



# Beware of Private Equity Led Insurance Company Financial Engineering & What You Can Do About It To Protect Your Clients

As a rule, agents and advisors like you want to do business in a way that minimizes the personal risk they take on as fiduciaries for their clients. To do this, you likely research the carriers you write business with, check out AM Best ratings, and pay attention to industry rumblings about companies that might not be as secure as they appear.

That's all well and good, but it falls short, and it is NOT your fault. Why? Because there is some financial sleight of hand your chosen insurers are performing behind the scenes that increase the level of risk you and your clients are taking on—all without you being aware. Thankfully, that's all about to change.

## The Changing Insurance Landscape

From the start, insurance was designed as a form of mutual protection, leveraging the law of large numbers to ensure that a homogenous group of participants could put in a set amount of money, and it would be enough to protect those who encountered unexpected hazards. Annuities, around since at least Roman times, were modernized in the 16th century with the single premiums used to fund wars, and governments then fulfilled the lifetime payment obligations for those who lived long enough to earn them. In America, some of the earliest annuities were given to pastors, paid for by donations made by their congregants, setting the stage for future annuities paid out to widows and orphans.<sup>1</sup>

Insurance rolled along, holding true to these fundamental business practices for many decades, until about the mid-1990s when a handful of big investment banks saw they could make money by converting mutual life insurers to publicly traded insurers. So the primary investment banks began meeting with the top executives of all the mutual life and annuity companies and extolled the virtues of going public. What virtues? The bonuses and stock options.

**The moment these companies went public, they faced a new kind of pressure they hadn't before: stockholder dividend expectations.**

The moment these companies went public, they faced a new kind of pressure they hadn't before: stockholder dividend expectations. Once insurance companies went public and started paying stockholder dividends, they faced an insurmountable pressure to continue paying dividends and to make sure those dividends gradually increased year after year. According to the NAIC, an insurer should not pay a stockholder dividend unless its surplus "is adequate to meet its financial needs."<sup>2</sup> Even if surplus is low, they can appeal to the commissioner and ask for permission to issue a stockholder dividend.<sup>3</sup> But insurance companies aren't always going to have surplus growth every single year—as claims hit and annuities are paid out, they will have years in which losses and heavy expenses strain surplus ... unless they find a way to erase the bad years.

<sup>1</sup> <https://due.com/annuity/a-brief-history-of-annuities/>

<sup>2</sup> NAIC Model Holding Company Act adopted by all 50 states

<sup>3</sup> State insurance statutes

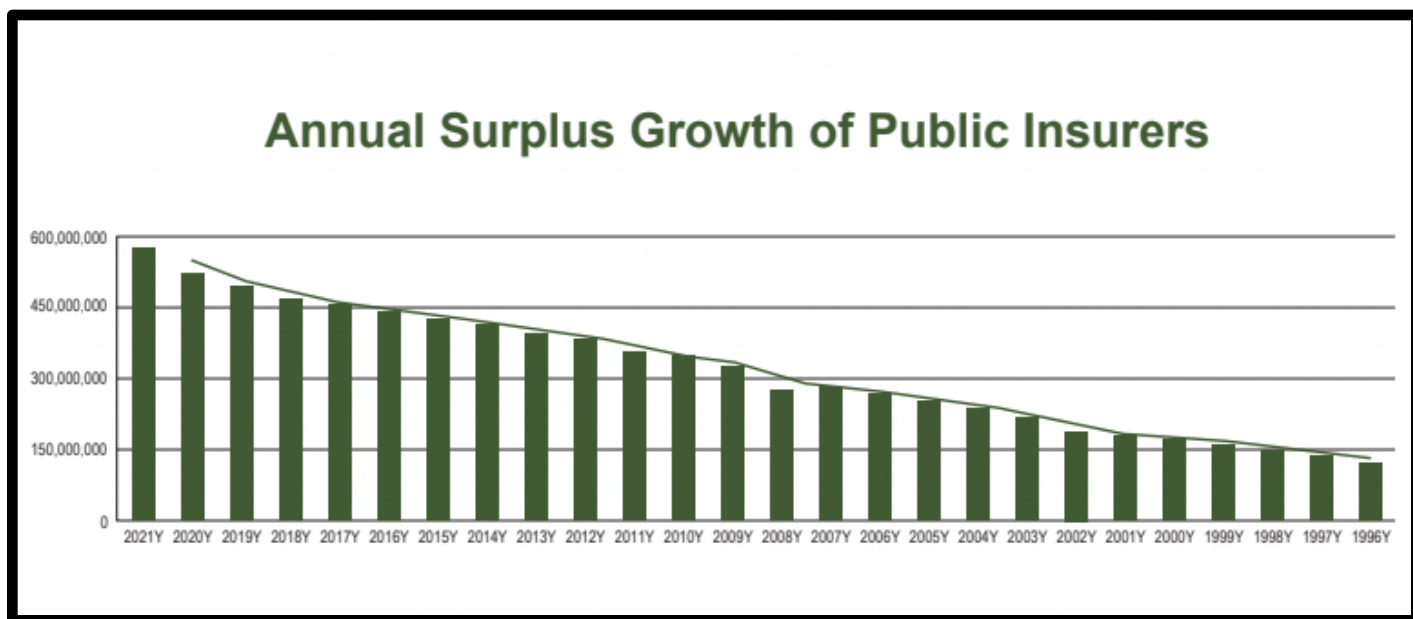


Figure 1

The graph in Figure 1 shows the annual growth of surplus among publicly traded insurance companies. Not only do these surplus numbers grow every single year, but there is some exponential growth in the years 2003, 2009 and 2012. Read on to learn why.

## Reinsurance Shenanigans ... Accounting Arbitrage

One way for an insurance company to pay out a dividend without much scrutiny is to make it look as though it has a surplus by ceding an increasingly larger amount of its business to a reinsurer. So, is it any surprise that at about the same time mutual insurers started going public, they began moving from well-known reinsurers, such as Lloyd's of London, and instead started using offshore reinsurers a lot more?

Referred to as the Bermuda Triangle strategy, insurers have been ceding larger and larger amounts to offshore reinsurance companies that have different accounting standards than U.S. reinsurers and who keep the paper trail of payments and policies hidden.



Figure 2



Figure 3

But then, the reinsurance problem got even worse in 2002—which is one of the years surpluses surged—when these newly public stock company insurers began using captive insurers in South Carolina and Vermont. Why? Because it was at that time SC and VT put forth bills to their state statutes under the insurance code. The bills said that insurers forming captives in these two states would be permitted to form special-purpose captives that would be regulated only by Vermont or South Carolina, and all records would be kept confidential—including financial statements.

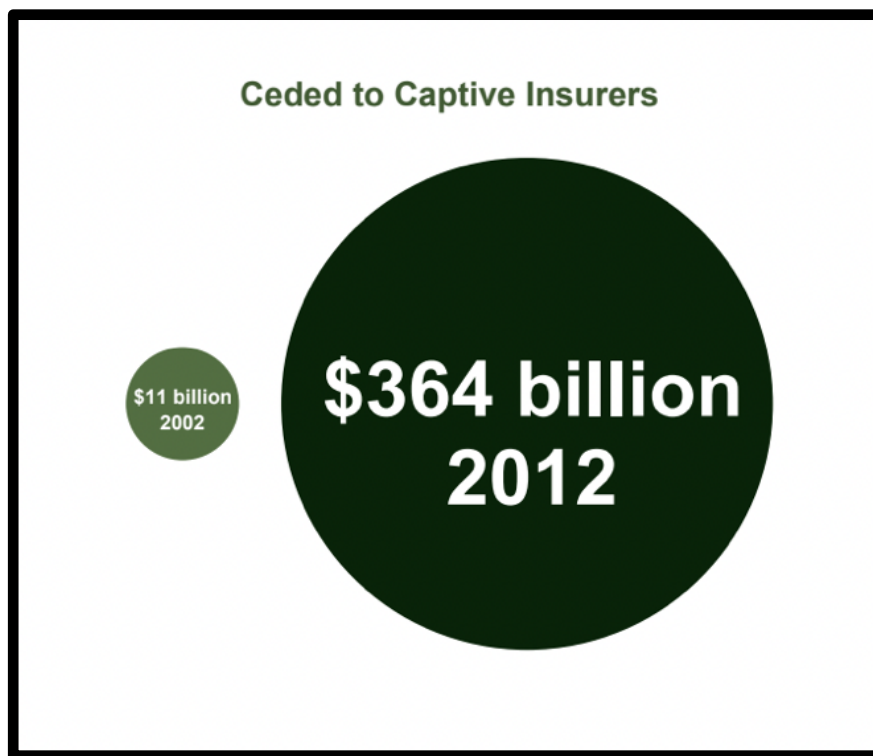


Figure 4

The issue of captive reinsurance is startling. In 2002 \$11 billion from the industry had been ceded to captive insurers. By 2012 that number had grown to almost \$400 billion.<sup>4</sup> There are articles touching on the problems this increased reinsurance can cause, but there are almost as many excuses as there are sleight of hand strategies. One article discussing the situation uses the excuse of interest rate risk. Another article uses the excuse of market volatility. Other articles bring up the fact that insurers are simply playing “regulatory arbitrage.”

It's true that our fragmented insurance situation allows exploitation of rules between states, yet what's really happening is a kind of accounting arbitrage, as the offshore reinsurers use different accounting principles and allow the submission of consolidated reports rather than statutory standalone reports with 10-Ks, 10-Qs and so on.

<sup>4</sup><https://www.nytimes.com/2015/04/12/business/dealbook/insurers-bypass-rules-to-add-hidden-risk.html>

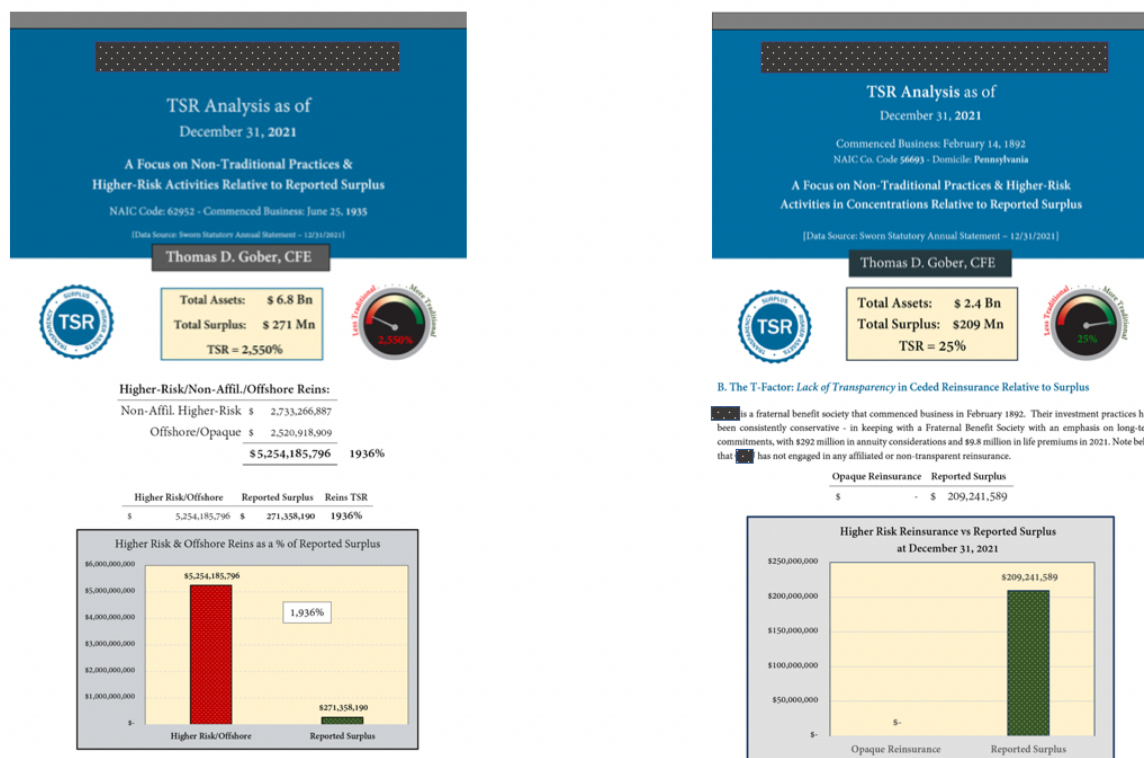


Figure 5

To truly understand how scary this situation is, look at Figure 5. You can see that company A, to the left, seems to have a reasonable surplus, making it appear healthy. Same thing with company B, to the right. But when you look at the true amount of offshore reinsurance Company A has, and you accurately take that away from the surplus, it changes the picture completely.

## Mark-to-Make-Believe

After the 2008 recession, there was an outcry pushing the SEC to suspend Fair Value Accounting Standards, otherwise known as mark-to-market. The argument for suspension was that if a company plans to keep a bond to maturity, they should not have to reflect fair market value on the books. Regardless of the fact that insurers might very easily need to liquidate bonds early to get funds to pay claims, mark-to-market was suspended.

Now, it's basically mark-to-make-believe—because if two top officers in a company swear that they plan to hold bonds to maturity, GAAP and SAP standards no longer require them to book the current fair market value for bond holdings.

Could that be part of the reason we see another surplus surge in 2009?

## Introducing Private Equity

The stability of many of the popular insurance companies promoted by the large field marketing organizations was further compromised around 2012 when private equity companies entered the scene. Private equity companies realized they could make tremendous money in the insurance game, so they started buying insurers and finding new ways to funnel money out of companies. One way they do so is by charging the insurers they buy for investment advice. Worse, they began having the insurance companies invest in higher-risk assets, which could prove problematic in the near future.

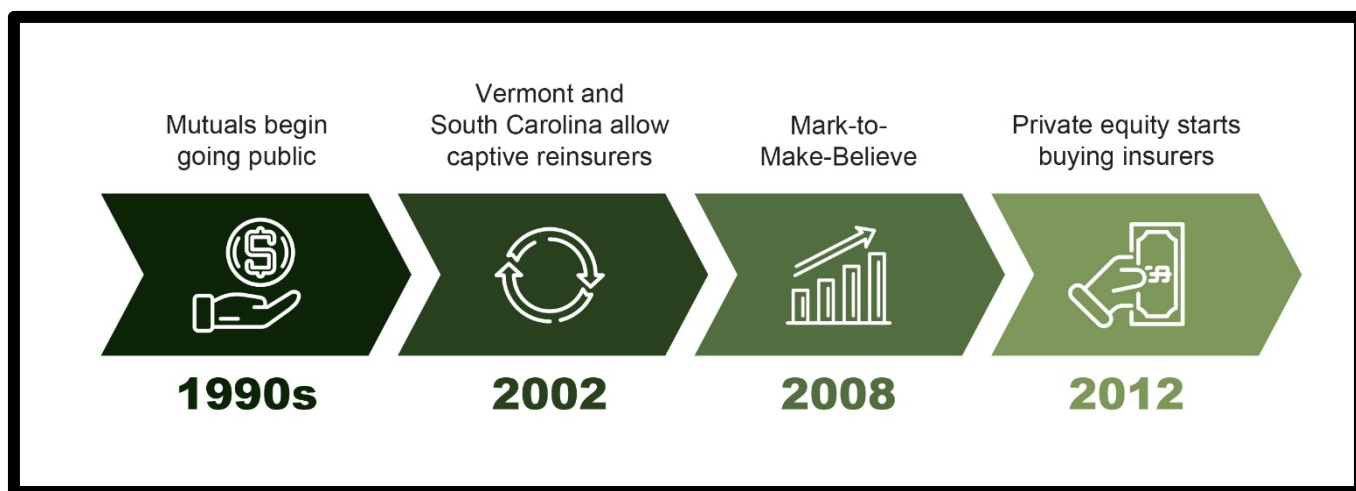


Figure 6

Each of the categories has its own potential issues with illiquidity and proper valuation. However, in a period of economic stress, many of these higher-risk assets would be far more susceptible to illiquidity and mark-to-make-believe shenanigans. In fact, in a time of economic stress, the insurers are far more likely to need funds—but stuck with illiquid investments potentially worth pennies on the dollar at the time, making them unavailable when they need funds for claims and cash surrenders—and these are very likely the companies you’re being solicited to write your client’s life and annuity policies with.

These nontraditional investment strategies and inherent systemic risks of private equity ownership of insurers concern many, including Senator Sherrod Brown, who wrote the following letter to the NAIC expressing his concerns.<sup>5</sup>

<sup>5</sup> [https://www.banking.senate.gov/imo/media/doc/brown\\_letter\\_on\\_insurance\\_031622.pdf](https://www.banking.senate.gov/imo/media/doc/brown_letter_on_insurance_031622.pdf)



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**United States Senate**  
COMMITTEE ON BANKING, HOUSING, AND  
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March 16, 2022

Steven Seitz  
Director  
Federal Insurance Office  
Department of the Treasury, MT 1001  
1500 Pennsylvania Avenue, NW  
Washington, D.C. 20220

Dean L. Cameron  
President  
National Association of Insurance Commissioners  
444 North Capitol Street NW, Suite 700  
Washington, DC 20001

Dear Director Seitz and President Cameron:

I appreciate the attention that the Federal Insurance Office (FIO) and the National Association of Insurance Commissioners (NAIC) have paid to the growing number of insurance obligations being sold to alternative asset managers, like private equity firms. I am writing to express my concern that insurance investment products workers depend on for their retirement are being transferred to these risky companies that have a track record of undermining pension and retirement programs. In FIO's most recent report, you pointed out these arrangements have become increasingly common over the last decade.<sup>1</sup>

This growth continued through 2021. In August of last year, *The Wall Street Journal* reported on a "frenzy among investment firms to amass insurance assets" as Brookfield Asset Management bought out American National Group.<sup>2</sup> Around that same time, Alcoa announced that it would transfer a billion dollars in obligations for defined benefit pension plans to Athene Holding,<sup>3</sup>

<sup>1</sup> Federal Insurance Office, Annual Report on the Insurance Industry 50 (Sept. 2021), <https://home.treasury.gov/system/files/311/FIO-2021-Annual-Report-Insurance-Industry.pdf>.

<sup>2</sup> Miriam Gottfried & Cara Lombardo, *American National Group to be Sold to Brookfield Reinsurance Arm*, Wall St. J. (Aug. 9, 2021), <https://www.wsj.com/articles/american-national-group-to-be-sold-to-brookfield-reinsurance-arm-11628501402#:~:text=The%20reinsurance%20arm%20of%20Brookfield,%24190%20a%20share%20in%20cash.>

<sup>3</sup> Tomi Kilgore, *Alcoa to Transfer \$1 Billion in Pension Obligations to Athene Holding*, MarketWatch (Nov. 17, 2021), <https://www.marketwatch.com/story/alcoa-to-transfer-1-billion-in-pension-obligations-to-athene-holding-2021-11-17>.

while Lockheed Martin transferred almost \$5 billion.<sup>4</sup> In November, Allstate completed the sale of its life and annuity businesses to Blackstone,<sup>5</sup> which also purchased a 9.9% equity stake in American International Group's life and retirement business.<sup>6</sup>

In February 2022, the consulting firm McKinsey & Company noted that if pending deals close, \$620 billion of life and annuity assets in the United States will be held by private funds, representing 12 percent of all such assets. It also observed that the five largest private equity firms all now hold life insurance assets, and that 15 alternative asset managers have entered, or announced plans to enter, the insurance market.<sup>7</sup>

Investment firms like asset managers and private equity funds often take on much higher risk strategies than traditional insurance companies, and do not face all of the same capital, liquidity, and policyholder protection requirements as well-regulated insurance companies. Consequently, many workers who chose to invest their retirement savings in conservative and long-lived insurance firms now find themselves paying premiums to much riskier firms with less experience in the insurance business. While investment firms might benefit from huge profits in the short term, failure to adequately manage these risks may ultimately cost policyholders their retirement incomes.

NAIC has also engaged in efforts to identify the challenges and systemic risks presented by this shifting marketplace, specifically with regard to structures that obfuscate regulators' ability to assess and address emerging risks. At their December Financial Stability Task Force Meeting, they noted that domestic and international regulators are concerned about PE-owned and traditional insurers with complex structures and riskier investment activities that may pose systemic risks.<sup>8</sup>

Given the rapid growth of insurance and retirement products held and managed by investment firms and the potential impact on workers, I am requesting that FIO, in consultation with NAIC, work to collect additional data from insurers and then further study this matter so it may issue a report to Congress no later than May 31, 2022 that evaluates the following concerns:

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<sup>4</sup> Reuters, Lockheed Reduces Pension Woes by Nearly \$5 Bln, Forecasts Hit to Profit on Actuarial Charges (Aug. 3, 2021), <https://www.reuters.com/business/aerospace-defense/lockheed-reduces-pension-woes-by-nearly-5-bln-forecasts-hit-profit-actuarial-2021-08-03/>.

<sup>5</sup> BusinessWire, *Allstate Completes Sale of Life and Annuity Business* (Nov. 1, 2021), <https://www.businesswire.com/news/home/20211101005951/en/Allstate-Completes-Sale-of-Life-and-Annuity-Businesses>.

<sup>6</sup> Duffie Osental, AIG Closes Sale of Equity Stake in L&R Business to Blackstone, Insurance Business America (Nov. 3, 2021), <https://www.insurancebusinessmag.com/us/news/breaking-news/aig-closes-sale-of-equity-stake-in-landr-business-to-blackstone-315329.aspx>.

<sup>7</sup> Ramnath Balasubramanian et al., McKinsey & Co., *Why Private Equity Sees Life and Annuities as an Enticing Form of Permanent Capital* (Feb. 2, 2022), <https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/why-private-equity-sees-life-and-annuities-as-an-enticing-form-of-permanent-capital>.

<sup>8</sup> National Association of Insurance Commissioners, Fall 2021 National Meeting Synopsis 22 (Dec. 30, 2021), <https://content.naic.org/sites/default/files/SYN-ZS-21-03.pdf>.

1. What risks do the more aggressive investment strategies pursued by private equity-controlled insurers present to policyholders?
2. What risks do lending and other shadow-bank activities pursued by companies that also own or control significant amounts of life insurance-related assets pose to policyholders?
3. Are there risks to the broader economy related to investment strategies, lending, and other shadow-bank activities pursued by these companies?
4. In cases of pension risk transfer arrangements, what is the impact on protections for pension plan beneficiaries if plans are terminated and replaced with lump-sum payouts or annuity contracts? Specifically, how are protections related to ERISA and PBGC insurance affected in these cases?
5. Given that many private equity firms and asset managers are not public companies, what risks to transparency arise from the transfer of insurance obligations to these firms? Will retirees and the public have visibility into the investment strategies of the firms they are relying on for their retirements?
6. Are state regulatory regimes capable of assessing and managing the risks related to the more complex structures and investment strategies of private equity-controlled insurance companies or obligations? If not, how can FIO work with state regulators to aid in the assessment and management of these risks?

I would appreciate your prompt attention to this matter.

Sincerely,



Sherrod Brown



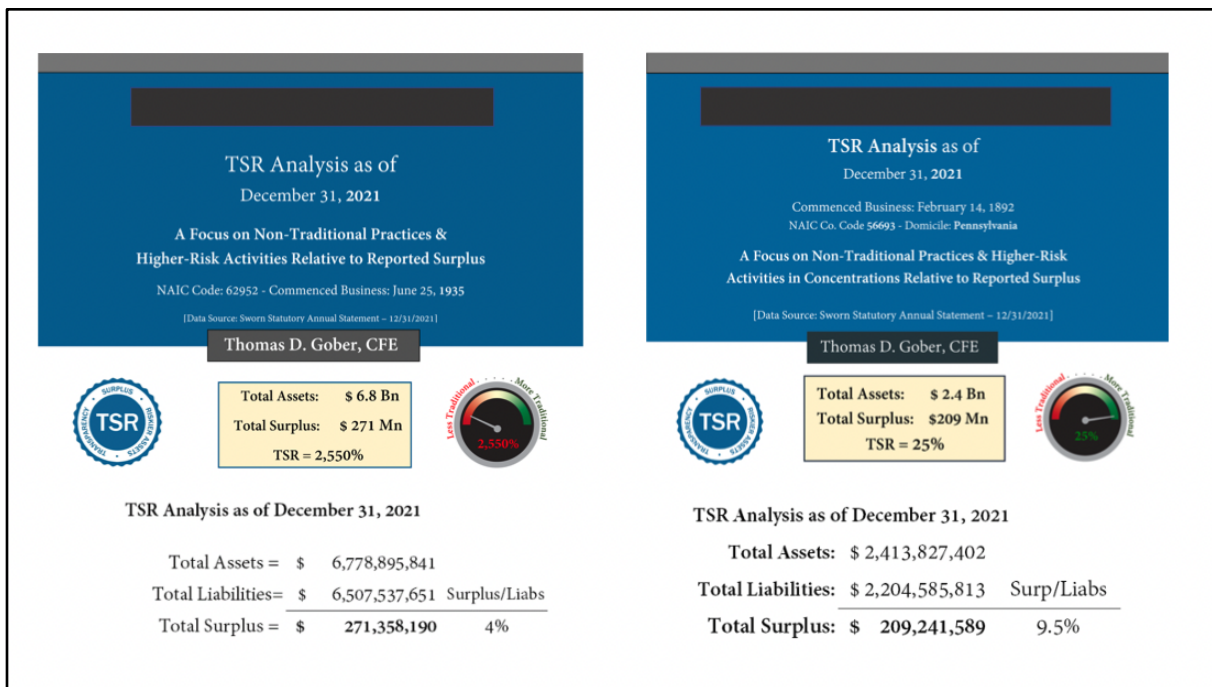


Figure 7

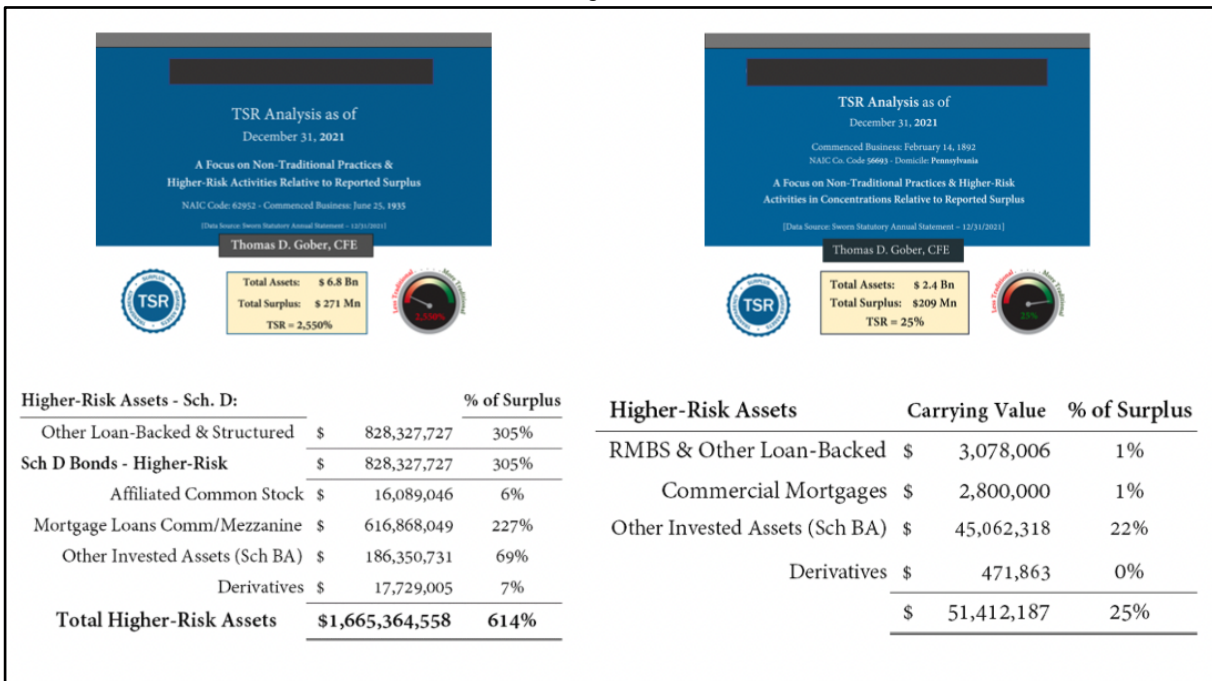


Figure 8

In Figures 7 and 8, you can see the impact of these high-risk assets on surplus when they are accurately reflected. In the conclusion, you see that Company A could withstand only a 2.3% write-down of all their high-risk assets where Company B could have ALL (100%) of their high-risk assets written to zero and remain solvent. It is critical to remember solvency for an insurance company is based on its ability to have adequate surplus above our clients' assets.

If a company is surplus-less, they are insolvent and then in the hands of the insurance commissioners and reliant on the Guaranty associations, which are allocation systems and not funded.

## Protecting Yourself and Your Clients

As a fiduciary, you have a duty to help your client get life insurance and annuity products with long-term promises that will be fulfilled. Insurance companies who have gone public are more focused on short- and near-term profits and paying quarterly dividends than on funding their long-term promises to the actual customer who pays in premium(s).

To help your clients get the coverage they deserve, you need to find a way to weed out those companies that take part in excessive use of high-risk assets and reinsurance sleight of hand. You need the TSR Ratio.

### What Is the TSR Ratio?

TSR is a tool that sheds light on this very real and present threat. It is driven by data analyzed by specialized forensic accountant Tom Gober, who uses each company's own annual sworn statement to pinpoint troubled reinsurance and excessive risk issues relative to the company's stated surplus—the same risks flagged by the Federal Reserve and the NAIC. The TSR ratio is mathematically represented as follows:

**What is the TSR Ratio?**

$$\frac{\text{Non-Transparent Reinsurance + Riskier Assets}}{\text{Surplus}}$$

*ALL information taken directly from the carriers' own sworn annual statements, yet no one else is choosing to shine a light on these highly risky & non-transparent practices.*

**The deep dive into the data is very complicated.  
The TSR makes it simple**

Thomas D. Gober

The TSR was created when Tom Gober and Matt Zagula joined forces to expose troubling risk-shifting and aggressive asset-purchasing patterns as they became more common from stock-owned insurance companies and even more so from private equity-owned insurance companies.

Together, Tom and Matt identified what they believe to be the most significant counterparty risk areas: affiliated and opaque reinsurance and excessive high-risk (and illiquid) assets, as expressed by the Federal Reserve and NAIC, in comparison to the insurance companies' reported surplus in their annual sworn statements.

The TSR ratio breaks down these factors into a detailed, three-page report identifying the higher-risk assets and opaque nontraditional reinsurance as a ratio to the reported surplus. REMEMBER: All data comes from the insurance companies' annual sworn statements. This is a mathematically determined ratio, devoid of opinion, that evolves from analyzing the company's own 1,500–6,000-page annual statement. The TSR ratio ultimately gives you access to a continuum for carrier comparisons to quickly contrast the difference between two very different companies—from more traditional to less traditional and more financially engineered insurance companies.

## What the TSR Ratio Has That Rating Agencies and Regulators Don't

- Rating agencies focus on assets. Rating agencies give very little attention to the substance of reinsurance or the excessive buying of affiliated assets compared to the insurance company's surplus. Most often, the ratio compares high-risk assets to total assets. From a policyholder view, the more important consideration is high-risk assets compared to the financial cushion: the insurance company's stated surplus. Tom says, "Rating agencies have an asset-rating heritage in their core DNA."
- State insurance regulators rely heavily on external audit workpapers. Examiners do on-site examinations every three to five years. But today's examinations are less rigorous, with a "by exception" focus, relying heavily on the audit firm, hired and paid by the insurance company. Tom, a former regulator, says, "The NAIC permits audit firm reliance in the review process."

## Introducing Tom Gober

Tom Gober, the only forensic accounting expert in the U.S. who focuses exclusively on the insurance industry and has worked with federal law enforcement to combat criminal fraud in the industry, has an answer for you.

Today, he works to help legal professionals, insurance agents through his work at the Smart Advisor Network, and the public understand what has happened to the financial condition of many stock life and annuity insurance companies. Then, he helps them find companies that emphasize appropriate financial security to fulfill their long-term promises through traditional means.

Tom is the expert that law enforcement relied upon for education and consultation with federal agents on a number of high-profile criminal cases, including Gen Re and AIG. He is also a former regulator in a state where his testimony landed his boss's wealthy friends in jail for accounting fraud. Tom is a champion to the policyholder and a true believer in the benefits of life insurance and annuities.

When we look back on past financial disasters, the center of the issues were leverage and inaccurate audit information. Today, we face these same dangers again in what should be the most reliable assets: life insurance and annuities. The leverage this time isn't from loans, but it comes from the complex multijurisdictional reinsurance arrangements to use GAAP accounting for discounts when SAP is required by all state Insurance Commissions and assets the Federal Reserve and the NAIC identify as higher risk due to liquidity limitations in down markets.

If you want to protect your clients from mark-to-make-believe, multijurisdictional accounting arbitrage, and excessive high-risk assets relative to a carrier's surplus, you need to know Tom Gober.

How do you get Tom Gober on your team?

Simple—go to [www.theTSRratio.com](http://www.theTSRratio.com) and sign up to attend one of our bimonthly TSR Ratio Spotlight Zoom meetings highlighting all the popular life and annuity carriers. Then you can decide whether to use the TSR ratio to guide your insurance carrier selections with our fiduciary approach.