Honorable Mention

By Editorial Staff *Mon, Nov 25, 2024*

Federal watchdog report briefly covers U.S. insurance industry; Fidelity's annuity platform adds rare Fidelity annuity; High surrender rates accompany high annuity sales, AM Best says; Greg Lindberg pleads guilty to $2 billion fraud; Retirement got tougher for more people in 2024: EBRI.

$8.5 trillion U.S. insurance industry briefly covered in federal watchdog report

The Office of Financial Research, established after the Great Financial Crisis of 2008 by the "Dodd-Frank" Act and charged with detecting signs of instability in the vast U.S. financial system, has issued its 2024 annual report.

The report has only a brief section on the $8.5 trillion U.S. insurance industry (p. 53), which covers both life and property/casualty insurance. *RIJ* has reprinted the section on life insurance below.

RIJ readers may also be interested in the section on "securitization" (p. 21) that explains collateralized loan obligations (CLOs) and the cash flows of special purpose vehicles (SPVs). The reinsurance "sidecars" that some U.S. life/annuity companies have established in Bermuda, which are the subject of the cover story in this issue of *RIJ*, are a type of SPV.

Overall the report finds moderate threats to financial system stability in these areas:

- Equity valuations and investor sentiment are high relative to historical averages, which raises the risk of large, sudden price declines.
- Exposures to some complex and opaque trading strategies are high overall. The use of leveraged trading strategies like the basis trade remains extensive. Issuance of some complex securitizations has risen.
- In Treasury markets, the type of debt ceiling used in the United States remains a major vulnerability. It makes the risk the government will fail to meet all its obligations, although low, more likely.
- At life insurers, leverage has remained fairly stable, while the credit and liquidity risk associated with their assets has grown.
- New types of private lenders, particularly those associated with private equity funds, have grown rapidly. Assessing their vulnerabilities is limited by data gaps regarding their leverage and portfolio exposures.

Regarding life insurers specifically, the report says:

The most important current life insurer vulnerabilities are associated with credit and liquidity risk. Life insurance companies provide annuities and other products, such as long-term care and disability insurance, in addition to life insurance. A growing number also assume obligations from corporate pension plan sponsors.

Life insurers are vulnerable to interest rate and credit risk affecting their investment returns and to mortality, morbidity, longevity, and other risks associated with the policies they issue. Realized credit losses have been the cause of most life insurer failures historically.

Although most of their liabilities appear to be long-term, some life insurance company liabilities have surrender or borrowing provisions that require insurers to remit requested funds to policyholders or other liability holders. These features mean that life insurers can be subject to the risk of a rapid withdrawal of liabilities.

Moreover, most life insurance companies have cash and short-term assets that are a modest fraction of total assets. A sufficiently rapid and unexpected withdrawal during periods of stress at the institution or in financial markets could lead to a fire sale of assets, with an associated effect on market prices and volatility. Insurers utilize surrender charges and other withdrawal penalties to limit incentives to withdraw. These measures may be insufficient when concerns about an insurance company's soundness are acute.

Life insurer leverage has changed little over time. Measured as the ratio of general account assets to policyholder surplus, leverage at life insurers remains consistently higher than that of property and casualty (P&C) or health insurers. Policyholder surplus is similar to insurer equity capital, and data on it are available for all insurers, including mutual insurance companies, which is not the case with some other measures of equity capital.

As at banks, insolvency risk depends both on the amount of equity capital relative to assets and on the risk embedded in portfolios. Portfolio risk has been increasing. The share of bonds in life insurers' portfolios has been falling, and the shares of mortgages and alternative investments have been rising.

The mix within categories matters as well. Among bond holdings, the share of high-yield bonds decreased to 5%, but the share of ABS [asset-backed securities] and other structured securities grew to more than 13% at year-end 2023. The share of medium-quality and riskier commercial mortgages rose to 11%, more than doubling since 2018. Alternative investments are more opaque, and less is known about their risk.

Fidelity's annuity platform adds rare Fidelity annuity

Fidelity is introducing a Fidelity Fixed Deferred Retirement Annuity (FDRA) product, the first proprietary annuity product launched by Fidelity Investments Life Insurance Company (FILI) in over 15 years.

FDRA is available through the Fidelity Insurance Network® (FIN), which provides a one-stop planning experience for comparing rates and products across a preferred group of reputable insurance providers.
FIN offers access to select annuity and insurance products from a total of eight third-party carriers: FILI, Guardian, MassMutual, Nationwide, New York Life, Pacific Life, USAA, and Western & Southern Financial Group.
Key product details:

- 3-year and 5-year terms available, including a death benefit for beneficiaries.
- The simplified renewal process allows clients to select multi-year terms with reduced surrender charges, without needing a new application.
- Partial or full withdrawals are available for terminal illness, nursing home care, and hospital stays (subject to meeting specific qualifications).

High surrender rates accompany high annuity sales: AM Best

The value of surrendered annuity policies among U.S. life/annuity (L/A) writers increased 19% through the first half of 2024, compared with the same prior-year period, according to a new AM Best report.

However, premium growth held steady at 21% through the same timeframe, with individual annuity premium notching its 14th consecutive quarter of year-over-year growth.

In a newly released *Best's Special Report*, AM Best notes that while the Federal Reserve reduced interest rates by half a point in September 2024, they remain nearly twice the level of five years earlier. The higher interest rates are an issue not experienced in the L/A industry in decades.

This creates the potential for disintermediation risk— the possibility that a policyholder may surrender a policy in favor of another one or an asset yielding a higher interest rate. The report notes that competition has remained generally rational, with no significant widespread race to undercut competition to spur growth.

Surrender benefits topped $100 billion for the fifth straight quarter and sixth in the last seven quarters, compared with an average of $86 billion prior to that dating back to 2019. Additionally, annualized surrenders as a share of reserves for the past three quarters are higher than at any other time going back to 2019.

“Surrender benefits as a percentage of premium, including individual and group annuity and individual life, are at their lowest levels since at least 2019, which reflects strong premium growth,” said Kaitlin Piasecki, industry research analyst, AM Best.

Companies unable to replace surrendered business are most likely to see a shrinking asset base, as maturing bonds may be used to cover additional surrenders instead of being reinvested.

The annuity market is highly competitive, with the higher interest rate environment leading to many new entrants, some without the burden of needing legacy system upgrades, as well as companies backed by private-equity and investment management firms that can leverage sophisticated investment expertise.

On a cash flow basis, companies in AM Best’s individual annuity composite have observed a downward trend much steeper in the ratio of premium cash flow in to benefits and surrenders cash flow out than reported at individual life and diversified companies in multiple lines.

When the individual annuity composite is viewed by premium scale, those smaller companies have seen the greatest deterioration in the cash flow ratio, with incoming premiums not covering benefits and surrenders flowing out.

The percentage of smaller companies with negative cash flow from operations has been trending up to a greater degree than for medium size and larger organizations, indicating possible shifts in market share. “Negative cash flows could lead to the selling of assets at unrealized loss positions, as higher interest rates have depressed bond values,” said Jason Hopper, associate director, AM Best.

Lindberg pleads guilty to $2 billion fraud

Former insurance executive Greg Lindberg admitted guilt in a $2 billion scheme to defraud regulators, insurers and policyholders, as well as related money laundering charges, according to the U.S. Department of Justice.

Lindberg pleaded guilty to one court of conspiracy to commit offense against the United

States, including crimes in connection with the insurance business, investment adviser fraud and wire fraud, as well as one count of money laundering conspiracy.

The admission of guilt is something of a reversal as Lindberg's counsel requested more time in August to review documents in the case as it prepared for trial. The government didn't oppose the extension.

From 2016 though at least 2019, Lindberg defrauded various insurance companies, third parties and thousands of policyholders, the Justice Department said. As part of the scheme, the former executive and co-conspirators invested more than $2 billion in loans and other securities with Lindberg-affiliated companies.

While processing these circular transactions, Lindberg and his associates made misleading statements and omitted materials from regulators, rating agencies, insurance companies, policyholders and others involved in the transactions.

The Justice Department said Lindberg also "forgave" $125 million in loans to himself from insurance companies he controlled.

Lindberg and his co-conspirators then deceived regulators, including the North Carolina Department of Insurance, in an attempt to evade requirements meant to protect policyholders, conceal the true financial condition of his companies and cover up improper use of company funds, the Justice Department said.

"Lindberg created a complex web of insurance companies, investment businesses, and other business entities and exploited them to engage in millions of dollars of circular transactions. Lindberg's actions harmed thousands of policyholders, deceived regulators and caused tremendous risk for the insurance industry," U.S. Attorney Dena J. King for the Western District of North Carolina said in a release.

A sentencing date has not been set. Lindberg faces a five-year maximum sentence on the charge for conspiracy to commit offenses against the United States and a maximum 10-year sentence on the money laundering conspiracy charge.

This is a separate case from charges Lindberg and a business associate face for allegedly offering North Carolina Insurance Commissioner Mike Causey millions in campaign contributions in exchange for putting a different regulator in charge of overseeing the executive's companies.

Retirement got tougher for more people in 2024: EBRI

Financially, the happiest retirees are those who had the longest work tenures at the fewest employers, the longest participation in retirement plans, and the most sources of guaranteed income in retirement, a survey from the Employee Benefit Research Institute suggests.

Results from EBRI's 2024 Spending in Retirement study also showed "dampened spending expectations due to lack of sufficient savings, inflationary pressures and rising credit card debt," especially among those with household incomes under $50,000.

As in prior iterations of the survey, EBRI's analysis showed a high proportion of current retirees retiring earlier than expected due to reasons beyond their control. Key highlights in the new survey report include:

- On a scale of one to 10, retirees rated their satisfaction with life in retirement at 6.9 in 2024, down slightly from 7.0 in 2022 and 7.4 in 2020.
- Retirees on average rated the "alignment" between their current retirement lifestyle and their pre-retirement expectations at 5.7 on a scale of one to 10 in 2024. That was down from 6.4 in 2022 and 6.8 in 2020.
- 31% of retirees said they were spending more than they could afford in 2024 (up from 27% in 2022 and 17% in 2020).
- 68% of retirees reported outstanding credit card debt in 2024, up from 40% in 2022 and 43% in 2020.
- Half of the retirees said they hadn't saved enough for retirement. One in three said they saved the right amount and 17% said they saved more than what was needed.
- 58% had retired earlier than expected, because of a health problem or disability (38%) or because of a downsizing, closure, or reorganization at their companies (23%).
- Eight in 10 retirees receive Social Security and say it represents about half of their current income.
- Aside from Social Security, 39% of retirees said they currently receive guaranteed income through a workplace pension or annuity.
- Among their current sources of income, 20% of retirees cited an individual retirement account (IRA) and 17% cited a defined contribution plan. They drew a median 10% and 15% of their incomes from these accounts, respectively.
- 38% of retirees said they have a "savings mindset" in retirement, 11% have a "spending mindset," and 51% were somewhere in the middle.
- 59% of retirees said they have three months of emergency savings, down from 69% in 2022.
- 36% of retirees have experienced unexpected spending needs since their retirement.

“A lack of sufficient savings and retirement preparation negatively influences retirees’ spending outlook, particularly among those with total annual household incomes below $50,000. Compared with 2020, fewer retirees indicated that they would spend down all or a significant portion of their financial assets over the course of their retirement,” said Bridget Bearden, Ph.D., research and development strategist, EBRI, in a release.

“These spending constraints contribute to declining levels of well-being in retirement, with retirees rating two out of three well-being measures lower in 2024 than they did in 2020 and 2022. Longer tenure, fewer employers over a career, more years participating in a retirement plan, and the presence of guaranteed income in retirement are correlated with more positive outlooks on spending and well-being.”

A total of 3,661 American self-identified retirees between the ages of 62 and 75 years old were surveyed during summer 2024 for EBRI’s third “Spending in Retirement” study. Capital Group/American Funds, Empower, Mercer, Principal Financial Group, Transamerica, BlackRock, J.P. Morgan, PGIM and SS&C Technologies provided financial support for the survey.

To review a summary of the 2024 Spending in Retirement report, visit www.ebri.org/publications/research-publications/issue-briefs/content/2024-spending-in-retirement-survey.