Lapse rates of ordinary life products near two-decade low: A.M. Best

By Editorial Staff *Thu, Jul 7, 2016*

The last two years have seen the highest persistency rates in nearly 20 years, around 86%, according to a new A.M. Best report.

Running between 5.3% and 5.9% in the years 2012 to 2015, lapse rates on ordinary life insurance products have fallen to their lowest level in nearly two decades, according to a new A.M. Best report.

The Best Special Report, titled, "Anemic Yields Put Spotlight on Retention," asserts that ordinary life persistency has been relatively steady, fluctuating between 81.1% and 86.5% in 1997-2015. The trend appears to be somewhat correlated to the U.S. unemployment rate. The last two years have seen the highest persistency rates in nearly 20 years, around 86%.

Lapse and persistency rates remain important issues for U.S. life/annuity (L/A) insurers, the report said. They can suppress revenue and reduce profitability. New policy sales can be a relatively costly and time-consuming process; if more policies remain in force, as measured by the persistency rate, acquisition costs decline and profitability rises.

Reducing lapses (policy terminations by nonpayment of premium, insufficient cash values, or full surrenders) isn't necessarily easy. Lapse rates result from a complex combination of enterprise-wide risk management (ERM) strategies and macroeconomic factors.

Total ordinary life DPW (direct premiums written) has generally risen since 2009, with a slight decline in 2013. At $140.0 billion in 2015, DPW reached its highest level since 2008. However, several factors have shifted the composition of total life premiums written.

Renewal premiums, for example, which accounted for 65.3% of ordinary life DPW in 2005, accounted for 72.6% in 2015. During this shift, single premium DPW declined to $18 billion in 2009 from $40.3 billion in 2007. Allocations of single premium ordinary life policies as a percentage of total life premiums have declined as well, to 14% of DPW in 2015 from 27.7% in 2007.

Generally, A.M. Best said it "views more favorably those companies that have an increased percentage of higher creditworthy and less risky products, which can positively impact business profile. Unless it is a lapse-supported product, persistency generally benefits a company's profitability; however, it is noted that even lapse-supported products need to persist for a good number of years to become profitable.

“Higher profit margins can be attained on renewal business, since acquisition expenses are recorded at the time of sale. Nevertheless, operating performance is also impacted by low interest rates, which may cause spread compression on interest-sensitive life products, such as universal life. Balance sheet strength is also impacted by strong persistency, as profitability from renewal business contributes to capital and surplus.”