Life insurers will take ‘manageable’ GAAP charges in 3Q2015: Fitch

By Editorial Staff *Thu, Oct 1, 2015*

"We believe that the Fed's position increases the likelihood that life insurers will take GAAP charges in third-quarter 2015 tied to a revision in long-term rate assumptions," Fitch analysts wrote.

Fitch Ratings issued the following alert this week:

US life insurers will be under increased pressure to rationalize long-term rate assumptions used to establish reserves given the market’s revised expectations for low rates, says Fitch Ratings. We see a heightening risk that life insurers could take charges in third-quarter 2015 due to rate expectations.

With last week’s Fed decision reinforcing expectations for a very prolonged return to higher interest rates, the probability dimmed for near-term low rate relief. Low interest rates mean lower average investment yields for fixed-income investments, which pressures life insurers’ earnings and reserve-adequacy projections.

In the third quarter, life insurers typically conduct a comprehensive review of assumptions underlying GAAP policy reserves. We believe that the Fed’s position increases the likelihood that life insurers will take GAAP charges in third-quarter 2015 tied to a revision in long-term rate assumptions.

While the probably of GAAP charges have increased, Fitch expects that potential charges tied to any assumption updates are expected to be very manageable in the context of life insurers’ earnings and capital. As a result, we believe that the impact of low interest rates on ratings assigned to life insurers to be limited over the near term.

The life insurance industry’s exposure to “interest-sensitive” liabilities that provide investment guarantees, deposit flexibility and liquidity options has increased over time and exacerbated the low-yield issue.

As industry sales have shifted away from traditional protection products involving mortality and/or morbidity (e.g. term-life policies are not considered “interest-sensitive”), products such as annuities and universal life insurance incorporating no-lapse guarantees, have increased. Insurers fund these interest-sensitive liabilities through general account assets.

Over the past several years the spread between investment returns on assets in the general accounts and the minimum rate guarantees (on products such as fixed annuities) has compressed, putting reserve margins at risk.