THE APOLLO MEMO: Leon Black's G.O.A.T. White-Collar, Fraud Scheme

Recent Misuse of ModCo to Falsely Reduce Required Capital

[Please note this is not a polished report…this short version is intended to assist you in preparation of a more complete discussion about current day misuse of ModCo to falsely reduce required capital. The brief background below helped me to put the misuse of ModCo in perspective.]

Prior to World War II (WWII) Germany was the primary hub for large, heavily-capitalized reinsurance companies. After WW II large reinsurance companies willing and able to assume large blocks of business from ceding companies became much more available in other countries.

Pre-WWII, U.S. insurance companies turned to the large German reinsurers for their backstop to absorb surges or spikes in claims volume. U.S. insurers and regulators trusted them to honor their commitments. As Hitler's threat grew, Germany's volatility made large reinsurance transactions by U.S. insurers with the German reinsurance hub more precarious. The U.S. insurers and regulators' distrust was not of the reinsurance companies willingness or ability to pay claims; it was Hitler's insanity. U.S. regulators had no doubt that the long-standing giants (Cologne Re founded 1846) were "willing and able" to honor their reinsurance commitments to U.S. insurers. With Germany war-torn and the threat of German military leaders potentially seizing their assets, Modified Coinsurance became a solution.

Modified Coinsurance is precisely the same as traditional Coinsurance in that the assuming reinsurance company is in fact on the hook to pay all losses that fall under the traditional Coinsurance contract and, of course, to share in the profits. The unique characteristic is that all funds that the ceding U.S. insurer would normally pay (along with the related liabilities) to the reinsurer (in Germany…a wartorn country) are actually held in trust or escrow by the U.S. ceding insurer. While it served its purpose in the instance of World Wars, it has more recently been used with affiliated, underfunded captives, as nothing but a farce for the sole
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purpose of "sleight-of-hand" accounting.

Note that the mechanics associated with such modified coinsurance (as compared with traditional coinsurance) are a tedious and onerous accounting mess. Ceding insurers must basically account for both ends of the reinsurance contract and exercise considerable fiduciary caution in pulling funds from the escrow account. Upon receipt of a claim, the ceding insurer must not only determine if the claim is or is not covered under the ModCo contract and report the claim to the assuming reinsurer, it must carefully document the propriety of pulling the funds from the escrow account. While the funds in escrow are safekept in the U.S., they are the property of the reinsurer. Also, the results of the ModCo are the same as traditional Coinsurance; hence, the onerous nature of the ModCo only makes sense if it is necessary. If the preferred reinsurers have substantial capital and the willingness to provide a backstop – but are domiciled in a war-torn country, then ceding insurers and their U.S. regulators might find that the additional safety net is worth the hassle.

No one can successfully challenge the reinsurance fundamentals that require bona fide risk transfer and, especially, the ability of the reinsurer to pay. Ceding insurers do not engage in large reinsurance contracts because they want to share their profits with them. But in order to have their commitment to honor claims/losses, they must be willing to share in profits as well. Coinsurance is truly share and share alike…both profits and losses. If the claims experience is especially bad for several periods, the reinsurers are on the hook for amounts which might be far in excess of anticipated claims patterns. In such events, the reinsurer must cough up substantial additional funds necessary to "true up" the higher reserve liabilities. IF THE REINSURER WAS NOT ABLE TO PAY IN THE EVENT OF SPIKES IN LOSSES, THE CEDING INSURERS WOULD NOT CEDE TO THEM VIA COINSURANCE, MODCO OR ANY OTHER FORM. More on point here, because of the onerous nature of the ModCo process, to do so with a reinsurer with insufficient capital would be foolish.

In recent years, I began to take notice that for-profit life insurers were employing a renewed use of ModCo contracts and in massive amounts. Frankly, given that I had already uncovered accounting schemes far in excess of the life insurer's total surplus, I was not in the hunting mode. More importantly, I was lulled into a false sense of security by the fact that with ModCo contracts, THE FUNDS DO NOT TRANSFER TO THE REINSURER. In fact, when I first focused on the potential problems with these ModCo deals, I called one of the most respected life actuaries in the country who has worked for more than 30 years with Tillinghast and served as a life actuary for more
than 40 years. Jeff had earned my respect and trust when he testified in a large criminal case involving fraudulent reinsurance which resulted in a lengthy prison sentence for the defendant. I testified in that same case with respect to RICO and money laundering which led to a record forfeiture under RICO; funds which went to the benefit of policyholders who had been unable to get claims paid. When I told Jeff that I had uncovered a new scheme involving ModCo, his first comment was "what concern would there be with ModCo, since the funds stay with the ceding company?" That is when I realized how this scheme had a
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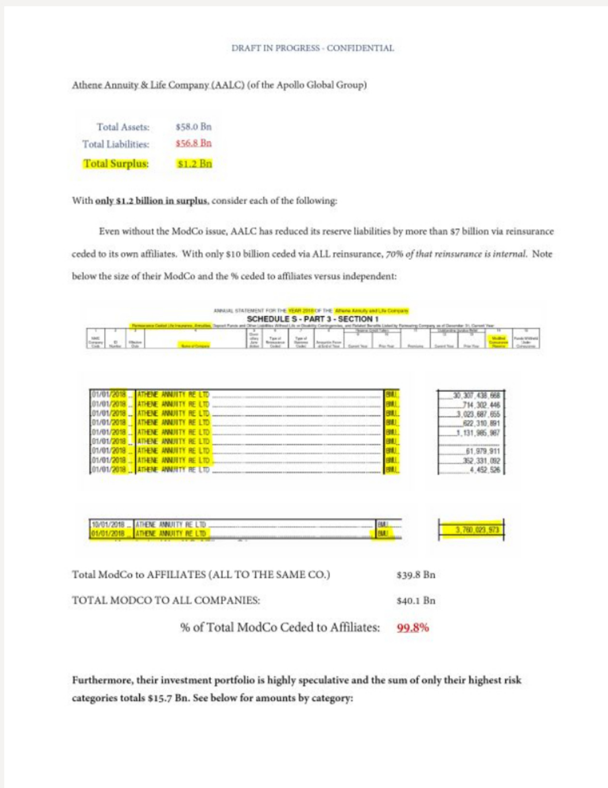
powerful "lulling" effect on regulators and fraud examiners. When I went on to explain that the scheme was not related to the funds themselves; but rather, it was actually nothing more than a trick to falsely reduce Risk-Based Capital (RBC) penalties, he agreed and suggested that I confirm that the RBC risk factors are transferred to the assuming reinsurer and, if that were the case, I had stirred up yet another hornets' nest.

I did confirm through multiple channels, including honest regulators and analysts, that ALL of the RBC risks do transfer to the assuming companies. That is what makes this scheme tricky to understand. To be clear, if the assuming companies were independent and well-capitalized, I would never raise an issue. I would question why they would go through the hassle of Modified Coinsurance given that the assuming companies are in blissfully safe domiciles, but if ModCo is their choice, fine. A quick note on RBC: the sole purpose of the complex and all- encompassing risk factors that flow into the RBC formula is to ASSESS LEVELS OF RISK related to investment concentrations, excessive reinsurance with high-risk reinsurers and excessive levels of interdependency on affiliates within the group, is to determine HOW HIGH THE SURPLUS MUST BE AT A MINIMUM. The higher the risks in a company, the higher their surplus must be relative to its size. Unfortunately, the recent use of MASSIVE AMOUNTS of ModCo involving subsidiaries and affiliates is the very type of process which RBC attempts to account for. Ultimately, life insurers are using these ModCo tricks to REDUCE their required surplus, when it ought to increase it.

For purposes of this discussion, I will tell you that all of the relevant ModCo schemes are ENORMOUS in dollar-volume and are ceded to AFFILIATED AND UNDER-CAPITALIZED reinsurers. The assuming companies are in under-regulated venues that permit reserve liability discounting and even allow NON-ASSETS to be carried as ADMITTED ASSETS to support their claims liabilities. Often, they are even wholly-owned subsidiaries of the ceding insurance companies. Based on the forgoing arguments, I consider these so-called reinsurance transactions to be an embarrassment to the U.S. life insurance industry.

Specific Examples:

The most relevant data in assessing these ModCo deals include the amount of the life insurer's Total Surplus as compared with its total liabilities, the speculative nature of their investment portfolios and the true nature of their reinsurance ceded portfolio. At the core of any large life insurance company, it is essential that their reinsurance genuinely transfers risk to the reinsurer; to do so, the reinsurer must be ABLE TO PAY. Below is a quick snapshot of those elements for several large life insurers. All actual examples below are using the most recent sworn annual statements date 12/31/2018.



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Athene Annuity & Life Company (AALC) (of the Apollo Global Group)

Total Assets:	$58.0 Bn
Total Liabilities:	$56.8 Bn
Total Surplus:	$1.2 Bn

With **only $1.2 billion in surplus**, consider each of the following:

Even without the ModCo issue, AALC has reduced its reserve liabilities by more than $7 billion via reinsurance ceded to its own affiliates. With only $10 billion ceded via ALL reinsurance, *70% of that reinsurance is internal.* Note below the size of their ModCo and the % ceded to affiliates versus independent:

ANNUAL STATEMENT FOR THE YEAR 2018 OF THE Athene Annuity and Life Company

SCHEDULE S - PART 3 - SECTION 1

01/01/2018	ATHENE ANNUITY RE LTD	BMU	30,307,438,668
01/01/2018	ATHENE ANNUITY RE LTD	BMU	714,302,446
01/01/2018	ATHENE ANNUITY RE LTD	BMU	3,023,687,655
01/01/2018	ATHENE ANNUITY RE LTD	BMU	622,310,891
01/01/2018	ATHENE ANNUITY RE LTD	BMU	1,131,985,987
01/01/2018	ATHENE ANNUITY RE LTD	BMU	
01/01/2019	ATHENE ANNUITY RE LTD	BMU	61,979,911
01/01/2018	ATHENE ANNUITY RE LTD	BMU	352,331,092
01/01/2018	ATHENE ANNUITY RE LTD	BMU	4,452,526

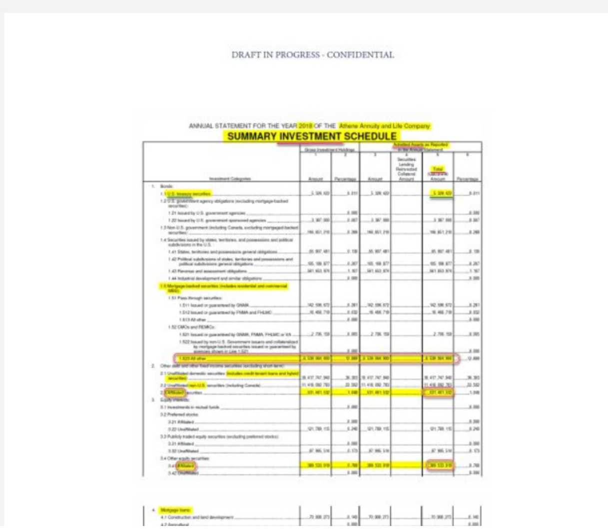
10/01/2018	ATHENE ANNUITY RE LTD	BMU	
01/01/2018	ATHENE ANNUITY RE LTD	BMU	3,760,023,973

Total ModCo to AFFILIATES (ALL TO THE SAME CO.) $39.8 Bn

TOTAL MODCO TO ALL COMPANIES: $40.1 Bn

% of Total ModCo Ceded to Affiliates: 99.8%

Furthermore, their investment portfolio is highly speculative and the sum of only their highest risk categories totals $15.7 Bn. See below for amounts by category:



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ANNUAL STATEMENT FOR THE YEAR 2018 OF THE Athene Annuity and Life Company

SUMMARY INVESTMENT SCHEDULE

4.3 Single family residential properties	[illegible]	[illegible]	[illegible]		[illegible]	[illegible]
4.4 Multifamily residential properties	[illegible]	[illegible]	[illegible]		[illegible]	[illegible]
4.5 Commercial loans	[illegible]	[illegible]	[illegible]		[illegible]	[illegible]
4.6 Mezzanine real estate loans	[illegible]	[illegible]	[illegible]		[illegible]	[illegible]
5. Real estate investments:						
5.1 Property occupied by company		[illegible]				[illegible]
5.2 Property held for production of income (including $ ____ of property acquired in satisfaction of debt)	[illegible]	[illegible]	[illegible]		[illegible]	[illegible]
5.3 Property held for sale (including $ ____ 57,000 property acquired in satisfaction of debt)	57,000	[illegible]	57,000		57,000	[illegible]
6. Contract loans	[illegible]	[illegible]	[illegible]		[illegible]	[illegible]
7. Derivatives	[illegible]	[illegible]	[illegible]		[illegible]	[illegible]
8. Receivables for securities	[illegible]	[illegible]	[illegible]		[illegible]	[illegible]
9. Securities Lending (Line 10, Asset Page reinvested collateral)		[illegible]		XXX	XXX	XXX
10. Cash, cash equivalents and short-term investments	[illegible]	[illegible]	[illegible]		[illegible]	[illegible]
11. Other invested assets	[illegible]	[illegible]	[illegible]		[illegible]	[illegible]
12. Total invested assets	[illegible]	100.000	[illegible]		[illegible]	100.000

To summarize: with Total Surplus of only $1.2 Billion and Affiliated Reserve Credits of $7 Billion, Affiliated ModCo of $40 Billion and high-risk investment categories of $15.7 Billion, it is my professional opinion that their total surplus is far below what would be mandated by an unadulterated RBC calculation.

By doing $40 Billion of ModCo all on one day in the reporting year, AALC created a massive reduction to its otherwise required surplus. Without affiliated ModCo, it is likely that AALC would require an estimated range of $3 to $4 Billion of surplus, not $1.2 Billion. Worse, because the assuming company is a Bermuda domicile, their sworn annual statements are not publicly filed in the U.S. and they are permitted to substantially discount their reserve liabilities by using modified GAAP in Bermuda but Statutory (SAP) in Iowa.

David,

Pulling this info together can be tedious and time consuming, but I would like to point out that the Apollo Global group includes 3 additional life companies: Athene Annuity & Life Assurance, Voya Insurance and Annuity Company and Structured Annuity Reinsurance Company. I have done the same analysis for them and they are all doing the same thing. TOTAL MODCO TO AFFILIATES IN 2018 FOR THE FOUR COMBINED COMPANIES TOTALED $90,213,674,029 as compared to their total combined Surplus of $4.99 Billion. They all had high-risk investment portfolios and virtually NO real reinsurance with independent well-capitalized reinsurers. I also want to share this excerpt from the Voya 2018 Audit Report. Seeing this in print is mind-blowing: (Note: RR is Rocky Range, Inc., an Arizona captive)

Effective May 31, 2018, and in accordance with the Acquisition described in Note 1, the Company recaptured its variable annuity guaranteed living benefit business previously reinsured to Roaring River II, Inc. ("RRII") Effective June 1, 2018, the Company entered into a reinsurance agreement with RR an Arizona pure captive insurance company which is a wholly-owned subsidiary of the Company. Under this agreement the Company cedes, on a funds withheld coinsurance and modified coinsurance basis, its variable annuity business to RR, which completes its financial statements on a modified U.S. GAAP basis.

The agreement has the economic impact of ceding 100% of the closed block variable annuity contracts previously issued by the Company, which includes contracts with multiple rider guarantees, including minimum accumulation, income, death, and withdrawal benefits policies. Also, as a result of the reinsurance agreement RR can use letters of credit, which would not be admitted assets to the Company, to back some or all of the reserves. Under the terms of the agreement, the Company reinsures to RR on a funds withheld basis, 100% of the general account liabilities of the reinsured policies. The agreement also cedes on a modified coinsurance basis, 100% of the separate account liabilities. Under the modified coinsurance structure the Company retains control and owns all assets contained in the separate account and holds separate account reserves.

Finally, David, I used the SNL Financial Data Wizard to pull together ALL U.S. ModCo to ONLY AFFILIATES. While Apollo is one of the worst, the enormity of sham ModCo is not unique to "Leon Black" types as other for-profits are abusing them as well…including those not owned by Private Equity. At December 31, 2018, the total of just 45 U.S. life insurers was $ 429,656,440,711. As is always the case, any additional research on my part will only add to my concerns. If I thought these life insurers using massive affiliated ModCo were merely arbitraging regulations or just seeking tax benefits, it would not be so bad. But these instances of "sleight-of-hand" are enabling even more dangerously thin surplus margins than in recent years. At the same time, their appetites for risk have substantially increased. That inverse relationship can only be sustained for very short periods of time. Yet their long-term commitments have recently expanded to include the assumption of large pension plan transfers…meaning they are now playing with policyholder, annuitant and pensioner funds.

I look forward to discussing this with you as soon as you can. Please honor my request for confidentiality.

Tom

CONTACTING TRIXIE

E-MAIL: saynototom@outlook.com

DISCLAIMER:

Please contact me with any professional questions or concerns regarding David or Tom to the email address listed

Truth is on my side. Therefore, note that there are absolutely no effective threats or actions that can be taken against me as they will be ignored & regarded as the ravings of exposed thugs. I WILL NOT BE BULLIED!

Our Visitor

Fundraiser by Trixie Russell : Big Insurer, Bigger Fraud & the Biggest Crooks
https://www.gofundme.com/f/big-insurer-bigger-fraud-the-biggest-crooks?utm_campaign=p_cf+share-flow-1&utm_content=undefined&utm_medium=copy_link&utm_source=customer&utm_term=undefined