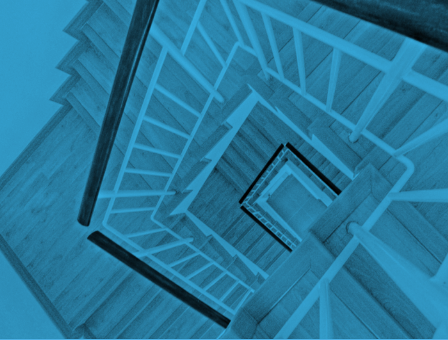


NEAM VANTAGE POINT

Perspectives

JULY 2024

OUR VIEW ON INSURANCE CAPITAL MANAGEMENT TOPICS

IN THIS ISSUE ►

2023 Life Industry Investment Highlights: Heading in the Right Direction!

Following a significant increase of 46 basis points (bps) in book yield in 2022, the life insurance industry's book yield saw another substantial rise of 37 bps in 2023.

EXECUTIVE SUMMARY

In 2023, the asset allocations of the U.S. life insurance industry have remained largely stable, with bonds, mortgage loans, and Schedule BA assets representing the top three sectors. In contrast, the industry's holdings in cash and short-term investments soared to an unprecedented 3.5%, a surge likely driven by attractive short-term interest rates. Consequently, the overall net investment income increased.

In 2022, the elevated level of interest rates positively impacted the book yield of the life insurance industry's fixed income portfolio. This trend continued into 2023, where the industry's fixed income book yield experienced an increase of 37 bps, despite the improvement in credit quality and the shortening of duration. The allocation to corporate bonds continued to decline, while allocations to private placements and asset-backed securities (ABS) reached new highs in 2023.

NET INVESTMENT INCOME (%) CLIMBED, THANKS TO BONDS, CASH & SHORT-TERMS

Table 1 highlights the life insurance industry's total cash and investments, along with the earned investment income on both a gross and net basis. Since 2019 (pre-pandemic), the industry's total cash and investments have grown 19% from \$4.5tn to \$5.3tn, and the net investment income (\$) has risen by 17%, moving from \$192.6bn to \$225.0bn. In 2023, the industry's annual net investment income (%) saw an increase of 26 bps, following a decline of 21 bps in 2022.

For more information on this topic, contact the authosr:

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

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

Eric Huang
Enterprise Capital Strategist
eric.huang@neamgroup.com

neamgroup.com

Table 1. Earned Investment Income $ Billion and Percentage

Category	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Total Cash/ Investments[$]	5,341.8	5,189.7	5,038.3	4,803.4	4,483.2	4,111.6	4,056.4	3,872.4	3,682.1	3,610.2
Gross Earned Investment Income[$]	246.2	224.5	222.4	205.8	207.1	200.2	194.0	184.1	181.2	182.0
Investment Expenses [$]	21.2	19.2	14.4	13.9	14.5	13.3	12.5	11.7	11.1	10.7
Net Investment Income[$]	225.0	205.3	208.0	191.9	192.6	186.9	181.5	172.4	170.1	171.3
Net Investment Income[%]	4.27%	4.01%	4.23%	4.13%	4.48%	4.58%	4.58%	4.56%	4.67%	4.84%

Source: NEAM, S&P Capital IQ Pro

Table 2 displays the industry's contribution to earned investment income from broad asset sectors. Combined, bonds and mortgage loans contributed 80% of the total, while unaffiliated equities contributed a mere 1%. Cash and short-term holdings made a meaningful contribution of 3%, likely due to the increased allocation observed in 2023 (refer to Table 3).

Table 2. Earned Investment Income Contribution by Sector

Asset Class/Sector	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Bonds	66%	63%	62%	67%	67%	65%	67%	69%	69%	70%
Mortgage Loans	13%	13%	12%	13%	12%	11%	11%	11%	11%	11%
Unaffiliated Equities	1%	1%	1%	1%	1%	1%	1%	1%	1%	1%
Affiliated Bonds/Equities	4%	3%	3%	3%	4%	4%	4%	3%	3%	3%
Cash/Short-Terms	3%	1%	0%	1%	1%	1%	1%	0%	0%	0%
Real Estate	1%	1%	1%	2%	2%	2%	2%	2%	2%	2%
Contract Loans	3%	3%	4%	4%	4%	4%	4%	4%	4%	4%
Derivitives	-2%	2%	3%	2%	1%	3%	4%	2%	2%	3%
Other (Sch. BA)	11%	11%	13%	8%	8%	8%	8%	7%	7%	7%
Total Gross Earned	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

Source: NEAM, S&P Capital IQ Pro

BROAD SECTOR ALLOCATIONS STEADY, RISING MORTGAGE LOANS & INCREASED SHORT-TERM HOLDINGS

In 2023, the U.S. life insurance industry's statutory asset allocation across broad sectors largely maintained its status quo, although it has been gradually shifting over the past decade (see Table 3). Bonds, despite a continued annual decrease in their allocation, remain the dominant sector. Mortgage loans, the second largest sector, saw their allocation peak at 13.7% in 2023. Schedule BA assets also experienced growth in 2023, with a high concentration observed among large organizations. A significant observation for 2023 was the increase in cash and short-term holdings, likely a result of attractive short-term interest rates.

Table 3. Broad Sector Asset Allocation

Holdings	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Bonds	68.1%	69.5%	70.0%	70.4%	71.2%	72.4%	72.9%	73.4%	73.8%	73.8%
Mortgage Loans	13.7%	13.4%	12.7%	12.5%	12.9%	12.7%	11.8%	11.3%	11.0%	10.3%
Cash/Short-Terms	3.5%	2.7%	2.9%	3.2%	2.7%	2.5%	2.5%	2.6%	2.7%	2.7%
Equities	2.5%	2.5%	2.8%	2.6%	2.6%	2.4%	2.6%	2.5%	2.4%	2.4%
Real Estate	0.4%	0.4%	0.5%	0.5%	0.5%	0.5%	0.6%	0.6%	0.6%	0.6%
Contract Loans	2.6%	2.5%	2.6%	2.8%	3.0%	3.1%	3.2%	3.3%	3.4%	3.6%
Derivitives	1.9%	1.8%	1.9%	2.5%	1.8%	1.4%	1.4%	1.6%	1.5%	1.6%
Other (Sch. BA)	7.2%	7.0%	6.6%	5.5%	5.3%	5.1%	5.0%	4.7%	4.7%	5.0%
Total Gross Earned	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

Source: NEAM, S&P Capital IQ Pro

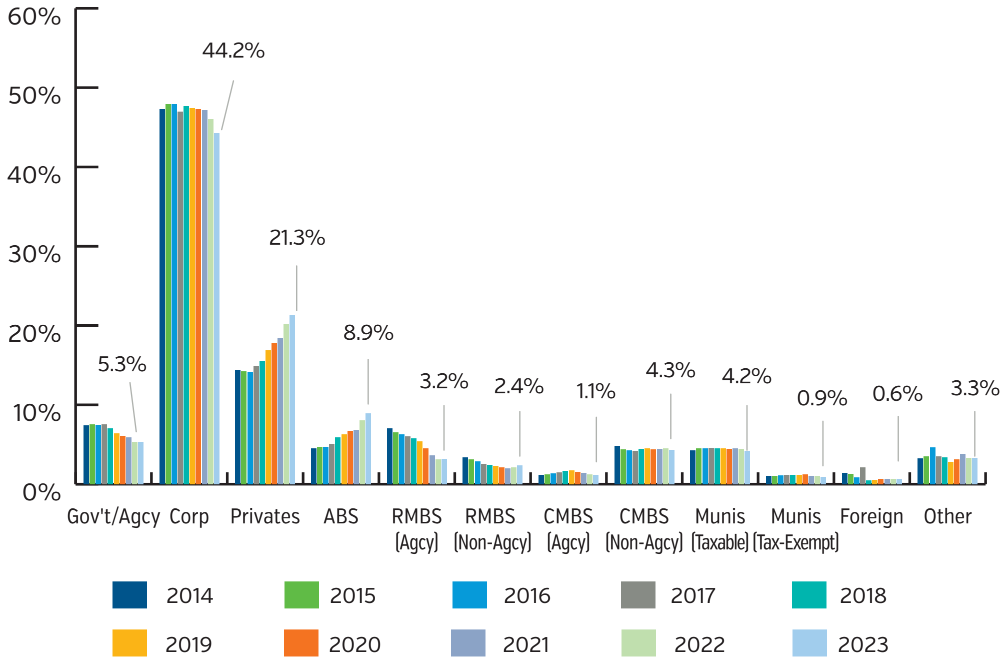
FIXED INCOME ALLOCATION: GROWTH IN PRIVATE PLACEMENTS & ASSET-BACKED SECURITIES

Chart 1 displays the secular trends in fixed income sector allocations over the past decade. The corporate and private placement sectors combined represent two-thirds of the total. In 2023, the corporate allocation continued to experience a significant decline, while the private placement allocation demonstrated sustained growth. As noted in prior publications, our reported private placement category excludes publicly traded 144A securities, unlike statutory Schedule D Part 1A reporting.

Within structured securities (i.e., ABS, RMBS, and CMBS), the asset-backed securities (ABS) sector has continued to grow over the last decade, reaching a new high of 8.9% in 2023. Conversely, the commercial mortgage-backed securities (CMBS) sector has remained range-bound, and the residential mortgage-backed securities (RMBS sector had shown a continued downward trend until its rebound in 2023.

The allocation to taxable municipal bonds increased from less than 1%[1] prior to the 2008 global financial crisis to a high of 4.6% in 2017 and has remained range-bound at that level since. This increase began in 2009 and 2010, following the passage of the “American Recovery and Reinvestment Act.” This act led to the creation of “Build America Bonds,” which enabled 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

ANOTHER YEAR OF SIGNIFICANT BOOST IN BOOK YIELD

In 2023, aided by generally higher interest rate levels, the industry's book yield continued to improve, ending at 4.62%, the second-highest level over the last decade. This follows a significant increase of 46 bps in the book yield seen in 2022 (Table 4). Furthermore, the book yield across all sectors, except for CMBS Agency, rose in 2023, with ABS leading the way with an increase of 110 bps.

Table 4. Fixed Income Sector Book Yield (%)

Sector	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Gov't/Agcy	3.37	3.16	2.79	2.98	3.53	3.60	3.44	3.46	3.54	3.64
Corp	4.39	4.21	4.03	4.23	4.46	4.57	4.57	4.72	4.90	5.01
ABS	6.41	5.31	2.89	3.07	4.07	4.33	3.84	3.78	3.68	3.53
RMBS - Agcy	3.71	3.34	3.17	3.35	3.61	3.70	3.67	3.79	4.02	4.15
RMBS - Non-Agcy	5.46	4.80	4.06	4.56	5.09	5.85	6.03	6.22	5.80	5.82
CMBS - Agcy	3.35	3.39	3.35	3.38	3.50	3.47	3.41	3.61	3.85	3.96
CMBS - Non-Agcy	4.53	4.07	3.38	3.57	3.77	3.90	3.83	4.09	4.46	4.67
Munis - Taxable	4.25	4.23	4.19	4.39	4.72	4.94	4.99	5.08	5.19	5.32
Munis - Tax-Exempt	3.85	3.81	3.68	3.78	3.95	4.04	3.94	4.06	4.18	4.25
Privates	4.67	4.21	3.90	4.04	4.29	4.33	4.35	4.53	4.70	4.92
Foreign	4.50	4.02	3.46	3.57	3.40	3.48	2.26	2.67	2.56	2.67
Grand Total	**4.62**	**4.24**	**3.78**	**3.97**	**4.29**	**4.40**	**4.31**	**4.44**	**4.60**	**4.71**

Source: NEAM, S&P Capital IQ Pro

DURATION CONTINUED TO SHORTEN

Table 5 presents the option-adjusted duration (OAD) for each fixed income sector. The OAD data is derived from CUSIP-level holdings, which are extracted from Schedule D statutory filings. This data does not include bonds held at the holding company level, derivatives, or private placement securities. Before the 2008 financial crisis, the industry's OAD was 5.5 years.[1] It extended to 7.9 years by 2017. From 2017 to 2019, the OAD remained relatively stable, likely due to asset liability matching requirements. During 2020 and 2021, the duration extension coincided with a broad-based bond duration extension, a result of the Federal Reserve's accommodative policy. In 2022, the industry's aggregate duration shortened, aligning with a broad-based bond duration shortening in a rising interest rate environment. In 2023, the industry continued to show a reduction in long-duration corporate bonds and an increase in short-duration ABS allocations, leading to the overall duration shortening observed in the industry.

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

Sector	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Gov't/Agcy	11.5	11.7	12.3	12.0	11.5	11.2	11.3	11.8	11.0	10.8
Corp	8.5	8.6	9.5	9.1	8.4	7.9	8.1	7.8	7.5	7.5
ABS	3.1	3.8	3.5	3.2	3.8	4.0	4.5	3.2	4.2	2.2
RMBS - Agcy	6.4	7.2	5.2	4.7	5.4	6.4	6.3	6.8	5.3	5.2
RMBS - Non-Agcy	5.4	5.4	3.3	3.5	4.1	4.2	4.2	3.9	2.7	3.2
CMBS - Agcy	4.7	5.2	4.9	4.5	5.7	6.5	6.2	6.2	6.8	7.0
CMBS - Non-Agcy	3.3	3.6	4.3	4.6	5.0	5.1	5.6	5.4	4.8	4.0
Munis - Taxable	9.3	9.4	9.8	10.0	8.9	8.5	9.1	9.4	9.5	9.9
Munis - Tax-Exempt	10.8	11.2	8.7	9.4	9.8	10.5	10.0	10.4	9.8	9.3
Foreign	6.9	7.1	7.5	7.0	6.7	6.6	8.6	14.4	14.3	14.3
Grand Total	**7.6**	**7.9**	**8.5**	**8.2**	**7.8**	**7.6**	**7.9**	**7.8**	**7.5**	**7.3**

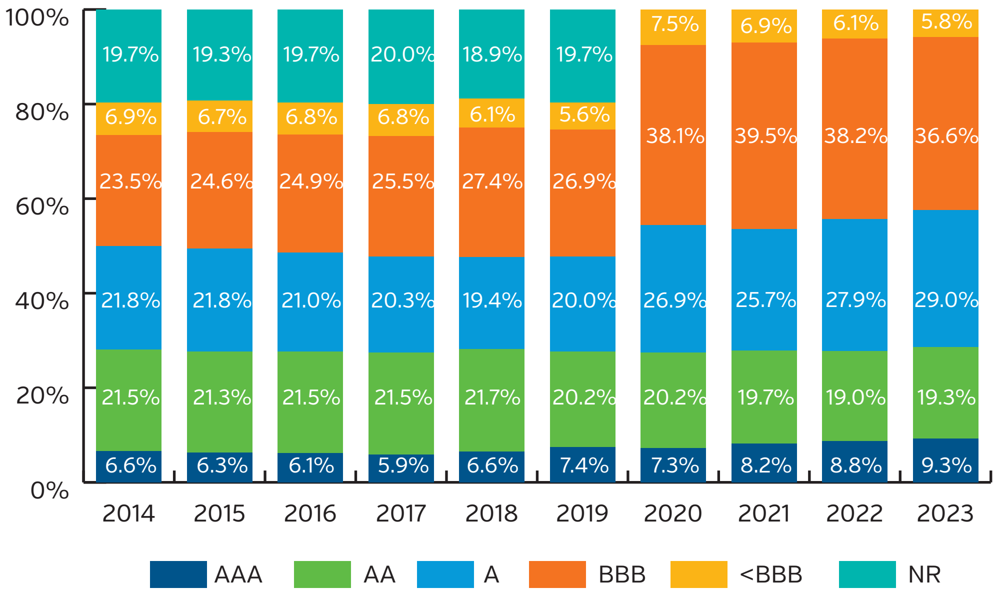
Source: NEAM, S&P Capital IQ Pro

CREDIT QUALITY CONTINUED TO IMPROVE

Prior to 2022, the low-interest rate environment led the industry to increase credit risk, as evidenced by increased allocations to BBB, which reached their highest allocations in 2021 (Chart 2). Beginning in 2022, with the Federal Reserve's aggressive tightening policy, the industry started to take advantage of elevated interest rates. It 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 mostly of "true"[2] 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 point increase in BBB allocation exhibited between 2019 and 2020 (Chart 2).

Chart 2. Fixed Income Credit Quality

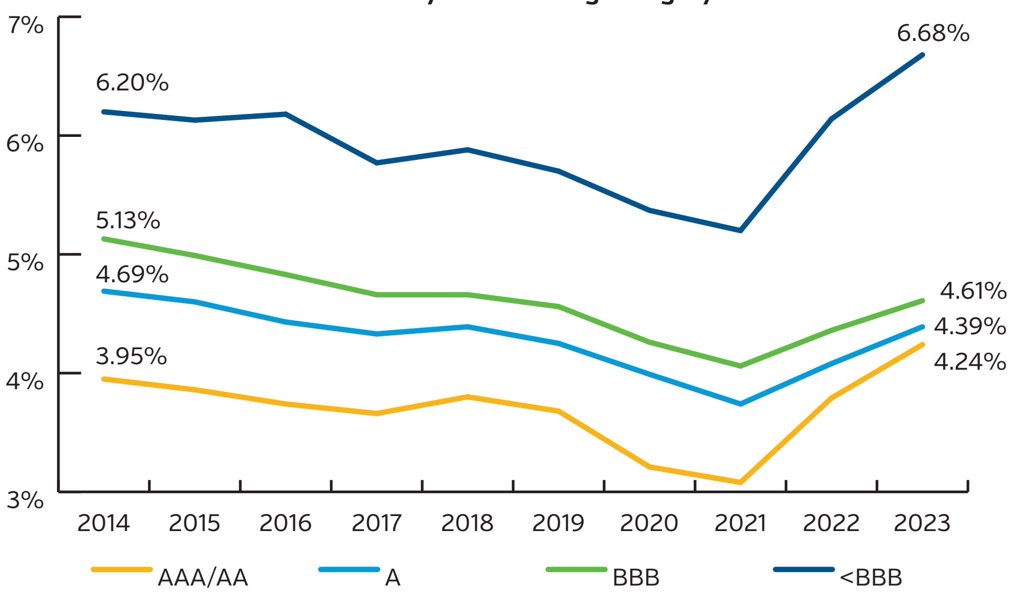


Source: NEAM, S&P Capital IQ Pro

ALL CREDIT RATING CATEGORIES EXHIBIT YIELD INCREASE & DURATION SHORTENING

Chart 3 displays the book yields for public fixed income securities by credit rating category. From 2022 onwards, we observe an upward trend in total fixed income book yields across all rating categories. Notably, the AAA/AA and <BBB categories experienced increases of 116 bps and 148 bps, respectively, over the last two years.

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 bonds (those rated <BBB) typically exhibit shorter durations than investment grade bonds. In 2023, durations showed a reduction across all rating categories. Private placement securities, which accounted for 21.3% of total fixed income holdings in 2023 (see Chart 2), were not included in the aggregate duration calculation.

Table 6. Fixed Income Duration by Credit Rating Category

Rating	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
AAA/AA	7.3	7.8	7.8	7.7	7.5	7.8	8.2	8.4	7.8	7.3
A	8.5	8.7	9.6	9.2	8.8	8.2	8.6	8.5	8.5	8.5
BBB	7.7	7.9	8.9	8.6	8.0	7.6	7.7	7.3	7.0	7.1
<BBB	4.1	4.6	5.0	5.0	4.7	5.1	5.1	4.7	4.1	4.3
Total (Private Placements Excluded)	**7.6**	**7.9**	**8.5**	**8.2**	**7.8**	**7.6**	**7.9**	**7.8**	**7.5**	**7.3**

Source: NEAM, S&P Capital IQ Pro

KEY TAKEAWAYS

- The industry experienced a rise in investment income (in percentage terms) in 2023. This increase was largely attributable to the contributions from bonds, and cash and short-term assets. The surge in allocation of cash and short-term assets in 2023 was likely influenced by favorable short-term rates.
- Broad sector allocations have remained dominated by bonds, mortgage loans and Schedule BA assets. However, there was a noticeable decrease in bonds, while mortgage loans and Schedule BA assets were on an upward trend.
- Within the fixed income portfolio, there was a continuing upward trend in allocations to private placement securities and (ABS). On the other hand, allocations to corporate bonds were on a downward trend.
- The industry's book yield saw a significant increase of 46 bps in 2022, followed by another substantial increase of 37 bps in 2023. During this period, the portfolio's overall credit profile improved, and its duration shortened.

Please contact us if you would like to receive a customized assessment. This assessment facilitates in-depth comparisons and contrasts of your company's enterprise characteristics relative to peer organizations. It supports decision-making processes concerning enterprise risk preferences and investment strategy.

ENDNOTES

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

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

NEAM New England Asset Management

neamgroup.com
Connecticut | California | Dublin | London