LOW-INTEREST RATE TASK FORCE

International Markets Subcommittee Meeting #1

3/31/2020

AGENDA

INTRODUCTIONS

International subcommittee members

Name	Company
Aadil Lokhandwala	Lincoln
Jean-Roch Sibille	Allianz
Lyndon Oliver	MetLife
Antonio Gonzalez	Prudential
Dave Dowrich	AIG
Michel Perrin	Equitable
Steve Cramer	Protective
Shin Yagisawa	RGA
Rich De Sousa	Scor Re
Alanna Schultz	Swiss Re

Facilitators

Strategic support

Industry group support

Name	Company
Kristin Ricci	Oliver Wyman
Joe Shamon	Oliver Wyman
Dave Levenson	LIMRA

INTRODUCTION: STATUS UPDATE

Workstreams

1 INT'L MARKET FOUNDATIONS

2 READINESS

3 CONSUMERS & DISTRIBUTION

4 REGULATORS & OTHER ENTITIES

Accomplishments to date:

- Conducted 1:1 interviews with subcommittee members
- Completed initial fact-pack on Japan/Germany

Today's objectives:

1. Review findings
2. Determine which learnings are relevant to the US life insurance market
3. Decide which topics warrant a further deep dive
4. Determine additional areas to focus on

FINDINGS RECAP: IMPACTS TO PROFITABILITY AND SOLVENCY

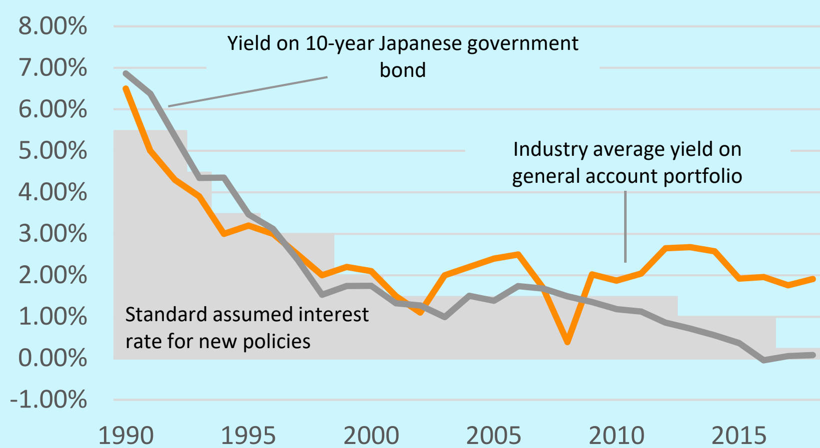
Lower rates have put pressure on profit margins due to high-guarantees on older blocks and meaningful ALM mismatches for both Japanese and German insurers

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**

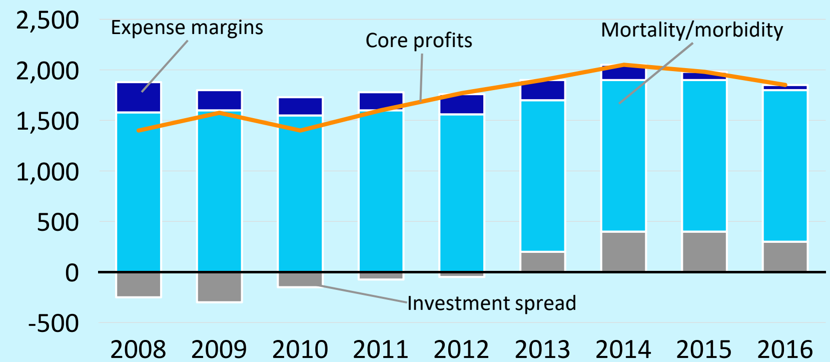
Case Study: Japan

YIELD / GUARANTEE RATE (%)



- 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

PROFIT CONTRIBUTIONS (¥ Billions)



- **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, Fukoku, Fukokushinrai, Meiji Yasuda, Mitsui, Nippon and Sumitomo, Moodys, Toa Reinsurance 2018 market report. *LIAJ, Federal Reserve Bank of Saint Louis, GenRe*

FINDINGS RECAP: IMPACT TO NEW BUSINESS SALES

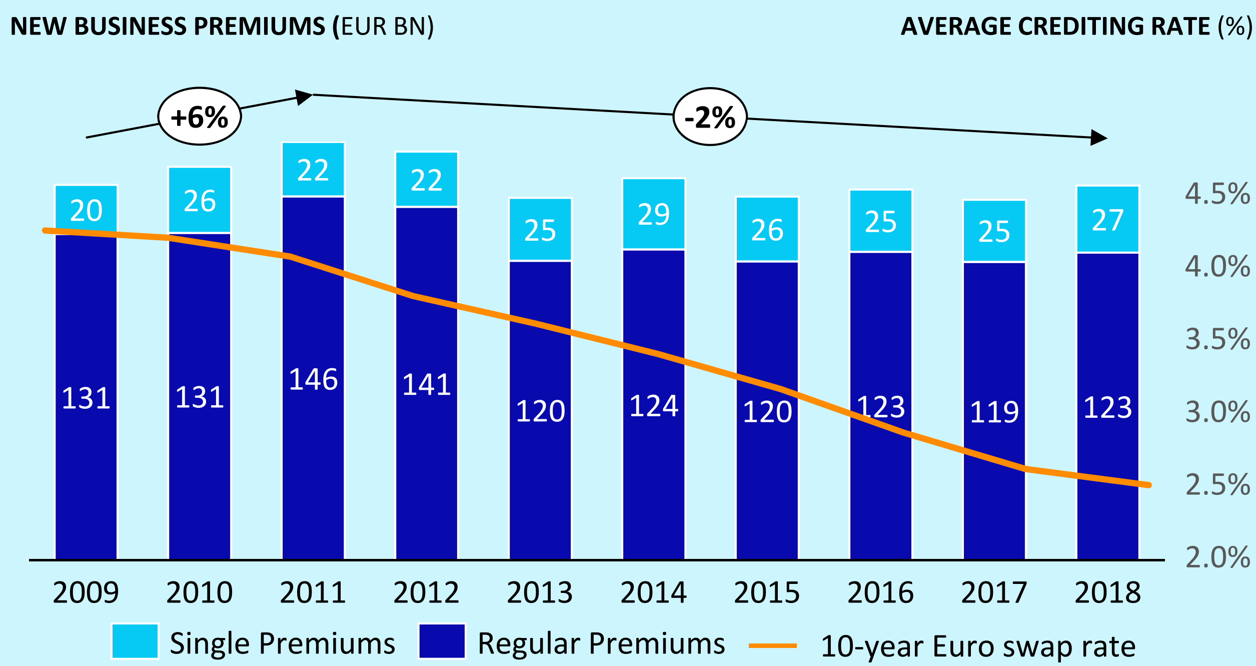
In both Japan and Germany, new sales suffered as lower interest rates eroded the savings-oriented customer value proposition

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

LEARNINGS RELEVANT TO THE US: ACTIONS TAKEN BY INSURERS AND REGULATORS

We examined the lessons learned from actions taken in Germany and Japan to identify near- and longer-term implications for the US market

We observed actions taken in the following categories:

- Asset and liability management
- In-force management
- Regulatory
- New business and distribution
- Expense Management

For each category, we will evaluate:

- What are key learnings from **actions taken** by insurers and regulators?
  - Which are relevant in the **near term?** (<6 months to implement action)
  - Which are relevant in the **medium / long term**? (>6 months to implement action)
  - Which are **not relevant** to the US?
- Which topics should we investigate further?

LEARNINGS RELEVANT TO THE US: ASSET AND LIABILITY MANAGEMENT

Note: flag indicates which countries pursued the action

Near term

- Established **hedging programs** to limit downside exposure and associated capital charges (e.g. swaps to extend asset duration)

Medium / long term

- Increased **portfolio asset duration** to avoid asset liability mismatching, especially by increasing allocations to **alternative investments** such as infrastructure, real estate and private equity
- **Changed quality of their corporate bond holdings** (e.g. moved down the credit curve in search of yield)

Not applicable to the US

- Invested in **foreign bonds** with higher yields (e.g., Italian BTPs, Euro OAT futures for Germany; US, AUS and ID-denominated for Japan, sometimes hedging currency risk)

For Discussion

- Do we agree with the categorization of learnings?
- Are there key learnings from Japan and Germany that we missed?
- Which topics should we investigate further?

LEARNINGS RELEVANT TO THE US: IN FORCE MANAGEMENT

Note: flag indicates which countries pursued the action

Near term

- Tried to **convert unprofitable customers to more profitable products** (e.g. converting annuity cash value to LTC policy)
- Tried to **buy existing policyholders out of unprofitable policies**

Medium / long term

- Completely **sold off their closed books** – leading to industry consolidations – and **pursued greenfield operations** (although not very common)
- **Demutualized** to gain access to capital markets

Not applicable to the US

- **Held onto returns** in excess of mandatory profit participation in order to smooth additional profits over time and **reduce the volatility of returns to policyholders**

For Discussion

- Do we agree with the categorization of learnings?
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- Which topics should we investigate further?

LEARNINGS RELEVANT TO THE US: REGULATORY

Note: flag indicates which countries pursued the action

Near term

- **Lowered the regulatory maximum rates** (standard assumed interest rate in Japan and maximum rate for reserve calculations in Germany), which led to insurers offering lower guarantees

Medium / long term

- Established **relief funds** to rehabilitate companies with solvency issues
- Allowed life insurance companies to **cut the guaranteed interest rates** on existing insurance policies (although none have been known to do so)
- Required a **new balance sheet reserve** to address the risk of future reinvestment at lower rates than the rates used for pricing

Not applicable to the US

- Allowed **slower implementation of Solvency II measures**, to keep insurers healthy and **avoid drastic changes to crediting rates**

For Discussion

- Do we agree with the categorization of learnings?
- Are there key learnings from Japan and Germany that we missed?
- Which topics should we investigate further?

LEARNINGS RELEVANT TO THE US: NEW BUSINESS AND DISTRIBUTION

Note: flag indicates which countries pursued the action

Near term	Medium / long term	Not applicable to the US
• **Re-priced** new policies to maintain margins • **Stopped selling traditional savings products** with guarantees altogether • Agents deemphasized guarantees and **focused more on strong historical crediting rates** to policyholders	• Changed product mix – Focused on **less interest rate sensitive and capital intensive products** (e.g. unit linked) – Introduced **new products** that were **profitable** and delivered a compelling **value proposition** (e.g. hybrid products, foreign currency products, modular products) – Began **selling higher margin health products**, including **fee based add-ons** such as fitness centers, diabetes screenings, and doctors visits • Leveraged captive distribution channels to **funnel customers into desirable products** and **convert unprofitable customers** (e.g. cash balances to LTC coverage)	• N/A

For Discussion

- Do we agree with the categorization of learnings?
- Are there key learnings from Japan and Germany that we missed?
- Which topics should we investigate further?

LEARNINGS RELEVANT TO THE US: EXPENSE MANAGEMENT

Note: flag indicates which countries pursued the action

Near term

- **Reduced sales staff**, **reduced pay** to employees, and moved departments out of prime real estate locations

Medium / long term

- Formed **joint ventures**, **consolidate entities**, and use **shared services** to maximize efficiency
- Achieved economies of scale through **M&A**
- Invested in **modernizing IT** services and **automating** services

Not applicable to the US

- N/A

For Discussion

- Do we agree with the categorization of learnings?
- Are there key learnings from Japan and Germany that we missed?
- Which topics should we investigate further?

NEXT STEPS

International Subcommittee Meeting #1
Today

Share findings and continue research
~Four weeks

International Subcommittee Meeting #2
Week of April 27th

01

- Determine implications of learnings for US life insurers
- Decide which topics to require further research / investigation

02

For discussion

- Share applicable findings with broader task force
- Further investigate topics of interest

03

For discussion

- Follow up on open items and topics identified for further investigation
- Identify areas to inform customer & distribution workstream

APPENDIX

PROJECT RECAP

Key questions for Low-Interest Rate Task Force:

How ready is the industry?

What can be done now to prepare?

What response actions can be taken?

What advocacy efforts can be pursued?

Working groups

1 **INT'L MARKET FOUNDATIONS** — What are the US-relevant learnings from int'l markets (e.g., Japan, Germany)?

2 **READINESS** — How should insurers ensure that they are prepared for a low-rate scenario?

3 **CONSUMERS & DISTRIBUTION** — How do insurers maintain a strong value proposition for consumers & distribution?

4 **REGULATORS & OTHER ENTITIES** — What are challenges / impacts to interactions with regulators, rating agencies, etc.?

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