Credit Research
May 2023

AEGON **INSIGHTS**

Signs of life (insurance): How higher interest rates have revitalized the sector

- *The high interest rate environment has been conducive to fixed-rate deferred annuity sales*
- *Sales momentum continues to build for the US life insurance industry from a record year in 2022*
- *The longer interest rates are high, the stronger the tailwind will be for earnings*
- *A possible recession could pose a potential headwind to momentum*

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Since interest rates bottomed out in mid-2020, they have quickly risen to the highest levels we've seen in the past decade. This has revitalized the US life insurance industry by making certain retirement products more attractive to consumers, lowering the cost for corporations looking to offload pension liabilities, and improving margins in insurers' spread-lending businesses.

The US life insurance industry is one sector that has benefitted from higher interest rates. The industry experienced a 23% increase in total annuity sales to a record $312.8 billion in 2022. The primary driver of this growth came from fixed-rate deferred annuity sales which have more than doubled to $113 billion according to LIMRA, Life insurers have been able to raise crediting rates on fixed-rate annuity products alongside the rise in interest rates which has made these products more appealing to investors seeking steady growth and protection. Total fixed annuity sales, which includes deferred, immediate, and structured settlements, increased 63% in 2022 to $209.9 billion, according to LIMRA. Fixed indexed annuity sales also had a record year in 2022 growing 25% to $79.8 billion. LIMRA, one of the largest insurance trade associations, expects the sales momentum built up from last year to continue and is forecasting a record-breaking first quarter 2023.[1]

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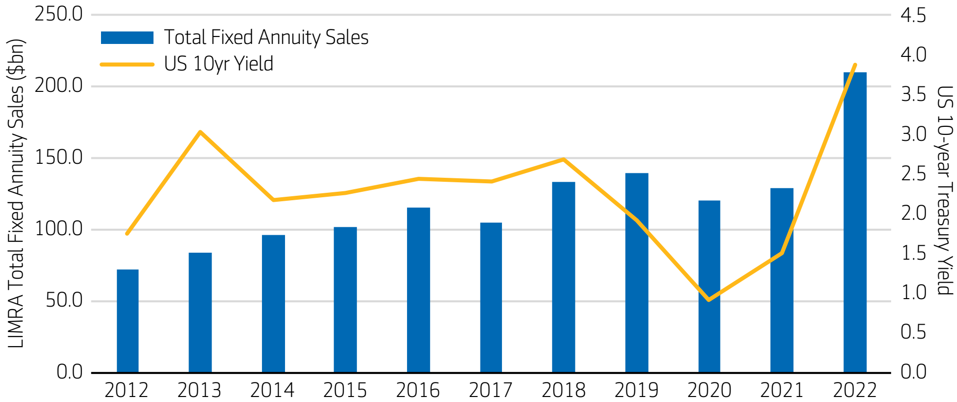
Exhibit 1: LIMRA Total Fixed Annuity Sales



Sources: Bloomberg and Aegon AM. As of December 31, 2022.

The longer interest rates remain elevated, the stronger these tailwinds will be for company earnings.

Opportunities for de-risking

Pension risk transfer sales have also accelerated in recent quarters because higher interest rates have improved funding status levels above 100%, enabling more companies to offload these liabilities to insurance companies without having to pay a ceding commission. According to Bloomberg, the funding status of the largest 100 US corporate pension plans improved to 110% earlier this year, the highest level in more than two decades. IBM executed a historic $16 billion pension risk transfer (PRT) transaction with Prudential Financial (PRU) and MetLife (MET) in September 2022, which was one of the largest transactions in history.

Spread margins, the difference between the investment yield earned by life insurers and the crediting rate paid out to policyholders, are also showing signs of improvement after a decade of compression. During 2022, new money yields rose throughout the year and finished above portfolio yields for many life insurers. The longer interest rates remain elevated, the stronger this tailwind will be for company earnings.

Potential headwinds

That being said, one near-term risk that warrants caution for the sector is the potential for a recession. While excess capital buffers should be sufficient to absorb the impact of a mild recession, consistent with Aegon AM's economic forecasts, a more prolonged or severe recession would have negative implications for capital ratios across the industry driven by downward ratings migration and credit impairments.

[1]https://www.limra.com/en/newsroom/news-releases/2023/limra-record-annuity-sales-in-2022-expected-to-continue-into-first-quarter-2023/

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