The Bucket

By Editorial Staff *Thu, Nov 20, 2014*

Brief or late-breaking items from Fitch Ratings, Cerulli Associates and Strategic Insight.

Private equity’s thrust into insurance will slow: Fitch

US private equity firms and their funds have grown investments in the life insurance sector over the past several years. However, that growth is expected to moderate as the high-value opportunities in the sector that manifested themselves the aftermath of the financial crisis have largely dried up, says Fitch Ratings. Heightened scrutiny by state insurance regulators will also be a headwind on private equity’s further penetration in the life sector, at least over the short term.

Private equity’s expansion into the life sector has helped certain European and Canadian insurers in their efforts to exit or pull back from the US life insurance and fixed-annuity market. Transactions completed over the past year include the acquisition of British insurer Aviva’s US life and annuity business by Apollo’s (Apollo, IDR ‘A-‘, Stable Outlook) insurance-focused affiliate, Athene Holding Ltd. (Athene), and Guggenheim’s acquisition of Canadian insurer Sun Life’s US life and annuity business. Other private equity firms that have completed acquisitions in the life sector include Harbinger, Global Atlantic and Resolution Life.

Apollo’s Athene has demonstrated an added rationale for private equity’s investment in the life space—the potential to manage acquired businesses’ investment holdings. Apollo earns a 40 bps fee on Athene’s overall investment portfolio, totaling $60.1 billion of AUM, and also earns fund-level private equity fees on the $11.8 billion of sub-advised assets invested across Apollo’s funds.

Regulatory risk has long been a curb on private equity’s interest in the insurance sector, as individual state regulators must approve matters such as changes in ownership and special dividends.

State insurance regulators’ concerns about private equity control typically center on the private equity’s potential prioritization of short-term profits over the long-term health of the insurance company and its policyholders. Fitch sees this concern as especially important when a fund purchases the insurance company, given the limited fund life and need for an exit strategy.

Recent tightening in state regulators' powers is exemplified by the New York Department of Financial Services proposing amendments to its regulations that would require insurance company acquirers to file additional information (and, potentially, establish keepwell trusts in the event capital is needed) in an attempt to address their concerns related to private equity ownership. The need to establish keepwell trusts would be considered by Fitch as a contingent obligation of the private equity fund and/or manager.

U.S. household investments grow 11%, to $33.5 trillion: Cerulli

New research from global analytics firm Cerulli Associates shows that at the end of 2013, U.S. households controlled $33.5 trillion in investable assets – up from $29.9 trillion in 2012.

"Thanks to another strong year in the stock market, U.S. household wealth was lifted significantly on an aggregate basis," Roger Stamper, senior analyst explains. "The mass-affluent market has the highest concentration of total financial assets."

Cerulli's latest report, *U.S. Retail Investor Advice Relationships 2014: Evolving Roles in Client Relationships*, provides perspective on the relationship between financial providers and retail investors. It covers the provider-client relationship from end to end, starting with client acquisition, progressing through advice delivery, investment management, pricing, and client retention strategies.

"Among the 122 million U.S. households that reached $33.5 trillion in 2013, 27 million are occupied by individuals under the age of 40 with investable assets of less than $100,000," Stamper continues. "These households have years of accumulation ahead of them, not to mention the expected wealth transfer from their Baby Boomer parents in the years to come."

Managed volatility funds surpass $350 billion in assets: Strategic Insight

As asset managers and investors realize the usefulness of managed volatility strategies, assets continue to rise according to Strategic Insight's newest in-depth research report, “Managed Volatility: Shifts in a Growing Market.” Strategic Insight reports a rise in assets from $30.9 billion at the end of 2006 to $360.9 billion in June 2014, an annualized growth rate of 36%.

With $260.8 billion in Q2’14, variable annuity (VA) assets constituted 72% of managed volatility funds. Mutual funds amounted to $100.1 billion, or 28%. By contrast, there are many more mutual funds, a total of 293, compared with 200 VA funds. The widespread use of managed volatility funds in association with VA guarantees accounts for their rapid growth there, but the trend is also catching on in the mutual fund space.

“We attribute the growth of managed volatility to the effects of the financial crisis” said Tamiko Toland, Managing Director of Retirement Income Solutions at Strategic Insight. “However, given the strength of asset growth and the breadth and depth of offerings, managed volatility is evolving into an important investment category.”

Strategic Insight splits managed volatility into two categories: tail risk managed and low volatility. The former includes a population of 258 funds and $265.4 billion in assets and the latter has 235 funds and $95.5 billion in assets. Generally speaking, tail risk managed funds are strongly represented among VA funds—in both assets and number of funds, while mutual funds have a great presence with low volatility funds.

Managed Volatility funds from Canada, Australia and Europe are also featured in the study. Exhibits track managed volatility assets by country/region and provide lists of managed volatility funds from each country/region.

The new research from Strategic Insight has identified almost 500 funds from over 100 different advisors. With so many players, there are a wide variety of approaches, all classified and identified within the report. “This report presents unique analysis of the managed volatility opportunity, from managers to investment styles,” Toland commented. “Because the trend is both new and fast spreading, we’ve also seen a lot of interest from mutual fund boards for data.”