

# Spread-based Products in the Current Environment

Presented by  
Noel Abkemeier, FSA, MAAA

November 19, 2009



## Spread-based Products

- Annuities
  - Managed Spread (Fixed and Indexed Annuities)
  - Fixed Spread (Variable Annuities)
- Life Insurance
  - Managed Spread (UL and Par Whole Life)
  - Fixed Spread (Variable Life)



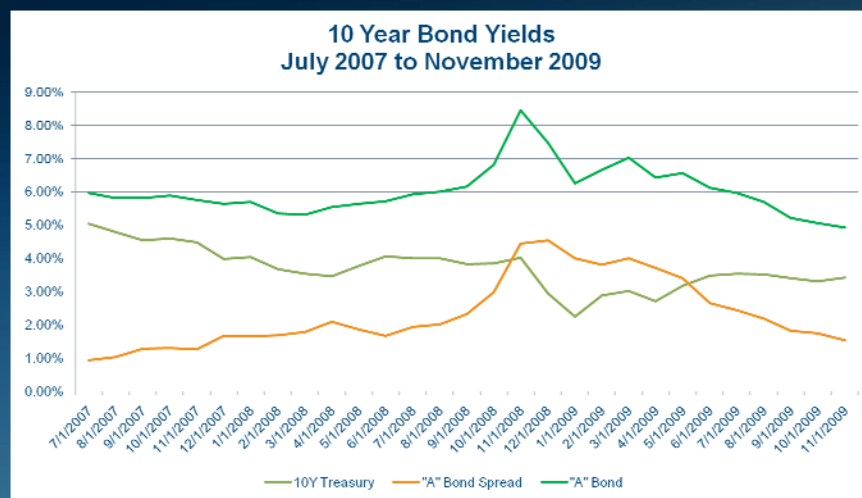
## The Environment Keeps Changing

- Treasury Rates plunged and partially recovered
- Bond spreads widened and partially retreated
- Bond yields spiked and drifted to a low level
- Equities plunged and partially recovered
- Equity volatility spiked and mostly retreated

3



## Bond Yields Have Been Volatile



4



## Investments Approaches Have Varied

- Some insurers have been selective and opportunistic
- Most have maintained their investment practices, but with some caution relating to financial issues
- A few have stockpiled T-bills with yields that cannot support new sales
  - Preparedness for outflows
  - Anticipation of better opportunities

5



## If Everyone Is Downgraded...

- Widespread insurer downgrades had limited impact on relative sales and competitiveness
- Other non-annuity and non-life insurance competitors also experienced downgrades

6



## Annuity Challenges

7



## Annuity Sales Changed in 2008

Sales in 4Q 2008 vs. 4Q 2007 showed strong realignment

- Variable annuity                      down 30%
- Book value annuity                    up 105%
- Indexed annuity                        up 14%
- MVA annuity                            up 305%
- Total deferred annuities            up 1% Total

VAs fell from 75% to 52% of deferred annuities

Source: LIMRA International

8



## And Changed Some More in 2009

Sales in 2Q 2009 vs. 1Q 2009 showed some reversion

- Variable annuity                    up 4%
- Book value annuity                down 25%
- Indexed annuity                    up 14%
- MVA annuity                        down 50%
- Total deferred annuities        down 9%

VAs moved back to 55% of deferred annuities

Source: LIMRA International

9



## Annuity Sales Drivers

- 2008 to early 2009
  - Flight from variable annuities
  - Rate spike in 4Q08
  - Rates high vs. CDs
  - Attractiveness of multi-year guaranteed annuities (MYGA)
- Currently
  - VAs slowly growing back with rising market
  - Capital shortage and widened margins
  - Advantage over CDs narrows

10



## Treasury Curve Raised MVA Issues

- Low curve plus high spreads turned some MVA formulae upside down
  - Positive MVA while gross yields were up
- Possible responses
  - Use credited rate basis rather than Treasuries
  - Narrow the range of upward MVA

11



## Capital Constraints Have Brought Changes

- Indexed and some fixed-rate sales curtailed due to capital shortage
  - Reduced crediting rates
  - Reduced sales compensation
  - First-year commission spread over two years
  - Cancel some distributor contracts
  - Increase GLWB charges
  - Suspend GLWB offering
- Annuity coinsurance being used

12



## VAs Face Challenges

- Decreased account values cut fee revenues
- Hedging costs skyrocketed but are improving
  - Risk-free rates remain somewhat low
  - Volatility remains somewhat high
  - Long-term volatility hedges scarce
- Hedging practices being adjusted
  - Focus moves to economic hedge from accounting hedge
- Will in-the-money guarantee benefits reduce 1035s?

13



## VA Guaranteed Living Benefit “De-risking”

- Increased charges on new business and restarts
- Roll-up rates reduced and period shortened
- Ratchets operate less frequently
- GLWB payout rate reduced
- Less risky allocations required
  - New business and some inforce

14



## Expect Rule 151A for Indexed Annuities

- Rule effectively requires securities registration for sales after January 12, 2011
  - Court ruling requires the SEC to still make a proper market impact demonstration but did not challenge the basic substance of the rule.
- Insurer responses:
  - More litigation in process
  - Some registered products being developed
  - Non-equity indexed products in focus

15



## Open Questions

- Will there be sufficient capital for sales?
- Will compensation changes be permanent?
- What will VA GLB hedging look like?
- Will VA GLB de-risking be permanent?
- What will post-151A be like?
- Will fixed-rate annuities retain momentum?

16



# Life Insurance Challenges

17



## Life Sales Have Fallen

- 14% drop in premium in 4Q08 vs. 4Q07
- 26% drop in 1Q09 vs. 1Q08
- 20% drop in 2Q09 vs. 2Q08

18



## Life Sales by Product in First Half of 2009

Product	Annualized Premium	Face Amount	Number of Policies
Universal Life	-29%	-13%	0%
Variable Life	-72%	-95%	-95%
Variable Universal Life	-55%	-50%	-51%
Term	-3%	-4%	-5%
Whole Life	-4%	-6%	-6%

Source: LIMRA

19



## Lower Interest Creates Challenges in Life

- Spread compression – low earned rates pushing pricing spreads down
- More difficult to price new products
  - Premium increases beginning
- Concern over possibility of rising interest rates and/or credit spreads
- Insurers giving closer scrutiny to lower asset classes

20



## Capital Issues Pressure Life Insurance

- Capital market solutions to reserve requirements have dried up
  - Securitization
  - Captive reinsurance
  - Cost of letters of credit has jumped
  - But tightening of spreads may improve possibilities
- Prices for term insurance and UL with secondary guarantees have risen in response

21 November 16, 2009



## Indexed Life may Face SEC Issues

- Not directly subject to Rule 151 A
- But probably will be measured by same principles
- Could be required to become registered

22



## Life Settlements are in Retreat

- Capital shortage and regulatory hurdles have dried up STOLI settlements
- Capital squeeze and rethinking of mortality is making all life settlements less attractive
- SEC Task Force and House Financial Services Committee are examining

23



## Open Questions

- Will there be sufficient capital for sales?
- Will there be enough economic rebound to revive sales?
- Will interest and inflation be stable?
- Will premium increases be significant?
- Will life settlements rebound?
- Will indexed life become a security?

24

