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Resolution Life Australasia Limited

19 January 2022

Sector: Financials
Sub-sector: Insurance
Country: Australia
Ownership: Private

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Issuer Outline

Resolution Life Australasia Limited (Resolution Life), previously AMP Life Limited, is the fifth largest provider of in-force life insurance policies and the largest life insurer as measured by statutory fund assets under management in Australia. Resolution Life is the former life insurance operation of AMP Limited (AMP), and is 80% owned by Resolution Life NOHC Pty Ltd, a member of the Resolution Life Group (Resolution), a global life insurance group focused on the acquisition and management of portfolios of in-force life insurance policies (closed life insurance funds) in mature markets, globally. Resolution recently agreed to acquire AMP's minority equity interest in Resolution Life, subject to regulatory approval (expected to conclude by mid-2022). We note that as part of the sale of its life insurance operations to Resolution, AMP Group provided an indemnity covering conduct prior to the acquisition.

Resolution is backed by a diverse group on institutional investors, including JPMorgan (banking), Nippon Life (life insurance), and KKR (private equity). Resolution has founded three separate insurance consolidation vehicles under the Resolution brand over the last 17 years, deploying over USD15bn in capital and generating returns of USD21.8bn.

Although closed to most new business, Resolution Life will continue to accept new premiums through top-up insurance. It is also anticipated any further locally acquired closed life insurance funds will be consolidated into Resolution Life. Resolution Life operates across two distinct business segments: wealth management (superannuation and investments; 24.0bn in AUM), and wealth protection (AUD1.7bn in AUM).

Key Financials (AUDm)

Last six months (30 June)	2021
Life insurance contract revenue[1]	1,212
Other income	877
Life insurance contract claims[2]	(1,352)
NPAT	113
Investments in financial assets	29,739
Life insurance contract liabilities	22,199
Investment contract liabilities	4,631
Capital adequacy multiple	249%

Source: Company Reports.
[1] includes life insurance claims recovered from reinsurer
[2] includes life insurance contract premiums ceded to reinsurers

Summary Bond Details

ISIN	Issue Amount	Ranking	Coupon	Coupon Frequency	First Call[1]	Maturity Date
AU3FN0057691	AUD300m	Subordinated Unsecured Tier 2	3M BBSW+3.30%	Quarterly	9 December 2025	9 December 2035

[1] Excludes potential terms that would allow the issuer to redeem prior to the maturity date through a make-whole call

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Strengths

- Strong market position as one of the largest providers of wealth protection and superannuation and investments: Resolution Life is the fifth largest provider of in-force life insurance policies (~10% market share) and the largest life insurer as measured by statutory fund assets under management (in Australia and New Zealand--although Australia accounts for more than 80% of its consolidated operations).

  As a closed-life book, Resolution Life will gradually see its market share reduce over time as it will receive only recurring premiums on its in-force book. However, this is likely to take place over a considerable period of time (decades; expected run-rate of maturing policies is 4%-5% p.a.) and it is expected any future acquisitions of closed life insurance books in Australian and New Zealand will be consolidated into Resolution Life, backed by Resolution Life's strong track record (Resolution Life has founded three separate insurance consolidation vehicles under the Resolution brand over the last 17 years, deploying over USD15bn in capital and generating returns of USD21.8bn).

  The closed book of in-force life insurance policies will also allow management to concentrate on existing customers and retention, with less focus and expenditure on attracting new customers. This can lead to a lower and more predictable risk profile (lower claims and lapse rates).

- Strong capitalisation and low leverage: Resolution Life is strongly-capitalised (and at the top-end of life and general insurance peers), with excess capital of ~AUD1.6bn above (regulatory) prescribed capital amounts. Its common equity PCA multiple is estimated at ~220% (compared with a minimum requirement of 80%), or 249% on a total capital basis (compared with a minimum requirement of 100%). Leverage is modest. Composition of capital is strong and is almost entirely comprised for common equity.

  Resolution Life's capital requirements (prescribed capital amounts) are likely to run-off along a broadly similar rate to that of the run-off (maturity) of its life insurance policies (4%-5% p.a.). Where capital is no longer required, it will be returned to equity holders. The ability of its parent company to extract earnings from Resolution Life is limited, however, as the latter is prudentially regulated (and as such, is required to maintain certain minimum levels). A trigger identified by Moody's for a downgrade on the credit rating would be a reduction in the insurers' regulatory capital coverage to less than 180%.

  Therefore, there should be little change to the level of capital held by Resolution Life relative to the assessed risk of its operations.

- Improved outlook for operating performance: Resolution Life's profitability has exhibited a high degree of volatility in the years prior to its sale, with an adverse experience stemming from changes to best-estimate assumptions, reserve strengthening, especially for income protection and total and permanent disability, and reported impairments related to the write-down of goodwill.

  Changes to best-estimate assumptions and reserve strengthening are in-effect adjustments to the amount of reserve set aside for future claims. As such, and given the improvement in earnings reported over the last two halves, we believe the forementioned adjustments should augur for a more stable outlook for earnings in the foreseeable future, as has been the case in recent periods.

- Low-risk investment portfolio and reinsurance arrangements provide good cover for wealth protection claims: To ensure the insurer has sufficient liquid funds available to meet claims obligations to policyholders within its wealth (income) protection segment, Resolution Life maintains a very high proportion of high-quality liquid assets, comprising 52% cash and 48% fixed interest (of which ~40% are sovereign exposures, while a further 50% are rated 'A' and above).

  The overall reinsured proportion of its wealth protection segment is ~65%, comprising quota share arrangements (60%) and per life surplus arrangements for large sums insured (5%), although it does not cover pandemic related claims (which, to date, have not had a material impact on the insurer). Reinsurance companies are regulated either by APRA or industry regulators in other jurisdictions and have a minimum credit rating of 'A+'.

- Modest exposure to individual disability income insurance subsector: Resolution Life's exposure to wealth protection (individual life and income protection) is modest, accounting for less than 8% of consolidated insurance policy liabilities;

the insurer is more heavily associated with the relatively lower risk wealth management (superannuation and investments) segments, where much of the investment risk is shared with policyholders.

The modest exposure to wealth protection is beneficial in-light of the decision by APRA in 2020 to intervene within the individual disability income insurance sector (which in recent years has been characterised as highly competitive and poorly priced, resulting in significant losses [which Resolution Life itself was not immune to, with the company reporting higher claims, policy lapses, and capitalised losses in recent years]). APRA requirements with respect to disability income insurance do not impact Resolution Life to the same degree as other life insurers (as it is largely closed to new business). The APRA requirements should provide a benefit to Resolution Life, in that their competitors are no longer able to offer new contracts on comparable terms to their in-force (legacy) policies. This reduces the propensity for policyholders to lapse as they are now unable to replace their policy with a new provider on the same terms.

Risks

- Closed book of in-force insurance policies sensitive to higher lapse rates and changes to insurance risk assumptions: As a closed fund, Resolution Life's financial performance is dependent entirely on generating earnings from its existing customer base. This leaves the insurer susceptible to higher lapse rates (competitive and otherwise) and changes to insurance risk assumptions (for example, increased disability income protection claims from the secondary economic impacts of COVD-19, and in particular, increased mental health related claims).

  We note that to date, on the latter, lapse rates haven't been significantly impacted by COVID-19 (~5% for super and investments--mostly maturing policies, and consistent with the expected run-rate for a run-off portfolio--and the low-teens for wealth protection)

- Future growth reliant on change in business model and further closed-book acquisitions: Resolution Life is currently transitioning its operating model from away from a vertically integrated subsidiary of Resolution Limited to a standalone in-force specialist operating model (which includes exiting certain material outsourcing agreements with AMP Limited, its prior owner). By extension, growth will be largely dependent on the successful acquisition and integration of local life insurance closed-books. While Resolution has a strong track record, and further divestments in Australia and New Zealand are likely in the future as the industry undergoes a structural change, the strategy is clearly not without its challenges.

- High exposure to risk assets within Resolution Life's participating business: For certain S&I products (including Whole of Life & Endowment Policies [~AUD11.0bn in AUM]), the policyholder participates in profits generated from these products ("participating business"). Resolution Life's participating business asset portfolio comprises a mix of fixed income (49%), yield enhancing equities (27%), property (8%) and infrastructure investments (4%), with the residual held in cash.

  A high level of yield enhancing risk assets backing traditional life policies exposes Resolution Life to potential financial market volatility, which may negatively impact profitability and capital if investment losses are not shared with the policyholder (policyholders generally receive 80 per cent of the profits, with shareholders sharing in the residual 20%). The sum (capital) insured is specified at inception and guaranteed (i.e. protected against negative returns; importantly, investment returns are not guaranteed).

  According to Moody's, "Resolution Life actively manages the equity exposure using put options and short futures positions to provide protection from equity market declines. Additionally the company also uses derivatives to protect against changes in long-term interest rates. These hedging strategies provide significant downside protection to both profitability and capital."

  Resolution Life has significant loss absorbing reserves available through the unvested policyholder bonuses (~AUD2.4bn). Although these represent undistributed past profits that are expected to be paid to policyholders through future bonuses, they are discretionary policy bonuses which are yet to be allocated to policyholders and are available to absorb investment market losses in subsequent years.

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Risks relevant to the Subordinated Unsecured Tier 2 instrument

- Subordinated ranking: Regulatory Tier 2 instruments are unsecured and subordinated instruments, ranking ahead only of ordinary shares and regulatory Additional Tier 1 hybrids. Tier 2 instruments rank behind senior creditors, which includes senior unsecured creditors and policyholders.
- Basel III compliant structural features: The subordinated bonds are Basel III complaint and as such do not include a step-up margin if not called and contain a point of non-viability clause. If APRA, the Australian Prudential Regulator, determines that Resolution Life requires capital support to prevent it becoming non-viable (a 'non-viability event'), the company may be required to convert some or all of the notes into ordinary shares or write-off some or all the face value of the notes. Whether a non-viability trigger event will occur is solely at the discretion of APRA. APRA does not define what constitutes a non-viability event and there are currently no precedents under Basel III to determine non-viability.

  The number of shares at time of conversion may be worth significantly less than the face value of the notes and a holder may suffer a loss as a consequence of conversion. Ordinary shares in Resolution Life are not listed on ASX or any other securities exchange and there may be no market in the ordinary shares issued on conversion. Accordingly, there can be no assurance that a noteholder will be able to sell the ordinary shares received on conversion. If the notes required to be converted following a non-viability event are not converted for any reason within 5 business days of the non-viability trigger, then conversion will not occur and the notes will be written off.
- Optional call dependent on regulatory approval: The Notes include an early call feature where the face value of the Tier 2 notes may be repaid early in cash in December 2025 and each subsequent interest payment date up the Maturity Date. The optional redemption requires regulatory approval, which may not be provided.

  In general, regulators are unlikely to provide approval for a Tier 2 instrument to be called if it results in a reduction in the issuer's capitalisation; regulators are unlikely to provide approval for a redemption or resale unless the issuer has, or is expected to, issue an instrument of similar size to replace the instrument subject to that call. To the extent the optional call was expected not to be exercised, it is likely that the price of the notes will be negatively affected, with this negative price movement being potentially material.

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Summary Financials

The financial summary below represents the consolidated operations of Resolution Life Australasia Limited.

FYE Dec 31 (AUDm)	2016	2017	2018	2019	2020
Summary Profit & Loss Statement					
Life insurance contract revenue	1,816	2,997	2,653	2,244	2,009
Reinsurance recoveries	59	234	487	512	556
Interest, dividends and distribution income and net gains on financials assets and liabilities at fair value through profit and loss	5,482	9,426	345	14,580	(5,008)
Fee revenue	1,072	1,191	1,044	878	342
Life insurance contract claims	(1,248)	(2,046)	(2,254)	(2,175)	(2,075)
Premiums ceded to reinsurers	(122)	(635)	(989)	(1,033)	(989)
Fees and commissions	(593)	(747)	(597)	(562)	(307)
Operating expenses	(703)	(932)	(905)	(684)	(483)
Change in policy liabilities[1]	(5,244)	(8,228)	170	(12,563)	5,631
Profit for the period	**308**	**565**	**(139)[2]**	**62**	**234**
Summary balance sheet					
Cash and cash equivalents	2,534	2,466	2,410	1,895	158
Investments	87,161	102,797	94,281	98,620	30,051
Reinsurance assets	94	804	1,073	1,222	1,448
Total assets	**91,671**	**108,353**	**99,812**	**103,893**	**33,120**
Life insurance contract liabilities	18,131	23,675	23,246	23,494	22,530
Investment contract liabilities	66,328	75,154	68,627	71,550	4,476
Reinsurance liabilities	530	1,450	1,452	1,515	1,546
Total liabilities	**88,656**	**104,541**	**97,100**	**101,554**	**30,918**
Contributed equity	939	1,473	1,473	1,473	1,632
Retained earnings	1,990	2,406	1,255	879	634
Total shareholder equity	**3,015**	**3,812**	**2,712**	**2,339**	**2,202**

Source: Company. [1]Policyholders' share of investment gains and losses attributable to investment risk [2] Loss primarily attributable to increase in claims for income protection and total permanent disability, as well as an increase in capitalised losses due to strengthening of best estimate assumptions.

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