Life Insurance Industry Report: Past, Present, and Future

Andrew Melnyk, Ph.D., CBE
Chief Economist and Vice President, Research

October 25, 2019
Life and Health Compliance Association Meeting, Washington, DC

Overview

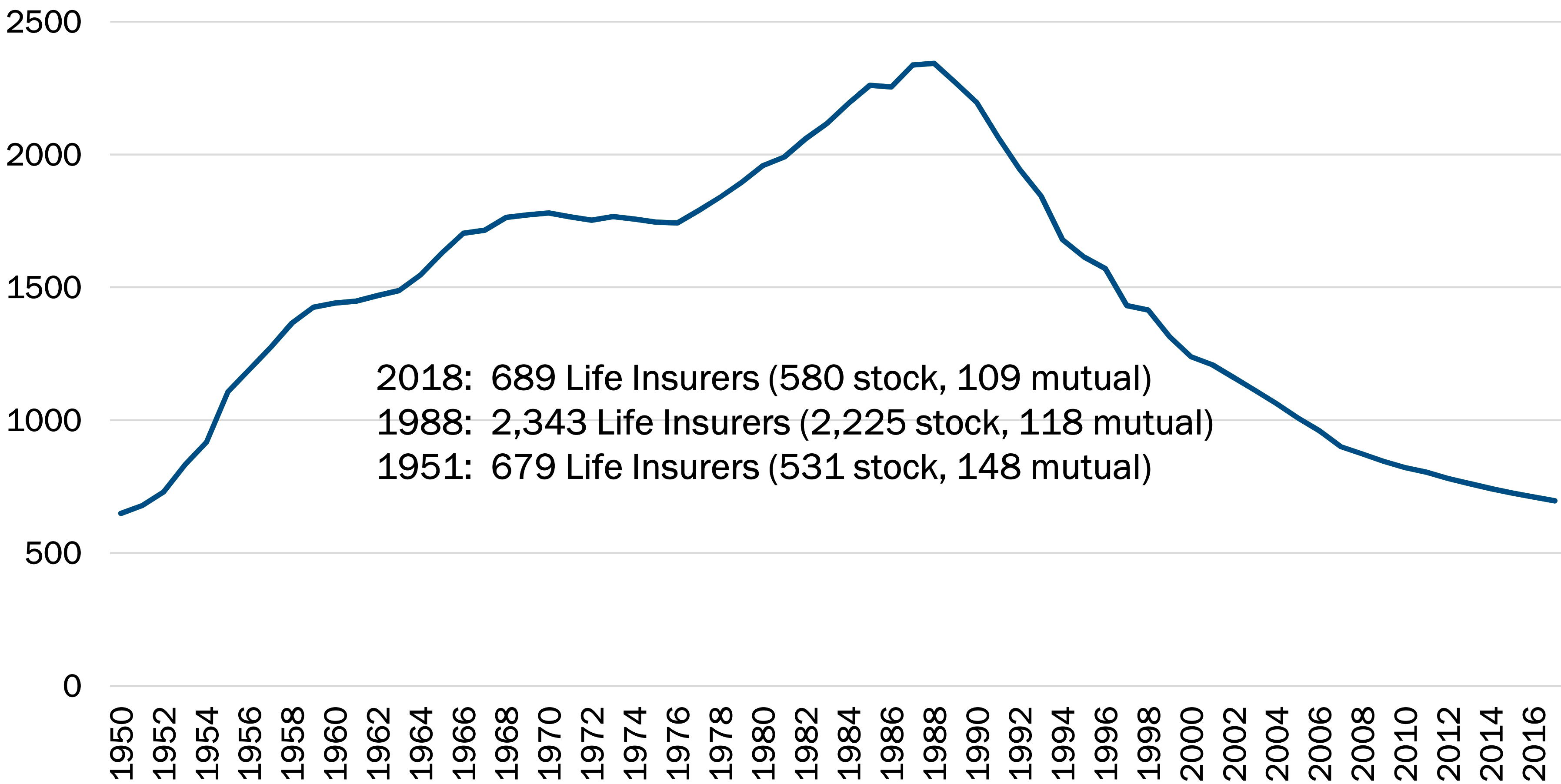
- Size of the Life Insurance Industry
  - Number of companies
  - Industry concentration
  - Employment
- The Investment Side of the Industry
  - Total Assets
  - Bonds vs. Equities vs. Mortgages
  - Low interest rates
  - Infrastructure Investment
- People and Products – What We're *Really* About
  - Life Insurance
  - Annuities
  - Long-Term Care Insurance
  - Disability Income Insurance
- The Future of the Industry: Challenges and Opportunities

Part 1: Size of the Life Insurance Industry

Size of the Industry: The Number of L&H Insurers

- Since 1988 the number of life insurers in the U.S. has been steadily declining, mostly due to consolidation.
- At its peak in 1988, there were 2,343 life insurers (i.e. life insurance groups) in the U.S.
- Today, there are 689 life insurers (stock and mutual). This is comparable to 1951, when there were 679 life insurers. However, the number of stock companies has *increased* and the number of mutual has *decreased*.
- If fraternal benefit associations are included, there are 764 life and health insurers in the U.S.

Number of Life Insurers (Stock and Mutual)

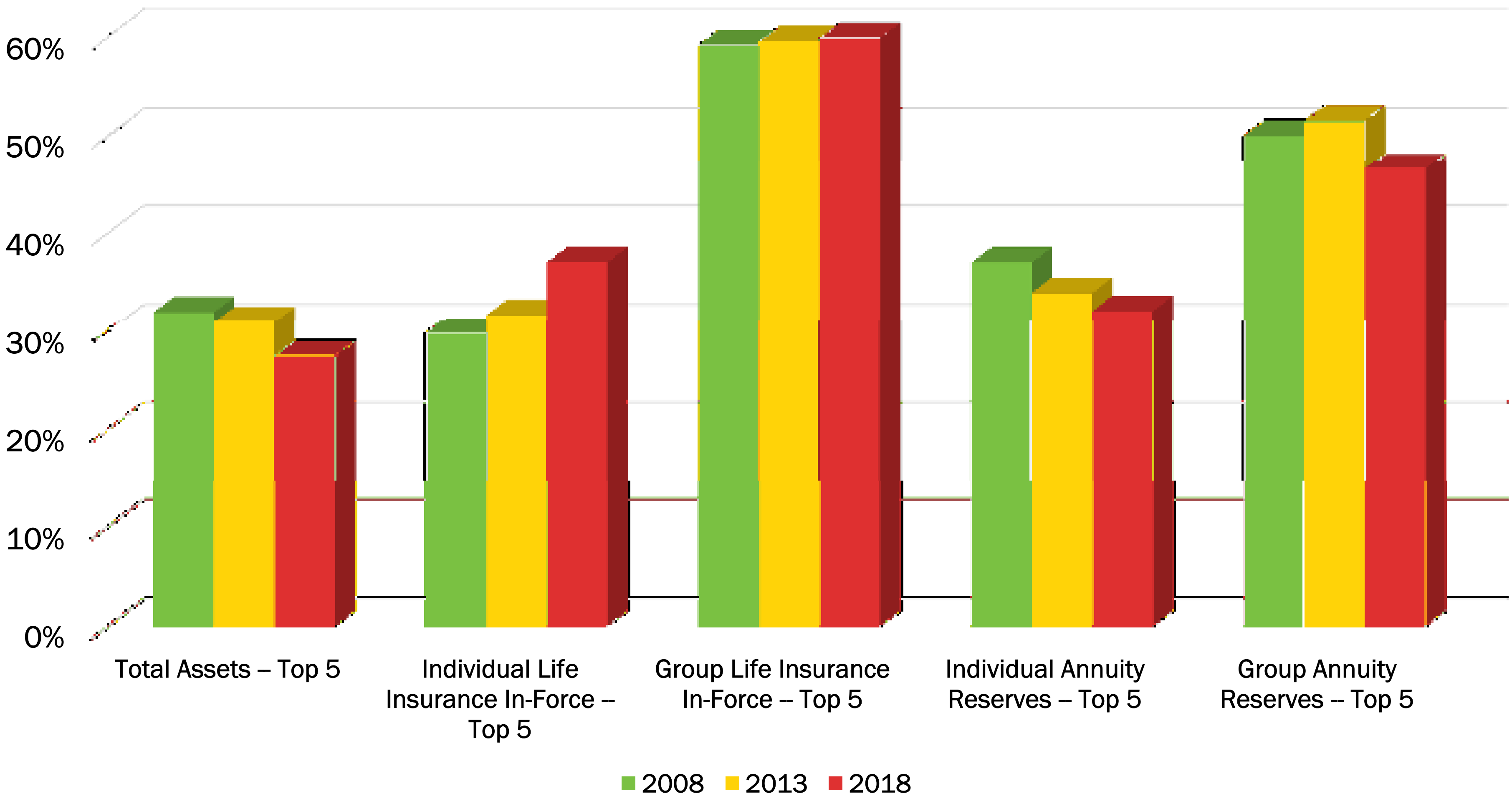


Size of the Industry: The Number of Life Insurers (cont.)

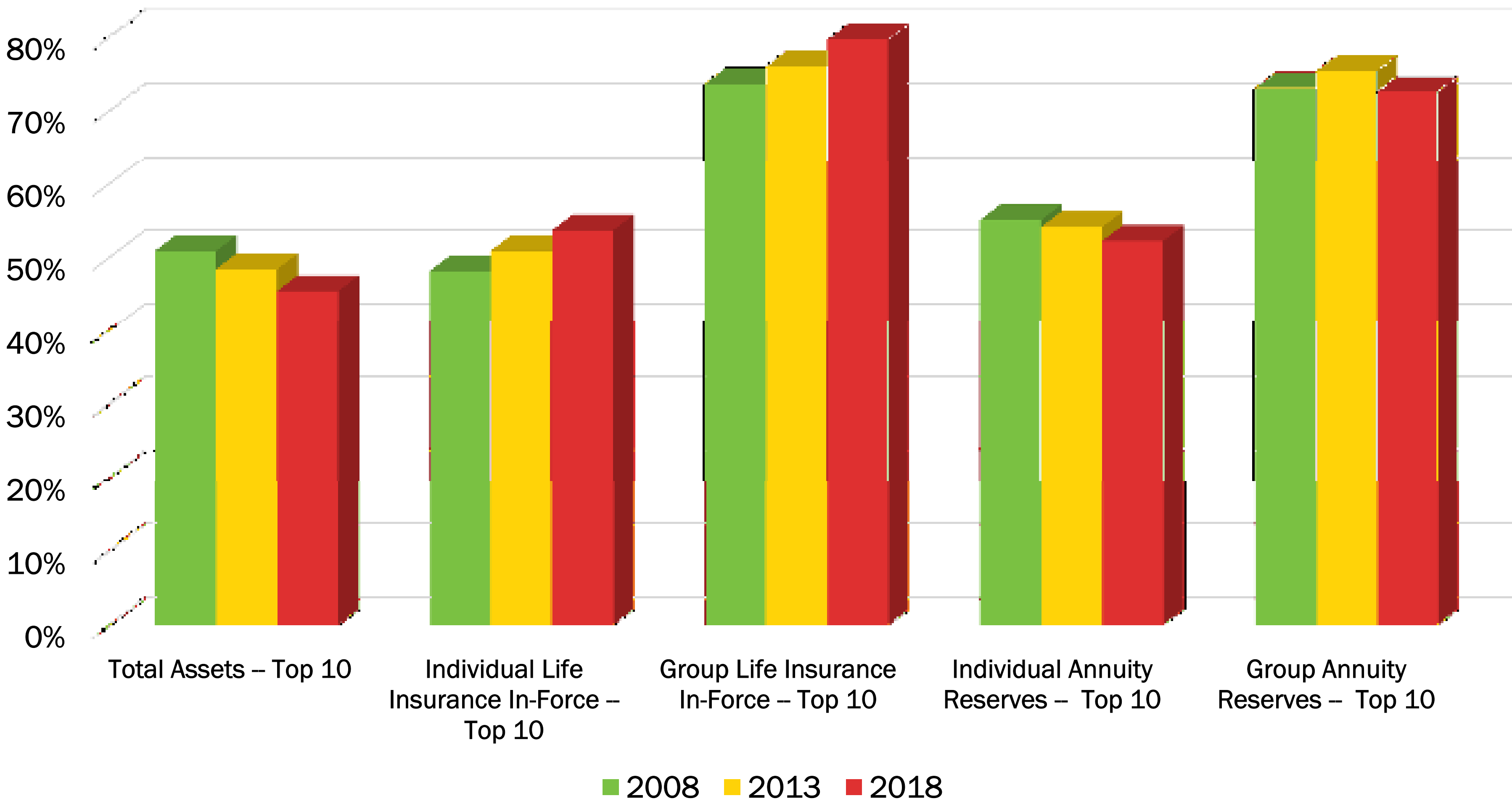
- Though there are fewer life insurers, *the industry is competitive*!
- Is the industry more concentrated? Yes and No
- From 2008 to 2018 there were *minor* changes in industry concentration:

	Top 5 Companies	Top 10 Companies
Total Assets	Decrease	Decrease
Individual Life (in-force)	Increase	Increase
Group Life (in-force)	No Change	Increase
Individual Annuities (reserves)	Decrease	Decrease
Group Annuities (reserves)	Decrease	No Change

Percent of Business -- Top 5 Life Insurers, 2008, 2013, 2018



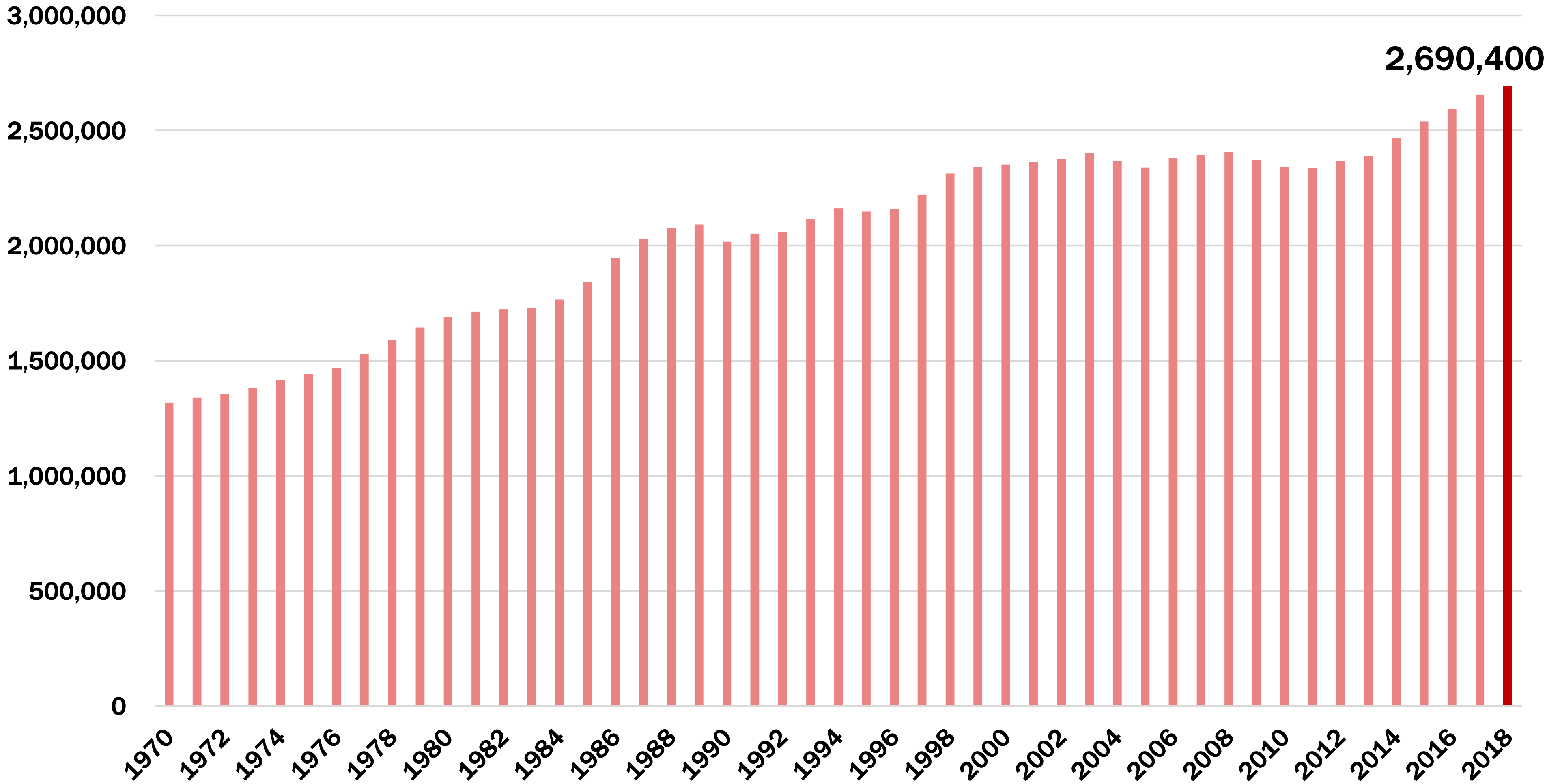
Percent of Business -- Top 10 Life Insurers, 2008, 2013, 2018



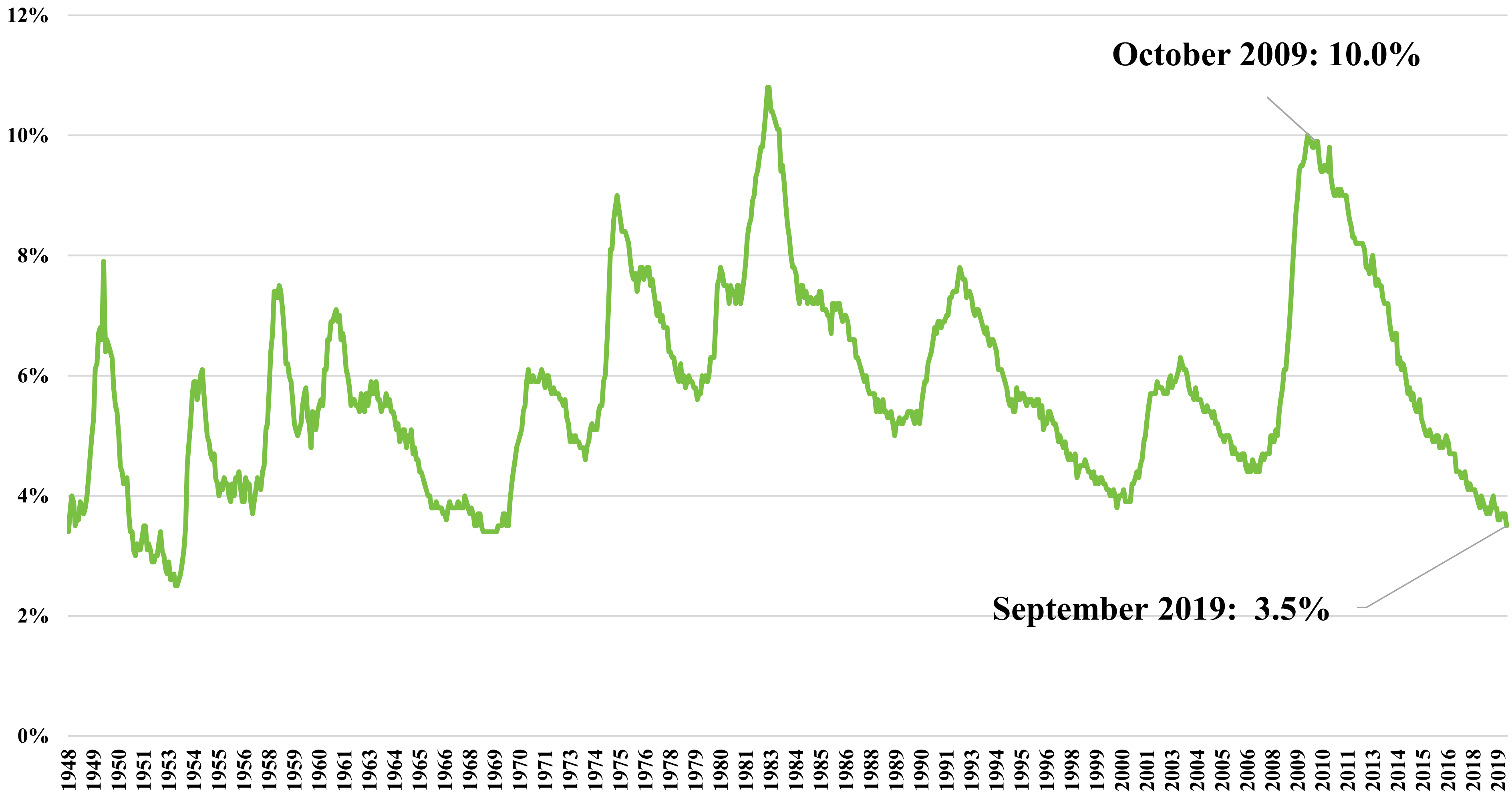
Industry Structure: Employment

- Employment in the life insurance industry is growing:
  - According to the Bureau of Labor Statistics, life and health insurers employed a record 2,690,400 people in 2018. This includes home-office, agents, brokers, and service personnel.
  - From 2008 to 2011, employment in the industry declined -2.9% (-68,500 jobs).
  - From 2011 to 2018, employment in the industry grew +15.2% (+353,900 jobs).
- The U.S. labor market is strong, *<u>at least for now:</u>*
  - A seller's market -- as of September 2019, U.S. unemployment stands at 3.5% (seasonally adjusted). This is the lowest unemployment rate since December 1969!
  - The unemployment rate is down from its recent peak of 10.0% in October 2009.
  - *Since December 2009, 20.5 million additional people are employed in the U.S. (a 14.0% increase in the number of people with jobs).*

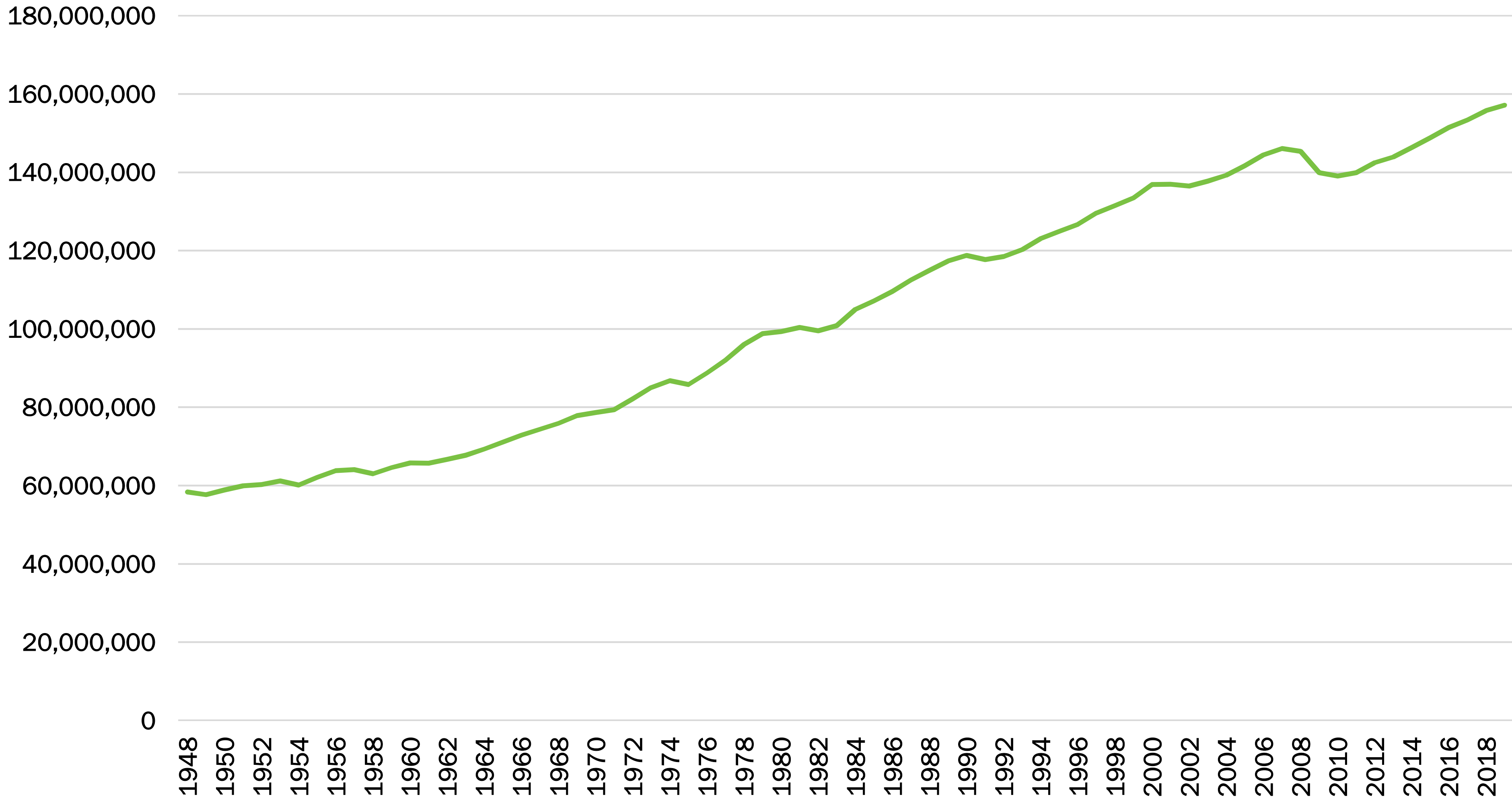
Total Employment in the Life and Health Insurance Industry



U.S. Unemployment Rate (1948-present)



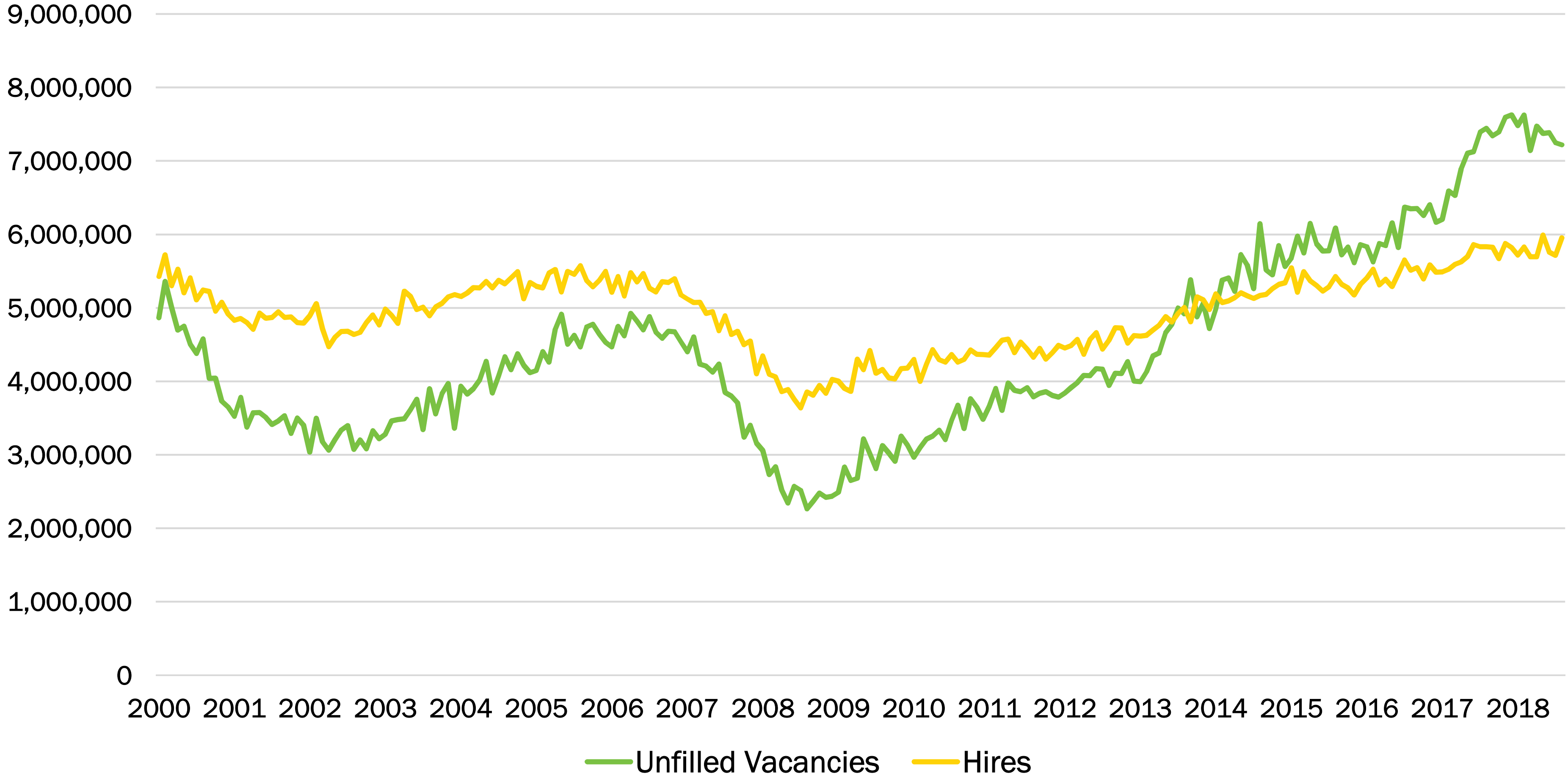
Number of Employed People in the U.S.



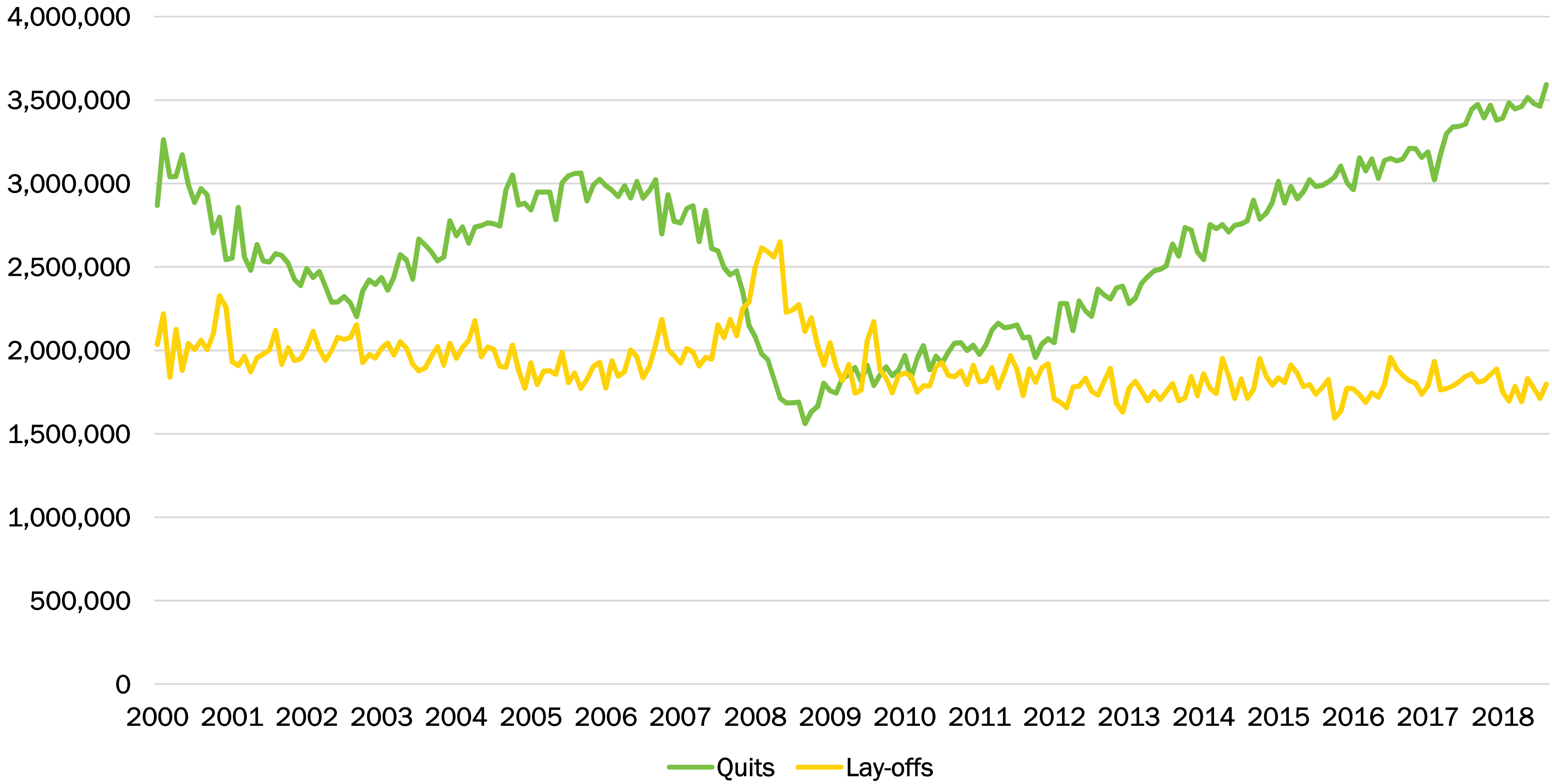
Industry Structure: Employment (continued)

- Because the labor market is strong, hiring the right people, *and keeping them,* is a challenge. Currently:
  - There are 7.2 million job openings in the U.S. (there were only 2.3 million in July 2009, a 220% increase).
  - In July 2019 there were 1,264,000 more <u>job openings</u> than there were <u>hires</u>. For every 100 people hired, there were 21 unfilled vacancies – <u>though a downward trend appears to be emerging</u>.
  - There is a great deal of labor turnover, with 3.6 million people – about 2.4% of all employed workers -- quitting their jobs in July 2019. In that month, That's the highest 'quit rate' since January 2001, the end of the dot.com bubble.
  - In July 2019, for every person who was discharged from their job, two people quit.

The U.S. Labor Market: Unfilled Vacancies and Hires, December 2000-July 2019



The U.S. Labor Market: Quits and Lay-Offs, December 2000-July 2019



Industry Structure: Employment (continued)

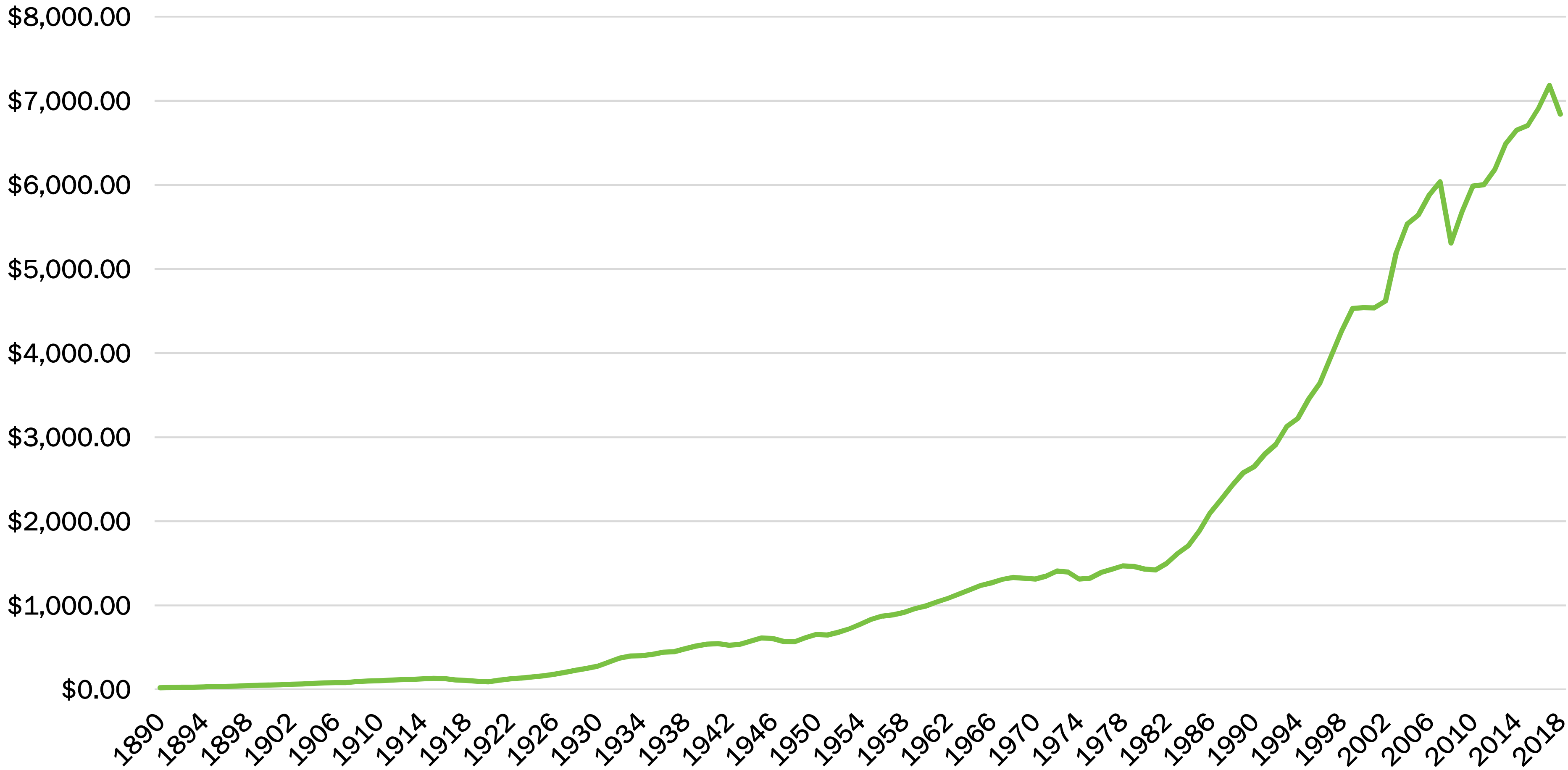
- Hiring the right people is a challenge (continued):
  - According to Indeed.com, average starting salaries for new graduates in computer science and other quantitative fields are over $100,000.
  - According to PWC's 2018 Survey of Insurance Company CEOs:
    - *81% are concerned about the shortage of technical skills in the industry.*
    - *86% are concerned about the shortage of technical skills in their company.*
  - According to PWC's *2019* Survey of Insurance Company CEOs
    - *When asked "what impact is 'availability of key skills' having on your organization's growth prospects?":*
      - *64% say 'people costs' are rising faster than anticipated.*
      - *50% say they are unable to innovate effectively*
      - *38% are missing growth targets.*
    - *BUT, there is improvement:*
      - *In 2018, 51% were concerned about the 'speed of technological change'.*
      - *By 2019, this declined to 31%*

Part 2: The Investment Side of the Industry

Assets and Investments

- At year-end 2018, life insurers held $7.0 trillion in assets.
  - A -2.7% decline from 2017, the first since the Financial Crisis and Great Recession.
  - The entire decline occurred in 2018-Q4 due to the market downturn.
  - Assets Immediate rebound in 2019-Q1.
- Overall, there has been a significant increase in asset holdings since 2008:
  - 50.4% *nominal* increase (not accounting for inflation).
  - 35.4% *real* increase (accounting for inflation).
- At year-end 2018, total assets of life insurers were equal to 33.5% of U.S. GDP, greater than at any time in the post-Great Depression period.
- In terms of total admitted assets, no matter how we look at it, our industry is large and growing.

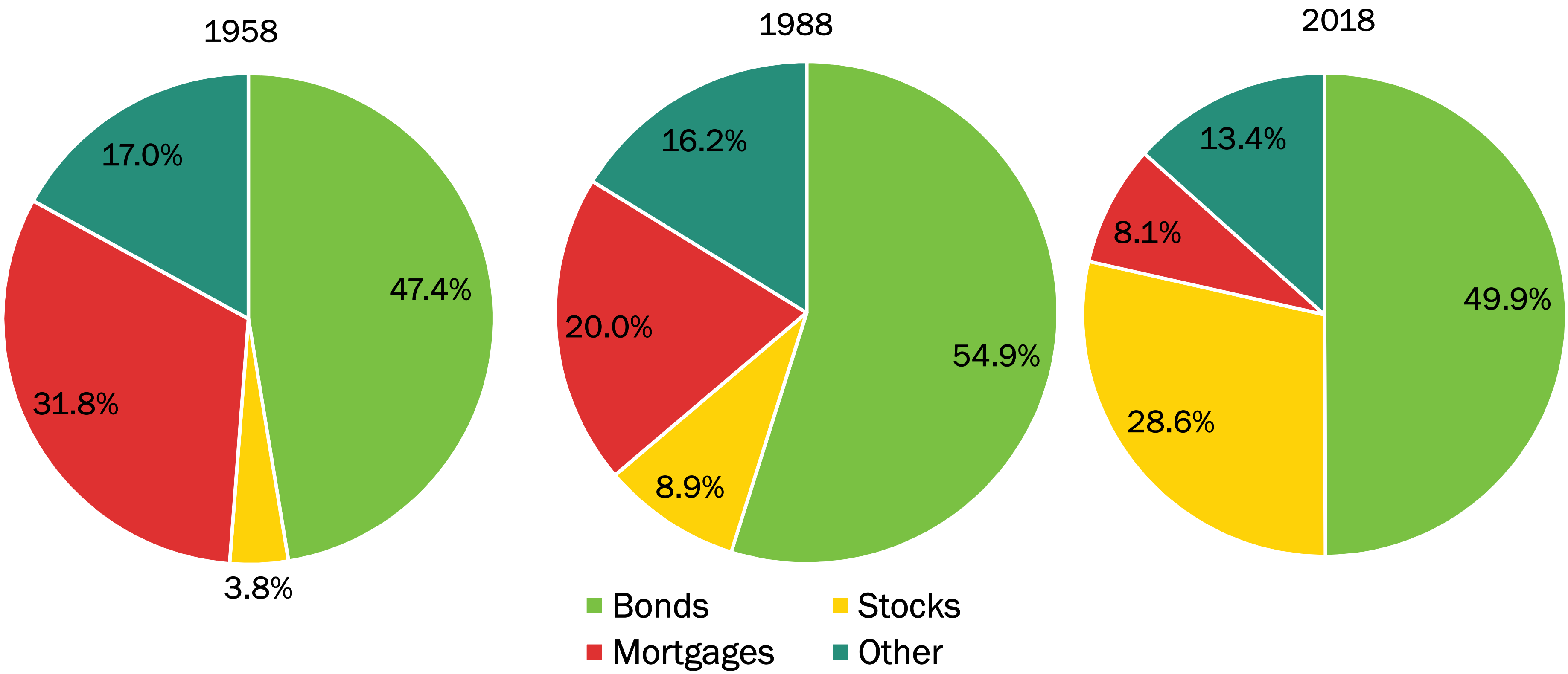
US Life and Health Insurers, Total Admitted Assets (in 2017 Billion USD), 1890 to 2018



Assets and Investments (continued)

- Investment allocation has remained relatively unchanged since 2012.
- At year-end 2018:
  - Most of our assets are still held in long-term bonds (49.9%).
    - Corporate Bonds: 34.9%
    - Government Bonds: 6.8%
    - Mortgage-Backed Securities: 8.2%
  - Followed by stocks (28.6%) and mortgages (8.1%)

Changes in Life Insurer Investments

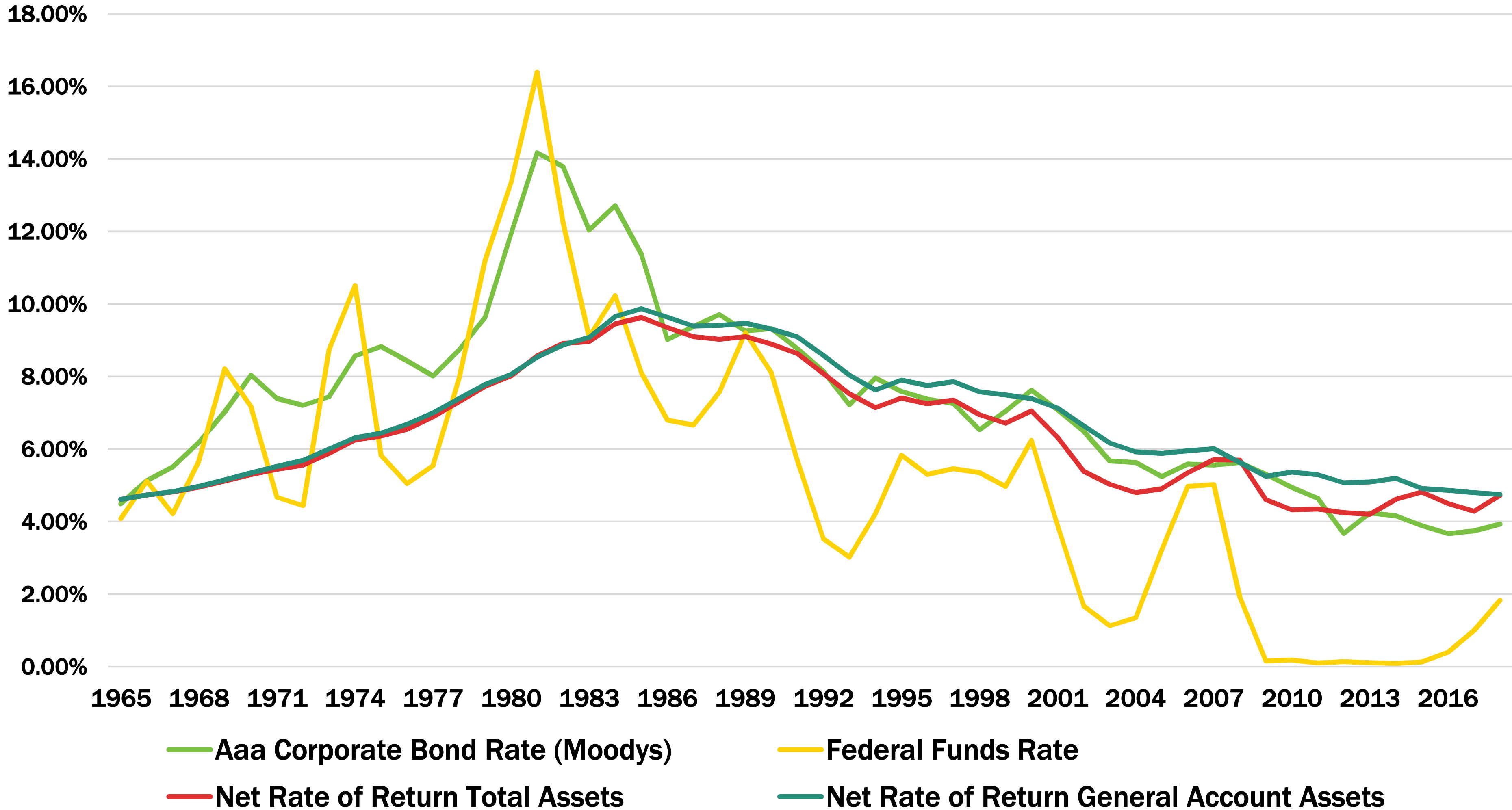


Low Interest Rates Present a Challenge .... Again!

- Federal Reserve Monetary Policy:
  - <u>December 2008 to November 2015</u>: Federal Funds Rate (FFR) kept at near-zero.
  - <u>December 2015 to December 2018</u>: FFR incrementally raised from near-zero to 2.25%.
  - <u>December 2018 to the present</u>: FFR incrementally lowered to 1.75%. More likely to come!
- Different interest rates (FFR, Treasury bonds, corporate bonds, etc.) tend to move in tandem.
- From 2009 to 2018:
  - The mean Federal Funds Rate was 0.55%, compared to a historical average of 5.24%.
  - The mean Aaa Corporate Bond Rate was 4.35%, compared to a historical average of 7.37%.
  - *The mean Net Rate of Return on <u>Total Life Insurer Assets</u> was 4.58%, compared to a historical average of 6.45%.*
  - *The mean Net Rate of Return on <u>Life Insurer General Account Assets</u> was 5.11%, compared to a historical average of 6.83%.*

	Historical Average (1954-2007)	November 2015	January 2019	September 2019
Effective Federal Funds Rate	5.69%	0.12%	2.40%	2.04%
Aaa Corporate Bond Rate	7.28%	3.97%	3.93%	3.03%
1-Year Treasury Rate	4.84%	0.48%	2.58%	1.80%
10-Year Treasury Rate	6.51%	2.26%	2.71%	1.70%

Interest Rates, Average Annual, 1965-2018



Why are Low Interest Rates a Challenge?

- The concern really is about *prolonged* low interest rates.
- In general, low interest rates are good for borrowers (e.g. mortgage, car loan, federal debt), but not for long-term investors (e.g. life insurers, pension funds), long-term savers (e.g. retirement savers), or current retirees.
- Life Insurers:
  - Need to match long-term liabilities with long-term assets.
  - Lack of appropriate investments.
  - If long-term investments offer low returns, products will be less appealing.
  - In particular, annuities and traditional long-term care insurance products may be less appealing to retirees and pre-retirees.
  - May also present a challenge for in-force policies (e.g. long-term care insurance).
  - Concern about rapid future interest rate increases. Late-1970s/early-1980s serve as an example – disintermediation.

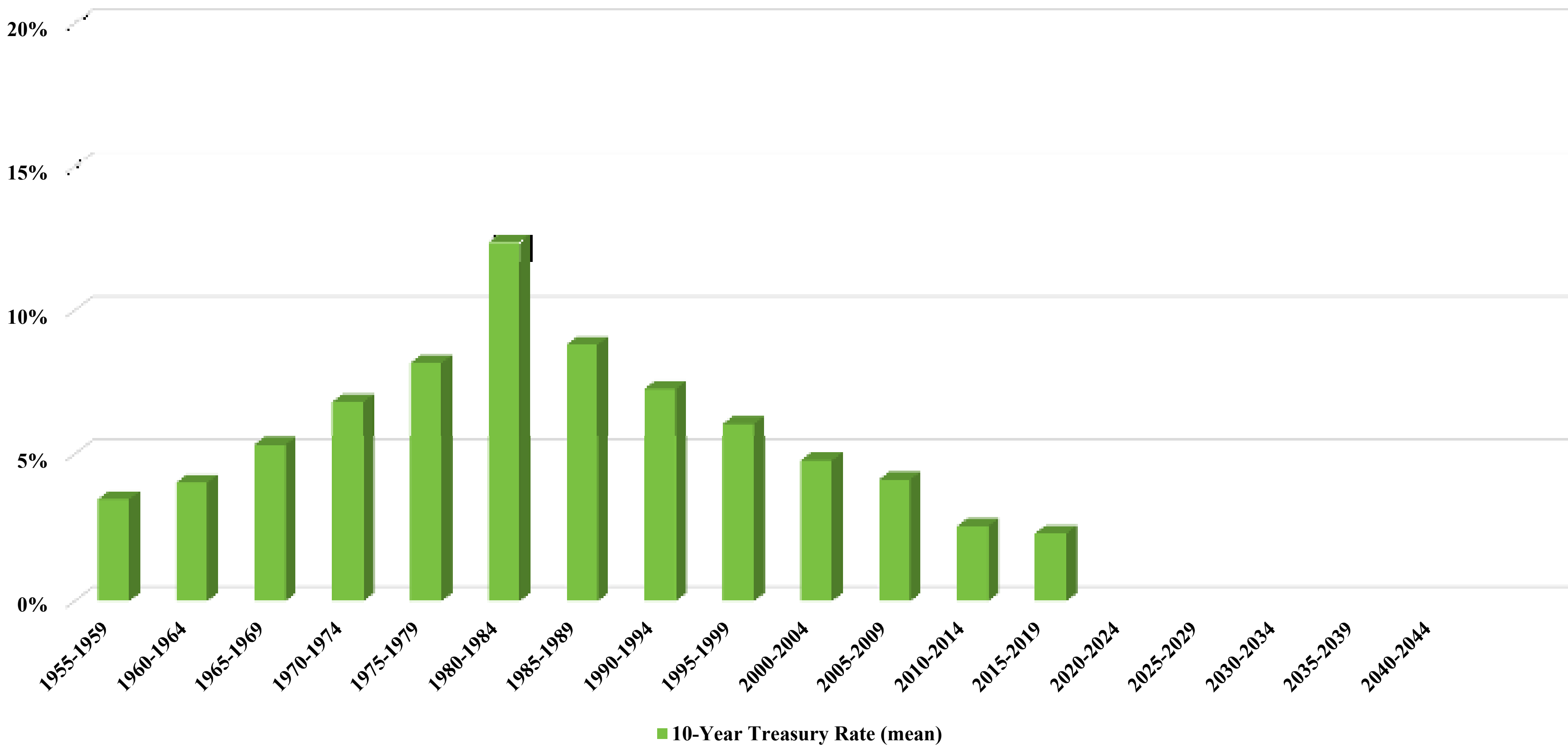
<u>Why are Low Interest Rates a Challenge</u>? (cont.)

- Pre-Retirees (age 50 to 64):
  - Should have an increasingly fixed-return-focused portfolio as they approach retirement.
  - Greater difficulty building wealth during the <u>accumulation</u> phase.
  - May need to delay retirement.
  - May need to increase saving to make up for decline in returns
    - <u>Typically</u>, the savings rate moves with interest rates - when interest rates are high, so is savings.
    - Since 2009, the opposite has occurred.
      - 2000-2008: average personal savings was 4.7%
      - 2009-present: average personal savings was 7.2%
- Retirees:
  - Greater risk of depleting wealth during <u>decumulation</u>.
  - May need to return to labor force.
    - 1987-2008: on average, 13% of 70 to 74-year-olds were in the labor force.
    - 2009-present: on average, 19% of 70 to 74-year-olds were in the labor force.
  - Risk of fixed income assets decreasing in value due to a *rapid increase* in interest rates.

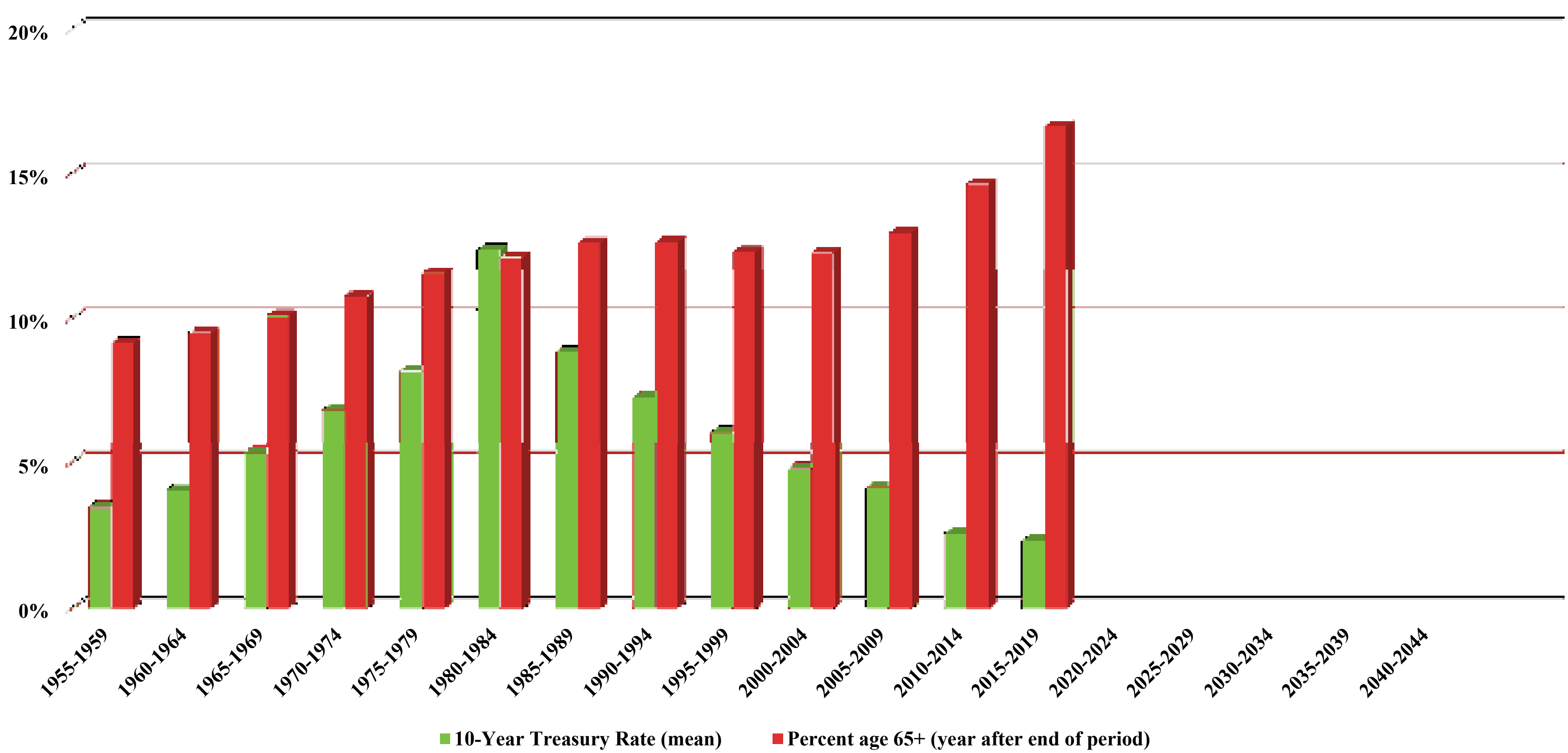
<u>Why are Low Interest Rates a Challenge</u>? (cont.)

- Both Pre-Retirees and Retirees:
  - Decreased consumption.
  - Annuities are less attractive.
  - Long-term care insurance is less attractive.
- Very bad timing.
  - Baby Boomers are either retired or will reach official retirement age by 2031 (in 12 years).
- Some eminent economists say low interest rates are permanent – this is a 'new normal".
- May encourage excessive risk-taking.
  - Larry Summers (Harvard Professor and former Treasury Secretary): "Monetary policies involving low or negative real interest rates may be sustainable over the long-term but they are likely to encourage financial risk, unsound lending and asset bubbles with potentially serious implications for medium-term stability".
- Really, really bad timing! The population is aging – world-wide!

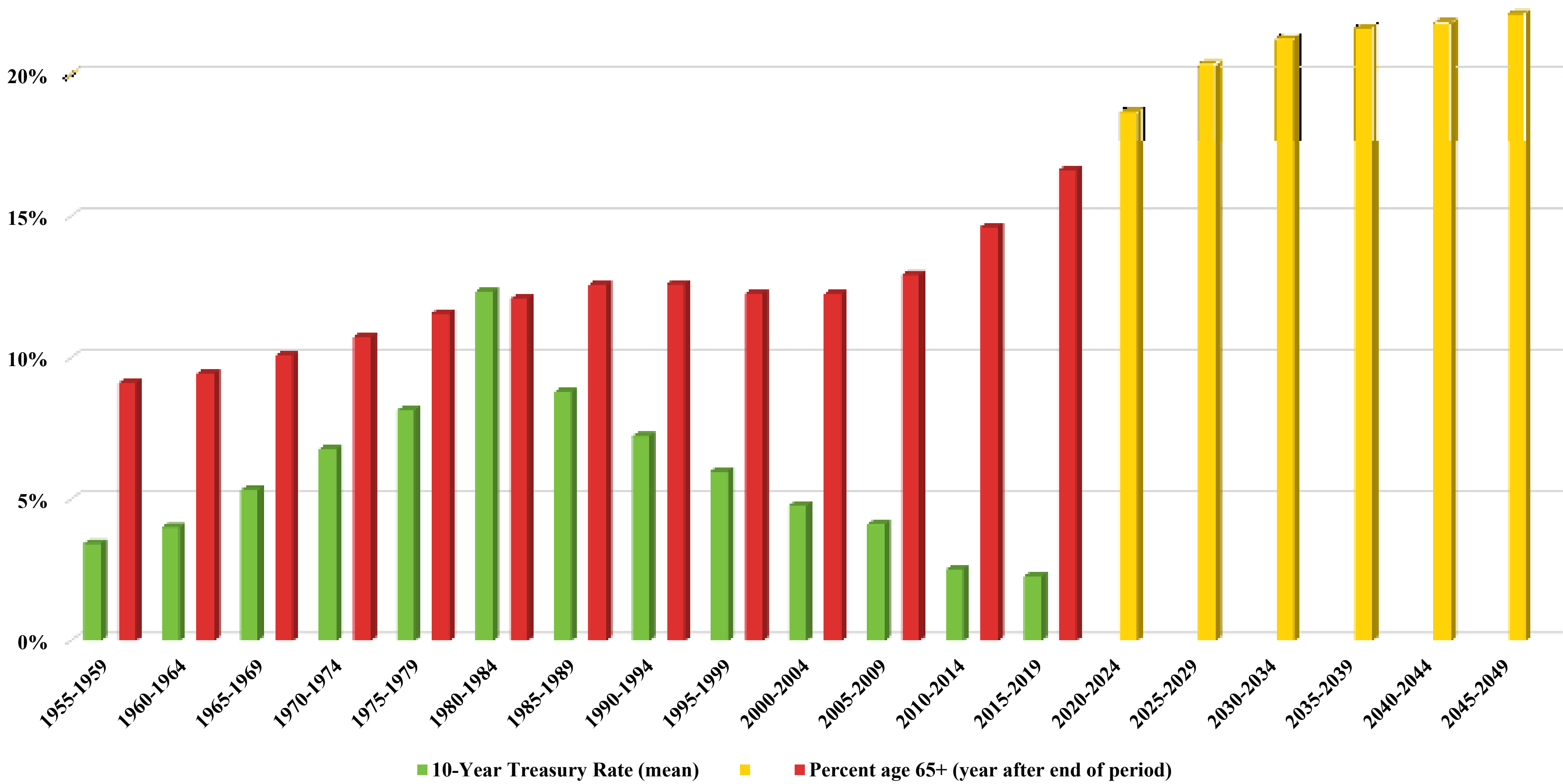
10 Year Treasury Rates, 1955-present



10 Year Treasury Rates and Retirees, 1955-present



10 Year Treasury Rates and Retirees, 1955-2050



Infrastructure Investment: Good for the Country *and* Good for Life Insurers?

- U.S. infrastructure needs improvement:
  - The American Society of Civil Engineers gave the U.S. a 'D+' for infrastructure.
  - The U.S. earned a 'D' for aviation, dams, drinking water, inland waterways, levees, roads; and a 'D-' for transit.
- Life insurers are long-term investors.
  - <u>Liabilities</u>: Life insurance, long-term care insurance, and annuity contracts routinely last for decades.
  - <u>Assets</u>: 39.3% of bonds purchased by life insurers have a maturity of 20 or more years; 72.2% have a maturity of 10 years or more.
- Is there a match?

Infrastructure Investment: Good for the Country *and* Good for Life Insurers? (continued)

- Municipal Bonds:
  - In 2009 and 2010, the U.S. issued $182 billion in ‘Build America Bonds’ (BAB).
  - Life insurers held $60 billion in BABs, about 1/3 of the total.
  - Build America Bond program was discontinued and will likely not be reintroduced.
- Public-Private Partnerships:
  - Popular in Europe, especially in the U.K., Spain, Portugal, Germany, France and Italy.
  - In the U.S., projects are usually local. Local governments often impose frequently changing conditions.
  - Private sector investment can be illiquid.
  - A great deal of variability in profitability.

Infrastructure Investment: Good for the Country *and* Good for Life Insurers? (continued)

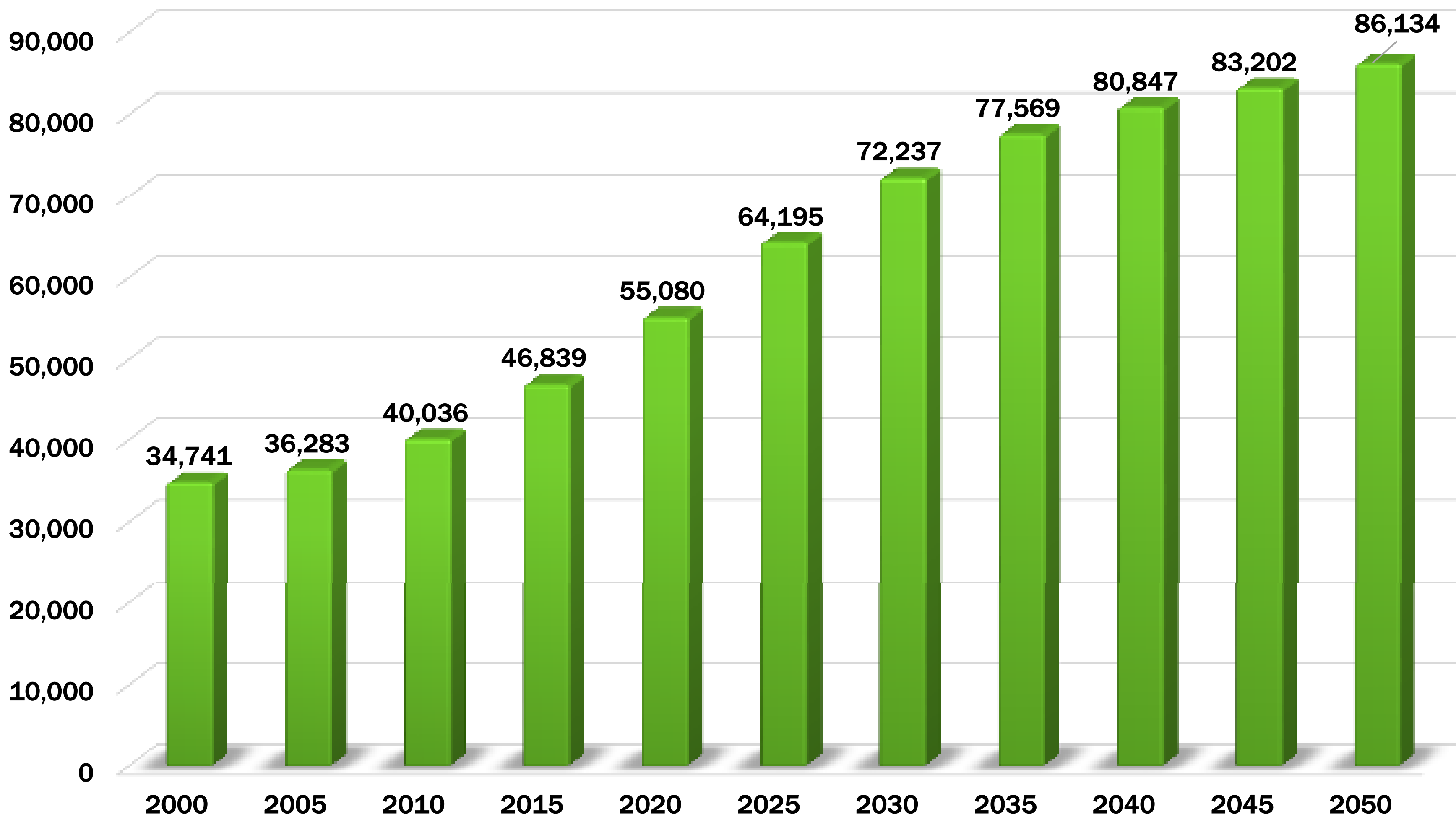
- A study is being planned by the NAIC Capital Markets Bureau and the NAIC Center for Insurance Policy Research.
- One RFI has been issues asking for assistance in defining ‘infrastructure’.
- Additional RFIs expected.
- Study should be released in the second half of 2020, likely with a panel discussion.

Part 3: People and Products – What we're Really About

Life Insurance Products: Annuities

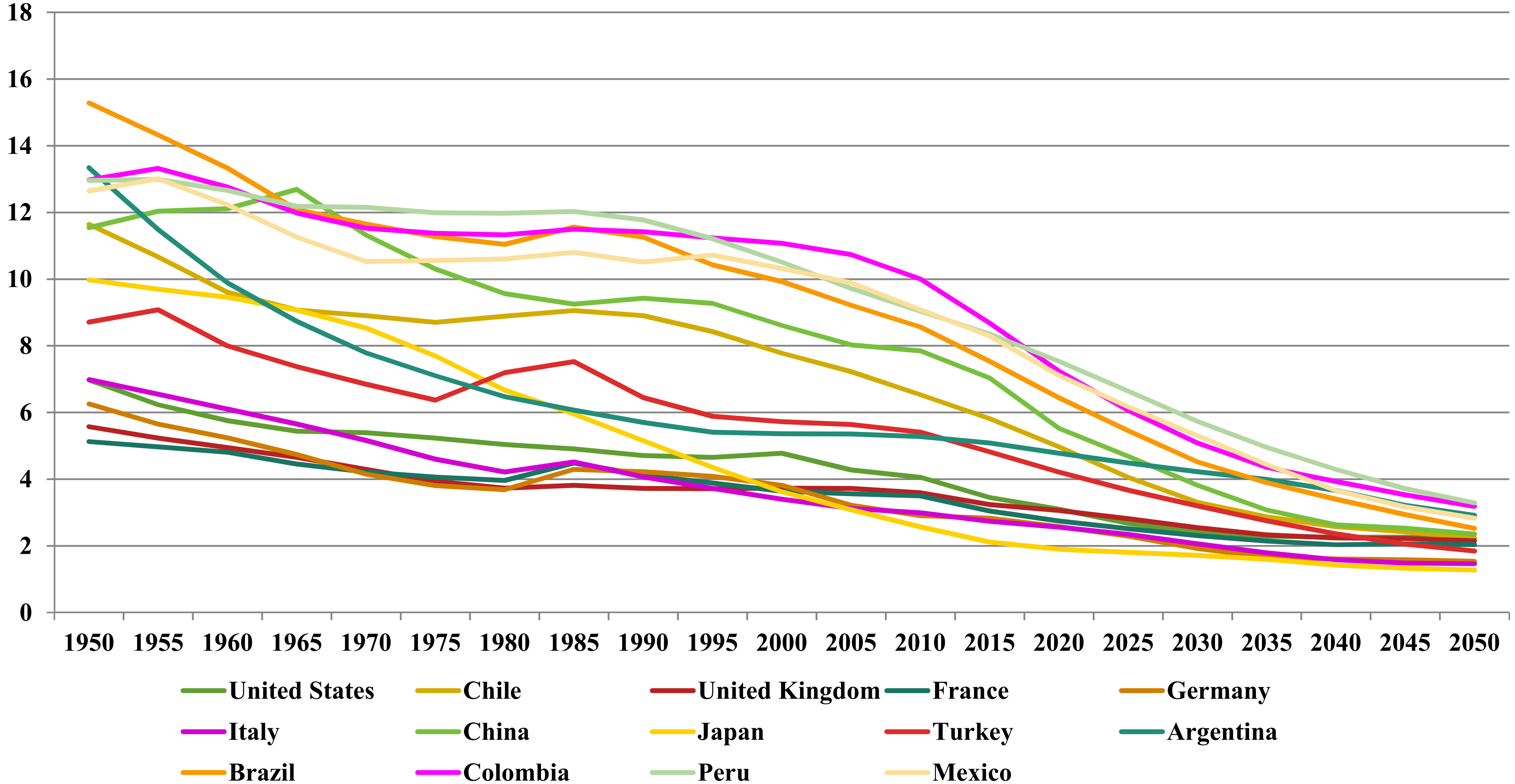
- From the standpoint of demographics and stated preferences, the United States should be entering the 'golden age' of annuities.
  - Americans age 65 and over:
    - 2010: 40.0 million → 13.0% of the population
    - 2020: 55.1 million → 16.6% of the population
    - 2030: 72.2 million → 20.4% of the population
    - 2040: 80.8 million → 21.6% of the population
    - 2050: 86.1 million → 22.1% of the population
- We're all aware of the need for guaranteed income in retirement, but there also appears to be a demand on the part of consumers:
  - 59% of pre-retiree households are at least somewhat worried about outliving their assets.
  - 76% of pre-retiree households are at least somewhat concerned about having adequate income during retirement.
  - 49% of working households like the *idea* of an annuity, at least somewhat.

U.S. Population Age 65 and Over (in thousands)

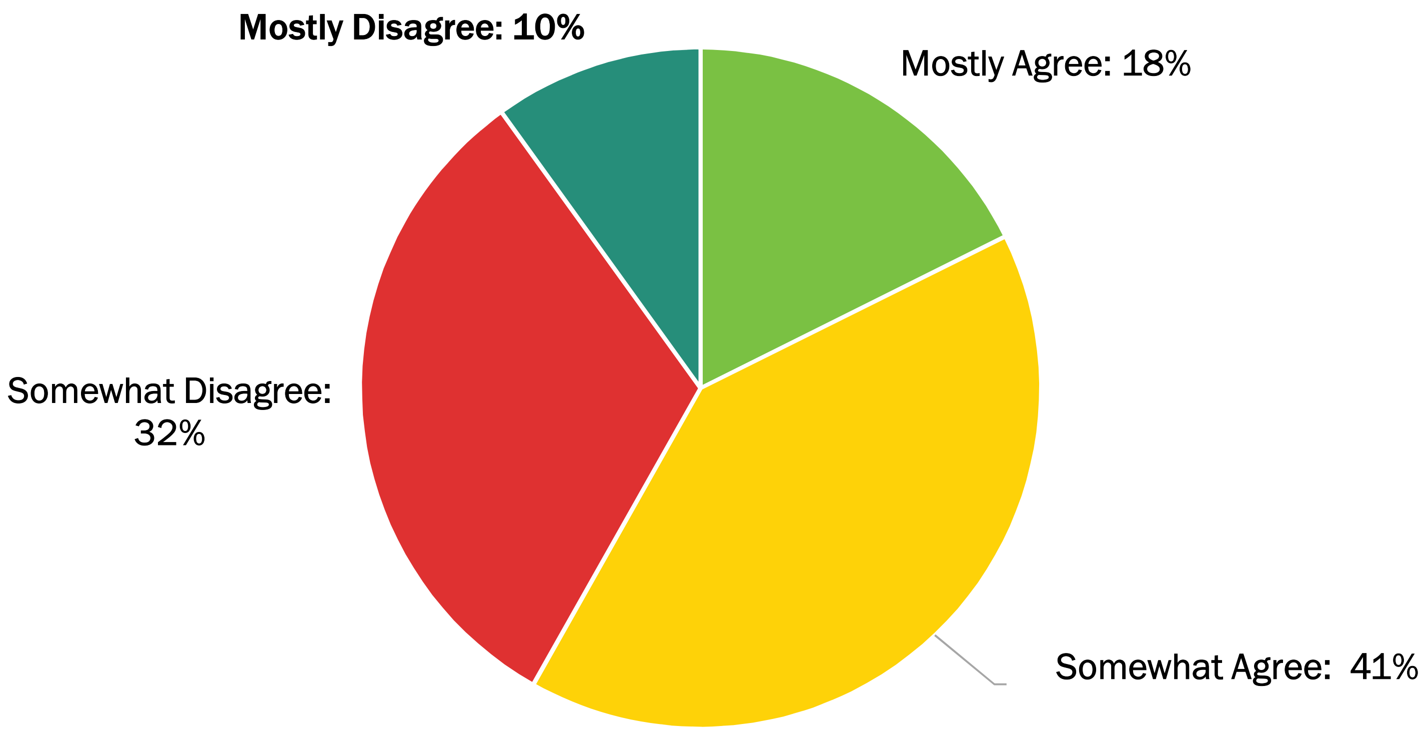


Year	U.S. Population Age 65 and Over	Percent of Total U.S. Population	Current (2016) TOTAL Population of Select Countries
2010	40.0 million	13.0%	Canada: 36.3 million
2020	55.1 million	16.6%	South Korea: 51.2 million
2030	72.2 million	20.4%	France: 66.9 million
2040	80.8 million	21.6%	Turkey: 79.5 million
2050	86.1 million	22.1%	Germany: 82.3 million

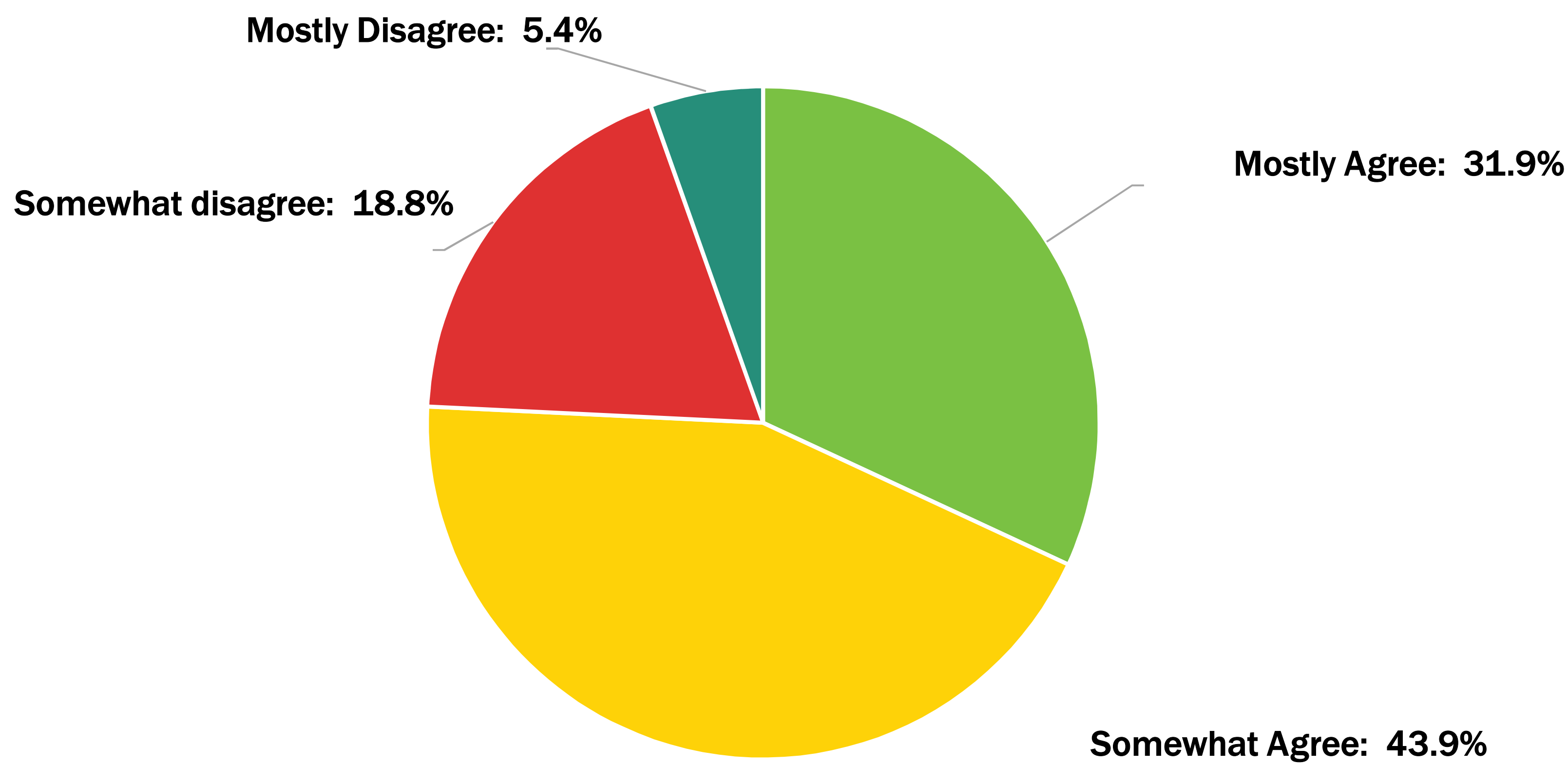
Workers Per Retiree, 1950 to 2050 (various countries)



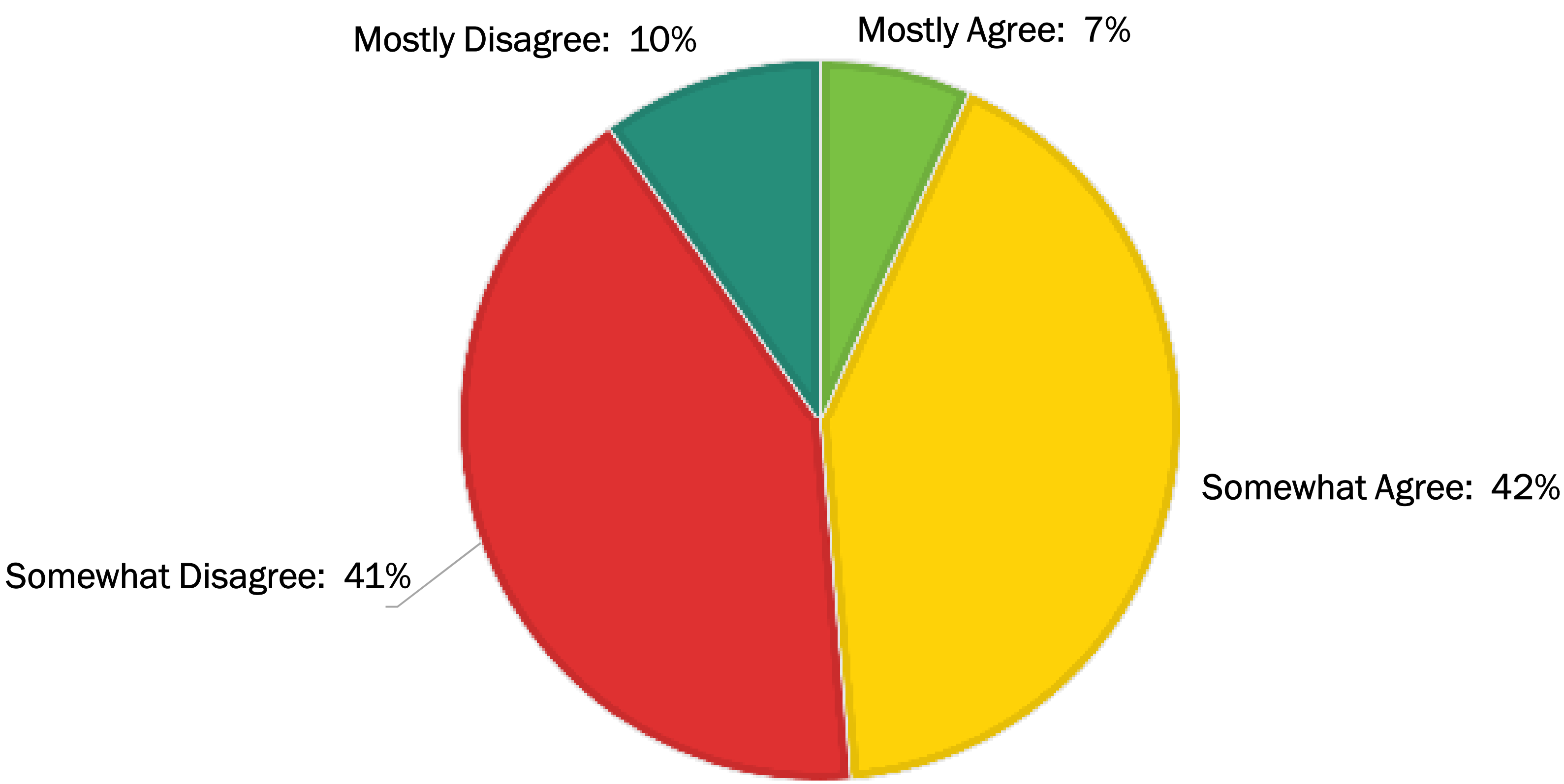
“I am worried about outliving my savings and investments” (non-retired households age 45 to 64)



"I am concerned about having adequate income during retirement" (non-retired households age 45 to 64)



"I would put most of my assets in an investment that provides a guaranteed income for life even if it pays a low interest rate" (working households)



Life Products: Annuities, cont.

- In April 2015, the DOL Fiduciary Rule was proposed, resulting a contraction in the variable annuity market.
- Individual variable annuity considerations *declined sharply*:
  - 2015: -4.9%
  - 2016: -20.4%
  - 2017: -6.7%
  - 2014-2017: -29.3%
- As of June 21, 2018, The U.S. Fifth Circuit Court of Appeals officially vacated the rule.
- On June 5, 2019, the Securities and Exchange Commission (SEC) adopted Regulation Best Interest, which requires broker-dealers to act in the best interest of their retail customers when making a recommendation.
- Several states are pursuing their own versions of the Fiduciary Rule.
- The annuity market is likely to rebound due to recent positive policy developments, coupled with the aging population.

Life Products: Annuities, cont.

- In April 2015, the DOL Fiduciary Rule was proposed, resulting a contraction in the variable annuity market.

<u>Individual Variable Annuities</u>

	Considerations (in millions)	Contracts Issued	Contracts In-Force
2014	$137,404	1,155,000	17,755,000
2015	$130,630	1,025,000	17,530,000
2016	$104,036	796,000	17,552,000
2017	$97,084	686,000	16,971,000

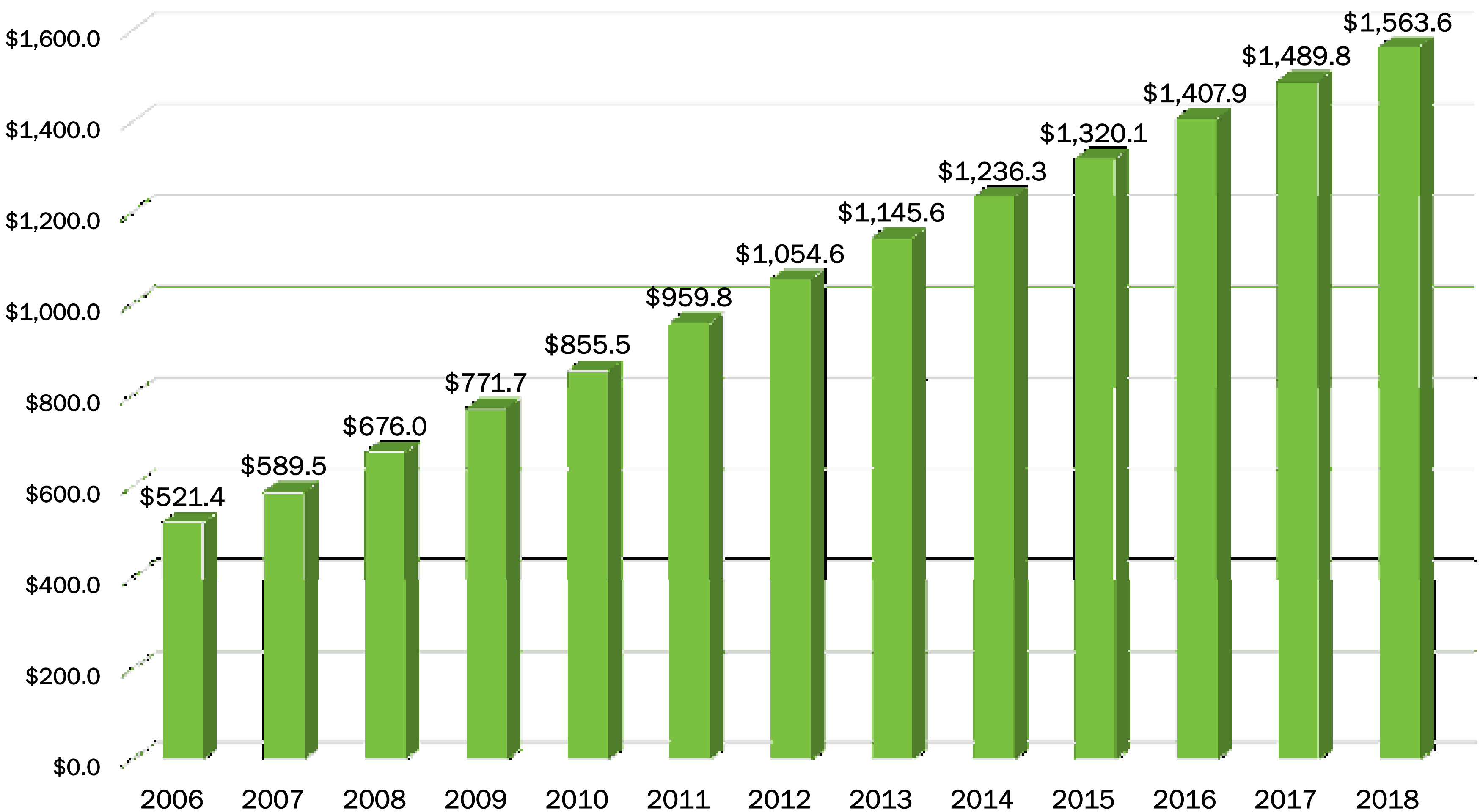
- 2018 variable annuity data is not yet available. *However, in 2018 total (fixed and variable) individual annuity considerations increased 14.4%, <u>suggesting that the individual VA market has rebounded</u>*.

Life Products: Life Insurance

- The percent of families owning any life insurance has steadily been declining since 1970.
- According to the Federal Reserve Survey of Consumer Finances, in 2016 only 57.7% of American families owned any life insurance.
- Why has ownership declined?
  - Changing demographics -- sales are particularly weak among Millennials and Hispanics.
  - Retirement savings (401k, IRA) may serve as a substitute for life insurance.
  - Two-earner households are the norm.
    - In October 1970, the female labor force participation rate was 43.2%, in October 2019 it is 57.6%.
  - Americans owe a record $1.5 trillion in student loans.
    - 54% of recent college graduates have a student loan. Of those with student loans, the median balance is $35,000.
  - Consumers tend to purchase life insurance at specific points in their lives – when they: get married; have children; purchase a home. Families are smaller, marriage is delayed or foregone, homeownership is delayed or foregone.

44

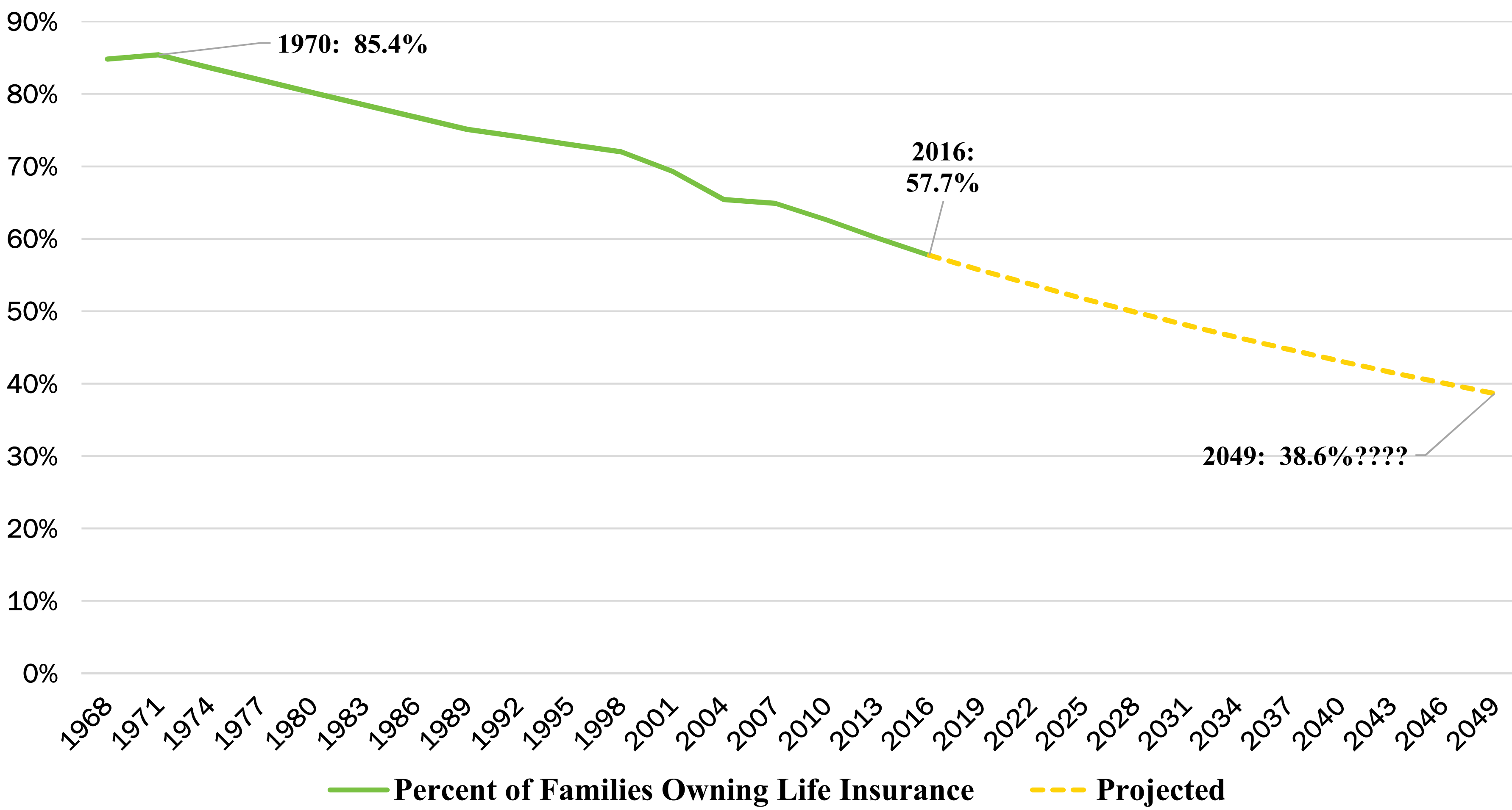
Student Loans Outstanding (in Billion USD)



Life Products: Life Insurance (cont.)

If in the last two years you:	You are this much *more likely* to have purchased a life insurance policy:
Had or adopted a child:	2.8 times
Had or adopted a grandchild:	2.4 times
Got married:	1.7 times
Purchased a home:	2.9 times
Started your first job:	1.5 times
Had a 25% or greater pay increase:	3.0 times

Percent of U.S. Families Owning Life Insurance, 1968-2049 (projected)

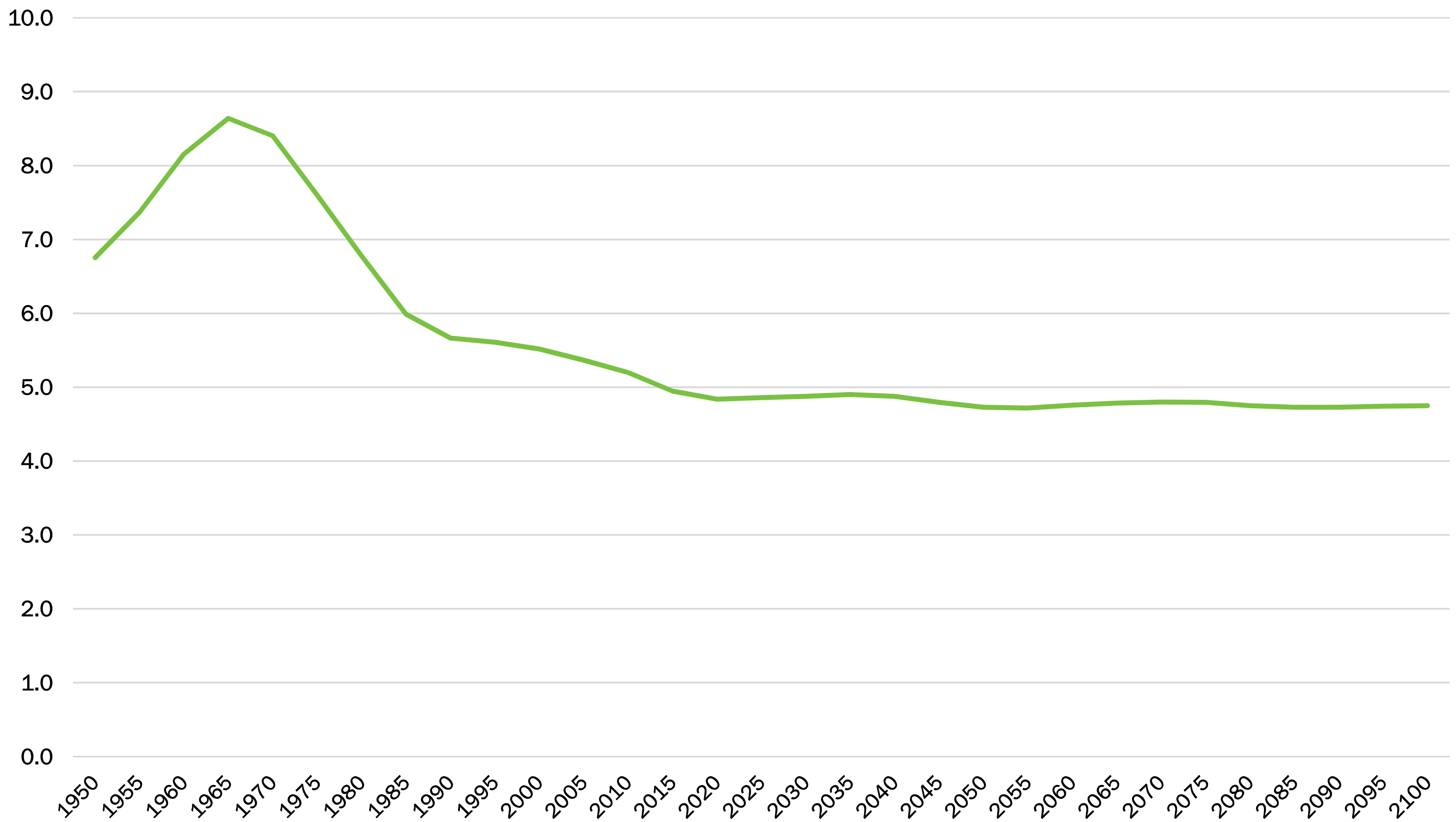


47

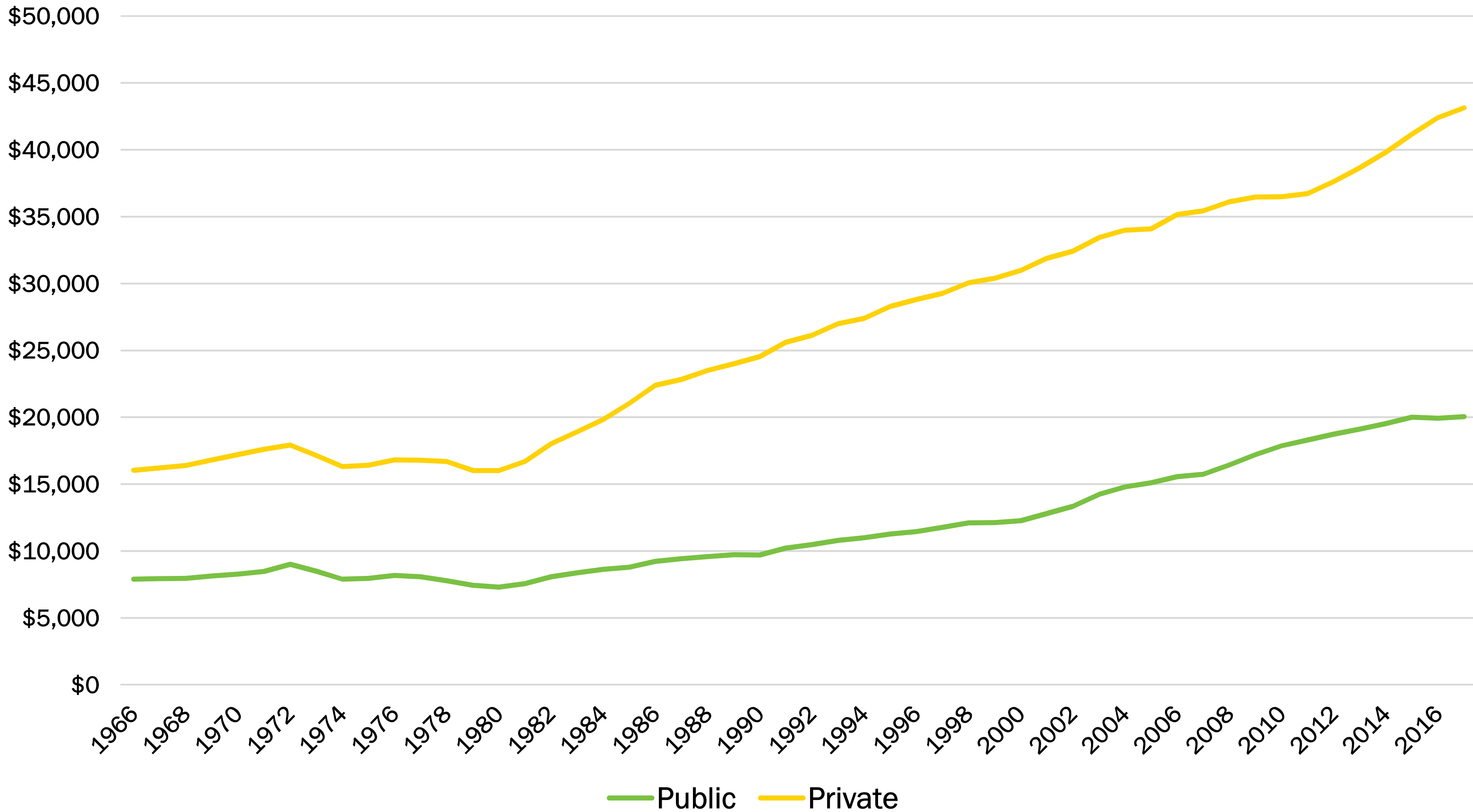
Life Products: Life Insurance (cont.)

- Several Reasons for Optimism:
  - Since 1965, the number of children (age 15 or less) per working age adult has declined:
    - 1965: 8.6 children per 10 working age adults
    - 2020: 4.8 children per 10 working age adults
  - According to both U.S. Census and U.N. estimates, from 2020 through 2100, *the number of children per working age adult will remain relatively constant*.
  - The cost of raising a child (from birth to age 17) is high and increasing, which should increase the demand for life insurance:
    - The average cost for middle-income ($59,200 to $107,400) households is $233,610, excluding education.
    - The average cost for higher-income (more than $107,400) households $372,210, excluding education.
  - The cost of a college education is high and increasing.
    - In 2017-2018, the average annual cost of tuition, room, board and fees was $20,050 for a public 4-year institution and $43,139 for a private 4-year institution.
  - A growing demand for LTC coverage may drive demand for life insurance/LTCI hybrid products.
    - According to LIMRA, combination products now represent 27% of the overall market.

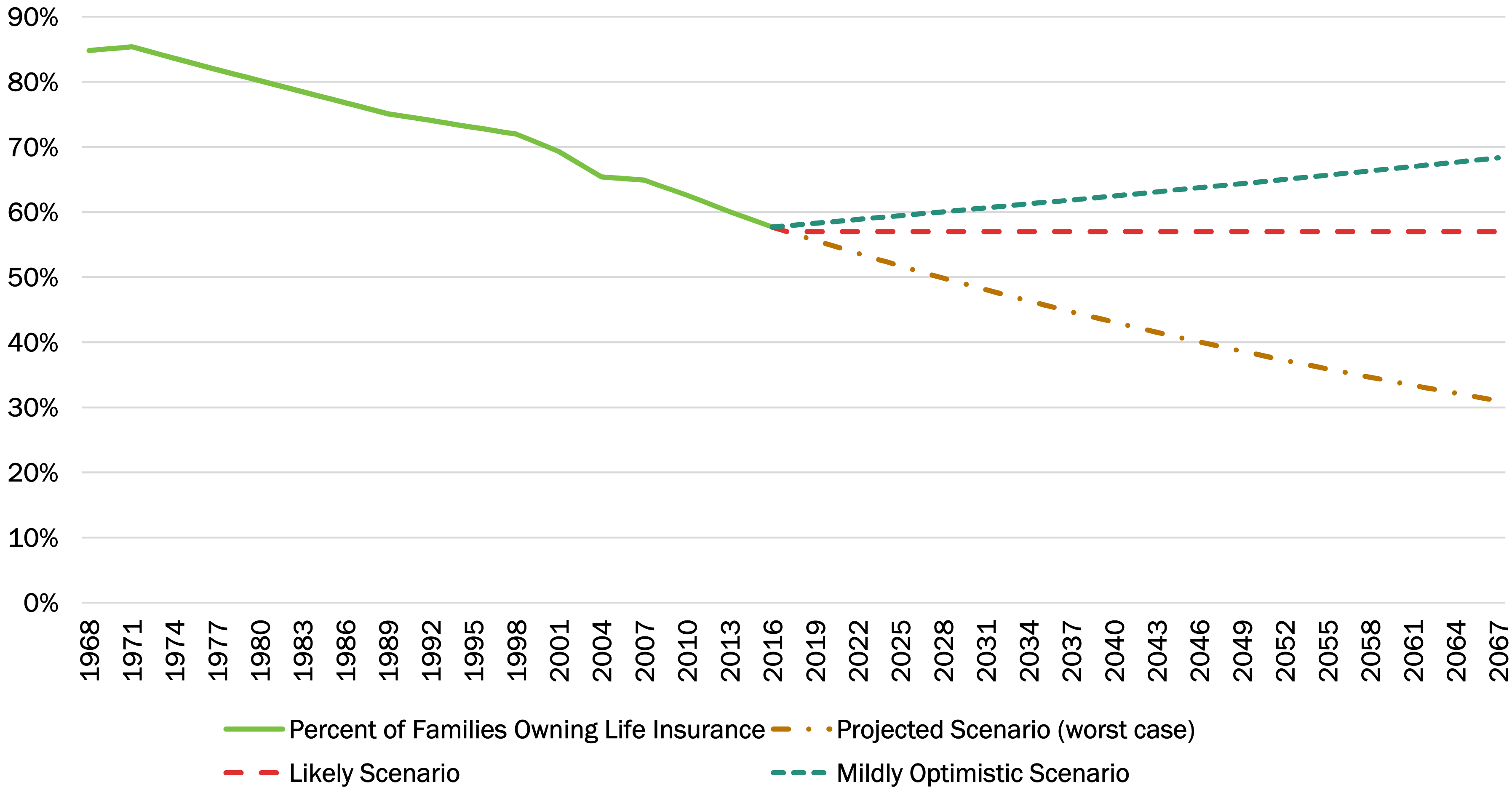
Number of Children Age 15 or Less Per 10 Working Age Adults (age 25 to 64)



Tuition, Room, Board, and Fees for a 4-Year College, 1966-2017 (2017 USD)



Percent of U.S. Families Owning Life Insurance, 1968-2067 (various scenarios)



Long-Term Care Insurance: An Evolving Product

- Currently, in the U.S.:
  - 4.74 million people utilize home health care agencies.
  - 1.4 million reside in nursing facilities.
  - 713,000 live in residential care communities
  - 273,000 use adult daycare.
- Demand for long-term care services will increase:
  - There will be a growing demand for LTC. From today to about 2037, the number of people age 85+ will double.
  - In 2049, when the youngest Baby Boomers will reach age 85, there will be 19 million Americans age 85 or greater.
  - Someone turning *age* 65 today has almost a 70% chance of needing some type of *long-term care* services.
- Long-term care is expensive, and costs are rising faster than overall inflation.
  - In 2018, a private room in a nursing home costs $100,380/year; a semi-private room costs $89,292 /year; and assisted living costs $48,000/year.
  - Since 2008, the annual cost of nursing home care and assisted living increased about 3.2% annually. By comparison, *inflation during that period averaged 1.8% annually*.
- In 2018, 6.4 million lives were covered by a 'traditional' LTCI policy. *However,* due to the increasing popularity of hybrid products and LTCI riders, <u>this is an underestimate</u>.
  - According to LIMRA, combination products now represent the majority of new sales for LTCI solutions.

Disability Income Insurance: A New Perspective?

- There is relatively broad support for paid family and medical leave (PFML).
  - According to a recent Associated Press-NORC 2018 Long-Term Care Trend poll, “80% of adults age 40 and over support paid temporary leave programs to care for family members”
  - The Democrat-sponsored FAMILY Act would provide up to 12 weeks of partial pay when workers take time off for the birth or adoption of a child, for serious health conditions or that of a close family member, regardless of employer size. Leave would be funded through a modest payroll contribution split between the employer and worker.
  - Some Republican support for the concept (e.g. Ivanka Trump, Sen. Marco Rubio).
- There is some overlap between PFML and private short-term disability income insurance. Effectively, short-term DI offers ‘PML’.
  - 25% of all short-term DI claims are for pregnancy.
- Some Life insurers are exploring the possibility of developing new, PFML-like products.
- This may present an opportunity for the industry to take the lead in meeting an important societal need.

Conclusions

- Though there are fewer life insurers than in the past, the industry is large and growing.
- There is some specialization, but the industry is competitive and vibrant.
- Employment has been growing but finding and retaining people with the right skills is still challenging.
- Life insurer asset holdings are on an upward trajectory, despite a 'blip' in 2018-Q4. Life insurers remain the largest institutional investor in long-term corporate bonds.
- Because of a significant demographic shift, the annuity market *should be* poised for growth.
- Sales of individual variable annuities declined substantially, but temporarily, in recent years. The decline is primarily due to the DOL Fiduciary Rule and similar proposed regulation. Positive regulatory developments have likely reversed this trend.
- The demand for life insurance has been in slow decline for several decades. Much of this is due to demographic factors beyond our control. There are strong indications that demand will stabilize.
- The need for LTCI coverage continues to grow. Much of the demand will likely be met by hybrid products.
- Paid Family Medical Leave is potentially a bipartisan issue. The overlap between Disability Income Insurance and PFML may offer opportunities for life insurers to both expand their business and to help meet societal needs.

Thank You!!!

Andrew Melnyk, Ph.D., CBE
Vice President and Chief Economist, Research
American Council of Life Insurers
Email: andrewmelnyk@acli.com

Data sources:

ACLI, Annuity Product Line Report, various issues.

ACLI, Life Insurers Fact Book, various issues.

The Associated Press-NORC Center for Public Affairs Research, “Long-Term Care in America: Increasing Access to Care”, Research Highlights, May 2018.

Bureau of Labor Statistics, Current Population Survey.

Federal Reserve Bank of St. Louis (see: https://fred.stlouisfed.org/).

Genworth, Cost of Care Survey, various editions.

NAIC Annual Statements.

Strategic Business Insights, 2018-2019 MacroMonitor Household Survey.