AM Best expects lower annuity sales in 2020

By Editorial Staff *Thu, Jun 25, 2020*

Drag from the low interest rate environment continues to hurt margins and stifle earnings growth, weakening the industry's investment returns, an AM Best release said.

The U.S. life/annuity (L/A) insurance industry saw its pre-tax operating income rise by 34% in 2019, to $63.4 billion, driven by a decline in transaction-driven volatility relative to previous years and favorable equity markets for the year, according to a new AM Best report.

In its Best's Special Report, "US Life/Annuity 2019 Statutory Results: Favorable Operating Results and Underwriting Performance," AM Best said that the L/A industry's underwriting performance was favorable, although margins narrowed owing to the ongoing decline in net investment returns.

For 2020, AM Best expects that annuity sales will not continue to grow at the same pace as the previous year given the current economic uncertainty, as the low interest rate environment, along with the impact of COVID-19, will exacerbate spread compression.

Low rates likely to continue to drag on margins until longer-term interest rates and credit spreads return to more historical levels. The ongoing drag from the low interest rate environment continues to hurt margins and stifle earnings growth, as is evident in the continued weakening in the industry's investment returns, an AM Best release said.

The 2019 pre-tax operating gain rose was still below 2016-2017 amounts. The increase was driven mainly by earnings volatility in 2018, because of a fair amount of one-off transactions and company-specific events, which negatively impacted the industry's statutory results. Partially offsetting the lower returns was the ongoing growth in absolute invested assets, which reached a record $4.49 trillion at year-end 2019.

Many transactions, which included affiliated reinsurance and captive transactions, were large in dollar amounts, but often had a neutral impact on enterprise-wide operating results.

Companies have been looking to offset the drag somewhat through expense efficiencies. The general expense to net premiums written ratio declined to 10.1% from 11.1% at year-end 2018, which shows that companies have found ways to be more efficient despite increasing their technology spending.

Statutory net income rose by 19% to $47.2 billion in 2019. There was a slight increase in realized losses, totaling $6.7 billion, as equity hedges and the decline in long-term interest rates impacted this line item.

While companies continued to build up capital, those capital levels will be tested in 2020, AM Best said. Modestly low single-digit premium growth was driven solely by a rise in annuity sales. AM Best expects growth to be challenged in 2020 due to the COVID-19 pandemic.

Companies are learning to make effective use of digital capabilities for sales, but innovation initiatives to bolster growth may be tested sooner than anticipated.

“However, even with falling equity markets, fixed annuities are still an attractive choice for consumers, and the need for guaranteed income could rise. Improving public perception about annuities, as well as simplification, should lead to increased sales,” the Special Report said.