Retirement Income
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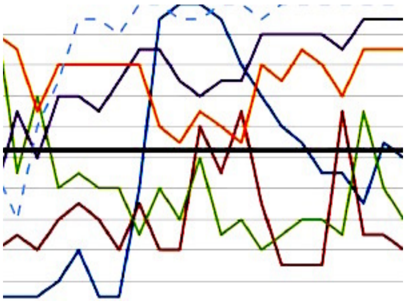
Surrender to Lapse Risk? Not These Insurers

By Kerry Pechter *Wed, Jun 29, 2016*

Over-estimates of variable annuity lapse rates have cost life insurers billions. A group of VA issuers is now working with actuaries at Ruark Consulting to predict those rates more accurately.



The variable annuity with a guaranteed lifetime income benefit (VA/GLWB) was and remains a masterpiece of flexibility. It lets contract owners keep their investment and income options open indefinitely. Since the early 2000s, that formula has helped close over a trillion dollars in sales.

But by giving clients lots of options, insurers made it harder for their own actuaries to predict how policyholders would use their contracts. That in turn, made it difficult to set prices and anticipate reserve requirements. Overestimates in surrender rates, for example, have led to sudden, expensive and unwelcome calls for extra reserves.

Moody's red-flagged this danger three years ago. Insurers "misestimated and underpriced the lapse rates on this product, as policyholders held on to their policies at a greater rate than the insurance companies anticipated," a Moody's analyst wrote in mid-2013.

"This miscalculation forced insurers to take significant, unexpected earnings charges and write-downs over the past year and a half," he noted. In November 2013, to name one instance, lower-than-expected lapse rates forced Prudential to take a $1.7 billion charge.

To better understand the factors that have driven their contract surrender rates in the past and to help them predict those rates more accurately in the future, a group of 18 large VA issuers, ranging from AIG to Voya, has been sharing anonymous client data with Ruark Consulting, a Simsbury, Conn., actuarial firm that specializes in this specific topic.

For several years, Ruark has been producing a series of "experiential" studies of actual VA contract owner behavior. This year, the firm and its "advisory council" of annuity issuers turned to the relatively new discipline of predictive analytics to build models that can predict policyholder behavior and help each company's actuaries make more accurate assumptions. That project, now being implemented at several of Ruark's client companies, could help annuity issuers hit their targets and meet the expectations of senior management, regulators, analysts and investors.

Predictive analytics

“Policyholder behavior assumptions used to be a relatively quiet corner of these products. They weren’t reviewed or challenged all that often,” Ruark president Tim Paris told actuaries from VA issuers during a recent webinar. “But income utilization behavior, and partial withdrawal behavior on GLWBs, are big question marks hanging over this line of business. How we answer them will help determine the profitability of the business over the next couple of years.”