SPECTRUM
Asset Management

Life Insurance Divestitures Lessen Business Risk

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The persistent compression in global interest rates continues to be a challenge for the insurance industry despite a backup from 2016 lows in US Treasury yields. Changing regulation and customer demographics, and macroeconomic factors (such as low rates), have led to an evolution in life insurance business models, which is supportive of credit fundamentals. For example, life insurers have been shifting their operational mix toward fee-based and underwriting/protection-focused products, and away from investment-based customer guarantees. These moves have been gradual, until recently.

This month Brighthouse Financial (BHF) began trading regular way as a public company separately listed from MetLife Inc. (MET). MET shareholders received one BHF share per 11 MET shares in the spinoff of BHF. MET's non-cash initial separation of >80% of a large majority of its US retail businesses — especially variable annuities (VA) with embedded investment guarantees to customers — signals the industry's shift to less capital intensive and lower-risk products. New VAs sold tend to have less generous policyholder features than those in BHF's back-book sold years ago. Though recent Department of Labor rules may continue to pressure new VA sales, BHF could nonetheless appear attractive to investors who expect a further backup in interest rates.

Another large insurer, French multi-national AXA SA, recently announced plans to IPO a minority stake in its US Life & Savings operations and interest in asset manager Alliance Bernstein. Despite less punitive Solvency 2 governance of AXA's US operations given third country regulatory equivalence, volatility associated with a large position in VAs is inconsistent with AXA's ongoing, more conservative strategy. Moreover, while AXA has proposed a transaction different from that of MET's, the underlying economic motivations are similar. AXA believes it can better deploy proceeds into more protection-oriented insurance offerings and higher growth markets.

In other news, Canada's Manulife reportedly is mulling an exit of its US-based John Hancock unit. London-based Prudential plc (*unrelated to Newark-based Prudential Financial*), also operating in the US and Asia, may be contemplating strategic options. And, Hartford Financial, which placed its VA business into runoff years ago, may be near a deal to sell this block.

The underlying industry theme underscores a trend towards businesses which are not as sensitive to macroeconomics and market swings. This broader industry shift bodes well for the insurance companies in which Spectrum invests, as it helps to reduce overall business risk. **Spectrum's life insurance investments are supported by strong capital, diversity and disciplined risk management.**

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