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In response to challenges insurers turn to asset management

For generations, life insurance was a fairly staid business. The purchase of policies was a common rite of passage for consumers upon starting a family, sales reps could count on a continual flow of new customers, and insurers turned that steady cash into reliable profits and dividends by predictably buying bonds and investing in property.

But consumer acceptance of life insurance has been declining in some markets, along with the formation of families in the developed world. In the U.S., the number of issued individual policies has dropped steadily over the past 30 years even as the population has climbed, while the number of employers offering plans dipped 14 percentage points between 2008 and 2017 to 48%, according to industry researcher LIMRA. A record 30% of households have no coverage at all, and even households with policies hold face amounts far below industry recommendations, on average.

That business challenge on the customer front has been joined in the past 10 years by low interest rates and tougher capital requirements in North America and Europe. "Life insurers are feeling the squeeze," Boston Consulting Group wrote in a December 2016 report. "The industry's overall business growth has stalled, and investment income has become a critical mainstay."

In response, life insurers worldwide have been turning to another source of growth and profitability: asset management. That shift has coincided with a few favorable trends for the industry, including regulatory changes that limit bank participation as principals in private equity, coupled with the strong institutional demand for such alternative investments. With plenty of capital and a long-term horizon, insurers have traditionally been engaged with such alternative investments as real estate and are well-placed to provide seeding and co-investment capital for other illiquid investments.

Indeed, third-party asset management has a compelling logic for an industry whose core competence involves investing, but asset management is also attractive as a capital-light business with attractive fees. For publicly traded insurers there's an additional potential benefit: A strong asset management business can boost valuation. "With approximately $8 trillion of general and separate account assets on their balance sheets, third-party asset management is a natural extension of North American insurers' in-house expertise," says Laura Bazer, vice president of **Moody's** (NYSE: MCO), which released a related report last year.

Of the 53 North American insurance firms Moody's rates, 21 either own U.S. asset managers directly or are part of global insurers that own them. More than half of those 21 companies have made acquisitions of asset managers, and Moody's suggests that the "fallout from the active to passively managed fund trend" may increase the availability of targets for insurers. For the 21 firms as a whole, asset management accounted for 20% of consolidated group earnings in 2016, "moderating the decline in insurers' spread-based earnings

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with low-risk fee-based earnings in the low interest rate environment."

Moody's points out that insurers with internally managed funds can also keep a larger percent of management fees in-house. For example, at **Principal Financial Group** (NASDAQ: PFG), which last year acquired real estate advisor Internos Global Investors, 56% of pension-related AUM is handled by the company's asset managers. At the same time, Moody's warns that greater exposure to asset management can create earnings volatility while fee compression and competition from passive products could impact fee income "over time."

For small to mid-size asset managers on the sell side, insurers offer distribution muscle, capital and technology. In discussing its 2016 acquisition by the asset management arm of **Swiss Life Group** (SIX: SLHN), UK real estate advisor **Mayfair Capital Investment Management** noted that it had been seeking a "strategic partner to assist with our growth strategy. The transaction will provide our clients with access to a wider range of investment solutions across major European markets and an investment platform with significantly enhanced distribution reach." Mayfair also noted the ability of its new parent to provide co-investment and long-term capital for new funds.

Insurers have generally sought out fixed income shops and alternative firms with a focus on property such as Mayfair Capital, but the range of alternatives and equity managers are also on the radar screen. The largest companies also take a global view in considering targets, in line with both geographic and portfolio expansion, but post-acquisition structure varies. In 2016, **Massachusetts Mutual Life Insurance** reorganized its asset management business by combining four affiliates into one multi-asset firm with strength in private assets and infrastructure, under the venerable **Barings** brand name. "As a unified firm we will be better able to deliver our diverse and global investment offerings to clients," Barings Chairman and CEO Tom Finke said at the time. By contrast, **New York Life Insurance Co.** and Principal employ a multi-boutique model.

New York Life, which remains a mutual company, is a good example of the shift large life insurers have been undertaking. As NYLIC's annual insurance sales nearly halved between 2008 and 2017 to $1.3 billion (they have been rebounding slowly for several years while annuities have shown solid growth), the asset management arm has seen its AUM double to $586 billion, with third-party assets assuming a more significant portion of the business. NYLIC has been one of the steadiest acquirers among its peers, pursuing a bolt-on strategy with one major exception: The $500 million-plus 2013 purchase of Europe's Dexia Asset Management (now **Candriam Investors Group**), which at the time added $100 billion in AUM (now $135 billion) and expanded NYLIC's footprint globally. (In the first quarter of this year, Candriam gained exposure to the European private equity property market by assuming a 40% stake in London-based **Tristan Capital Partners**.)

NYLIC's 2017 acquisition of a majority share in **Credit Value Partners** (AUM: $2.5 billion), which invests in opportunistic and distressed debt and high-yield corporate credit, is more reflective of the targeted deals that define the company's strategy. NYLIC called the acquisition "an attractive opportunity to expand our alternative offerings," noting that CVP's capabilities "align with the income generation needs and total return profile of our investor base." For its part, CVP, an independent firm since 2010, cited the greater "access to capital and investment opportunities" its new parent could provide.

Sun Life Financial (NYSE: SLF) has been another aggressive buyer. In 2014, the Canadian firm created **Sun Life Investment Management** to "take some of the alternative yield strategies like real estate and commercial mortgages that we've used at Sun Life and bring them to investors," as one executive explained at the time. A year later, Sun Life made three acquisitions, including a $455 million deal for real estate advisor **Bentall Kennedy**. A second acquisition that year involved a fixed income specialist, **Ryan Labs Asset Management**, a New York liability driven investment manager with more than $5 million in AUM at the time. In 2017, Sun Life cut a deal for a small Canadian emerging markets specialist, **Excel Funds Management**, which offers a lineup of subadvised fixed income, equity and balanced funds, as well as exchange traded funds. In 2017, asset management accounted for 30% of Sun Life's underlying net income, compared with 47% for individual and group insurance combined, while AUM topped the $500 billion mark for the first time in January.

MetLife (NYSE: MET) has joined its peers in both restructuring its business and pursuing deals. Last year, MetLife paid $250 million for institutional fixed income shop **Logan Circle Partners** (AUM: $37 billion), calling the transaction "an important milestone" as it "expands its domestic and international investment management business for third-party clients." As part of a "transformation into a less capital intensive company with stronger cash flow," MetLife also spun off its U.S. retail insurance and annuity business, **Brighthouse Financial** (NASDAQ: BHF). In addition to its asset management unit, MetLife retains its international insurance and annuity businesses. MetLife launched the asset management business in 2012 with a focus on real estate and private debt, aimed at institutions. The company has $587 billion in AUM, primarily fixed income, with third-party assets having grown to more than one-quarter of that total, including legacy assets managed for Brighthouse and assets from Logan Circle.

The former Standard Life has done the most radical makeover among major life insurers, having completed in the first quarter its metamorphosis to a pure-play asset manager with the £3.2 billion ($4.5 billion) sale of its remaining insurance business to **Phoenix Group** (LON: PHNX) of the UK. That followed the £3.8 billion acquisition last year of Aberdeen Asset Management. The resulting **Standard Life Aberdeen** (LON: SLA) is one of Europe's largest active asset managers. In commenting in its latest annual report on the sale to Phoenix, Standard Life Aberdeen wrote, "Under the proposed transaction we are selling our capital-heavy insurance business, which will complete our transformation

to a fee-based, capital-light investment company." Just five years ago, the former Standard Life managed one-third the amount of assets it does today and asset management accounted for only one-quarter of pretax profits.

While other European life insurers haven't chosen such radical surgery, they are expanding their asset management units. These include **Aegon** (NYSE: AEG), **Generali Group** (MTA: G), **Legal & General Group** (LON: LGEN) and **Prudential** (LON: PRU), among others. Legal & General has been particularly active in the U.S., where it is aiming to be a top-10 manager. Toward that ambitious goal, the U.S. unit of **Legal & General Investment Management** has amassed $189 billion in institutional assets since its founding 12 years ago — including $32 billion in net inflows in 2016-2017 — making the U.S. L&G's No. 2 asset management market after the UK. The company made its first U.S. asset management deal in 2014 for a target date funds specialist, Global Index Advisors. The addition of Global's $16 billion in index AUM brought L&G's assets in the U.S. above $50 billion at the time. In addition to its asset management and life insurance businesses in the U.S., L&G is building a third one focused on corporate pension risk transfers, a focus for the company in the UK.

In Europe, LGIM enhanced its distribution and added an ETF portfolio with the 2017 acquisition of Canvas, an open-architecture and UCITS-compliant (Undertakings for the Collective Investment of Transferable Securities) ETF platform. Canvas had been the platform for former parent **ETF Securities**. The deal included $2.7 billion in ETF assets, a natural extension of L&G's large indexing business. In a 2017 earnings call following the Standard Life-Aberdeen deal announcement, L&G's former chief financial officer said the company would maintain its strategy of "small bolt-ons from time to time. On the very large transactions in the asset management space right now, L&G will not be participating." In 2017, LGIM accounted for £400 million in operating profit, up 9% from the prior year and less than one-fifth of the parent's total.

Among Asian insurers, **Nippon Life Insurance** has been the most notable buyer, cutting deals for minority stakes in asset managers in developing Asia, Europe and the U.S. as it responds to the challenges of generating investment returns in its low-yield domestic market and selling life insurance in a graying nation with a declining population. In the first quarter of this year, that global expansion included buying a 5% shareholding in the partial IPO of **Deutsche Bank**'s (NYSE: DB) asset management unit, **DWS Group** (FWB: DWS). A longtime shareholder in Deutsche Bank, Nippon Life agreed as part of the deal to expand DWS' business in Asia, transfer assets to DWS for management, and jointly develop products. At the same time, Nippon converted its **Nissay Asset Management** business into a wholly owned subsidiary "in order to reinforce and expand the asset management business." NAM has more than $90 billion in AUM.

In 2017, Nippon Life returned to the U.S. marketplace to make a fixed income deal for the second time in five years, acquiring a minority investment in **TCW Group** (AUM: $200 billion), which was already selling its products through Nippon Life's asset management unit. Nippon said TCW's capabilities benefit its insurance investment business and will provide expertise regarding "overseas asset management." Nippon Life made its first U.S. deal in 2013 involving a minority stake in high-yield and senior loan manager **Post Advisory Group**, which is part of Principal Financial.

Within Asia, Nippon Life has assumed a minority stake in an Indian asset management joint venture with local conglomerate **Reliance Group**. Nippon Life purchased the stake in **Reliance Nippon Life Asset Management** (NSE: RNAM) in stages between 2012 and 2017. RNAM, which did a partial IPO last November, is one of India's largest asset managers with $61 billion in AUM. Following the IPO, Nippon Life's stake dropped from 49% to 43%. "The mutual fund market in India is still at a nascent stage," Kazuhide Toda, Nippon Life's general manager for Asia-Pacific, told Indian business Website livemint last November. "That points at only one thing: growth potential in both debt and equity." Toda anticipates consolidation in India's asset management industry and said his company is prepared to support RNAM "if any such opportunities come in future." ▲