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In researching key issues relating to the U.S. life insurance industry for the latest CIPR study, *State of the Life Insurance Industry: Implications of Industry Trends*,¹ the CIPR team conducted a series of interviews with a number of top executives (including some CEOs) of life insurers. To better understand the challenges facing life insurers and to better capture the breadth and variety of responses, executives were selected as to better represent the industry's organizational and market diversity. Executives from mutual and stock companies—as well as large, medium-size and specialty insurers—were interviewed. This article highlights some of the key points in their responses to a number of questions regarding the challenges facing the industry as well as the opportunities presented for future development and growth.

◆ GREATEST CHALLENGES

In response to a question about which developments and obstacles had the greatest impact on their companies in the past 10 years or so, most pointed first to the adverse economic environment due to the recent financial crisis. Only the executive of a large mutual life insurer answered the most transformative development for the life industry was the change in organizational structure during the demutualization wave in the late 1990s. The executive argued this change had wide implications for the insurance marketplace, as it fundamentally impacted how companies behaved vis-à-vis consumers and each other and how they responded to market signals.

The persistent low interest rates and the overall market volatility were also noted as serious challenges for all the companies. Low interest rates, in particular, have impacted insurers' longer term products, such as annuities and long-term care. A top executive of a large insurance group said, "the financial crisis changed the way companies consider risk, market volatility and liquidity" and has forced the reexamination of "what, up to that point, were considered as extreme scenarios."

Another executive of a large annuity provider said, although the crisis made some problems more acute, the evolution of products toward increasing complexity is a critical issue that predates the crisis. More complex products, he added, "have resulted in a lot more complications around keeping the books and understanding the balance sheet and the income statement of an insurance company. Going forward, issues like complexity and volatility have to be addressed." Looking ahead at the next decade, the same executive em-

phasized "addressing issues around volatility, complexity and transparency and becoming more investor-friendly as it relates to our balance sheet and income statement are important themes. So, maybe part of what needs to be done in the next decade is unwinding the things that have happened over the past 10 years."

A mutual company's top executive also pointed to the potential changes in tax laws as an issue of concern. He added "the role of the federal government and what becomes of the Federal Insurance Office is another very important issue going forward." This concern was echoed by other executives who also suggested "regulatory developments, at the federal and international level, are likely to have significant impact on us going forward in the next decade."

Concluding the responses to the first question, executives of insurance companies active in retirement products noted a great present challenge comes from the demographic changes in the country. In this new environment, the top priority of an aging population is securing sufficient and steady incomes during retirement. In that light, a top executive of a large insurance group noted "retirement solutions are going to be a primary focus because people today are woefully unprepared financially for retirement. Consider what has happened with defined benefit plans, with less than 20% of people having such plans, and consider that the average 401(k) balance recently is approximately \$65,000. This is not going to help them much in their retirement years, especially given that people are living longer. So, helping with product solutions with an ongoing income stream in their retirement and balanced by protection against market volatility is going to be critical." A different executive pointed to the shift from the once-dominant defined benefit plans to defined contribution plans and 401(k) plans and said insurers can help employers as they are "pursuing more choices for their employees to deal with their financial protection needs. I think we will have a more balanced approach to funding employee benefits over time."

◆ RESPONSES TO CHALLENGES

The second question was related to how life insurers have responded to the challenges presented by the crisis and the prevailing economic environment. Most executives seemed to be in agreement, pointing to the reduction of risk as the most important response to the problems facing insurance companies today. Discussing the widespread discounting of risk in the financial markets prior to the crisis, one executive said: "The starting point for understanding the implications of the crisis is the recalibration of the risk environment and,

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by that, I mean the realization that details of outcomes may be a lot further out than we thought they were and they may also be quite a lot more likely than we thought they were. I guess, I say we generally responded in a way a company would respond if it woke up one day and saw the world was riskier than it thought previously." Describing specific steps toward better risk management, he pointed to changes "in our proprietary investing activities in which we have discretionary money invested in a wide range of different financial products to reduce volatility and the amount of capital we had tied up in such activities. We have been derisking products, we have been adding capital where we have changed our assessment of range of outcomes and of the appropriate consideration of risk of products that might have a lot of market content and, therefore, be more volatile."

A top executive of a mutual life insurer said: "We have always had a focus on the importance of substantial capital buffer. I think in a world with even more uncertainty, which we have all seen since 2007 and 2008, we have even higher levels of capital. Also, given the volatility in the marketplace and given life insurers operate better in stable markets, especially stable fixed-income markets, we looked at the guarantees we offer and have made adjustments in terms of the product portfolio to ensure that we are comfortable with all of the remaining optionality that exists in the products we offer."

Another executive noted, while "for many years introducing or repricing products was fairly slow, we have stepped up our game in terms of the frequency of repricing products and getting them to the market. With the use of technology and better focus we have accelerated the process, which has been very important because we can respond quicker to the changing economic conditions."

One of the lessons learned, according to the executive of an insurance group, is "capital and cash are not quite as fungible across entities as we might have thought they were." Continuing, he argued "now we pay more attention to local balance sheets, local capital, local liquidity in addition to the consolidated view that has had an impact on product pricing and product delivery and also operationalization of risk management as it relates to capital and liquidity management."

The importance of stress testing was also emphasized, with a mutual executive noting, although "we have always done a fair amount of stress testing, since our company is focused primarily on long-term resiliency, we have sharpened our stress testing and we are doing a lot more of it."

◆ MARKET OPPORTUNITIES

The executives were then asked to talk about what opportunities their companies have explored in the area of annuity and life products. The executive from the one company not in the annuity business said: "We periodically take a look at this market. The current interest rate environment though is not conducive to any thoughts for us to enter the annuity business now. I think those companies that are already in the market have their hands full."

An executive of a mutual life insurer active in the annuity business said: "We have introduced and began about eight, nine years ago to promote and explain the benefits of premium annuity products and expanded that line with a whole series of options that make them more accessible to the consumer. Also, in the last couple of years, we have leveraged our core whole life product line to offer products that allow for not just substantial and appropriate tax benefits but also cash value buildup where consumers have to option in terms of the frequency of the payments and the number of payments they make."

A leading annuity provider's top executive emphasized the company's "innovations with respect to living benefits and variable annuities." He added the company is "particularly interested in products that provide secure retirement income, which means they have the living benefit guarantee packages. Also, we have been heavily focused over the past five years on the mitigation of risk with the product and redesigning the things that clients can do with their account or things we will do with client accounts in volatile markets to help manage the exposures that we have on these living benefit guarantees."

He continued, currently, the "focus has been on the combination of providing secure retirement incomes but doing it with a risk value proposition that is attractive to our shareholders. We haven't been aggressive on universal life with secondary guarantees. We haven't liked those products very much. So we don't have a lot of exposure to the interest rate risk that goes along with those products. The flip side of it is we've lost market share as a result of not being more aggressive in some of those product categories. The main things we have emphasized in life is in the arena of term insurance combined with channel initiatives where we're trying to align the best products we can come up with for specific channels or specific segments as opposed to competing broadly both with respect to universal life with secondary guarantees but also in the context of competing with mutuals who have a different view of the world and compete differently in the permanent whole life market. So,

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for us, it's a dichotomy there; aggressive and innovative in annuities and more conservative in traditional life."

Highlighting new opportunities that have emerged in retirement products, an executive said: "The big product mix change for us is in institutional retirement business. This is a great opportunity to put a lot of capital into it and to be very profitable. The institutional retirement market is a good business for us. The other is the investment-only stable value product, which is a product where we provide a wrapper around an investment option in a 401(k) or other defined contribution platform. We provide the wrapper and manage the assets but it is not on our balance sheet and that's a product also very attractive from a capital standpoint, very attractive from a risk return standpoint. We are seeing a lot of action around institutional retirement products way beyond the traditional 401(k) initiative that everyone has been pushing over the past 20 years."

◆ EMERGING PRODUCT TRENDS

Following up on the previous question, the executives were asked what emerging product trends they have noted in the life insurance market. Most answers focused primarily on the annuity space and the complications and challenges arising from the variety and complexity of guarantees their companies offer. Executives from non-annuity providers pointed first to developments in the long-term benefit business as the most important current trend.

Currently, "the biggest area of significant development is in the variable annuity space" said the CEO of a large life insurer. He noted how "companies continue to add various kinds of complex guarantees to their basic variable annuity in order to give it more attractiveness to the consumer in terms of future income guarantees. Related to that is this recent development of what are called contingent deferred annuities, or putting some of the same annuity-like guarantees on top of a portfolio asset." Then again, another executive said: "We now see companies limiting the term of the guarantees and trying to protect capital because there is an appetite in the low rate environment for capital to support these products. In this low rate environment, index universal life is a fast-growing product in the market."

The difficulties with long-term care insurance were noted by several executives who talked about how their companies deal with the demand for long-term care benefits by consumers. "We often note some of the trends around long-term care, both in terms of companies adding features and products, riders and hybrid designs" said a top executive, adding "recently, companies have decided to cut back on or exit the broader traditional long-term care space. Some

have become hesitant because of the assumptions around the price and some of the unknowns with respect to the ultimate way the assumptions play out in the marketplace." A different executive submitted that the contraction in the long-term care business "will probably lead to some consideration to new types of solutions in life insurance products and other products that have accelerated benefits or multiple use benefits that I think could emerge in the future as well to try to cover some of that gap."

Pointing to other emerging trends, the top executive of a prominent life insurer said: "The development of chronic illness riders that accelerate death benefits and this is a benefit tied to a life insurance product that is not new, but is getting more interest again and probably a nice way to complement some of the pressure on the underlying profitability of life products and a low rate environment. More emphasis on fee income, less investment content in products generally again because margins are harder to earn when rates are as low as they are."

Another executive suggested "riders are appealing as the idea of a combination product generally is something of interest to people who have limited funds so getting coverage that will fit different life events is important. It is something we need to work more on in terms of going back to existing customers."

◆ PRODUCT EVOLUTION

Asked to comment on how they foresee products evolving over the next decade or so, most executives stressed the importance of developing retirement products to meet the needs of an aging population. One executive said if interest rates remain at relatively low levels, companies' efforts will likely concentrate on "pricing for more mortality risk contents and getting paid for it or pricing for more longevity risk content in the case of retirement products and getting paid for it and removing the investment content because of the combination of volatility and low rates." He added "the next generation of annuity products, for example, may well be very much fixed-income driven and look a lot like selling longevity protection."

Moving toward simpler products that can be offered online was also noted by one executive of a large group who said "simplicity is going to be an area we need to focus on" adding that insurers should look into "term products without significant inherent investment risk, at least for the consumer."

Starting from questions regarding the current state and long-term viability of the Social Security system an execu-

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tive of a company active in retirement, disability and critical illness products noted the coming changes (eligibility, living adjustments, etc.) in Social Security “will affect how insurance companies may develop products and services to fill those gaps as they emerge as you get some of that shift from public sector financial pressure to private sector opportunity.” Other executives also recognized the need for more holistic solutions for retirement products and long-term care to complement the often inadequate protection people already have.

A hot market right now, according to a large life company executive, is in institutional products, such as pension risk transfer. A number of insurers have announced significant deals taking over pension liabilities from major corporations. The same executive underscored “as corporations paying a lot of attention to getting out of the defined benefit pension plan that will be a big deal for the insurance industry, particularly the larger, stronger insurers.”

◆ **ENTERPRISE RISK MANAGEMENT**

The next question concentrated on enterprise risk management (ERM) and how it is implemented by insurers. While all the executives, without exception, touted the benefits of ERM and the strength of their risk-management framework, their varying perspectives on the quality and purpose of ERM came to the fore.

The top executive of a mutual life insurer outlined the importance of ERM for his company, stressing the different priorities mutuals have compared to stock companies. Being a mutual company, he said: “Our objective is to be able first and foremost to honor all the obligations that we make in the marketplace. Our focus is on long-term financial strength to meet the commitments to our policyholders. That’s not just a marketing proposition, that’s how we orient the company. As a result of that, risk management in many ways is job number one. It’s not just a necessary condition in trying to run a profitable business. For us, running a profitable business is a means to an end, with the end being to be able to provide long-term guarantee to our policyholders. If you think about that then, the first order issue is what guarantees, what things are we comfortable offering, the best risk management is deciding what business we choose to be in and what businesses we choose not to be in.” Discussing the use of financial models, he said his company has a more cautious orientation and, although it uses sophisticated modeling, it does not “over-rely on models, recognizing that at the end of the day, just like reserves should be conservative, so should our judgment around our understanding the risks of the marketplace. Therefore, we have a deliberate decision-making process not being over-

confident in our ability to hedge things that in many ways are not hedgeable and do our best to avoid systemic kind of risks where everybody is likely to be facing the same challenges at the same time.”

From a stock company’s perspective, an executive of a leading public insurer pointed out, for them, “ERM begins with the deployment of capital. We pay a lot of attention to intrinsic risks in business models and the intrinsic earnings power in business models and the way in which they relate to the risk profile of the company’s volatility of earnings, the volatility of capital, capital requirements overall and our ability to take and manage the risks that go with the products that we sell.” He then said: “ERM is kind of summarized by the notion that we pay a lot of attention to the way in which our capital is deployed under our businesses and what that means for the risk we take and the overall profile of earnings power and risk for the company.”

Another executive described her company’s ERM framework, emphasizing it “encompasses a fairly broad risk universe where we are looking at all of the investments and counterparty risks. So, if you think about credit, equity volatility, liquidity, mismatch in terms of our interest rates, the interest rate volatility and the typical underwriting risk for mortality, morbidity, lapsed policyholder behavior then the newest piece is operational risk. What is needed is a much more formalized review of the business, the legal compliance, tax processing systems, people.”

◆ **PRINCIPLE-BASED RESERVING**

CIPR staff also inquired about the impact principle-based reserving (PBR) has had on insurance companies’ actuarial operations, product development and design and pricing. Top executives of large groups active in a variety of highly complex products tended to be enthusiastic about PBR, while their counterparts from smaller companies, and particularly from those that concentrate on simpler life products with generally fewer guarantees, were not quite as animated about the prospect of PBR. An executive from a company specializing in disability insurance commented that, because they are active mainly in “the employee benefits world without significant inherent investment risk, [they] don’t have quite the principle-based pressures as maybe others in the industry have.” At the same time, she added: “I think we have the opportunity with principle-based models to think about capital sensitivity maybe do a lot more stress testing around assumptions that we use and reserve in asset modeling and then, in turn, think through the variables that will emerge depending on how many degrees of freedom you pursue around what might happen to those assumptions.”

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An executive from a large mutual noted “there is a cost associated with PBR, both in terms of the infrastructure for it, but also for the skill sets to be able to deploy PBR which may put a burden on smaller companies. I don’t know if it would cause them to exit lines, but it usually is harder with some of the smaller companies especially when it involves pretty significant changes like this.” He added “if PBR was implemented effectively and consistently with appropriate reserving levels that would be a great thing and would be worth absolutely the burden of any costs associated with implementation. [PBR] would result in a much more transparent and understandable product because many products today are designed essentially trying to crack the mouse-trap of what is a formula reserve structure and it is unfortunate but that is true, the product designs are made to work their way through the regulatory formulas to get to a lower level of reserve and creates some very strange design and have a complexity not even the designers understand.”

Another executive from a leading annuity provider spoke about what is needed to implement PBR: “We have had to invest much more in sophisticated modeling technology hardware and software. We also had to increase our pool of actuarial talent. The skills it takes in the actuarial world to implement PBR are more complicated and more sophisticated and more demanding in terms of the platform, as well as the people. I say the immediate implication has been more contained around the resources and the platform and the people within the actuarial function and the ability to run these models.” He also talked about the expected benefits of PBR, suggesting it “can shorten the product life cycle and it is going to allow us to get to the market quicker. It also provides us with better insight with respect to risk and capital.”

◆ **INFORMATION TECHNOLOGIES**

With the increasing importance of information and mobile and Web-based technologies, the executives were asked to comment on the impact these technologies could have on their companies. An executive of a large company recognized the enormous significance of emerging technologies, arguing companies need to “learn how to understand [new technology], leverage it, make sure they are prepared and how it impacts, how consumers learn about your products, how consumers have the ability to voice their thoughts around your products, how you measure and manage your brand.” He explained how important it is to “improve service levels and the like by leveraging greater investments in technology, allowing for self-service kinds of transactions.” Another executive stressed the impact will be dramatic, “from the transition of technology from kind of a stand-alone thing to something that is neither discrete or isolated,

but central and integrated. It affects the way we collaborate, the way we work, the way we share, the way we deliver and the way we support.”

◆ **DECISION TO DEMUTUALIZE**

The executives were asked if their companies had demutualized in the past 30 years and, if so, what the impact was of such a change. An executive of a prominent mutual explained his company decided not to become a publicly traded company. He argued there are several “competitive differences between a mutual company and stock company. It shows up in most every behavior you see in the marketplace today. The way you think about capital depends on the organizational form. To either minimize capital to boost the return on equity to create a theoretical return that will please shareholders for a temporary period of time or to ensure on behalf of all your policyholders that you have the necessary buffering cushion to deal with a whole bunch of unknown investments in an increasingly uncertain world. If you are a stock company, you think the former, and if you are a mutual company, you think the latter.”

As far as the products a mutual chooses to offer, he suggested “there are certain product lines that are great consumer buys that public companies would not get the support of the shareholders to remain in. An example might be take a good life insurance product that offers a good consumer value and is profitable and, yet, because of the capital required to appropriately reserve for that, maybe never going to get more than 8% or 9% return. If the marketplace is telling you your return on equity has to be 12% or 13% or you promise shareholders that, how can you proceed to sell any significant amount of a product that offers you a 9% return if you are telling Wall Street your company is going to deliver a 12% or 13% return?”

A top executive of an insurer of a comparable type that did elect to demutualize noted his company’s international presence compelled them to demutualize, because the “financial architecture of a mutual insurance company doing things like that is not appropriate.” Also, being a large international asset manager “doesn’t fit well with being a mutual.” He continued, saying that demutualization had “the impact we wanted, enabling us to execute our business strategies. It also had the right impact on the motivation of employees. When your stock price is in the paper every day, you think differently. The flip side of this, though, is there is a lot of aggravation these days attached to being a public company and the volatility of earnings doesn’t help, but public companies are looked at certain ways. Sometimes the connection of fundamentals to market prices is fairly strong and other times nonexistent.”

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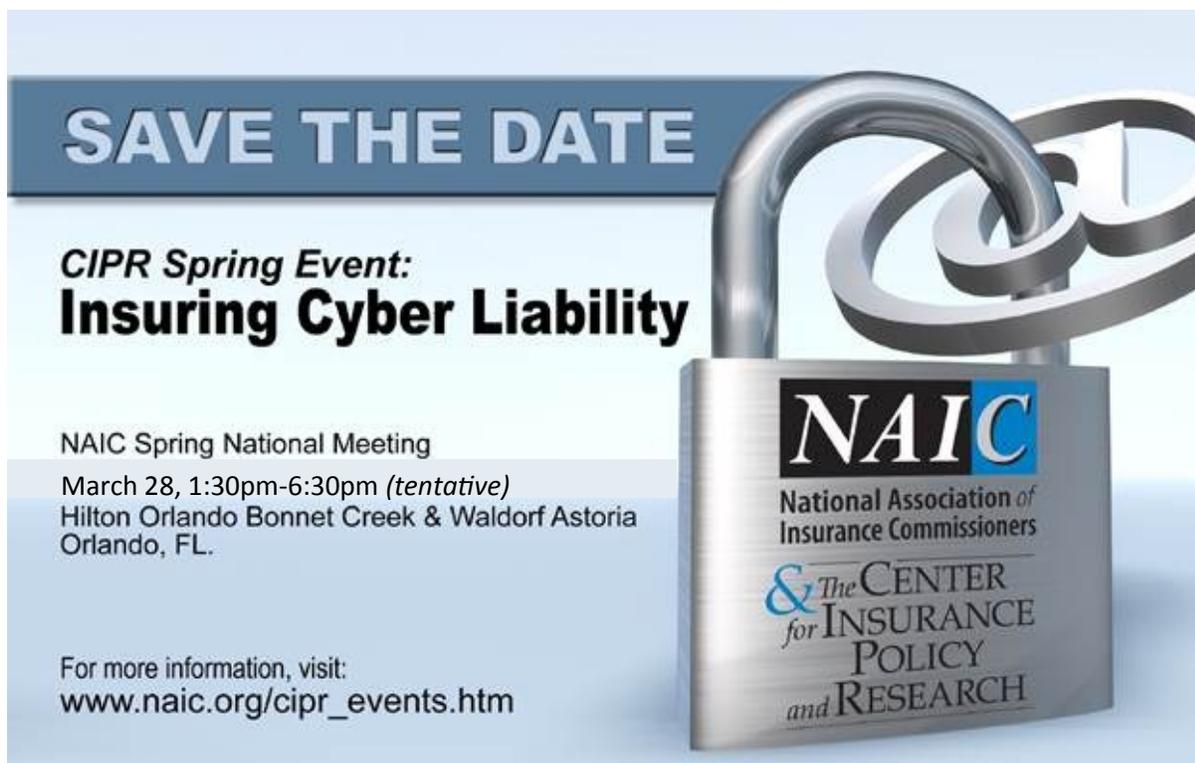
◆ **CONCLUSION**

The CIPR would like to thank all the executives that participated in the interviews. These interviews provided CIPR staff with the opportunity to get in-depth and detailed responses to a series of questions by top executives of a number of notable insurance companies. As the industry continues to evolve in a dynamic and challenging economic and social environment, primary research methods can greatly help understand insurers' actions and motivations. The executives were given the opportunity to discuss present and emerging risks and challenges and highlight how they manage those risks. They also noted how their companies' product mix is driven primarily by consumers' needs and macro-economic factors. Furthermore, all executives, without exception, pointed to the key role demographic changes and technological advances play in shaping demand and, in turn, product design and sales.

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