Independent Analysis of
Insurance Company Risk Trends
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TransAmerica to Cease Writing Guaranteed Variable Annuities, Fixed Annuities, and Long-Term Care Insurance (December 11, 2020)

On December 10, 2020 AEGON N.V. (AEG), parent company of the TransAmerica U.S. life insurers (TRANS), announced significant changes to its U.S. individual businesses in an effort to strengthen the business, provide capital relief, and create value for AEG's customers and shareholders. These changes include the following:

- TRANS will cease new sales of variable annuities with significant living and death benefit guarantees, stand-alone long-term care insurance, and fixed annuities, but will continue to offer mutual funds and individual retirement products, including accumulation variable annuities that have limited sensitivity to interest rates.
- AEG is reviewing the potential to implement a dynamic hedging strategy for its in-force U.S. variable annuities with income and death benefit guarantees. Further, AEG management also stated that it will consider "a broad range of actions" for TRANS' existing block of variable annuities with guarantees.
- In its U.S. individual life insurance business, AEG (and TRANS) plans to increase sales and aim to regain "Top 5" positions in certain life insurance products.
- TRANS will also continue its focus on the small and mid-sized retirement market, where the company believes it has a leading market position.
- ***The near-term effect from these announcements is negligible as there is no change to any existing contracts, and the actions to be taken relate almost entirely to TRANS' sales efforts going forward. The TRANS insurance subsidiaries that issued the contracts retain the legal obligation for all in force policy contracts.***
- As for AEG's exploration of "a broad range of actions," any potential transactions (including timing, structure, or economics) remain unknown at this time.

These announcements constitute the latest in a series of strategic changes for TRANS. Other changes included the following:

- The sale of its U.S. life reinsurance business in 2011 and in-force payout annuities and bank owned/corporate owned life business in 2017.
- Exit of the institutional group annuity business in the wake of the financial crisis.
- The considerable downsizing of the insurer's once large individual fixed annuity business during the 2010s.
- The exit of, and then re-engagement in, the individual long-term care insurance business.
- Runoff of guaranteed universal life insurance, among other restructuring efforts and product changes related to its individual life insurance businesses.

Industry Trends

TRANS' exit from new sales of guaranteed variable annuities, long-term care insurance, and fixed annuities and AEG's exploration of strategic options with respect to TRANS' guaranteed variable annuities, is another in a long list of U.S. life insurers changing their product strategy and/or selling part or all of their U.S. individual life insurance or annuity businesses[1]. These groups include but are not limited to the following:

AIG / American General Life	Hartford Fin'l Services Group	Prudential Inc. (U.S.)
Allstate	ING USA	Prudential Plc (U.K.)
Aviva	Jackson National	Sun Life of Canada
AXA	Liberty Mutual	Symetra
Equitable	MetLife	TransAmerica (prior actions)
Great American	Ohio National Life	Voya
Great-West	Phoenix	

The long-dated liabilities associated with many life insurance and annuity contracts are under ongoing pressure from the falling investment returns, while other businesses (property/casualty insurance, group retirement and accident & health businesses, international operations, etc.) are now viewed more favorably by institutional investors in publicly-traded stocks.

Some of the dynamics behind these divestitures include:

- The steep drop in equity markets and elevated investment losses during the financial crisis,
- The multi-decade period of declining interest rates and investment returns,
- Increased regulatory activity at the point of sale,
- Changing financial reporting and reserve requirements (both in the U.S. and internationally),
- Tepid demand for many of the industry's products,
- The growth of privately-owned insurance groups interested in entering the life insurance and annuity business (or growing existing businesses). Some of the reasons for the increased interest include (perceived) attractive pricing of blocks of business, asset management opportunities, and/or the greater ease for a private company in hedging equity market and/or interest rate sensitivity, as compared to a public company that has to report quarterly earnings.

Many if not most of these factors remain in place today and ALIRT believes that additional changes are possible in company ownership, as well as insurer exits from various business lines and/or the continued "de-risking" of current and future product offerings.

Effects of TRANS Ceasing Sale of Fixed and Guaranteed Variable Annuities, Long-Term Care

- TRANS' insurance and annuities are issued by TransAmerica Life Insurance Company (TLIC) and TransAmerica Financial Life Insurance Company (TFLIC; dedicated New York subsidiary).

- TLIC merged with affiliated insurer TransAmerica Premier Life Insurance Company in October 2020, which made TLIC (already TRANS' "lead" life insurer) a substantially larger company.

- ***The immediate financial impact to TLIC or TFLIC from the cessation of new sales of guaranteed variable annuities, fixed annuities, and long-term care insurance is minimal, as existing policy contracts remain in force (at least for now).***

[1] Over the last two months, ALIRT published releases on substantial transactions by AIG/American General, Equitable Financial, Great American, and Prudential (U.S.). Please visit the ALIRT web portal site to access our thoughts on these.

- The exit from new sales may lead to a reduced need for capital for either company, given the expected reduction in business volume. All things equal, this could potentially lead to an increased level of shareholder dividends paid by TLIC and/or TFLIC. AEG management stated that its capitalization target for its U.S. life insurers is a risk-based capital ratio of 400%.

- In terms of the business profile, below is a breakdown of **individual annuity** premiums for TLIC and TFLIC combined for 2019 (this information is available only on an annual basis):

  - Variable Annuities with Guarantees: $3,187 million
  - Variable Annuities without Guarantees: 462 million
  - Indexed Annuities: 56 million
  - Fixed Annuities: 40 million

- This highlights the small share of fixed annuities relative to total individual annuities, as well as the substantial reduction in this business for the TRANS life insurers relative to the past.

- It also reflects the absence of a significant individual indexed annuity business for TLIC and TFLIC. Combined with the lack of a registered indexed annuity product, the exit from variable annuities with guarantees severely reduces TRANS' footprint in individual annuities, as there is not another product that TLIC and TFLIC can attempt to transition sales and distribution efforts.

- **Long-term care insurance** premiums totaled $457 million for TLIC and TFLIC combined in 2019, which equaled 2.6% of total net premiums written. New premiums written would have been demonstrably smaller.

- Going forward, TRANS' plans to concentrate its individual life insurance and annuity operations in growing its market share in term life, indexed universal life, and final expense life insurance.

- As for other products, the group plans to build on its significant market condition in qualified retirement annuities related to defined contribution pensions, as well as offer variable annuities without guarantees in the non-qualified retirement space.

AEG to Explore Strategic Options with Respect to Guaranteed Variable Annuities

- As mentioned above, the exit from new sales in these business lines does not affect the existing exposures. Total general account policy reserves for TLIC and TFLIC combined at year end 2019 were 13% individual fixed annuities, 12% individual long-term care insurance, and 5% for variable annuity secondary guarantees.

- As a result, TLIC and TFLIC's financial profile will still be impacted by these product lines, until or unless these policy liabilities are reinsured or sold (either in total or in part).

- AEG stated that it will consider a broad range of actions for its variable annuities. ALIRT notes that there have been several major transactions involving variable annuities over the last several years, which include the Hartford and VOYA sales in 2018, and Equitable's announcement earlier this autumn that it plans to sell a large share of its existing guaranteed variable annuities to the Venerable group.

- These transactions indicate that AEG (and by extension TRANS) may be able to sell some or even all of its guaranteed variable annuities in force in the current market environment. However, this may change if equity markets, credit markets, and/or economic conditions deteriorate.

- We also note that though the Hartford, VOYA, and Equitable transactions are sizable, in the end the acquisitions were made by two organizations (the Talcott and Venerable groups). Though there may be other groups interested in acquiring variable annuity businesses, only two organizations (three if we include Delaware Life) have actually executed transactions.

- Further, in November 2020 Prudential Inc. announced similar plans with respect to its own variable annuities, and Prudential Plc is planning to spin-off (via an initial public offering) its U.S. business, which is largely comprised of the variable annuity dominant Jackson National Life Insurance Company.

- Hence, there are now at least a few other possible opportunities for investors within the guaranteed variable annuity industry, which could impact pricing or terms and conditions for AEG/TRANS.

As indicated before, it is impossible to know when (or if) any divestiture, reinsurance, or other transaction will transpire, and if a transaction (or transactions) do occur, we would need to await news on the structure, economics, and timing to assess the ultimate impact.

ALIRT Thoughts

- TRANS' decision to exit the sale of guaranteed variable annuities, long-term care insurance, and fixed annuities is the latest in a series of insurers de-emphasizing or exiting various businesses.

- The capital-intensive nature of (and volatility inherent in) guaranteed variable annuities, combined with lower than expected policy lapses and the long decline in interest rates and investment returns all contribute to a dampening of investor enthusiasm for such products, which are trends years in the making. However, the substantial decline in interest rates in 2020 has intensified these effects to some degree.

- Also, stockholder demands for enhanced short-term returns in the form of share buybacks and dividends has increased the attractiveness for public companies to reduce the capital intensity of their business and improve the predictability of cash flows and available capital for such activities. The cessation of new business in these products may allow for a greater flow of shareholder dividends from TLIC and/or TFLIC to the parent company.

- The financial results for TLIC were mixed over the last decade or so, and the inconsistent earnings and returns on equity and assets (both in aggregate and for the company's principal business lines individually) may have been a catalyst for some of the changes in strategic direction and business operations, both the announcements made today as well as the many changes made since the financial crisis of 2008-2009.

- TRANS (through TLIC and FLIC) has only a very small fixed indexed annuity business and does not offer a registered indexed linked annuity, and as a result the exit from guaranteed variable annuity sales (and to a much lesser degree from fixed annuities) greatly diminishes TRANS' individual annuity business. The company does plan to continue to issue variable annuities without guarantees, but these comprise only a small portion of total individual annuities for TLIC and TFLIC.

- Going forward TRANS' plans to focus its insurance and annuity business on individual life insurance and hopes to increase its market share in term life, indexed universal life, and final expense life insurance. TRANS enjoys substantial distribution through both independent life insurance agents, as well as through its affiliated World Financial Group distributors.

- That said, growing individual life insurance is a difficult endeavor for any insurer at any time (at least for the last 30 years), and the challenge may be even more significant now given less attractive products relative to years past (due to falling investment returns), the high level of uncertainty in economic performance for at least the next few years, and the disruption in sales caused by Covid-19 and related governmental edicts limiting travel and business activity.

- The companies will also continue to offer annuities and related products to the defined contribution market. These products carry a great deal less risk for the insurer, as they lack secondary guarantees with respect to living or enhanced death benefits. However, these products are something of a commodity, and face strong competition from other insurers as well as mutual fund companies, asset managers, and other investment vehicles.

- In regards to AEG exploring its options with respect to TRANS's existing guaranteed variable annuities, an increased appetite for this business (both for existing blocks of business and new business capabilities) would indicate that TRANS may well have opportunities and options for possible divestment and/or reinsurance transactions for this business.

- However, this could change if equity markets deteriorate, interest rates remain at their current very low levels, or if the weak economic conditions persist and lead to material investment losses for insurers (which could reduce capital available for acquisitions and/or make transactions less attractive to potential acquirers).

We will continue to follow developments at AEG/TRANS and its subsidiary insurers and we will report back to clients as warranted. Please feel free to contact us should you wish to discuss or if you have any questions.

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