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M Intelligence

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Mutual Life Insurance Company Dividend Rates for 2017

Downward pressure from low new money interest rates have caused portfolio yields and dividend interest rates at life insurance companies to decline. As a result, many mutual insurance companies with sizeable blocks of participating whole life insurance liabilities have shifted their portfolios in the direction of riskier, less liquid assets in search of higher yields to support their dividend payments to policyholders.

Near the end of each calendar year, mutual insurance companies declare their dividend interest rates on participating whole life (WL) insurance policies for the upcoming year. Below are the declared 2017 dividend interest rates (DIR) of four major mutual life insurance companies, which are the largest issuers of participating whole life policies.

- Guardian Life Insurance Co. of America 5.85% (down from 6.05% in 2016)
- Massachusetts Mutual Life Insurance Co. 6.70% (down from 7.10%)
- New York Life Insurance Co. 6.20% (unchanged)¹
- Northwestern Mutual Life Insurance Co. 5.00% (down from 5.45%)

Source: Each respective carrier's public dividend announcement

Policy Reviews

As DIRs continue their downward trend, it is imperative that whole life policies have updated in-force illustrations run at the new dividend scale and are stress tested at lower DIRs, which are likely to be in effect in future policy years. With lower dividend scales, additional premium will likely be required to maintain existing coverage for life. Policyholder options to review include:

- Paying additional premium
- Adjusting policy into reduced paid-up status
- Adjusting policy into extended term status
- Surrendering the policy
- 1035 exchanging the policy to another product

An experienced life insurance consultant can assist policyholders in understanding options and suggesting recommendations for courses of action, including evaluating 1035 exchange opportunities for clients who have policies with DIRs substantially lower than the rate offered at the time the policy was issued.

1 New York Life changed the methodology it uses to calculate the dividend interest rate (DIR) in 2010 to more closely align with the DIR methodology used by other carriers. This change had the effect of raising the DIR by 32 basis points from the previous method. The DIR in years prior to 2010 have been adjusted to reflect this change in methodology.

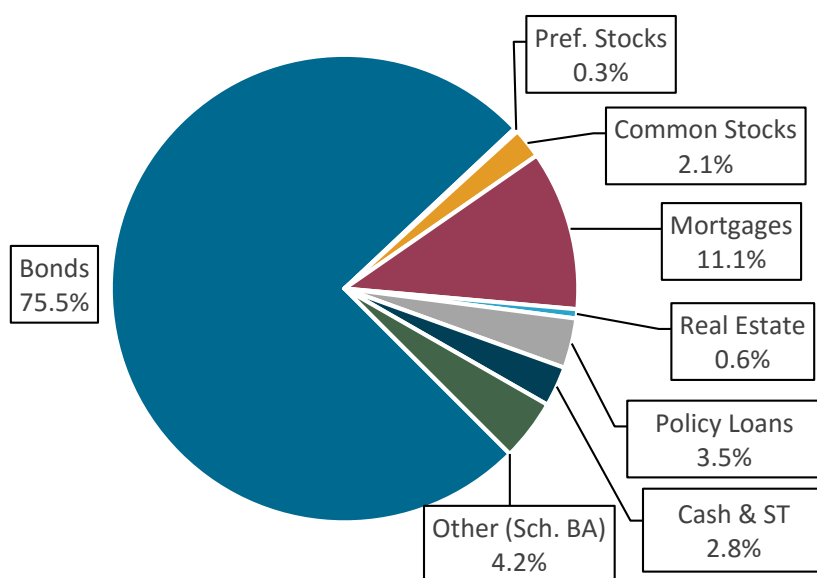
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Fixed Income Asset Classes Lead Insurance Company Portfolios

Insurance companies invest assets primarily in investment grade bonds and mortgages. These fixed income asset classes are a strong match in supporting longer-term insurance liabilities. As seen in Figure 1, more than 86% of insurance industry invested assets were in bonds and mortgages at year-end 2015. Table 1 shows that 94% of industry bond holdings were class 1 and 2 (i.e., investment grade); 63% were class 1.

Figure 1. Asset Allocation of U.S. Life/Health Industry Invested Assets, 2015



Source: A.M. Best Statement File

Table 1. NAIC Classification of U.S. Life/Health Industry Bond Assets, 2015 (with Moody's and S&P equivalent ratings)

Class 1 (Moody's 'A3' or better; S&P 'A-' or better)	63.4%
Class 2 (Moody's 'Baa'; S&P 'BBB')	30.8%
Class 3 (Moody's 'Ba'; S&P 'BB')	3.8%
Class 4 (Moody's 'B'; S&P 'B')	1.6%
Class 5 (Moody's 'Caa'; S&P 'CCC')	0.4%
Class 6 (Moody's below 'Caa'; S&P below 'CCC')	0.1%

Source: A.M. Best Statement File

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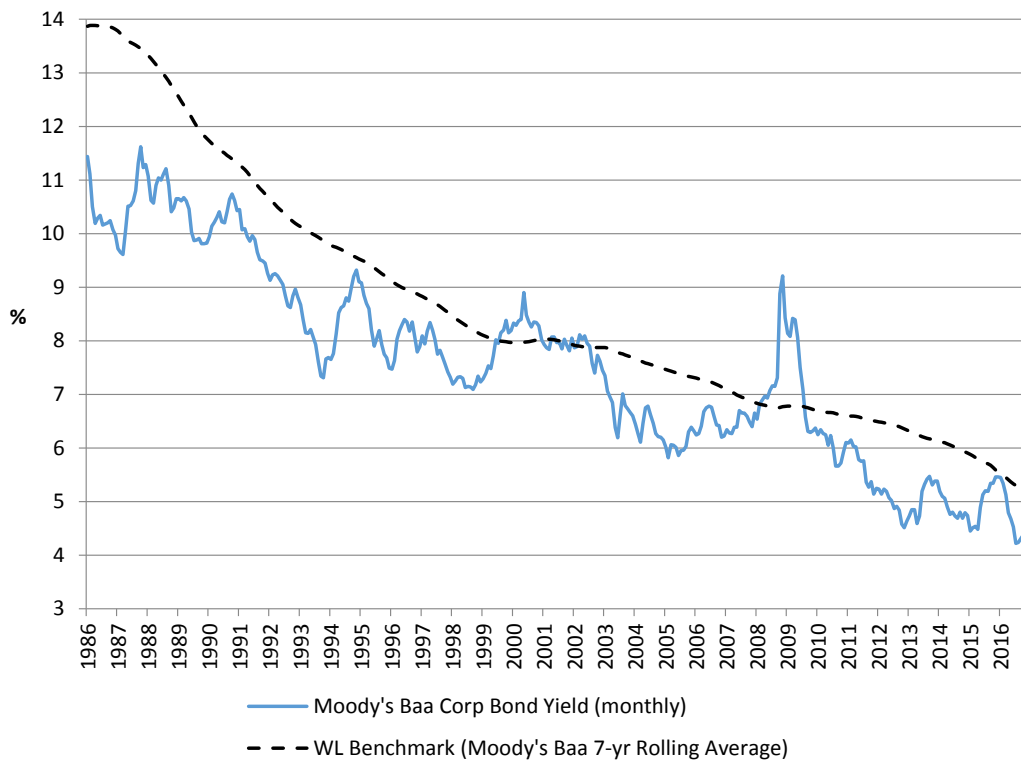
The Correlation between Dividend Interest Rates and Fixed Income Benchmark

Because insurance company invested assets are concentrated in bonds and mortgages, changes in DIRs generally correlate to long-term interest rate changes, especially benchmarks reflecting a seasoned portfolio of long-term interest rates.

The Moody's 'Baa' Long-Term Corporate Bond Yield Average, which provides the new money rate for an investment grade fixed income instrument, serves as an effective proxy for a typical insurance company asset. The seven-year rolling average of Moody's 'Baa' can provide an example of an insurance company portfolio yield as the rolling average contains both older and newer investments, simulating the older assets that mature and roll off the books and the purchase of new assets over time.

When referring to Figure 2, which shows historical interest rates, note that new money interest rates have been declining; the seven-year rolling average (proxy for portfolio yield) has also been declining but lags new money rates. For example, if new money rates are below the portfolio yield and were to remain level, the portfolio yield would steadily decrease over time and would equal the new money rate in seven years (the lag factor).

Figure 2. Monthly and 7-Year Rolling Average of Moody's 'Baa' Long-Term Corporate Bond Yield Average



Source: M Financial Group

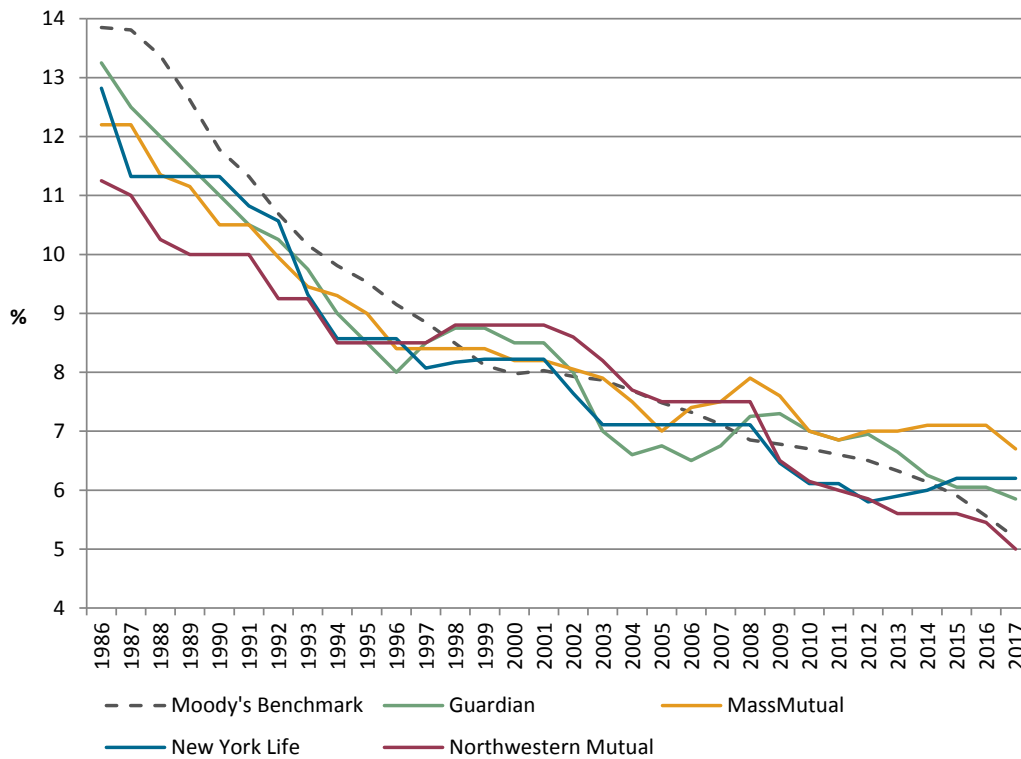


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Historically, the annual change in the seven-year rolling average of the Moody's 'Baa' Long-Term Corporate Bond Yield Average, referred to in this analysis as the Moody's Benchmark (Figure 3), correlates well with the annual change in DIRs. Since insurance companies declare their annual dividend near the end of the previous year, the Moody's benchmark is as of the end of the prior calendar year.

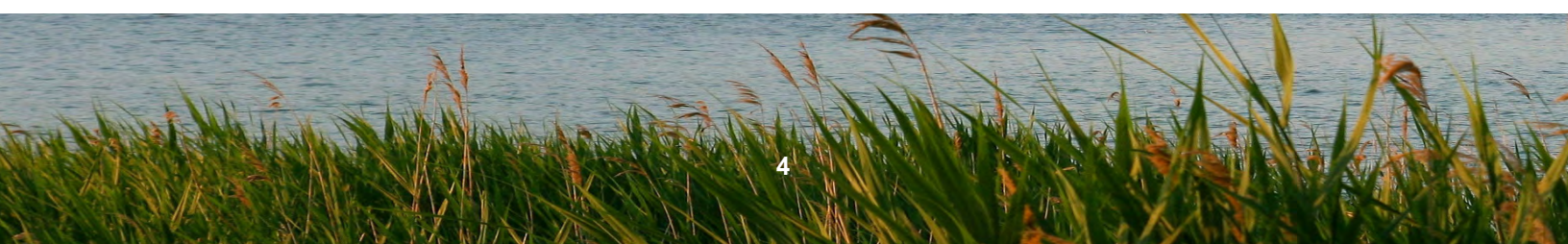
Figure 3. Moody's Benchmark & Insurance Company Annual Dividend Interest Rates (1986–2017)



Source: M Financial Group

More Recent Divergence between DIRs and Moody's Benchmark

Focusing on the period since 1998, Figure 4 shows that DIRs have become more divergent from the Moody's Benchmark. This trend began in the mid-1990s and has become even more pronounced in recent years.



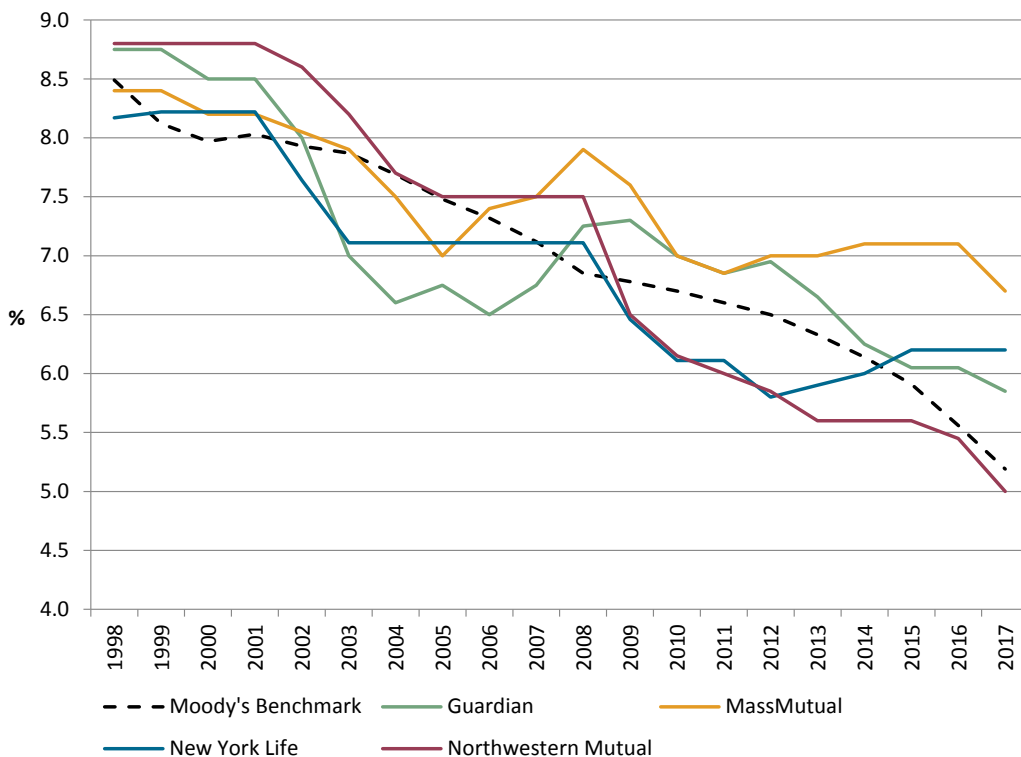
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Figure 4. Moody's Benchmark & Insurance Company Annual Dividend Interest Rates (1998–2017)

It is instructive to note that since the financial crisis in 2008-2009, some carriers (MassMutual, New York Life) have increased the difference between their DIR and the benchmark, while other companies (Guardian, Northwestern Mutual) have adjusted their DIR in accordance with the trend in fixed income portfolio yields.

Mutual Company General Account Investment Allocations Show Higher Risk than Average



Source: M Financial Group

Industry Allocation

When spreads increase, or DIRs are maintained/increased in a decreasing interest rate environment, it is natural to question the future sustainability of that spread/DIR (and explore what may be driving the spread).

Insurers vary their investment allocations to assets with an eye towards balancing asset/liability matching with yield. Some mutual companies invest in alternative investments (also referred to as Schedule BA assets), like subsidiaries or private equity. However, alternative investments tend to be less liquid and generate more volatile returns, which may result in more risk to the dividend scale (DIR). Table 2 shows the general account investment allocations of the four mutual companies compared to the U.S. Life & Health industry in 2015².

² Information on investments for life insurance companies is not available until the end of the first quarter of the following year.

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Table 2. Asset Allocation of Mutual Company Invested Assets, 2015

	U.S. L&H	GUARD	MASS	NYL	NML
Bonds	75.5%	73.5%	59.2%	63.4%	65.7%
Preferred stocks	0.3%	0.4%	0.4%	0.0%	0.1%
Common stocks	2.1%	3.4%	6.8%	6.9%	1.9%
Mortgages	11.1%	7.8%	16.4%	10.1%	15.9%
Real Estate	0.6%	1.0%	0.7%	1.0%	1.0%
Contract Loans	3.5%	7.7%	8.8%	7.7%	8.4%
Cash & ST	2.8%	1.8%	2.3%	3.2%	0.7%
Other (Sch. BA)	4.2%	4.4%	5.6%	7.0%	6.3%

Source: A.M. Best Statement File

Notably, all four companies have a higher than average allocations to Schedule BA assets, led by New York Life at 7.0%. In addition, Mass Mutual and New York Life both have allocations to common stocks that are more than three times the industry average. Mass Mutual and Northwestern Mutual have significantly lower allocations to bonds but appear to make up for the difference with larger allocations to mortgages (primarily commercial). In each case, the mutual companies are allocating higher percentages of their general account to assets considered more risky than the investment-quality bonds that comprise the bulk of most life insurer's portfolios.

Rating agencies have noticed the shift in investment allocations for mutual life insurance companies.

- A.M. Best commented that in recent years "New York Life has increased the risk profile of the investment portfolio with what A.M. Best deems as high risk assets."³
- Moody's Investors Service commented on MassMutual that its "[d]ependence on earnings from other business segments, and particularly asset management profits, to boost par WL dividend interest is risky, and not likely to be sustainable, particularly in volatile or bear markets... In a market downturn, the DIR earnings component from these investments will also decline."⁴

³ A.M. Best Credit Report, New York Life Insurance Company, 8/18/2016

⁴ Moody's Investors Service, Issuer In-Depth, Massachusetts Mutual Life Insurance Company, 7/12/2016

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Conclusion

Declining rates for investment-grade fixed income securities have caused portfolio yields at life insurance companies to decline. This has caused reductions in dividend interest rates for participating whole insurance policies and a shift in allocations by life insurers towards riskier, less liquid assets in search of higher yields to support their dividend payments to policyholders.

Going forward, even a gradual increase in interest rates will not reverse the downward trend in portfolio yields for life insurers for at least several years, which will continue to put pressure on their ability to maintain their dividend interest rates.

In concert with an experienced life insurance advisor, policyholders should evaluate the impact of reduced DIRs on their policies and new buyers should consider the supportability of current DIRs as part of the product selection process.



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