

LOW INTEREST RATE TASK FORCE

Customer and distribution subcommittee kickoff meeting

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AGENDA

01 INTRODUCTIONS & CONTEXT 15 min

02 CUSTOMER & DISTRIBUTION SUBCOMMITTEE 15 min

03 DISCUSSION: LOW RATE CHALLENGES 25 min

04 NEXT STEPS 5 min

APPENDIX:

- INTERNATIONAL WORKSTREAM HIGHLIGHTS
 - NEW BUSINESS SURVEY HIGHLIGHTS
-

INTRODUCTION: SUBCOMMITTEE MEMBERS

SUBCOMMITTEE MEMBERS

Name	Company
Paul Mineck	Allstate
Gumer Alvero	Ameriprise
Steve Rueschhoff	Edward Jones
Sue Fiengo	Global Atlantic
Dominique Baede	Guardian Life
Brian Sward	Jackson
Steve Robinson	Legal & General
Jen Rutley	Mass Mutual
Holly Snyder	Nationwide
Michael Kula	NY Life
Chris Calabro	Ohio National
David Lautenschlager	Pacific Life
Mike Mock	Sammons
Mark Caner	Western & Southern

FACILITATORS



Scott Campion
Partner, Oliver Wyman



Kristin Ricci
Partner, Oliver Wyman



Dave Levenson
CEO, LLG Global

INTRODUCTION: RULES OF THE ROAD

Ground Rules

- **Chatham House Rules:**
 - Participants are free to use the information received, but neither the identity nor the affiliation of the participants may be revealed
 - We may follow up with an anonymous survey for topics that you do not feel comfortable speaking about in front of competitors, or where we want views from a broader range of insurers
- Our **focus will be on readiness**
 - Regulatory issues will be passed to ACLI for further consideration, but will not be a core focus of this group
- Discussion should focus on topics that are **most valuable to the industry as a whole**
- The output of this work will be **circulated to participants, reported to the taskforce**, may also be synthesized for **industry consumption**

General rules of antitrust compliance

- No Anticompetitive Agreements or Understandings, express or implied, among competitors
- No Discussion of Prices, Interest Rates, etc. of any products offered for sale
- No Exchange of Pricing Data
- No Exchange of Cost Information – Prices, Products & Services

CONTEXT: LOW INTEREST RATE TASKFORCE

Overview of efforts

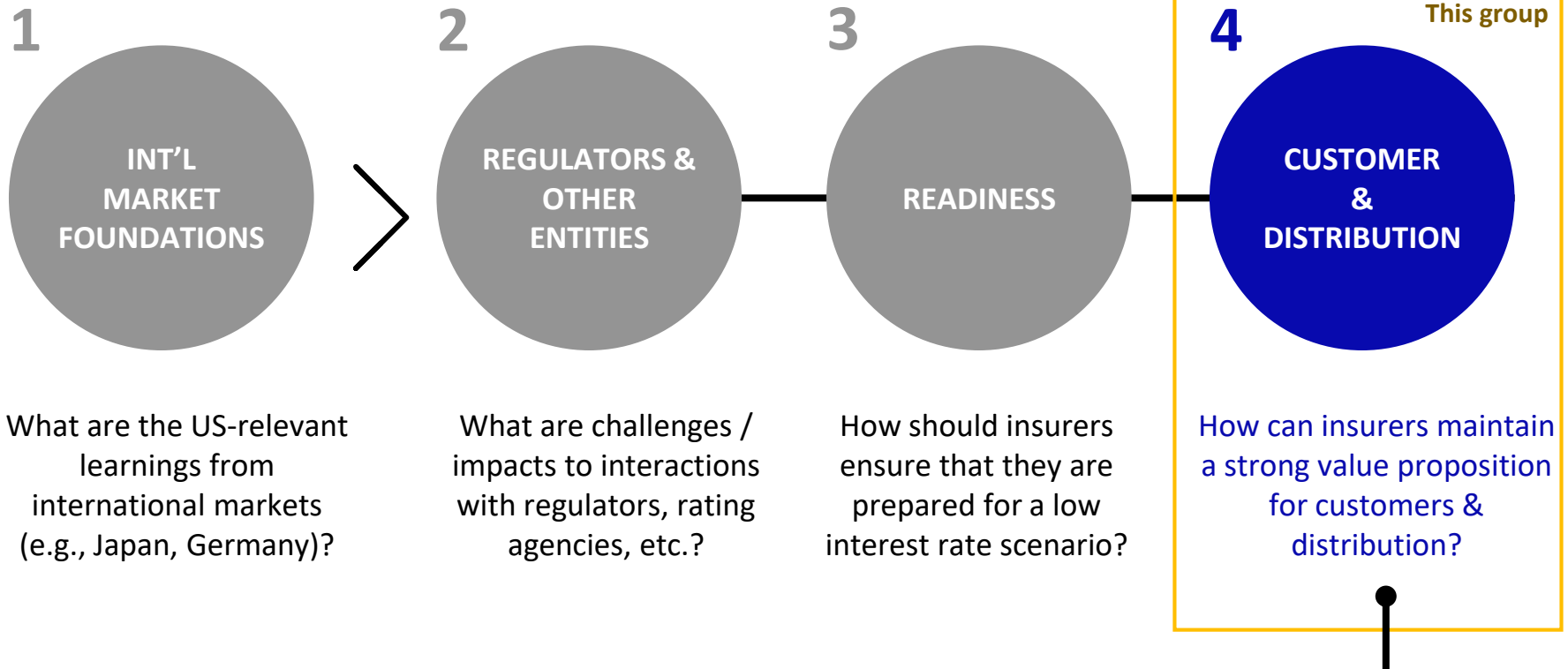
- Convened in February 2020 to help the life insurance industry consider the impacts of lower interest rates with an initial focus on industry readiness
- Efforts accelerated following COVID-19 & resulting market shocks, bringing in new partners and launching a series of sprints
- Accelerated timeline allow us to progress on several efforts:
 - Facilitated discussions on issues and best practices
 - Fielded surveys with robust questionnaire on industry practices & responses
 - Advanced research on low rate experiences in international markets (e.g., Germany and Japan)

Stakeholders



125+ stakeholders from
40+ life insurance companies

SUBCOMMITTEE OBJECTIVES



This subcommittee will:

- **Identify and assess challenges** that low rates pose to insurer value propositions for customers and distribution
- **Envision what a compelling value proposition could look like** in a low rate environment

PLAN FOR THIS SUBCOMMITTEE

Focus of today's discussion

1. ALIGN ON CHALLENGES

What challenges do low rates pose to maintaining a strong value proposition?

- Low rate challenges
 - Insurer profitability
 - Customer value
 - Distribution sustainability

2. ASSESS IMPACT

What impact could future low rate scenarios have on insurer value propositions?

- Scenarios to consider:
 - “Moderate rate rise”
 - “Low for long”
 - “Negative rates”
- Which life insurance products would be most challenged?
 - Term life
 - Permanent life
 - Fixed annuities / FIA
 - Variable annuities
- What products outside insurance would do well in these scenarios?
- Relative impact on insurers, customers, distribution

3. ENVISION SUCCESS

How can insurers achieve a successful value proposition in a low rate environment?

- Customer value e.g., savings / protection needs
- Distribution considerations e.g., advisor compensation, advisor recruitment & retention
- Insurer considerations e.g., profitability, distribution relationships, customer loyalty
- Levers to achieve success e.g., product design, pricing, product mix, customer experience, distribution channels, partnerships

**OCTOBER –
LLG ANNUAL
MEETING**

LOW RATE CHALLENGES – FOCUS AREAS

Impacts

Low interest rates

COVID-19
mortality/morbidity

Credit spreads

Social
distancing/shutdowns

Equity levels

Equity volatility

Credit performance

Implications

Product pricing/generosity

Customer behavior

Insurer profitability

Inforce profitability

Volumes

Insurer capital/solvency

Distribution

Customer value/outcomes

Focus for
subcommittee

DISCUSSION: LOW RATE CHALLENGES

For discussion:

1. Are these the right challenges? Are we missing anything?
2. Which of these challenges are most concerning to you?
3. To what extent are these challenges being faced by the industry today (vs. in future low rate scenarios)?
4. What is the tipping point where insurers stop selling new business?
5. What is impact on reinsurers and other stakeholders (e.g. guarantee associations, regulators)?

Stakeholder	Challenges identified at project kickoff
Insurers	<ul style="list-style-type: none"> • Reduced volumes: risk of declining new business volumes for insurance and savings products as customer value proposition is challenged • Reduced margins: lower portfolio yields, burden of existing guarantees (back-books), and external constraints on new business pricing (e.g., minimum credit rates in tax code) • Solvency risk: concerns over industry-wide solvency that could have knock-on effects to own business model via (i) state guarantee funds or (ii) ability of insurance industry to meet its promises to customers
Customers	<ul style="list-style-type: none"> • Increased cost: low rates drive higher pricing on new policies (or reduce income available), reducing affordability for customers • Reduced options: expectations from some firms that, in most adverse scenarios, industry would largely close off new sales for certain products
Distributors	<ul style="list-style-type: none"> • Declining volumes: declining volume directly reduces advisor compensation • Sustainability of captive agent force: lower advisor compensation threatens recruitment and retention • Relevance to independent distribution: declining customer value proposition of insurance products may lead advisors to emphasize other products (e.g. mutual funds)

NEXT STEPS

- Next steps:
 - We will hold subcommittee meetings every 3 weeks
 - Report back to taskforce every 6 weeks
 - Next session to begin looking at impact assessment

Other resources:

[Visit the low interest rate microsite](#)



The screenshot shows the top of a microsite. At the top, there is a navigation bar with logos for LIMMA, LOMA, Secure Retirement Institute, ACLI (Financial Security, for Life), and IRU, followed by the OLIVER WYMAN logo and a Logout button. Below the navigation bar, the text "Low Interest Rate Task Force" is centered. The main content area has a dark blue background. On the left, the text "COVID-19 Primer" is displayed in white, followed by a paragraph: "COVID-19 continues to spread around the world with new information emerging daily. Designated a global emergency by the World Health Organization, the outbreak has had far-reaching effects, including on the public at large as well as travel, supply chains, and economies globally." Below this text is a link that says "Continue reading...". On the right, there is a graphic with the text "RESPONDING TO COVID-19" in large white letters, and below it, in smaller white text, "Primer, Scenarios, and Implications".

[Visit the OW dedicated COVID-19 website](#)



Oliver Wyman and our parent company Marsh & McLennan (MMC) have been monitoring the latest events and are putting forth our perspectives to support you clients and the industries you serve around the world. The Coronavirus Hub will be updated daily as the situation evolves.

APPENDIX

INTERNATIONAL FINDINGS RECAP: IMPACTS TO PROFITABILITY AND SOLVENCY

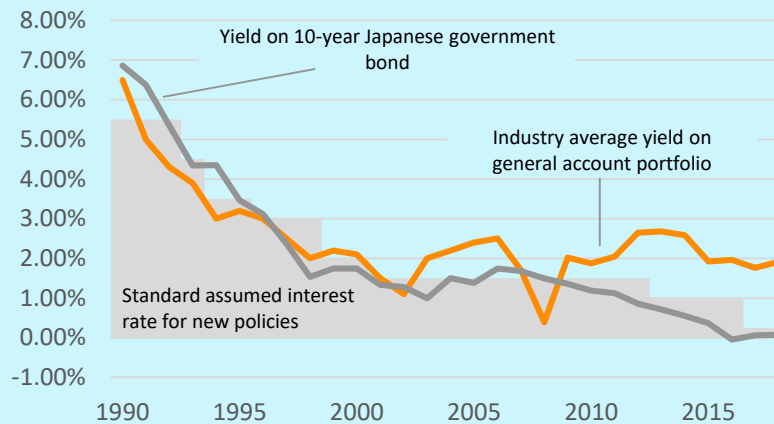
Lower rates have put pressure on profit margins due to high-guarantees on older blocks and meaningful ALM mismatches for both Japanese and German insurers

Key themes

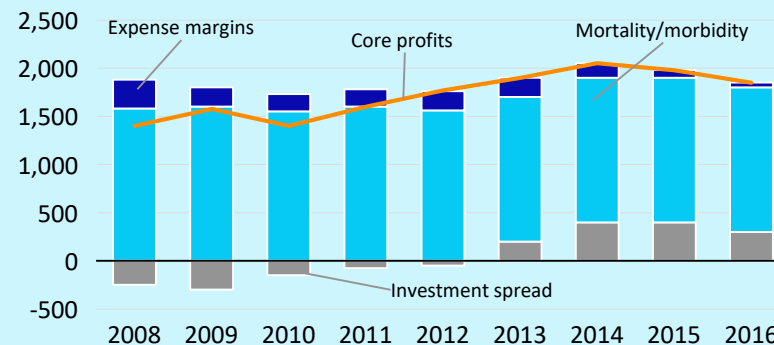
- Long liabilities have made **duration matching difficult**, leaving insurers with **reinvestment risk** (especially in Germany, where assets and liability gaps can be 10+ years)
- Declining interest rates and ALM issues have reduced the average portfolio yield for insurers
- Lower average portfolio yields along with honoring **high back book guarantees** has put **pressure on investment margins**
- In some cases, margins pressures have caused **solvency issues requiring regulatory intervention**

Case Study: Japan

YIELD / GUARANTEE RATE (%)



PROFIT CONTRIBUTIONS (¥ Billions)



- In the 1980s - 90s, when interest rates were high, Japanese life insurers offered high **guaranteed rates**, some of which were **as high as 5-6%**
- As interest rates have declined, life insurers have faced **negative spreads**, where investment yields are lower than average guaranteed rate on many in-force policies
- As a result, 7 insurers went insolvent in the early 2000s, prompting regulators to establish a **new set of regulatory guidelines** and relief measures for insurers with solvency risk
- **Negative spread issues** were pervasive in the industry **until 2013**, when improved ALM began to improve results
- Insurers **relied on mortality profits** to contributed significantly to accumulating retained earnings in the face of negative spread issues
- Mortality margins still account for the majority of core profit at rated Japanese life insurers

Source: Source: Disclosures from Dai-ichi, Fukuoku, Fukuokushinrai, Meiji Yasuda, Mitsui, Nippon and Sumitomo, Moodys, Toa Reinsurance 2018 market report. LIAJ, Federal Reserve Bank of Saint Louis, GenRe

INTERNATIONAL FINDINGS RECAP: IMPACT TO NEW BUSINESS SALES

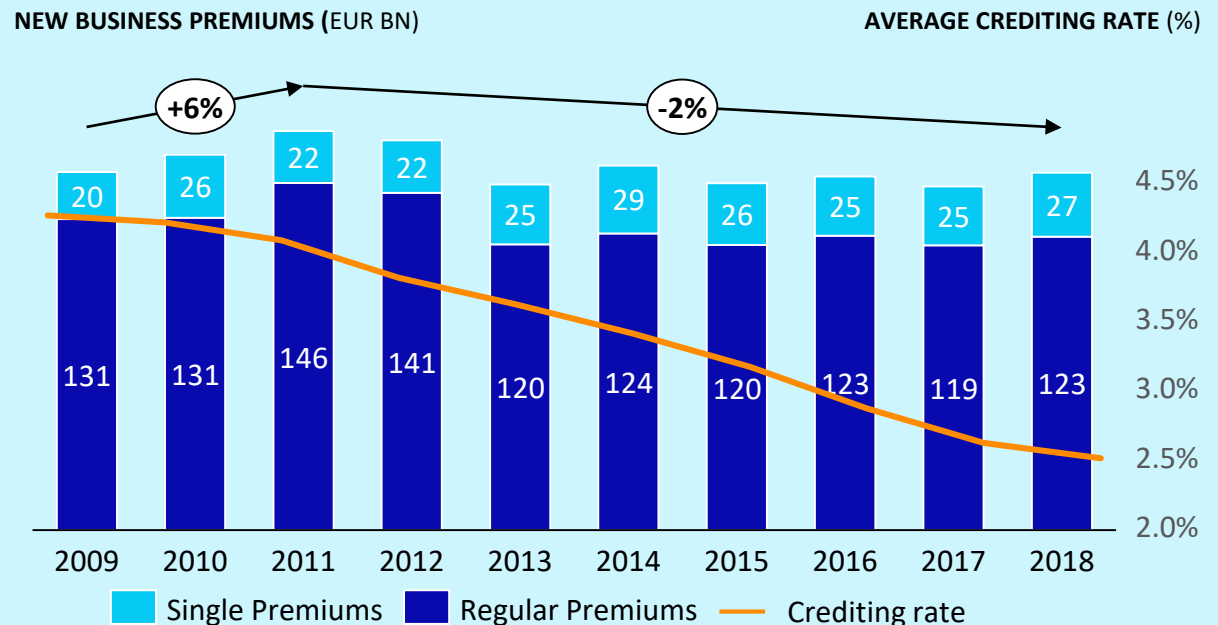
In both Japan and Germany, new sales suffered as lower interest rates eroded the savings-oriented customer value proposition

Key themes

- Lower interest rates, and in turn lower investment return guarantees to policy holders has **eroded the customer value proposition** of life insurance as a savings vehicle
- Insurers have **tried to leverage distribution channels** to emphasize benefits of savings products, **but customers have been turned off by the lack of downside protection** that life insurance is traditionally characterized by high guarantees
- These challenges have **forced insurers to innovate and diversify their product offerings** (e.g. health products in Japan, hybrids in Germany), with varying degrees of success
- Protection, health and disability sales have been largely **unaffected**, and in some cases, increased (e.g. third sector products in Japan)

Case Study: Germany

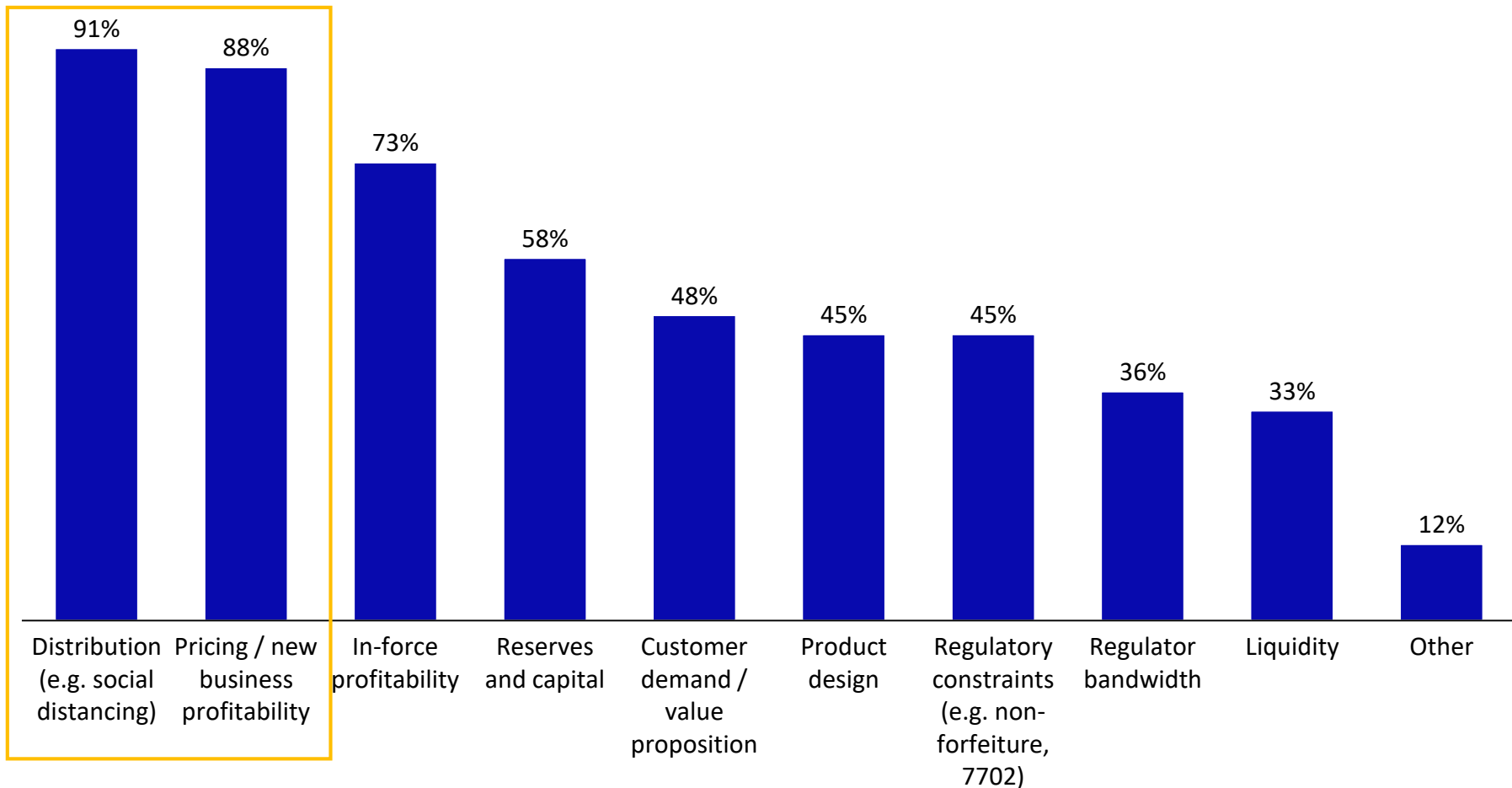
- Low interest rates have caused life insurers to **lower guarantees on new business** and have **driven down average crediting rates**
- Lower guarantees and crediting rates have made **traditional guarantee products less attractive**, causing Germany insurers to **rethink their product strategy and customer value proposition**
- In the face of these challenges, **German insurers have demonstrated resilience**, as new business sales have remained fairly steady over the last decade despite these challenges



1. Savings products include: fixed annuities, unit-linked annuities, hybrid annuities, basic endowment, unit-linked endowment; Protection products include: term and disability insurance
Source: GDV Statistical Yearbook 2013

NEW BUSINESS SURVEY RECAP: NEARLY ALL INSURERS CONCERNED ABOUT DISTRIBUTION & PROFITABILITY

Question 1: Please indicate **which of the following factors is a concern** to your organization regarding new business in light of COVID-19 and recent market conditions? (please select all that apply) (n = 33)



NEW BUSINESS SURVEY RECAP: NEW BUSINESS PROFITABILITY AND DISTRIBUTION WERE THE TOP CONCERNS FOR MANY INSURERS

Question 2: Please rank the following factors according to your organization’s level of concern regarding new business in light of COVID-19 and recent market conditions. (n = 33)

Key takeaways

Around 90% of insurers cited distribution challenges and new business profitability as concerns in light of recent events, and nearly 2/3rds of respondents listed one of these as their top concern

Insurers are also concerned about the profitability of their in-force book, as well as pressure on their balance sheet (~20% listed reserves and capital as a top concern); liquidity was not a top concern

Nearly half of respondents listed customer value proposition and product design as concerns, but these concerns generally ranked behind more near term issues

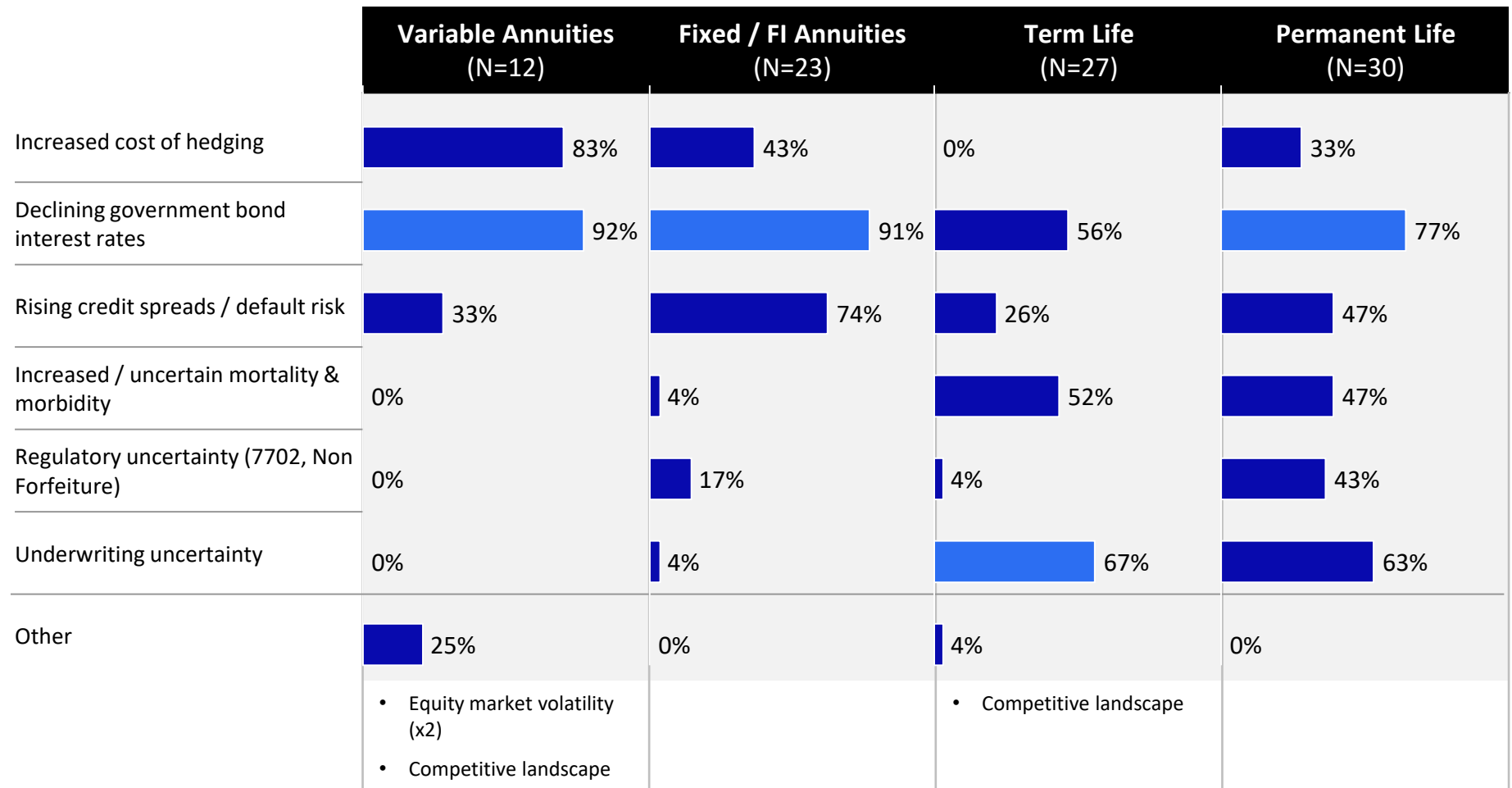
Concerns	% concerned
Distribution (e.g., social distancing)	91%
Pricing / new business profitability	88%
In-force profitability	73%
Reserves and capital	58%
Customer demand / value proposition	48%
Product design	45%
Regulatory constraints (e.g. non-forfeiture, 7702)	45%
Regulator bandwidth	36%
Liquidity	33%

Count of rankings by category

	1 st	2 nd	3 rd	4 th +
Distribution (e.g., social distancing)	10	8	3	9
Pricing / new business profitability	11	6	4	8
In-force profitability	3	7	6	8
Reserves and capital	6	2	1	10
Customer demand / value proposition	1	1	7	7
Product design	0	0	5	10
Regulatory constraints (e.g. non-forfeiture, 7702)	2	2	1	10
Regulator bandwidth	0	1	2	9
Liquidity	0	2	1	8

NEW BUSINESS SURVEY RECAP: DECLINING INTEREST RATES IS THE MOST COMMONLY CITED ISSUE THAT HAS CHALLENGED PRICING ACROSS PRODUCT TYPES

Question 6: Please indicate which of the following factors have challenged your organization's pricing in the current environment.



Note: light blue represents most cited concern for each product

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