Private-equity firms will keep buying life insurers: Cerulli

By Editorial Staff *Thu, Sep 17, 2020*

'A takeover of general account assets by a PE firm gives the insurer, in effect, an affiliated PE manager and the fee advantages typically seen in co-investing scenarios,' a Cerulli Associates analyst reports.

As insurance firms remain challenged by a return to historically low interest rates, private-equity (PE)-driven mergers and acquisitions (M&A) have become an increasingly attractive option for both insurers and PE managers, according to Cerulli Associates.

Broad economic uncertainty and social distancing may have tempered the pace of M&A deal making, but longer-term dynamics in the industry are likely to drive persistent activity, says Cerulli's latest report, *U.S. Insurance General Accounts 2020: Finding Solutions Outside the Core*.

U.S. insurance companies are among the largest investors in the world—assets increased by 6.7% in 2019 to reach a total of $6.7 trillion, the majority of which is allocated to investment grade long-term bonds. Battered by a return to ultra-low interest rates, they are also perhaps the most challenged institutional investors.

"The low interest environment leaves very little room for poor underwriting or asset management performance—it's a rising threat to insurers' business models," states Robert Nelson, associate director. According to the research, 88% of insurers cite low interest rates/generating returns or yield at the top of their list of concerns.

Seeking to match asset returns with underwritten liabilities and position their business for long-term growth, many insurers are looking to partner with PE firms. Insurers increasingly depend on higher-yielding asset classes via separate accounts or in a fund structure.

"A takeover of general account assets by a PE firm gives the insurer, in effect, an affiliated PE manager and the fee advantages typically seen in co-investing scenarios—a much more cost-effective and efficient way to attain the desired alternatives exposure," according to Nelson.

Private equity firms' motivation for pursuing insurance assets is twofold: they gain a reliable return stream on invested capital while also gaining highly coveted permanent capital from the insurer.

“Permanent capital is more valuable to PE firms because it’s stickier,” says Nelson. “Stable and positioned for the long term, permanent capital is perfectly fitted for the longer time horizon investments for which private investors are known. It also reduces the need for external fundraising on a cyclical basis.”

Buying a stake in the insurer also has proven a lucrative strategy in an environment of climbing valuations.

While deal flow has slowed, recent announcements show that big PE players are still focused on the industry and willing to pull the trigger for a target that fits within their business strategy. There is also evidence of smaller players executing on similar acquisition strategies.

“Deal making remains challenged by the absence of in-person due diligence and engagement that normally occurs when mergers commence; however, businesses are adapting and creating workarounds to pandemic-related hurdles. It won’t be long before this transformative trend resumes across the industry,” Nelson concludes.