

The Alt-Asset Teams that Reinvent Annuity Companies

By Kerry Pechter *Wed, Nov 17, 2021*

'Insurance Solutions' groups use private assets to boost the returns of life/annuity company investment portfolios. RIJ talks with Todd Fonner of Investcorp Insurance Solutions about this trend.



The global private-asset titans who've disrupted the US life insurance business in recent years—and whose annuity-issuing subsidiaries now account for almost half of domestic fixed indexed annuity sales—have also formed tactical “Insurance Solutions” groups.

KKR, Blackstone, Ares, Apollo and others have hung out shingles on the internet saying, in effect: ‘Small publicly traded life insurers: We can ramp up the sluggish yields on your off-the-rack investments by adding tailored alternative assets to your general accounts.’

The PE firms, evidently, don't have to look very hard for this business. It comes to them. Stock life insurers feel pressure from their shareholders and analysts to invest in assets like real estate-backed securities and leveraged loans to get the yields that A-rated bonds aren't delivering.

One of the latest asset managers to bet on this market is Bahrain-based **Investcorp**. Boutique-sized but ambitious, it recently financed the purchase of inactive Sunset Life for \$6.5 million and set up Investcorp Insurance Solutions (IIS) with former Blackstone and RenaissanceRe executive Todd Fonner as its chief investment officer.

Fonner recently spoke with *RIJ* about the nature of insurance solutions units in general and about Investcorp Insurance Solutions in particular. Here's an edited transcript of our conversation.

RIJ: Todd, who is Investcorp? That's an entity my US readers might not be familiar with.

Fonner: Historically, Investcorp has been an alternative asset manager, primarily for high net worth investors and institutions in the Persian Gulf region. It helped them invest mainly outside the gulf, in assets such as US real estate equity and US and European private equity and a hedge-fund-of-funds platform. Until fairly recently, its size was modest, with only about \$7 billion or \$8 billion under management. But about five years ago, there was a succession in management and the new executive chairman [Mohammed Alardhi] undertook

a strategy to broaden the strategies managed by Investcorp and also broaden its base of investors.

Assets-under-management has grown to \$38B, the number of strategies has broadened beyond the initial focus and we now have larger relationships with investors in Europe and the US. The footprint of the business, in terms of office locations and personnel, is roughly one-quarter London, one-quarter US and one-third Bahrain with several other smaller offices in important markets. My role is as the chief investment officer of Investcorp Insurance Solutions and at this stage our sole client is Sunset Life. Sunset Life has hired Investcorp Insurance Solutions via an IMA [Investment Management Agreement] to manage all its invested assets, which is similar to other relationships between strategically aligned asset managers and life insurers, such as Blackstone and F&G and Apollo and Athene.

RIJ: Sunset Life seems to be a blank canvas. According to its website, it stopped writing new life or annuity business in the early 2000s. What changes do you plan to make there?

Fonner: Yes, it is a blank canvas and the company will be looking to grow the business organically. Sunset Life will be primarily an annuity platform initially. There will be a new name. The management team is also working with AM Best to determine the ratings for the business. The insurer is onshore, it's Missouri-domiciled. There's also a holding company, Cordillera, that has 100% ownership of an intermediate holding company domiciled in Delaware, called Bona Holdings, which owns Sunset. It's a pretty straight-forward vertical structure that supports the insurance carrier. Investcorp has provided the initial capital for the business, but does not control or manage any of the corporate entities.

RIJ: Like several other asset managers, Investcorp has set up an Insurance Solutions group. Exactly what does an 'Insurance Solutions' group do?

Fonner: In the current low yield environment, there's been a real uptick in activity among asset managers trying to create higher yielding investments strategies for insurers that tap into alternatives. These business units are often called insurance solutions groups. For a lot of asset managers the focus is just that, selling the wares of an asset manager to insurance companies. But we, and folks like Apollo and KKR, are trying to do more than that.

RIJ: And what products or services does that entail?



Todd Fonner

Fonner: There are three activities here that are inter-related. There's the activity of running an insurance company, which in this case is the business of selling annuities. That's separate from and independent of the Insurance Solutions business. Then there's the activity of allocating the insurance company's investment portfolio, which we call the IMA or Investment Management Agreement.

Third, there's the activity of running specific investment strategies that are well-suited for insurance companies, which we call the SMA [Separately Managed Accounts]. The IMA and SMA activities are what often fall under the umbrella of an Insurance Solutions business. In the SMA world, the asset manager might say to the insurer, 'Here's my product. You figure out how it fits your liability.' In that case, the investment allocation activity happens inside the insurance company. Many insurers are working with asset managers this way, where the asset manager is just playing in that third bucket and providing SMAs but not involved with the allocation process or invested in the insurance business.

RIJ: Of these three activities, the relatively new piece is the IMA, right? Why does a life insurer need help 'allocating' its investment portfolio?

Fonner: I think that's right. Moving the IMA so that it sits inside the asset manager is new, and building that capability for the IMA can be tricky. But there are some real benefits. With annuities there's a very direct interplay between pricing the product and choosing investments. The yield that you can achieve drives the pricing for the policy, but there's also

asset liability and cash flow matching between the assets and liabilities. When you move the *allocation* function to the asset manager, it creates a very direct line of communication between the team that evaluates the alternative-asset opportunities and the team that designs and prices the product. For Investcorp and Sunset Life as partners, it's all about the allocation piece and bringing in a new level of collaboration.

RIJ: My understanding is that loan origination, private credit expertise, and alternative assets—like opportunities in the booming residential home rental business—are the main strengths that big asset managers bring to life/annuity companies to help them raise their investment yields. Is the 'allocation' function something else?

Fonner: I think it is. The asset manager, in addition to designing and building the investment strategies, is also taking on the complexity of understanding the rated and regulated world of insurance. When the allocation function moves to the asset manager, so does some of the analysis of the required capital considerations and the liquidity and cash flow matching considerations. It's critical to get these right when an insurer shifts from traditional assets to alternative asset classes.

RIJ: Is the asset manager building alternative assets for the life insurer, or is the life insurer buying investments from an asset manager's shelf?

Fonner: Buy-versus-build is one of the dynamics that is emerging in this business. Traditionally, insurers mainly bought their portfolios; for alternative asset managers, many of their strategies are built. The strategies don't exist unless the manager negotiates and makes the investment with the counterparty. I call this 'building an investment'. These 'built' opportunities are typically not broadly syndicated. They are more bespoke.

With a lot of the SMAs that insurance solutions groups are offering, the strategies are built, not bought. In a traditional syndicated deal, a life insurance company might buy 2% of a deal that comes along. But with a 'built' deal, many of the deals will be private and narrowly syndicated. There might be only two or three investors. But this is the SMA process. The IMA relationship is different. The asset manager is allocating to different strategies and asking, 'How do we use a combination of buy *and* build to create the best possible portfolio, while keeping cash flow constraints and RBC [risk-based capital] charges in mind?'

RIJ: Investcorp will own the renamed Sunset Life, through the Cordillera and Bona holding companies, right? Other big asset managers have been buying life insurers outright, setting up reinsurers to buy life insurers, or buying minority stakes in life insurers stakes. What's

the business logic of doing that? I can see the potential for both synergies and conflicts of interest.

Fonner: Investcorp has provided the initial capital for the purchase of Sunset, but Investcorp does not control or manage the business. It's possible that other third-party investors will also contribute capital to the business. But obviously, Investcorp will have an ownership interest in the insurance business. When there's economic ownership, people are motivated to put investments into the insurer's portfolio that they believe in. It means you're eating your own cooking. And if you're comfortable with your colleagues who are building the investments, you have more confidence in the investments and the portfolio. With this structure, we're aligning the insurance company, the allocation function, and the SMAs for the 'plus' assets [i.e., the assets that provide alpha to the insurance company general account]. When the asset manager is also invested in the insurance company, that makes the alignment tighter.

RIJ: What's so valuable about *alignment*?

Fonner: When you have that alignment, you will know, for instance, that four or five weeks from now a large private deal will become available that might fit the higher-yielding part of the insurer's portfolio. You have a clear line of sight to the assets. You know what the opportunity set will look like six weeks from now.

RIJ: As I understand it, Insurance Solutions providers combine alternative asset management expertise with reinsurance transactions that reduce the levels of surplus capital that life insurers have to hold against their annuity liabilities. Is there a reinsurance component to Investcorp Insurance Solutions? According to your bio, you once managed the investment portfolio of RenaissanceRe Holdings Ltd. in Bermuda.

Fonner: We have the reinsurance expertise in our team. Nathan Gemmiti [the new CEO of Sunset Life; former Chief Operating Officer of Knighthead Life, and former chairman of Cayman International Reinsurance Companies Association] was a consultant to Apollo when it was setting up Athene. I was in property and casualty reinsurance business for a long time. If you look at Knighthead, they wrote direct business and did reinsurance. Blackstone, where I worked in 2019 and 2020, did both direct origination and reinsurance. But Sunset Life will focus initially on organic growth—selling annuities through the IMO channel [Insurance Marketing Organizations and their affiliated insurance agents].

RIJ: Doing reinsurance deals where you acquire billions of dollars of assets to manage all at

once can be very attractive, right? Assuming the deals are priced correctly, is there any downside to that?

Fonner: Reinsurance deals that involve legacy blocks can be challenging. You're trying to put large blocks [of assets] to work quickly, but that can be difficult because you're working with a given set of liabilities and probably some investment guidelines from the cedant [the original issuer of the annuities in question] that constrain what you can do. You also might have some exposure to legacy product features, like minimum rate guarantees. From where we sit, it's a very competitive reinsurance market right now. The pricing in the small to mid-sized block trade reinsurance business is pretty frothy. It doesn't have the most compelling economics, and we think it's a harder business to execute. But if it became very lucrative, we have the experience to do it.

RIJ: So you prefer the 'organic growth' path?

Fonner: With organic growth, the company can design the product the way it wants to. You're not inheriting someone else's annuities. Sunset Life thinks there's a great opportunity in issuing annuities. It thinks it will match up well against the competition. The annuity market is growing. It's shifting to fixed products. The offerings are attractive. If you look at the 10-year [fixed indexed annuity] products, the crediting rates are attractive. The product is a great product. Annuities are a great business to be in. Investcorp has a long-term vision for funding the future growth of an annuity carrier and for building a platform to manage insurance-related assets.

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