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Five Challenges for Life Insurers in 2012: E&Y

By Editor Test *Wed, Dec 7, 2011*

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Finding ways to manage both capital and risk in an uncertain political and economic climate will be the U.S. life insurance and annuity industry's challenge in 2012, according to Ernst & Young's new Global Insurance Center US Outlook.

"Pressures such as low interest rates, volatile equities markets, and a political and regulatory environment in flux will continue to impact the industry, making it difficult for insurers to boost earnings," said Doug French, Financial Services and Insurance and Actuarial Advisory Services Leader at Ernst & Young LLP (US), in a release.

Ernst & Young has identified five challenges for US life insurers and annuity issuers in 2012:

1. **The low-interest-rate environment:** Low interest rates should persist until at least 2013, increasing the risk of spread compression for existing products. At the same time, efforts to increase sales of fixed annuities and universal life insurance are hampered by low rates. While interest rates are likely to remain low through 2013, they could climb rapidly after the Federal Reserve's Treasuries buying spree come to an end, French says. In such an event, disintermediation risk could be a concern, as policyholders jettison existing products in favor of investing in new ones with higher rates. Understanding the interaction of the asset and liability cash flows under a variety of scenarios will help prepare insurers to weather these stormy financial times.

2. **Accounting and regulatory convergence:** Regulatory ambiguity will likely persist through 2012. Although the Dodd-Frank legislation has passed its first anniversary, many key rules have yet to be formalized, several of which will impact insurers. The Federal Insurance Office (FIO), created under Dodd-Frank may contend with the National Association of Insurance Commissioners (NAIC) around the Solvency II issue of "equivalency" for US insurance regulation. In addition to global regulatory developments on a macroeconomic scale, insurers may also want to consider specific regulatory changes at the microeconomic level and use them to their advantage.

3. **Predictive modeling:** Analytic and predictive modeling techniques continue to improve, creating opportunities for increased sales, improved efficiency and expanded capabilities. Life insurers are looking to use predictive modeling to improve the speed and accuracy of underwriting, which is traditionally time-consuming and expensive. Beyond underwriting, life insurers are increasingly using analytics and predictive modeling to create opportunities for increased sales and improved efficiency, and even mitigate strategic risks. Given the extensive modeling of multiple scenarios required by the developing principles-based regulations, insurers will find that they can improve their risk management processes by gaining insight into the range of outcomes that can occur in the current volatile environment.

4. Life insurance taxation: Insurers may be challenged by future Congressional efforts to reform the federal tax code. Implications exist for both corporate-level taxes and policyholder tax issues. Budget deficits and revenue generation are serious concerns, yet they will remain in flux because of the economic and political changes underway. The health of the economy will be a central political issue in the 2012 general election. That hot button could set in motion changes in the tax code, which may have significant repercussions for the life insurance industry.

5. Internet potential: Insurance companies have historically operated via a very traditional sales model involving agents and face-to-face sales to consumers. At present, the extent of life insurer presence on the Internet largely consists of financial calculators of insurance needs; lead-generating activity like educational materials and product information; and proprietary web applications that support the sales force through online insurance application forms and illustrations. While insurance in its current form does not lend itself well to web sales, life insurers can leverage the technology to develop stronger ties to customers and build a better brand – especially with younger, web-savvy generations of insurance buyers.