Retirement Income
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In Hedges and Reserves We Trust

By Editor Test *Wed, Jun 2, 2010*

Chris Blunt, executive vice president of Retirement Income Security at New York Life, says his company cushions itself from a potential interest rate hike in three principal ways: by buying hedges on its portfolio, careful asset/liability management and relying on its $15 billion in surplus. "A steady rise in rates would be positive actually. It... Read more »

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"A steady rise in rates would be positive actually. It would be wonderful to see a 50 bps rise per year" because the rise in investment income coupon allows New York Life to credit higher rates, and, "as buy and hold investors, we are less affected by any interim decline in market price. The 'spike in rates' scenario is the one that would hurt most insurance companies. If rates go up 500 bps in a year, then investment income bond coupons can't catch up with the sharp decline in market prices."

Because the assets and liabilities of New York Life's existing books of immediate annuities and life insurance contracts are more easily matched, a change in interest rates doesn't affect them, he said. And because an insurer has a lot of long-dated obligations, fluctuations in short-term rates don't matter much. But New York Life also sells a lot of fixed annuities, which are more difficult to asset/liability match, and are less competitive with certificates of deposit when the yield curve flattens. His company also sells income annuities, which are less competitive when yields on long-term bonds are low.

"We model our liabilities on a spike scenario. We ask, 'What happens to liabilities and assets under different circumstances, what are the potential mismatches and will the mismatch be beyond our reserves?' So we modeled out the scenarios to see what happens if interest rates go up and by how much, and we purchased over $100 million in interest rate caps, which buys us a significant amount of coverage.

"These are interest rate options that only pay off if short-term interest rates go up a significant amount. That would help prepare us for a 'black swan' type of event," he added. The derivatives are purchased from about a half dozen counterparties to diversify the risk. "We would like to think that others have taken similar steps, but we're a mutual so we know we can afford to sacrifice short-term profits to assure the long-term permanence of the institution."

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