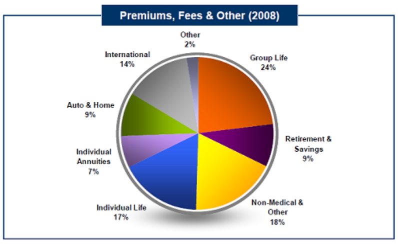
Retirement Income
JOURNAL

Making More Than Peanuts at MetLife

By Kerry Pechter *Mon, Jun 8, 2009*

The financially fit, well-diversified insurer collected almost twice as much in annuity premiums as its closest competitor in the first quarter of 2009, benefiting from a "flight to quality" in the wake of last year's economic meltdown.



MetLife's Diverse & Complementary Businesses

The sweatiest moment for MetLife executives over the past year may have occurred during the December 2008 Investors Day, when chief financial officer Bill Wheeler hastened to assure shareholders that a dire assertion by Goldman Sachs equity analyst Chris Neczypor wasn't true.

A month earlier, Neczypor wrote that life insurers could collectively lose $55 billion on their guaranteed lifetime income benefits (GMIB) business, and predicted that MetLife alone could lose $6.3 billion. Nine days later, MetLife's stock and that of other life insurers fell to their lowest levels in five years.

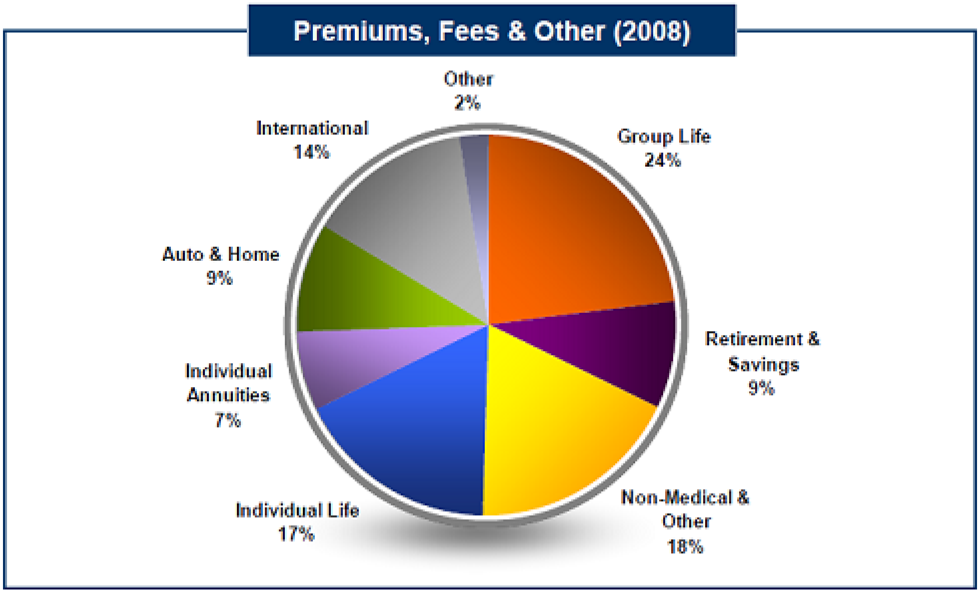
So on Investors Day, Wheeler parried the analyst's report with a PowerPoint slide that shouted in red letters, "This Is NOT Correct!" about the $6.3 billion.

Wheeler turned out to be right. And while MetLife and the other big life insurers who manufacture variable annuities currently have a ton of out-of-the-money living benefit guarantees, MetLife appears to be handling the crisis better than most.

LIMRA's first quarter 2009 sales data showed that MetLife was the top seller of both variable ($3.74 billion) and fixed ($3.85 billion, up from only $445.4 in first quarter 2008) annuities. Its $7.86 billion in total annuity sales was almost double that of runner-up New York Life.

Success has bred success for MetLife. Having maintained high strength ratings (A+ from A.M. Best, AA- from S&P, and Aa2 from Moody's), with a reported $31 billion in cash and a passing grade on the government's recent "stress test" for banks, MetLife (which is a bank as well as insurer) has enjoyed a "flight to quality" and picked up business that might have gone to AIG or Hartford were they in better financial shape.

"MetLife is one of the few left standing with decent ratings. It's not the product, it's the company that's being sold," said one industry observer.



MetLife's Diverse & Complementary Businesses

Diversification works

A diversified product offering underlies MetLife's stability. Individual annuities account for only about seven percent of its premiums and fees. Within individual annuities, it sells both fixed and variable annuities. On the distribution end, it has a strong captive agent force as well as strong third-party sales through broker-dealers, independent advisors, and banks.

"While many other firms are letting go of wholesalers, our wholesaling force has stayed strong, has stayed loyal, and stayed dedicated, as has our affiliated field force," said MetLife's Lisa Weber at the May 1 conference call on earnings.

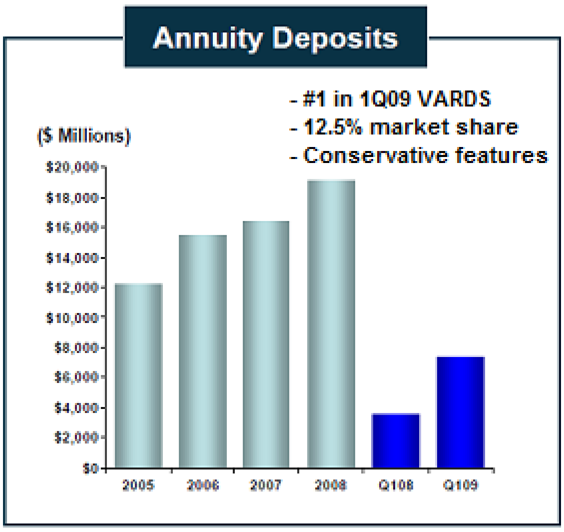
Last fall, MetLife offered some of the most aggressive 10-year rates of the fixed annuity providers, apparently by taking advantage of of a spike in yields on depressed, investment quality corporate debt. It raised $2.3 billion last fall, in the depths of the market collapse, with surprisingly strong equity offering. In April, it was confident enough to decline assistance from the government's Troubled Asset Relief Program (TARP).

"MetLife has enough capital to handle any investment losses that might come down the pike this year, while still having enough money to write new business," said Steven Schwartz, an equity analyst for Raymond James in Chicago. "They're going to be around and everybody knows it. It's a fairly simple story with MetLife."

More GMIBs than GLWBs

MetLife's VA business differs from that of many of its competitors in that most of its contracts carry a GMIB living benefit, which works like a deferred income annuity, rather than a GLWB (guaranteed lifetime withdrawal benefit), which provides guaranteed income without annuitization. Both types of guarantees became much more expensive to hedge after the equity market crash and reduction in interest rates. But GMIBs aren't quite as risky as GLWBs, in part because contract owners must wait 10 years before converting to lifetime income.

About 60% of MetLife's variable annuities have GMIB riders. As of last September 30, about 40% of MetLife's $92.5 billion in domestic variable annuity assets was covered by a living benefit rider. About 70% of the living benefit riders were GMIBs, and 80% of living benefit rider sales in the third quarter 2008 were GMIBs. The most popular version of MetLife's living benefits is the GMIB "Plus," which annuitizes for life with a five-year period certain. GLWB and GMAB (guaranteed accumulation benefit) contracts account for the rest.



MetLife Annuities
Benefiting from a Flight to Quality

MetLife's GMIBs, which at one point allowed up to 85% of account assets to be allocated to equities, were clearly hurt by the financial crisis. And, like GLWB shops, MetLife has had to make its living benefit less generous since last fall. Starting May 1, MetLife reduced the annual roll-up in the guaranteed income base of its GMIB contracts to five percent from six percent, raised the cost of the GMIB Plus rider by 20 basis points, and limited equity exposure in the portfolios to 70%, among other cutbacks.

But, because of its focus on GMIBs, MetLife wasn't exposed to as much risk—or criticism—as GLWB shops. "The GLWB was the source of losses for many companies, and GLWB players like Hartford took big hits. When the media started hammering the GLWBs and the havoc they caused, MetLife could say, 'We don't sell much of that.' MetLife was not entirely spared, but because the GMIB was not as significantly impacted as the GLWB by the increases in volatility and costs, they were better able to withstand the storm," said one industry observer.

Risk management leader
"Unlike the [GLWBs], which [from the investor's perspective] are in-the-money at issue, [GMIBs] are way out-of-the-money at issue," said MetLife's Stanley Talbi, executive vice president, Financial Management & Oversight, at a J.P. Morgan-sponsored risk management conference on June 3. Still, "given the change in interest rates at the end of the year and the decline in equities, about 40% of our GMIB balances were in-the-money as of year-end. So we changed the rider fees, we pulled back on the guarantees and we reduced volatility by reducing the [maximum] equity allocations."

There's some debate over whether the GMIB is a more conservative, safer, or more sustainable type of income guarantee for life insurance companies to offer large numbers of baby boomers, compared to the GLWB. In terms of risk to the carrier, it's probably half way between an income annuity and a GLWB.

In practice, the durability of either product depends on how generous the specific guarantees are and how carefully or thoroughly the issuer manages the risks. Prudential's GLWB, for instance, has suffered less than other GLWB riders because of its dynamic-rebalancing method, which protects the guarantee by moving contract assets to bonds during falling markets.

Even at the height of the VA "arms race," MetLife was conservative with its guarantees, permitting annual rather than quarterly step-ups in the income base, for instance. Like other issuers, its rider fee is based on the guaranteed income base rather than the actual account balance, so that the rider fees don't drop during down markets, and it retains the right to raise fees if the contract owner elects to step-up the income base to the account value.

As for risk management, MetLife has invested heavily in protecting the GMIB, with a 50-person risk management unit backed by a huge server farm. "We were hurt less because we hedged everything, we set up a separate grid with 400 servers, we did a daily extraction to hedge market movements all during the day," Talbi added.

"MetLife possesses the most comprehensive risk management program in the industry and sells more conservatively designed products than many of its peers," Wachovia Securities analyst John Hall said last December.

Popularity of annuitization unclear

On April 14, MetLife announced that it would not participate in the government's program to provide emergency funds for troubled assets. But the company missed analysts' earnings estimates due to investment losses, and its stock price fell. The company doesn't expect a big economic rebound in 2009, but it is confident about the future.

"In terms of the variable annuity market, we continue to see that business as strong for us with the flight to quality and people looking for safe havens," said Weber. "We're comfortable both with our product offering as well as our pricing, our hedging, and very significantly our strong and broad distribution, which continues to bode really well for us. So we're positive as we go forward here."

As for Goldman Sachs' estimate that MetLife could lose $6.3 billion on its GMIB, Talbi told attendees at the J.P. Morgan conference that Goldman's data assumed that MetLife hadn't hedged its GMIB, that all its GMIB owners would annuitize as soon as they were eligible, and that all MetLife's GMIB contract assets were invested in equities. MetLife said the product is well-hedged, that contract owners won't necessarily annuitize at 10 years, and that one-third of GMIB assets are in bonds.

While it's tempting to conclude that MetLife's success in selling GMIBs indicates that significant numbers of Americans are ready to embrace the concept of deferred annuitization, it's still too early to say. The earliest buyers of MetLife GMIBs can annuitize in 2011, but most contracts have more than five years to go. A lot depends on whether the guarantees are in or out of the money when each client's 10-year waiting period ends. And even if the guarantees are in the money, it's not clear if clients will give up liquidity and annuitize.

Time, as they say, will tell.