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Chairperson's Corner

When Change Happens All At Once

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What do you get when you cross an elephant with a jar of peanut butter?

Answer: an elephant that sticks to the roof of your mouth.

Isn't it easy to appreciate the simplicity of jokes like that?

Well then … what do you get when you cross public mistrust of insurance companies with high unemployment, volatile equity markets, companies teetering on the brink of ruin, and surplus issues for some of those that are stable?

Answer: the potential for sweeping product changes.

And that's no joke at all.

It's almost unbelievable, the change that's been wrought on the economic and insurance landscape over the past year. The effect this decline has had on the asset and liability side of many insurance company financial statements is equally difficult to comprehend, at least until you see the hard numbers.

Let's review a bit of the carnage:

Equity declines pound variable annuity writers, some having significant guaranteed living benefit exposure. Required increases in surplus, along with hits to income, create a double whammy for under-hedged books of business. For those that are hedged, costs increase substantially with the roiled markets.

Severe declines in asset values, the result of mortgage-backed security woes and increases in credit spreads, pinch surplus levels in many companies. Some companies are downgraded (not only for this reason) and others are forced to look quickly for cash infusions or divestiture opportunities.

The company surplus squeeze and increasing difficulty in finding surplus-relief solutions force companies to review their ability and willingness to pursue ultra-competitive term and universal life with secondary guarantee products.

The insurance industry finds itself a frequent target of media criticism as a barrage of unflattering stories on insurance company woes strike a blow at public trust.

As unpleasant as those descriptions are, they are far from a complete or detailed list of the challenges we face. Nonetheless, they provide a backdrop for some of the potential changes in insurance products that may already be coming.

For variable annuities, it seems doubtful that the appetite for offering the guarantees so popular in the last few years will remain at 2007 levels, at least at 2007 prices. The benefits themselves may become less aggressive and/or prices may increase. This is completely separate from any discussion of how interested the insurance-buying public continues to be in variable annuities (which is no guarantee itself).

CONTINUED ON **PAGE 4**

Price-oriented protection products like guaranteed level term and universal life with secondary guarantees may undergo changes. With fewer cost-effective means to reduce the surplus strain associated with reserve levels of the most competitive products, it is likely that premium levels will increase and/or guarantee periods will become shorter. This process has already started at the time this article is being written.

It's hard to put a finger on the effect damaged public trust will have on insurance product. Will it affect which companies get sales? Will certain products be more or less desirable? Does the perceived need for life insurance coverage mean this business is less affected by trust issues than annuities, which often compete with deposit products outside the insurance industry? Does heightened media coverage lead to calls for more regulation? New regulation could clearly change product—ask indexed annuity marketers about the SEC and 151a.

And what do ratings changes mean for the insurance market? For example, single-premium immediate annuities (SPIAs) have enjoyed steady growth over the last several years as marketing fervor and consumer need have increased together. Will a future public view a SPIA purchase as less of a price-driven commodity and more of a long-term contract that requires financial stability in the providing company? If so, it seems likely that a similar thought process would enter the mind of life insurance buyers, especially those looking at permanent insurance.

Maybe this is all overstated. Many of the issues addressed above have always been a part of the insurance industry dynamic. It doesn't take much of a change in emphasis, however, for the balance of an existing dynamic to switch a market's focus from price to long-term carrier viability.

For companies perceived to be on the wrong side of any viability determination, that's far from a joking matter.