October 23, 2024

Canadian Life/Annuity: Insurers Look to the Future amid Economic Uncertainty

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Principle Takeaways

- Canada's life/annuity performed relatively well in 2023, owing to economic growth and favorable interest rates.
- The capital and financial impacts of IFRS 17 were largely as expected and have been incorporated into companies' financial plans.
- Insurers continue to accelerate digitization to keep up with competition and improve the customer experience

AM Best's outlook on Canada's L/A insurance industry is Stable, based on the following factors:

- Prudent regulatory capital levels as well as adequate liquidity and financial flexibility to navigate through uncertainty
- Favorable earnings and underwriting as interest rates have begun to come down
- Favorable top-line growth supported by ongoing improvements in customer experience and technology enhancements, and diversified lines of business
- Canadian L/A insurers have performed relatively well over the past year due to sales growth and favorable interest rates, but they still face a number of headwinds, including the following:
- Rising costs due to persistent inflationary pressures
- Ongoing uncertainty about domestic and global economy due to inflation and the potential for further interest rate cuts
- Concerns about L/A insurers' exposures to real estate and private credit investments

In 2023, Canada's L/A insurers again posted generally positive operating results in their core lines of business due to favorable investment returns owing to higher interest rates, as well as accelerated demand for products such as participating whole life and fixed-rate annuities. Both of these product lines continue to achieve record sales in Canada and the US the past year. Canadian life insurance new annualized premium increased 4% in 2023 to CAD 1.86 billion per LIMRA. Sales growth has been supported by technology-driven, customer-centric business models and the increased accessibility of customer data. Results are positive overall but can be sensitive to movements in interest rates, although the industry has done a good job at hedging interest rate risks.

Credit impairments have been manageable and limited in recent quarters, but changes in interest rates and commercial real estate portfolios need to be monitored, especially amid economic uncertainty. Still, Canadian L/A insurers remain in a solid position, with strong balance sheets marked by high levels of regulatory capital, deployable excess capital, and good financial flexibility. In addition, L/A insurers continue to focus on enterprise risk management programs to manage current as well as new and emerging risks. As a result, Canada's L/A insurers are well equipped to navigate changing conditions over the near term, including the current economic uncertainty.

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2024-115.3

Rating Actions

As in previous years, the vast majority of Canadian life insurance company rating actions were affirmations driven by favorable levels of risk-adjusted capitalization supported by consistently positive earnings (**Exhibit 1**). All of the Canadian life insurance companies rated by AM Best have financial strength ratings (FSRs) of A- (Excellent) or higher. Of the three companies whose rating or outlook changed in 2023, two were driven by acquisitions. After being under review with negative implications, ivari was downgraded due to its acquisition by Sagicor Financial Company Ltd. from Wilton Re Ltd., which was completed in late 2023.

Exhibit 1
Canadian Life – AM Best Ratings

AMB #	Company Name	Long-Term ICR	FSR	ICR Rating Outlook	Rating Effective Date
08074	Assumption Mutual Life Insurance Co	a-	A-	Stable	9/11/2024
94126	Beneva Inc. (C)	a	A	Stable	11/10/2023
66835	BMO Life Assurance Co	a	A	Stable	12/15/2023
62246	Brookfield Annuity Co	a-	A-	Positive	11/1/2023
06493	Canada Life Assurance Co	aa	A+	Stable	1/25/2024
66801	Canadian Premier Life Insurance Co	a	A	Stable	11/30/2023
06290	Co-operators Life Insurance Co	a	A	Stable	3/7/2024
66893	First Canadian Insurance Corp	a	A	Stable	11/30/2023
66847	Foresters Life Insurance Co	a+	A	Stable	9/16/2024
60132	Independent Order of Foresters	a+	A	Stable	9/6/2024
06554	Industrial Alliance Ins & Financial Svcs	aa-	A+	Stable	6/23/2023
66805	ivari*	a-	A-	Stable	3/27/2024
06688	Manufacturers Life Insurance Co	aa-	A+	Stable	8/10/2023
66827	Optimum Reassurance Inc.	a	A	Stable	9/12/2023
66889	PartnerRe Life Reinsurance Co of Canada	aa-	A+	Stable	2/8/2024
60156	Primerica Life Insurance Co of Canada	aa-	A+	Stable	11/15/2023
66806	RBC Life Insurance Co	a+	A	Stable	3/27/2024
66817	RGA Life Reinsurance Co of Canada	aa-	A+	Stable	12/8/2023
07101	Sun Life Assurance Co of Canada	aa	A+	Stable	2/22/2024
66882	TruStage Life of Canada	a+	A	Stable	12/7/2023
60079	Wawanesa Life Insurance Co	a	A	Stable	1/25/2024

Notes: As of August 20, 2024. ICR = Issuer credit rating; FSR = Financial strength rating; u = under review.
* Rating on ivari under review with negative implications.
Source: BESTLINK

The rating on TruStage Life of Canada (formerly, Assurant Life of Canada) was upgraded due to further integration with the CMFG Life Group companies, as it provides additional product and income diversification. Finally, the rating outlook on Brookfield Annuity Company was revised to Positive based on continued favorable risk-adjusted capitalization and qualitative balance sheet factors. No Canadian life insurance company currently rated by AM Best has a negative outlook. This relatively high ratings distribution for Canadian L/A insurers is partly due to Canada's comprehensive regulatory environment, which advocates for conservative reserving practices, robust risk-adjusted capitalization, and high liquidity when possible.

Operating Results Remain Favorable Post-IFRS 17

After two notable outlier positive years for pre-tax net income and other operating metrics following COVID-19 in 2021 and 2022, results in 2023 were a reversion to the mean for the insurance segment. A direct comparison is more difficult owing to the IFRS 17 update, but comparing 2023 results to 2022 results restated under IFRS 17 indicates a strong year of earnings (**Exhibit 2**). Year-end 2022 restated operating results took a dramatic hit, falling to CAD 4.4 billion compared to initially reported earnings of CAD 15.7 billion, due in large part to IFRS 9 transitional impacts. Manulife in particular was a major driver of the unfavorable swing as its initial 2022 net earnings of CAD 7.2 billion fell to a CAD 2.0 billion loss.

Industry year-end 2023 pre-tax operating income of CAD 14.9 billion was largely in line with pre-IFRS 17 results in 2018-2020 (**Exhibit 3**). Net income figures showed a similar story, with year-end

Exhibit 2

Canadian Life – Income Statement

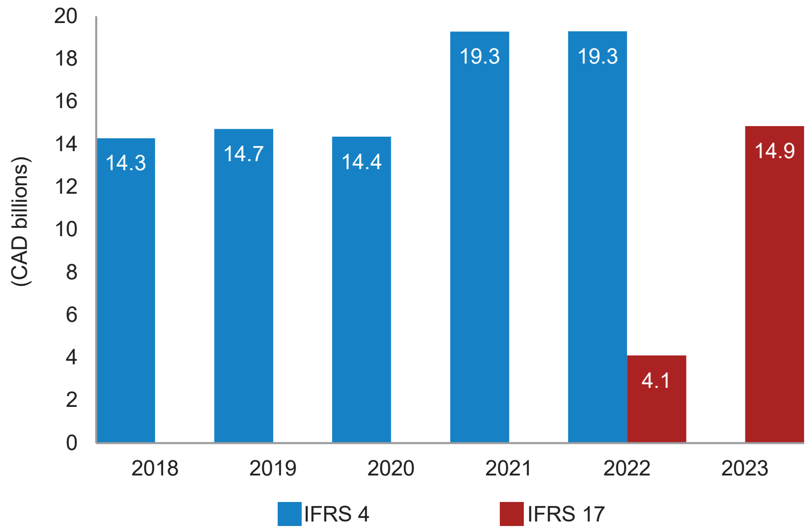
(CAD billions)

	2023	2022 Restated	YoY Change	YoY % Change
Total Insurance Revenue	88.4	79.1	9.3	11.8
Insurance Services and Reinsurance Expenses	76.7	69.4	7.3	10.5
Insurance Services Gain/Loss	**11.7**	**9.7**	**2.0**	**20.5**
Interest Revenue on Financial Assets Not Measured at FVTPL	15.3	18.5	-3.1	-17.0
Investment Income excl. Seg. Funds	36.4	-75.0	111.4	-148.5
Investment Income Seg. Funds	62.8	-68.3	131.1	-191.9
Provision for Credit Losses	0.4	0.2	0.2	74.1
Investment Return	114.8	-124.6	239.5	-192.1
Net Finance Income/Expenses and Movement in Contract Liabilities	108.4	-119.4	227.8	-190.8
Net Investment Results	**6.4**	**-5.3**	**11.7**	**-222.4**
Other Income and Expenses	-3.3	-0.4	-2.9	-775.0
Pretax profit/loss	**14.9**	**4.1**	**10.7**	**261.5**
Net Income	**13.3**	**4.4**	**8.9**	**199.6**

Source: BESTLINK

Exhibit 3

Canadian Life – Pretax Operating Gains



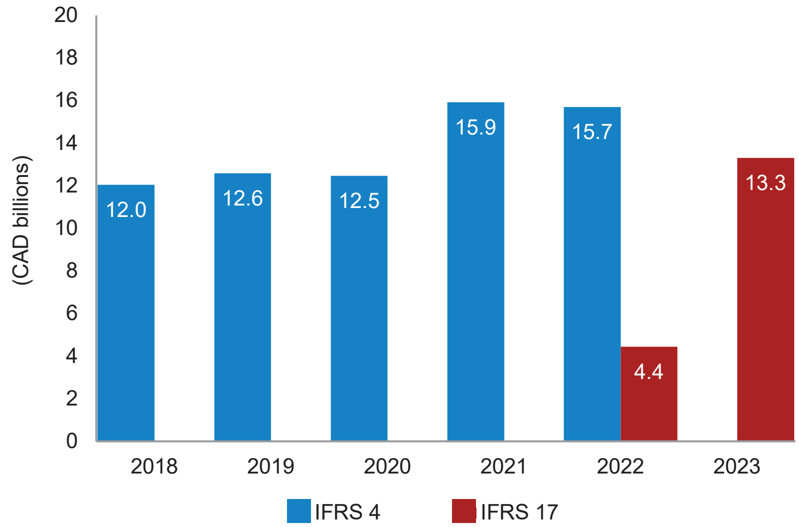
Source: BESTLINK

2023 earnings of CAD 13.3 billion, in line with modest growth from pre-IFRS 17 results, which ranged from CAD 12 billion to CAD 12.6 billion in 2018-2020 (**Exhibit 4**).

Group life insurance dominated insurance revenue reported, at just under CAD 25 billion, followed by individual life insurance at just over CAD 13 billion and European business at just under CAD 11 billion. Annuity business resulted in insurance revenues of CAD 4.5 billion for group and CAD 2.8 billion for individual. Pre-tax operating gains largely followed suit with group life insurance the largest contributor to insurance revenue totals. Asian business was a notable outlier, however, accounting for only CAD 1.9 billion of insurance revenue, although it was the second-most profitable line on a pre-tax basis. This is a rebound from 2022, as insurers with exposure to Asian markets such as Hong Kong and mainland China experienced a significant disruption in sales due to prolonged and widespread COVID-related lockdowns. With multiple restrictions lifted, the Asian market's operating performance in 2023 improved, given the typically higher growth rates than in the more mature economies of Canada, US, and Europe. This trend is expected to continue over the medium to longer term, barring further external disruptions.

Nearly all Canadian life insurers recognized improved mortality experience in 2023 compared with 2022, when the residual impact of COVID-19 remained above assumptions for most.

Exhibit 4
Canadian Life – Net Income



Source: BESTLINK

Valuations of Mortgage Holdings

Demand for office buildings in particular was still dampened owing to a lag in employers' return-to-office plans, leading to higher vacancy rates. This decline, coupled with higher interest rates, has resulted in valuation reductions negatively impacting the overall operating performance of real estate assets directly and, in some cases, commercial mortgage loans, indirectly. AM Best has noted potential issues in the commercial real estate space since the emergence of the pandemic, but to date life insurers have mitigated the risk well by adjusting allocations away from office type buildings, ensuring substantial diversification, and by persistent monitoring to quantify risks.

Capitalization Solid Through IFRS 17 Transition

Canada's L/A insurers maintained their strong capital positions, as evidenced by Life Insurance Capital Adequacy Test (LICAT) ratios well in excess of the OSFI Supervisory Target Total Ratio of 100% and the Supervisory Minimum Total Ratio of 90%. The capital of entities under Quebec's Capital Adequacy Requirements Guideline for Life and Health Insurance ratios (CARLI) also remains well in excess of the AMF's (Autorité des marchés financiers) supervisory target. The strong ratios are supported by solid core earnings and minimal investment impairments. Furthermore, L/A insurers have generally maintained adequate financial leverage the past year, as they have been more hesitant about issuing new debt due to the rising costs of doing so.

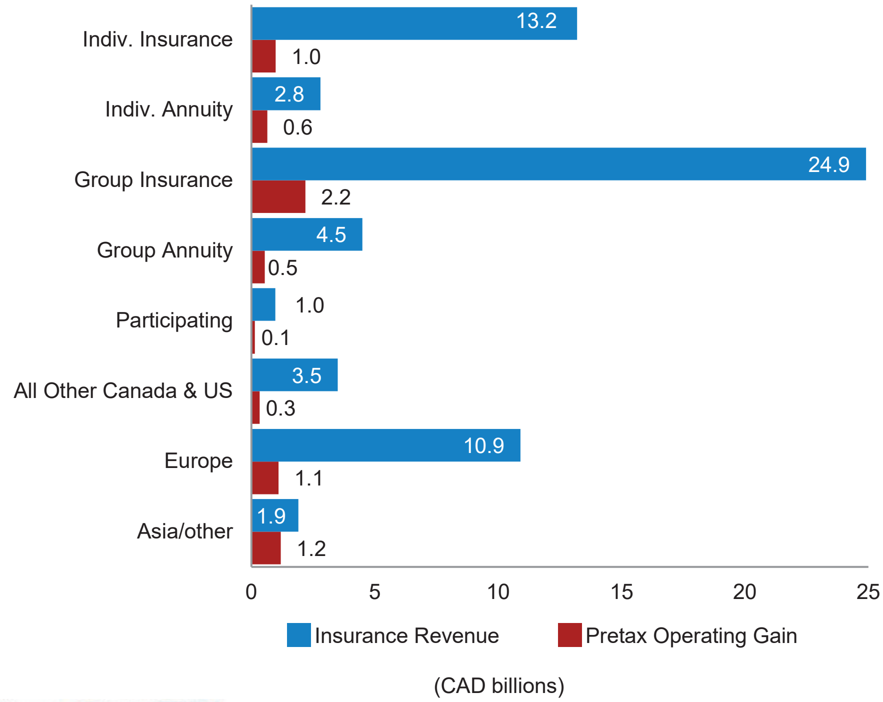
The transition to IFRS 17 has been a time-consuming and expensive endeavor, but Canada's carriers were largely well prepared for the switch on January 1, 2023, and reporting on a full year of IFRS 17 for year-end 2023. Canadian L/A insurers began communications with investors and other stakeholders about the impact of IFRS 17 well in advance of implementation. The restated year-end 2022 equity balance for the industry fell around 24% to CAD 122 million (**Exhibit 5**). From 2022 to 2023, capital increased 4%, to CAD 127 million. Some of decline in the equity balance is due to restated amounts, which are muted when looking at total available capital because of the establishment of the contractual service margin (CSM), which defers the recognition of new business gains and certain investment-related activities under IFRS 17.

Although shareholders' equity has declined, the OSFI will be treating CSM as available capital when calculating LICAT ratios. The OSFI has also applied a similar treatment to the IFRS 17 risk adjustment. Because of these factors, most of Canada's L/A insurers did not experience a material impact on their LICAT ratios at transition. In addition, the expectation is that LICAT ratios will become less sensitive to interest rate movements under IFRS 17.

CSM arising from life business is viewed as economic capital. AM Best currently adjusts reported equity when assessing available capital for the BCAR, to allow for the net economic value due to long-term business (NEVLtB) in the life segment. This approach continues under IFRS 17. The equity credit granted in Best's Capital Adequacy Ratio (BCAR) would not normally exceed 50% of the measure representing this economic value.

Exhibit 5

Canadian Life – Insurance Revenue and Pretax Operating Gains by Line of Business, 2023

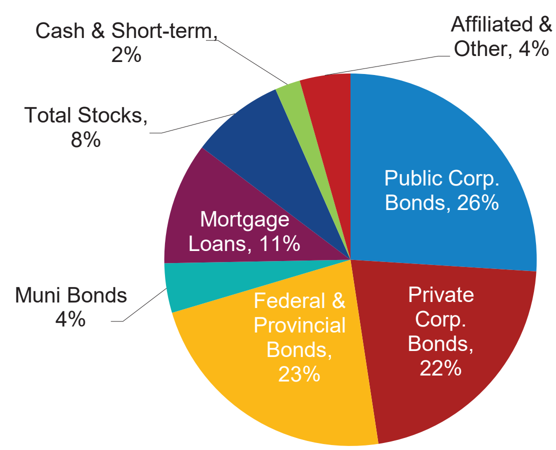


Source: BESTLINK

Under IFRS 17, the life segment CSM and risk adjustment will form the basis of the NEVLtB. AM Best will consider the source and profile of CSM amortization and the volatility of the CSM balance. Equity credit might in well-defined cases could vary from 50%, though we envisage it will be in the 40%-65% range. The haircut reflects volatility of the economic value in this component, including sensitivity to assumption changes and fungibility constraints.

Exhibit 6

Canadian Life – 2023 Invested Assets



Source: BESTLINK

Investment Portfolios Through Economic Cycles

The Canadian market has now seen a full two years of higher interest rates, but given the long-term nature of many investments held on carriers' balance sheets, taking advantage of this rate change has been gradual. The asset distribution for 2023 saw a move toward bonds, reversing a slow and long-term trend toward higher-yielding but lower-quality asset classes. However, this flight to bonds indicates the ongoing desire for higher-yielding issues, as private corporate bonds accounted for 21.6% of general account investment holdings, up from only 13.4% in 2022 (**Exhibit 6**). Public corporate and municipal bonds allocations remained steady, at a respective 26.0% and 4.3%, compared to 27.6% and 3.9% in 2022. Somewhat offsetting the move to private credit was a moderate rise in federal and provincial bond allocations to 22.8% from 18.3% and a decline in below-investment-grade holdings to 1.5% of total bonds holdings from 2.7%. Bond holdings by sector saw only minimal movement in 2023 versus 2022, with the largest changes being energy sector bond allocations, which fell from 9.1% to 8.4%, and utility sector bonds, which rose from 23.3% to 24%. Allocations to consumer non-cyclical, technology, and communications also declined minimally, while allocations to basic materials, diversified/health, and other grew slightly.

Allocations to mortgage loans declined slightly, from 11.3% in 2022 to 10.6% in 2023. Ongoing monitoring of these risks continues to show a largely insignificant impact due to strict underwriting and substantial diversification. As a result, although some insurers have been marking down the value of these investments to fair value, as required by IFRS guidelines, and increasing their expected credit losses, the number of delinquencies to date remains modest and most commercial mortgage loans are current on loan payments.

Canadian life insurers have seen equity holdings rise from 6.7% of invested assets in 2022 to 8.1% in 2023, driven by strong equity returns, including just over 8% for the S&P/TSX Composite index and 24% for the US S&P 500 index. AM Best expects these allocations to continue to move with general market fluctuations over the near to medium term, while available cash from older maturing bonds is reinvested into higher yielding issues, to take advantage of spread value in private corporates.

Focus on the Customer Experience

Canadian L/A insurers have continued to accelerate digitization to keep up with competition and improve the customer experience. They continue to make strides post-pandemic, particularly in digitization. Many L/A carriers are now striving to become digital leaders, with the lofty goal of becoming fully digitized over the next several years. L/A insurers have launched or acquired digital platforms for both customers and agents in a number of markets, to substantially enhance efficiency with regard underwriting, administration, claims handling, and customer service. Furthermore, given more recent advancements in artificial intelligence, many carriers are looking to incorporate AI into their platforms for greater efficiency. Insurers that were early to embrace innovation during and immediately following the height of the pandemic generally outperformed their peers and are well positioned to take advantage of future growth opportunities. These realized efficiencies are of greater importance recently, to combat the inflationary environment, which can impact new sales and retentions.

Published by AM Best

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Version 011624