Pressure to reinsure VA riders may ease: A.M. Best

By No Author *Thu, May 24, 2018*

The National Association of Insurance Commissioners (NAIC) is trying to modify reserve and capital requirements for variable annuity riders so that non-economic volatility is diminished, A.M. Best reported.

To reduce the "non-economic volatility" associated with minimum guarantee benefit riders and to better align those risks with their hedging programs, variable annuity writers often reinsure this business with affiliated captives. But they may not need to do that as much in the future.

The National Association of Insurance Commissioners (NAIC) is considering steps to modify reserve and capital requirements so that non-economic volatility is diminished, according to "Current VA Reserve and Capital Requirements Challenging L/A Insurers," a new report from the rating agency A.M. Best.

"The use of captive reinsurance is likely to decline significantly, as a result of the recommended changes," said George Hansen, senior industry research analyst at A.M. Best, in a release. "So long as true economic values and those of various accounting regimes differ, the use of alternative financing methods will continue."

"Of the four primary guaranteed benefit types, guaranteed minimum withdrawal benefit bases exceed the account value, while death benefits, income benefits and accumulation benefits have account values exceeding benefit bases as of year end 2016," Hansen told *RIJ* in an email.

"The data is based on what companies submit in our Supplemental Rating Questionnaire (SRQ). Most VA writers offering guaranteed minimum withdrawal benefits have very strict limits on where policyholders allocate funds in order to reduce volatility. Therefore, the account value growth may be much lower than how the S&P 500 performs."

Oliver Wyman has conducted two quantitative impact studies with large variable annuity writers and made recommendations to the NAIC in December 2017. Regulators and other industry groups are reviewing these recommendations with no fixed schedule for implementation.

A primary recommendation involves changing the accounting treatment for such hedges to better align them with the respective liability. Hedges are currently marked to market, leading to non-economic volatility. Amortizing the cost of hedges over a period closely matching the liabilities will minimize this volatility, according to the Best's Special Report.

Although the recommended changes will help fix various flaws in the existing framework, the potential for greater volatility in the equity market will challenge variable annuity writers. Hedging is not the only answer, but the solutions available are limited, as reinsurance has dropped off, according to the report.

Data from A.M. Best's supplemental rating questionnaire highlights the status of variable annuity reserve and capital components through 2016 and illustrates the conservative reserving relative to capital that can result under the current framework.

A.M. Best's SRQ data also tracks the funding status of guaranteed minimum benefit riders attached to variable annuities, and with recent market gains, the guaranteed withdrawal amounts still exceed the account values on hand at year-end 2016 compared with other guaranteed benefits.

The report notes that variable annuity writers have increasingly hedged products with guaranteed minimum withdrawal benefits since 2011, but these have the least exposure when compared with three other types of guaranteed minimum benefits. Variable annuity products with guaranteed minimum death benefits remain the most exposed, creating more exposure to mortality risk.