A.M. Best gives life/annuity industry a “negative outlook”

By Editorial Staff *Thu, Feb 15, 2018*

The industry 'remains plagued by macroeconomic and regulatory factors' as well as 'lackluster sales, rapidly evolving technological requirements and changing consumer preferences and behavior,' the ratings agency said in a new report.

A new report from A.M. Best contains good news and bad news for the U.S. life/annuity industry.

The good news: The industry in 2017 had strong balance sheets, solid earnings, focused business profiles and ongoing enhancements to enterprise risk management programs, according to A.M. Best’s U.S. Life/Annuity: 2018 Review & Preview report.

More good news: The industry’s statutory pretax operating earnings totaled $48.3 billion through third-quarter 2017, up from $32.2 billion in the same period in 2016. Reinsurance activity was high in both periods. Capital and surplus grew by $19.4 billion since the start of 2017, to $414.7 billion through third-quarter, the report said.

The bad news: The industry “remains plagued by macroeconomic and regulatory factors” as well as “lackluster sales, rapidly evolving technological requirements and changing consumer preferences and behavior.”

A.M. Best also found that the L/A industry lags technologically and recommended upgrades. “Such moves go directly against an industry that is characterized as being plodding and slow; however, the industry remains hamstrung by too many antiquated front- and back-end systems, which makes leveraging the significant amount of data many carriers have already amassed difficult,” the report said.

A.M. Best is therefore maintaining a negative outlook on the L/A industry for 2018. “Sales of mainstream L/A products continued to struggle in 2017 and may be challenged in the coming year as well,” the ratings agency said. According to the report, sales of individual annuities, which account for over a quarter of total L/A direct premiums written (DPW), fell to $203.1 billion in 2016 from $213.2 in the previous year, and at third-quarter 2017, stood at $140.0 billion.

A tailwind from rate hikes?

Anticipated interest rate hikes in 2018 may create a tailwind for insurers if it leads to an eventual steepening of the treasury yield curve, which may make fixed annuities more attractive and allow insurers to attain more favorable interest rate spreads.

“Capitalization has been qualitatively diminished by the ongoing use of captives, permitted practices, surplus note issuance and other forms of redundant financing, although at the holding company level, financial flexibility and liquidity remain sound.”

Although the industry saw some upward movement in interest rates in 2017, generally low inflation and strong global economic metrics kept the longer end of the 10-year yield curve relatively flat. That put pressure on companies selling universal life and fixed annuity products, which have more interest-sensitive profiles.

A.M. Best expects another challenging year for insurers seeking higher asset yields to maintain operating profitability and manage spread compression. Potential exists for increased economic and regulatory volatility, such as a correction in the equity and credit markets.

Insurers’ focus will remain on core fixed income, private placements and collateralized mortgage loans. Because many L/A carriers have strong credit expertise, investing in collateralized loan obligations also likely will remain popular, the report said.