Effects of COVID-19 on the Life Insurance Industry

Friday, Nov. 6 | Noon to 1:15 p.m. EST

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PRESENTERS

Tricia Matson, MAAA, FSA
Actuarial Partner

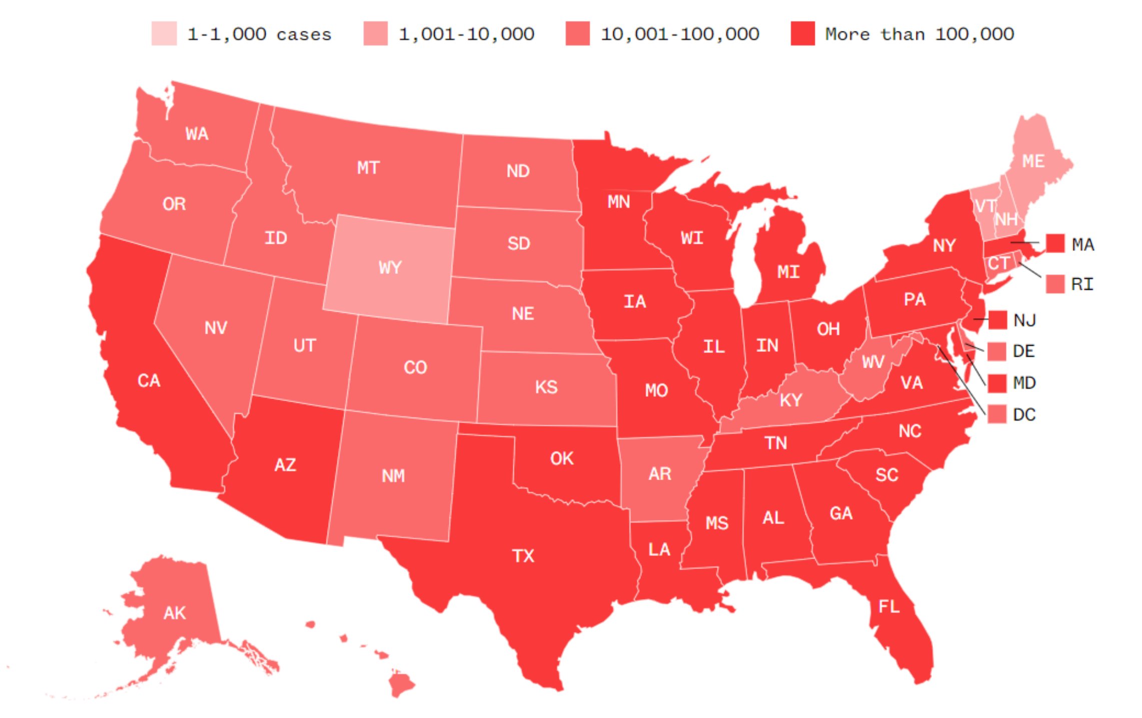
- Key areas of expertise include financial reporting, reserving, enterprise risk management (ERM), internal capital models and regulatory requirements
- Serves as a member of several American Academy of Actuaries' (Academy) committees related to financial reporting, risk-based capital, and risk management and as the prior chair of the Actuarial Standards Board
- Has authored and spoken on financial reporting and risk management topics, which includes co-authoring several Academy practice notes and white papers on financial reporting and ERM topics.

OBJECTIVES

- Provide an overview of potential risks to insurers due to the COVID-19 pandemic
- Describe the impacts identified to date through earnings calls and discussions with rating agencies
- Discuss implications for future performance, risk, and risk mitigation

COVID-19 OVERVIEW

- As of mid October, there have been approximately 8.2M cases of COVID-19 in the United States, and approximately 221K deaths



https://www.nbcnews.com/health/health-news/coronavirus-u-s-map-where-virus-has-been-confirmed-across-n1124546?icid=related

rrc risk & regulatory CONSULTING

Source: NBC News

COVID-19 Economic Impacts

The Federal Reserve annually publishes a "severely adverse" scenario for banks to use as part of the capital framework (CCAR). Some insurers consider this as a benchmark severe economic scenario in their stress testing. A comparison of *point in time* scenario variables is below:

Variable	Current*	Fed CCAR**
Dow Jones	18,214	16,518
Equity Volatility (VIX)	82.7	60.3
10 year Treasury	0.52%	0.70%
BBB Corporate Bond	2.29%-5.56%	5.2%-6.6%
Inflation	0.1%	1.7%
Unemployment	14.7%	8.4%
GDP Growth	(9.0%)	(9.9%)

** Represents the extreme level to date in 2020*
***Represents the worst point in the scenario in all of 2020*

COVID-19 Key Risks

Life Insurers
Increased death claims (offset somewhat over time by longevity risk business)
Investment portfolio losses
Counterparty defaults
ALM/hedging mismatch/liquidity shortfalls
Slowdown in sales/premiums
Other operational risks (business continuity, litigation, fraud, cyber, employee shortages)

Illustrative Mortality Risk

- Industry face amount is approximately $19.57 trillion*
- Assuming 6 deaths/1000 (high est., similar to 1918) and reserves are 70% of death benefit (a rough approximation assuming relatively older age deaths)
  - COVID-19 deaths could cost the industry $117 billion
  - Average RBC ratio would drop from 424%* to 388%
- Assuming 1 death/1000 (low est.) and reserves 70% of death benefit
  - COVID-19 deaths could cost the industry $20 billion
  - Average RBC ratio would drop from 424%* to 418%
- Impact is unknown at this time and extremely sensitive to ultimate death rate and other factors:
  - Differences in health status and age mix (e.g., level of underlying conditions, increased risk to older population)
  - Mix of business and associated reserve levels available to cover claims

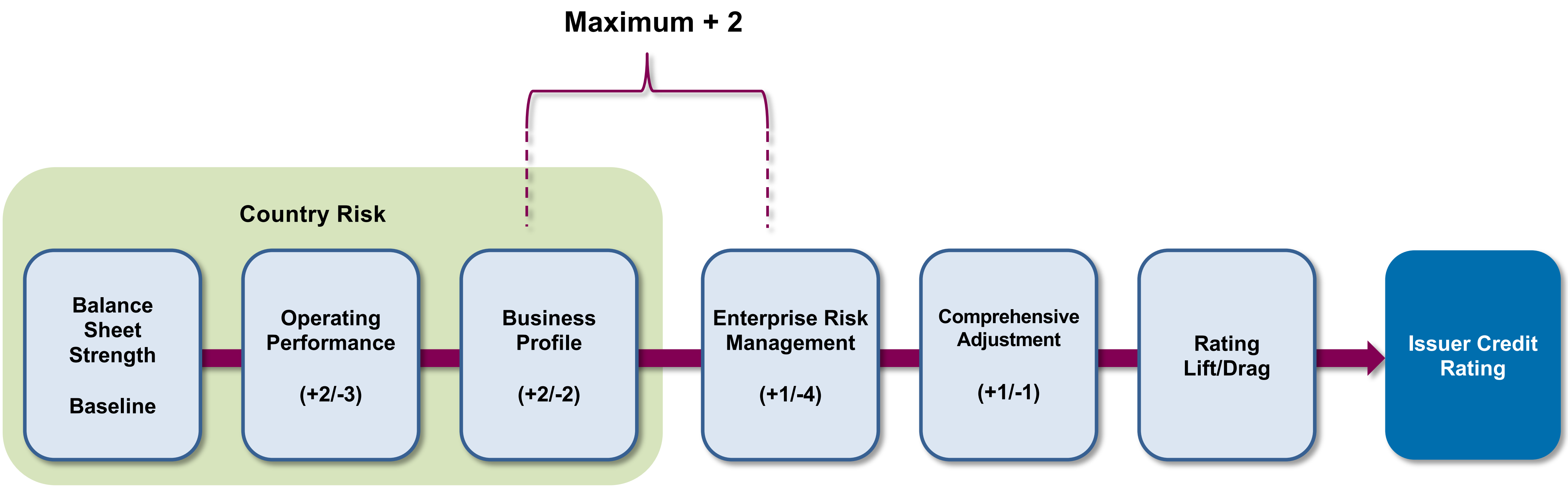
** Source: ACLI 2019 Life Insurers Fact Book*

George Hansen

Actuary, Research and Analytics, AM Best

November 6, 2020

AMB BCRM Building Block Approach



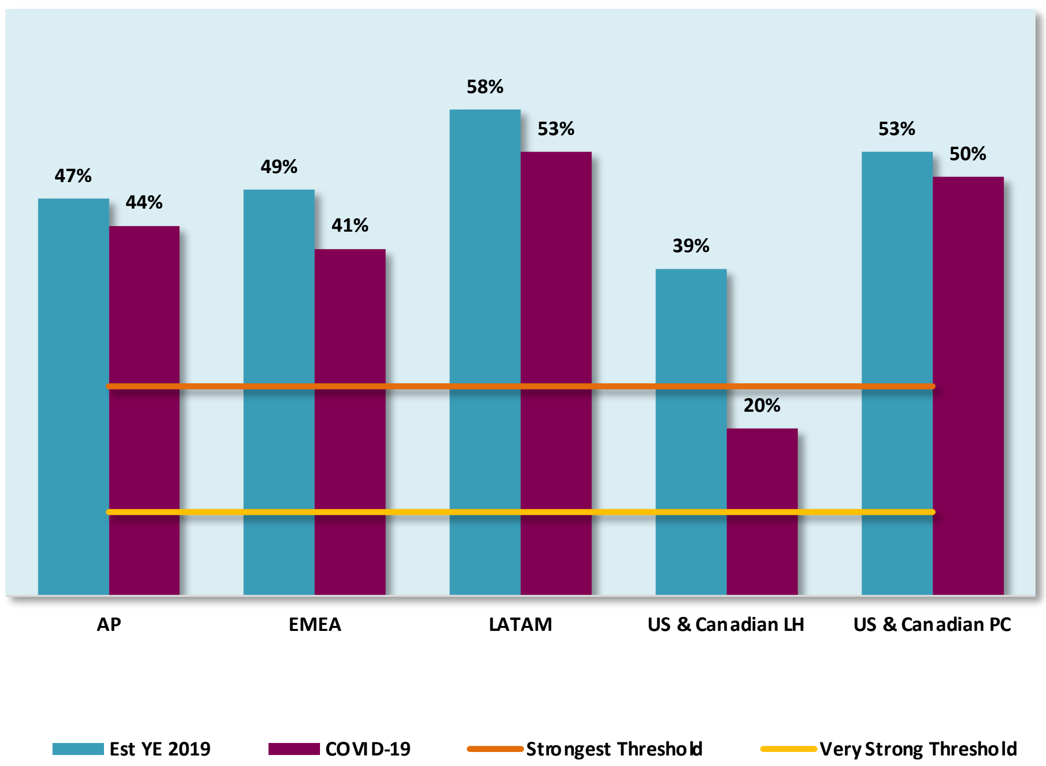
AMB BCAR Guidelines

$$\text{BCAR} = \frac{(\text{Available Capital - Net Required Capital})}{\text{Available Capital}} \times 100$$

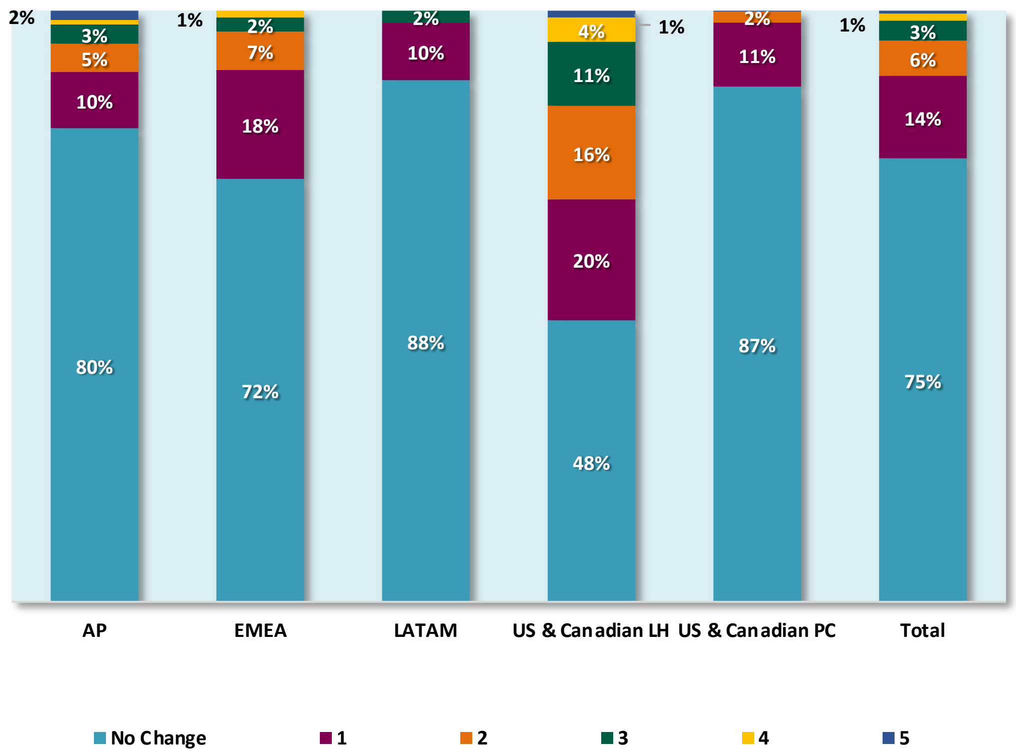
VaR Level (%)	BCAR	BCAR Assessment
99.6	> 25 at 99.6	Strongest
99.6	> 10 at 99.6 & ≤ 25 at 99.6	Very Strong
99.5	> 0 at 99.5 & ≤ 10 at 99.6	Strong
99	> 0 at 99 & ≤ 0 at 99.5	Adequate
95	> 0 at 95 & ≤ 0 at 99	Weak
95	≤ 0 at 95	Very Weak

Segment Result – AMB Stress Testing

Median BCAR Score



Change in BCAR Assessment



US insurance industry is well capitalized, and the rated insurers generally withstood the stress test

Segment Result – US Life/Annuity Groups

Results	Key Exposures	BCAR/Liquidity	Status
• BCARs generally declined 10%-25% • No credit for risk mitigation	• Downward credit migration of the fixed-income portfolio, mortgage defaults, and mortality	• Capitalisation "Strongest" benefitting from growth in absolute capital • Liquidity is strong, including increased FHLB capacity • Good access to financial markets • Risk mitigation practices in place	• At present, operating performance expected to be further negatively impacted • Capital management practices in place (capital raising, buyback restrictions) • Close monitoring required for assets

BCARs withstood the stress test – earnings likely to be impacted by impairments and prolonged spread compression

AM Best ERM Assessment - Framework Evaluation

Methodology

Framework Assessment	Key Characteristics
Embedded	The rating unit has implemented systematic enterprise-wide risk management practices that are appropriate given its profile and that are integrated throughout all levels of the enterprise. The processes in place are robust, regularly updated as needed, and have demonstrated their effectiveness—based on objective measures—during times of significant negative external pressure.
Developed	The rating unit has generally implemented enterprise-wide risk management practices that are appropriate given its profile. Some development work remains, but in general the processes related to the framework component operate effectively. The assessed framework component is integrated and in use throughout the rating unit, but has not been thoroughly tested by external events.
Evolving	The rating unit has implemented some enterprise-wide risk management practices. However, the performance of the processes in place indicates ongoing challenges. Achieving widespread use and/or acceptance of this framework component is a continuing process.
Nascent	The rating unit has recognized the need for enterprise-wide risk management practices and has started the implementation process. However, for the assessed framework component, the processes in place are in the initial stages of development.
Unrecognized	The rating unit has not acknowledged the need for enterprise-wide risk management practices. Formal risk management processes related to the assessed framework component are not in place.

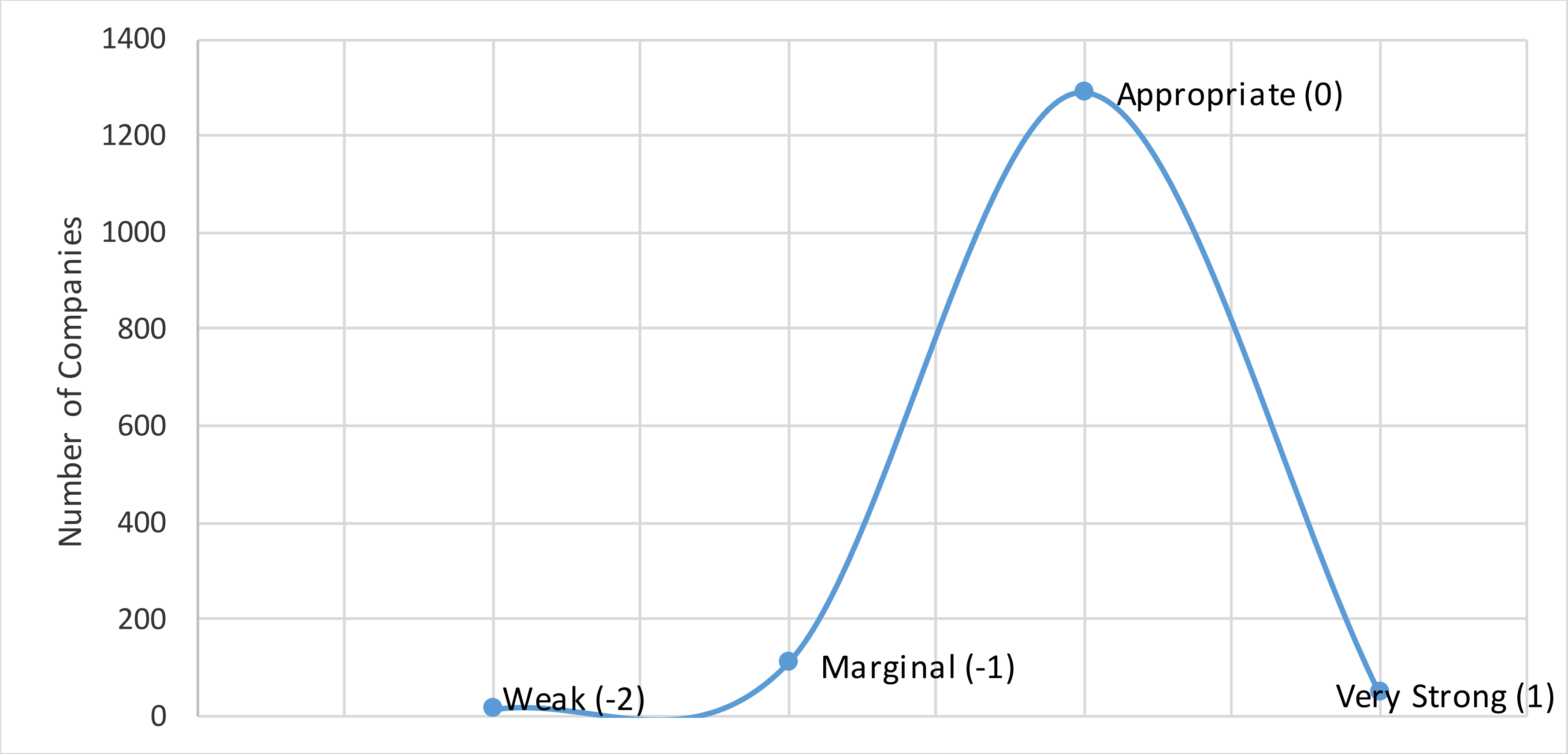
AM Best ERM Assessment - Risk Evaluation

Methodology

	Assessing risk capabilities
Very Strong	• Risk management capabilities **add value** to the company, evidenced by strong performance and risk-based decision making. • Risk capabilities drive market best practice. • All elements of “Appropriate”. • The company would be considered unlikely to breach its risk tolerances in an uncontrolled manner.
Appropriate	• The company is able to identify, measure, monitor and manage risks appropriately within its risk appetite and tolerance. • Risk management capabilities are designed appropriately for the size and complexity of the organization. • The company is able to demonstrate the effectiveness of risk management capabilities. • Risk management capabilities are well integrated into the organization and are time and stress tested. • Risk management capabilities continue to develop in line with the changing risk environment, technology and strategy
Marginal	• The company has limited ability to identify, measure, monitor and manage risks within a defined risk appetite. • There are gaps in the company’s risk management capabilities. • The company has demonstrated deficiencies in applying risk management capabilities. • Development of risk management tools has stagnated.
Weak	• The company has material deficiencies in its ability to identify, measure, monitor and manage risks. • The company’s performance has been impacted by weak risk management capabilities.
Very Weak	• The company is highly exposed to losses as a result of its lack of risk management capabilities. • The company does not have tools and processes with which to manage risk. • Management lacks awareness of the risks it faces or competence to manage these risks. • Management does not acknowledge the need to improve risk management.

AM Best ERM Assessment

ERM Assessment Distribution – Global (2019: 1,456 Companies*)



** For 56 companies that went to committee twice (3x) in 2019, only last committee is included*

COVID-19 Impact to Life/Annuity Insurers – Segment Outlook

Headwinds	Tailwinds
Significant market volatility in US and Global economy	Strong risk-adjusted capitalization
Increased expectations for deterioration in operating performance trends	Improved company-wide liquidity profiles
Accelerated negative impact from markets on both assets and liabilities	Ongoing product de-risking and pricing discipline
Concentrated investment strategies	Regular stress testing performed as part of improving ERM profiles
Concentrated product strategies	Innovation in U/W and customer experience limits need for face-to-face interaction

AM Best revised the Stable Outlook on the US Life/Annuity sector to Negative in March 2020

COVID-19 Impact to Life/Annuity Insurers – YTD Financials

- Cohort-specific increases in mortality
- Product-specific decreases in morbidity
- Sector-specific bond rating downgrades
- Equity market volatility
- Commercial mortgage loan forbearance
- Increased hedging costs
- Declining new business volumes
- Increased capital markets activity

COVID-19 Impact to Life/Annuity Insurers – Sales Trends

- Life Sales Declined 3% Through the 2nd Quarter
  - Term Life and Variable Life Sales are up, while Whole Life and Universal Life are down
  - Career agent and other face-to-face channels are impacted more significantly, while DTC channels are making inroads
  - Second half of 2020 likely to see some improvement over 2nd quarter, as companies/agents acclimate to operating remotely
- Annuity Sales Declined 16% through the 2nd Quarter
  - Decline was led by fixed indexed annuity sales, which were down 40% in the 2nd quarter
  - The one area of strength continues to be with the RILA products, where sales are up 9% through the first half of 2020
  - Fixed deferred annuity sales were relatively flat in the 2nd quarter, presumably benefiting from March spread-widening

COVID-19 Impact to Life/Annuity Insurers – Looking Ahead

- Asset impairments
  - Bond defaults/rating downgrades
  - Commercial mortgage loan defaults
- Interest rate-related reserve charges
- Ongoing mortality pressures
- Moderation of morbidity improvements
- Increases in pension plan liabilities
- Interest-sensitive product withdrawals
- Continued sales challenges
- Intensifying spread compression

Asset Classes and Sectors to Keep an Eye On

- Commercial mortgages
- Structured securities
- Sovereign debt of countries dependent on tourism

- Sectors
  - Leisure/Hospitality
    - Hotels
    - Cruise Lines
    - Gaming
    - Rental Cars
  - Restaurants
  - Transportation
    - Airlines
    - Aircraft manufacturers
  - Energy
  - Retail

Market Segment Outlook – US Health

Headwinds	Tailwinds
Increase in severity of medical claims	Strong risk-adjusted capitalization
Decline in premiums from layoffs	Trend of strong earnings
Decreased sales	Higher persistency
Temporary increase in cash & short-term	Suspension of non-essential care
Investment income & credit risk	Majority who test positive are not hospitalized

AM Best has maintained the Stable Outlook on the US Health sector in March 2020

COVID-19 Impact to Health Insurers

2021

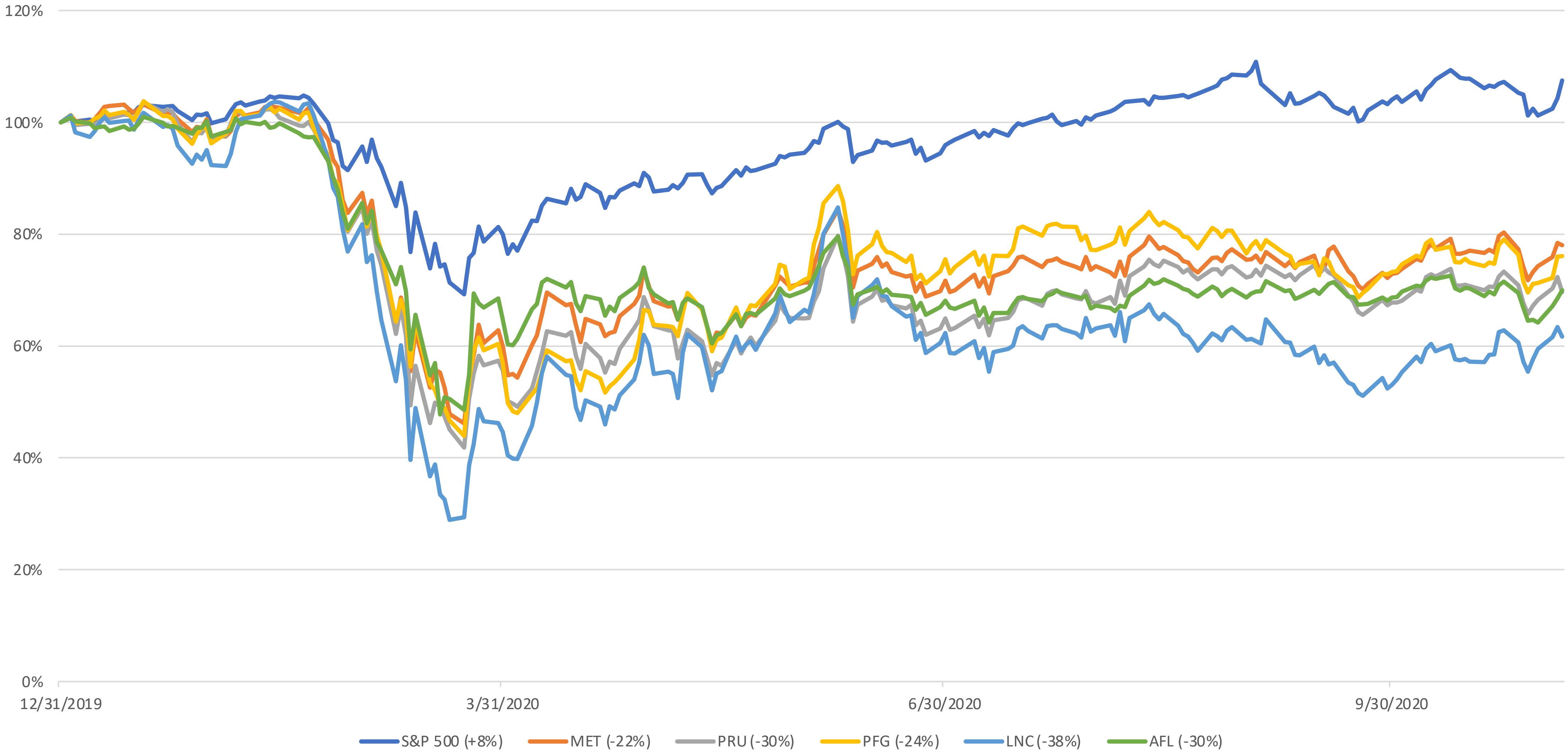
- Rate increases single digits for individual & small group
- Earnings expected to temper:
  - Unknown timing of vaccine and cost
  - Economic impact/layoffs
    - Decreasing commercial enrollment
    - Increasing number of Medicaid eligible
    - Pressure on state budgets
- Potential for pent up demand from deferred care
- Concerns about higher morbidity from lack of care in 2020
- Unknown long-term impact from those adversely impacted by COVID

Eric Berg, CFA

Chairman and Founder
With You in Mind, A Competitive Intelligence and Publishing Firm

November 6, 2020

Recovering from an Initial Huge Hit



Making Sense of the Pandemic's Effect on Life Insurers: The Big Themes So Far

1. Mortality
2. How Layoffs and Furloughs Have Pressured Sales
3. The Impact of Lower Interest Rates

Making Sense of the Pandemic's Effect on Life Insurers: The Big Themes So Far

4. Credit Migration and Impairments
5. Expense Cutting and Product Repricing
6. Exiting Businesses that Have Low Returns, Heavy Capital

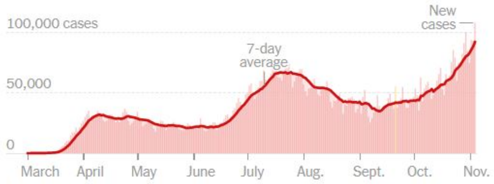
Mortality and the Pandemic

- Initial perspective was that the pandemic's mortality impact would be devastating.
- Carriers described the expected mortality impact in terms of after-tax hit to earnings per 100,000 COVID-19 deaths. Carriers appeared to have worked together to develop this approach. Role of the SOA or Academy?
- Actual impact has been well below what carriers forecast. They haven't disclosed their methodology so it's hard to know where they went wrong.
- Clues in the earnings releases: Discussions about the average age of COVID-19 patients, insured versus the uninsured population.

Covid in the U.S.: Latest Map and Case Count

By The New York Times Updated November 5, 2020, 2:28 P.M. E.T.

Leer en español



	TOTAL REPORTED	ON NOV. 4	14-DAY CHANGE
Cases	9.6 million+	107,872	+51%
Deaths	234,835	1,616	+21%

Day with data reporting anomaly.

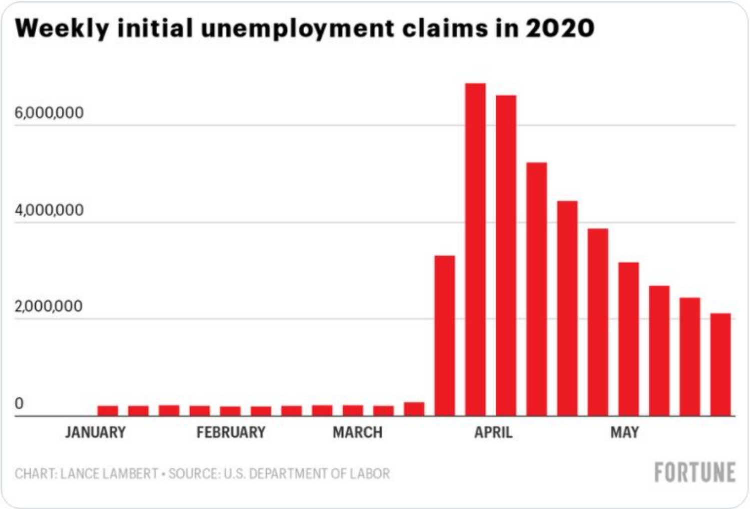
Includes confirmed and probable cases where available. 14-day change

Source: New York Times

How Layoffs and Furloughs Have Pressured Sales

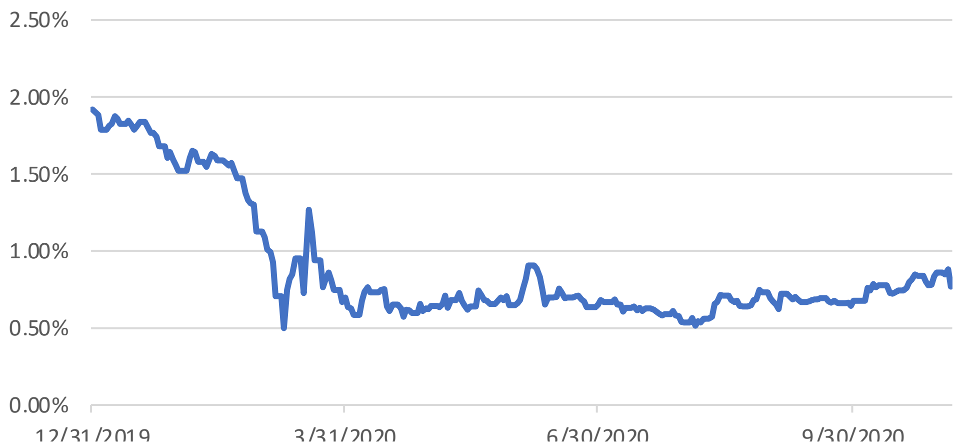
- The layoffs, the surge in unemployment, the furloughs—all have contributed to a level of uncertainty and therefore anxiety among insurance purchasers.
- The result has been a slowdown in purchasing decisions and in some cases buyer paralysis.
- Examples abound: Sharply lower individual insurance sales and lower group premiums in force at Principal, lower sales in a number of individual life categories at Prudential, and a 21% drop in life sales at Lincoln.
- To be sure, across the industry product repricing in response to the decline in interest rates has contributed to the softening in top line. But industry executives tell us that new business would have been off in any case.

An Open Question: To What Extent Will Automatic Underwriting and Touchless Underwriting Extend to Larger-Face-Amount Policies?

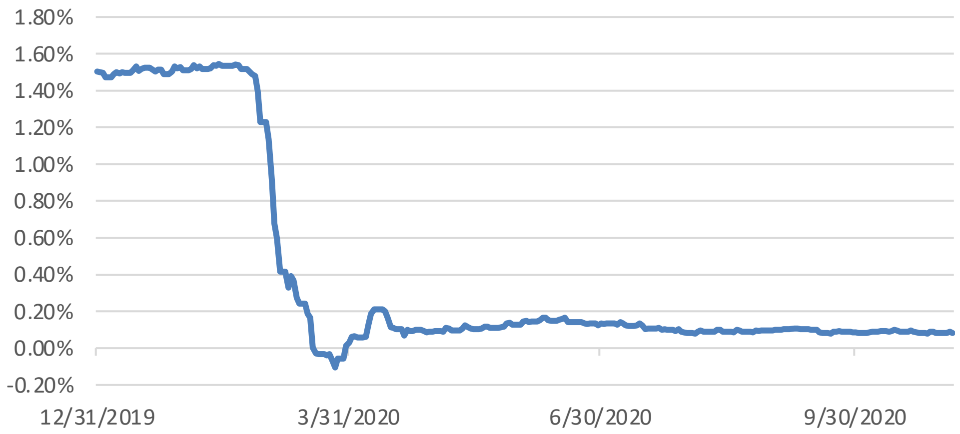


The Impact of Lower Interest Rates

Yield on 10-Year Treasury Note



Yield on 13-Week Treasury Bill



- Net investment income has taken a further hit, and not just in the general account. If a life insurance organization owns a broker/dealer and invests customers' cash balances, those returns too have suffered.
- The further decline in rates has touched off some additional mortgage refinancing, meaning insurers have given up the yield on certain RMBS.
- The decline in rates has touched off a re-examination of the industry's entire product portfolio.

With short-term rates close to zero, which products can be sold at adequate returns and not be priced so expensively as to scare consumers away?

The State of Play

Not Selling Well		Selling Well
Guaranteed Universal Life	→	Indexed Universal Life
VA's with Guarantees	→	VA's without Guarantees, Buffer Annuities
Fixed Annuities	→	Indexed Annuities

Exiting Businesses that Have Low Returns, Heavy Capital

- Among the CEOs who've said that reinsuring or selling businesses is now part of the plan: Charlie Lowrey (Prudential), Dan Houston (Principal), Jim Cracchiolo (Ameriprise), Dennis Glass (Lincoln), Mark Pearson (Equitable)
- Topping the list of candidates for unloading: Blocks of fixed annuities without living-benefit guarantees. But Voya exited individual life, Prudential announced in the quarter just ended that it will no longer sell variable annuities with living benefits, and Lincoln's Dennis Glass said just yesterday that with Lincoln's fixed-annuity block in runoff it would be considered for disposal.

The Stars Are Aligning

- Equitable announced a massive transfer of its legacy business—and not a sale but a reinsurance transaction.
- Private equity is gorging with cash as investors disappointed with active equity investing continue to redeploy their capital into PE.
- Athene Envy Abounds
- Carriers know they must move to provide ballast to their ROE