Life/annuity industry upgraded to stable from negative by A.M. Best

By Editorial Staff *Thu, Dec 13, 2018*

Although volatility ratcheted up in the second half of 2018, the equity markets and interest rate movements should be net positives for operating performance, according to a recent report by the ratings agency.

A.M. Best has revised its market segment outlook for the U.S. life/annuity (L/A) industry to stable from negative for 2019, citing increased profitability, improved regulatory and tax environments and a strengthening U.S. economy, along with overall reduced balance sheet risk due to a proactive approach taken by companies in recent years.

A series of Best's Market Segment Reports includes a discussion of A.M. Best's outlook revision and views on the entire L/A industry, as well as the individual life insurance and annuity segments. Overall, the stable outlook reflects the improved risk-adjusted capitalization and liquidity of L/A industry participants.

Although volatility ratcheted up in the second half of 2018, A.M. Best expects the equity markets and interest rate movements to be net positives for operating performance. Business profiles in general are stronger, as companies continue to focus on core business lines and make use of alternative risk transfer mechanisms to shed risk. Enterprise risk management programs also continue to evolve to further identify and manage current and evolving risks.

The market segment reports outline other factors that are driving the outlook revision, including the following:

Products such as indexed universal life, which offer higher potential crediting rates under favorable equity market conditions, and other protection-based products continue to sell well despite overall flat premium trends in the life insurance segment.

Individual annuity sales increased 11% through third-quarter 2018, following three years of declines. A.M. Best views the impact of the SEC's proposed "best interest" legislation as likely to be limited given the industry's progress in preparing for the changes previously proposed under the vacated U.S. Department of Labor's fiduciary rule.

Lower effective tax rates going forward will improve U.S. L/A insurers' earnings, albeit partly countered by a decline in deductibility for absolute tax reserves.

Modestly rising interest rates, coupled with a relatively benign credit environment for the coming year, should bolster portfolio returns, which should restore investment spreads to equilibrium as new money yields gradually approach existing portfolio returns.

Insurers continue to take on greater risk in their investment portfolios, through either higher credit risk or lower liquidity, but many have done so by employing a barbell strategy. A.M. Best believes this approach works in a modest economic downturn but could have a greater negative impact on surplus if a more recessionary environment unfolds.

The divide between technologically superior companies and much smaller, less tech-savvy companies is getting wider. However, insurers overall acknowledge their shortcomings with respect to innovation. A.M. Best believes companies that take a measured, methodical approach to identifying where innovation can best help them now and in the future will compete effectively.