PHL Variable Insurance Company: Negative Surplus Position

(Update: May 21, 2024)

Overview

PHL Variable Insurance Company's (PHLV) filed its year-end 2023 regulatory financial statement in late April 2024, seven weeks after the required filing date of March 1. **The company reported a negative surplus[1] position of -$92 million at 12/31/23, which was a $177 million deterioration from +$85 million at 12/31/22**. The deterioration in surplus was driven by a large after-tax operating loss of $162 million incurred in 2023, which was not balanced by any capital support from PHLV's parent company.

The culprit behind the operating loss: a reduction in reserve credit PHLV can recognize related to its captive insurer Concord Re, given Concord Re's own negative surplus position at year-end 2023. This required PHLV to reduce the reserve credit it receives from business ceded to Concord Re, and to increase its own reserves by a matching amount (hence the sharp increase in PHLV's policy reserves in 2023).

The timeline leading up to severe financial problems for life insurance companies is often gradual. The case of PHLV is no different and below we explore how PHLV got to this point and what the future may hold for the company.

Background

PHLV was a subsidiary of the Phoenix Companies (a former mutual life insurance organization, which reorganized into a publicly-traded company in 2001) from the early 1990s, primarily focusing on individual life insurance and annuity products for the high net worth market. Following the financial crisis of 2008-2009, the Phoenix Companies restructured its business operations in light of the group's markedly weaker financial performance, the loss of major distribution partners, and public rating agency downgrades. This resulted in the sale of its private placement life insurance and annuity business to private investment firm Tiptree, Inc. in 2011, and ultimately the sale of the entire organization (including PHLV) in 2015 to the Nassau Financial Group (NFG), a newly formed group backed by private asset manager Golden Gate Capital.

PHLV has long underperformed the broader life insurance industry[2] and its financial performance was especially poor over the last five years (see below). Up until 2023, PHLV reported solvent capitalization measures (notably its risk-based capital ratio), though such measures generally trailed the industry average and the company struggled to maintain its surplus position without significant capital support.

Historical Trend of ALIRT Scores (2013-2023)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
PHL Variable Ins. Co.	34	35	32	29	36	28	22	13	20	20	12
ALIRT Life Composite	54	54	50	49	50	48	53	48	54	52	50

[1] Total adjusted surplus is the sum of capital and surplus as well as the interest maintenance reserve and the asset valuation reserve.

[2] As measured by the ALIRT Life Composite which is comprised of 100 of the largest U.S. life insurers ranked by general account invested assets (=85% of industry invested assets).

To illustrate this, PHLV's total adjusted surplus declined from $239 million at year-end 2013 to $85 million at year-end 2022, despite $245 million of net capital infusions received over this same period and $55 million of surplus notes issued. Put another way, the company would have been insolvent long ago without this capital support provided by both the Phoenix Companies (prior to the sale in 2015) and NFG. We note, however, that $85 million of the capital support received by the latter parent was used to help fund the formation of captives Concord Re and Palisado Re.

In 2021 PHLV was separated legally from NFG and the company became a subsidiary of a new holding company, PHL Holdings, LLC. PHLV and its new direct parent company, however, remain subsidiaries of Golden Gate Capital, the ultimate parent company of NFG. Following this restructuring, PHLV has not received any additional capital support.

PHLV's operational struggles have largely been tied to adverse performance in the company's guaranteed universal life insurance business, reflecting higher-than-expected mortality experience, the decades-long decline in interest rates and investment returns (which was only partially reversed in 2022 and 2023), and lapse rates that were far lower than anticipated. PHLV's deteriorating operating performance has been a key driver of the company's declining surplus position and contributed to multiple ratings downgrades from rating agencies in the years subsequent to the financial crisis (PHLV was a "A" rated carrier by AM Best in the mid-2000s but was rated "B" in 2020 when the rating was withdrawn). Amid its ongoing struggles, PHLV halted new business sales in 2019 and reinsured much of its remaining life insurance and annuity business to a newly-formed U.S. domiciled captive, Concord Re.

PHLV stated in its year-end 2022 regulatory financial statement that it had concern over the viability of Concord Re and that a deterioration of capital in Concord Re could in turn adversely impact PHLV's capitalization, and possibly subject PHLV to regulatory action. ***Given the concerns over the performance of Concord Re, the Connecticut Department of Insurance (CT DOI) placed PHLV under administrative supervision in March 2023.***

At year-end 2023 PHLV's reserve credit for reinsurance arrangements with Concord Re totaled $1.31 billion, however, this was down from $1.48 billion at year-end 2022. This decline reflected the negative surplus position of Concord Re at the end of 2023 and its diminished ability to meet policyholder obligations assumed from PHLV. As mentioned, the reduction in reserve credit taken forced PHLV to increase reserves on its own balance sheet and pushed the company's surplus position into negative territory at year-end 2023.

Outlook

Going forward there are a handful of points to consider:

- As of this writing PHLV remains under administrative supervision by the CT DOI. Consequently, any business or governance actions (outside of the course of ordinary business) taken by PHLV requires approval from the CT DOI.

- Given the company's negative surplus position, its Risk-Based Capital (RBC) ratio is below the mandatory control level as of year-end 2023 and this would allow state regulators to take control of an insurance company via some form of receivership.

- PHLV has stated that is currently not in receivership but that the CT DOI "has indicated a regulatory action, whereby the Department assumes control of PHLV, would not be precluded at any time during the next twelve months".

- PHLV subsequently noted that it had **<u>"substantial doubt"</u>** regarding the company's ability to continue as a going concern given the company's declining financial performance and the potential for regulatory action.

- PHLV stated that it is exploring strategic actions that could potentially help the company's financial position but that no assurances can be made in terms of successfully executing any potential actions.

At present, the Connecticut DOI has not issued any comment regarding the status of PHLV but it seems likely that further regulatory action is pending. What's more, the chances of PHLV implementing any material strategic actions to improve the company's reported capitalization and financial results seem low, especially now that the company is no longer owned by NFG. It is reasonable to ask why the Connecticut DOI allowed NFG to spin off PHLV, given the company's long standing financial struggles and the reliance on parent company capital support.

NFG, for its part, likely wanted to separate direct ties to PHLV given its growth ambitions in the annuity market, led by Nassau Life & Annuity Insurance Company. Continued ownership of PHLV and the need for ongoing capital support may have diminished the group's ability to access third party capital to support this strategic growth plan. To this point, NFG completed multiple third-party capital raises in recent months including a $130 million investment from Fortress Investment Group in September 2023 and issued $250 million of non-convertible debt in February 2024.

Finally, PHLV stated that a further deterioration in Concord Re's capitalization could result in additional reserve increases for PHLV, as PHLV would have to further reduce reserve credit related to the business reinsured with Concord Re. This could exacerbate PHLV's negative surplus position, which could 1) make it increasingly difficult for PHLV to secure necessary capital support, and 2) reduce funds available for policyholder obligations.

As of year-end 2023, PHLV is projecting sufficient liquidity and assets to meet policyholder obligations through 2038. This was two years shorter than the projection of 2040 the company made one year ago (stated in the year end 2022 regulatory financial statements). In other words, the financial position of PHLV is in flux and available assets and funds to support policyholder liabilities may deteriorate further.

At this point, regulatory action seems imminent, absent capital support provided to PHLV by its parent and/or a successful execution of a strategic transaction to improve PHLV's financial profile.

Update: On May 20, 2024 the CT DOI issued a press release[3] stating that PHLV, as well as its subsidiaries, had been placed under Rehabilitation. Additionally, the Connecticut Superior Court issued a moratorium limiting payments for some policies while the rehabilitation plan is developed, which is expected to be completed in the next twelve months.

What's more, court filings related to the rehabilitation order show that PHLV is now projecting that it has funds to cover policyholder obligations though 2030, a significant decline from the estimate of 2038 that was projected at year-end 2023. The current estimate would leave $1.46 billion in policy liabilities unfunded.

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[3] https://portal.ct.gov/cid/phl?language=en_US