Life Insurance Risk Transfer

Thomas Gallagher, CFA
212-446-9439
Thomas.Gallagher@evercoreisi.com

Russell Haug
212-497-0834
Russell.Haug@evercoreisi.com

Evercore ISI

Where Risk Transfer Began: Fixed Annuities

- Risk transfer deals primary began in the fixed and fixed indexed annuity space, with the first transactions taking place in the early 2010's

- Athene was a pioneer in the acquisition of FA/FIA blocks, with its landmark acquisition of Aviva USA in 2013 allowing it to significantly scale its operations

- However, fixed annuity risk transfer really began to heat up in the 2018-2020 time period, in which a handful of counterparties were acquiring blocks (i.e. Athene, Global Atlantic)
  - Notable deals during this period included LNC's $8B fixed annuity block deal with ATH, VOYA's ~$20B FA/FIA block deal with ATH, Ameriprise's first fixed annuity transaction w/ Global Atlantic, and MassMutual's acquisition of Great American Life

- Fixed annuity risk transfer allows the primary to divest a low ROE fixed block and redeploy proceeds more efficiently (i.e. share buybacks), while counterparties can improve profitability of the blocks by reallocating the investment portfolio

VAs Were the Next Evolution in Risk Transfer

- Variable Annuity Risk Transfer began in late 2017 with VOYA's divestiture of its Closed Block Variable Annuity business to Venerable and Hartford's sale of Talcott Resolution
  - The transaction allowed VOYA to shed it's highest tail risk business, and the transaction led to significant re-rating in the shares in the months following the deal

- However, much of the VA risk transfer activity didn't start until 2020, when Equitable reinsured it's highest risk living and death benefit vintages to Venerable
  - This also drove significant re-rating in the shares, as this reinsured block was viewed as the most macro sensitive and capital-intensive variable annuities EQH had

- In 2021, Prudential and Manulife both did VA reinsurance deals on ~$30B of account value, and PRU's deal introduced a new VA risk transfer counterparty, Fortitude (owned by Carlyle)

- VA Risk transfer mostly serves to lower tail risk / mitigate capital markets sensitivity and policyholder behavior uncertainty

Life Insurance Deals Gaining More Traction Recently

- Over the last couple of years, there have been a few risk transfer deals among life insurance blocks
  - These include VOYA's sale of it's Individual Life business to Resolution Life, PFG's reinsurance of its Guaranteed UL block to Sixth Street, and LNC's reinsurance of BOLI/COLI liabilities to Resolution

- These transaction served different purposes for the primaries:
  - The VOYA and PFG blocks largely served to reduce tail risk, as VOYA's individual life block was it's last remaining business with meaningful tail risk and capital markets sensitivity (1/3 of the block was higher risk Guaranteed UL), while PFG paid a negative ceding commission to shed its Guaranteed UL business
  - Guaranteed UL businesses are viewed unfavorably by investors and tend to weigh on valuations, as it is largely believed that insurers assumptions around lapse rates, investment yields, and mortality improvement may be insufficient

- In contrast LNC's COLI deal was solely to generation proceeds at an attractive valuation to repurchase shares (transaction garnered a 16x GAAP P/E while LNC's shares traded at only 6x)

LTC Risk Transfer Still in Early Innings

- Long-Term Care insurance is the one life insurance liability where we have yet to see significant risk transfer activity

- This is because LTC has caused significant problems for the industry related to insufficient assumptions around claims incidence, investment yields, claims duration, and cost of care among others
  - There is still significant uncertainty around how claims incidence and cost of care will trend in the future, as well as the extent to which primaries can get further rate increases to offset the pressure on future claims vs. expectations at pricing

- The only notable LTC risk transfer deal was when CNO divested it's highest risk block in 2018 to Wilton Re, though they paid a 30% negative ceding commission on transferred reserves just to get rid of the block

- Considering CNO's block was among the lowest risk (very little compound inflation and lifetime benefits) and they still paid a 30% negative cede, this has caused the bid-ask on other blocks to remain too wide to transact

Rationale for Risk Transfer Among Life Insurers

- The key reasons primaries engage in risk transfer transactions include
  - **Taking Advantage of the public to private valuation arb:** The private market valuations for certain life & annuity liabilities is significantly higher in the private market than public markets, allowing primaries to unlock value for shareholders by divesting certain blocks in the private market at solid valuations, and using proceeds to repurchase their stock at relative attractive levels
  - **Mitigate tail risk:** Risk transfer allows insurers to shed businesses that have significant capital market sensitivity that can cause volatility in statutory earnings and capital. Getting rid of these businesses should allow for more consist free cash flow, which should improve share valuations
  - **More efficient use of capital:** This mostly relates to lower risk liabilities like fixed annuities and traditional life insurance – insurers can reinsure a business generating a low ROE and still get a decent price for the block, because the counterparty can increase profitability by either reallocating the investment portfolio or running off excess reserves/capital over time

- Risk transfer has emerged as a dominant theme among the life insurers in improving valuations, and we think this trend will continue as more private-equity based insurers enter the space looking to acquire blocks

Future of Risk Transfer?

- We see more VA deals (MET, EQH, AEGON, AMP have also indicated potential interest in transacting), while there may continue to be some life insurance and fixed annuity deals

- Long-Term Care represents the bigger unknown, though most insurers are interested in divesting or shrinking exposures if this market opens up

- **Tailwinds for LTC deals:** Higher interest rates, aging of blocks, and some potential structures to embed future rate increases in deal pricing (Earn outs?)

- **Headwinds for LTC deals:** Bid-ask spreads have been wide based on management commentary and more recently there have been concerns on elevated cost of care from wage inflation.