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GE’s $15B Infusion into LTCI Biz Sets Off Industry Alarm Bells

By Warren S. Hersch January 17, 2018

GE's corporate headquarters in Boston.

The news that multinational conglomerate **General Electric** will be injecting an eye-popping $15 billion into its beleaguered long-term care reinsurance run-off business and is weighing a break-up of the company is reverberating industry-wide. The announcement is raising questions about other potentially troubled LTCI run-off businesses, the financial health of life-annuity carriers that have substantial closed LTCI blocks, and the ability to sell these blocks to potential buyers.

Among equity research firms alarmed by GE’s disclosure is **Evercore ISI**, which in November 2017 noted that “reserve deficiency” of carriers with closed LTC blocks — **CNO Financial**, **Genworth Financial**, **Manulife** and **Unum** — represents an “out-size risk factor” for these companies. The unexpectedly high capital charges that GE has now disclosed has prompted Evercore to revise its outlook.

“After an analysis of the GE long-term care exposure, we had thought an outsized charge was likely, but have to admit the $15 [billion] of additional capital ultimately being required was far in excess of our adverse case expectations, and is a negative read for other insurers with sizable long-term care blocks in our view,” states Evercore ISI in a report prepared by analysts **Thomas Gallagher**, **Kosta Kasidakos** and **Andy Lee**. “The size of these charges and capital contributions may serve as a wake-up call for investors for others with large LTC blocks. We think this risk is being underestimated for certain insurers which have above average exposure," including Unum and, to a lesser degree, CNO Financial.

Edward Kohlberg, an associate director at A.M. Best.

Edward Kohlberg, an associate director at A.M. Best, adds that GE's announcement could make divestitures of closed LTCI blocks more challenging for GE and other insurers that carry them. Whereas, he notes, equity and interest rate risk associated with legacy variable annuity blocks can be hedged using derivatives, such techniques aren't available for run-off LTCI businesses.

Upshot: Carriers holding legacy LTCI blocks will not likely be able to emulate the favorable deals crafted by **The Hartford** and **Voya Financial**, which recently sold runoff variable annuity businesses to investor groups for $2.05 billion and $54 billion respectively.

"You can't hedge policyholder behavior with LTCI blocks," says Kohlberg. "Buyers of LTCI run-off businesses need to know what they're getting into. That's why you haven't seen any of these blocks move. [GE's announcement] will make it even harder to sell such blocks."

Taking a Big Hit

In a January 16 conference call with stock analysts, GE Chairman and CEO **John Flannery** said the company will be reporting in its fourth quarter earnings results an after-tax charge of $6.2 billion ($7.5 billion when factoring in a 21% tax rate). To prop up its insurance unit, the North American Life & Health portfolio of subsidiary GE Capital, GE plans also to allocate $3 billion in cash in the first quarter of 2018, and then another $2 billion between 2019 and 2024. The total outlay of capital and statutory reserves is pegged at about $15 billion.

GE Chairman and CEO John Flannery.

"Needless to say, at a time when we're moving forward as a company, I'm deeply disappointed at the magnitude of the charge in this legacy portfolio," said Flannery during the analyst call, which was transcribed by Seeking Alpha, a financial markets content service. "It's especially frustrating to have this type of development when we've been making progress on many key objectives."

GE's troubles — and the prospect of a break-up of the Boston-based multinational conglomerate — comes in the wake of other negative developments reported by long-term care insurers. Prominent among them is Genworth Financial, which has failed to date to secure the U.S. government's okay for its $2.7 billion buyout by **China**

Oceanwide because of national security concerns about the deal. If the deal is not finalized (the merger has been delayed repeatedly, this time until April 2018, to allow the Treasury Dept. more time to review the pact) the future of Genworth, once the LTCI market's top player, remains in doubt.

Other major insurers have recently exited the business for stand-alone long-term care insurance because, like Genworth, they made misguided assumptions about LTCI policy lapse rates, claims, interest rates and long-term care costs. As reported in *Life Annuity Specialist*, Manulife terminated sales of LTCI products in Canada in December, about one year after its U.S. unit, **John Hancock**, did the same. The development follows announcements by multiline insurer **State Farm** and **Desjardins**, a Canadian financial services cooperative, regarding their own departures from the LTCI market.

More than a dozen other insurers, including **AXA**, **MetLife** and **Prudential Financial**, have stopped selling LTCI policies within the past decade. Steps undertaken by the carriers to prop up their LTCI businesses, including repeated policy rate hikes, have diminished demand for stand-alone long-term care insurance to all but the most affluent consumers. The departures have reduced to fewer than a dozen the number of life-annuity carriers — among them **Lincoln Financial**, **MassMutual, Nationwide**, **New York Life, Pacific Life** and **Transamerica** — that are still active in the space.

GE's own troubles date from 2004, when GE North American Life & Health reinsured legacy LTCI blocks of, among other insurers, Genworth Financial. (GE established Genworth from **GE Capital**'s insurance businesses in an IPO that year. And much of the legacy LTCI run-off business impacted by the GE announcement was insured by Genworth.)

GE exited between 2004 and 2006 most of the insurance businesses it held, reducing its risk exposure by $130 billion and securing $13 billion in capital to reinvest back in the business. GE's decision to retain its current insurance businesses, including the reinsured LTCI blocks, was based on GE's belief that a "gradual run-off" of the business would "yield a better economic result" than a more accelerated timetable, according to Flannery.

What Now for LTCI Legacy Blocks?

That's proved not to the be the case. And market-watchers are now questioning the financial outlook for GE and other insurers with similarly large LTCI run-off businesses.

Eric Ause, a senior director of the corporates group at FitchRatings, says that higher than expected LTCI claims has reduced the valuation of GE Capital, which funds reserves for the run-off business. The aforementioned capital charges also "increase the risk of future financial support" for GE Capital by the parent company.

Doug Meyer, a managing director at **FitchRatings**, believes that older LTCI blocks issued prior to the early 2000s (when assumptions about policy lapse rates, interest rates and long-term care costs were substantially revised), will remain challenging to sell. And they'll be difficult to hold profitably absent continuing premium rate hikes approved by state insurance regulators.

Doug Meyer, a managing director at FitchRatings.

But he views prospects for more recently issued LTCI policies more favorably. And likely buyers, he says, include private equity firms with billions in capital to invest.

“I would expect to see more transactions” he says. “The long-term tail liability [of legacy LTCI blocks] makes them particularly attractive for private equity firms with alternative investment strategies.

“But to the extent that you’re reinsuring a block of LTCI business to a non-traditional [PE] player, you would be trading direct LTCI risk for reinsurance counterparty risk,” he adds. “[LTCI sellers] will have to get comfortable with that counterparty risk exposure. That’s been an impediment to transactions with private equity firms.”

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