

To Our Clients and Friends,

The insurance industry is in a moment of active transformation. There are developments—often major changes – in regulation, technology, transactions, litigation, enforcement, tax, policy coverage and many other areas, seemingly every day.

The purpose of this Newsletter is to focus, on a regular basis, on specific areas of change and examine them through the lens of corporate governance:

- What does this rapidly evolving environment require of those entrusted with oversight and management of insurance businesses?

The Emerging Role of Private Capital

There has been much said and written lately about the role that private equity firms are playing in the insurance sector, particularly (but by no means exclusively) through investments in and acquisitions of life and annuity companies, and the provision of investment management services to those companies through long-duration investment management agreements. For more detail on recent regulatory developments involving private capital, see our article in the *Debevoise Private Equity Report*.

The emergence of private equity and debt capital as a force in the insurance sector is not a surprise and in fact is nothing new. Private equity firms have sought to bring particular expertise to the insurance sector for decades, and, indeed, some prominent firms have been formed specifically to specialize in investments in the insurance and other financial services sectors.

The difference now is in the macro environment in which insurance companies are operating. In particular, the low interest rate environment that has prevailed for a decade; increasing competition for retirement assets; demographic changes; evolving legal, regulatory and accounting regimes; and, of course, the ongoing effects of the global pandemic,

- What are the implications for shareholders, investors, policyholders, regulators and other constituents?
- How can our clients best position themselves to anticipate and respond to these specific changes in an industry that is broadly transforming itself?

This month, we discuss private capital's entry into the insurance sector.

have led insurance companies to look closely at their core, spread-based business models. This strategic reevaluation process is a fundamental aspect of good corporate governance.

Private capital moving into the industry on a long-term basis may create challenges for traditional insurers, but it also creates opportunities. It is at least arguable that the long-term nature of insurance commitments makes those businesses at least as well suited for private (including mutual) forms of ownership as for public market ownership, with its quarterly challenges. The ability to sell run-off businesses to privately financed buyers allows traditional insurers to free up capital and make investments in technological innovations and other critical aspects of new business growth. Relying on the expertise of the credit-focused private investment firms to source higher yielding and less volatile assets can help traditional insurers better focus on building attractive products and growing their businesses profitably. There are strong market precedents to demonstrate improvement in private equity-owned and managed insurance company investment portfolios, with no material increase in risk.

At the same time, it is appropriate to think about what competitive challenges private equity capital presents to the traditional insurance model. Boards and management should be evaluating what, if any, parts of their businesses can be better (i.e., more efficiently, and on a cost-effective basis) handled by third parties, where the risks in their businesses are, and whether private equity can help solve problems. Traditional insurance companies need to consider what the emergence of private equity-backed insurers means for the overall competitive environment and how traditional insurers can responsibly source higher yielding assets with, or without, the help of

Conclusion

We think boards and senior management of insurance businesses should be focused on the impact of private equity as an emerging competitive force in the sector. We believe there are good examples of private equity being an important part of the solution for a range of problems that currently impact the industry. But it is equally important to consider the challenges that will be presented by the shift towards private equity. Most importantly, the opportunities and challenges presented by the emergence of private equity will vary significantly from company to company and, as we have seen, within different regulatory regimes. But the shift, which is quite possibly permanent, is unmistakable and critical. We believe focusing on these issues presents not just a strategic and business priority but also a corporate governance imperative.

credit-focused firms. These issues require a view not only of the short-term risks in the businesses but also the long-term direction of the economy – how fast will corporate interest rates rise, what will be the impact of inflation, what is the lasting impact of the current pandemic, and what products will resonate with consumers? Indeed, given the centuries-old history of insurance, it is fair to ask whether the role of private equity is permanent or whether it will expand or contract as these macroeconomic factors inevitably change.



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