
A.M. Best reports on impact of low rates

By Editor Test *Wed, Nov 16, 2011*

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U.S. life/annuity insurers' earnings are being pressured by the prolonged low interest rate environment. In the near term, writers of single-premium deferred annuity and flexible-premium deferred annuity products are not expected to be significantly impacted, except perhaps structured settlement annuity writers.

Insurers actively hedging interest rate risk across product portfolios are expected to experience less of an impact, although most hedging programs have been more narrowly focused on variable annuity product lines.

Companies that have diversified their earnings by maintaining larger percentages of less interest-rate sensitive business lines—group retirement, supplemental health lines, traditional life, fixed indexed annuities—are likely to fare better from a capital and earnings perspective.

While interest rates remain a key concern, the risk has been partially offset by lower levels of credit impairments, higher levels of capital and overall stability in credit spreads.

Nevertheless, the negative impact of interest rates on statutory capital requirements may be longer term because many insurers' cash flow testing assumptions include reversion to the mean in their interest rate and equity market scenarios, which may deviate substantially from actual results.

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In the near term, A.M. Best expects the earnings' impact to be significant, although manageable. The ability to weather prolonged low interest rates partially depends on an insurer's growth strategy. An important consideration will be the growth of higher margin business that can offset embedded low-margin products.