



*American Council  
of Life Insurers*

# Creating Connections

## Seizing Opportunities

ACLI Annual Conference 2018

# **When The Cycle Turns: S&P Views on Macro factors, Credit Markets, and Life Insurers**

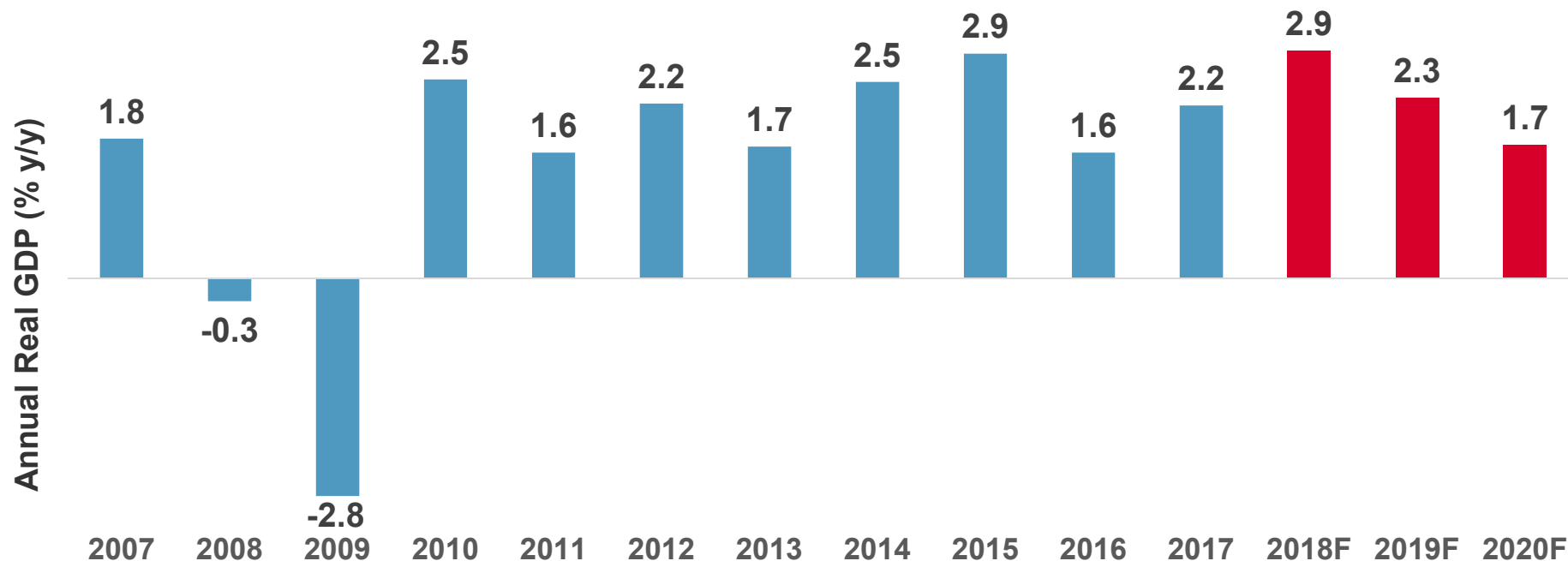
**Deep Banerjee**  
**Director and Sector Lead, S&P Global Ratings**

**Hot Issues Breakfast**  
**ACLI Conference, Oct. 2018**  
**Washington D.C.**

# Macro View

# Gradual, But Mostly Stable, Growth

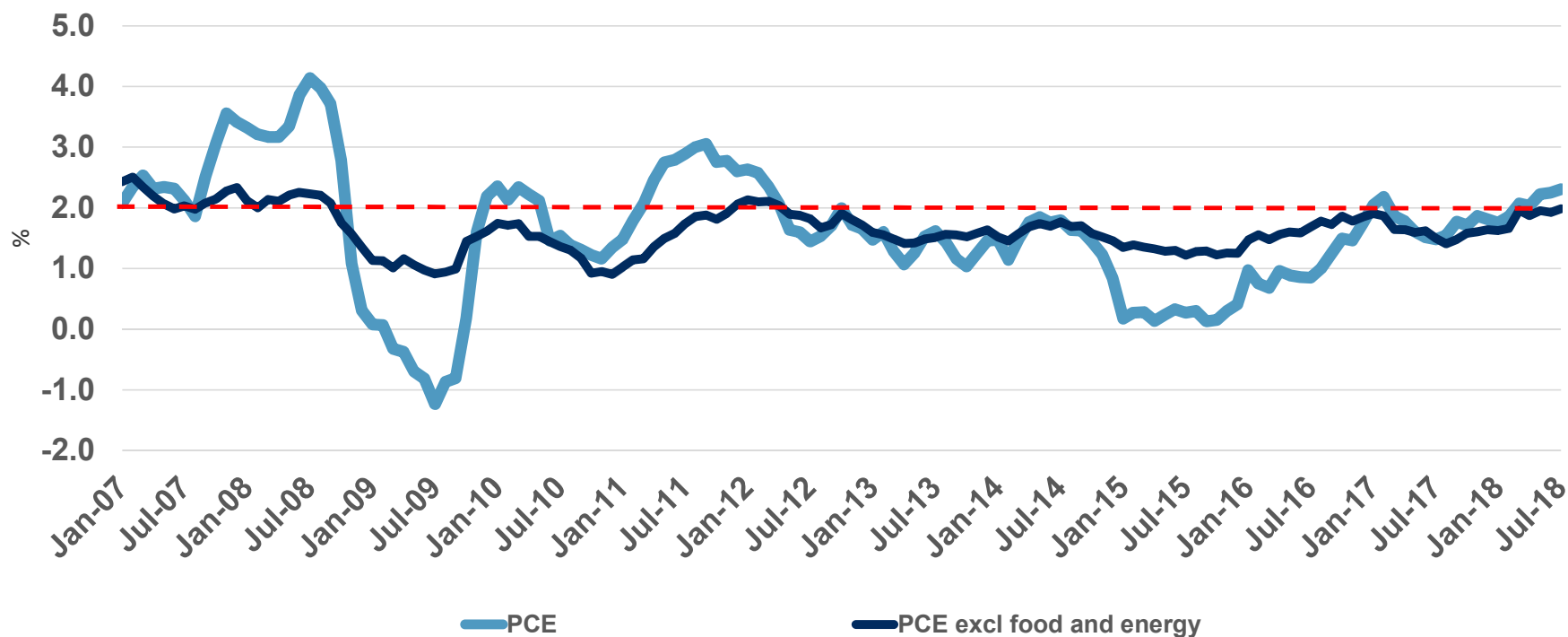
## 2<sup>nd</sup> Longest Expansionary Period To Get A Bump in '18 & '19



. F- Forecast; Sources: Bureau of Economic Analysis, Bureau of Labor Statistics, and S&P Global Economics' forecast.

# Inflation is Slowly Climbing Up

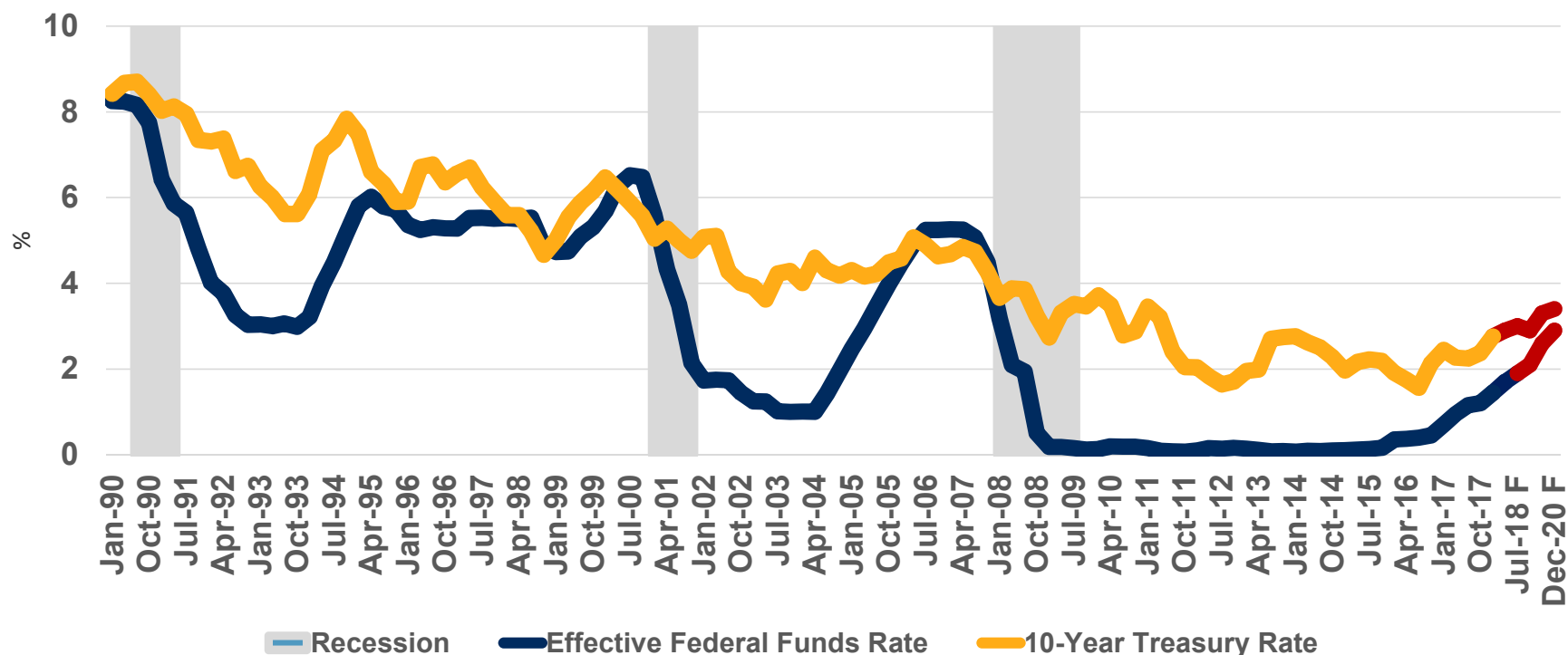
## Getting to the Fed's 2% target



PCE: Personal Consumption Expenditure; Bureau of Economic Analysis, Bureau of Labor Statistics, and S&P Global Economics' research.

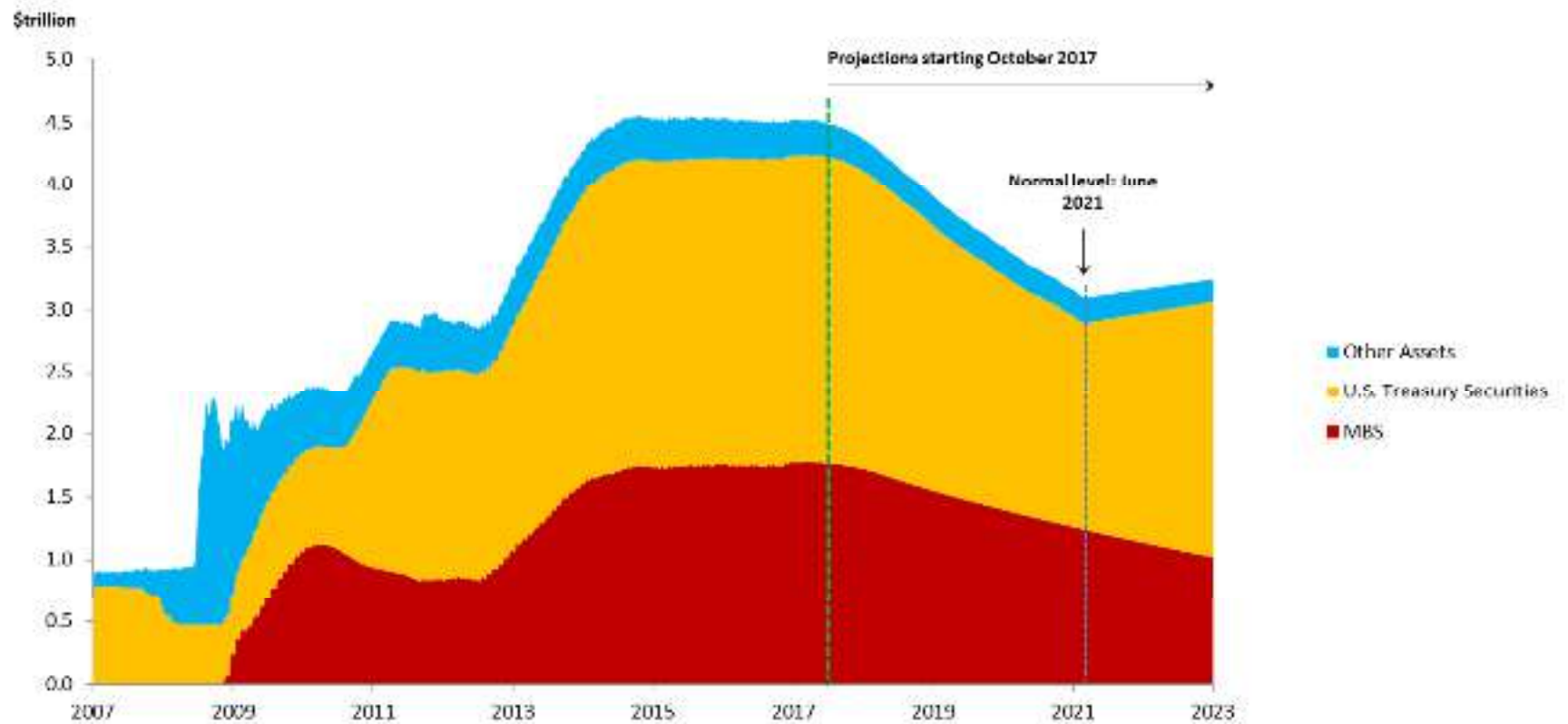
# Fed To Continue Raising Rates

Flatter Yield Curve; Expect Long-Term Rates To Be Pressured

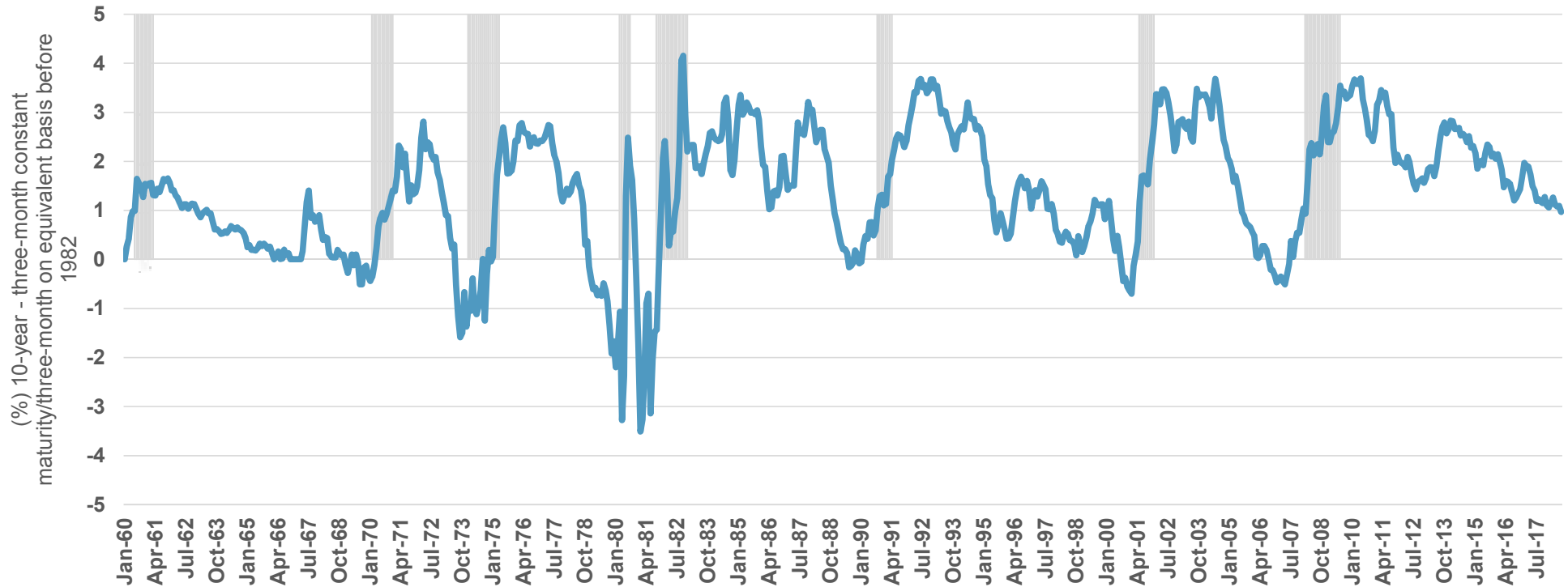


F- Forecast; Sources: FRED, S&P Global Economics' Forecast

# Fed. Balance Sheet on 'Autopilot' as Rates Climb Higher



# Yield Curve's Impressive Track Record



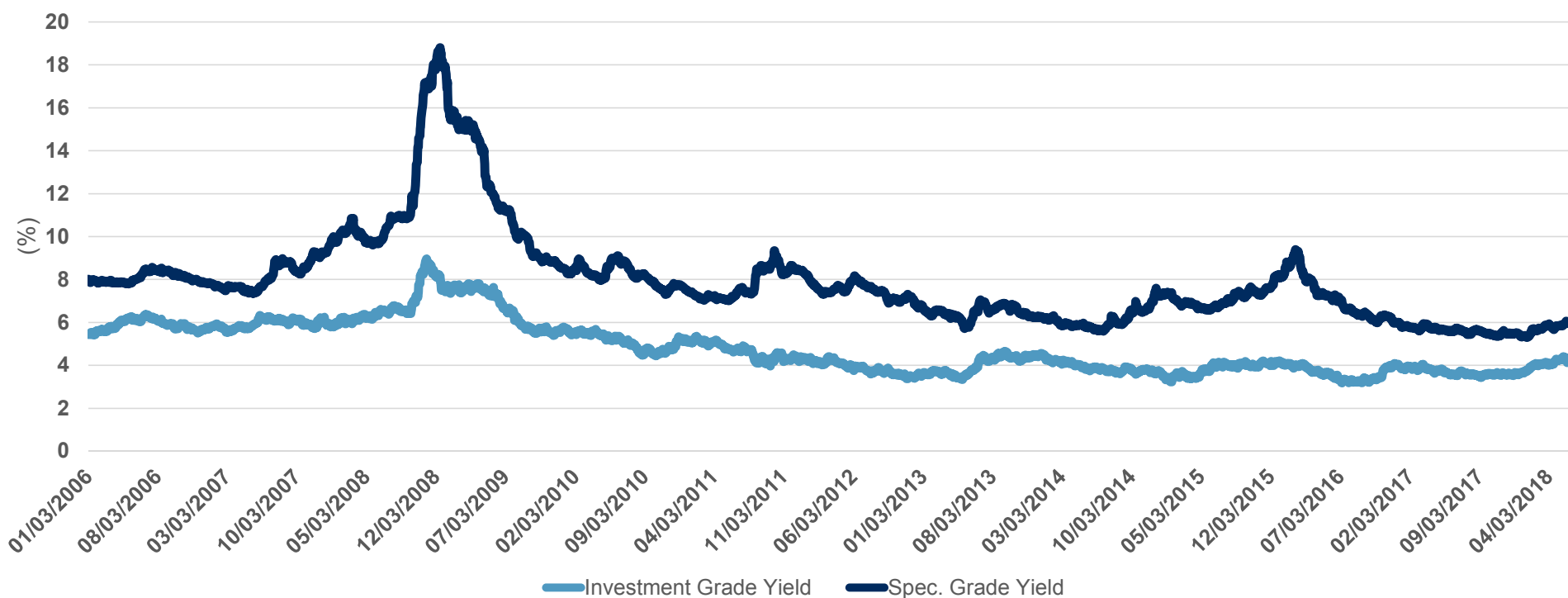
Note: Since the three-month constant maturity rate only dates back to 1982, to extend the series, we: 1) used secondary market three-month rate and convert the three-month discount rate to a bond-equivalent basis, 2) used federal funds rate before 1982 as a substitute for three-month constant maturity ("3Mo-Federal Funds"). Sources: St. Louis FRED and S&P Global Economics calculations.



# Credit Markets

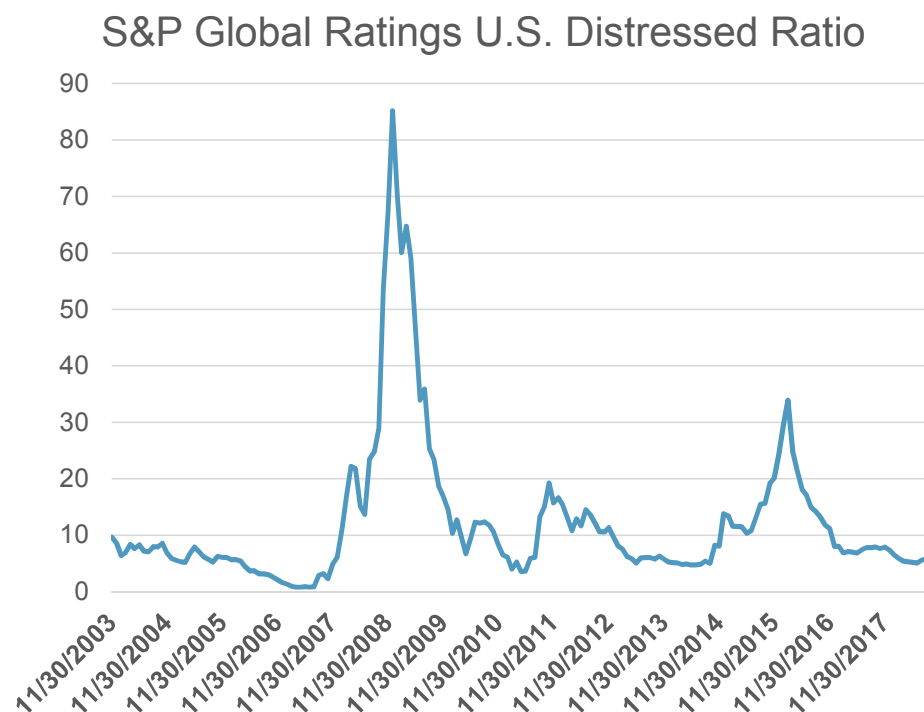
# Financing Conditions Remain Favorable

## Bond Yields Remain Low, With Some Recent Uptick



Note: Bond yields for U.S. corporates, calculated as a composite. Investment-grade yields based on bonds with a 10-year maturity; speculative-grade yields based on bonds with a five-year maturity. Data as of July 2, 2018. Source: S&P Global Fixed Income Research.

# Distress Ratio Remains Low



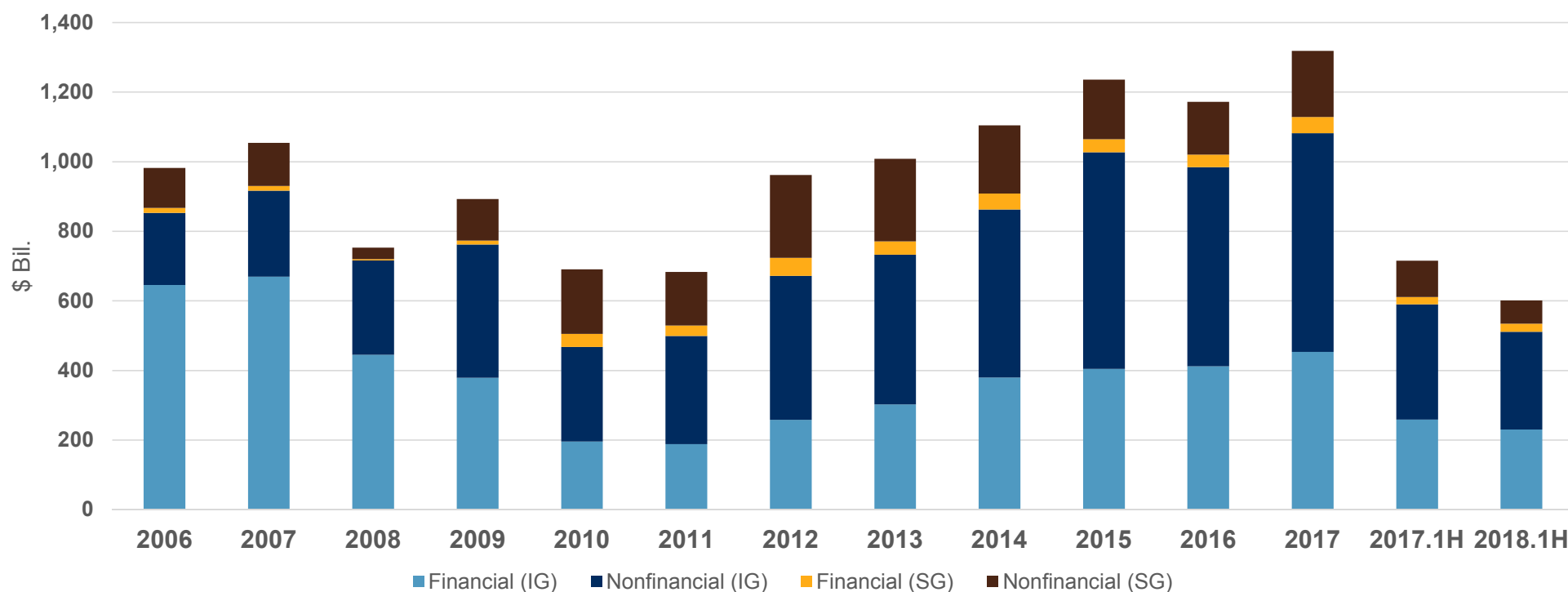
## Distress Ratio by Sector (Top 6 Most Distressed)

Retail/Restaurants	16.1%
Telecommunications	15.2%
Oil & Gas	10.1%
Metal, Mining, & Steel	5.8%
Consumer Products	5.0%
Financial Institutions	2.1%

Note: S&P Global Ratings' distress ratio is defined as the number of speculative-grade issues with option-adjusted spreads above 1,000 basis points divided by the total number of speculative-grade issues. Speculative-grade financial institutions have a small base of issuers. Data as of Sept. 13, 2018. Sources: S&P Global Fixed Income Research, and S&P Global Market Intelligence's CreditPro

# Lesser Bond Issuances So Far In 2018

More companies look to loan market



IG--Investment grade. SG--Speculative grade. Data as of June 30, 2018. Sources: Thomson Reuters and S&P Global Fixed Income Research.

# Maturities Set To Increase

**\$1 Trillion of U.S. corporate debt maturities in 2021-2022**



Note: Includes bonds, loans, and revolving credit facilities that are rated by S&P Global Ratings from financial and nonfinancial corporates. 2018.2H--Debt set to mature from 7/1/2018 through 12/31/2018. Data as of June 30, 2018. Source: S&P Global Fixed Income Research.

# U.S. Life Insurers

# **U.S. Life Insurance Credit Overview**

## **Sector Outlook Remains Stable**

### **Capitalization: Capital remains strong**

- Capitalization remains strong and supportive of stable outlook

### **M&A: Lot of different buyers puts M&A in the forefront**

- Active M&A season, with non-traditional buyers willing to take legacy risks

### **Products: Annuity sales to rebound in 2018; PRTs continue to gain momentum**

- Annuity sales see a rebound in the first half of 2018
- PRTs and combo-LTC will remain stronger growth areas of insurers

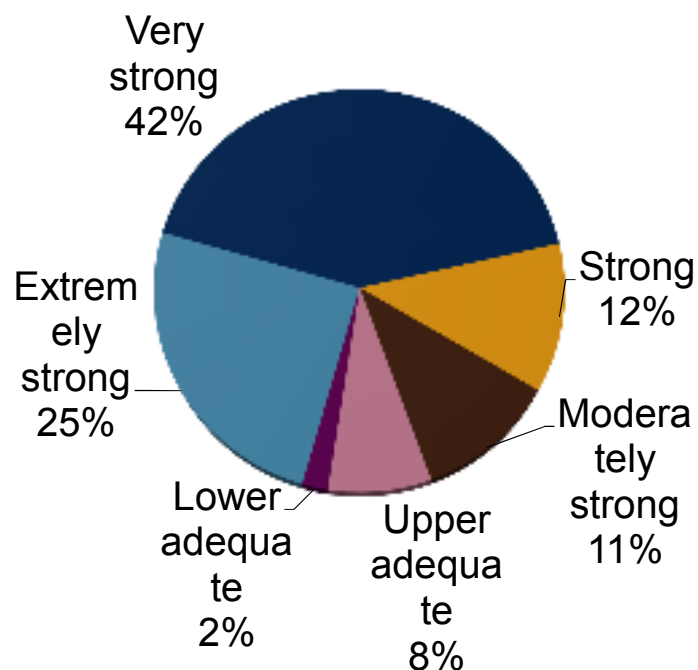
### **Investments: Increased illiquidity risk, but stable credit risk**

- Asset-backs, private bonds, and mortgage see increased new money investment

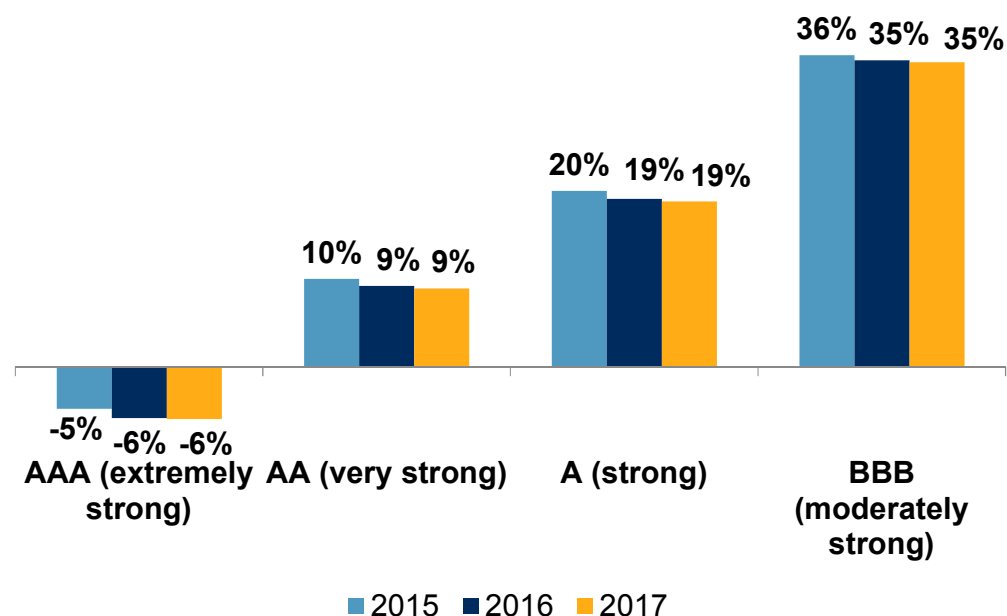
### **Legacy Risk Remains, and may cause earnings and reserve volatility**

# Strong Capital Levels Persist in 2018

**80% of Rated Insurers have Strong or Better Capital**



**Industry Has Close to 20% Buffer at 'A' level**



\*2017 buffer is a combination of actual and pro forma company analysis; S&P Global Ratings research



# A Very Active M&A Season

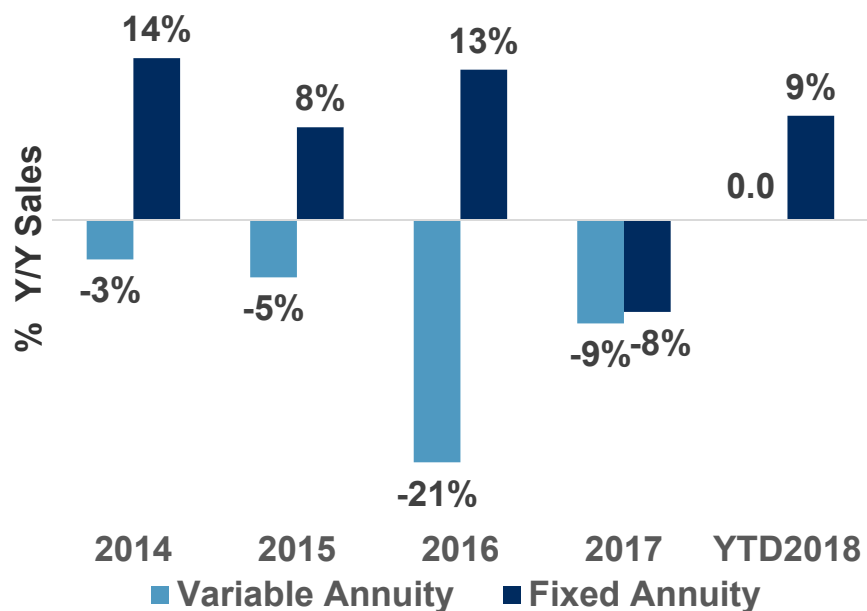
## Mix of Traditional And Alternative Buyers

Type Of Buyer	Example of Recent Transactions
<b>Traditional U.S. based insurers</b> looking for scale or specializing in closed block transactions	<ul style="list-style-type: none"><li>- Lincoln National acquiring Liberty Life's group business</li><li>- Athene acquiring VOYA's retail fixed annuity business</li><li>- Hartford acquiring Aetna's group business</li><li>- Wilton Re acquiring Transamerica's run-off business</li><li>- Protective Life acquiring Liberty Life's life and annuity business</li></ul>
<b>Non-traditional or Investors consortiums</b> bringing new capital to industry	<ul style="list-style-type: none"><li>- Investor consortium acquiring Harford's run-off life and annuity business</li><li>- Investor consortium acquiring VOYA's closed block VA business</li><li>- HC2 Holdings acquiring Humana's closed block of LTC policies</li></ul>
<b>Public Equity Markets</b>	<ul style="list-style-type: none"><li>- MetLife's separation of Brighthouse Financial</li><li>- AXA SA's selling a minority stake in AXA U.S. operations</li></ul>

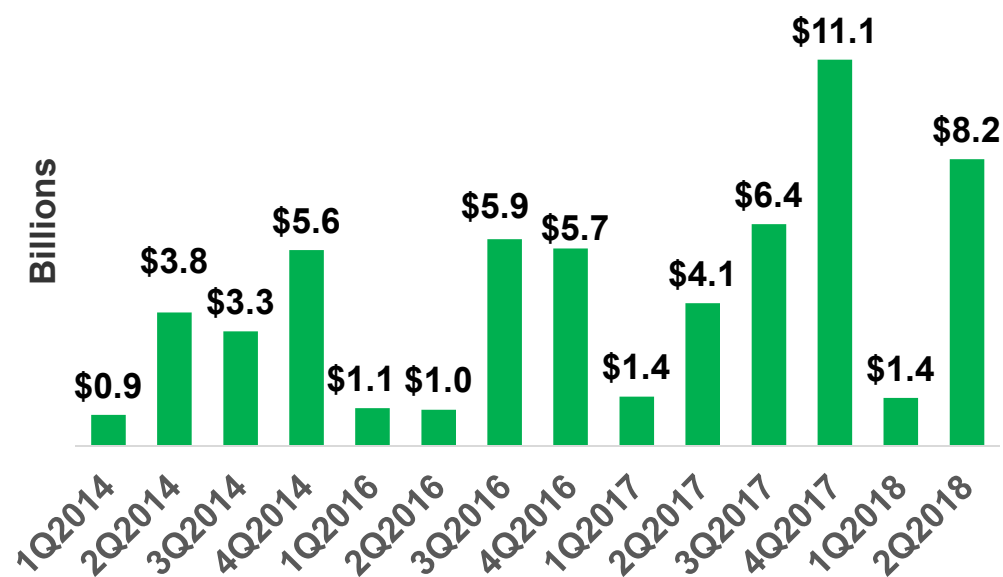
# What's Selling & What's Not?

## Pension Risk Transfers To Remain A Major Growth Area

Annuities Posed To Rebound After A Weak 2017



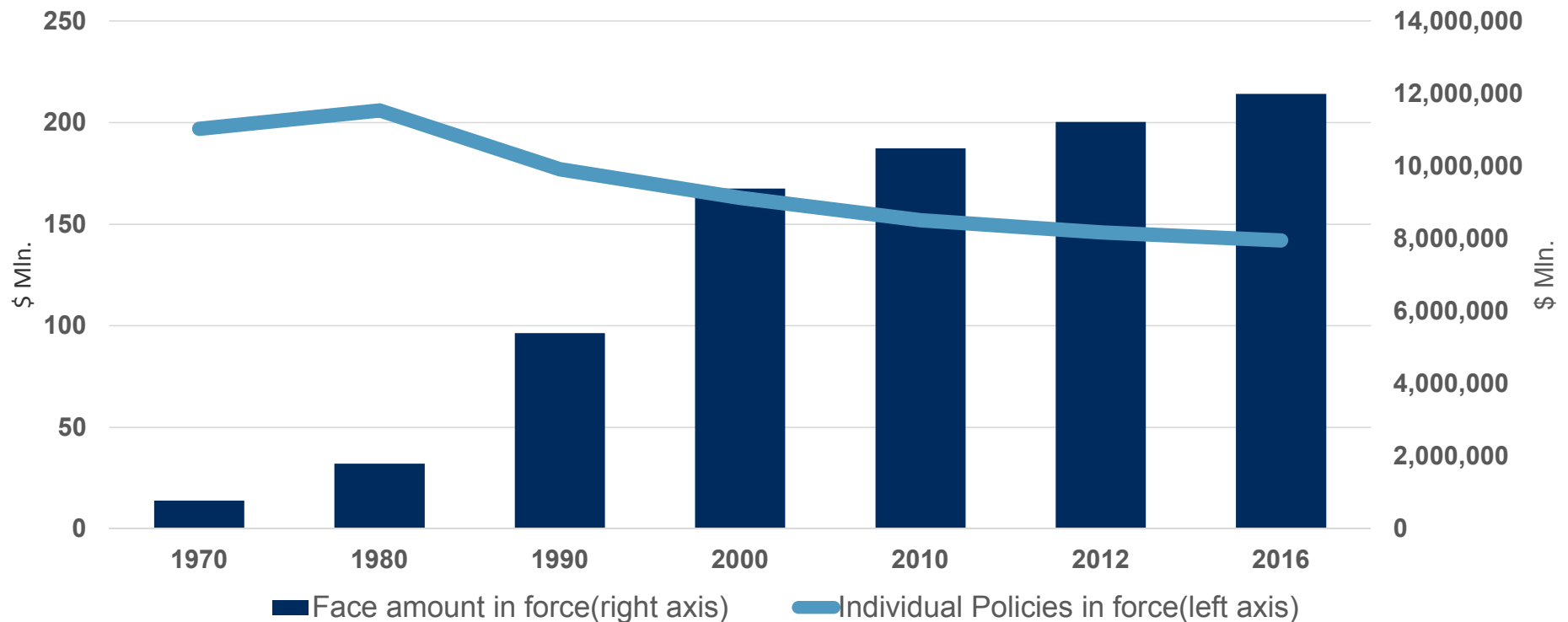
Pension Buy-Outs: 13 Quarters of Over \$1 Billion In Sales



Source: LIMRA Secure Retirement Institute; Q2 2018; S&P Global Ratings research

# Individual Life Insurance Trend

## Fewer Policies, But Increasing Face Amounts

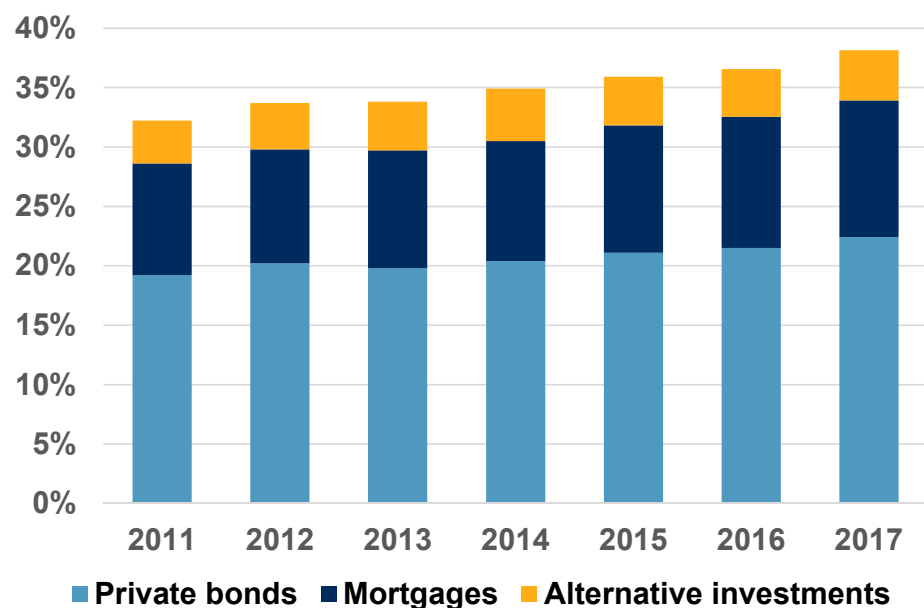


Source: ACLI Insurance Fact Book 2017; S&P Global Ratings research

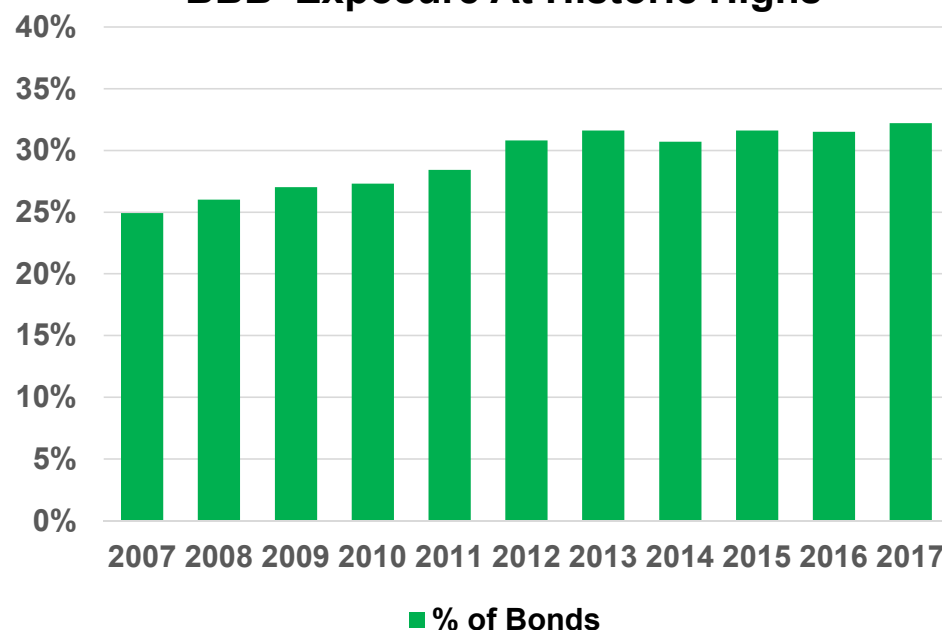
# Life Insurers' Thirst For Yield

## Less-Liquid Assets And 'BBBs' Are Investment Risks Of Choice

More New Money Going Towards  
Less-Liquid Assets



'BBB' Exposure At Historic Highs



Source: U.S. Life Insurers' NAIC Statutory Filings; S&P Global Ratings research

# Spotlight on Long-term Care

- **Key LTC news so far in 2018:**

- GE announces multi-year reserve hit
- PRU incurs reserve charge in from assumption update in Q2
- UNUM announces reserve charge via an accelerated reserve testing in Q3
- CNO announces sale of LTC block to Wilton Re
- HC2 completes acquisition of Humana LTC block

## **What's next for LTC reserves?**

- Likely more convergence of the varying company assumptions
- Q3 2018 earnings may include LTC reserve increases for some insurers
- Sale of blocks more likely post reserve updates
- Any rating action will depend on size of charge as well as insurers' capital cushion and financial flexibility to offset related impact

# Regulatory Update

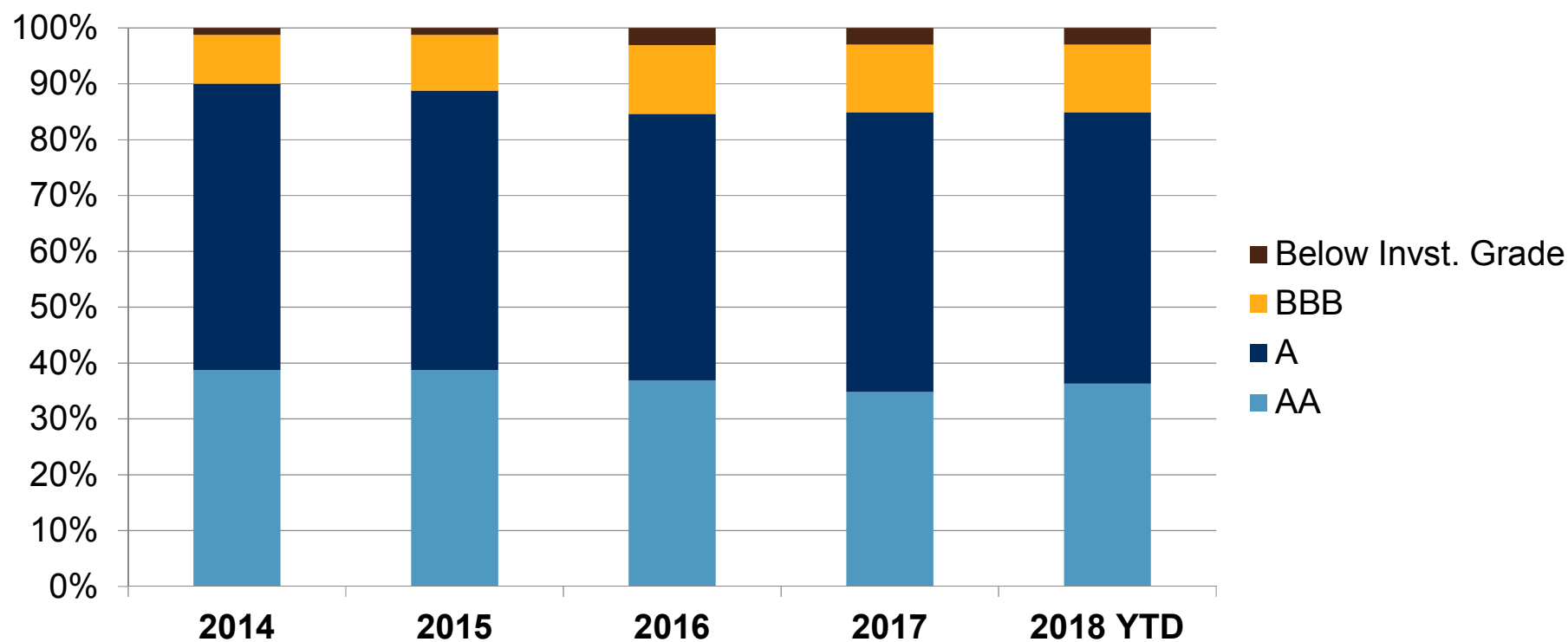
- **NAIC Variable Annuity Update**

- Implementation likely starting 2020
- 3 year-phase in period likely will be available to insurers
- Some key changes include use of more prescribed assumptions, increased hedge admissibility, and better alignment of reserves and TAR

- **NAIC Capital Factors Updated For Tax Reform**

- Insurers will implement new factors for 2018 statutory RBC filing
- Expect decline in NAIC RBC ratios
- No impact on S&P insurance capital model

# Predominantly Strong Ratings Persist in the Sector



\*As of Dec. 31 of each year for 2014-2017; as of Aug 13 for 2018 YTD

# Q&A



# Thank You

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