

STABLE VALUE MARKET UPDATE

Insurance Industry Trends and Our Credit Outlook for Stable Value Contract Issuers

First Quarter 2021

Following the announcements of significant strategic changes by Prudential and AIG in late 2020, we thought it would be valuable to provide an update on the forces driving strategic change within the insurance industry and its relevance to the stable value contract market as we look into 2021 and beyond.

While consisting of a diverse group of financial institutions (including both banks and insurance companies), the market for stable value contracts remains dominated by life insurers. Over the last decade, the life insurance industry has experienced a number of major strategic shifts due to a confluence of events, including: the "arms race" period for variable annuities (VAs) with guarantees prior to the global financial crisis; the increase in investment risk to support those and other policies; the global financial crisis itself and the low rate, tight spread period that has followed it; major legacy underwriting issues in old-age life and long-term care policies; and competition from well-funded alternative capital insurers. Together, these events have depressed the earnings potential of legacy individual life and annuity business lines, due primarily to overly generous guarantees, spread compression, and weak underwriting earnings or underwriting losses. These factors have also contributed to difficulty selling new policies, both due to the attractiveness to consumers in a low rate/return environment and to competition from alternative capital insurers (which generally are not burdened with problematic legacy books of business, rely more on aggressive investment allocations and tax advantages than underwriting to generate returns, and whose capital structures give them greater flexibility to tolerate short-term earnings volatility).

In this context, a number of insurers active in the market for stable value contracts have made major strategic changes in recent years as a result of these factors, with the changes thematically seeking a greater emphasis on fee-based products with lower capital intensity. Notably, MetLife spun out most of its individual life and annuity business as Brighthouse Financial in 2017, with the capital intensity and high volatility of these businesses among the stated rationale. Similarly, Voya has shed its legacy VA liabilities since spinning out of former Dutch parent ING Group in 2013 and more recently completed the exit of its individual life policy business on January 4, 2021. In October 2020, AIG announced its intent to split its General Insurance (property and casualty insurance) business from its Life & Retirement business. While AIG had long been pressured by activists and other investors to do so, it had resisted this pressure for nearly a decade but may have relented with the General Insurance business now on stronger footing. In November 2020, Prudential announced plans to stop selling VAs

with guarantees and universal life policies with guarantees, and management also indicated they would be examining strategic options for certain blocks of individual life and annuities.

Despite the long-term challenges posed by the current market environment, we believe our approved stable value contract issuers – including both our bank issuers and our insurance company issuers – are well capitalized to meet their obligations and do not have concerns with respect to their creditworthiness. Relevant to AIG's stable value business, AIG plans to keep the Life & Retirement business unit together (likely requiring a spin-out transaction in the next two or three years), which we believe will retain sufficient scale and capitalization to avoid a material impact to our credit opinion of them as an issuer. Similarly, we do not believe Massachusetts Mutual's September 2020 announcement of the sale of its group retirement plan business to Empower or Transamerica's October 2020 merger of Transamerica Premier Life Insurance Company into sister company Transamerica Life Insurance Company have a material impact on the creditworthiness of those issuers.

Though the challenging environment has caused some insurers to reevaluate their overall business strategy, these changes have not impacted the issuers' commitment to their stable value businesses. In fact, the fee-based stable value business – which is not capital intensive and has relatively low exposure to market volatility risk – fits the profile of the type of businesses insurers are seeking to emphasize. This conclusion is supported by issuers' continued desire to grow their stable value businesses and willingness to compete with respect to terms and pricing in order to do so. We continue to actively engage issuers, utilizing the leverage provided in this environment to improve terms and pricing for our clients. While we are seeing signs that the pace of fee reductions that we have delivered in recent years has begun to slow, we will continue to push for industry leading terms and pricing while remaining attentive to issuer credit quality, industry expertise and commitment, and diversification.

Looking forward, a low rate, low return environment will likely continue to pose challenges for banks and insurance companies, and the economic overhang from the COVID-19 pandemic – should it result in a punishing credit cycle – could pose an additional source of stress. Given this uncertainty and the long-term nature of stable value contracts, we continue to mitigate these risks through our initial underwriting standards and rigorous on-going credit analysis. Via these processes and diversification across multiple issuers, we continue to strive to avoid issuer credit problems and to provide reliable principal protection by identifying problematic trends in advance and maintaining diverse alternatives for stable value coverage should credit problems evolve.

