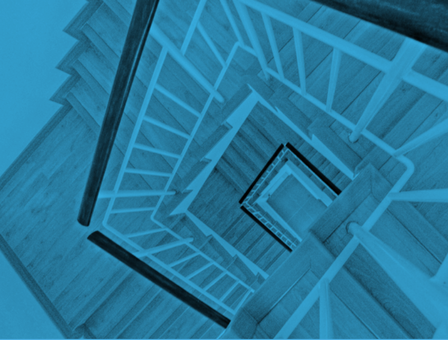


NEAM VANTAGE POINT

Perspectives

JULY 2023

OUR VIEW ON INSURANCE CAPITAL MANAGEMENT TOPICS

IN THIS ISSUE ►

2022 U.S. Life Industry Investment Highlights: Book Yield Boosted!

After a long and steady decline, the life industry's book yield finally experienced a meaningful increase of 46 basis points in 2022.

EXECUTIVE SUMMARY

The U.S. life insurance industry's broad sector allocations remain largely unchanged, with bonds and mortgage loans combined representing 83% of total invested assets. In 2022, the industry's annual net investment income (%) declined marginally, largely driven by reduced contribution from alternative assets.

With the Federal Reserve Bank's aggressive tightening policy, 2022 turned out to be a historic outlier year in terms of the magnitude of market value declines for both fixed income securities and equities. However, the sharp rise in yields had a positive impact on income. Fixed income book yield saw an increase of 46 basis points (bps) while the portfolio's overall credit profile improved, and duration shortened. The corporate allocation declined while private placement and asset-backed securities (ABS) allocations reached their new highs in 2022.

BROAD SECTOR ALLOCATIONS RELATIVELY UNCHANGED

The U.S. life insurance industry's statutory asset allocation across broad sectors remains mostly unchanged for 2022 (see Table 1). Faced with pandemic crisis and business uncertainty, the industry strengthened its liquidity through additional cash and short-term holdings in 2020, but since then has gradually reduced its liquidity to pre-pandemic levels. Bonds remain the largest sector, although their allocation has continued to decline year over year. The allocation to mortgage loans, the second largest sector, reached a new high of 13.4% in 2022. Schedule BA assets exhibited additional growth in 2022 and remained highly concentrated among large organizations.

For more information on this topic, contact the authors:

Mark Yu
Head of Enterprise Capital Strategy
mark.yu@neamgroup.com

Phil Lee
Enterprise Capital Strategist
phil.lee@neamgroup.com

neamgroup.com

NEAM New England Asset Management

Table 1. Broad Sector Asset Allocation

Holdings	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
Bonds	69.5%	70.0%	70.3%	71.1%	72.4%	73.0%	73.5%	73.8%	73.9%	74.5%
Mortgage Loans	13.4%	12.8%	12.6%	13.0%	12.6%	11.7%	11.2%	10.9%	10.3%	10.1%
Equities	2.4%	2.8%	2.5%	2.5%	2.3%	2.6%	2.5%	2.3%	2.4%	2.5%
Real Estate	0.4%	0.5%	0.5%	0.5%	0.5%	0.6%	0.6%	0.6%	0.6%	0.6%
Contract Loans	2.6%	2.6%	2.8%	3.0%	3.1%	3.2%	3.3%	3.4%	3.6%	3.7%
Derivatives	1.9%	2.0%	2.6%	1.8%	1.4%	1.4%	1.6%	1.5%	1.6%	1.1%
Other (Sch. BA)	7.0%	6.5%	5.5%	5.3%	5.1%	5.0%	4.7%	4.7%	5.0%	4.7%
Cash/Short-Terms	2.8%	2.9%	3.2%	2.7%	2.5%	2.5%	2.6%	2.7%	2.7%	2.7%
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

Source: NEAM, S&P Capital IQ Pro

NET INVESTMENT INCOME (%) DECLINED

Table 2 highlights the life industry's total cash and investments, and earned investment income on a gross and net basis. Over the last decade, the industry's total cash and investments grew 45% from $3.5tn to $5.0tn, while net investment income ($) rose by only 19% from $166.6bn to $197.8bn. The industry's annual net investment income (%) declined by 18 bps in 2022, after a short-lived uptick observed in 2021, largely driven by lower contribution from Schedule BA assets (see Table 3).

Table 2. Earned Investment Income $ Billion and %

Category	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
Total Cash/ Investments($)	5,008.6	4,858.5	4,630.0	4,316.7	4,090.6	4,036.0	3,853.7	3,664.1	3,592.6	3,448.1
Gross Earned Investment Income($)	216.6	212.9	198.8	199.8	199.3	193.1	183.3	180.4	181.1	177.0
Investment Expenses($)	18.9	14.1	13.6	14.2	13.2	12.5	11.7	11.0	10.6	10.4
Net Investment Income($)	197.8	198.8	185.2	185.6	186.1	180.7	171.7	169.4	170.5	166.6
Net Investment Income(%)	4.01%	4.19%	4.14%	4.42%	4.58%	4.58%	4.57%	4.67%	4.84%	4.89%

Source: NEAM, S&P Capital IQ Pro

Table 3 displays the industry's earned investment income contribution from broad asset sectors. Bonds and mortgage loans combined contributed three quarters of the total, while the contribution from unaffiliated equities represented merely 1%. Although the contribution from Schedule BA assets declined in 2022, it remained at a meaningful level similar to that of mortgage loans.

Table 3. Earned Investment Income Contribution by Sector

Asset Class/ Sector	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
Bonds	63%	63%	67%	67%	65%	67%	69%	69%	70%	71%
Mortgage Loans	13%	12%	13%	12%	11%	11%	11%	11%	11%	11%
Unaffiliated Equities	1%	1%	1%	1%	1%	1%	1%	1%	1%	1%
Affiliated Bonds/Equities	3%	3%	3%	4%	4%	4%	3%	3%	3%	3%
Cash/Short-Terms	1%	0%	1%	1%	1%	1%	0%	0%	0%	0%
Real Estate	1%	1%	2%	2%	2%	2%	2%	2%	2%	2%
Contract Loans	3%	4%	4%	4%	4%	4%	4%	4%	4%	4%
Derivatives	2%	3%	2%	1%	3%	4%	2%	2%	3%	3%
Other (Sch. BA)	11%	13%	8%	8%	8%	8%	7%	7%	7%	6%
Total Gross Earned	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

Source: NEAM, S&P Capital IQ Pro

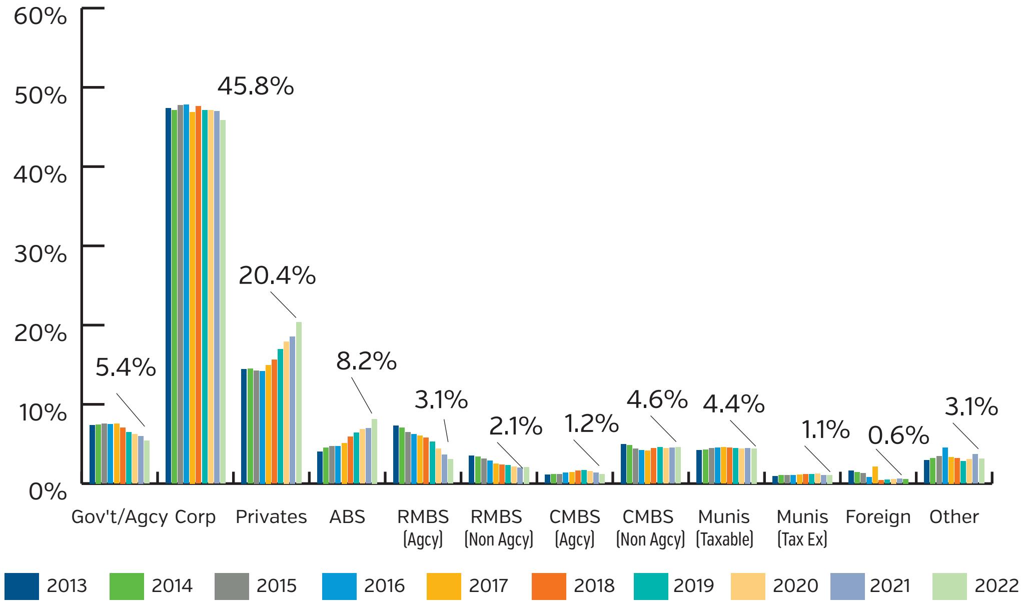
FIXED INCOME ALLOCATION: PRIVATE PLACEMENTS AND ASSET-BACKED SECURITIES GROWING

Chart 1 displays secular trends in fixed income sector allocations over the past decade. Corporate and private placements sectors combined represent two-thirds of the total. In 2022, the corporate allocation experienced a meaningful decline while the private placement allocation exhibited its continued growth. As noted in prior publications, unlike statutory Schedule D Part 1A reporting, our reported private placement category excludes publicly-traded 144A securities.

Within structured securities (i.e., ABS, RMBS and CMBS), the ABS sector has continued to grow over the last decade, reaching a new high of 8.2 % in 2022. On the other hand, the CMBS sector has stayed range-bound while the RMBS sector has shown a continued downward trend.

The allocation to taxable municipal bonds rose from less than 1%[1] prior to the 2008 global financial crisis to its high of 4.6% in 2018 and has remained largely at that level. This increase began in 2009 and 2010, after the passage of the "American Recovery and Reinvestment Act." This act led to the creation of "Build America Bonds," which allowed municipalities and municipal authorities to raise debt, with the federal government providing a direct subsidy of the interest cost.

Chart 1. Fixed Income Sector Allocation



Source: NEAM, S&P Capital IQ Pro

BOOK YIELD BOOSTED BY FED'S TIGHTENING POLICY

In 2022, the Federal Reserve Bank raised the Federal Funds Rate seven times and the 10-year Treasury yield reached 4.35% in October 2022. As a result, the industry's book yield saw a meaningful increase of 46 bps in 2022, after a long and steady decline (Table 4). Moreover, the book yield across all sectors rose in 2022, with ABS leading the most increase of 245 bps.

Table 4. Fixed Income Sector Book Yield (%)

Sector	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
Gov't/Agcy	3.18	2.81	3.00	3.55	3.60	3.44	3.46	3.54	3.64	3.72
Corp	4.22	4.03	4.23	4.47	4.58	4.57	4.72	4.90	5.02	5.13
ABS	5.34	2.88	3.07	4.07	4.33	3.84	3.78	3.68	3.52	3.56
RMBS - Agcy	3.36	3.20	3.42	3.64	3.70	3.66	3.79	4.02	4.15	4.28
RMBS - Non Agcy	4.82	4.06	4.55	5.10	5.85	6.03	6.22	5.80	5.82	6.04
CMBS - Agcy	3.36	3.35	3.37	3.50	3.47	3.41	3.61	3.84	3.96	4.02
CMBS - Non Agcy	4.08	3.38	3.58	3.78	3.90	3.83	4.09	4.46	4.67	4.95
Munis - Taxable	4.24	4.20	4.40	4.73	4.94	4.99	5.08	5.19	5.32	5.42
Munis - Tax Exempt	3.81	3.68	3.78	3.95	4.03	3.93	4.06	4.17	4.25	4.19
Privates	4.22	3.90	4.04	4.29	4.34	4.36	4.53	4.71	4.92	5.15
Foreign	4.08	3.47	3.59	3.34	3.48	2.26	2.67	2.56	2.67	2.71
Grand Total	4.25	3.79	3.97	4.29	4.41	4.31	4.44	4.61	4.71	4.85

Source: NEAM, S&P Capital IQ Pro

Table 5 displays option-adjusted duration (OAD) by fixed income sector. The OAD statistics are based upon CUSIP- level holdings extracted from Schedule D statutory filings and exclude any bonds held at the holding company level, derivatives, and private placement securities. The industry's OAD was 5.5 years[2] right before the 2008 financial crisis and then gradually extended to 7.9 years through 2017. From 2017 to 2019, the industry's OAD remained relatively unchanged, *likely* driven by asset liability matching requirements. The duration extension seen during 2020 and 2021 coincided with broad-based bond duration extension resulting from the Fed's accommodative policy. In 2022, the industry's aggregate duration shortening corresponded with broad-based bond duration shortening, except for MBS where prepayment slowed and duration extended, under a rising interest rate environment.

Table 5. Fixed Income Sector Option Adjusted Duration (Years)

Sector	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
Gov't/Agcy	11.7	12.5	12.2	11.6	11.2	11.3	11.8	11.0	10.8	11.2
Corp	8.6	9.5	9.2	8.5	7.9	8.1	7.8	7.5	7.5	7.4
ABS	3.8	3.5	3.2	3.8	4.0	4.5	3.2	4.2	2.2	3.2
RMBS - Agcy	7.3	5.2	4.7	5.5	6.4	6.3	6.8	5.3	5.2	6.3
RMBS - Non Agcy	5.4	3.3	3.5	4.1	4.2	4.2	3.9	2.7	3.2	2.7
CMBS - Agcy	5.3	4.9	4.5	5.7	6.5	6.2	6.2	6.8	7.0	6.9
CMBS - Non Agcy	3.6	4.3	4.6	5.0	5.1	5.6	5.4	4.8	4.0	3.6
Munis - Taxable	9.4	9.9	10.0	9.0	8.5	9.1	9.4	9.6	9.9	10.0
Munis - Tax Exempt	11.3	8.8	9.5	9.8	10.4	10.0	10.3	9.8	9.3	9.6
Foreign	7.1	7.5	7.1	6.9	6.6	8.6	14.4	14.3	14.3	14.6
Industry OAD	8.0	8.6	8.3	7.9	7.6	7.9	7.8	7.5	7.3	7.4

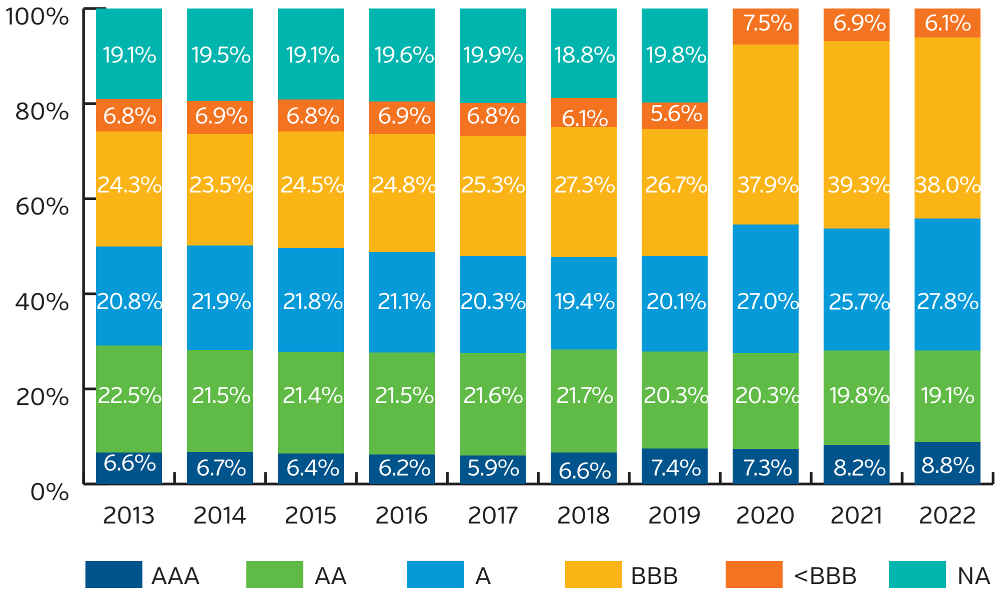
Source: NEAM, S&P Capital IQ Pro

CREDIT QUALITY IMPROVED

Over the past decade, under the low interest rate environment, the industry increased its credit risk, evidenced by increased allocations to BBB, which reached their highest allocations at year-end 2021 (Chart 2). In 2022, with the Fed's aggressive tightening policy, the industry took advantage of the rising rates and improved its credit profile by increasing the allocations to AAA and A securities and reducing BBB and below investment grade (<BBB) allocations.

Starting in 2020, the National Association of Insurance Commissioners (NAIC) expanded the credit rating reporting from six to 20 categories. The NR category shown for 2019 and prior years consists of mostly "true"[3] private placement securities (Chart 1). Based on historical statutory filings, about half of the industry's private placement securities fell into the BBB rating category. This explains the 11 percentage points BBB allocation increase exhibited between 2019 and 2020 (Chart 2).

Chart 2. Fixed Income Credit Quality

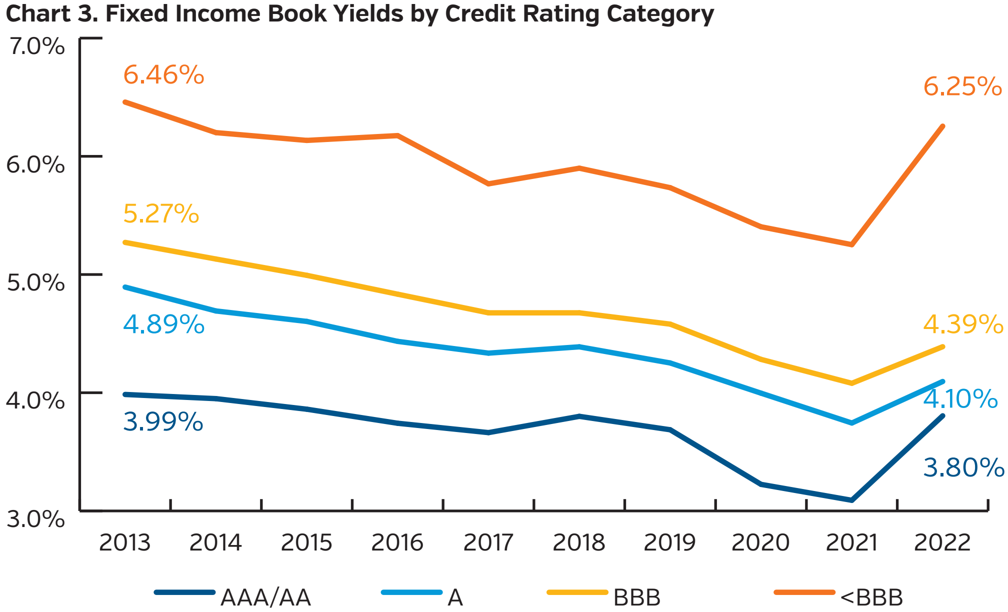


Source: NEAM, S&P Capital IQ Pro

ALL CREDIT RATING CATEGORIES EXHIBIT YIELD INCREASE AND DURATION SHORTENING

Chart 3 displays the book yields for public fixed income securities by credit rating category. In 2022, total fixed income book yields rose across all rating categories, with <BBB category showing the largest increase of 100 bps.

Chart 3. Fixed Income Book Yields by Credit Rating Category



Source: NEAM, S&P Capital IQ Pro

Table 6 displays the OAD for public fixed income securities by credit rating category. High yield (<BBB) bonds typically exhibit shorter durations than investment grade bonds. In 2022, durations shortened across all rating categories. Private placement securities, which accounted for 20.4% of total fixed income holdings in 2022 (see Chart 2), were not included in the aggregate duration calculation.

Table 6. Fixed Income Duration by Credit Rating Category

Rating	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
AAA/AA	7.9	7.9	7.8	7.6	7.8	8.2	8.4	7.8	7.3	8.1
A	8.8	9.7	9.3	8.8	8.3	8.6	8.6	8.5	8.5	8.0
BBB	8.0	9.0	8.7	8.1	7.6	7.8	7.4	7.1	7.1	7.0
<BBB	4.6	5.0	5.0	4.7	5.1	5.1	4.7	4.1	4.3	4.0
Total (ex. Priv. Placem.)	8.0	8.6	8.3	7.9	7.6	7.9	7.8	7.5	7.3	7.4

Source: NEAM, S&P Capital IQ Pro

KEY TAKEAWAYS

- Faced with the pandemic crisis, inflation pressures and business uncertainty, the industry strengthened its cash and short-term holdings in 2020, but has since reduced its liquidity to pre-pandemic levels; the broad sector allocations remain relatively unchanged.
- The industry's investment income declined, thanks to reduced contribution from Schedule BA assets. Alternatives allocations reached a new high in 2022 and their contribution to the industry's investment income is now comparable to that of mortgage loans.
- Within the fixed income portfolio, allocations to private placement securities and ABS continued to trend upward. The industry's book yield exhibited the highest annual increase of 46 bps, thanks to the Fed's aggressive tightening policy. The portfolio's overall credit profile improved, and duration shortened.

Please contact us if you would like to receive a customized assessment, which facilitates in-depth comparisons and contrasts of enterprise characteristics of your company relative to peer organizations. The assessment supports decisions with enterprise risk preferences and investment strategy.

ENDNOTES

[1] Please see prior issues of NEAM *Perspectives* – U.S. Life Industry Investment Highlights

[2] Please see prior issues of NEAM *Perspectives* – U.S. Life Industry Investment Highlights

[3] "True" private placement category excludes any 144A securities that are publicly traded.

neamgroup.com
Connecticut | California | Dublin | London