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Black's Apollo Seeks Control of Athene to Gain Annuity Assets

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By Miles Weiss

Oct. 22 (Bloomberg)– Leon Black's Apollo Global Management LLC is seeking to acquire control of Athene Holding Ltd. as the private-equity firm increasingly turns to the insurance business for assets to invest in high-yield and distressed debt.

Apollo, which owns a nonvoting stake in Athene through an affiliate, has asked the Delaware Department of Insurance to approve transaction involving the insurer's voting stock, a step that would subject Black's firm to regulation as an insurance holding company, according to a regulatory filing. The deal would pave the way for Athene, which originates and reinsurers fixed annuities, to raise additional capital, said a person with knowledge of the plan, who asked not to be named because the information is private.

Black's company, the third-largest buyout firm by assets, is pushing into annuities as it seeks to reduce its reliance on leveraged takeovers and secure long-term financing for less-liquid investments. Money managers such as New York-based Apollo and Guggenheim Partners are betting they can wring more profit from annuity contracts than non-U.S. life-insurance companies that are exiting the business as falling interest rates and rising capital requirements cut their returns.

"Athene, Guggenheim and others believe they can manage the risk and allocate capital at more economic levels" than the insurers that have traditionally originated fixed annuities, said Chris Stroup, chairman of Wilton Re, a Wilton, Connecticut- based life reinsurer. "These companies are interested in accumulating annuity liabilities to gain assets to invest."

Charles Zehren, a spokeman for Apollo, declined to comment. James Belardi, one of the co-founders of Athene, didn't return a telephone call seeking comment.

Revenue Stream

Apollo, co-founded in 1990 by Black and three of his colleagues from Michael Milken's Drexel Burnham Lambert Inc., is one of several publicly traded buyout firms seeking to diversify their revenue sources. Blackstone Group LP, the largest private-equity firm by assets, has expanded its hedge-fund and credit-investing businesses, with KKR & Co. and Carlyle Group LP taking similar steps.

Apollo's capital markets group, which includes hedge funds and investment in Athene, surpassed private equity as the firm's largest business unit earlier this year, with $56.1 billion in assets as of June 30. The firm manages about $105 billion across all of its businesses.

Europe Plan

Apollo oversaw $10.7 billion for Athene at midyear, including $3.5 billion invested in its hedge and real estate funds and $7.2 billion for which the firm provides asset-allocation services, according to an Aug. 2 earnings call. In the second quarter, an Athene unit committed at least $133.7 million to three Apollo funds, state filings show: the AGRE U.S. Real Estate Fund LP, the Apollo-Asia Private Credit Fund LP and the Apollo European Principal Finance Fund II, which focuses on nonperforming loans.

Black's firm has hired RMR Advisors Ltd., started earlier this year in London by former UBS AG bankers Jamie Robinson, Deepak Rajan and Henrik Matsen, as consultants to build the European life insurance and reinsurance unit, two people with knowledge of the plan said. They may also look to grow the business through acquisitions and insurance-linked financing such as securitizations, the people said.

Assuming Risk

Belardi, the former chief investment officer of American International Group Inc.'s retirement-services unit, and Chip Gillis, the former head of insurance solutions at Bear Stearns Cos., co-founded Athene in 2008 with financial backing from Apollo. The Pembroke, Bermuda-based firm, which has offices in Manhattan Beach, California, was set up as a reinsurer for fixed annuities, meaning it would assume some of the risk that life insurers take when they write the contracts in return for the right to manage and reap any additional gains from the underlying customer deposits.

A fixed-annuity client typically makes an initial lump-sum payment to an insurer in return for a series of guaranteed payouts in the future. The insurer then invests the cash in corporate, government and asset-backed bonds, seeking to earn a return that exceeds the payments promised to the buyer.

'Significant Pool'

Marc Rowan, an Apollo co-founder and senior managing director who also serves on Athene's board, compared its annuity contracts to the deposits a bank gets: both are long-term liabilities that don't have to be repaid for years and carry low fixed-interest rates. Athene invests the money in higher-yielding bonds and mortgage-backed securities, earning the same type of spread a bank makes by lending out customer deposits at higher interest rates.

"We have long-term, locked-in liabilities that give us the ability to have a significant pool of capital to go after illiquid investments, "Rowan said during a May conference call for AP Alternative Assets LP, a publicly traded private-equity fund that holds Apollo's stake in Athene. He said "Athene is a very large buyer" of structured assets, such as residential and commercial mortgage-backed securities, "that the marketplace, in its desire to go short and liquid, has overlooked," according to a transcript of the call.

Moreover, Athene positions Apollo to benefit from a confluence of two demographic trends: the demise of the traditional pension plan and the aging of the "baby-boom" generation born between 1946 and 1964. Life insurers market fixed annuities to people who want to ensure they have a certain level of income in retirement.

‘Massive Demand’

“You have 80 million baby boomers coming on line who want annuities as part of their financial-planning strategy,” said John Coughlin, chief executive officer of Safe Harbor Re Ltd., a Bermuda-based company that is also reinsuring annuities. “When interest rates rise, you are going to see a massive demand.”

Until now, Athene has been structured in a way that permits Apollo to earn fees and a share of profits from the Bermuda-based company’s annuity origination and reinsurance business without Apollo coming under the jurisdiction of U.S. insurance regulators. Apollo’s majority stake comprises nonvoting shares. Athene’s voting stock is controlled by Belardi and 10 other individuals through Cayman Islands-bases Athene Group Ltd., filings show.

Transaction Proposed

In August, Apollo, Black, Rowan and Joshua Harris, another co-founder, submitted a Form A Statement Regarding the Acquisition or Merger with a Domestic Insurer with the Delaware Department of Insurance, according to a second-quarter filing by Athene Annuity & Life Assurance Co., a unit of Athene Holding. While Athene Annuity is based in Greenville, South Carolina, the company is domiciled Delaware for regulatory purposes.

The confidential filing seeks the approval of the Delaware Insurance Commissioner for a proposed restructuring so that Apollo and its co-founders can acquire “indirect control”of Athene Holding, according to the quarterly statement. Under the Delaware Insurance Code, companies or individuals who want to acquire 10 percent or more of a local insurer’s voting securities must get approval from the state.

Delaware regulators can’t comment on whether an application has been filed until the agency schedules a public hearing, said Linda Sizemore, director of company regulation within the state insurance department. At the hearing, an independent hearing officer would receive testimony from the insurance staff and the applicant and then make a recommendation to the insurance commissioner, who makes the final decision, Sizemore said in an interview.

Abu Dhabi

Apollo proposed the transaction, which will bring the firm under increased regulation, because insurance has become an increasingly large part of its business, a second person familiar with the company said. It would also make it easier for fast-growing Athene to raise additional capital, according to the first person.

Among possible sources of capital, the Abu Dhabi Investment Authority, a sovereign-wealth fund also referred to as ADIA, has expressed interest in swapping its 40 percent stake in publicly traded AP Alternative Assets for shares of Athene, this person said. ADIA invested $600 million in Black’s management firm in July 2007 and another $600 million in AP Alternative Assets, which Apollo formed to invest alongside its buyout funds.

Athene has about $750 million in capital and is seeking to raise that figure to $1.75 billion by the end of this year, the person said.

Capital Base

Erik Portanger, a spokesman for ADIA, said he had no immediate comment.

In 2013, Athene may hold a private sale of shares to mutual-fund companies, the person said. Athene would typically be required under the terms of a private placement to complete an initial public offering within one year to create a liquid market for the shares bought by the mutual funds.

Athene, which targets a 25 percent internal rate of return, could use the capital to originate more annuities or invest in assets that European and Canadian insurers are seeking to divest. Guggenheim Partners, based in New York and Chicago, is also acquiring annuity assets from insurers in a bid to leverage the expertise of its large money-management staff.

Guggenheim's Strategy

"We have a 700-member investment team that allows us to do things differently than insurers who are getting out of the industry," President Todd Boehly said in a telephone interview. "Most insurance companies that have $10 billion to $15 billion of assets can't justify" that large a staff, he said.

Athene bought Liberty Life Insurance Co. of Greenville, South Carolina, from Royal Bank of Canada in April 2011 for $624.8 million, and agreed in July to acquire Presidential Life Corp. for $414.3 million. It's a potential bidder for the U.S. life insurance division of Aviva Plc, the U.K.'s second-largest insurer by market value, people familiar with the situation said last month.

Regulatory filings by Liberty Life, renamed Athene Annuity & Life Assurance Co. in February 2012, show different investment approaches by Athene and RBC, as the insurer did less trading under its former owner. State regulatory filings show that it sold $150.4 million of debt securities and bought $861 million of them in 2009, a year in which annuity sales boomed, increasing the size of its bond portfolio to $3.4 billion. In 2010, Liberty Life sold $269.9 million of bonds and purchased $926 million of them, lifting its holdings to $4 billion.

Bond Trading

In 2011, the year it was acquired by Athene, the insurer sold $2.9 billion of bonds and bought $3.5 billion of the securities. In the first half of this year, it sold $7.8 billion of bonds and acquired $7.4 billion worth.

Athene also changed its bond mix, selling most of Liberty Life's municipal, corporate and agency debt while spending almost $2 billion to buy residential mortgage-backed securities, state regulatory filings show. The purchases included $1.5 billion spent on RMBS backed by subprime and Alt-A mortgages, the types of securities that were most affected by defaults and downgrades during the 2008 recession.

Athene's annuity unit acquired many of the subprime securities through a $3.1 billion reinsurance transaction with Aegon NV at the end of last year, a person familiar with the transaction said. Athene carried out the reinsurance deal together with UBS.

Athene acquired the subprime securities at a discount to face value, paying as little as 8 cents on the dollar, the filings show. Its RMBS holdings, including both those purchased at par and at a discount, had a face value of $3 billion.

UBS Swaps

That December, Athene Annuity and its affiliates entered into total return swaps with UBS in which the Swiss bank assumed the credit and market risk on subprime bonds with a book value of $1.4 billion.

Under the swaps, which expire in 2014, UBS receives the actual interest paid on the bonds, along with any realized gains or losses on sales or any temporary gains or losses. In return, UBS pays Athene a floating interest rate based on the London Interbank Offered Rate, or Libor, plus 70 basis points, on the book value of the bonds, the state filings show. A basis point equals a hundredth of a percentage point.

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Editors: Josh Friedman, Larry Edelman

To contact the reporter on this story: Miles Weiss in Washington at +1-202-624-1899 or mweiss@bloomberg.net

To contact the editor responsible for this story: Christian Baumgaertel at +1-617-210-4624 or cbaumgaertel@bloomberg.net