Not All Annuity Issuers Are Alike

By Kerry Pechter *Thu, Aug 26, 2021*

When choosing an annuity from a life insurer, advisers and clients need to understand that life/annuity companies have different business models and ownership structures, and that these differences matter. That's especially true now that private equity firms are in the annuity business.

When fee-based advisers who've dealt only with investments decide to become "ambidextrous," they can be forgiven for not instantly knowing every nuance about insurance products and life insurance companies.

"Ambidextrous" is *RIJ*'s adjective for advisers who use investments and annuities to maximize clients' income and peace of mind in retirement.

The other day I was talking to a investment-centric adviser and differences in the ownership structure of life/annuity companies. She didn't know there were differences. So we began talking about the business models that life insurers use: Mutual, publicly traded (stock), private equity-controlled, foreign-owned, and fraternal, for instance.

Ownership and business model should matter to advisers and clients. They help determine the culture of the company, its strength and credit ratings, the types of products it manufacturers and sells, its pricing and distributing channels, its compensation for intermediaries, the level of profits that its owners seek, the regulators it reports to, how it reinsures its liabilities, the content of its communications to policyholders and sometimes the quality of its customer service.

These characteristics can matter as much as or more than price.

Mutual companies (New York Life, Guardian, Thrivent, MassMutual and Northwestern Mutual) are owned by their policyholders, who typically receive dividends. Stock companies (Prudential, Brighthouse Financial, AIG, Equitable, Principal, Lincoln Financial) are owned by their shareholders, who hold stock in them.

Private equity-affiliated (PE) life/annuity companies (F&GL, Athene, Global Atlantic) are a more recent phenomenon. They may be public or not, but they tend to partner strategically or be affiliated with a big PE or buyout firm (Apollo, KKR, Blackstone). This model has focused on fixed indexed annuities in the past five to eight years. A recent McKinsey report described their business model (see below).

Foreign-owned companies (Allianz Life, Symetra, Protective; Jackson National until recently) are subsidiaries of overseas life insurers. Some foreign insurers—ING, AXA—withdrew from the US market after the Great Financial Crisis.

In addition, there are a few companies that have gone from mutual to public or from public to private (Nationwide). Some public companies are global; others are controlled by a single family. There are "fraternal" insurers, which tend to be smaller and whose customers tend to be affiliated with each other in some way.

These differences may be familiar to some *RIJ* readers, but they're not sufficiently well-known, in my opinion. The lines between ownership style can be blurred; business models overlap. Any life insurer might offer all types of annuities or only one. The low interest rate (and bull equity market) environment has driven all life insurers more or less toward index-linked annuities, whose gains are derived mainly from stock market gains.

You could write a long and dry book on this topic. I'll pick up the pace until we get to the private equity-affiliate life/annuity companies.

Mutual companies are the "quiet" companies. The *Wall Street Journal* rarely covers them because they aren't listed on stock exchanges. If true to type, they focus on plain-vanilla fixed deferred and fixed single premium immediate annuities, selling them through "career agents." Their customers are their primary clients; they return some of their profits to certain policyholders as dividends.

Stock companies are listed on stock exchanges, owned by their shareholders. They're honor-bound to put their shareholders' interests first. They strive for higher earnings and higher stock prices. "If you're an equity company you have to deliver equity returns," a product chief once said privately. In a low rate environment, that means selling high-fee products indirectly tied to the equity markets, like variable annuities and index-linked fixed or structured annuities.

That brings us to the private equity-led life/annuity companies. After the 2008-09 financial crisis, the big asset management firms started talking to life insurers. Capital-rich asset management firms were looking for assets to manage. Several public life insurers wanted to sell themselves or their blocks of in-force annuities (i.e., hundreds of billions of dollars; the more or less guaranteed savings of conservative Americans).

On Wall Street, the PE firms were seen as saviors for life insurers with depressed stock prices. They would use their storied "smartest-guys-in-the-room" investment, "loan-origination," and securitization skills to "redeploy" annuity assets for solid returns than traditional life insurance investment departments could. They could then use those higher returns to offer (mainly) fixed indexed annuities with higher yields for savers and higher agent commissions. The PE firms also knew how to reduce drag and "release" life insurer capital by reinsuring blocks of in-force annuities in on-shore or offshore regulatory havens.

First Harbinger bought Old Mutual, then Athene Holding (majority-owned by Apollo, the giant asset manager) bought Aviva plc's US life and annuity businesses in 2012. Goldman Sachs was in and out of the business, buying Hartford's annuity business and selling it. Former Guggenheim Partners executives are involved. Today, five giant asset managers or holding companies—Apollo, Ares, Blackstone, Carlyle and KKR—have invested in the life/annuity business. They now account for almost half of fixed indexed annuity sales.

So, what does this ownership structure imply for advisers, agents and retirement savers who want guaranteed savings products or income? According to reports from the CFA Institute blog and McKinsey, the big buyout firms got into the insurance business to give themselves a source of "permanent capital."

To the extent that their insurance subsidiaries can acquire retirement savings in the form of long-dated annuities, they get money that they don't have to return to clients for five, seven or even 10 years. They can capture an "illiquidity premium" from buying Collateralized Loan Obligations, or bundles of loans to high-risk companies. Their asset management arms have a steady source of fee-generating money to manage.

"Annuities providers represent a bedrock of capital that can be used as security or lending facility to fund deals. Last year, KKR took a similar view with its acquisition of retirement and life insurance company Global Atlantic, adding $70 billion to its asset base," **wrote** a blogger at CFAInstitute.org last June, in an article about the quest for permanent capital by PE firms.

Here's an excerpt from an **article** that McKinsey published online yesterday:

> With recent moves to take insurers private, sophisticated PE investors are buying blocks of policies and assuming those risks—and billions in assets often come with that

> risk. In the United States in 2020, entities affiliated with general partners (GPs) acquired more than $100 billion in general account liabilities from traditional insurers' balance sheets. If the current low-interest-rate environment persists, growing pressure could make acquisition candidates of another $2 trillion in liabilities, further accelerating growth in GP insurance capital.
>
> As insurers are under pressure to divest assets and liabilities that were underwritten at much higher rates, GPs have both the investment capabilities to manage the assets and the culture and skills to build the operational capabilities to handle the policies.
>
> Specifically, investors that combine operating capabilities with skill in managing investments and maximizing returns have a clear value proposition, making management teams more comfortable in taking over their blocks and customers.
>
> Meanwhile, PE investors see significant value in long-term capital with a life cycle beyond that of a typical fund, reducing the fundraising burden on GPs and increasing through-cycle investment flexibility. Purchasing divested blocks also provides income diversification and a predictable, captive stream of fee income. For example, after a long track record in insurance vehicles, one investment management firm reported that nearly half of its assets under management were in insurance, amounting to half of all management fees earned.

My takeaways from this are still evolving. I think it means that public life/annuity companies will increasingly promote index-linked annuities, which appear to pose little risk to insurers, which means they require minimal reserves, which frees up capital. *RIJ*'s "Bermuda Triangle" series focuses on PE-led life/annuity companies.

Generally, the life/annuity business appears in danger of becoming a subsidiary of the investment industry. The "life" in life insurance companies refers to their expertise in using time and the law of large numbers to extract value from pooling mortality and longevity risk. Only life insurers can issue annuities. Annuities enjoy the privilege of tax deferral because they're supposed to serve a public service.

Annuities and investments are both similar and different. When people invest, they take varying amounts of risk. They expect to pay for advice, but not for risk. When people buy insurance, they transfer risk to the insurer and expect to pay a price for that service. When investment and insurance overlap, as they do in annuities, unsophisticated people don't necessarily understand exactly which they're buying or what they're paying for. They need to.

After reading the McKinsey excerpt yesterday, a retirement income expert told me, “I’m having a ‘this won’t end well’ moment.”