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Mutual Life Insurance Company Dividend Rates for 2018

For 2018, the four major mutual companies held the dividend interest rates on their participating whole life (WL) insurance policies close to their 2017 dividend scale. Guardian held their dividend rate at the 2017 level, while other companies had modest decreases.

Below are the declared 2018 dividend interest rates (DIR) for four of the major mutual life insurance companies, which are the largest issuers of participating whole life policies.

- Guardian Life Insurance Co. of America 5.85% (unchanged from 5.85% in 2017)
- Massachusetts Mutual Life Insurance Co. 6.40% (down from 6.70%)
- New York Life Insurance Co. 6.10% (down from 6.20%)[1]
- Northwestern Mutual Life Insurance Co. 4.90% (down from 5.00%)

Source: Each respective carrier's public dividend announcement or communication to field agency.

Despite an increase in short-term interest rates[2], long-term interest rates have remained near historical lows (Figure 1), and it is expected this will result in a continued decline in portfolio yields at life insurance companies over the next few years. Offsetting the rate decline is a shift in their investment portfolios in the direction of riskier, less liquid assets in search of higher yields to support their dividend payments to policyholders. While this is expected to increase returns in the future, it also adds risk in the case of an economic downturn.

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.
2. The rate on the 1-year T-bill increased from 0.85% at the end of 2016 to 1.76% as of December 29, 2017.

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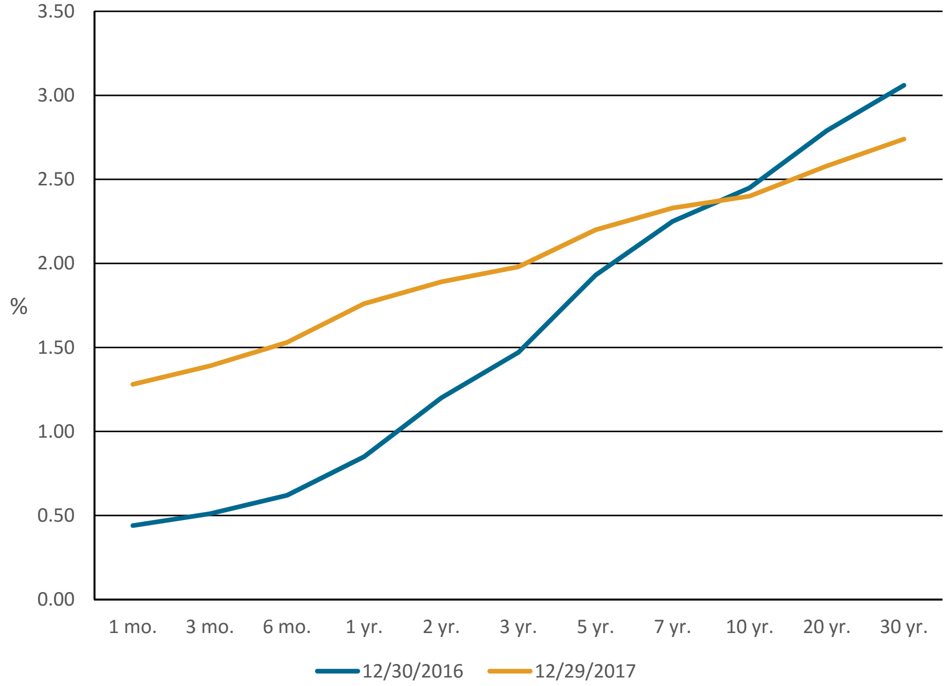
Figure 1. Yield Curve of U.S. Treasury Bills



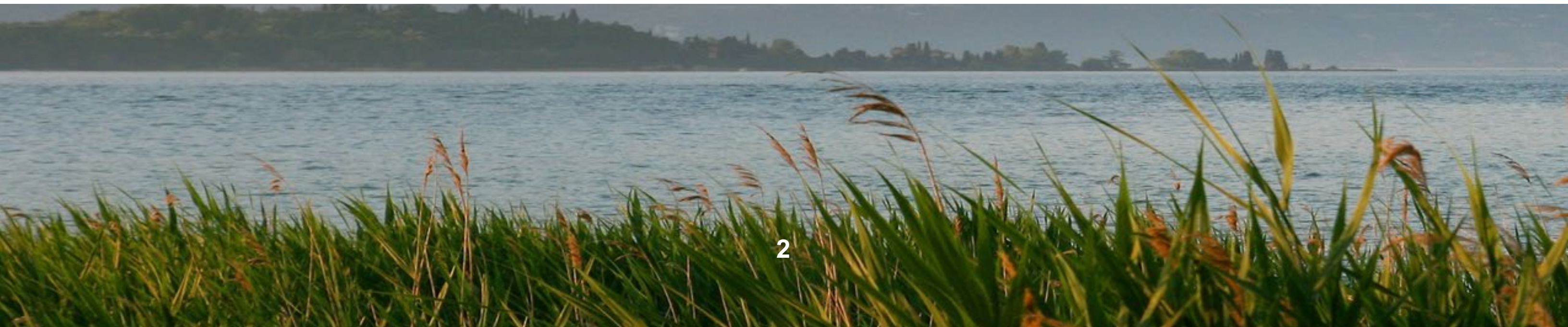
Source: Moody's Investors Service

Policy Reviews

As DIRs continue to edge downward, it is advisable that clients with whole life policies request updated in-force illustrations, that are run at the new dividend scale and are stress tested at lower DIRs. Similar to reduced crediting rates for UL policies, lower dividend scales typically required additional premium payments to offset lower future dividends. Policyholder options include:

- Paying additional premiums
- Using policy loans to pay premiums
- Adjusting the policy into a non-forfeiture option (reduced paid-up status or extended term)
- Surrendering the policy
- 1035 exchange of the policy to another product

An experienced life insurance professional can assist policyholders with identifying their options and may suggest recommended 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.



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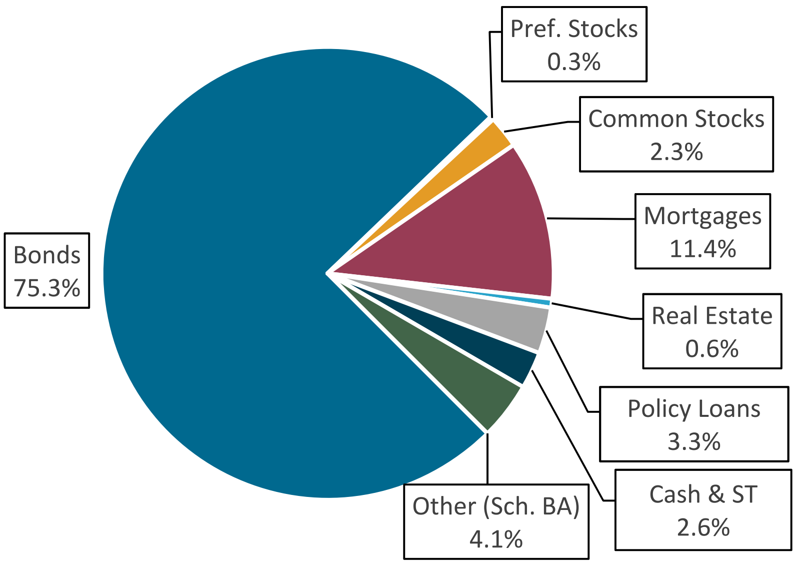
Fixed Income Asset Classes Lead Insurance Company Portfolios

Insurance companies' general accounts primarily invest in investment grade bonds and mortgages. These fixed income asset classes provide high quality investments while matching well with longer-term insurance liabilities. As seen in Figure 2, more than 86% of insurance industry invested assets were in bonds and mortgages at year-end 2016. Table 2 shows that nearly 94% of industry bond holdings were class 1 and 2 (i.e., investment grade); 62% were class 1.

Figure 2. Asset Allocation of U.S. Life/Health Industry Invested Assets, 2016

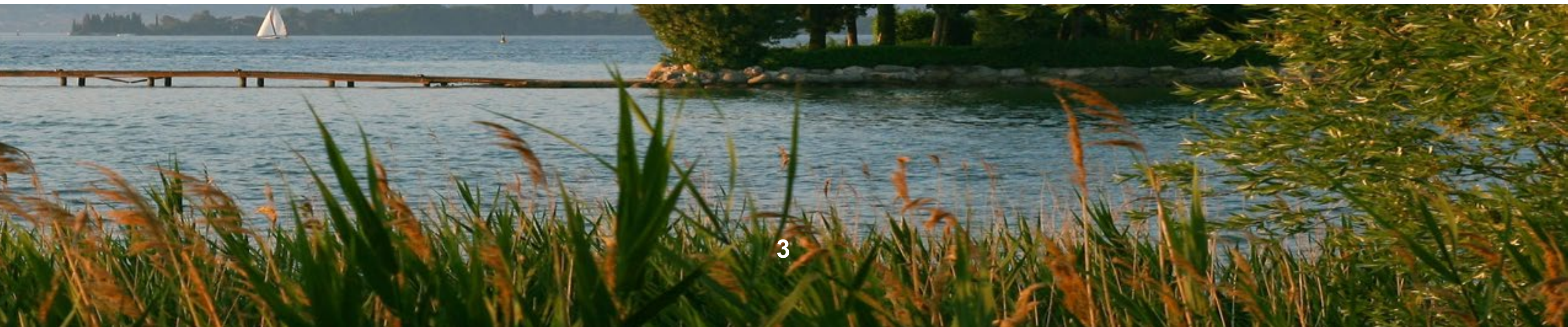


Source: A.M. Best Statement File

Table 3. NAIC Classification of U.S. Life/Health Industry Bond Assets, 2016 (With Moody's and S&P Equivalent Ratings)

Class 1 (Moody's 'A3' or better; S&P 'A-' or better)	62.3%
Class 2 (Moody's 'Baa'; S&P 'BBB')	31.6%
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')	0.5%
Class 6 (Moody's below 'Caa'; S&P below 'CCC')	0.1%

Source: A.M. Best Statement File



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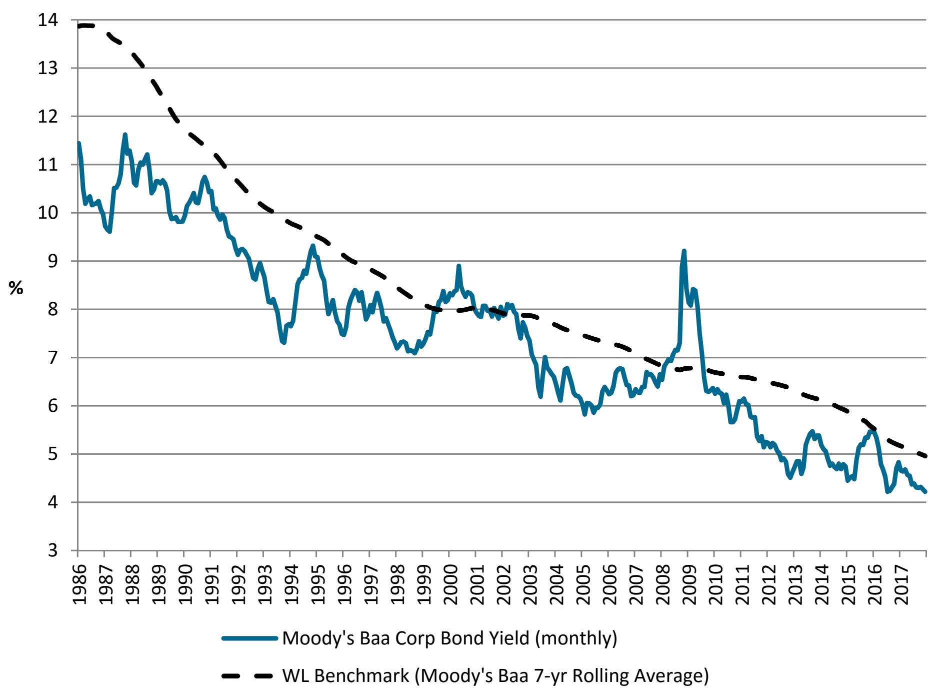
The Correlation Between Dividend Interest Rates and Fixed Income Benchmark

Since 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.

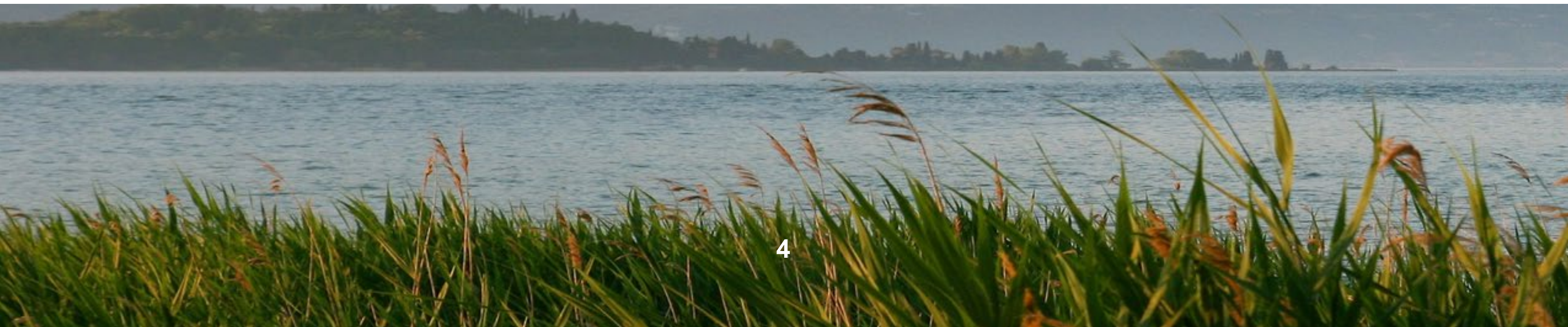
The Moody's 'Baa' Long-Term Corporate Bond Yield Average, which provides the new money rate for an investment grade fixed income instrument, may serve as an effective proxy for a typical insurance company asset. The seven-year rolling average of Moody's 'Baa' can provide an example of an insurance company 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 4, 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 4. Monthly and 7-Year Rolling Average of Moody's 'Baa' Long-Term Corporate Bond Yield Average



Source: Moody's Investors Service



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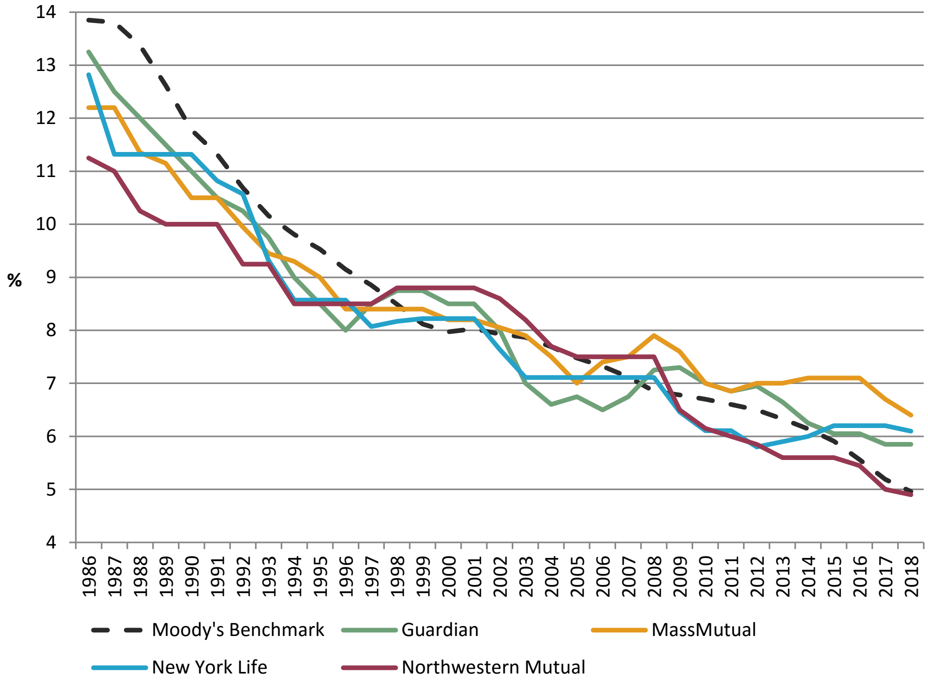
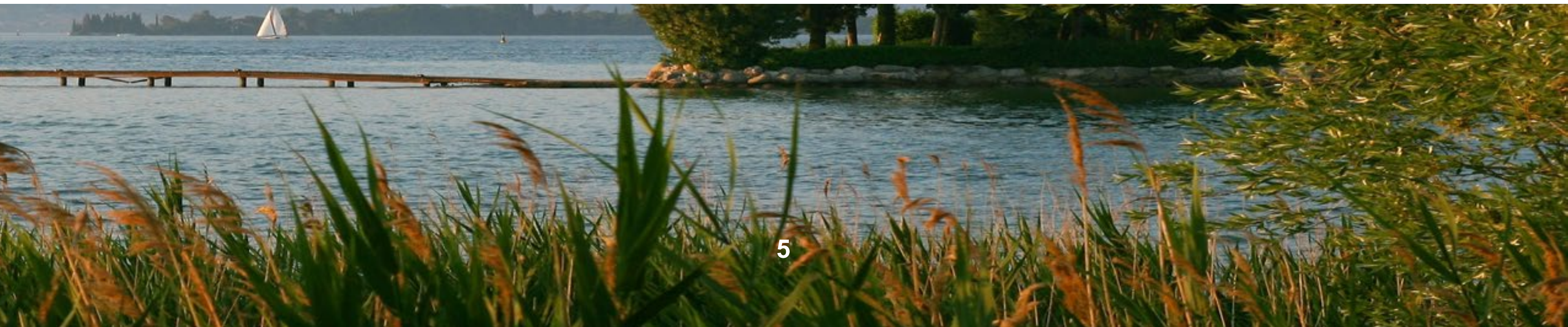
Historically, the annual change in the seven-year rolling average of the Moody's 'Baa' Long-Term Corporate Bond Yield Average, referred to in this analysis as the Moody's Benchmark (Figure 5), correlates well with the annual change in DIRs. Since insurance companies declare their annual dividend near the end of the previous year, the Moody's benchmark is as of the end of the prior calendar year.

Figure 5. Moody's Benchmark & Insurance Company Annual Dividend Interest Rates (1986–2018)



Source: Moody's Investors Service



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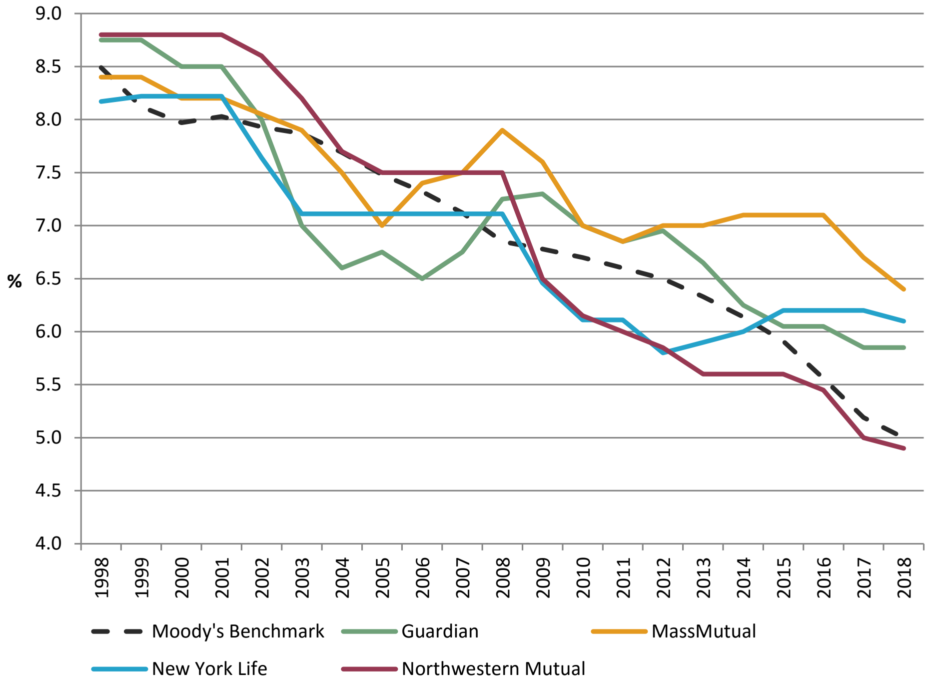
More Recent Divergence between DIRs and Moody's Benchmark

Focusing on the period since 1998, Figure 6 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.

Figure 6. Moody's Benchmark & Insurance Company Annual Dividend Interest Rates (1998–2018)



Source: Moody's Investors Service

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

Mutual Company General Account Investment Allocations Show Higher Risk than Average Industry Allocation

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). Below is a table showing the general account investment allocations of the four mutual companies compared to the U.S. Life & Health industry in 2016[3].

Table 7. Asset Allocation of Mutual Company Invested Assets, 2016

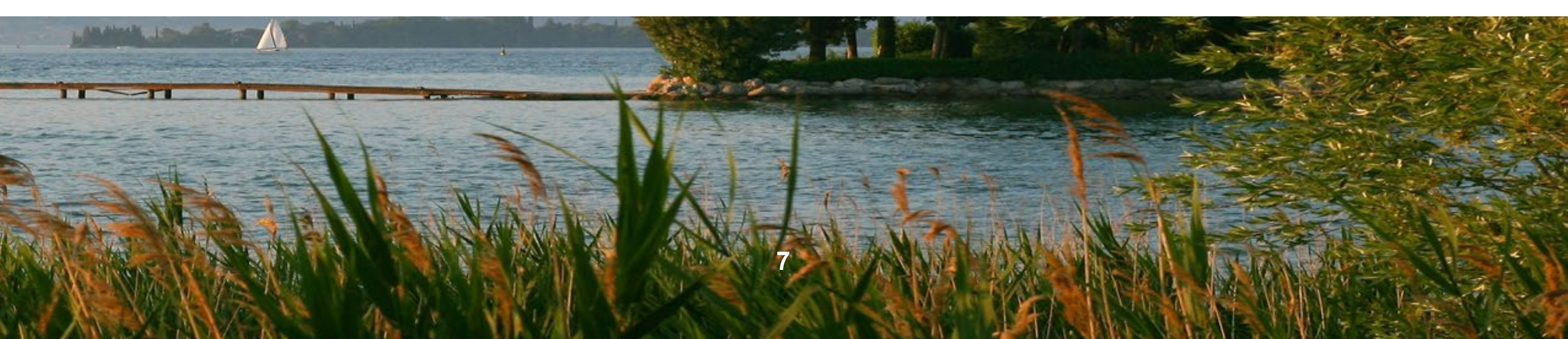
	U.S. L&H	GUARD	MASS	NYL	NML
Bonds	75.3%	75.7%	57.8%	65.6%	65.8%
Preferred stocks	0.3%	0.1%	0.3%	0.0%	0.1%
Common stocks	2.3%	3.2%	10.6%	6.9%	1.9%
Mortgages	11.4%	7.4%	14.5%	10.5%	16.1%
Real Estate	0.6%	0.8%	0.7%	1.1%	1.2%
Contract Loans	3.3%	7.3%	8.6%	7.5%	8.1%
Cash & ST	2.6%	1.8%	2.6%	2.1%	1.1%
Other (Sch. BA)	4.1%	3.8%	5.0%	6.2%	5.8%

Three of the four companies (with the exception of Guardian) have a higher than average allocation to Schedule BA assets, led by New York Life at 6.2%. 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 has a significantly lower allocation to bonds but appears to make up for the difference with larger allocations to mortgages (primarily commercial) and common stocks. In most cases, 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 "Over recent years, New York Life has increased the risk profile of the investment portfolio."[4]
- Moody's Investors Service said "Northwestern Mutual's ratio of high-risk assets as a percentage of shareholders' equity has been consistently high… We believe that much of the risk from these high-risk investments is mitigated by the participating nature of most of the company's product liabilities, which these assets are largely supporting.[5]

3. Information on investments for life insurance companies is not available until the end of the first quarter of the following year.
4. A.M. Best Credit Report, New York Life Insurance Company, July 20, 2016
5. Moody's Investors Service, Credit Opinion, Northwestern Mutual Life Insurance Company, July 28, 2017



Moody's Investors Service announced in December 2017[6] that it was downgrading the outlook for its 'Aa2' insurance financial strength (IFS) rating on Mass Mutual to negative. Moody's stated the revision in its rating outlook for Mass Mutual was attributable to the company's "growing appetite for, and investment in, higher-risk, asset-generating securitization vehicles." Moody's also said Mass Mutual's "high DIRs are highly dependent on earnings from other business segments, like asset management, to boost the rate – a trend that is unlikely to be sustainable in a stress situation, or market/economic downturn, which will likely depress earnings from these businesses."[7]

Conclusion

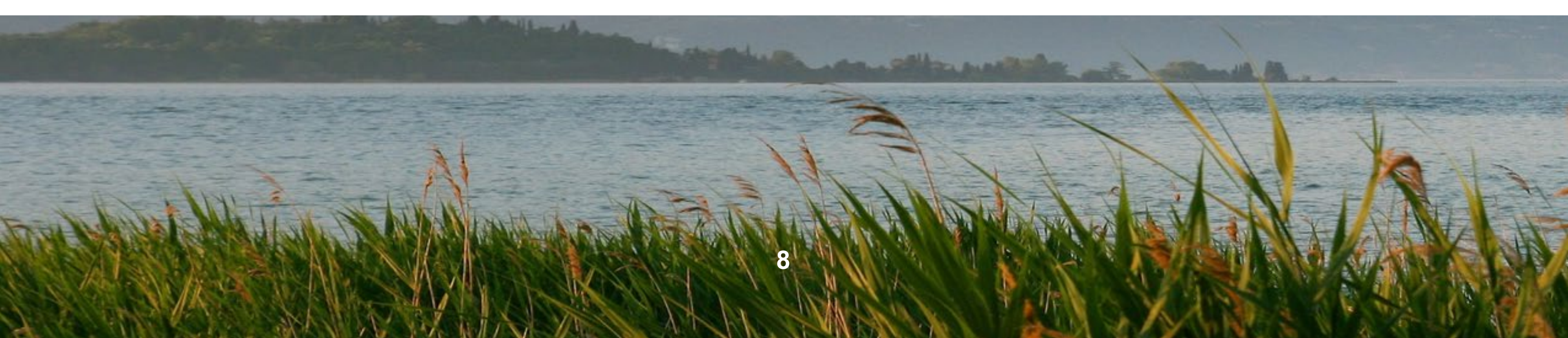
Declining rates for investment-grade fixed income securities have caused portfolio yields at life insurance companies to decline. This has caused reductions in dividend interest rates for participating whole insurance policies and a shift in allocations by life insurance carriers towards riskier, less 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 experience 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.

6. Moody's Investors Service Rating Action, "Moody's affirms MassMutual's Aa2 IFS rating; outlook to negative", December 6, 2017

7. Moody's Investors Service, Credit Opinion, Massachusetts Mutual Life Insurance Company, December 8 , 2017



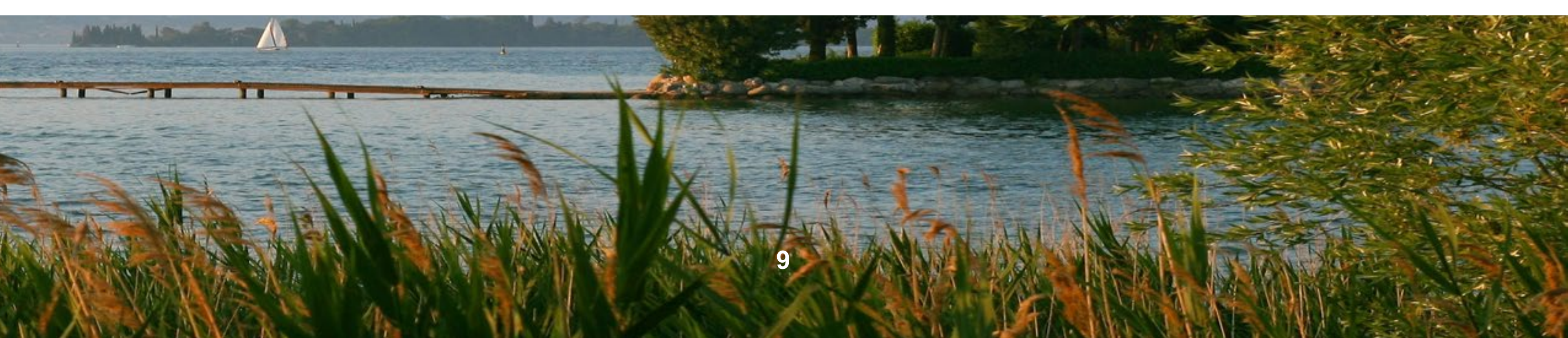
Appendix

Mutual Company Dividend Interest Rate History (%)

	Guardian	MassMutual	Northwestern Mutual	New York Life
1999	8.75	8.40	8.80	8.22
2000	8.50	8.20	8.80	8.22
2001	8.50	8.20	8.80	8.22
2002	8.00	8.05	8.60	7.64
2003	7.00	7.90	8.20	7.11
2004	6.60	7.50	7.70	7.11
2005	6.75	7.00	7.50	7.11
2006	6.50	7.40	7.50	7.11
2007	6.75	7.50	7.50	7.11
2008	7.25	7.90	7.50	7.11
2009	7.30	7.60	6.50	6.46
2010	7.00	7.00	6.15	6.11*
2011	6.85	6.85	6.00	6.11
2012	6.95	7.00	5.85	5.80
2013	6.65	7.00	5.60	5.90
2014	6.25	7.10	5.60	6.00
2015	6.05	7.10	5.60	6.20
2016	6.05	7.10	5.45	6.20
2017	5.85	6.70	5.00	6.20
2018	5.85	6.40	4.90	6.10

** 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. The DIR in years prior to 2010 have been adjusted to reflect this change in methodology.*

This information is provided for educational purposes only and should not be construed as advice. You should consult with a financial professional before making any decisions.



March 2018

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