Fitch sees stability for life insurers in 2014

By Kerry Pechter *Thu, Dec 19, 2013*

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The release of Fitch Ratings' "2014 Outlook: U.S. Life Insurance" report this week was upstaged by the Federal Reserve's indication yesterday that it would taper its monthly bond-buying policy slowly over the course of 2014 and keep interest rates low for the foreseeable future.

While the equity markets loved the Fed's reassurances, which sent the Dow up almost 300 points on Wednesday, the life industry might have preferred something different. According to the Fitch Outlook, a 50 to 100-basis point uptick in rates would "have positive implication for our outlook on U.S. life insurers."

But Fitch acknowledged that the Fed's low-rate policy has helped life insurers in two ways. It has buoyed equities, which help fund variable annuity guarantees and raise fee revenue. It has also helped revive the economy, which in turns has stabilized the bond market.

Overall, Fitch's near-term outlook for the life insurance industry is "stable," assuming no major interest rate spikes, no international crises and a continuation of the weak recovery, modest GDP growth and high unemployment.

A sustained interest rate spike would be an increase of 500 basis points or more, the report said. A jump of that magnitude would instantly reduce the value of the insurers' bond portfolios and cause flight from products with low fixed crediting rates.

A rate spike wouldn't be all bad, Fitch said. It would make payout annuities, long-term care insurance and universal life products with no-lapse guarantees more attractive.

Fitch mentioned three areas of concern for life insurers: the continued drag on profitability from legacy variable annuity business, uncertainty over the possibility of new regulatory structures, and "macroeconomic shocks," such as a decline in the creditworthiness of U.S. sovereign debt.

The new year could bring an increase in mergers and acquisitions in the life insurance industry, Fitch noted. More European insurers are expected to divest U.S. life subsidiaries, partly in reaction to Solvency II capital requirements. Also, private equity firms are expected to continue to look for opportunities to pick up assets at bargain prices and to establish a footprint in the ever-growing retirement market.