

LOW-INTEREST RATE TASK FORCE

Readiness Subcommittee – Meeting #3

April 2, 2020

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AGENDA

STATUS UPDATE	5 minutes
REGULATORY PROGRESS UPDATE (ACLI)	20 minutes
READINESS PROGRESS UPDATE	10 minutes
SPRINTS – INITIAL FINDINGS	20 minutes
OPEN DISCUSSION AND NEXT STEPS	5 minutes

APPENDIX 1: SPRINTS – INITIAL FINDINGS

APPENDIX 2: TASK FORCE & SPRINT PARTICIPANTS

STATUS UPDATE: STATUS & REVISED WORKPLAN

- Our accelerated **Readiness** workstream timeline has resulted in progress on several efforts:
 - Launched sprints on high-priority issues and identified initial findings
 - Developing surveys to provide additional context on industry practices
- Near-term meeting cadence:
 - Weekly Readiness Sub-Committee meetings (Thursdays at 3pm)
 - Bi-weekly Task Force SteerCo meetings (next meeting: 4/7)

READINESS: LAUNCHED SPRINTS ON HIGH-PRIORITY TOPICS

Process update

- Initial meetings have been held for each sprint, focusing on:
 - Agreeing on **key challenges** that life insurers are facing in light of current market conditions
 - Identifying **emerging best practices** in response to these challenges
- We have identified initial views and challenges for each of the sprints (see next slides and appendix)
- We are launching surveys for selected sprint topics (e.g., COVID-19 mortality, CFT, New business, ALM)
 - Surveys being developed in partnership with SOA
- Sprint follow-up calls to be held over the next two weeks

Sprint topics

- Cash flow testing – 3/26 kickoff
- COVID-19 mortality – 3/26 kickoff
- VA/FIA hedging – 3/27 kickoff
- New business & products – 3/27 kickoff
- ALM – 3/30 kickoff
- Social distance & distribution – 3/31 kickoff

READINESS: INITIAL SPRINT FINDINGS (1/2)

Topic	Initial views & challenges raised to date
Sprint #1: VA/FIA hedging	<ul style="list-style-type: none"> • While recent high market volatility has challenged VAs and FIA hedging programs, participants felt that these programs and managed vol funds have largely performed as expected to date • Top concerns raised were: <ul style="list-style-type: none"> – Combined impact of low rates/high volatility on hedging costs – Emerging lapse experience & GA transfers (with limited and mixed early results) • Several participants indicated that they are exploring shifts in strategy (static vs. dynamic, hedging instruments), trade frequency/triggers in response to high vol/market gaps
Sprint #2: New business & product	<ul style="list-style-type: none"> • Participants described a difficult new business environment characterized by pricing challenges, tighter underwriting, and questions on the customer value proposition of products • Insurers may consider feature changes (e.g., hedging features, rates, and profit participation mechanism) as a source of relief, but are concerned around refiling approval and speed • Participants expressed interest in learning about quickly how the industry is responding with pricing and product changes
Sprint #3: ALM	<ul style="list-style-type: none"> • Broad agreement that top challenge is managing duration gaps within the portfolio, although several “secondary” challenges: <ul style="list-style-type: none"> – Assets: managing short-term liquidity vs. credit spread volatility, near-term asset availability, need to prepare for scenario where spreads tighten, defaults expectations – Liabilities: flexible premium products, MVA (where tied to risk-free rates), complex duration/convexity profiles, policyholder behavior if rates rise • Actions considered & potential ALM strategy decisions include increased monitoring, changes to ALM appetite, portfolio extension (i.e., lock-in impact); also considering LDTI in decisions

READINESS: INITIAL SPRINT FINDINGS (2/2)

Topic	Initial views & challenges raised to date
Sprint #4: CFT	<ul style="list-style-type: none"> • Many participants have received inquiries from rating agencies on CFT impact • Core concerns and attention is centered around scenarios used in CFT: <ul style="list-style-type: none"> – Evolving approach to assess impact of market conditions on CFT (e.g., initial focus on immediate impacts, growing focus on planning for year-end) – Topics of focus included: base scenarios, range of scenarios, testing frequency, negative rates, spread widening, definition of moderately adverse, mean reversion targets • At this point, no expectation on changes to non-economic assumptions (not in focus)
Sprint #5: COVID-19 mortality	<ul style="list-style-type: none"> • Initial focus on mortality (vs. morbidity), recognizing that there may be secondary impacts • Significant unknowns: ultimate infection rate, containment effort effectiveness, health care system capacity, potential relapse (e.g., next fall/winter) • Challenges identified around communication with stakeholder groups (including senior management, regulators, and rating agencies) given limited / inconsistent data sources • Participants expressed interest in understanding scenarios others were modeling, and changes to life underwriting and product availability
Sprint #6: Social distance & distribution	<ul style="list-style-type: none"> • Participants discussed operational challenges faced by agents, carriers, and agents with work from home / social distancing • Some processes are slowly transitioning to become more digital (e-sign, contract delivery), while others are left with truly disrupted (paramed disruption, prospecting, client servicing) • Participants expressed interest in gaining a broader perspective from ground agents and carriers on their challenges

OPEN DISCUSSION AND NEXT STEPS

- **Any other topics for discussion?**
- **Proposed agenda for next Working Group call (4/9, 3pm)**
 - Key developments from readiness sprints
 - Update on advocacy efforts

APPENDIX 1: SPRINTS – DETAILED INITIAL FINDINGS

SPRINT #1: VA/FIA HEDGING

Challenges of low interest rates / market volatility related to VA / FIA hedging

Topic	Initial views & challenges raised to date
High volatility & options costs	<ul style="list-style-type: none"> • Combination of volatility and low rates has increased options cost with implications to new business: <ul style="list-style-type: none"> – Near-term: implications for setting rates – Longer-term: questions on product features, value proposition of certain products • Most companies are operating with expectation that options costs will revert over longer-term • Concerns on potential for liquidity challenges in the futures market
Hedge performance	<ul style="list-style-type: none"> • Significant management focus on this topic – with need for “real time” updates on hedge performance • Hedge programs have largely performed as designed – that is, with losses/breakage as expected for the current market environment/strategies • No significant concerns on hedge effectiveness, basis risk remained a concern
Hedge strategy	<ul style="list-style-type: none"> • Strategy: re-visiting choice of static vs. dynamic hedging to address observed limitations • Instruments: evaluating new instruments to address options cost, market gaps • Triggers: adjusting triggers to avoid rebalancing multiple times per day, and associated transaction costs
Risk controlled funds	<ul style="list-style-type: none"> • Risk controlled funds performing as intended
Policyholder behavior	<ul style="list-style-type: none"> • Carefully watching emerging lapse behavior, with limited and mixed early results • To-date, slightly uptick in transfers to fixed funds, but less than observed during the financial crisis
Remote working	<ul style="list-style-type: none"> • Overall, no major challenges with transitioning hedging teams to fully remote-working • Minor challenges : occasional lags in technology / speed; initial access to resources (Bloomberg)

SPRINT #2: NEW BUSINESS & PRODUCT

Challenges of low interest rates related to new business and products

Category	Initial challenges & considerations
Challenging product economics	<ul style="list-style-type: none"> • Low rates create new business and product challenges (e.g. declining customer value proposition, increasing capital requirements for new business in the current rate environment, changes to policyholder behavior) • In addition to rates, increased cost of hedging, (potentially) rising spreads/default risk, increased / uncertain mortality & morbidity, and underwriting uncertainty all contribute to a challenging pricing environment • These concerns will affect volumes, below-hurdle profitability and deteriorating distribution • Insurers may consider feature changes (e.g., hedging features, rates, and profit participation mechanism) as a source of relief, but are concerned around refiling approval and speed
Pricing volatility	<ul style="list-style-type: none"> • Rapid movements in interest rates, spreads and equities have made it difficult to keep up with pricing
Challenging sales & tighter underwriting process	<ul style="list-style-type: none"> • There is some concern around potential mis selling claims and increased regulatory scrutiny of products • Tighter underwriting resulting from increased/uncertain mortality may lead insurers to consider exclusions/waiting periods for recent travel, shutting business in specific geographies and repricing
Distribution	<ul style="list-style-type: none"> • There is concern that if annuities become less attractive, advisors will shift to other products • However, guaranteed products have appeal in this volatile environment • If rates stay low for long, there are concerns around ability to support captive agency cost-base, recruit new talent, and ability to train distribution to sell new products less-focused on guarantees
Communication	<ul style="list-style-type: none"> • Agents face challenges talking when talking to customers about recent market volatility and illustrating products features

SPRINT #3: ALM

Challenges of low interest rates related to ALM

Category	Initial challenges & considerations
Impact of low rates on ALM	<ul style="list-style-type: none"> Broad agreement that top challenge is managing duration gaps within the portfolio, but also that decision to close ALM gaps is a trade-off between mitigating future risk and locking in losses Asset-related challenges: <ul style="list-style-type: none"> Managing short-term liquidity needs vs. increased credit spread volatility Decreased portfolio yields & reinvestment rates Higher expected volatility increases cost of options Default risk Liability-related challenges: <ul style="list-style-type: none"> Ability to support guarantees identified as a challenge by several participants Uncertainty around policyholder behavior (e.g., flexible premiums, lapse) MVAs linked to risk-free rate, not portfolio yield
Go-forward expectations	<ul style="list-style-type: none"> Continuing to evaluate expectations for this year: Shape & slope changes, spread movements, government actions (e.g., Federal stimulus), including: <ul style="list-style-type: none"> Potential for negative rates in line with historical experiences in other countries Scenarios with continued lower rates and narrower spreads Most see low risk of inflation, with possible exception in targeted areas (i.e. long-term care) Also evaluating changes to long-term modeling (mean reversion parameters, equity returns)
Potential responses & actions	<ul style="list-style-type: none"> Adjust investment allocation, but also concern that assumptions such as a correlation between lower rates and lower volatility could drive riskier investment allocation and may not hold in this market environment Move to sensitivity analysis to calculate duration at different rate levels rather than using convexity (e.g., “duration trading grid”) given complex duration profile arising from impact of liability floors Increased monitoring of liquidity (e.g., monthly to weekly) and policyholder behavior (e.g., loan utilization, additional premiums)

SPRINT #4: CASH FLOW TESTING

Challenges of low interest rates related to CFT/AAT

Category	Initial challenges & considerations
Impact & assessment	<ul style="list-style-type: none"> • Top priority for companies is understanding the impact of the market environment on year-end CFT results <ul style="list-style-type: none"> – Initial focus on assessing immediate impacts – Gradual transition towards planning & risk mitigation – “What if” scenarios used to evaluate potential actions (e.g., investments, product management) • Several companies have re-run CFT; range of frequencies planned for rest of year • Concerns on the objectives & use of CFT while in a “tail” scenario <ul style="list-style-type: none"> – Use of CFT to assess adequacy of reserves vs. usage of capital
Scenarios	<ul style="list-style-type: none"> • Interest in understanding the range of industry practices for CFT in new market environment <ul style="list-style-type: none"> – Baseline and range of expectations for this year – Negative rates (determinist and stochastic) and mean reversion targets (stochastic) – Credit spreads • NY-specific CFT challenges: hedge rebalancing, credit spread caps • Senior management increasingly engaged in discussions on negative rate scenarios and mean reversion targets (“how low for how long?”)
Methodology	<ul style="list-style-type: none"> • No expectation of changes to non-economic assumptions; preference to retain actuarial discretion
Communication	<ul style="list-style-type: none"> • Majority of the participants had received questions from rating agencies on CFT <ul style="list-style-type: none"> – Qualitative & quantitative requests (e.g., running CFT with more severe assumptions) – Impact of low interest rates & equity markets

SPRINT #5: COVID-19 MORTALITY

Potential implications of COVID-19 related to mortality/morbidity for insurers

Topic	Initial views & challenges raised to date
Disease scenario	<ul style="list-style-type: none"> Significant unknowns remain: ultimate infection rate, containment effort effectiveness, health care system capacity, potential relapse (e.g., next fall/winter) As a result, insurers need to consider a wide range of scenarios
Mortality scenario	<ul style="list-style-type: none"> For most participants, the initial priority is mortality (vs. morbidity) In addition to the disease uncertainty, ultimate impact will depend on more complex factors <ul style="list-style-type: none"> Mortality by age (e.g., vs. exposure by age) Secondary mortality related to non-COVID cases due to an overwhelmed health care system Impact of morbidity on mortality Companies have used a range of modeling strategies and data sources; participants expressed interest in scenarios others were modeling
Life insurance claims	<ul style="list-style-type: none"> Will be challenging to identify deaths related to COVID-19 (vs. pneumonia), and claims processes may be difficult (e.g., ability to get death certificates)
New business	<ul style="list-style-type: none"> Increased difficulty of underwriting new policies due to social distancing Limited metrics available to assess COVID-19 mortality risk (e.g., travel history may not be effective in areas with community spread)
Communication	<ul style="list-style-type: none"> Communications have already started with regulators and ratings agencies; however, most attention is on economic impacts rather than COVID-19 mortality Significant time is being spent responding to questions from senior management, who are reacting to volatile news and emerging studies
Reinsurance	<ul style="list-style-type: none"> Reinsurer exposure to COVID-19 may be valuable as a forward-looking indicator; some concern about availability of life reinsurance

SPRINT #6 – SOCIAL DISTANCING & DISTRIBUTION

The current environment highlights operationally archaic business models, but this may provide impetus for positive industry change

Distribution process

Process step	Initial views & challenges raised to date
<pre> graph TD Prospecting --> Financial_planning[Financial planning] Financial_planning -.-> Prospecting Financial_planning --> Product_sale[Product sale] Product_sale -.-> Medical_underwriting[Medical underwriting] Medical_underwriting -.-> Product_sale Medical_underwriting --> Fulfillment_documents[Fulfillment / documents] Fulfillment_documents -.-> Product_sale Fulfillment_documents --> Servicing[Servicing] </pre>	<ul style="list-style-type: none"> Agents/branches are in survival mode, and not necessarily focused on pipeline "Finding prospective clients is nearly impossible"
	<ul style="list-style-type: none"> Retirement plan business for 403B plans relies on in-person interactions between teachers/school officials and financial advisors Clients/agents may not be comfortable with technology or have restricted ability (e.g., lack of internet access)
	<ul style="list-style-type: none"> There are varying impacts on ability to sell product, some are experiencing disruptions, others are steady but limited pipeline Swing away from VA business to Fixed index and buffered annuities
	<ul style="list-style-type: none"> In-person paramedic disruption, both on supply and demand sides Participants recognized the need to relax standards for underwriting, hold them off completely or identify creative digital underwriting solutions catered to risk-appetite
	<ul style="list-style-type: none"> Lack of comfort of some distributors going digital (e.g. electronic contract delivery, e-sign) <i>E-sign / docuSign regulations vary by state</i> <i>Moving from opt-in versus opt-out on e-delivery</i>
	<ul style="list-style-type: none"> Strain on call centers and mail mediations with shelter in place Lack of personal connection with clients <i>Managing antiquated state laws with wet-signature rules (e.g., Section 1035 exchange)</i>

Items in blue are regulatory considerations

Wholesaling

Initial views & challenges raised to date

- Shift away from traditional in-person client/advisor relationship and delivery, and disruption of the wholesalers' day-to-day work (e.g., increased information flow)
- Difficulty recruiting producers, new talent and prospective clients
- Impediments to obtaining and maintaining licenses, which may require on-site testing, and in-person finger-printing

APPENDIX 2: TASK FORCE & SPRINT PARTICIPANTS

READINESS & ADVOCACY SUBCOMMITTEE

MEMBERS

Keith Werschke	Pacific Life
Linda Durman	Sammons
Dan Jackson	Athene
Michael Slipowitz	Guardian Life
Stephen Turer	Lincoln
Meagan Phillips	Securian
Bill White	USAA
Ken McCullum	Principal
Todd Henderson	Western & Southern
Dennis Martin	Oneamerica
Tim Corbett	Mass Mutual
Ellen Cooper	Lincoln
Raj Krishnan	F&G Life
Paul Gerard	Ohio National
Liz Brill	NY Life
Tom Leonardi	AIG
Jim Mikus	Ameritas
Cliff Lange	Boston Mutual
Joe Engelhard	Met Life
Joel Steinberg	New York Life

Jason Klawonn	Northwestern Mutual
Connie Tang	Prudential
Karry Sweeney	Athene
Kevin Mechtley	Sammons
Richard (Rich) White	Jackson
Quentin Doll	Northwestern Mutual
Betsy Ward	Mass Mutual
Alison Weiss	Mass Mutual
David Chang	Pacific Life
Adam Brown	Allianz
Don Preston	SwissRe
Marcia Wadsten	Jackson

FACILITATORS

Dave Levenson	LLG
Kristin Ricci	Oliver Wyman
Scott Campion	
Paul Graham	ACLI (Advocacy)
Wayne Chopus	IRI (Advocacy)
Jason Berkowitz	

SPRINT PARTICIPANTS

1. VA/FIA hedging	2. New business & products	3. ALM	4. Cash flow testing	5. COVID-19 morbidity & mortality	6. Social distance & distribution
Participants:	Participants:	Participants:	Participants:	Participants:	Participants:
1. Participants:	1. Adam Brown, Allianz	1. Dan Jackson / Jeff McClure, Athene	1. Michael Harwood, AIG	1. Cliff Lange, Boston Mutual	1. Michael Brodeur / Johnpaul Van Maele, AIG
2. Marcia Wadsten / Angie Matthews, Jackson	2. Cliff Lange, Boston Mutual	2. Scott Orr / Jack Geiger, MetLife	2. Doug King, Athene	2. Deborah Vandommelen, Northwestern Mutual	2. Adam Brown, Allianz
3. Stephen Turer, Lincoln	3. Stephen Turer, Lincoln	3. Linda Durman, Sammons	3. Marcia Wadsten, Jackson	3. Joel Sklar, Prudential	3. Quentin Doll, Northwestern Mutual
4. Keith Werschke / David Chang, Pacific Life	4. Betsy Ward, Mass Mutual	4. Bill White, USAA	4. Betsy Ward, Mass Mutual	4. Meagan Phillips, Securian	4. Steve Rueschhoff, Edward Jones
5. Scott Orr / Chia Yin Chew, MetLife	5. Quentin Doll, Northwestern Mutual	5. Todd Henderson, Western Southern Life	5. Stephen McNamara, NY Life	5. Bill White, USAA	5. Paul Mineck, Allstate
6. Dan Jackson, Athene	6. Jodi Kravitz / Andrew Ng, NY Life	6. Chris Trost, Northwestern Mutual	6. Linda Durman, Sammons	6. Amy Rider, Sammons	6. Brian Delegat, Nationwide
7. Connie Tang, Prudential	7. David Lautenschlager, Pacific Life	7. Oksana Cherniavsky, NY Life	7. Aaron Sarfatti, Equitable	7. Liz Brill, NY Life	7. Jerry Blair / Amy Rider, Sammons
8. Mark Kalinowski, Sammons	8. Liz Dietrich / Vy Ho, Prudential	8. Ed Freeman, Guardian Life	8. Michael Slipowitz, Guardian Life	8. Sam Early, Principal	8. Anthony Vossenber, Thrivent
9. Steve Cramer / LT Grant, Protective	9. Meagan Phillips, Securian	9. Steve Cramer / Adam Adrian / Lance Black, Protective	9. Brock Peters, Prudential	9. Tim Wood, Protective	9. Steve Sanders, F&G Life
10. Jacob Steuber, Western Southern	10. Brian Sward, Jackson		10. Miranda DiMaria / Chris Kinnison, Principal	10. Dan Harris, Western Southern	10. Phil Pellegrino, UBS
	11. Katie Bezold, Western & Southern				11. Joe Toledano, Morgan Stanley
	Wayne Chopus / Frank O'Connor, IRI				Jason Berkowitz / Wayne Chopus, IRI

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