Retirement Income
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Low rates are ‘key obstacle’ for U.S. life/annuity firms: AM Best

By Editorial Staff *Thu, Aug 6, 2020*

Life insurers have exited, re-priced or de-emphasized their most interest rate-sensitive business lines, including individual and group annuities, the ratings firm said in a new report.

An AM Best analysis of U.S. life/annuity companies’ investment strategies amid the past decade of low interest rates found that the number of companies considered non-interest-sensitive more than doubled those deemed interest-sensitive.

However, those companies exposed significantly to interest rates have managed an average 76% of the industry’s invested assets in the last 10 years, and have different investment risk tolerances and strategies to aid in backing a product profile that is linked more to interest rates.

The low interest rates continue to hamper the life/annuity (L/A) industry, and with the COVID-19 pandemic impact, the trend is likely to exacerbate. In a new Best’s Special Report, “Interest Rates: Different Impact Severity, Different Strategies,” AM Best notes that insurers have been strategically de-risking their product portfolios for some time to counter the impacts on spread compression and earnings volatility.

Strategies have included exiting, re-pricing or de-emphasizing certain business lines, particularly those that are interest-sensitive. According to the report, companies considered interest-sensitive were those with a liability and premium mix concentrated in individual and group annuities, deposit-type contracts and interest-sensitive life products, as defined by the NAIC for statutory statement reporting.

Interest-sensitive companies typically generate the bulk of the industry’s earnings. Based on 2019 capital and surplus levels, interest-sensitive companies have nearly four times the amount of capital on average—approximately $2.3 billion, compared with roughly $610 million for non-interest-sensitive companies.

Commercial mortgage loans remain a staple of life insurers’ investment holdings, growing more than 80% to $578.5 billion in 2019 from $317.1 billion in 2010. Interest-sensitive companies were responsible for the growth, as their average exposure rose to 8.2% in 2019 from a low of 5.8% in 2010, versus a slight decline in non-interest-sensitive companies, whose average exposure came to 4.2% of invested assets in 2019.

Pre-tax net operating gains have been relatively consistent for non-interest-sensitive companies. In contrast, interest-sensitive companies have reported much more fluctuation over the last 10 years, although earnings have been consistently positive. Interest-sensitive companies also earn higher yields on average than non-interest-sensitive companies.

The low interest rates will remain a key obstacle as L/A insurers continue to invest new money, as well as the proceeds from higher-yielding maturing assets, into new assets at lower rates. The COVID-19-fueled economic slowdown has amplified the likelihood of dampened earnings in 2020 for spread and fee-driven businesses.

AM Best believes there is the potential for further swings in the equity markets, and will be looking closely at companies’ asset-liability management programs as closely matched assets and liabilities can immunize against interest-rate sensitivities.