November 30, 2023

Market Segment Outlook: US Life/Annuity

The Stable outlook is based on the segment's persistently strong capital and liquidity positions, as annuity sales drive premium growth

AM Best is maintaining its Stable outlook for the US life/annuity segment. Key factors include the following:

- Strong liquidity and capital positions
- Robust annuity sales
- Slightly improved new money yields in a benign credit environment

Factors offsetting these tailwinds include the following:

- Market volatility and increased uncertainty
- Asset classes, such as structured credit and commercial real estate, that remain a concern
- Legacy liabilities

The Stable outlook for the US life/annuity segment is supported by the industry's absolute level of capital, as well as solid levels of risk-adjusted capitalization. Although required capital may be higher due to growth, both capitalization metrics are expected to remain favorable. Strong capital buffers and the ability to maintain excess capital allow the industry to absorb financial market risks and potential changes in asset and liability valuations, which is likely to be bolstered as new capital is injected into the industry. Given the long-term nature of the L/A insurance business, insurers continue to demonstrate good liquidity management to meet their short-term liquidity needs.

The industry had endured decades of a low interest rate environment. The dynamics shifted recently and rates have risen, negatively impacting the value of bondholdings, leading to unrealized losses on fixed maturities that directly affect capital levels. However, more favorable rates allow insurers to extend asset durations, with bonds maturing in the near term being reinvested at more attractive interest rates, and new money being deployed in the current environment.

Despite very strong levels of risk-adjusted capital, there are additional headwinds. Inflation may continue to hamper profitability. Credit losses in commercial mortgages and collateralized loan obligations may also pose some risk, although we have not yet seen a material increase in impairments or defaults.

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Record Annuity Sales Growth

The L/A industry has recorded 10 straight quarters of year-over-year individual annuity premium growth, attributable mainly to ongoing equity market declines and rising interest rates, which has led to solid growth for fixed-rate deferred annuity sales and fixed-indexed annuity sales. Growth in the annuity market has heightened competition, as many new companies have entered the space, including several new private equity and asset management-backed insurers looking to capitalize on the difference between the cost of liabilities and potential favorable investment returns. These new market entrants have added much-needed capacity to the market, launching multi-year guaranteed annuities (MYGA) due to their attractive interest rate spreads.

US annuity sales have continued to grow in 2023. During the second quarter of 2023, sales increased 12% YoY, to $88.6 billion, the highest quarterly figures ever recorded by LIMRA. The growth was due mainly to ongoing equity market declines, coupled with rising interest rates, which has led to solid growth in registered index-linked annuity and fixed-indexed annuity products.

AM Best is concerned that annuity growth will be accompanied by an increase in surrender benefits. Although surrenders topped $100 billion in the second quarter of 2023, they remain low as a percentage of annuity premium growth. Companies are looking to mitigate the risk and disincentivize surrenders. In many cases, companies are attaching market value adjustments (MVAs) to surrender charges, so that if yields are higher at the time of withdrawal than when the contract was purchased, the surrender charge is higher.

Growth in the L/A segment is not limited to annuity sales, however. Although the COVID-19 pandemic dampened operating earnings due to higher mortality, it also renewed interest in life insurance. Many innovative companies have found ways to sell products through digital channels, driving double-digit premium growth and improving the industry's outlook. This sales growth has since moderated, as new annualized premium only increased 2% in the second quarter of 2023.

ERM Anchors Stability

L/A liabilities are backed by financial assets, so insurers must continuously manage significant market risk, carefully measuring credit, equity, liquidity, and interest rate risk. In the aftermath of the 2008-2009 financial crisis and the pandemic, the ability to execute on strong enterprise risk management strategies has provided insurers with added operational security and favorable outcomes for these risks.

The segment faces some fundamental risks: mortality, morbidity, longevity. Although COVID-19 impacted mortality, it was seen as mostly manageable, as companies updated assumptions for their impact on life products. However, greater uncertainty and risk are being introduced in the relatively newer and growing annuity product lines, where experience may not yet be fully developed. Examples include embedded risks related to future policyholder behaviors, annuitization rates, the impact of surrenders and lapses, and the longevity risk associated with growth in pension risk transfer deals. Risk managers and insurance executives continue to grapple with operational challenges such as cyber risk, as the industry improves its digitization capabilities.

Strong corporate governance structures contribute to better capital management outcomes, strengthening insurer resilience and bolstering an insurer's ability to adjust to changing market conditions. The market acknowledges that risk is not static. An integrated, dynamic ERM framework and continuous evaluation of risk components require ongoing improvement to keep up with changing risks. In addition, stress-testing and a strong corporate governance structure consisting of risk management committees have become integral to the operations of many insurers, which has helped them size the capital required to support the business. In addition, workplace challenges such as cyber risk and the war for talent remain top of mind for many insurance executives and operational risk managers.

Managing Legacy Liabilities

Although traditional L/A insurers are well capitalized, prudent asset-liability matching remains key to a successful ERM framework. Primary L/A insurers have generally enhanced their balance sheet strength through business diversification, but many are now looking toward third-party reinsurers to achieve the same results. Primary L/A writers are tapping the global reinsurance market more frequently to help mitigate long-term liability risk. Reinsurers can provide capacity for large one-off full or structured risk reinsurance transactions on in-force blocks, which helps the primary company more efficiently manage capital and improve the risk profiles for some of these blocks. Other primary writers look to the reinsurance market to access expertise and compete in new markets. They may seek guidance in working with distribution channels or refining underwriting methods.

Market Uncertainty

AM Best remains cautious about ongoing market uncertainty, which can alter the dynamics of industry profitability. This includes concerns about asset classes with higher risk and less liquidity, encompassing structured credit and commercial real estate investments. As we look to 2024, we will continue to monitor issues such as inflation, slowing economic growth, market-sensitive lapse rates, and asset credit risk, including commercial real estate impairments. However, we believe the challenges the segment faces will be manageable, given its sizable capital base and favorable liquidity measures.

These are the key factors determining our outlook at this time. AM Best reserves the right to revisit the outlook if any of these risks fall outside expectations.

GUIDE TO BEST'S MARKET SEGMENT OUTLOOKS

Our market segment outlooks examine the impact of current trends on companies operating in particular segments of the insurance industry over the next 12 months. Typical factors we would consider include current and forecast economic conditions; the regulatory environment and potential changes; emerging product developments; and competitive issues that could impact the success of these companies.

A Best's Market Segment Outlook can be Positive, Negative, or Stable.

Best's Market Segment Outlook	
Positive	A Positive market segment outlook indicates that AM Best expects market trends to have a positive influence on companies operating in the market over the next 12 months. However, a Positive outlook for a particular market segment does not mean that the outlook for all the companies operating in that market segment will be Positive.
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We update our market segment outlooks annually but may revisit them at any time during the year if regulatory, financial, or market conditions warrant.

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BEST'S MARKET SEGMENT REPORT

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