

Term Topics

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Topics

- Recent impacts on term market
- How have rates changed?
- What are companies doing to compete?
- Term Market Outlook for Near Future

Recent impacts on term market

Recent Impacts on Term Market

- 2001 CSO
- Reinsurance market impacts on term

2001 CSO Impacts

- Some expected up to 20% premium reductions due to 2001 CSO
- Initial estimates may not have taken into account the impact of 2001 CSO in the presence of coinsurance
- Reinsurance quota shares on term tend to be in the 80 – 90% range
 - Reinsurers were already efficient with reserves
 - Higher quota shares minimize any gains resulting from 2001 CSO

2001 CSO Impacts – Hypothetical Scenario

- Term portfolio with 10- and 20-year term products
 - PV (LOC expense) / PV (Net Reins Premium)
 - 1980 CSO - 5.2%
 - 2001 CSO - 4.1%
- Net effect of 2001 CSO to reinsurer for this case
 - 1.1% Net reinsurance premium
- Translates to roughly 1 allowance point

Reinsurance Market Impacts on Term

- Consolidation of reinsurers
 - 1994 – Top 5 reinsurers had 56% of reinsurance IF
 - 2002 – Top 5 reinsurers had 71% of reinsurance IF
 - Source MARC survey
- Companies have left the market, been acquired, or run into financial trouble
- May open the door for new entrants into the reinsurance market

Reinsurance Market Impacts on Term

- Increasing LOC costs for reinsurers
 - Increasing cost may offset any gains due to 2001 CSO
- Hypothetical case
 - $PV(\text{LOC expense}) / PV(\text{Net Reins Premium})$
 - 1980 CSO, LOC = 80bps - 5.2%
 - 2001 CSO, LOC = 80bps - 4.1%
 - 2001 CSO, LOC = 80bps - 4.8%
 - Translates into less than 1 allowance point

Reinsurance Market Impacts on Term

- Lower interest rates
- Reinsurers continue to refine their mortality expectations
 - Translates into higher expectations in some places and lower expectations in others
- Some reinsurers requesting higher reins premiums

How have term premium rates changed?

How Have Term Premium Rates Changed?

- Norm used to be to reprice term portfolio annually
- Rate decreases were largely justified with lower reinsurance rates
- Tightening of reinsurance market has slowed the pace of term rate changes

How Have Term Premium Rates Changed?

- Comparison looks at
 - Rates on 20-Year term
 - Based on Compulife data
 - Male NT best class only
 - \$500,000 face

How Have Term Premium Rates Changed?

- Breakdown of term rate changes (April to April)

| | IA 35 | | | |
|-----------|-------|------|------|------|
| | 2001 | 2002 | 2003 | 2004 |
| Increased | 3% | 4% | 11% | 7% |
| Decreased | 39% | 51% | 34% | 24% |
| No Change | 58% | 44% | 55% | 70% |

| | IA 45 | | | |
|-----------|-------|------|------|------|
| | 2001 | 2002 | 2003 | 2004 |
| Increased | 3% | 4% | 8% | 7% |
| Decreased | 39% | 51% | 37% | 22% |
| No Change | 58% | 44% | 55% | 71% |

| | IA 55 | | | |
|-----------|-------|------|------|------|
| | 2001 | 2002 | 2003 | 2004 |
| Increased | 6% | 5% | 6% | 6% |
| Decreased | 37% | 48% | 37% | 23% |
| No Change | 57% | 47% | 57% | 71% |

How Have Term Rates Changed?

- Average rate change by year

| | IA 35 | | | |
|--------------|-------|------|------|------|
| | 2001 | 2002 | 2003 | 2004 |
| Avg Increase | 7% | 6% | 7% | 11% |
| Avg Decrease | -14% | -13% | -12% | -14% |

| | IA 45 | | | |
|--------------|-------|------|------|------|
| | 2001 | 2002 | 2003 | 2004 |
| Avg Increase | 8% | 3% | 4% | 2% |
| Avg Decrease | -9% | -11% | -9% | -10% |

| | IA 55 | | | |
|--------------|-------|------|------|------|
| | 2001 | 2002 | 2003 | 2004 |
| Avg Increase | 7% | 13% | 5% | 1% |
| Avg Decrease | -13% | -13% | -14% | -9% |

What are companies doing to compete?

What are companies doing to compete?

- Securitization
 - Not everyone can play
 - Complexity
 - Need large volume
 - Need access to an offshore reinsurance company
 - Reinsurers continue to explore this and similar alternatives
 - Could make it indirectly accessible to all companies

What are companies doing to compete?

- Accepting lower profitability
 - May have had rates increased by reinsurer
 - May have higher expense and/or other assumptions
 - May try to offset by gains in another LOB
 - How long can they hold out in this environment?

What are companies doing to compete?

- Riders
 - Differentiation by offering unique riders
 - ROP
 - Critical Illness (accelerated DB)
 - Subsidizing lower profitability in base plan with “fat” riders

What are companies doing to compete?

- Changes to underwriting requirements
 - Direct writers typically want faster, less expensive, quicker to market
- Must consider
 - Impact on mortality
 - Impact on reinsurance rates
 - Additional expense (including not takens)
 - Inconvenience to policy holder
 - The effect on time to issue policy
 - Agent / brokers reaction

What are companies doing to compete?

- Adjusting preferred criteria
 - Changing the number of preferred classes
- Tightening preferred criteria
 - Consider your objectives
- Debit / Credit
 - Helps company to better classify risks
 - How will distribution respond

What are companies doing to compete?

- The “wait and see” approach
 - I’m going to wait and see what everyone else does
 - Must be willing in some cases to accept lower profitability in the interim
 - Most likely a hope that reinsurers will find alternatives to LOCs that will help stabilize costs
 - Companies that have had the same reinsurance rates for a few years may end up with reins rate increases

What are companies doing to compete?

- Increasing premium rates
 - More companies are increasing rates than in the recent past
 - Companies are very reluctant to take this approach
 - Many of the “wait and see” companies are feeling pressure to do so

Term Market Outlook for Near Future

Term Market Outlook for Near Future

- In general term rates are likely to remain flat
- Direct writers and reinsurers will continue to look to take advantage of LOC alternatives
- Companies who are unable to decrease premium rates will likely look for ways to differentiate their term products
- It's possible we'll see new reinsurance players