Life/annuity industry moving toward equilibrium: AM Best

By Editorial Staff *Fri, Mar 11, 2022*

The life/annuity industry is approaching an equilibrium between companies seeking 'to build a less capital-intensive business' and those with 'a capital-intensive business appetite,' the ratings agency said.

US life insurance and annuity writers achieved record levels of capitalization, maintained strong liquidity and posted improved earnings in 2021 despite historically low interest rates, inflationary headwinds and continued pandemic uncertainty, according to a new AM Best report.

The annual Review & Preview Best's Market Segment Report, "U.S. Life/Annuity: Record Capitalization, Strong Liquidity, and Improved Earnings in 2021," notes that although initial fears about the effects of the pandemic on the life/annuity industry have subsided, COVID-19 cases and death claims continued in 2021, further impacting the mortality book of business that is core to life insurers. At the same time, according to the report, many companies benefited from their prior investments in enterprise risk management, took advantage of the opportunity to shed legacy businesses and saw realized and unrealized gains from strong financial markets.

The industry's capital and surplus showed solid growth through third-quarter 2021, up \$26.2 billion to \$480.9 billion, and is likely to continue to grow for full-year 2021. The life/annuity segment recorded net income of \$27.0 billion in the nine-month period, up 105% from the same prior-year period, with overall sales of life insurance and annuities seeing strong growth.

"The pandemic drove home the importance of life insurance and consumers adjusted to life during a pandemic," said Michael Porcelli, senior director, AM Best. "Companies also became acclimated to the remote work and sales environment, which was needed to compete during COVID-19."

Other highlights in the report include:

Schedule BA assets continued to grow, to 8.4% of total invested assets at third-quarter 2021, compared with 6.2% in 2016, although some insurers have securitized Schedule BA assets and sold them to institutional investors as a way to diminish exposure and capital risk charges.

Although the commercial mortgage loan market has seen increases in delinquencies, exacerbated by the pandemic, life/annuity insurers' allocations still grew, albeit with a modest shift to industrial properties and multifamily housing from office and retail.

Overall headwinds from the low interest rate environment, as evidenced by an investment yield that has declined each year of the past decade and was 4.1% in 2020, are likely to continue to create drag on margins until longer-term interest rates and credit spreads return to more-historical levels.

New capital continues to enter the life/annuity market, driven by private equity firms with an ability to source and manage fixed-income assets and greater interest in the pension risk transfer market. Additionally, with insurers willing to shed certain blocks of business, merger and acquisition activity ramped up in 2021.

AM Best expects the life/annuity industry to reach an equilibrium between companies seeking opportunities to build a less capital-intensive business, minimize the pressure of persistent low interest rates on profitability and diversify earnings; and companies with fixed-income asset management sourcing, evaluation capabilities and a capital-intensive business appetite.

"As 2021 has shown, life/annuity insurers will seek to unload interest-sensitive lines of business, including variable and fixed annuities, as well as capital-intensive lines of business, such as long-term care and universal life with secondary guarantees," said Porcelli. "Also, given consumers' growing awareness of the need for financial security, companies looking for scale and efficiency may make investments in and partnerships with insurtechs a higher priority."