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Survey Results on COVID-19 Effects on VA Business

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At the time of setting their assumptions for year-end 2019, no one had predicted that in the following six months a virus would have spread around the world causing the death of over half a million¹ people nor the economic volatility and disruption that accompanied it. This brief article provides the results from a survey conducted by KPMG LLP with variable annuity (VA) writers and a discussion of what companies

are considering when it comes to assumptions for the rest of 2020.

SURVEY RESULTS

Participants were asked various questions regarding preparedness and expectations in light of COVID-19 for variable annuity business. The survey results reflect the views of 21 respondents who represent over 70 percent of VA market share. Below is a summary of the results.

Hedge Performance and Strategy

All participants responded that their hedging strategy performed as expected during Q1 2020. While there was some disconnect between liability and asset movements given the magnitude of market movements, no respondent indicated an intention to change their hedging strategy at this time.

Fund Movement between Separate and General Account

Few companies experienced increased fund movement between the separate account and the general account with the down market. All companies that saw a change expect the behavior



to revert to normal levels later in 2020 in line with market movements.

Policyholder Lapse Rates

Most participants did not note an increase in actual lapse experience in Q1 2020. One company did experience an increase in lapses and another mentioned that it was unable to assess the impact. When asked about the remainder of 2020, only three companies expect an increase in lapse rates due to COVID-19.

Off-cycle Updates to Liability Assumptions

Three companies either have made or are planning on making changes to their economic assumptions (e.g., long-term interest rate assumption), and another company is reviewing all long-term assumptions. Other than these four companies, no company responded that it was planning an off-cycle assumption update; rather, they will be following the normal timing for assumption unlocking.

RBC Ratio Movement

Around 40 percent of the companies had a decrease in their RBC ratio during Q1 2020, while 50 percent of the companies saw the ratio remain stable and 10 percent of companies saw an increase in the RBC ratio. The underlying question in the survey grouped the RBC ratios within bands spanning a 50 percentage point range, so those companies that remained stable may have increased or decreased within their initial range.

Counterparty Defaults in Bonds or Reinsurance

In Q1 2020, only one participant observed an increase in counterparty default rates from bonds. No companies observed an increase in the defaults of reinsurers. However, seven companies expect to see an increase in counterparty default rates in the remainder of 2020 compared to prior estimates.

Management Actions in Response to COVID-19

Around 50 percent of the participants responded that they have taken or will be taking new management actions which were not previously planned earlier in the year. This includes but is not limited to, changes in pricing, product de-risking, change in

hedging portfolios, and temporary changes in contract features to support policyholders.

CONSIDERATIONS FOR 2020

As we can see from the results of the survey, many companies do not intend to make off-cycle adjustments to their assumptions. Are they right? There are a number of items to consider in answering this question.

Does Experience Demonstrate a Need for Change?

So far, companies are not seeing a material increase in the number of death or surrender claims. This may be because the exposure companies have in their insured population is different to the excess mortality experienced in the wider population. Alternatively, it might be a delay in the reporting of deaths and the collection of information relating to the cause of death. Experiencing no change in one's data does not preclude the possibility that there might be an increase in the future.

What Does the Future Hold?

While there have been increased deaths in the short term which can be measured, the longer term is less obvious. The mortality impact could continue to be elevated, revert to the mean or possibly move below the mean before reverting back to the mean again as deaths from higher risk groups are accelerated. At this time it is not clear what the outcome will be as it relates to COVID-19. Another factor to consider is the development of a vaccine or therapeutic treatments and how these might affect the mortality associated with COVID-19. These uncertainties around the future path of long-term experience will make updating assumptions, especially mortality, difficult for 2020 year-end.

What Role does Economics Play?

In March 2020, the Federal Reserve cut the federal funds rate to near zero. For those VA riders that are currently valued under the fair value methodology (i.e., GMWB and GMAB), this drop in rates materially increased the reported GAAP reserves as of the end of Q1. While there is some offset due to the increase in corporate spreads in the short term, we have seen that these spreads already decreased during Q2 while the Federal Reserve is signaling that it will maintain interest rates at the current levels for the next few years. It is likely that the low interest rate environment question will be a part of the business environment longer than expected 12 months ago. For SOP 03-1 reserves, the mean reversion long-term returns are more subjective and may need more focus in assessing whether they should be changed.

The speed at which the economy rebounds may have additional effects on certain policyholder behavior assumptions, namely utilization and lapsation. If there is a persistent decrease in the economy, the need for policyholders to access money may cause an increase in partial withdrawal and lapsation, or an increase in the overall utilization which may lead to a further increase in reserves.

Most participants did not note an increase in actual lapse experience in Q1 2020. One company did experience an increase in lapses and another mentioned that it was unable to assess the impact.

Ultimately, company actuaries and management will have to decide what their view of the future is, based on the data available both internally and externally. While they may not elect to make changes in assumptions given the uncertainty of the current environment, they can provide additional disclosures to users of financial statements. Additional disclosures to demonstrate the sensitivity of results to certain movements where there is uncertainty relative to the current environment could be important for management, shareholders and regulators. ■



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ENDNOTES

- 1 544k as of July 8, 2020 based on WHO statistics.