings diversification, as this acquisition will enhance its product lines and distribution channels," A.M. Best said in an October 2 release. "[The acquisition of Forethought] will provide additional product diversification to Global Atlantic, including its pre-need insurance."

Like other recent purchases of domestic life insurers by other private companies, Global Atlantic's purchase of Forethought has triggered a burst of conversation, speculation (and anxiety, in some quarters), especially in the fixed indexed annuity part of the life business, where total sales are currently running at an all-time high of about $9 billion a quarter.

"The established FIA companies are very frustrated and feel that they can't compete," said one industry watcher. Others are more sanguine.

"I'm in favor of the deal," fixed indexed annuity authority Jack Marrion told *RIJ* this week regarding the Global Atlantic-Forethought deal. "Global-Commonwealth wants to get bigger in this area and Forethought was looking for more capital." As a consultant to the companies involved, Marrion said he couldn't comment further.

Market share triples since 2008

Other private companies that have taken advantage of the divestitures and depressed values of annuity and life insurance assets in the wake of the financial crisis include Guggenheim Partners (owner of Equitrust, Security Benefit, Sun Life Assurance), Apollo Global Management (owner of Athene Re, purchaser of Aviva plc's US business and purchaser of Presidential Life) and Harbinger Group Inc., which in 2011 bought the U.S. life and annuity businesses of Old Mutual plc.

Company: Global Atlantic Financial Group	
Headquarters: Hamilton, Bermuda	
Ownership: Privately-held (Goldman Sachs Group Inc., 23%, and many others)	
Assets: $31 billion	
Segments: Global Atlantic Life and Annuity, Global Atlantic Property and Casualty **Insurance companies:** • Commonwealth Annuity and Life • Commonwealth Annuity and Life Reinsurance • First Allmerica Financial Life • Aviva Life and Annuity • Forethought Financial Group • Ariel Re	
Products: Life insurance, fixed and variable annuities, pre-need (burial) insurance, property and casualty insurance, reinsurance.	
History: Until April 2013, Goldman Sachs Reinsurance Group	
Chairman and CEO: Allan Levine (B.S. Miami University; MBA, Columbia 1995; former CEO, Goldman Sachs Reinsurance Group)	

These companies—particularly Security Benefit—have shaken up the status quo in the fixed annuity business by, in some cases, offering higher sales commissions and/or richer bonuses, payout rates and riders and climbing the sales rankings. They've taken advantage of the popularity of the fixed indexed annuity category—popular among risk-averse investors who are disappointed with CD returns or are looking for guaranteed retirement income—and, some say, invigorated an already strong product category.

The private company share of fixed indexed annuity sales has tripled in five years. According to industry sources, in second quarter 2008 private companies had an 8% market share. By second quarter of 2013, they had a 23% share. FIAs appeal to private companies in part because sales are strong, because less-than-A-rated companies can sell them, and because they're not SEC-regulated are less transparent than securities products. They also involve a lot of financial engineering, a presumed strength of private equity firms.

"There's skepticism about these companies—and a lot of it is unfair," said one life insurance industry watcher this week. A retirement industry insider said: "These new investors in the life insurance industry are experienced managers of insurance assets—80% of the assets were outsourced to them anyway—and they've put extremely fit management in place."

Commitment questioned

But regulators (Ben Lawsky in New York State), rating agencies, the more conservative (bank channel and broker-dealer) distributors and established competitors in the life insurance and annuity field have raised a lot of questions about the short-term, risk-on reputations of the private company entrants, some of which have less than A ratings from A.M. Best. Equitrust is B+ and Security Benefit is B++, for instance. Athene's Aviva Life and Annuity was downgraded today to B++ from A-minus by A.M. Best.

“We’re just not sure about their commitment to the industry,” said one competitor, referring to the possibility that the private companies might be pumping up sales of fixed annuity issuers in hopes of selling them in a few years—an unwelcome trend in an industry where companies boast about their 19th century provenance, if they have even the most tenuous justification for doing so.

“I have to assume that Global Atlantic’s motivations are similar to the other private companies that have come into this space,” said a person who follows the FIA business. Because of the low interest environment, they can get a great deal on the life and annuity assets. Forethought is known for its funeral policies or ‘pre-need life insurance.’ That could be part of the motivation.”

The same observer was troubled about upward trends in the share of FIA business going to companies rated less than A-minus by A.M. Best, the amount of business going through proprietary channels (“where life insurer A works with distributor A only”), and about the higher commissions that lower-rated companies were paying in order to boost sales.

Average commissions for FIAs have come down from a peak of about 9% before the financial crisis to about 6% today, but some private equity-owned companies tend to be above average. Equitrust (B++), a Guggenheim property, offers an 8.5% commission on its Market Power Bonus Index and Market Twelve Bonus products. Fidelity and Guaranty Life (owned by Harbinger) pays 8% on at least two products. Athene Life (B++) offers 7%.

By contrast, higher rated companies tend to pay lower commissions. American General (A) pays a 3.5% commission on its AG Horizon Index 9 product. Lincoln National (A+) offers 4.5% on its OptiPoint 10 and New Directions 8 products. (All ratings are by A.M. Best.) That gives them an edge in the bank channel but not so much in the independent agent world, where most FIA sales originate and always have.

How do they do it?

The frequent question about the private companies is: how do they pay for the richer sales percentages and more attractive product features? There are lots of answers: They save on taxes and reserves by using captive offshore reinsurers; they earn management fees on the assets they acquire; they take greater credit risk on their fixed income portfolios; their people are smarter than yours.

Matt Hutton, a life insurance specialist at Deloitte in New York, put it this way: “First, they get the assets at a good price. Second, they don’t have ‘analyst fatigue.’ Third, they manage the investments a bit better. Fourth, unlike the public companies that have to face the analysts every quarter, they can take a long-term view regarding volatility.”

Another New York-based analyst agreed with the idea that the most successful private equity firms do tend to make smarter bets, not just riskier ones. “Frankly, they’re smarter than most of the institutional people. There’s a reason why investors demand more from them and pay them more. They wouldn’t be in business if they had no track record of beating the markets, especially the credit markets,” he said.

“When you’re talking about a spread-based business, it’s almost 100% commoditized,” he added. “Then it comes down to, Who are the smarter guys in the room? Whether its asset selection, leverage or timing, if they can generate even a modest incremental portfolio yield versus the typical investment grade bond portfolio, it makes a big difference. In this business mix, every basis point counts."

'Not close to the end' of this trend

As for the question of mortgage-backed securities (MBS), which privately-owned life insurers are said to be loading up on, he believed that the private equity fixed income specialists are good at distinguishing between securities that are cheap because they're trash and those that are true bargains.

"This asset class has gotten painted with a broad brush. But when you dig beneath the surface, you find many important nuances that many people, including most of the media, don't get. For instance, it matters at the end of the day whether you were assessing the value of a fixed or floating rate instrument, a callable or non-callable instrument, or a package of 2006-or-prior vintage mortgages versus mortgages packaged in 2007-2009," he told *RIJ*.

"If you were smart and had the cash and were willing to invest for the long-term, then you could find good, lower-risk assets that were priced the same as the lousy assets," he added. "You weren't throwing the baby out with the bathwater. And especially at the private equity firms, there's a lot of leverage they could put on those bets."

The shape of the annuity space will continue to evolve, he predicted. "Apollo is on the record as saying that they would take Athene [Life and Annuity] public by the end of 2015, so we will see more disclosure from them," he said.

"I don't think we're anywhere close to the end, in terms of private equity-sponsored insurance companies' interest in the fixed and fixed indexed annuities space. We'll see over time if that evolves into some interest in the variable annuity space." But that may have to wait until their strength ratings improve.