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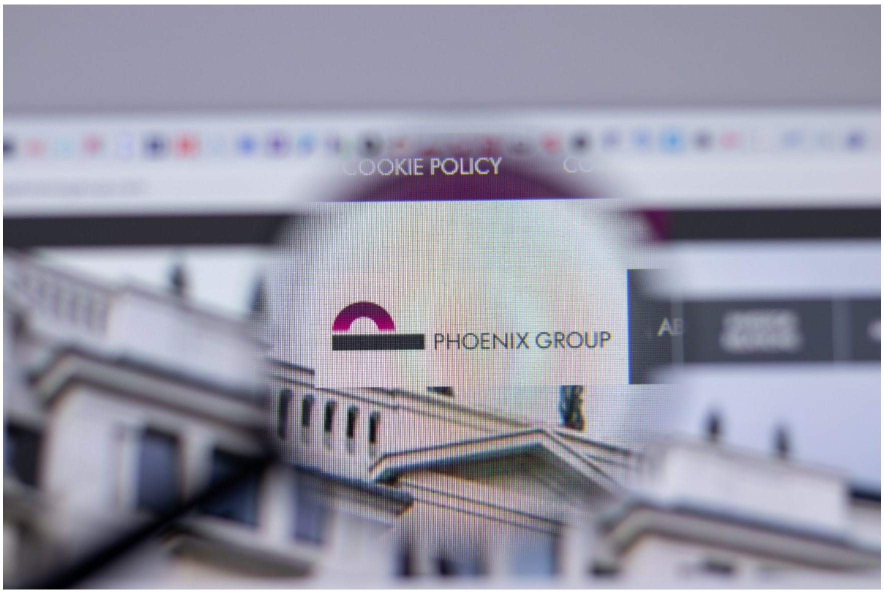
Three strategies for insurance run-off books

Run-off books pose a significant profitability challenge for insurance companies. Three main strategies for addressing it are internal optimisation, outsourcing of certain activities, and selling the closed book to a specialised consolidator. In this article, we explore these options



Phoenix Group is one of the largest consolidators of closed life books

Insurance companies are currently dealing with numerous market challenges. Low interest rates, Solvency II capital charges and an ever-changing regulatory framework are among those issues. In this environment, the most logical way for insurers to create value is through new business. However, another way in which insurers are seeking to create value is through the optimisation of already existing books, especially the ones which are called closed books or backbooks, to which new policies are not being added and the old ones are allowed to run their course. Closed books are often comprised of old-style high guarantee policies with extremely high capital requirements. They pose a profitability challenge – with fewer and fewer policies in the portfolio, it becomes increasingly expensive to manage them, pushing expenses and costs per policy higher every year. It also often means that the insurer has to maintain legacy operational and IT systems which correspond to the management of the closed book. All this leads insurers to seek alternative solutions to managing closed books.

So what are the possible solutions for insurance companies to lift the burden of backbooks? Closed books can be managed in several different ways:

Firstly, insurance companies can optimise the way they run the closed books themselves. This may include such initiatives as optimisation of IT systems, certain changes to investment policies, price adjustments, and assets/liability management. However, in practice, such a strategy comes with a lot of constraints. For instance, optimisation of the investment strategy, such as a change to higher-yielding assets, comes with higher capital requirements, which already pose a challenge to insurers. Another potential pitfall arises from a reputational risk while implementing price adjustments and other strategies to lower the pay-outs. As such, internal optimisation of the closed books, while a viable alternative, comes with so many constraints that it is in our view not the most effective option. It basically means trying to achieve similar results as consolidators without having the benefits of being a consolidator (see below).

Secondly, an insurer can opt for outsourcing certain activities of managing closed books to an external provider. This most often involves operations and IT, as external specialised parties can provide more efficient solutions. The downside of this method is the fact that as the book stays on the balance sheet of the insurer, it remains a capital heavy item. However, the reputational risk is kept to a minimum and the insurers can keep interacting with their customers.

Lastly, an insurer can sell backbooks to a specialised consolidator. This is the market that has emerged through activities in the US and the UK and recently keeps expanding in continental Europe. Through the sale, an insurer completely gets rid of the balance sheet exposure, therefore liberating itself from all the capital requirements, the operational and IT costs, the investment portfolio that comes with it, and so on. Such portfolios are being sold to run-off players, which can be either large specialised consolidators that normally belong to private equity (PE) and are fully dedicated to managing closed books, or other independent insurers. Mostly they are looking for various optimisation solutions, such as: merging portfolios in order to achieve economies of scale and decrease expenses per policy, optimising operations and IT to maintain legacy systems, digitalising processes, switching to less liquid and alternative higher-yielding investments, especially in the case of private equity-owned consolidators, and so on. One of the ways to decrease pay-outs to clients with life insurance policies is the “payments in advance” way. For instance, if someone has a terminal illness, the consolidator might suggest paying out a certain percentage of their life insurance while they are still alive, as opposed to paying the full amount after their death. In doing this, they manage to decrease their pay-outs and costs. We would like to point out that, in our view, this method still carries a certain reputational risk for the insurer that has a responsibility to its customers. If the consolidator that bought the portfolio doesn’t treat the clients in a fair and respectful way, it can reflect badly on the insurer who sold its portfolio to them.

Who are the consolidators? Some of the largest consolidators are insurance, reinsurance and specialised consolidators. Amongst them are such names as Phoenix, Athora, Rothesay Life, Catalina Re, Monument Re and Compre.

Phoenix Group is the UK’s largest long-term savings and retirement business and one of the largest consolidators of closed life books. Recent deals include the acquisition of Swiss Life Re closed book ReAssure for £3.2bn in 2020 and the purchase of Standard Life Aberdeen’s insurance arm in 2018 for £3.28bn. In March this year, Phoenix announced its shift from a traditional consolidator business in order to grow consumer brands, including under the newly purchased brand name Standard Life (2021).

Athora built its presence in Europe mainly through portfolio transfer, acquisitions and reinsurance. Such acquisitions include Delta Lloyd Deutschland, Aegon Ireland, Generali Belgium and VIVAT which is currently in the process of purchasing Amissima Vita. The insurer consolidator states that its efficient operations, risk, capital and asset management capabilities allow it to effectively manage purchased books. One of the subsidiaries of Athora, Athora Life Re is based in Bermuda, where the equivalence based Solvency II capital regime offers certain advantages in capital optimisation and risk management.

Rothesay, a pensions insurance specialist in the UK, with GIC (global investment firm) and MassMutual (mutual life insurance company) as largest shareholders, is also specialised in buying closed books. As MassMutual is an insurance specialist itself, it shows how interconnected the consolidators market is, with firms behind them being not only such traditional shareholders as private equity and investment firms, but also other insurers and pension funds. In 2018, Rothesay announced its intentions to purchase a £12bn annuity portfolio from Prudential. This was blocked by court in 2019 but later was allowed to go through in 2021, making Rothesay the UK's largest specialist annuity insurer.

Catalina Re is one of the most active consolidators. To date, it has made 30 acquisitions across Europe, the UK, the US, the Middle East and Asia. The shareholders of Cataline Re are Apollo, Renaissance Re and Management. The most recent transaction is the purchase of ACR, a Singapore-based reinsurance company in run-off with $2.1bn assets.

Monument Re is also a Bermuda-based player. The consolidator's main focus is the European Life segment with activities ranging from reinsurance to portfolio transfers and acquisitions. It mainly acquires run-off portfolios with annuity, guarantee or linked products. Its shareholders include Hannover Re, Enstar and E-L Financial. Monument Re describes its own strategy as "providing capital and risk solutions". Benelux is the key area of its operations, with the acquisitions including ABN AMRO Life Capital, Ethias FIRST A, Enstar, Aspecta Assurance International Luxembourg, Amerborgh Financial Services and Curalia.

Compre, a consolidator owned by PE firm Cinven and pension fund and public investment company BCI, has been in business for more than 30 years.

According to 2022 Fitch data, since 2016 more than 70% of liabilities of life closed books sold to consolidators in Europe were in the UK, while the BeNeLux market, the second-largest in Europe, accounted for only 11%. Larger deals once used to dominate the market, but in the last few years more than half of the total volume of transactions was attributed to smaller deals (under €5bn in liabilities). While the market for closed books in the US and the UK is booming, the activity in the EU has not yet reached the same levels. However, the number of deals in the market across Europe continues to grow, with Dutch insurers playing an active role. In spring 2021, Allianz sold 90,000 policies to Monument Assurance Belgium NV. The latest to announce was Athora Belgium seeking to acquire the closed life book of NN Insurance Belgium with €3.3bn of assets under management. The deal is expected to close in mid-2022.

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