Shocks loom for U.S. life insurers, annuity issuers: A.M. Best

By Editorial Staff *Wed, Mar 18, 2020*

The ratings agency identified three big headwinds facing the life/annuity industry, but also identified some strengths.

AM Best has downgraded its outlook on the U.S. life/annuity (L/A) industry to negative due to the “significant volatility and uncertainty in the financial markets created by the COVID-19 virus,” the respected ratings agency reported this week.

In its March 17 report, “Market Segment Outlook: U.S. Life/Annuity,” AM Best reversed its previous view that “the overall impact for most carriers was likely to be manageable.”

“Because the financial markets have responded negatively and quickly to the outbreak of COVID-19, the longer-term economic impact remains uncertain,” the report said. “As interest rates and the equity markets plummet, AM Best expects operating performance to move to the negative, driven by declining sales and intensifying spread compression.”

While acknowledging the L/A industry’s strong capital and liquidity resources, the report identified these challenges:

- A material acceleration in a global economic slowdown, increasing the expectation of dampened earnings throughout 2020 for spread and fee-driven businesses
- A rapid further deterioration in the U.S. economy, paired with its direct impact on equities and interest rates
- A greater expectation of a longer path to sufficient improvements from record low levels for the 10-year Treasury yield, as well as a flattened yield curve

In the United States, the Federal Reserve (Fed) cut the federal funds rate by 50 basis points on March 3, 2020, followed quickly by a further reduction on March 15 to a target range of 0-25 basis points. At the same time, the Fed launched a $700 billion quantitative easing program. The 10-year Treasury note fell below 50 basis points to a record low at one point this March, and remains below 1%.

AM Best anticipates that COVID-19 also will significantly affect the L/A industry’s ability to move forward quickly with costly innovation efforts. Factors moderating these negatives include:

- The industry’s strong capitalization and improved liquidity
- Stress testing that has better prepared the industry for downturns from economic and

pandemic-type events
- Credit spread widening to offset some of the interest rate decline

"Carriers with less capital, questionable liquidity access and limited business profiles or outsized exposures to at-risk sectors such as energy, retail, and travel, will feel the negative economic impact faster and more deeply than most of the industry," the report said.

"For companies active in variable products, separate account assets will be marked to market, resulting in declines in asset-based fees. L/A insurers taking on higher degrees of investment risk and those with less-than-optimal asset-liability matching strategies are likely to be more negatively impacted as well."

Ironically, the U.S. life/health industry saw solid growth in pre-tax and net operating profits in 2019. Net income increased by 12.6% year-over-year to $45.6 billion. Capital and surplus for the industry increased by 6.2% from the end of 2018, reaching $415.6 billion at year-end 2019.

These preliminary financial results were detailed in the recent Best's Special Report, titled, "First Look: 12-Month 2019 Life/Annuity Financial Results." The data is derived from companies' annual statutory statements that were received by March 10, 2019, representing an estimated 95% of total industry premiums and annuity considerations.

According to the report, the life/annuity industry's total income for 2019 increased by 3.0% to $872.3 billion compared with the previous year. A $59.5 billion increase in premiums and annuity considerations was offset by a $38.0 billion decline in other income.

These significant swings were primarily the result of modified coinsurance agreements and the recapture of retrocessions from foreign affiliates at American General Life Insurance Company, Hannover Life Reassurance Company of America and United States Life Insurance in the City of New York.

Income growth slightly outpaced a 2.5% increase in total expenses, leading to a pre-tax operating gain of $55.1 billion, 11.8% higher than in the previous year. A $4.2 billion increase in taxes was offset by a $3.5 billion reduction in net realized capital losses, resulting in the $5.1 billion year-over-year increase in net income.