Life and annuity companies will face reckoning in 12-14 months: Conning

By Editor Test *Thu, Feb 28, 2013*

Conning's new report is titled, "U.S. and Global Insurance Industry Outlook: Economic, Capital Markets, and Regulatory Challenges Continue—Nothing to Be Gained by Waiting for Things to Get Better."

A new report from Conning on the global insurance industry suggests that the life and annuity sector continues to be plagued by three main problems: a slow economy, low interest rates, and regulatory advancement.

The 70+ page proprietary report, titled "U.S. and Global Insurance Industry Outlook: *Economic, Capital Markets, and Regulatory Challenges Continue—Nothing to Be Gained by Waiting for Things to Get Better,*" makes the following points about the life and annuity business:

- The life and annuity sector has more asset leverage than the property-casualty and health sectors and "a more uniform national perspective as opposed to significant variability in product and market characteristics at the state level."
- The low interest rate environment has a negative effect on investment income and on policyholder behavior, and exacerbates the mismatch of asset and liability durations.
- Performance margins are hurt by relatively low sales of discretionary products and spread compression of investment yields compared with guaranteed credited rates.
- Companies continue to seek ways to de-risk interest rate exposures and income guarantees, but the extended environment with little near-term chance for reversion to "normal" levels makes this increasingly problematic.
- Falling surrender rates are increasing the effect of net spread compression and forcing increases in statutory reserves.
- Operating margins on net premiums are half pre-financial crisis levels.

According to report, "life and annuity products may be seen as discretionary purchases that may be broadly constrained in times of financial stress. Individual annuities, both fixed and variable, will continue their decline in premium from shifting policyholder behavior, while indexed annuities and group annuities are doing well."

Regulatory challenges are affecting solvency and risk management approaches, investment and hedging capital charges, reserving for contingencies and policyholder behavior, and distribution strategies.

Major differences "between regulators and companies on the degree of conservatism in reserving may swing toward the regulators' position if the low interest rate environment is seen as extending beyond the next couple of years," the report said.

Strategies pursued by life insurance companies include:

- Increased divestitures of blocks of business and noncore operations (including bank and savings and loan affiliates).
- Aggressive investment in infrastructure improvements.
- Alternative distribution strategies and more focused market approaches
- Broader ranges of investment alternatives.

As for companies that are adopting a “wait and see” attitude, the report said that strategy might work if normal conditions return in the next 12 to 14 months, but not if “sluggish conditions” and “intensifying regulatory challenges” persist.