WILL HISTORY REPEAT ITSELF?

A Past and Present View of How the Economy and Annuities Intersect

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The unfathomable events of the first quarter of 2020 have disrupted every corner of both personal and professional life for people worldwide. From cancelled travel and virtual schooling to legitimate concern about individual health and business resilience, the coronavirus pandemic is a force that seems to alter reality daily. It also must be considered in the context of its power to upend already fragile economies around the globe.

In the United States specifically, 2020 began with a prolonged low-interest-rate environment that continued its widespread impact on the economy. While there already was talk of the Federal Reserve reducing interest rates again, the coronavirus scare vastly accelerated the response, with two emergency interest-rate cuts by mid-March. *The Wall Street Journal* reported that, "The Federal Reserve cut its benchmark interest rate to near zero and unleashed an aggressive set of moves aimed at stabilizing markets as the new coronavirus pushed the U.S. economy toward a recession."[1] A Bloomberg article adds that the pandemic "has wreaked havoc across financial markets and threatens to tip the U.S. into recession too — if it hasn't done so already."[2]

The R Word

And just like that, the dreaded term "recession" comes to the forefront again, bringing with it fresh waves of anxiety and flashbacks to 2008–2009. Taking a step back for a moment, however, it is helpful to begin with a clear, shared definition…

> ***Financial Definition of Recession:***
> *A recession is two consecutive quarters of declining gross domestic product (GDP)*

Since 1947, there have been 10 recessionary periods, and not all were equal. Some were mild while others such as the most recent Great Recession were significant. And when considering financial markets, we can see that the impact to interest rates and equity markets varies (Figure 1).

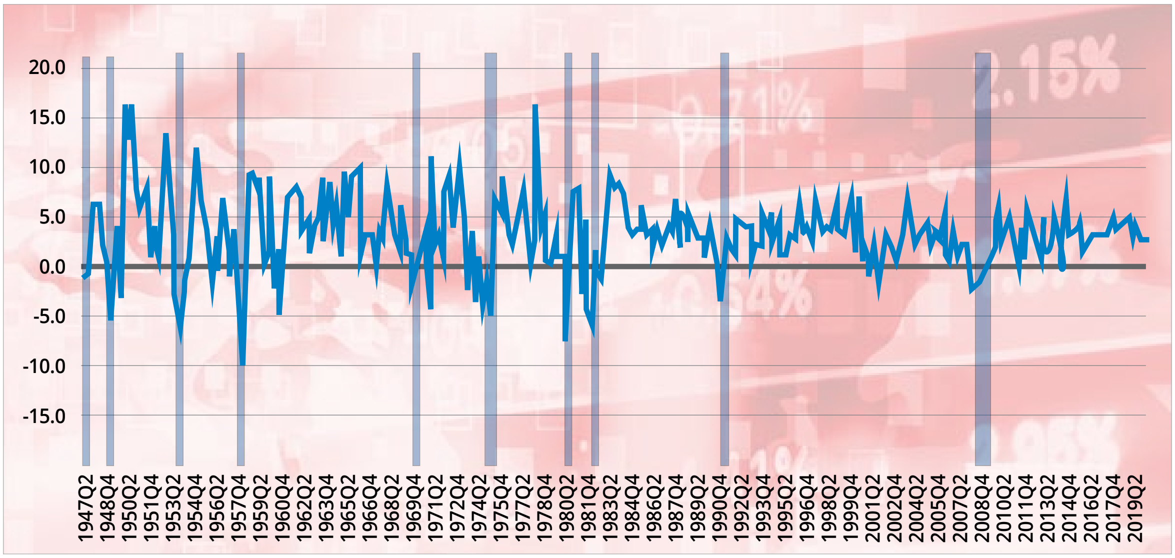
Prior to the financial strain caused by a world pandemic, U.S. equity markets were on the longest bull run in history. There were signs of an impending recession — such as the inversion of the yield curve in 2019 — and many were not questioning whether it would happen, but when.

With regard to the annuity landscape, a recession climate undoubtedly has a widespread impact on Americans, often varying by segment:

- *GDP drops:* Since 1947, during a recession, average GDP drops to negative 3.6 percent.
- *Unemployment increases:* In 2009, there was a 102 percent increase in Americans who lost their jobs when compared to 2007. The unemployment rate rose from 4.6 percent in 2007 to 9.3 percent in 2009.
- *Consumer spending declines:* During the last financial crisis, total consumer spending dropped by 2 percent from 2007 to 2009, and took three years to rebound. During a recession, Americans are continuing to outlay the same for essential needs and services. Essential needs and services don't change regardless of a recession, but overall discretionary spending declined over 5 percent from 2007 compared to 2009. **Insurance spending, which some can argue is essential or discretionary based on the insurance type, declined by almost 12 percent in this same period.**

Figure 1

GDP Levels Since 1947*



*Shaded areas indicate U.S. recessions

Source: U.S. Bureau of Economic Analysis

Figure 2

10-Year Treasury Constant Maturity Rate*

*Shaded areas indicate U.S. recessions

Source: U.S. Bureau of Economic Analysis

- *Investable asset levels decline:* Americans' investable assets dropped by 5 percent during the last recession.[3] In 2007, the average level for financial assets dropped from $259K to $248K in 2010. **The largest hit demographics were those just entering or in retirement (ages 65 to 67) with asset levels dropping by 14 percent (from $501K to $430K).**
- *Investor confidence fades:* According to the Yale School of Management, in 2007, just prior to the financial crisis, individual market confidence average index level was 80.6.[4] These values declined during 2008 to 73.1 and 76.0 in 2009. Since the financial crisis of 2008–2009, individual confidence has not recovered. From 2002 to 2007, the average individual confidence level was 85.9. From 2010 to 2019, the average level dropped drastically to 71.1. **Even though equity markets have reached record highs in the past decade, U.S. investors have never fully regained confidence in the stock market since the financial crisis of 2008–2009.**

The news in general — as well as specifically from ratings agencies — also contributes to a lack of confidence. For example, AM Best recently revised its market segment outlook for the U.S. life and annuity sectors from stable to negative, "due to the significant volatility and uncertainty in the financial markets created by the COVID-19 virus."[5]

It may also raise alarms when consumers hear of annuity companies lowering their rates or suspending the sale of products.

Historical Impact

During the Great Recession, equity markets dropped over 50 percent and interest rates declined by 1.37 percentage points,[6] inciting fear in many Americans, particularly those near or in retirement.

Fear is powerful and impacts everyone differently… and when it comes to investments and money, rational individuals can quickly turn irrational. I experienced this first hand, working in a large bank during the financial crisis in 2008–2009. As equities fell quickly, some people were rational and took defensive positions, some panicked and sold of all of their investments, while others emptied their accounts and hid their money under their mattresses. Trust in financial services declined as well; and, as you might expect, individual annuities sales declined, too (Figure 3).

Overall individual annuity sales peaked in 2008 before declining 10 percent in 2009 due to the impact of the Great Recession. Some product lines saw an increase in sales, while others were negatively impacted. For the most part, investors used individual annuities during this period as a shield against investment loss. Sales of fixed-rate deferred annuities spiked from $35 billion in 2007 to $68 billion for *both* 2008 and 2009.

Guaranteed income sales during this period declined, and a majority of the sales of products with guaranteed income features were variable annuities with a guaranteed living benefit, followed by single premium immediate annuities. Election rates of optional living benefits dropped as investors were more concerned with preservation than guaranteed income.

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What Might Be Next?

With this backdrop, we can begin to anticipate and address what the impact of the current environment might look like — as well as how carriers can view, and perhaps stabilize, their position.

Figure 3

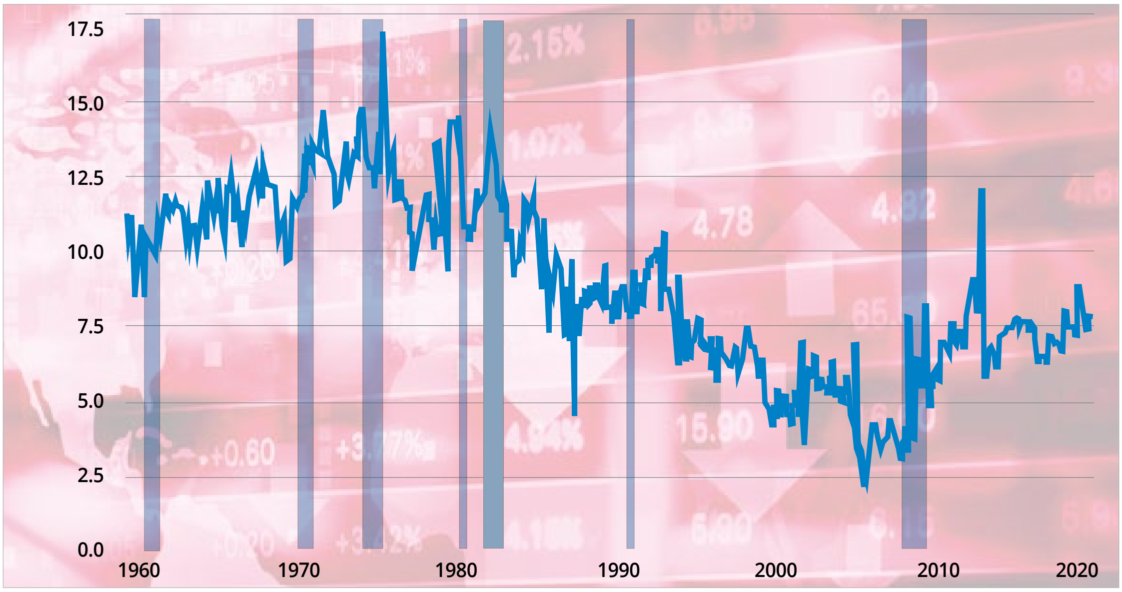
Dow Jones Industry Average From 1985 – 2019*

*Shaded areas indicate U.S. recessions

Source: S&P Dow Jones Indices LLC

Figure 4

Personal Savings Rates From 1960–2020*



*Shaded areas indicate U.S. recessions

Source: U.S. Bureau of Economic Analysis

If the current events do pull the U.S. economy into a recession, there will be material differences from what we experienced in 2009. During the Great Recession interest rates declined, but outside a short slip of the 10-year Treasury, rates for the most part remained above 3 percent, creating an environment where fixed annuities could provide a safety net with attractive rates.

This won't be the case in the current environment, as interest rates were already well south of these levels, and the current economic strain has brought interest rates to levels insurance companies likely never imagined were possible. This environment will dampen the flight to safety in fixed annuities, as it is probable that advisors will use shorter duration products to ride out the storm. Given that, it is still likely we will see an uptick in fixed rate deferred annuities as fear of loss will outweigh investment return.

Similar to the Great Recession, it is expected that equity-based products, such as variable annuities will struggle — and likely significantly — as investor fear takes over, steering them away from products with loss potential.

One aspect that might help Americans during the next recession is their level of personal savings. Before the Great Recession, personal savings rates were declining and hit the lowest level ever seen (Figure 4). Fast forward to 2019 and the average personal savings rate has increased by nearly four times that of the low point. Individuals now appear to be more cautious; saving more money to ensure they have enough capital to last them through the next economic downturn.

Another factor to consider is the magnitude of the disruption COVID-19 has brought to not only the U.S. but also to the entire globe. With average annuity buyers being in their 60s, their concerns about the global pandemic combined with businesses going completely remote will likely cause a significant disruption, creating short-term chaos for the financial services industry.

As of late March 2020, there was limited indication of how long the economic strain due to the global pandemic could last, and many are questioning what the new normal will be once we get past this historic event. Will financial decision-making processes change? Will retirees' priorities and activities change? Will the way we plan for the future change? While we don't know the answers yet, there is no doubt the economic impact will be a short-term pain point for the individual annuity market, with **individual annuity sales in both the U.S. & Canada having the potential to drop by 25 percent or more** over the next few quarters.

An Opportunity

Amid all of the chaos, it is critical to remember that challenging circumstances often present a unique chance for our industry to demonstrate stability and value. Americans are better positioned, as savings rates are significantly higher than they were prior to the Great Recession. Those carriers that have prepared and aligned for possible market realities will be in a position of strength. Advisors that have done the ongoing work to build deep, long-term relationships with their clients will be much more likely to have their loyalty and trust as they weather the current storm. Companies are more diversified in their annuity offerings, are able to react more quickly, and have learned lessons from the Great Recession putting companies in a better spot to rebound.

Our opportunity as an industry is to position insurance needs — whether the benefits of individual annuities or other insurance types — as indispensable. Consider that nearly $1 trillion is invested in products that are protecting Americans from loss today. Consider that over $30 billion is paid annually in guaranteed lifetime income payments from annuities. Consider how this is helping provide stability and peace of mind to the owners of these annuities in an unstable time. As has been proven again and again across markets, difficult times are an opportunity for companies to show what they are made of — to stand out and stand up for those they serve.

[1] Timiraos, Nick, Harriet Torry, and Josh Mitchell, "Fed Takes Emergency Steps as Virus Pushes Economy Toward Recession," *The Wall Street Journal,* March 15, 2020.

[2] Boesler, Matthew, "The Fed's Future Is Already Here as U.S. Joins Zero-Rate World," Bloomberg, March 16, 2020.

[3] University of California, Berkeley.

[4] Yale School of Management International Center for Finance; United States Stock Market Confidence Indices — Individual.

[5] "Best's Market Segment Report: AM Best Revises U.S. Life/Annuity Market Outlook to Negative," www.businesswire.com press release, March 16, 2020.

[6] macrotrends, 10 Year Treasury Rate - 54 Year Historical Chart, https://www.macrotrends.net/2016/10-year-treasury-bond-rate-yield-chart.

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