A mixed picture of life/annuity industry from A.M. Best

By Editorial Staff *Thu, May 18, 2017*

'Earnings from individual annuities business were strong, up 63% from 2015, due mainly to the Federal Reserve's 25-basis-point interest rate increase during the fourth quarter and the decline in asset adequacy reserves,' the ratings agency said.

Full-year statutory pre-tax net operating gains for the U.S. life/annuity (L/A) insurance industry increased by 22% to $67.6 billion in 2016 from $55.2 billion in 2015, thanks to a one-time company-specific event and favorable equity market performance, according to a new A.M. Best Special Report.

The report, "U.S. Life/Annuity Industry Core Earnings Remain Profitable as Companies Look to Sustain Yields," noted that an $8.0 billion statutory gain for American International Group Inc.'s AGC Life Insurance Company subsidiary helped overall industry results significantly.

The gain was due mainly to a one-time reserve reinsurance transaction with Hannover Life Reassurance Company of America, which ceded approximately $14 billion of in-force reserves.

Although a 3.2% rise in the broader stock market in fourth-quarter 2016 and an 11.9% gain for the full year boosted insurer earnings, the report said. But earnings remained below historical level–despite a steady increase in invested assets and capital—because

the persistent low interest rate environment and the mature nature of the industry.

Earnings from individual annuities business were strong, up 63% from 2015, due mainly to the Federal Reserve's 25-basis-point interest rate increase during the fourth quarter and the decline in asset adequacy reserves.

The L/A industry's net income declined approximately 12%, to $36.8 billion from $41.1 billion, owing to a large realized capital loss of around $12.5 billion. The capital loss was due mainly to the impact of derivatives hedges, which were hurt by rising equity indices and interest rate swaps resulting from declining long-term interest rates.

The industry's largest investment allocation is still in bonds; however, bond holdings as a percentage of invested assets continue to decline, to 73.6% in 2016 from 74.6% in 2012, while less liquid mortgage loans increased to 11.2% of invested assets in 2016 from 9.8% in 2012.

Insurers pull back from hedge funds

Another new Best's Special Report, titled, "Insurers Continued to Pull Away From Hedge Funds in 2016," stated that based on 2016 data from year-end NAIC statutory financial statements, the insurance industry's investment allocations to hedge funds declined approximately 28% to just under $18 billion in 2016 from $25 billion in 2015.

The retreat by the insurance industry was widespread, with 65% of U.S. life/annuity (L/A) insurers and 60% of U.S. property/casualty (P/C) organizations reducing their positions.

“Investors have grown impatient as managers charge substantial fees for their services for the industry’s below-market returns, and the oversaturation of the competitive market has led to a number of hedge fund liquidations. This has led investors to continue to pull money out at an increasing pace and report five consecutive quarters of net outflows,” A.M. Best said in a release.

The shift away from hedge funds by insurers was led by the L/A sector, which saw a 42% decline to $8.3 billion in 2016 from $14.2 billion in 2015. The P/C segment declined by just more than 10%, to $9.1 billion from $10.2 billion over the same time period, while the health segment had total hedge fund holdings below $1 billion.

Just five of the top 20 insurers investing in hedge funds increased their allocations in 2016 from 2015, one of which was the result of a reclassification of the investments as opposed to strategically investing new money in hedge funds.

While still maintaining the largest hedge fund portfolio in the insurance industry, American International Group, Inc. pulled more than $4 billion out of hedge fund investments in 2016, accounting for more than half of the insurance industry’s reduction. Metlife, Inc. also had a substantial decrease, with more than $600 million flowing out of its asset class.

Overall, hedge fund exposure remains minimal as a percentage of capital & surplus for each of the three industry segments. While most hedge fund investors in the insurance space are disappointed in performance, there are limited attractive alternatives in which to invest in this current low-return environment.

A.M. Best expects most of the proceeds from insurers’ hedge fund portfolios to go back to more traditional investments, such as investment grade corporate bonds and/or commercial mortgage loans and common stock.