

Equity-Based Insurance Guarantees Conference

Nov. 6-7, 2017

Baltimore, MD

Market Trends

Matthew Coleman

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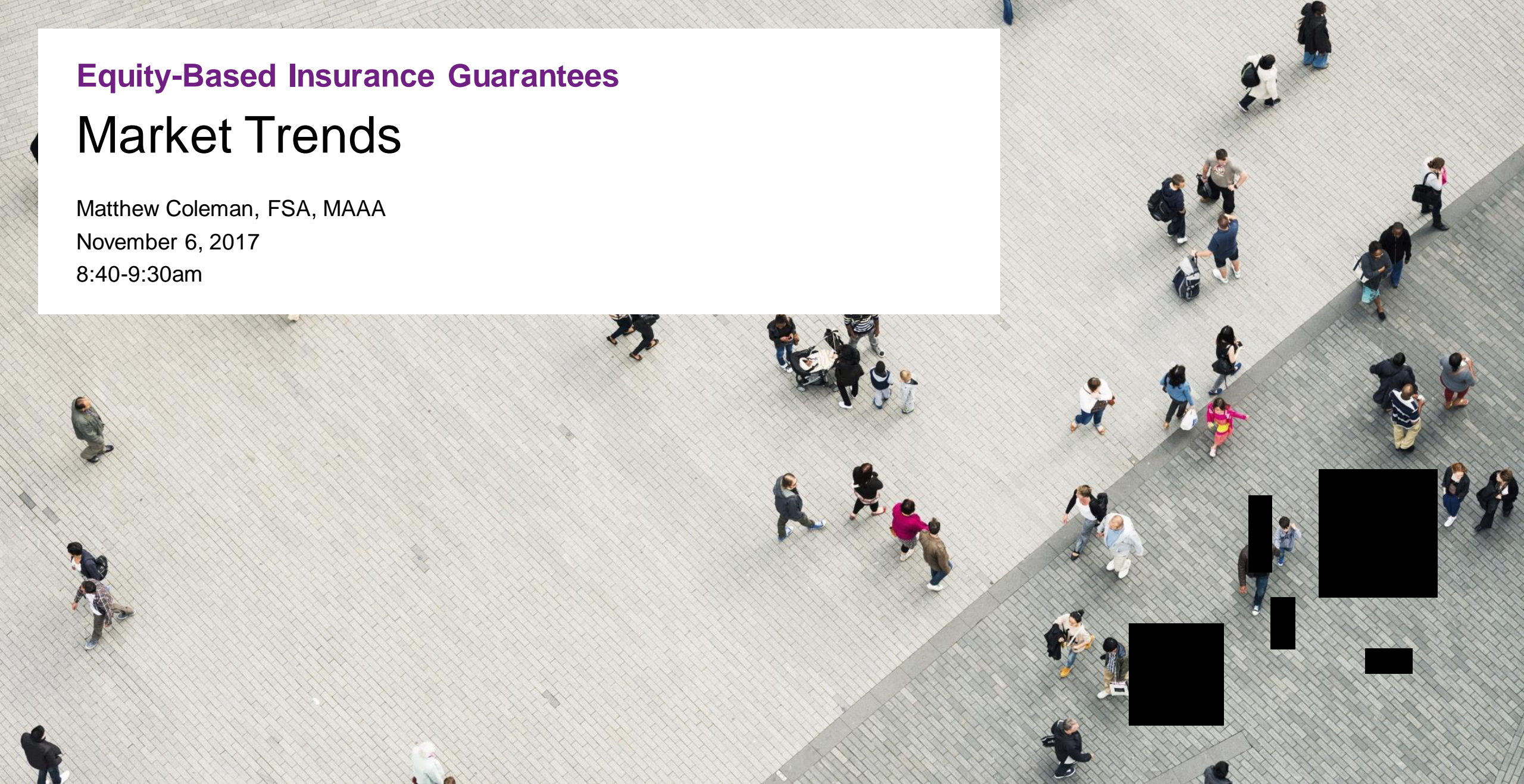
Equity-Based Insurance Guarantees

Market Trends

Matthew Coleman, FSA, MAAA

November 6, 2017

8:40-9:30am



Trend Drivers:

- 1. Regulation**
- 2. Technology**
- 3. Bond & Equity Markets**
- 4. Product Trends**

Sales Regulation

The Department of Labor’s Conflict of Interest “Fiduciary” Rule

Fiduciary

fi·du·cia·ry | fə-'dū-shə-rē

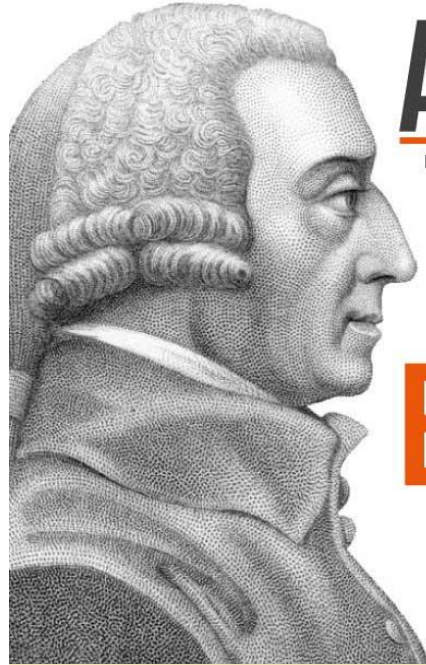
noun (pl) -aries

- one who obligates himself or herself to act on behalf of another (as in managing money or property) and assumes a duty to act in good faith and with care, candor, and loyalty in fulfilling the obligation.

adjective

- of, relating to, or involving a confidence or trust in a guardian acting in his fiduciary capacity.

From Merriam-Webster.com



ADAM SMITH THE FATHER OF MODERN ECONOMICS



- Influential writings explore the mechanics of morality, markets, and capitalism in an industrialized society.
- His work Wealth of Nations (1776) lays the foundations of modern capitalism.
- Invisible Hand theory: The automatic market force whereby the individual self interests of the participants of a free market drive the supply and demand of goods and services to reach equilibrium.

The World According to Adam Smith

- “It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest.” – Adam Smith
- Self-interest drives supply, demand and competition.
- Competition in the marketplace affects supply, demand and ultimately sets prices at efficient levels.
- Much of the financial services industry, especially insurance, has been operating under these free market concepts.

So which is it?

Annuity Regulation for Example

Current Annuity Regulation categories

- Product requirements (Nonforfeiture)
- Disclosure requirements (Prospectus, Securities Act of 1933)
- Seller requirements (Licensure, FINRA, RIA)

Implications

- Current rules govern the disclosure, the seller and the product, but not their interests.
- Imply that the buyer and seller are acting in their own interests.

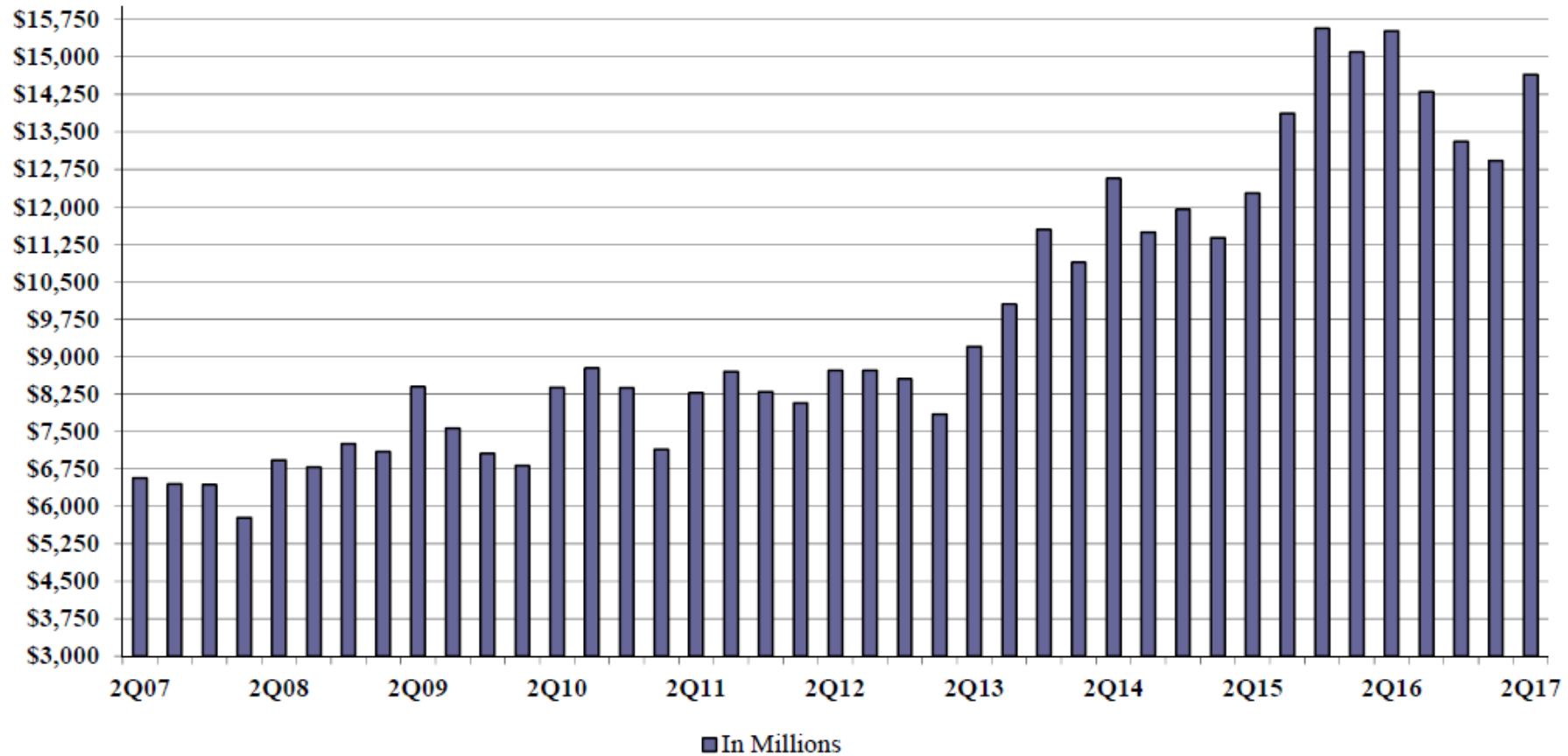
Recent Suitability Regulations

- Suitability requirements – modern fiduciary-lite regulation that requires the seller to consider the interest of the buyer, generally.

But Do Self Interest Driven Markets Work?

Hard to say, but...

Indexed Annuity Sales By Quarter

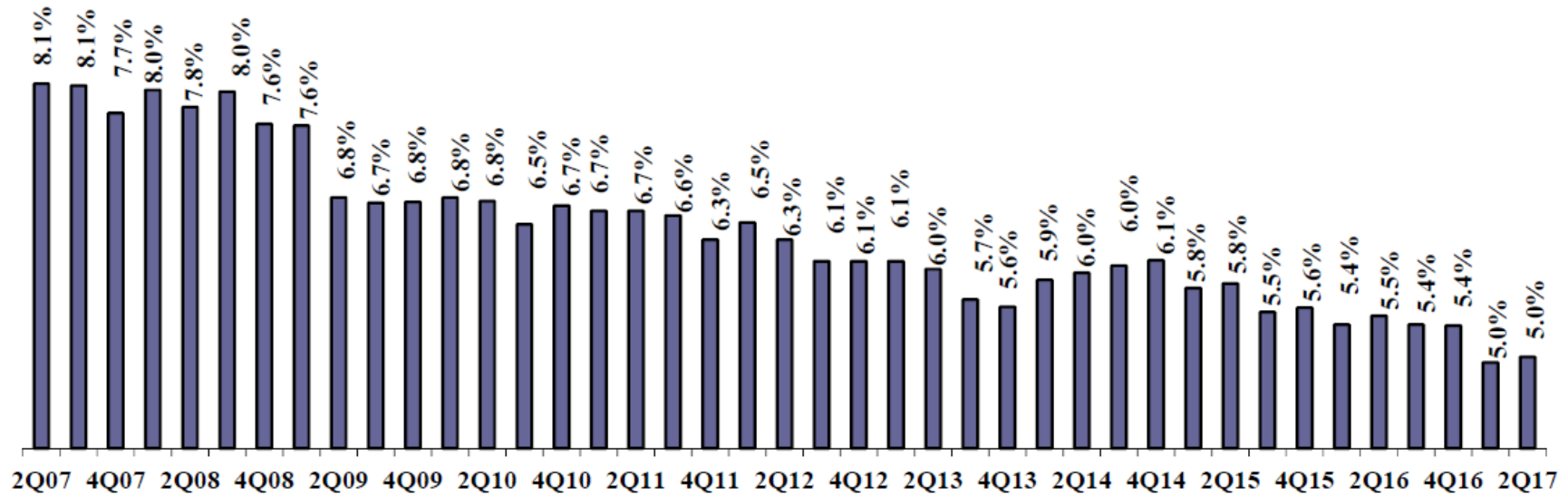


Source: Wink Sales and Market Report

But Do Self Interest Driven Markets Work?

Hard to say, but...

Indexed Annuity Average Agent Commission



Source: Wink Sales and Market Report

A Fundamental Change

- The Conflict of Interest Rule fundamentally reorients the financial & insurance industries from capitalistic, market-oriented model to a regulation/litigation oriented model.
- The capitalistic, market-oriented model recognizes and assumes conflicts of interest are inherent in every interaction.
 - Conflicts of interest are addressed via disclosure and competition.
 - The buyer is primarily the arbiter of their own interest.
- A regulation/litigation-oriented model identifies conflicts of interest as problematic.

How the DOL Rule Works

- All transactions involving qualified money (especially Fixed, Indexed and Variable Annuities and mutual funds) where commissions are paid, become Prohibited Transactions under the rule.
- Prohibited Transactions are subject to IRS tax of 100% of any amount received.
- Certain defined Prohibited Transaction Exemptions (PTE's) allow for commission to be received including PTE 84-24 and the new BICE PTE.
- PTE's under the new rule require either contractual or declarative statements whereby the advisor (or agent) acknowledges fiduciary duty to impartial conduct standards.
- These fiduciary standards are principles based and no safe harbor is provided under the rule.
- The Department of Labor has no enforcement arm. This rule employs increased legal jeopardy as a means of enforcement.

Impartial Conduct Standards

- Effective 6/9/2017 for all qualified transactions.
- Provide investment advice that is in the “Best Interest” of the retirement investor.
 - Act with care, skill, prudence and diligence.
 - Act without regard to financial interest of advisor or financial institution.
 - Receive no more than “reasonable compensation.”
 - Make no material misleading statements.
- Some believe that the updated requirements for 84-24 which require commission disclosure still apply.
- Violations of the fiduciary obligations may lead to:
 - Civil action by the DOL
 - Civil action by the investor
 - Excise taxes by the IRS
- Both the DOL and the IRS have stated that during the period prior to 1/1/2018, they will focus on compliance assistance with those who are working diligently and in good faith to comply.

Executive Action

2010: Original Conflict of Interest Rule proposed

2011: DOL rescinds rule under significant bipartisan and industry pressure

2016 (April): Strengthened Final rule promulgated

01/20/2017: Perez resigns & long-time DOL employee, Ed Hugler becomes acting Labor Secretary

02/03/2017: President Trump issues Executive Memorandum to Labor Department requesting:

- Review of impact on retiree access to retirement products
- Review of impact on increased litigation and associated costs on retirees
- Review of impact on effect on small business (advisory business)

02/16/2017: President Trump nominates Alexander Acosta as Labor Secretary

03/01/2017: Hugler proposes 60 day delay to complete Presidential Memo requirements

03/03/2017: Acosta declares he will follow the president's guidance in examining the rule

04/07/2017: 60 day delay is final

04/10/2017: Original Effective Date of Rule

04/26/2017: Secretary of Labor Acosta confirmed

06/09/2017: Delayed effective date for Fiduciary Conduct Standards

07/01/2017: Nevada shifts from a Suitability Standard to a Fiduciary Standard

08/29/2017: OMB approves delay to 07/01/2019

11/02/2017: DOL files final 18 month delay rule documents

11/??/2017: 18 month delay is published in the Federal Register and become effective

Legal Action

4 Lawsuits have been levied against the DOL. The courts have found, in 3 of the 4 cases, that the DOL is within its authority to issue (and perhaps also to rescind) the fiduciary rule.

1. NAFA vs DOL, Washington DC District Court, 11/4/2016

- Challenged the rule on numerous grounds.
- Contended the rule would be catastrophic for FIA's.
- Judge found DOL has authority to issue rule. (Nov 2016)

2. Market Synergy vs DOL, Kansas Federal Court, 11/28/2016

- Challenged the DOL's inclusion of FIA's into the BICE requirements.
- Judge found that plaintiffs did not prove that DOL failed to follow procedures. (Late 2016)

3. US Chamber of Commerce vs DOL, Texas District Court

- Challenged the rule on numerous grounds.
- Contended that one-time transactions should not be burdened with heavy regulation.
- Judge found DOL has authority to issue rule. (Feb 2017)
- Appealed to the 5th Circuit. (July 2017)
- May be first victory for rule opponents.
- Decision expected later this fall.

4. Thrivent vs. DOL, Minnesota District Court

- Challenged the rule regarding fraternal's ability to require arbitration.
- DOJ wrote to Judge: "class action provision will likely be mooted in the near future." (Aug 2017)

Legislative Action

Financial Choice Act of 2017

- A revision of similar bill tabled in 2016
- Weakens elements of Dodd-Frank
- Repeals the DOL Rule
- Passed the US House of Representatives (June 2017)
- Faces possible filibuster in the Senate

Protecting Advice for Small Savers (PASS) Act of 2017

- Passed the US House Financial Services Committee (Oct, 2017)
- Establishes a best-interest standard for broker-dealers
- Repeals DOL Fiduciary Rule

Regulation

Capital, Reserving and Reporting

Other Regulatory Market Drivers

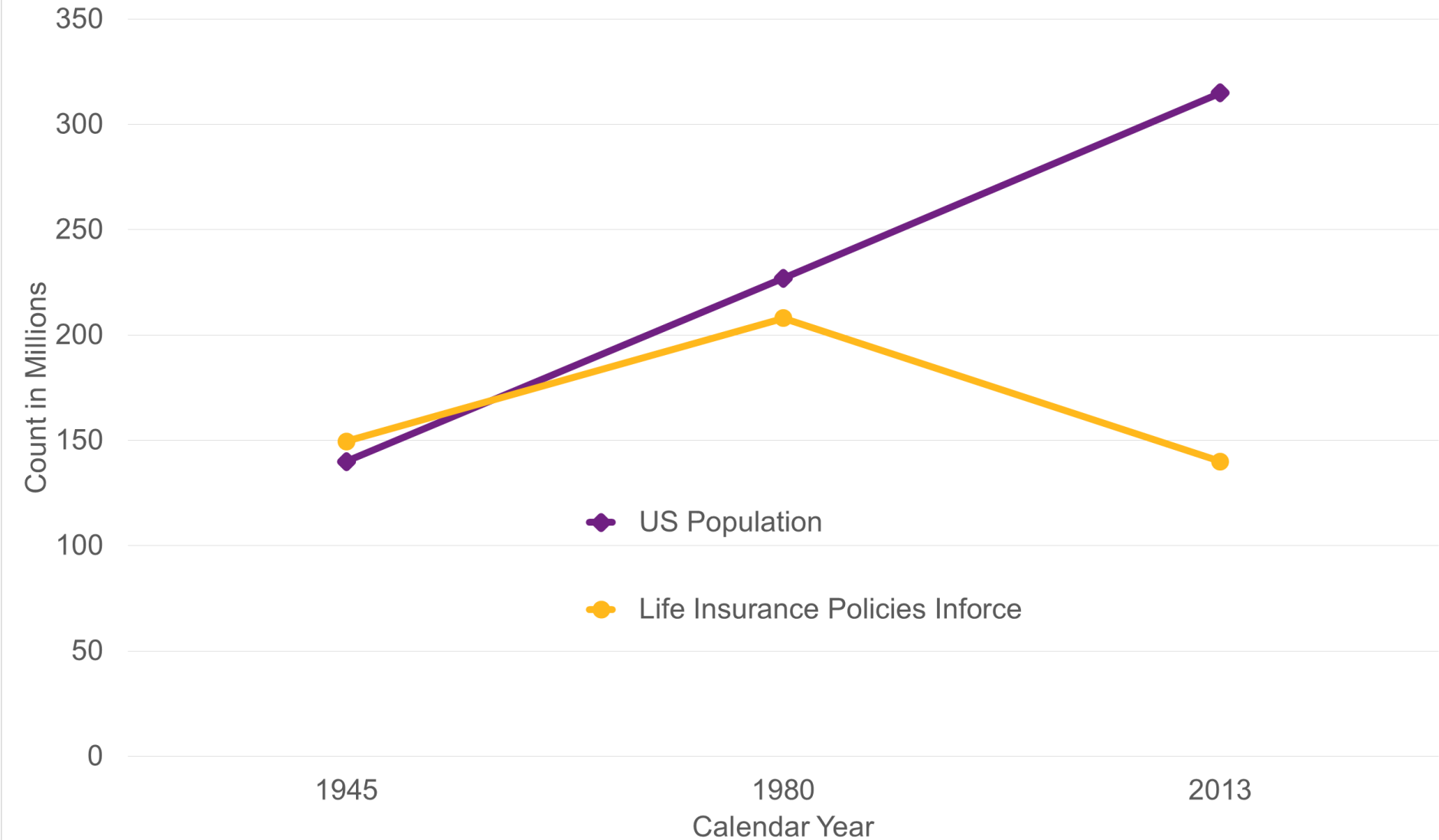
- Principles Based Reserving (VM-20)
 - For Life Insurance
 - Required in 2020
 - Some companies are transitioning now (in 2017)
- International Financial Reporting Standards (IFRS-17)
 - Applies to companies operating or with ownership outside the US, China and Northern Africa
 - Affects Reinsurers
 - Effective 1-1-2021
 - Replaces IFRS-4
 - Effects: Profit patterns/Earnings volatility, Disclosure
- VM-22:
 - Effective 1/1/2018:
 - Lower Valuation Rates for Payout Annuities (approx. 50bps lower)
 - Higher Cost for Guaranteed Payout Structures (SPIA, GLWB, GMIB, DIA, etc)
 - Other principles based guidance is being developed for deferred, non-variable annuities

Other Regulatory Market Drivers

- Annuity Reserving Working Group
 - Evaluating a PBR method for Non-Variable Annuities
 - Consistent with AG 43/VM21
 - Exclusion Test and Floor Reserve Approaches under consideration
- SVL Interest Rate Modernization Work Group
 - Updating Statutory Reserve Rates Similar to VM-22 for Deferred Annuities
 - Likely leading to lower reserve rates and higher reserves
- NAIC LATF/RBC Longevity Risk Subgroup
 - Recommendations on how to recognize longevity risk in RBC or statutory reserves
- Quantitative Impact Studies I & II
 - Refinements and Harmonization of AG43 and C3P2

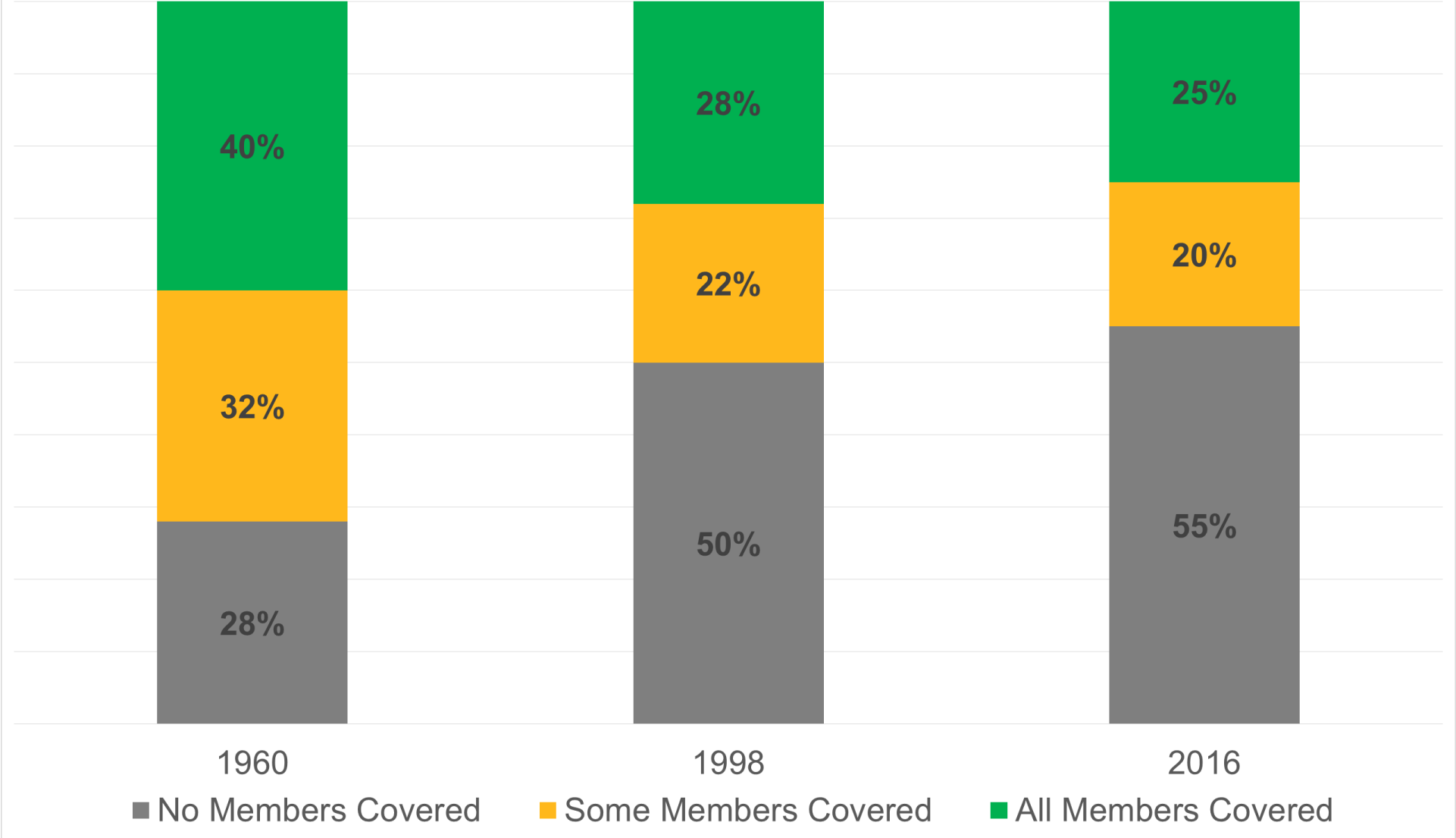
Technology

Life Insurance Coverage Gap in the US 1945-2013



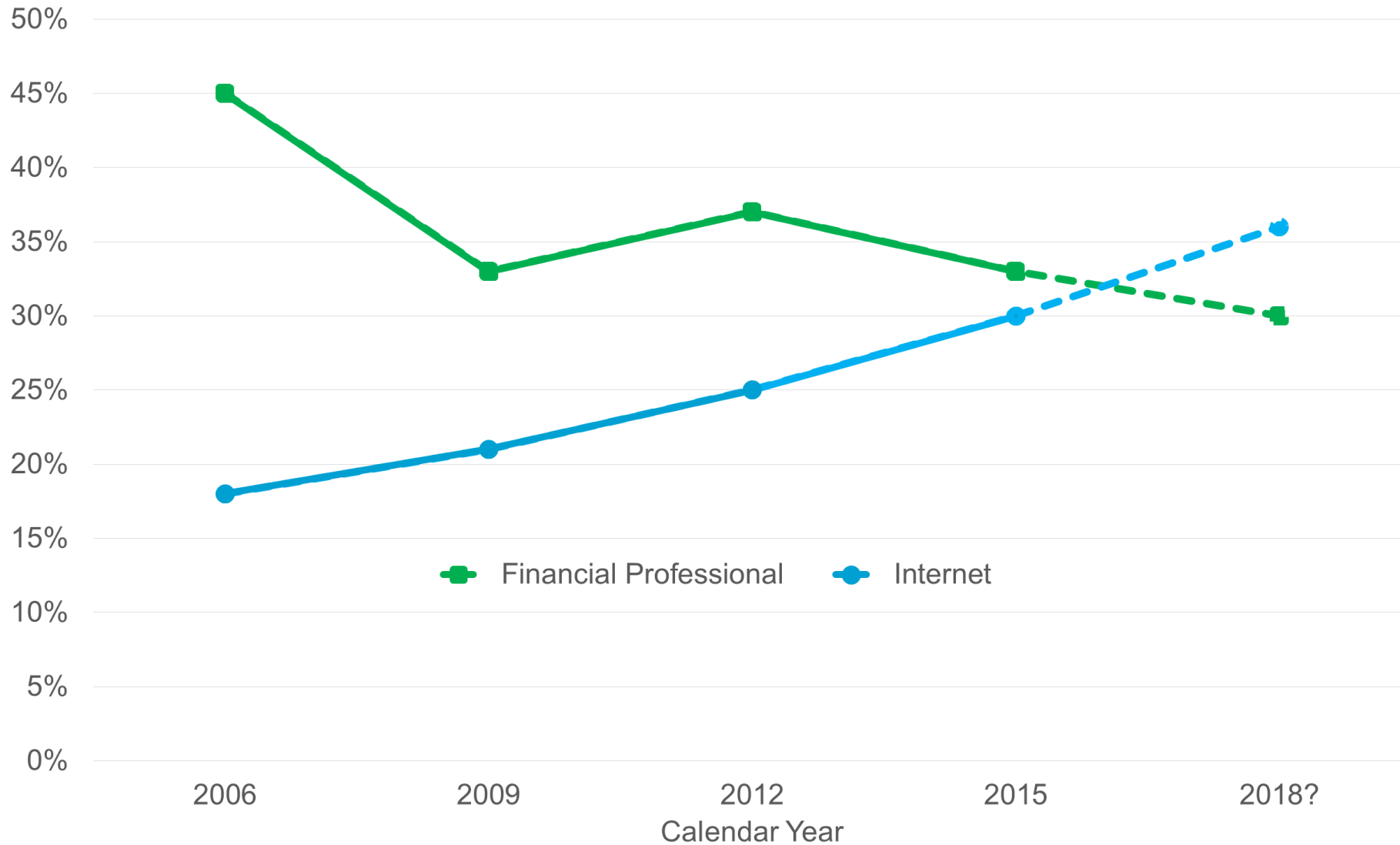
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Household Individual Life Insurance Coverage 1960-2016



Limra

Most Valuable Source of Information 2006-2018



Limra

InsureTech

- Direct to Consumer (Internet) Marketing
 - Is insurance bought or sold?
 - InsureTech is challenging assumptions
 - New products for new distribution models
 - Effects of InsureTech on Behavioral assumptions

InsureTech

- Mobile Sales Enablement for Agent-Based Distribution
 - Mobile Applications and straight-through processes
 - Regulatory compliance enhancement
 - Reduced NIGO and associated cost
 - Aging Agent population has uneven acceptance rates
- Mobile Experience for Policyholders
 - Enhanced customer control and engagement
 - Effect on utilization and antiselective behavior

InsureTech

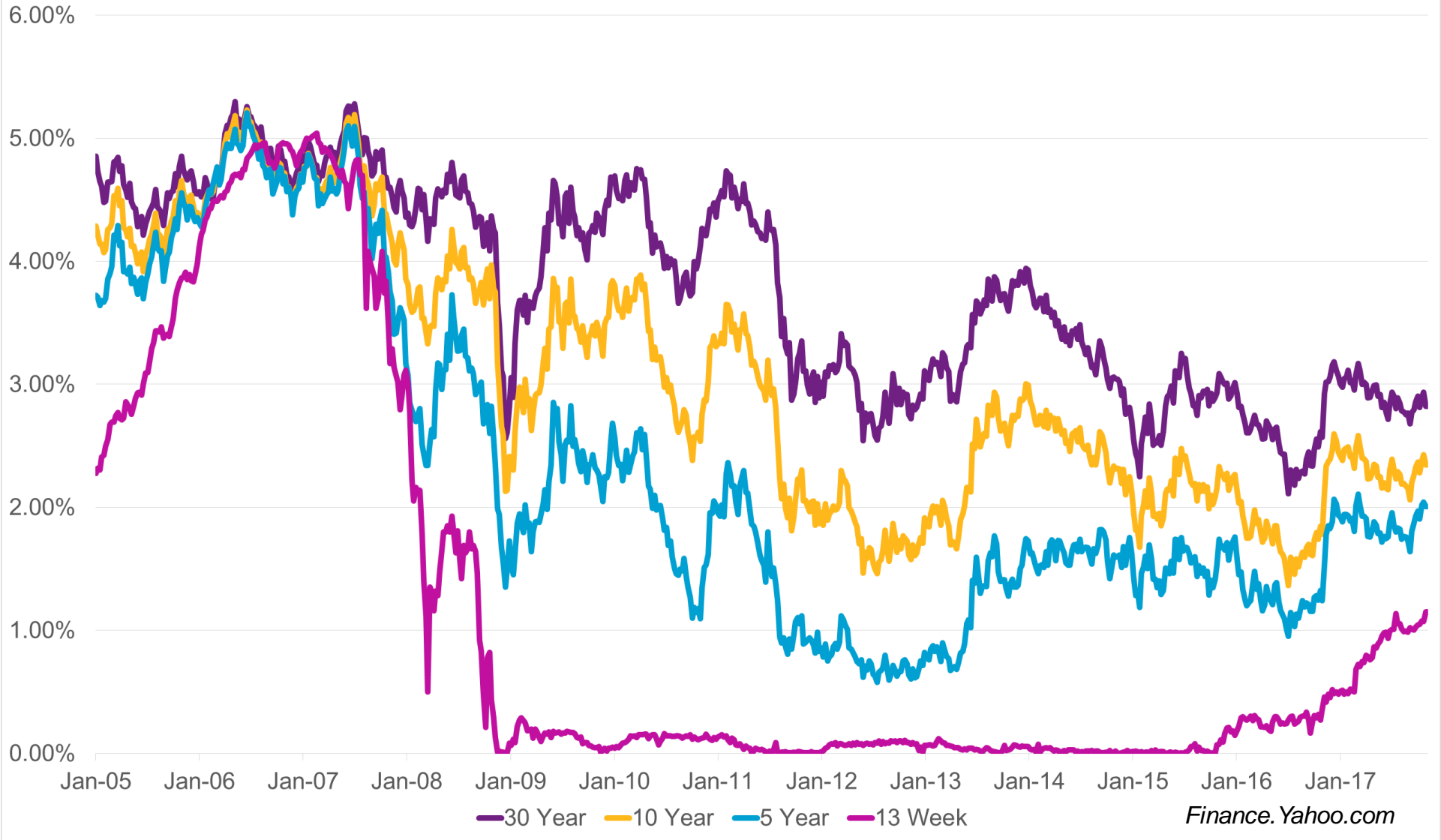
- Simplified/Accelerated Underwriting for Life Insurance
 - Instantaneous Acceptance/Rejection/Referral
 - Less direct data (from fluids)
 - New and different data sources
 - Driving record
 - Credit
 - Prescriptions
 - Genetic Testing
 - Electronic Medical Records
 - Tele Underwriting
 - New 3rd Party Tools
 - LexisNexis Risk Classifier
 - Transunion TrueRisk Life
 - Milliman Rx Score

Advanced Analytics

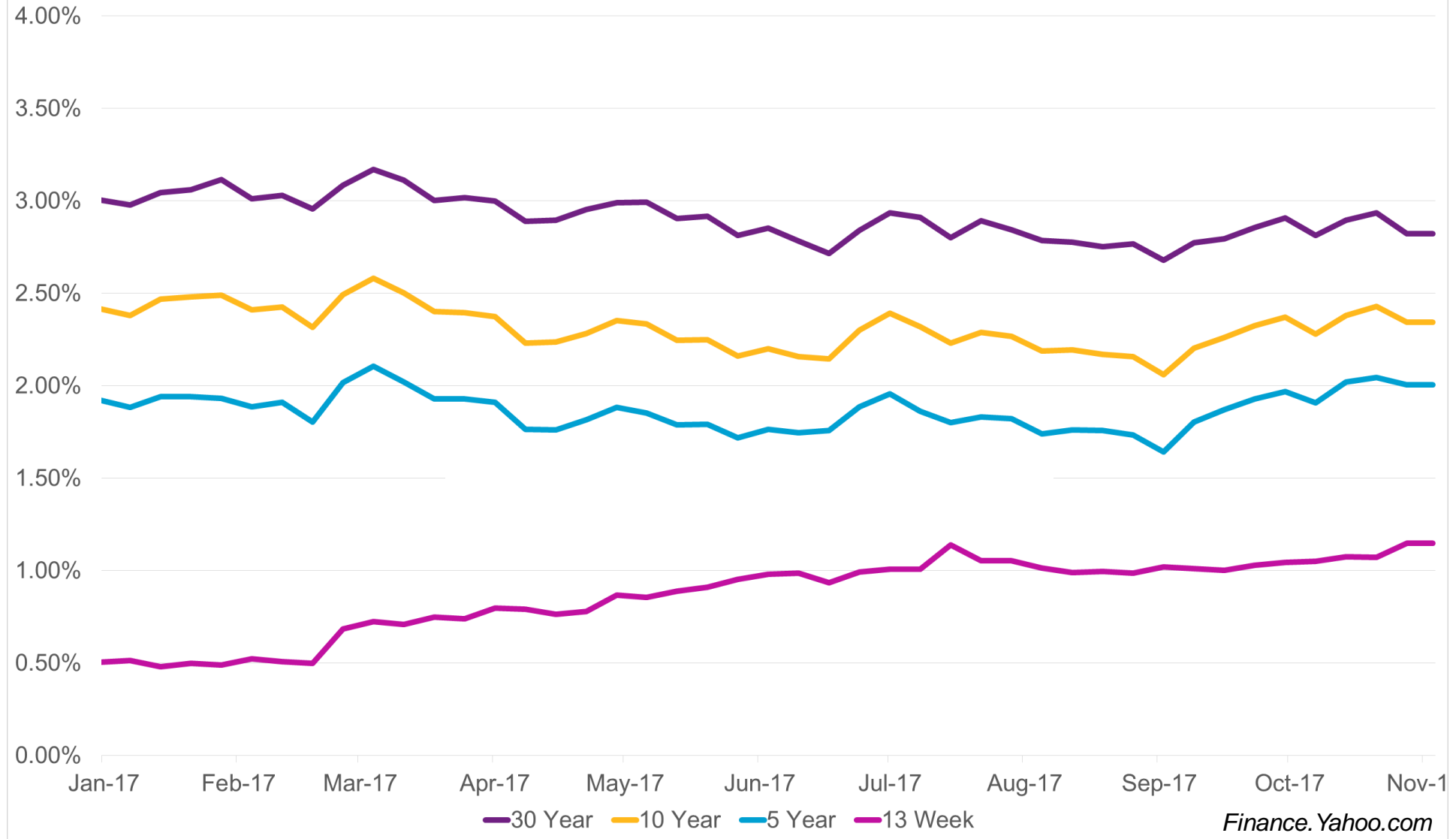
- Predictive Analytics
 - Identifies sub-trends and sub-factors within data
 - Refinement of policy owner behavior
 - Mortality and Morbidity tables
 - Tailoring of products and pricing to specific applications
- Machine Learning
 - Ongoing data monitoring
 - Updates and recalibrates predictive analysis outcomes

Fixed Assets & Equities

Treasury Yields 2005 - 2017

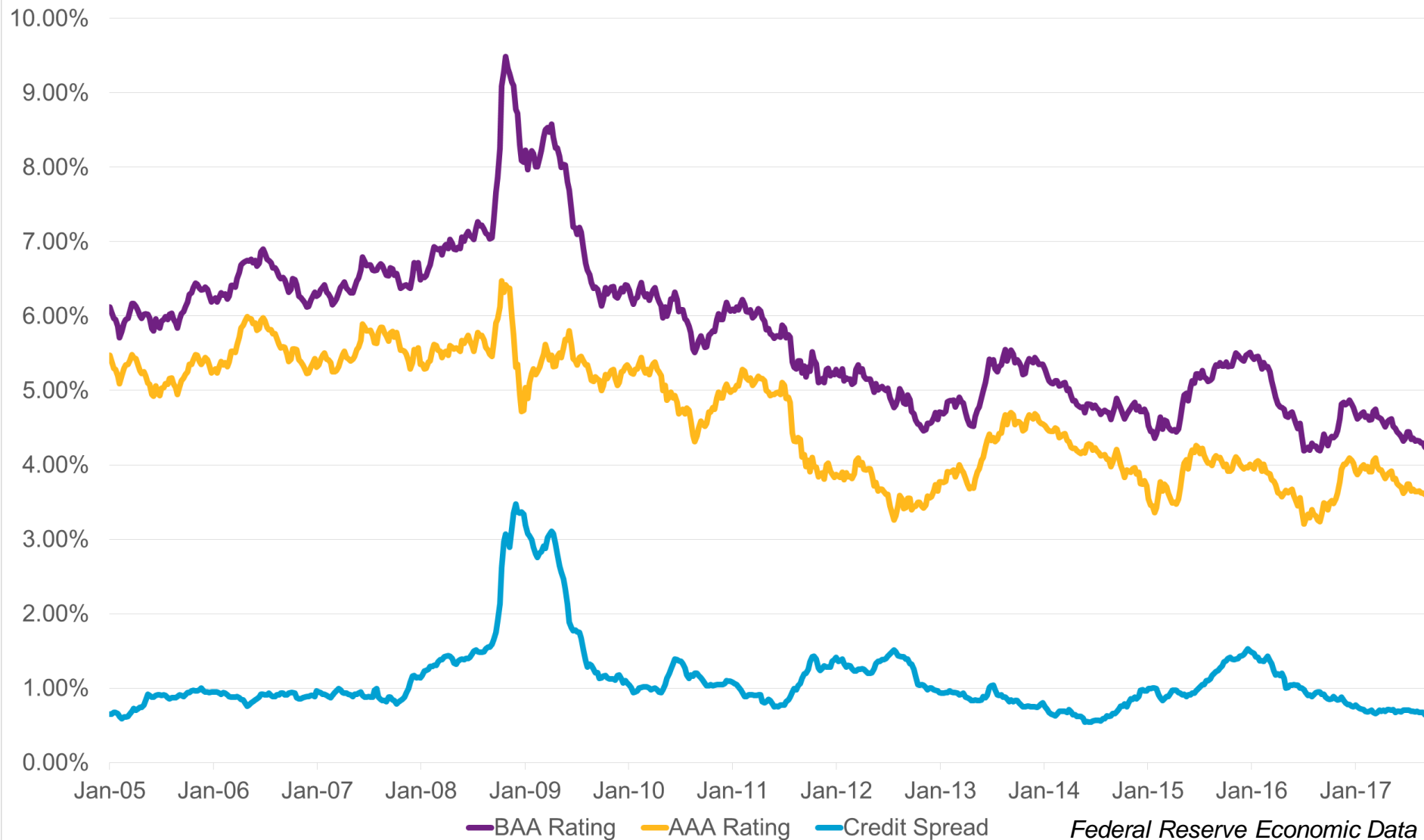


Treasury Yields 2017

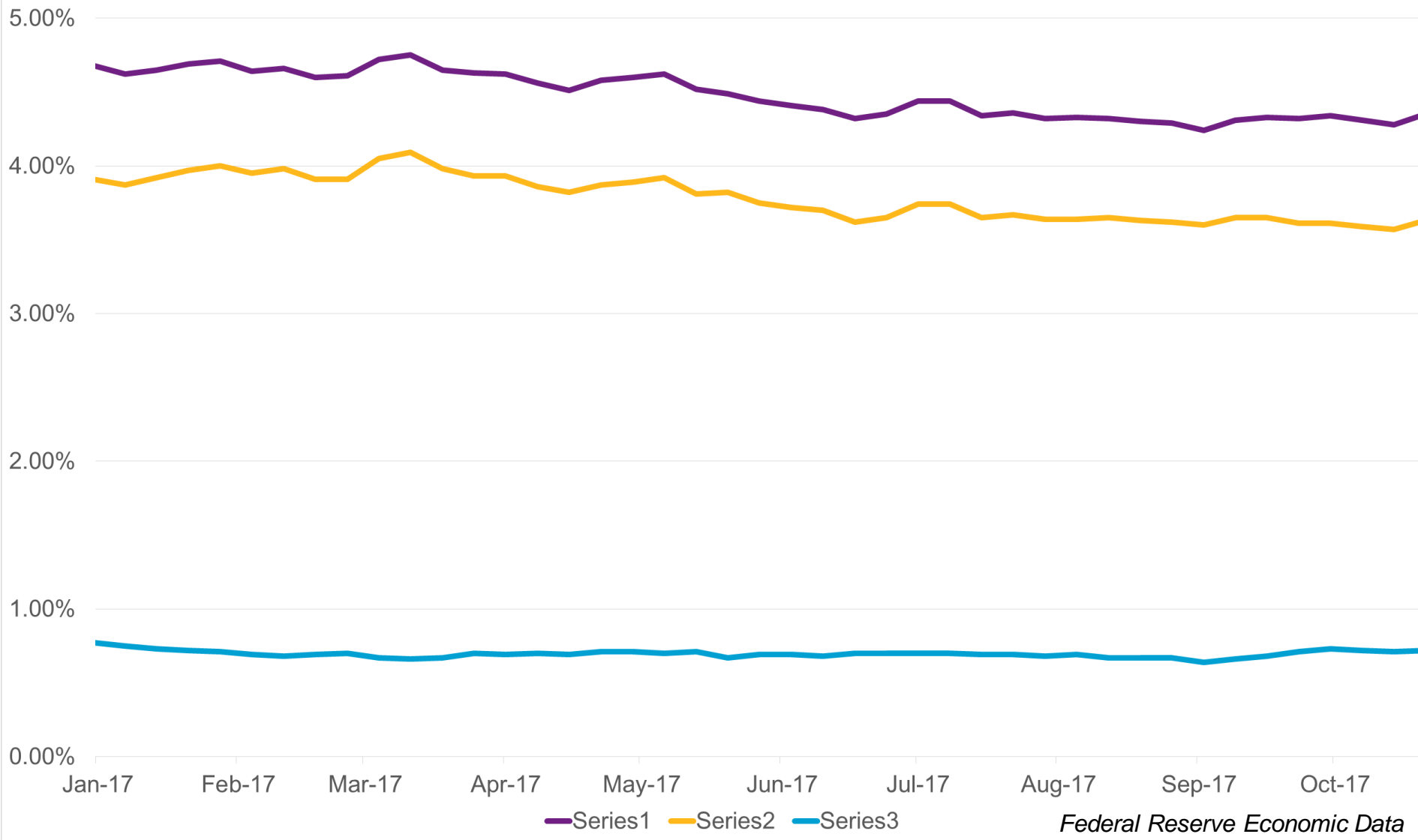


Finance.Yahoo.com

Moody's Seasoned Corporate Bond Yield Averages 2005 - 2017



Moody's Seasoned Corporate Bond Yield Averages 2017



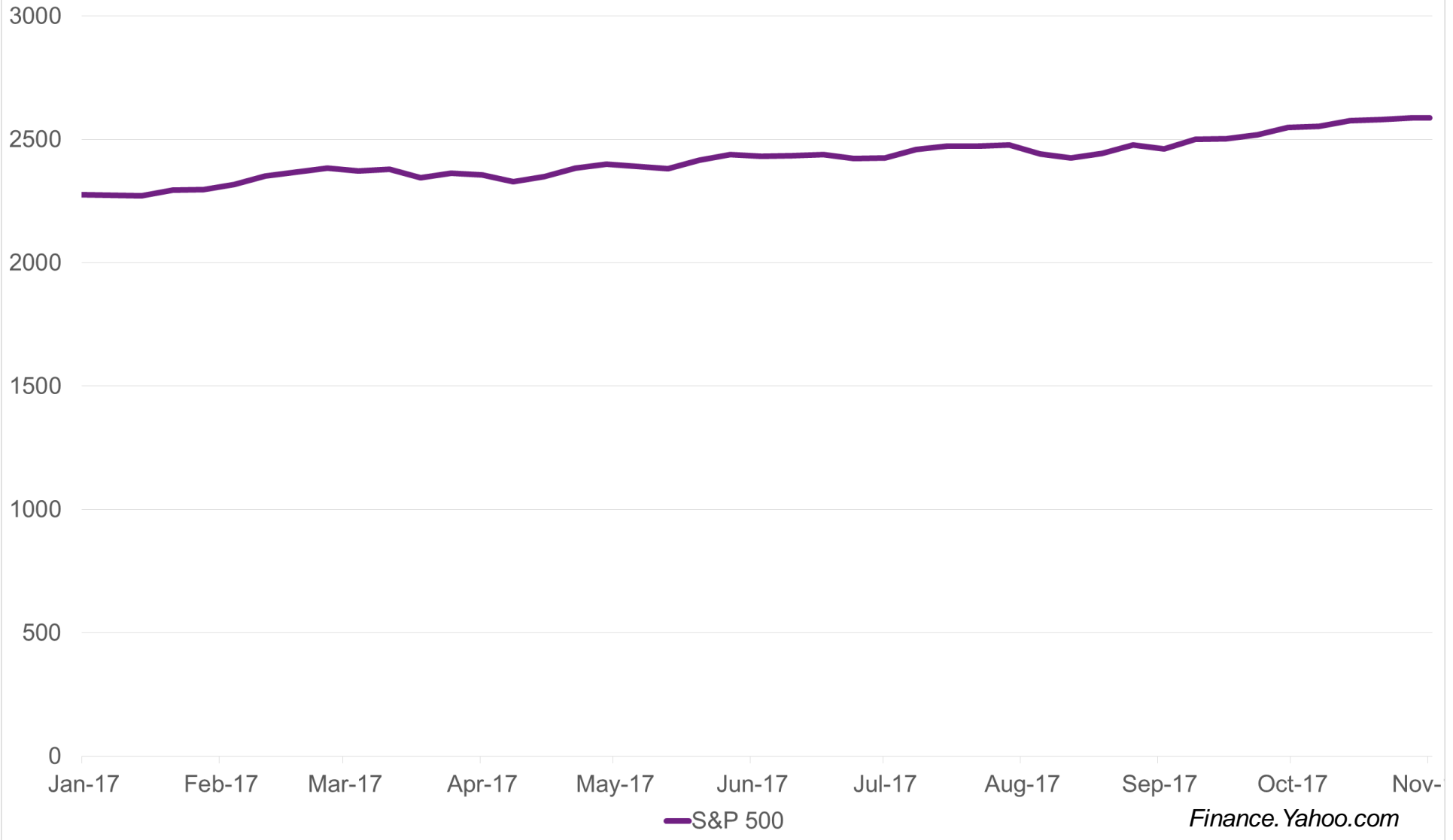
Series1 Series2 Series3

Federal Reserve Economic Data

S&P 500 2005 - 2017

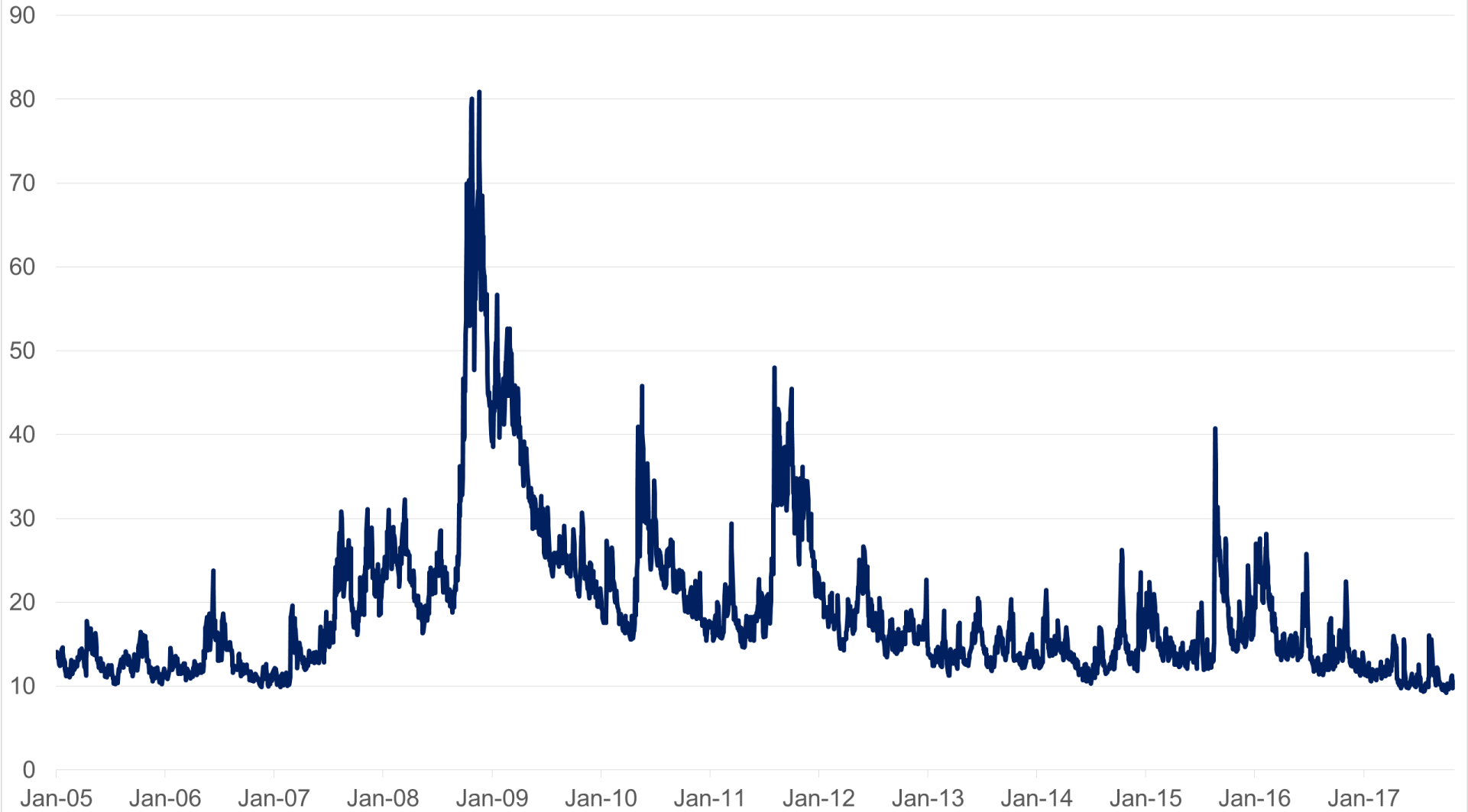


S&P 500 2017



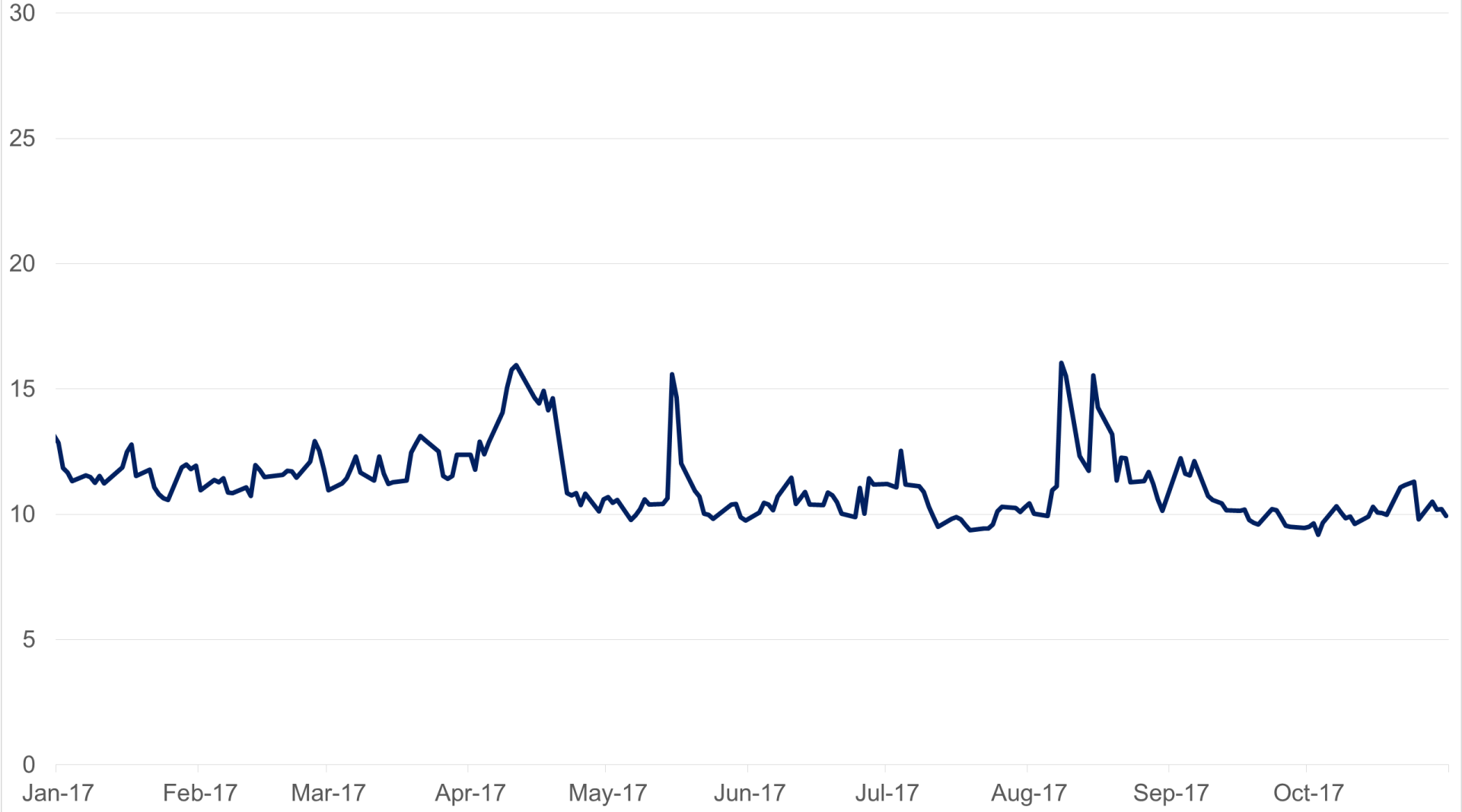
VIX

2005 - 2017



Federal Reserve Economic Data

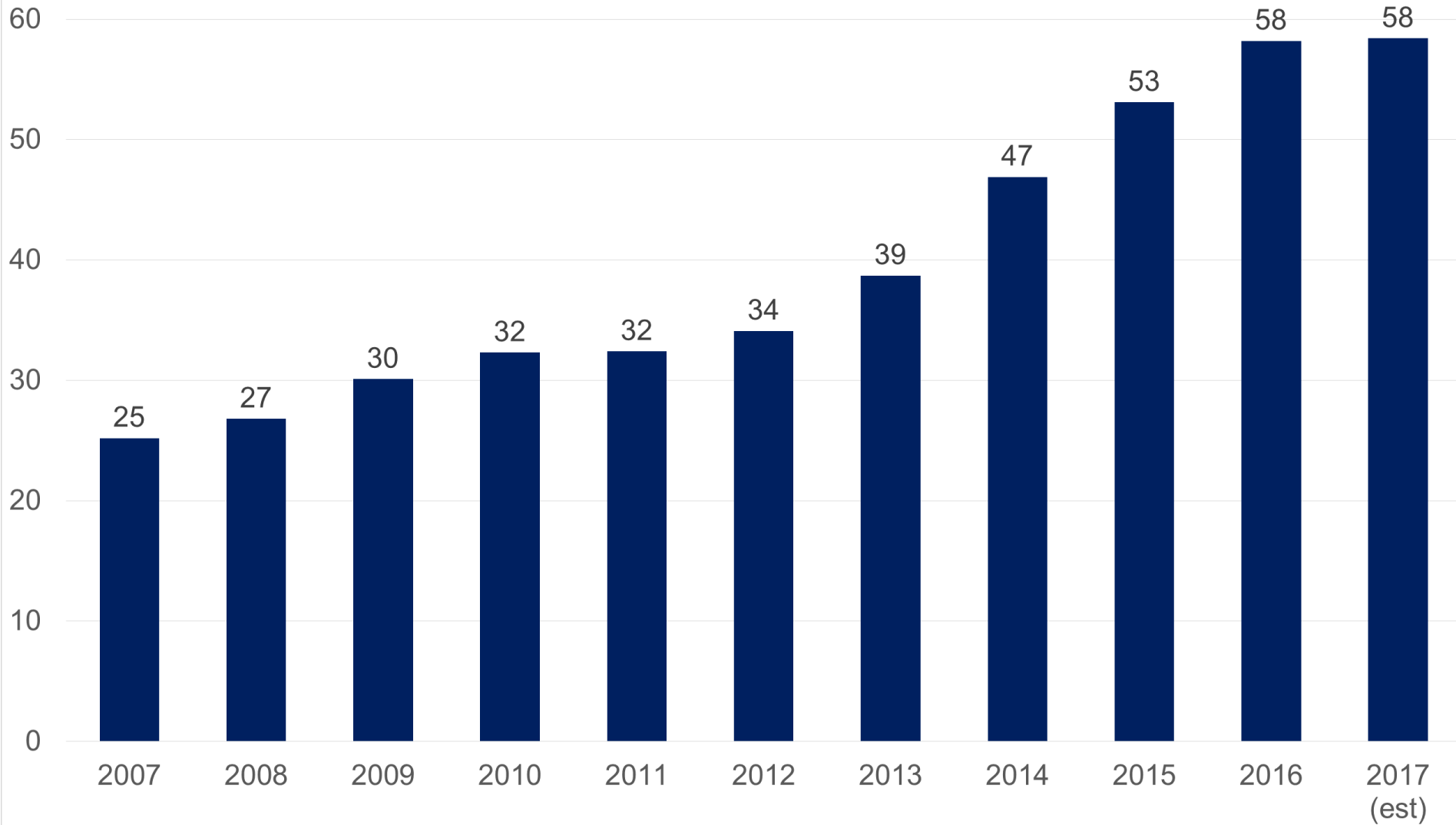
VIX 2017



Federal Reserve Economic Data

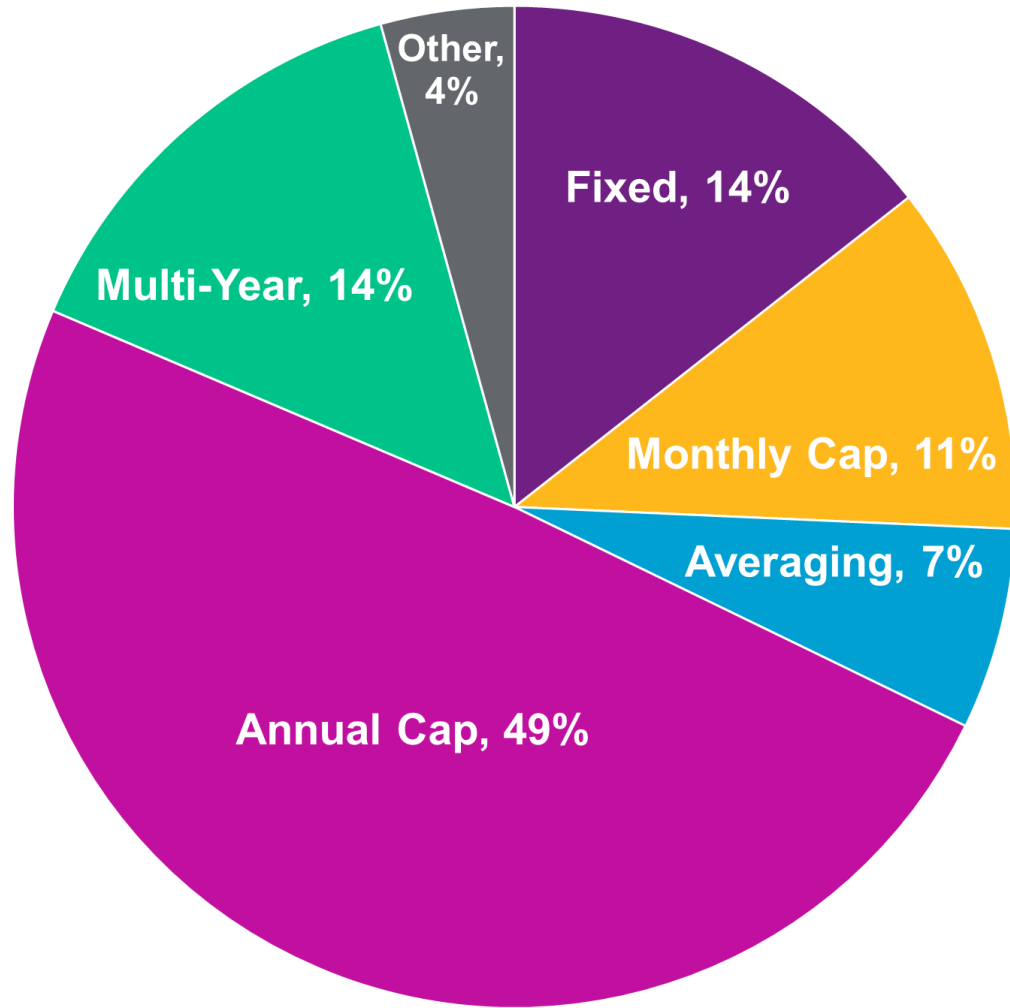
Product Trends

Fixed Indexed Annuity Production 2007-2017

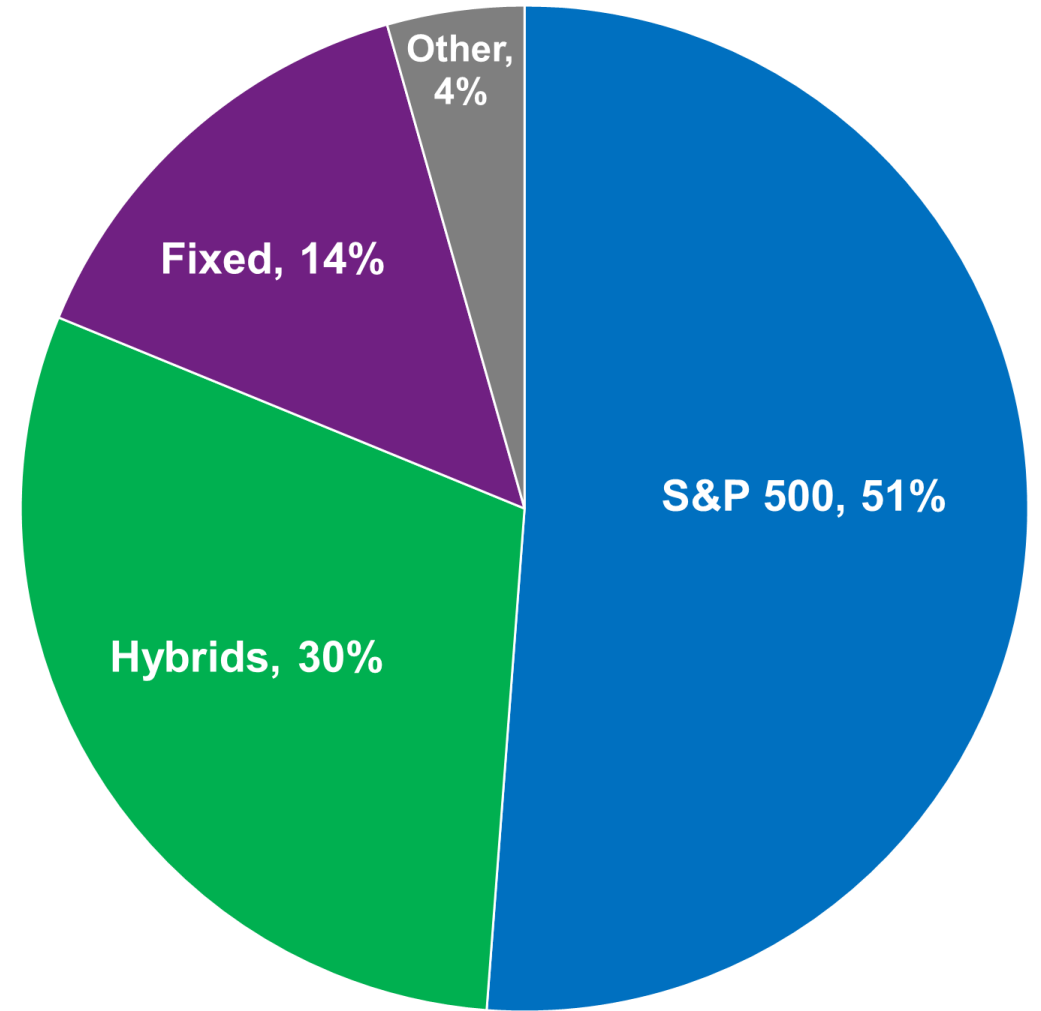


Wink Market Reports

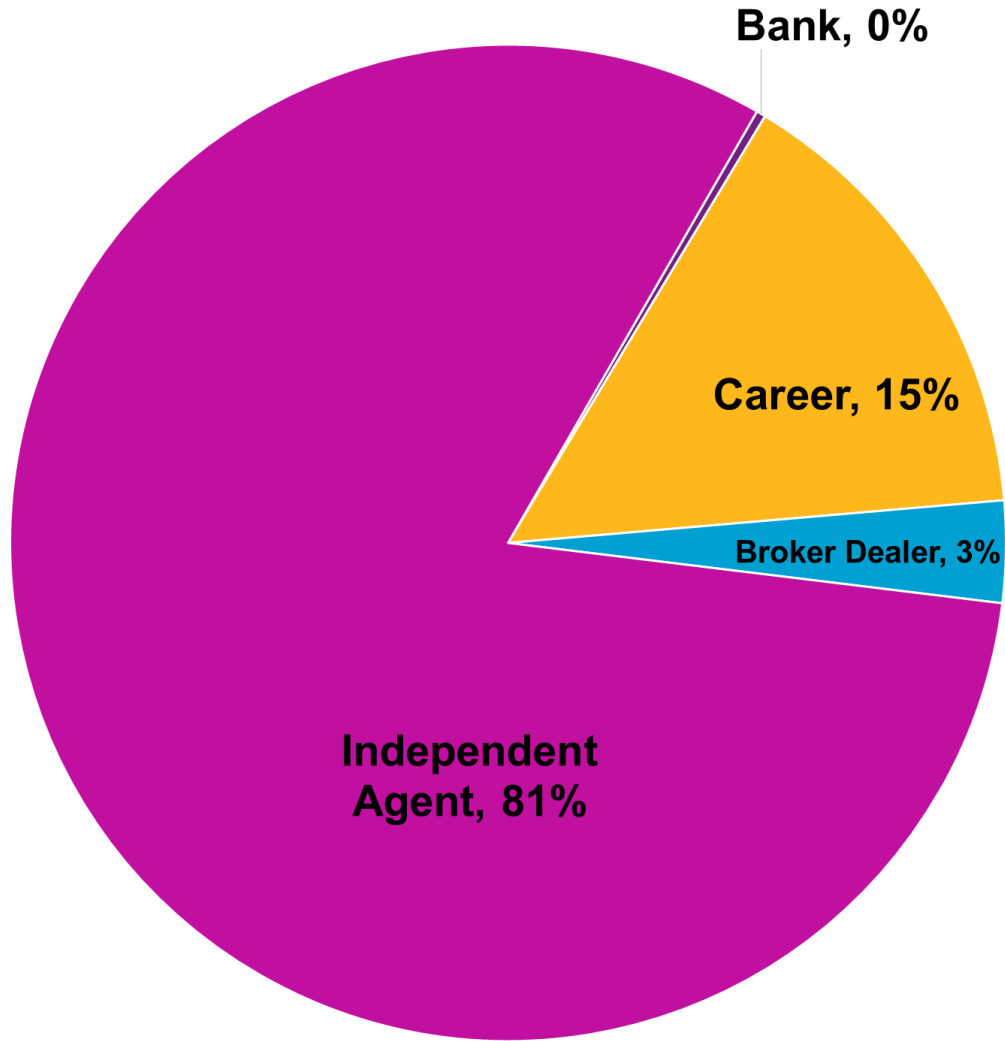
FIA Crediting Methods



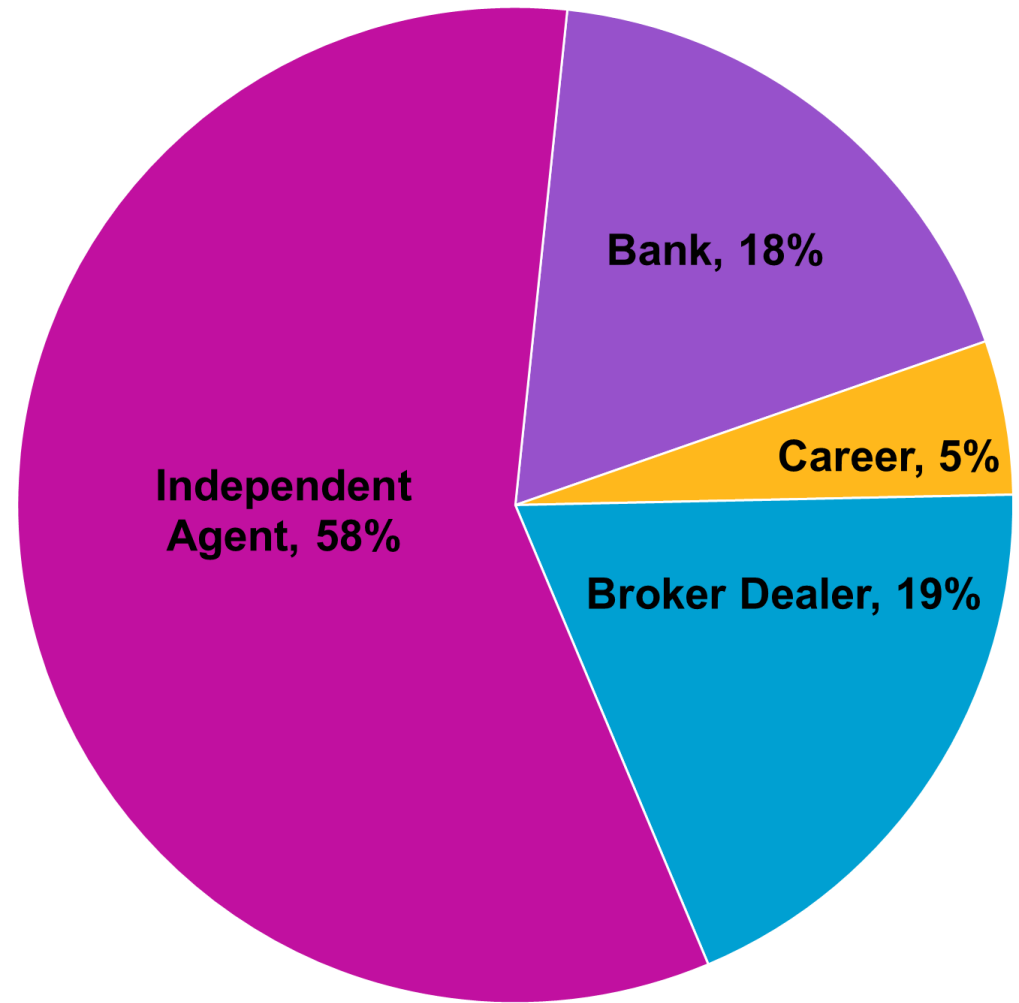
FIA Indices



FIA Sales 2013



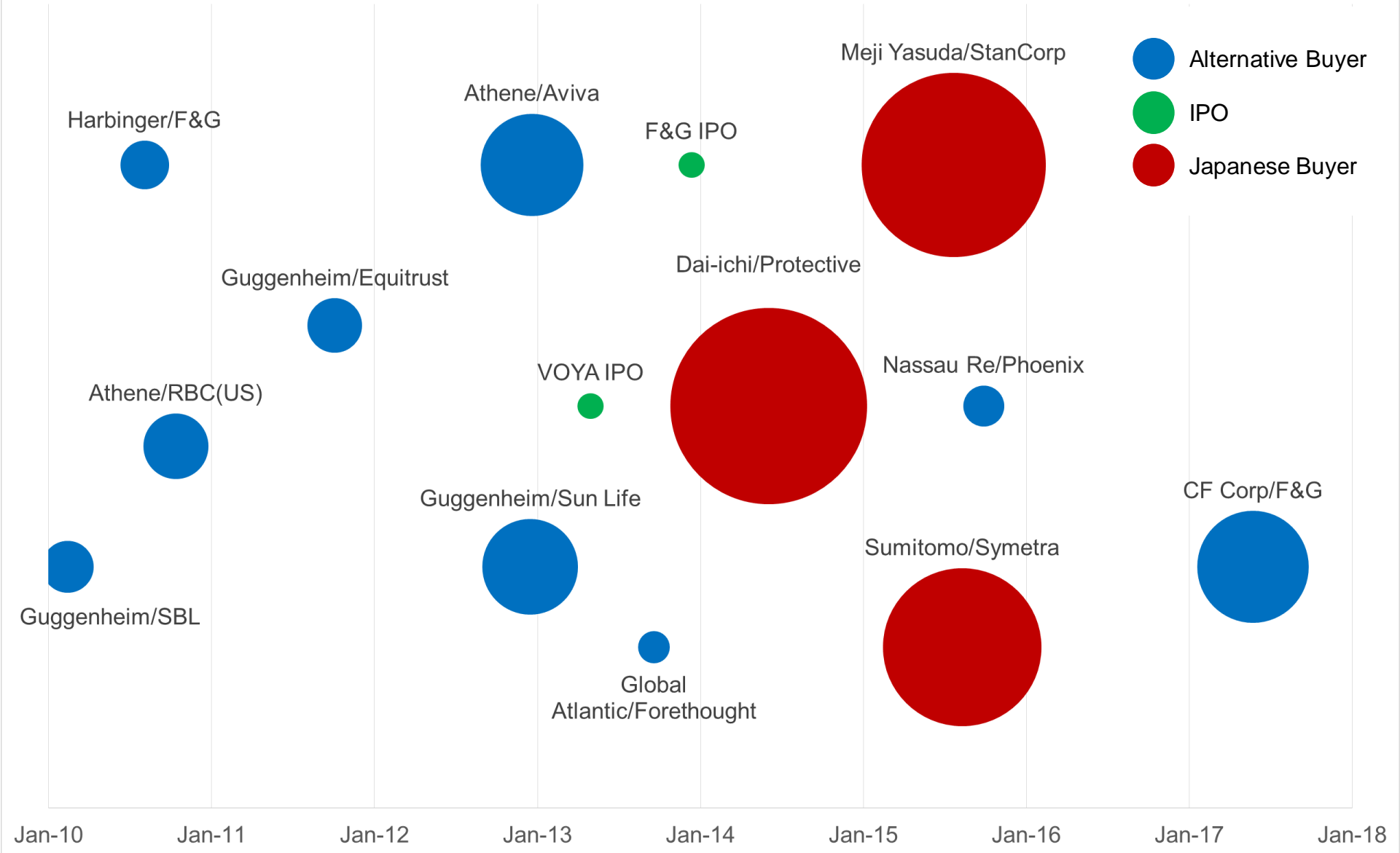
FIA Sales 2017



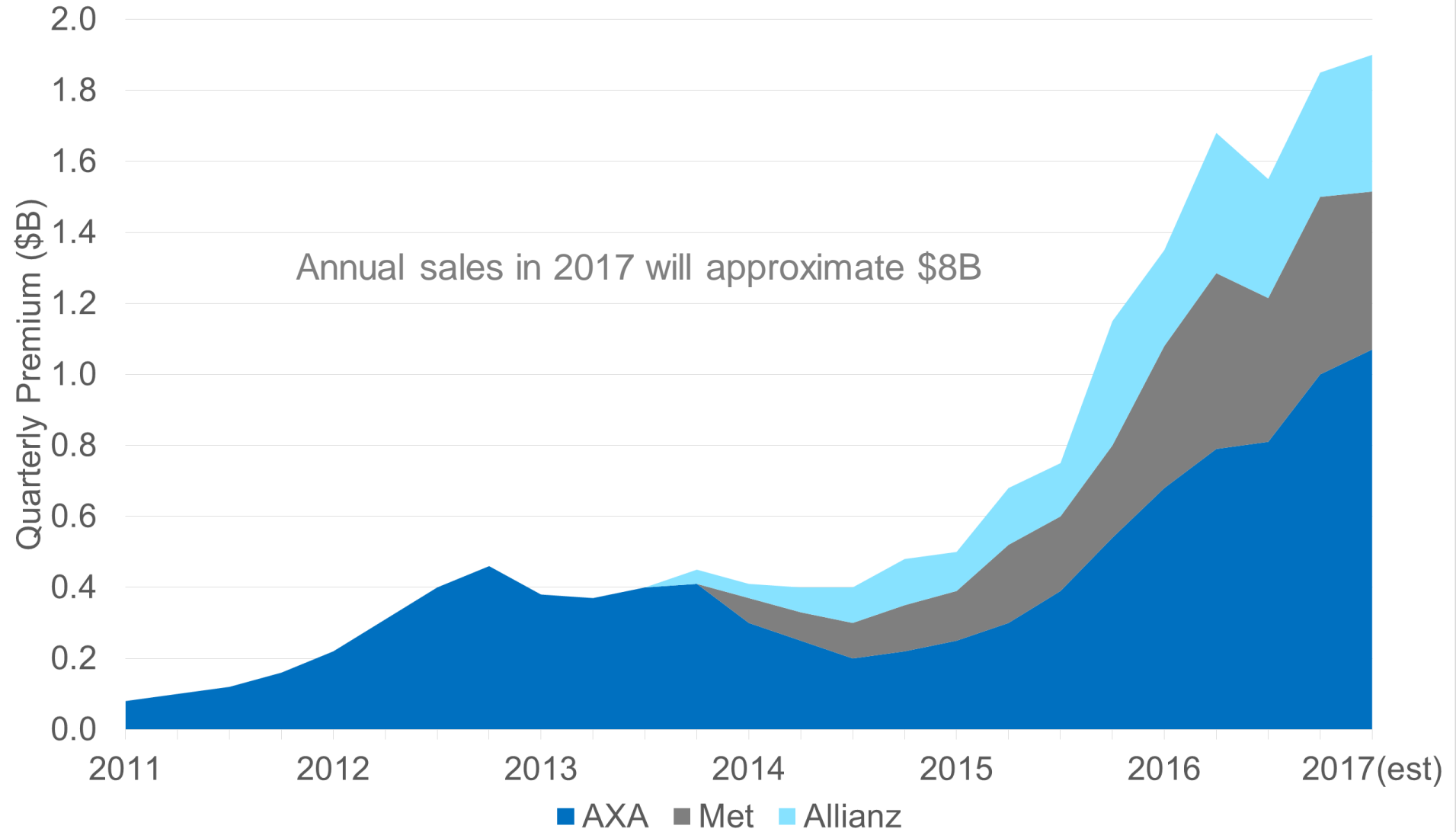
Fixed Indexed Annuity Marketing

- 45 carriers are on pace to write \$100M or more in 2017
- 24 carriers are on pace to write \$1B or more in 2017
- Significant sales growth in the bank and broker dealer channels
- Average FIA commission has dropped to 5.00% from 8.00% over the past 10 years.
- Average single premium has increased to \$110,000 from \$50,000 over the past 10 years.
- Income benefits are dominant sales drivers
 - GLWB'S with guaranteed roll-ups and guaranteed income
 - GLWB'S with stacked or other indexed roll-ups
 - Nursing home and confinement triggered income
- Rider fees are both implicit and explicit, but impact indexing caps and other adjustments
- Volatility control indices increase caps and other adjustments
- Hybrid indices are selected for illustration and presentation qualities
- Fee-based FIA'S developed in response to DOL rule – 7 recent product launches

FIA Related Acquisitions



Registered FIA Sales 2011-2017

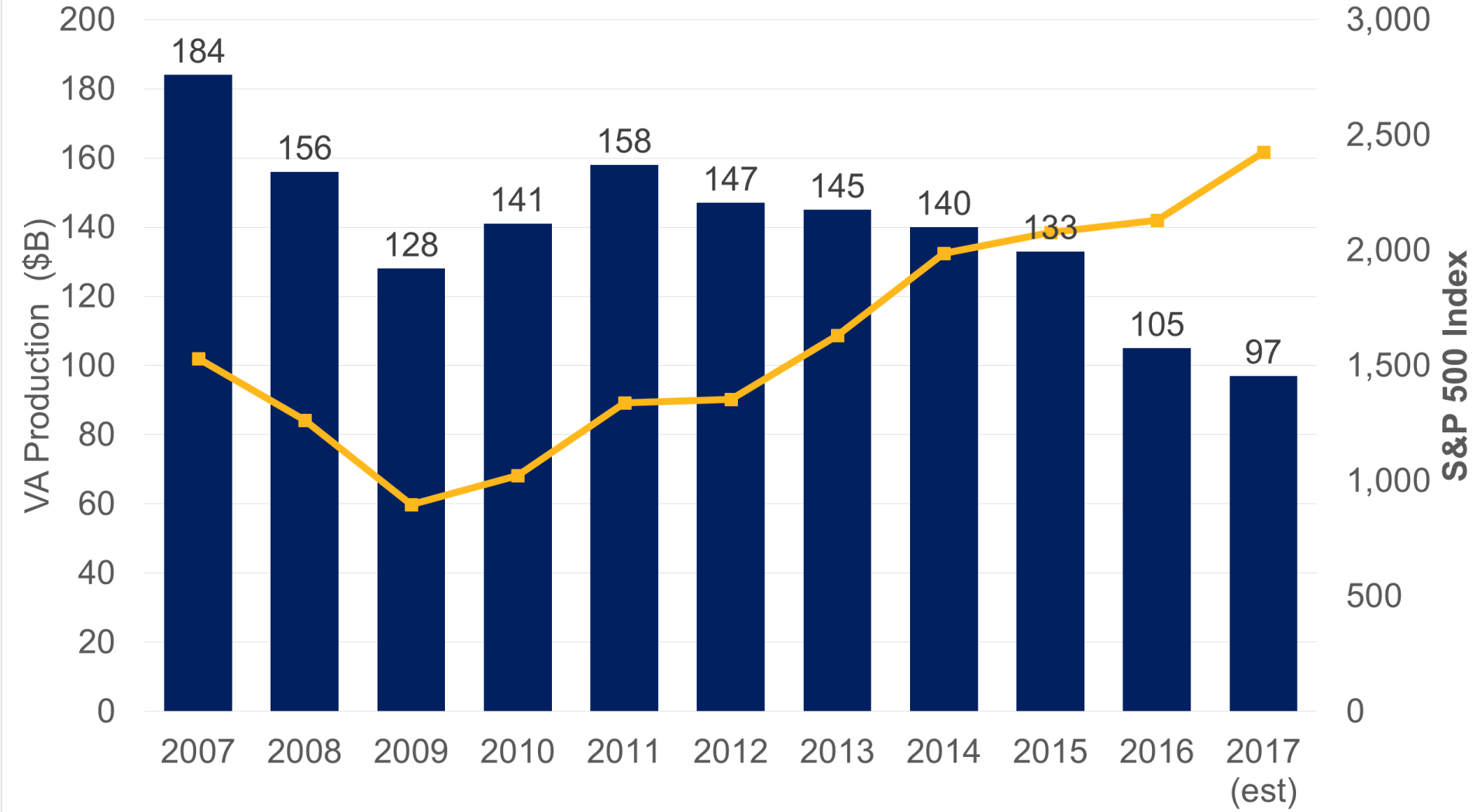


Morningstar

Registered FIA's (RFIA's)

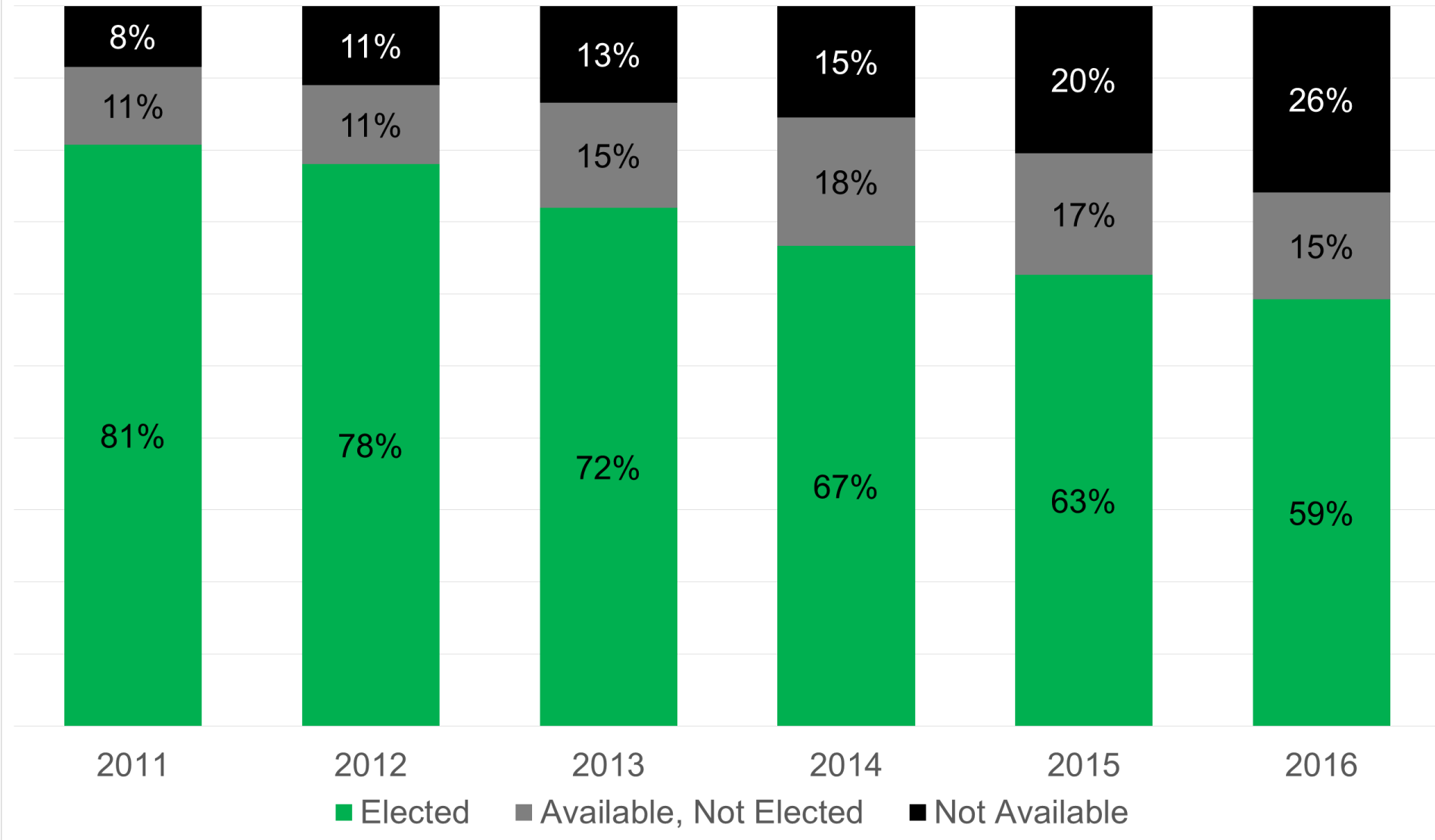
- Also called Structured VA's
- AXA the first to develop in 2010
- 6 new entrants since 2013
- Fast growing market segment
- Higher caps and possibly better potential crediting
- Bringing the FIA story (downside risk mitigation) to the registered space
- Offers risk diversification relative to traditional VA products

Variable Annuity Production 2007-2017



Limra

VA's with Income Benefit Riders 2011-2016



Limra

Final Thoughts

- A range of rational and less rational regulation will make the medium term future somewhat less predictable.
- Technology is searching for ways to enhance products or distribution, but direct-to-consumer sales efforts remain unproven.
- The financial markets have been remarkably tranquil.
- FIA's are succeeding in new markets and have not been hampered by new ownership.
- RFIA's are the fastest growing annuity segment.

WillisTowersWatson 

Matthew Coleman

Senior Consultant

101 South Hanley Road, Suite 900, St. Louis, MO 63105-3437

T +1 913 689 8679

E Matthew.Coleman@willistowerswatson.com

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