

Note: This session has live audience polling

# Review & Preview

**AM Best's 31<sup>st</sup> Annual *Review & Preview* Conference**  
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# **Annuity 2.0: What the Industry Looks Like in a Rising Rate Environment**

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# Market Segment Outlook

## Positive factors impacting the annuity market

- Demographics
  - Baby Boomers with trillions need income and wealth transfer solutions
- Rising rates
  - Help old blocks with reinvestment rates
  - Help new spreads on new sales
- Competition remains rational and spreads continue to expand

# Market Segment Outlook

## Positive factors impacting the annuity market (cont'd.)

- Record sales
  - Pent-up demand for fixed income solutions to retirement
    - Growth in the bank channel
- Regulation allowing annuity products in 401(k)s (SECURE Act 2.0)
- Higher mortality compared to pricing assumptions and historical trends helps annuity market
- PRT market ripe for strong growth due to:
  - Rising rates for new investments and equity market leading to ...
  - ... High funding status of plans and (more importantly) increases in the discount rate

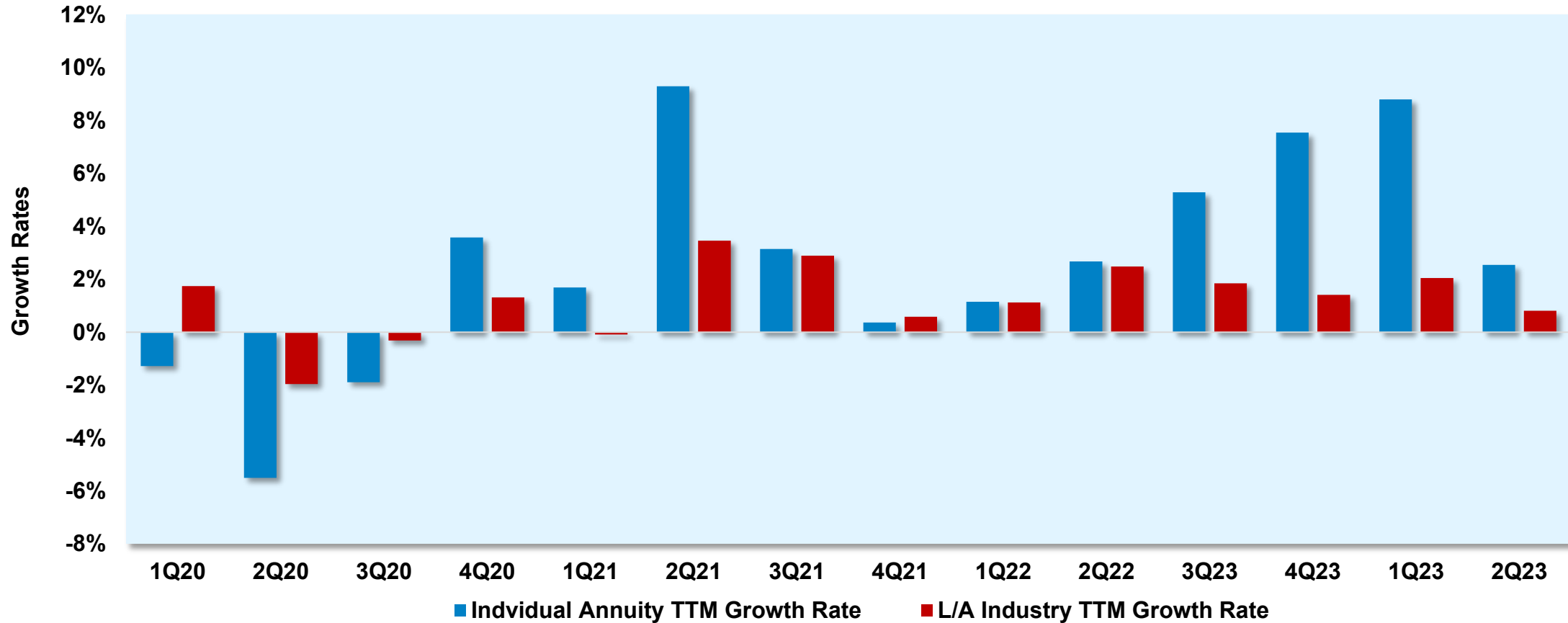
# Market Segment Outlook

## Factors partially countering these positives include the following:

- Distribution consolidation could continue to drive bargaining power to agents
- Private equity and new capital coming into the market could compress spreads
- Increased asset risk in investment portfolios
- Direct-to-consumer products have had little impact on the market and innovation is slow to add true value
- Increased regulation and unknowns for DOL fiduciary rules seem to never go away
- PRT market has long-term assets with large unrealized losses that make transferring them a little less likely despite higher funding levels

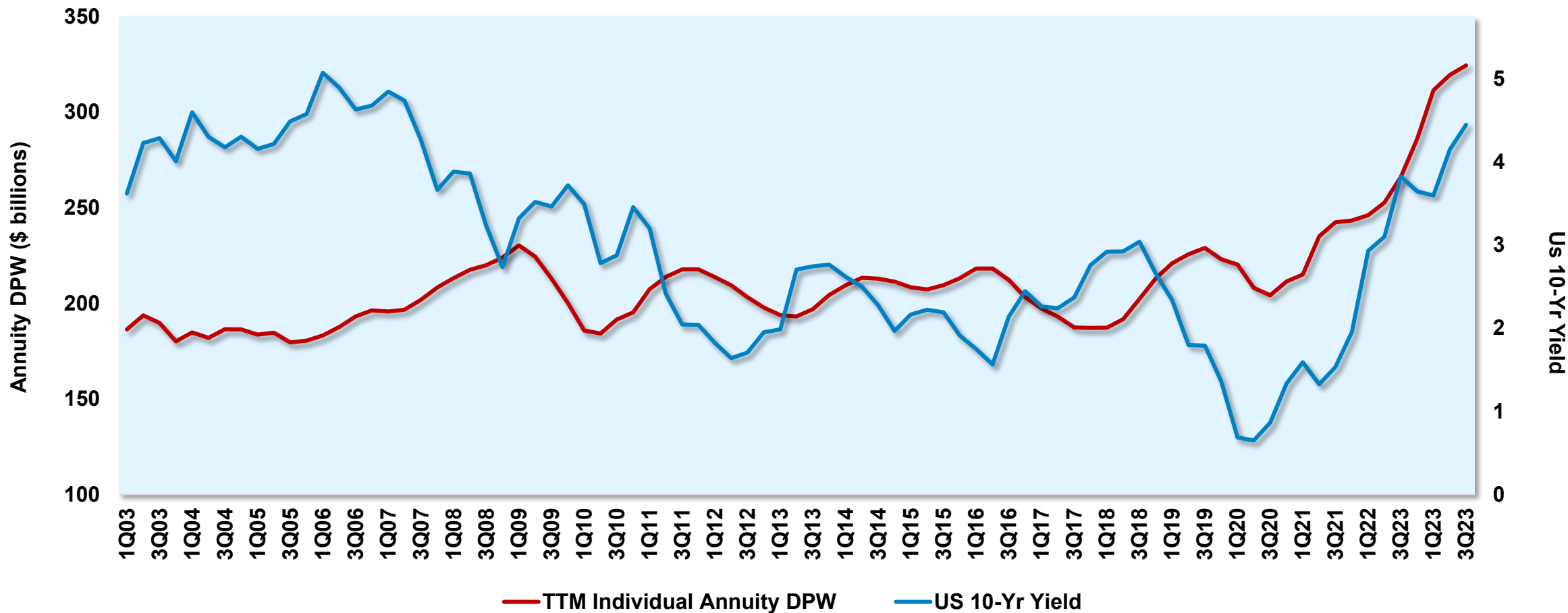
# Individual Annuity Premiums Are Still Volatile

TMM Industry Individual Annuity vs Total Premiums Growth Rates



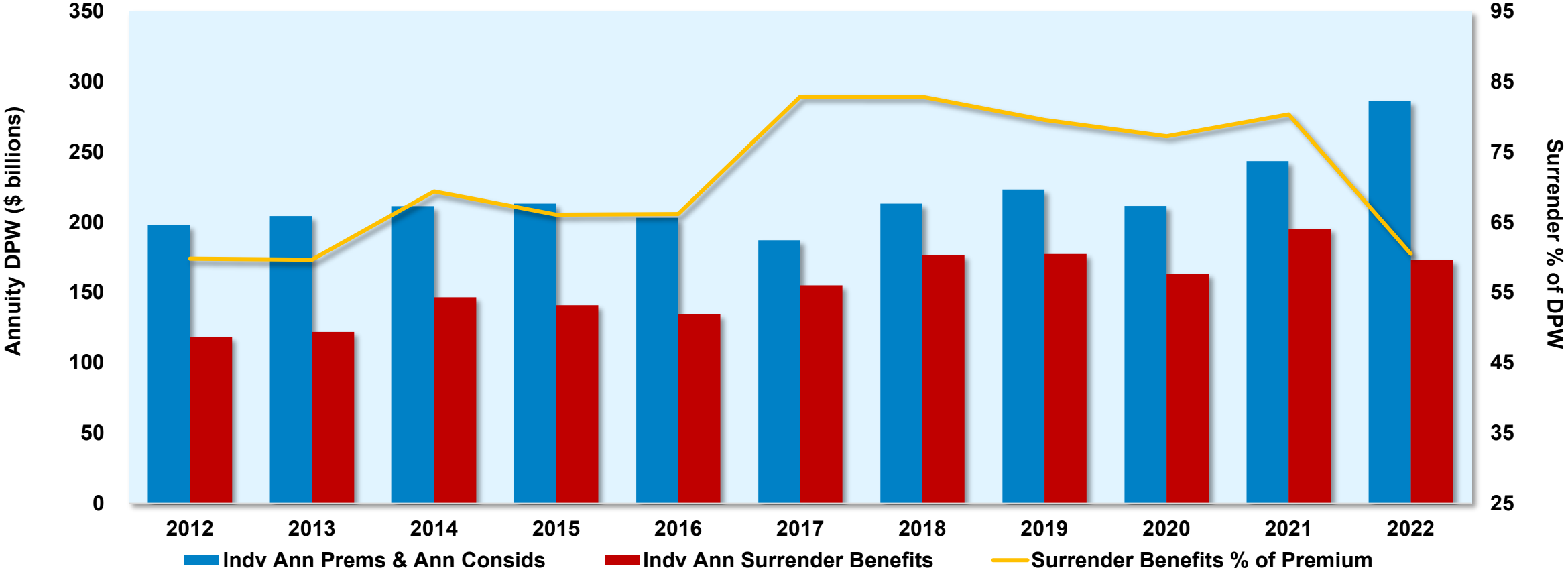


# Individual Annuity DPW and US 10-Year Yield Are Correlated



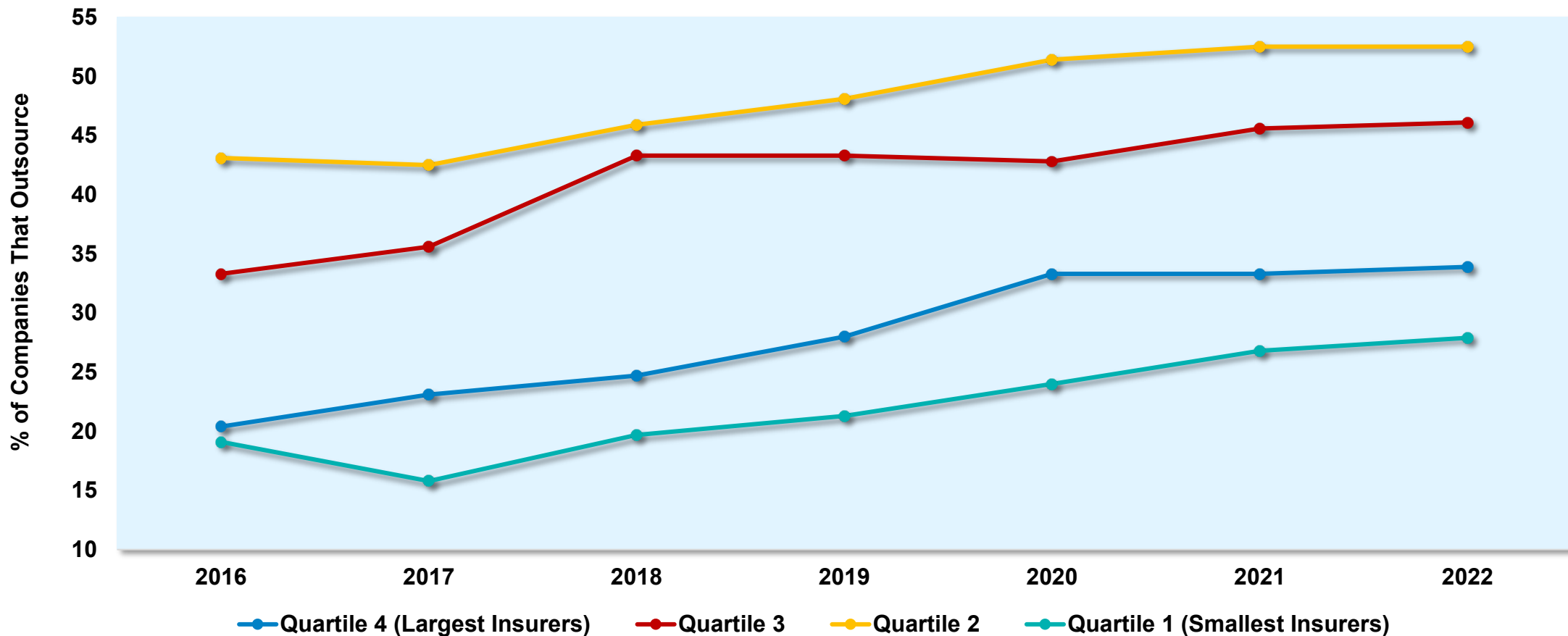
# Direct Premiums Written Up, But So Are Surrenders

Indv Annuity Premiums, Surrenders and Surrenders as a % of Premium



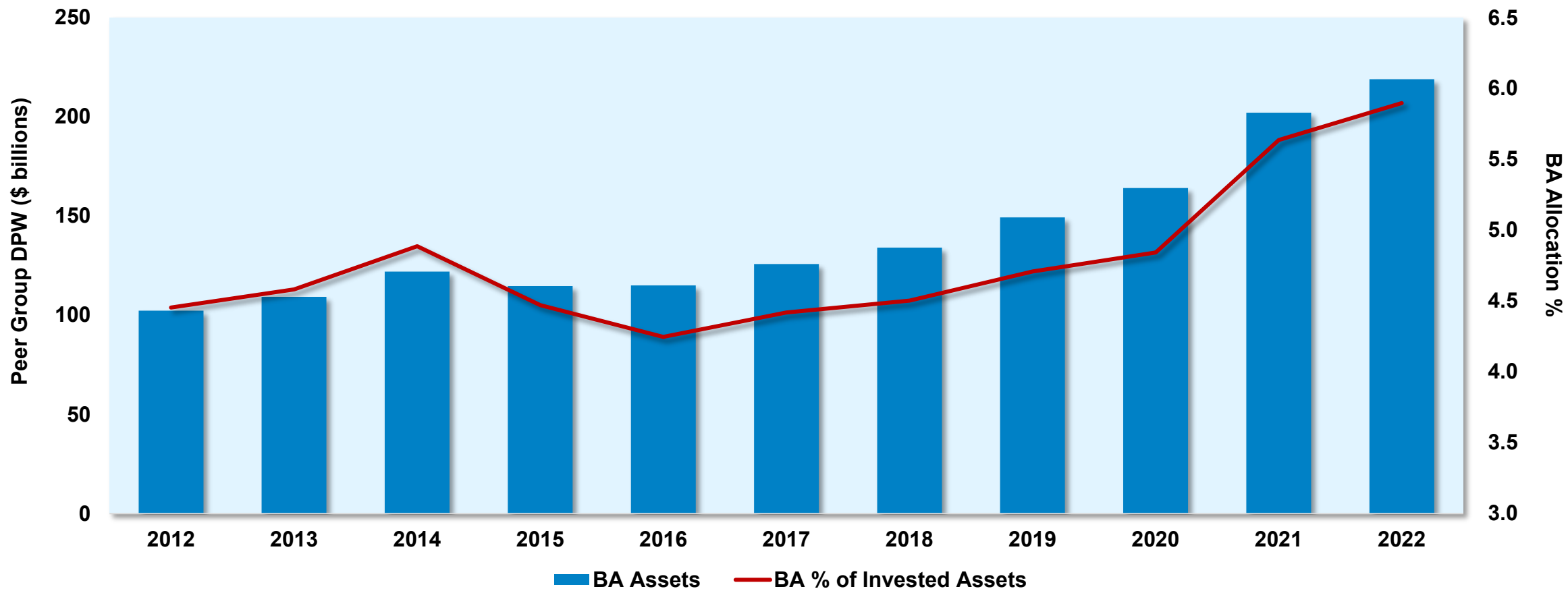
# Companies of All Sizes Outsourcing More Assets to Third-Party Managers

% of Each Quartile That Outsources More Than 10% of Assets

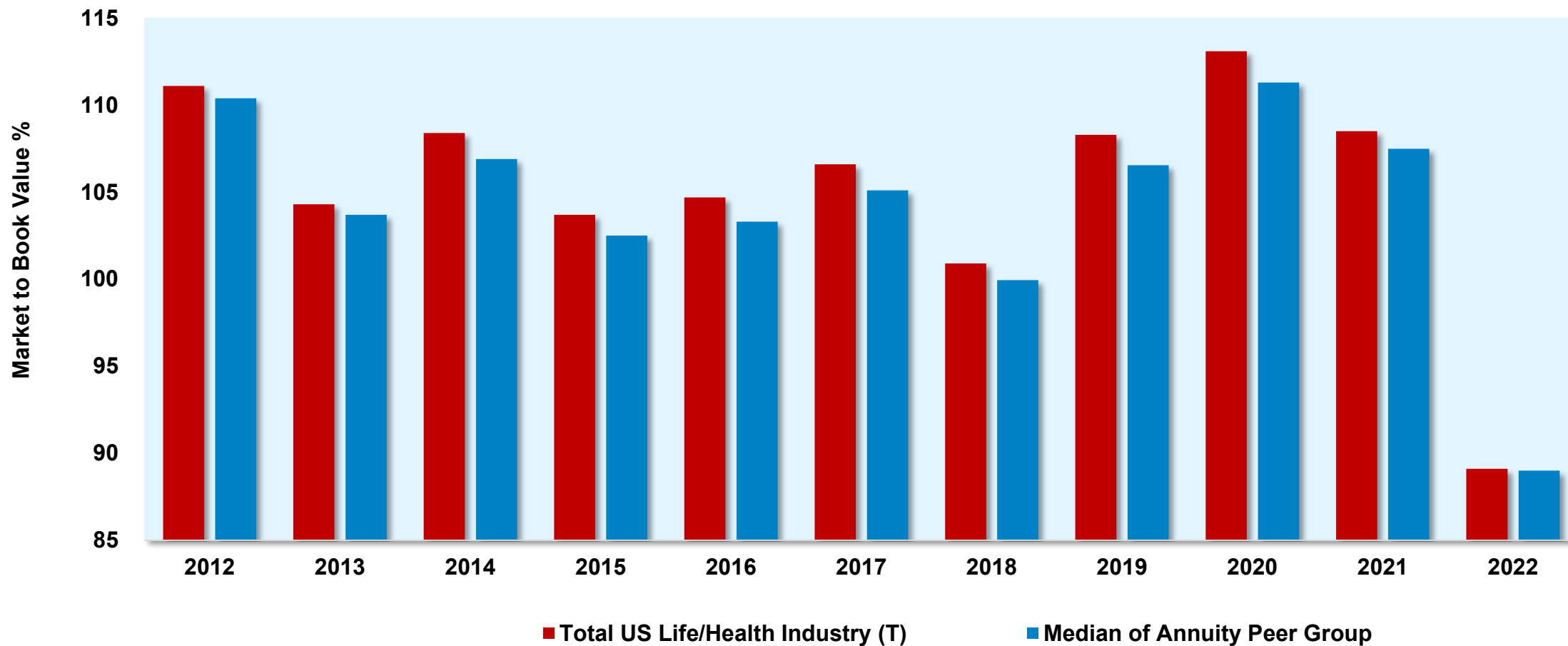


# Annuity Companies Continue To Move into BA Assets

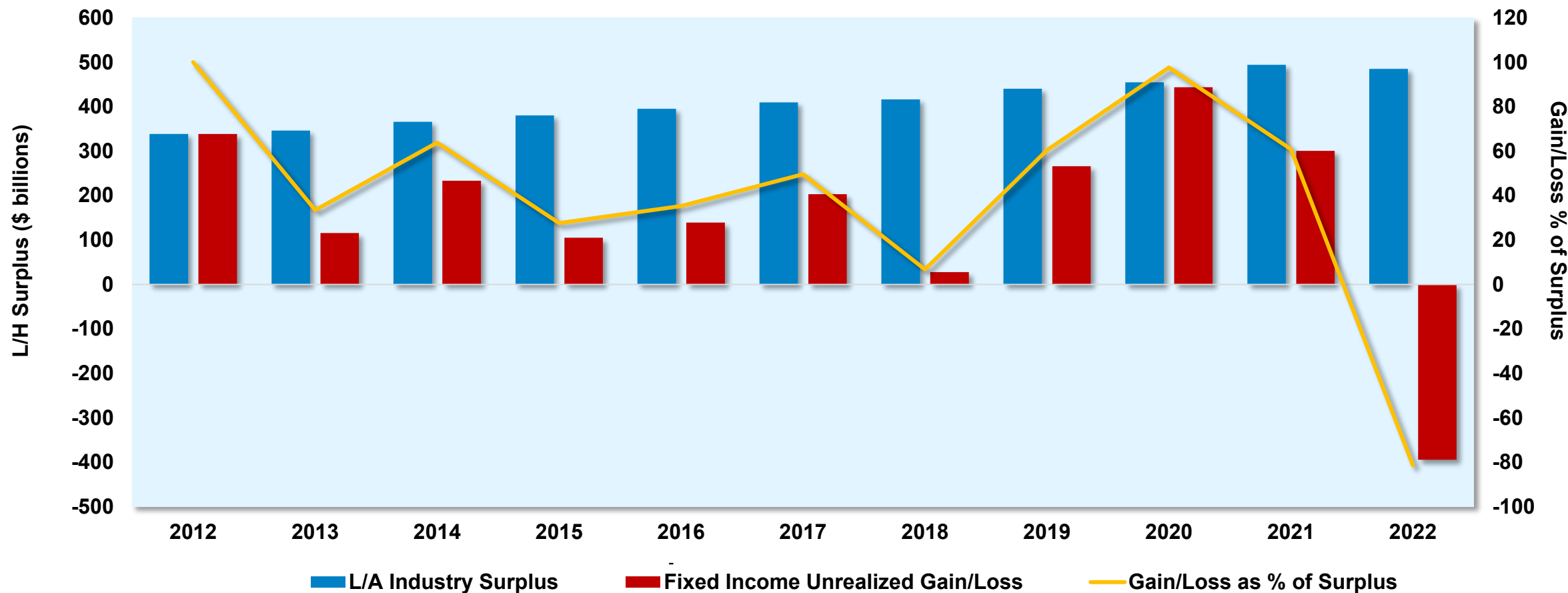
Annuity Peer Group Total BA Assets and % of Invested Asset Allocation



# Market Value to Book Value – Fixed-Income Assets

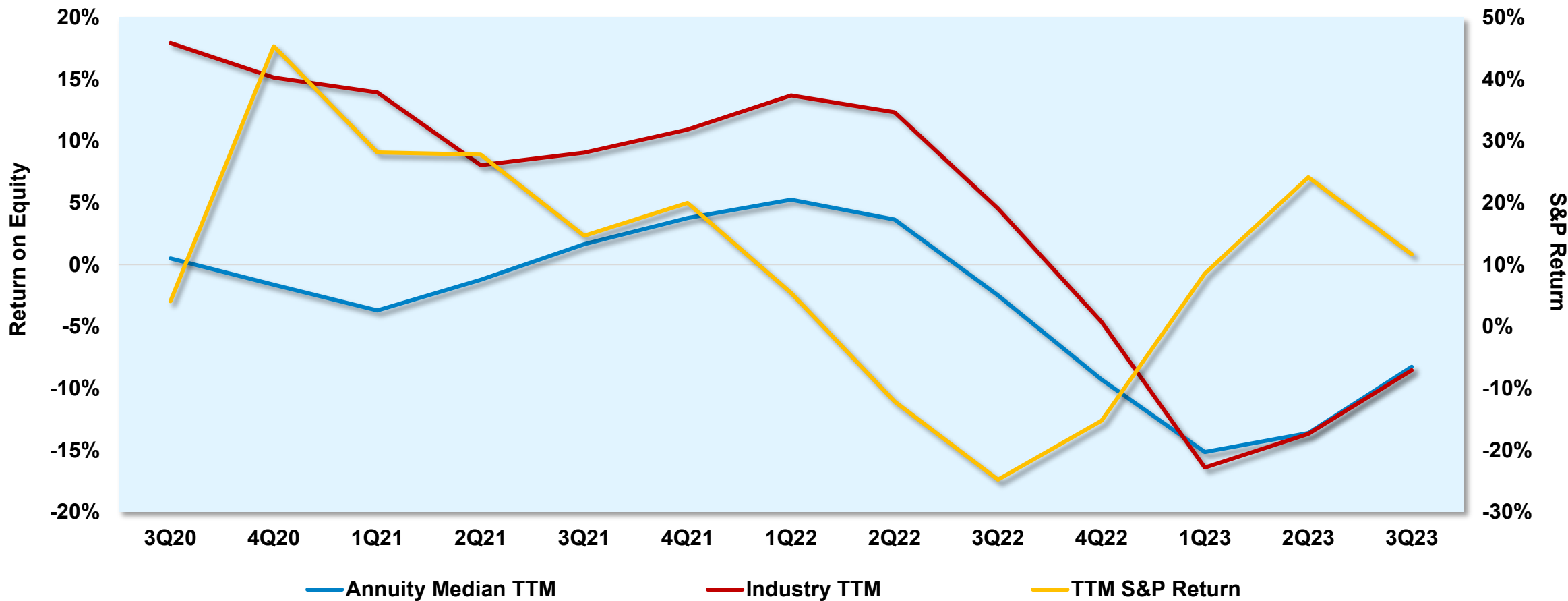


# Historical Unrealized Fixed-Income Portfolio Gain/Loss and Industry Surplus



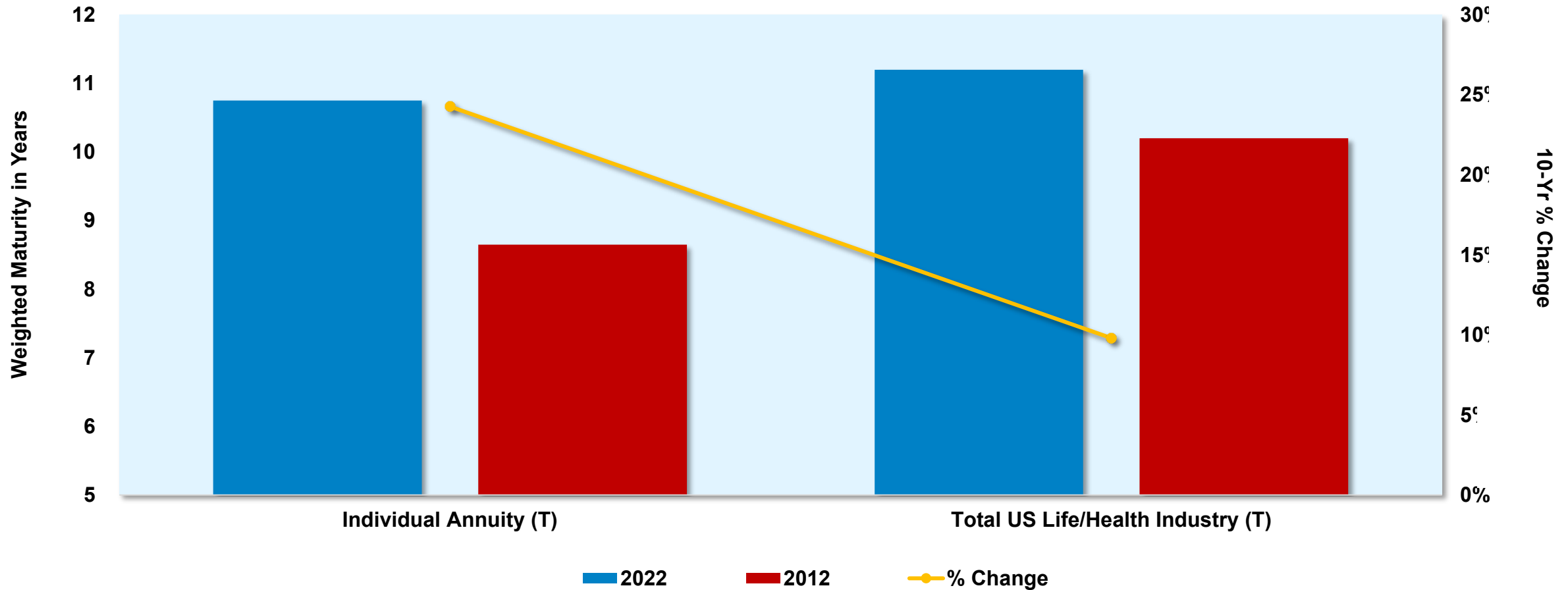
# Annuity Unrealized Gain/Loss and Market Returns

Unrealized Gain/Loss as a % of surplus and S&P 500 Index



# Fixed-Income Portfolio Duration Significantly Extends

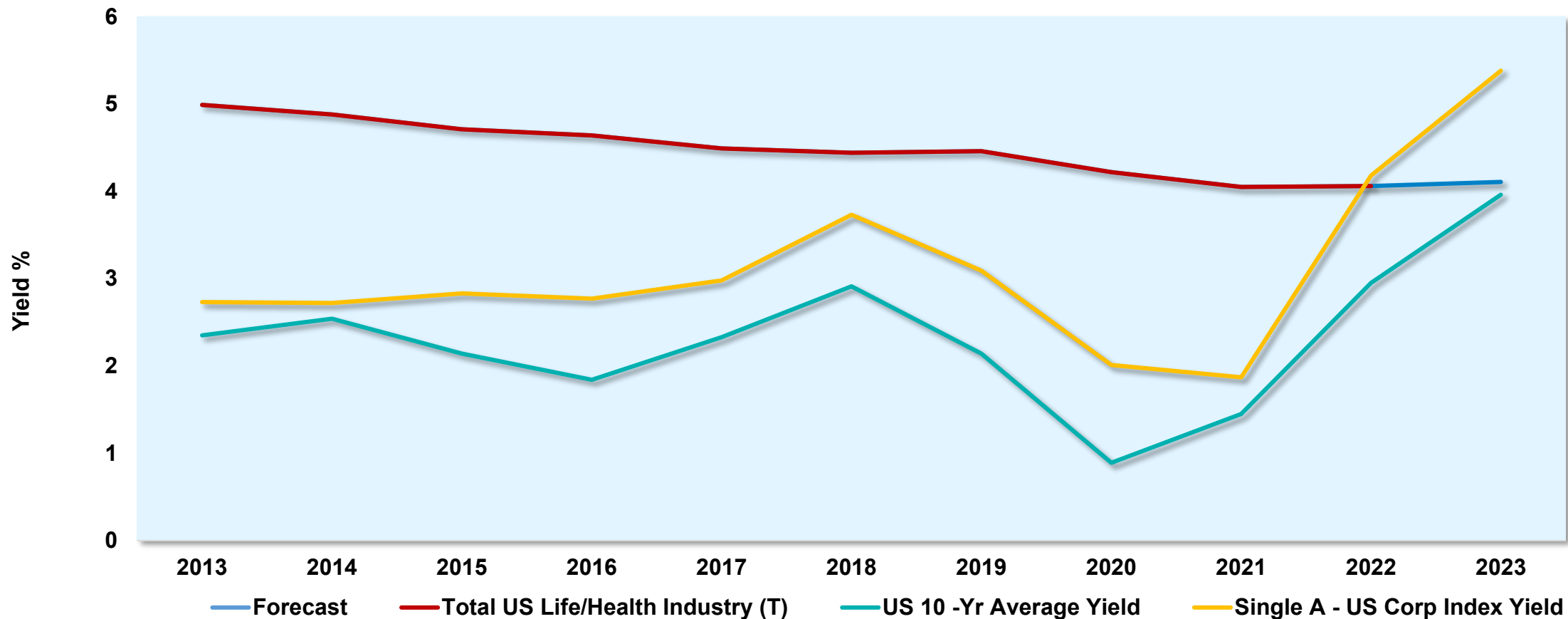
Weighted Average Maturity of Fixed Income



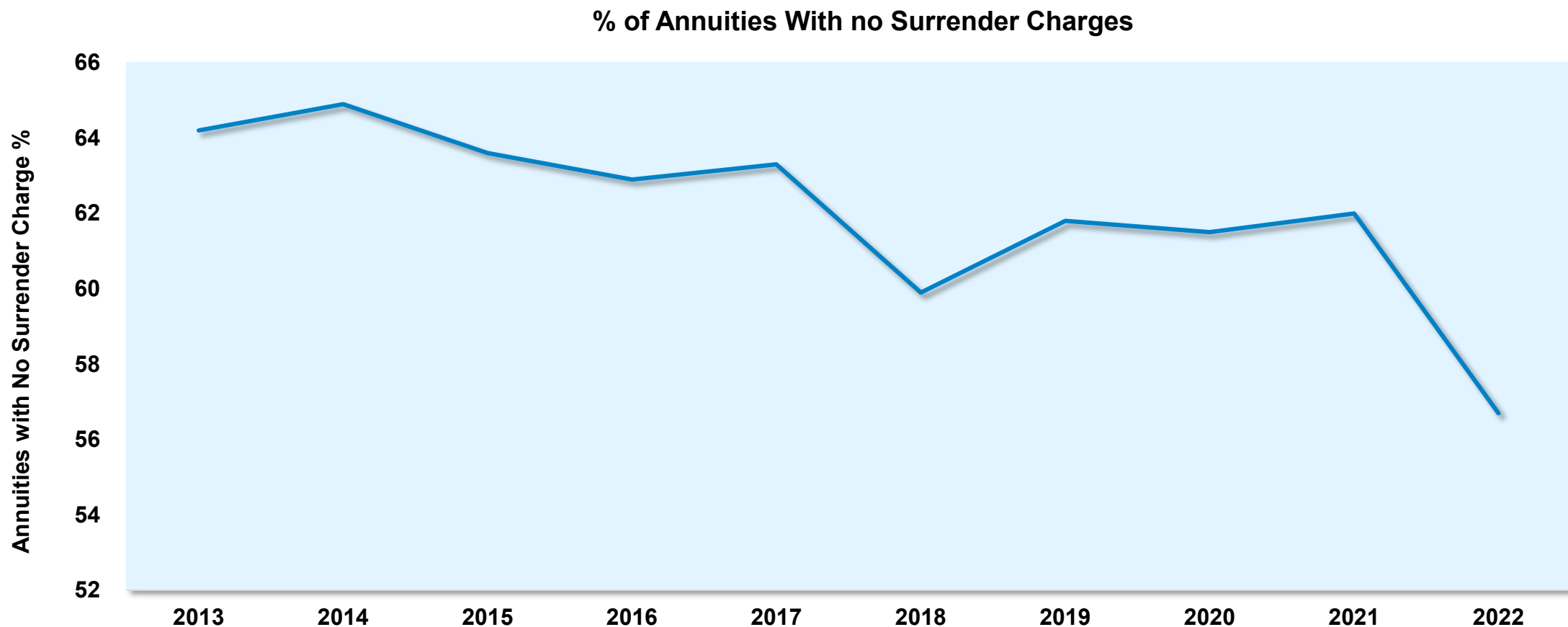


# Industry Yield to Lag Rates

## L/A Industry Fixed Income Yield

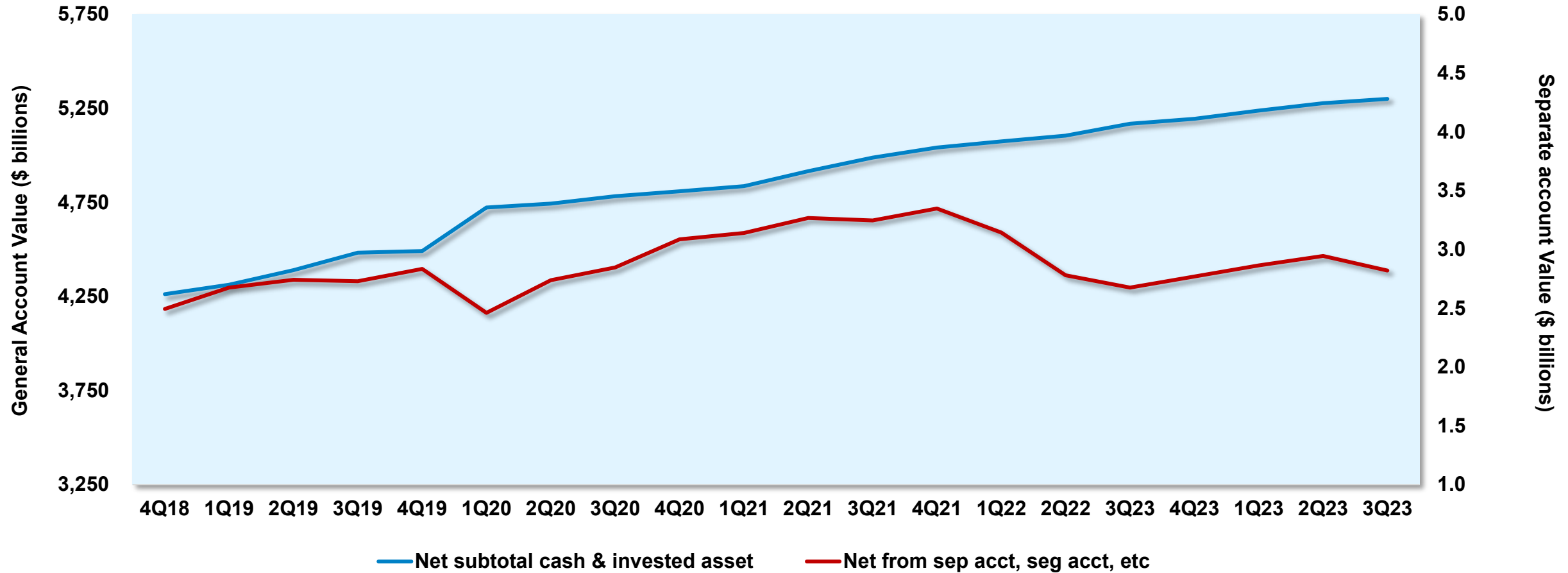


# Reserves with Surrender Charge Protection Increase



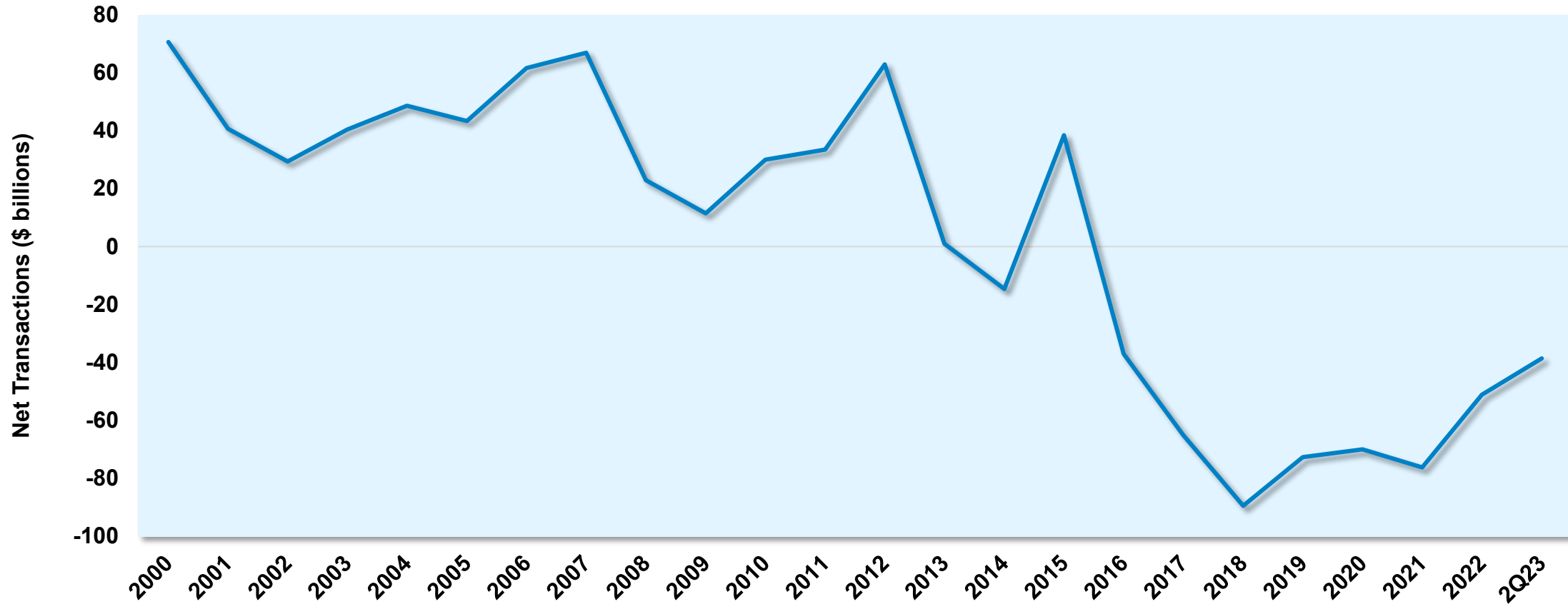
# Separate Account Fee Business Under Pressure

Industry Invested Assets and Separate Account Assets

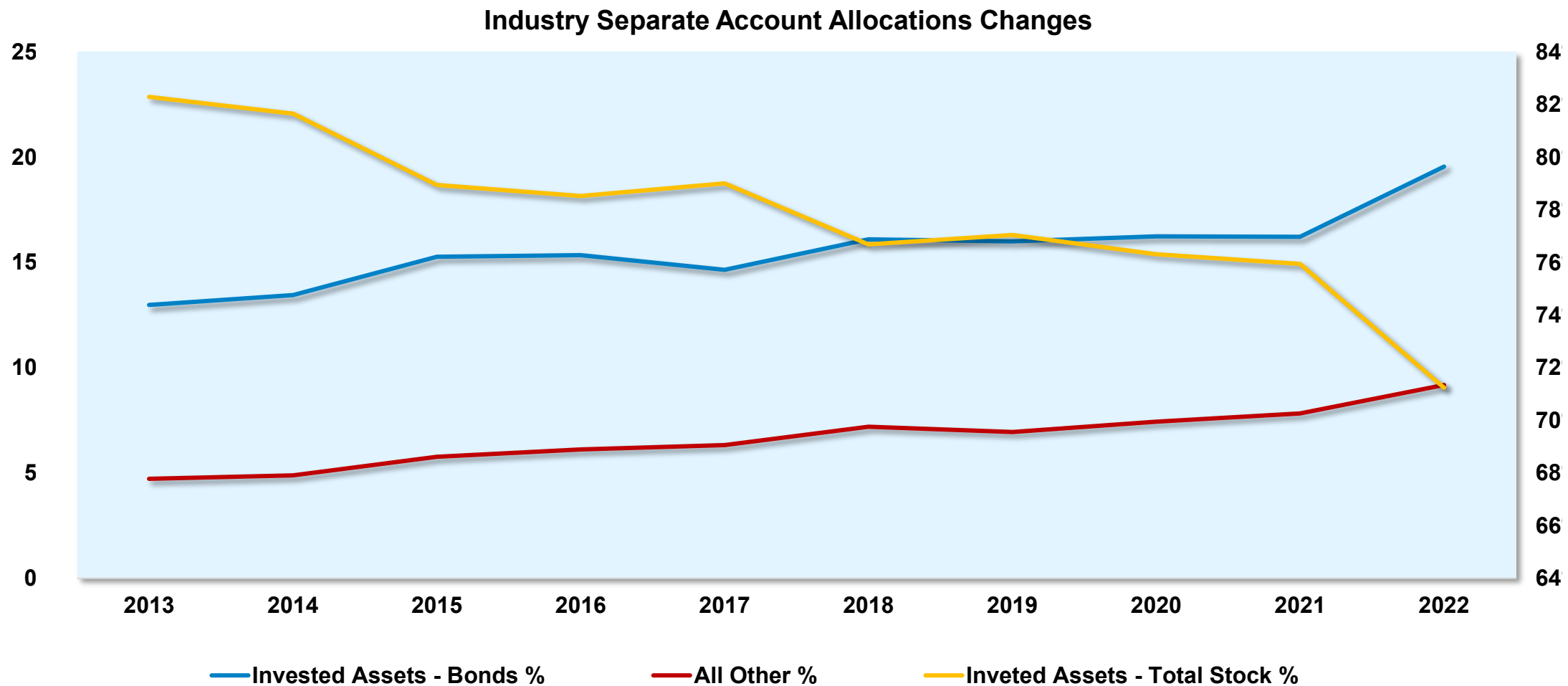


# Money In and Out of Separate Accounts

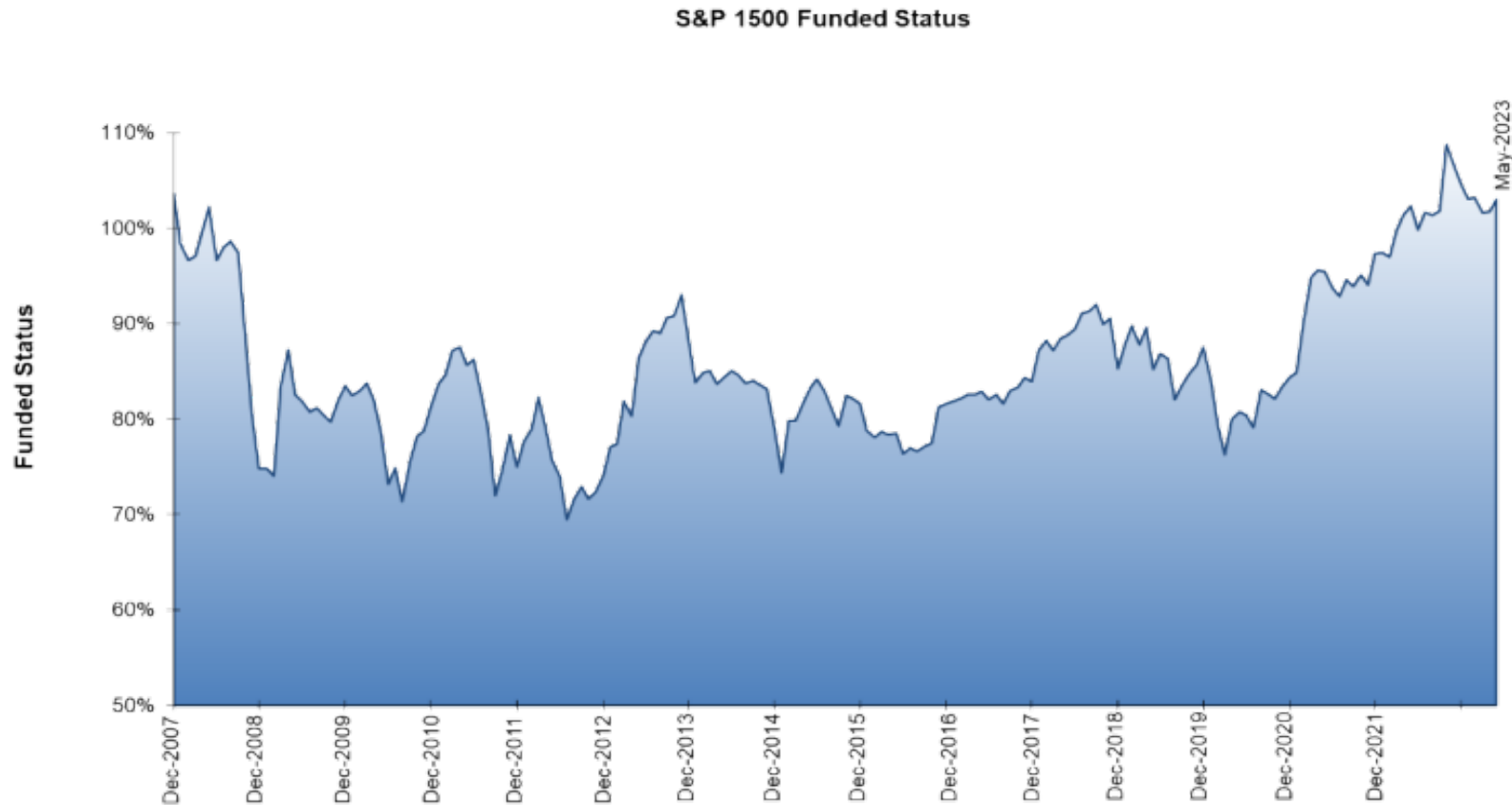
## Net Transfers to/from Separate Accounts Net of Reinsurance



# Separate Account Allocation Changes Over Time Due to Market Movements



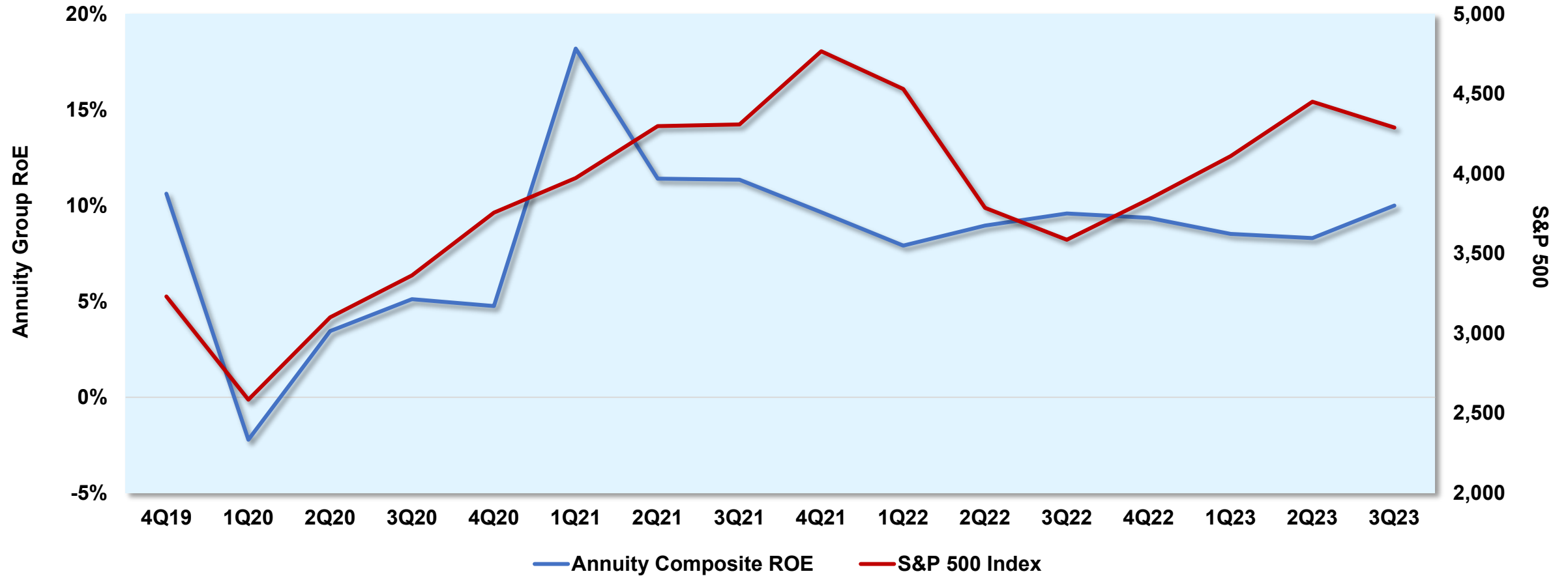
# Funding Status of Public Company Pension Plans to Lead to More PRT Deals



Source: Mercer

# Annuity Composite ROE and S&P 500 Market Index

Annuity Composite TTM RoE and S&P 500 Index



# What Are Annuity Companies Doing That Differs for ERM in This Interest Rate Environment?

**ERM Framework**

**Risk Evaluation**

**Emerging Risks**



# Regulatory/Accounting Impacting the Annuity Market

## Suitability Standards

- The SEC passed its “Best Interest” regulation (Reg BI), requiring broker-dealers to not put their financial interests ahead of those of a retail customer.
- The NAIC adopted a similar “Best Interest” model law that would apply to insurance agents, when adopted.
- 2020 Revisions to Model Reg #275 adopted by 40 states as of November 2023.
- The model now requires agents and carriers to act with “reasonable diligence, care and skill” in making recommendations.
- The revisions also include enhancements to the current model’s supervision system to assist in compliance.

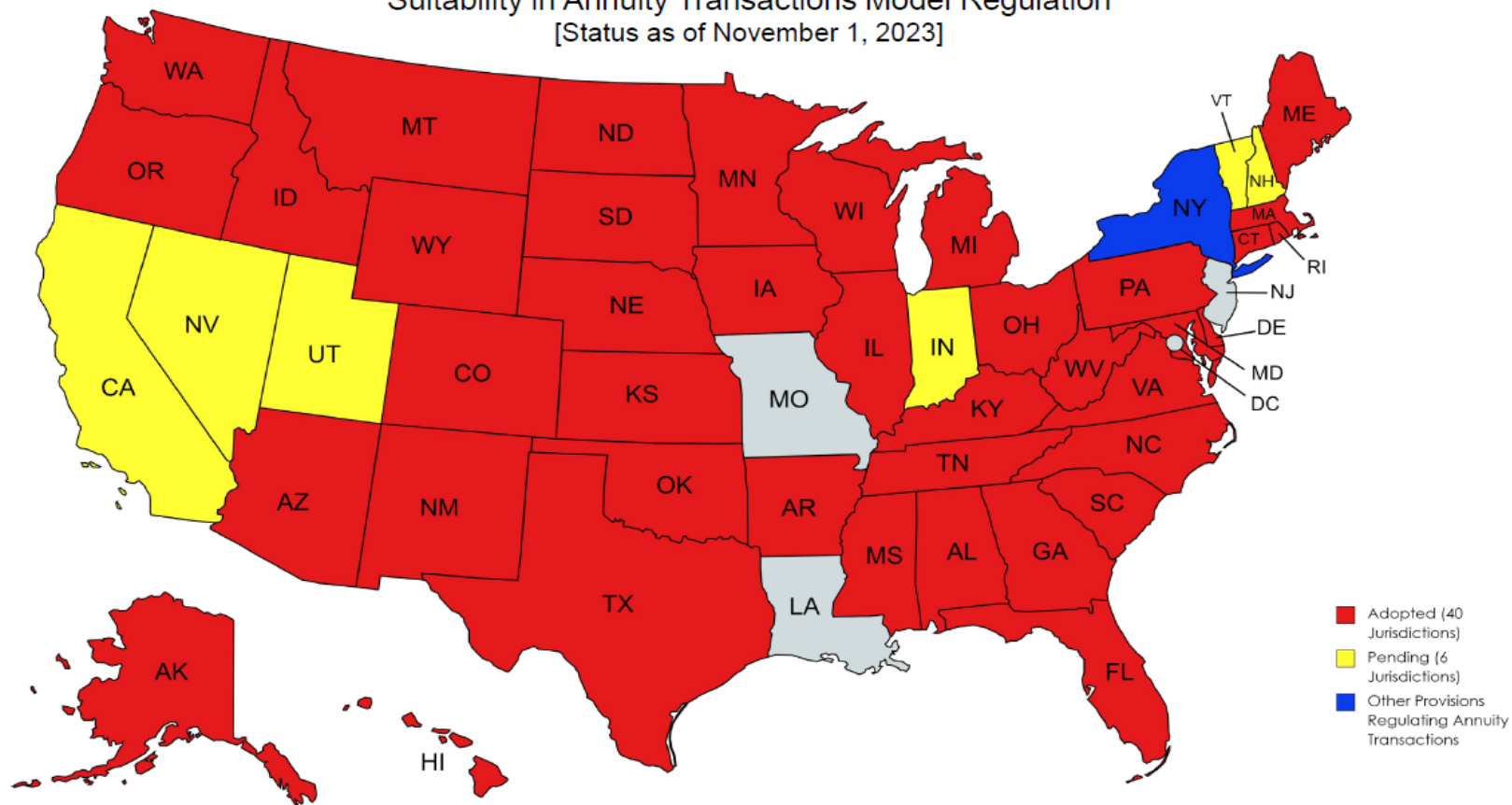
# Regulatory/Accounting Impacting the Annuity Market

## IFRS 17 and LDTI

- No direct impact on AM Best ratings.
- BCAR is unchanged for IFRS 17 reporters to maintain comparability over time periods.
- Credit and financial reports updated for reporting changes; five-year historical data will be a mix of IFRS and non-IFRS reporting.
- Additional IFRS 17 disclosures have been included in the SRQ.
- Initial fears from early LDTI testing have not played out, with help from the rising rate environment.
- LDTI is a disincentive to remain in the variable annuity business, as fair value of the Market Risk Benefit (MRB) will increase financial statement volatility.

# Revision to Model #275

Implementation of 2020 Revisions to Model #275  
Suitability in Annuity Transactions Model Regulation  
[Status as of November 1, 2023]



# Life Mergers & Acquisitions

Drivers To Sell	Drivers To Acquire
<ul style="list-style-type: none"><li>• ERM</li><li>• Cash flow testing results/reserving</li><li>• Desire to unwind underperforming blocks</li><li>• Costs related to insurtech and regulatory compliance</li></ul>	<ul style="list-style-type: none"><li>• Lack of organic growth</li><li>• Need to innovate</li><li>• Diversification into asset management and reinsurance</li><li>• Use of excess capital/inorganic growth strategy</li><li>• A way for new players in market to grow</li></ul>

Legacy blocks

Distribution growth

Technology expansion

## Use of Reinsurance

**AM Best has seen an increase in the use of unrated or low-rated reinsurers to provide capital and capacity to some start up annuity writers**

**Lingering concerns about the source of capital and the understanding of the business**

**Affiliated investments have historically proven to be problematic**

**Increased focus on use of off-shore jurisdictions**

## Polling Question #1

What do you think the most important driver of profitable growth will be for the annuity marketplace in the near term?

- a) Persistently higher rates above historical averages
- b) Competition remaining rational, with limited race to the bottom on spreads and limited new capital coming into the market
- c) Macroeconomic conditions remain stable and we get a soft landing
- d) Regulatory changes propelling growth from uniform Best Interest/fiduciary standards and improved access to annuity markets in the 401(k) segment
- e) Improved funding status of retirement plans leading to more deals in the PRT segment



# Q&A



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# Annuity Policies are Getting Larger, but Policy Count Remains Muted

