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EXPECTING THE UNEXPECTED

As people live longer, insurance companies tweak products or develop new ones to address unique challenges.

by Angelo John Lewis

"Longevity risk" means something very different to individuals and insurers.

For individuals, it means the fear of outliving their money, often because of expensive health care costs that can accompany advanced age.

For life insurers, it means the fear of higher and longer payouts on insurance products that were not designed for greater life expectancies now being seen.

"The bottom line is that the impact of longevity on life insurers is mixed," said Colin Devine, principal of C. Devine & Associates and an insurance industry consultant. "In theory, rising longevity is positive if you're a carrier that just wrote whole life; people would pay premiums for longer, and business would be more profitable. The problem with that statement is that most carriers for at least the past decade have reinsured out most of their mortality risk, so the benefit of rising longevity is probably good for life reinsurers, but I'm not so sure it helps primary insurers."

Another problem rests with companies that sold annuities, which are paid out over a person's lifetime.

"That means you're going to be making payments longer," Devine said. "But the question that's even more important to ask

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Key Points

The Trend: As longevity increases so does the demand for insurance products such as life combination and annuities with living benefits.

The Impact: Insurers must understand longevity risk on their books, specifically the degree to which greater life insurance premiums balance extended annuity payouts.

The Future: New and revamped insurance products will likely address growing concerns about outliving savings.

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concerns the impact of rising longevity on products that might have been priced with incorrect lapse assumptions," he said.

In addition to the obvious long-term care products, this category also includes universal life with secondary guarantees, and variable annuities with living benefits, he said.

One of the biggest examples of missing the longevity mark came last year, when Genworth Financial Inc., the long-term care industry leader, posted a $760 million net loss, or $1.53 a share, related to claims on long-term care policies. Many LTC insurers faced similar, though perhaps not as large, losses because their old blocks of business were priced with overly optimistic lapse predictions and incorrect mortality assumptions.

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Stuart Silverman
Milliman

Balancing Act

Stuart Silverman, principal and consulting actuary at Milliman, said to avoid that scenario, insurers need to appropriately balance life insurance and annuity risks.

"As the populations are aging, as those books of business start moving toward the pay-out phases of that risk, and as individuals are demanding or interested in more longevity risk product types of offerings, insurers are going to need to understand the diversification better, not just from a pricing perspective, but also from an economic capital perspective," Silverman said.

Many of today's longevity products have in recent years been re-priced upward to reflect increased longevity and a better understanding of lapse risk. And some carriers that were not comfortable with the risk or reserve requirements for these products have exited the business altogether.

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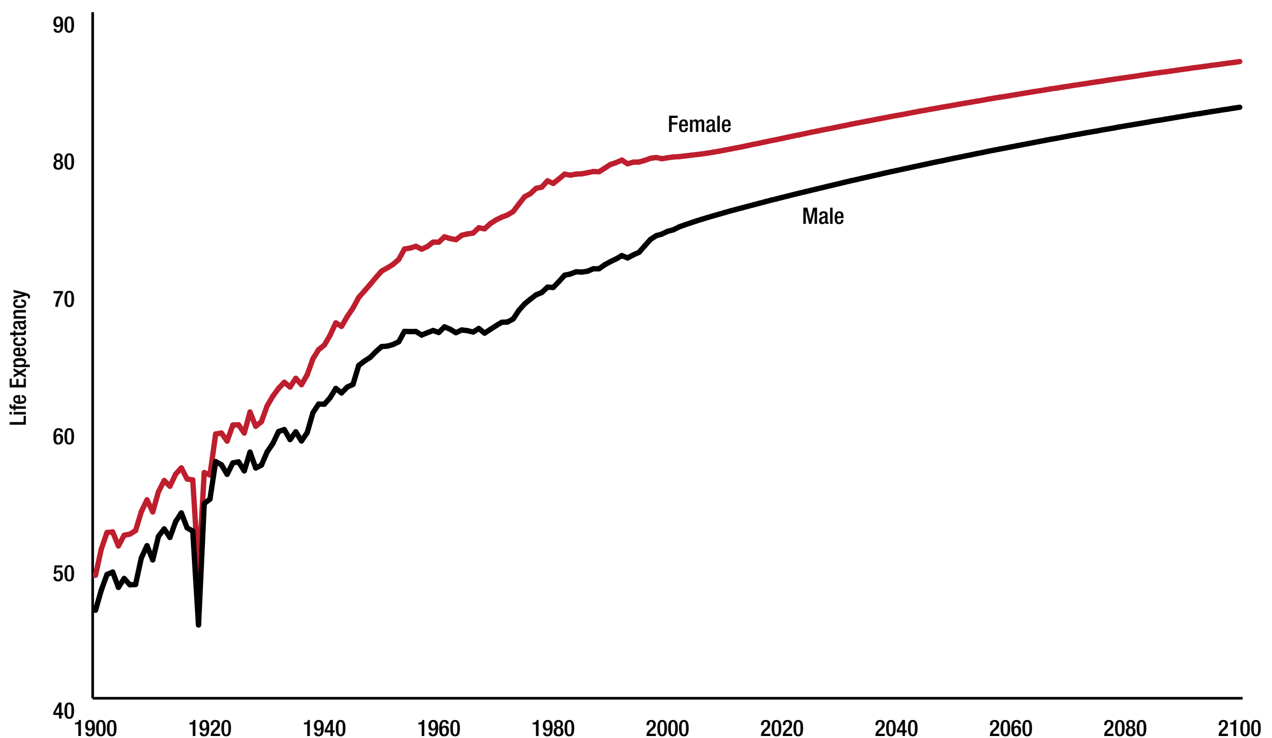
Mike Vaughan
Nationwide

Life Expectancy at Age 0
By gender and calendar year



Source: U.S. Social Security

For example, last year SunLife announced it would increase premiums up to 25% for LTC policies sold prior to 2013. And a 2014 Milliman survey reported 10 of 26 carriers said they planned to re-price their ULSG products, while five said they'd already exited the market.

New Opportunities

"As we see demographics shifting, we're going to see a change in demand for certain products," said Silverman. "As baby boomers start to retire, we may see less of a demand for traditional life products. Traditional life products will always be there, but there is definitely an increased demand for longevity risk protection types of products."

Options include life combination products with long-term care or chronic illness riders, and annuities with living benefits.

"I think the biggest thing from the annuity standpoint is lifetime income benefits, which didn't exist 15 years ago or so," said Mike Vaughan, associate vice president for life insurance at Nationwide. "A slight majority of annuity products are now bought with some sort of living benefit which allows clients to annuitize their contracts and convert their assets into an income stream."

"The historical benefits that were offered at retirement, such as life insurance and health care extensions to augment Medicare, for the most part are no longer offered or are frozen."

J. Philip Bruen
MetLife

In addition, many of the newer products address the growing concern of morbidity, which often accompanies longer life spans.

"If mortality improves, sometimes morbidity can be worse," said J. Philip Bruen, head of life and disability products for MetLife group, voluntary, and worksite benefits. "So if people live longer, they may have greater chances of living with an impairment or disability; the two often go together."

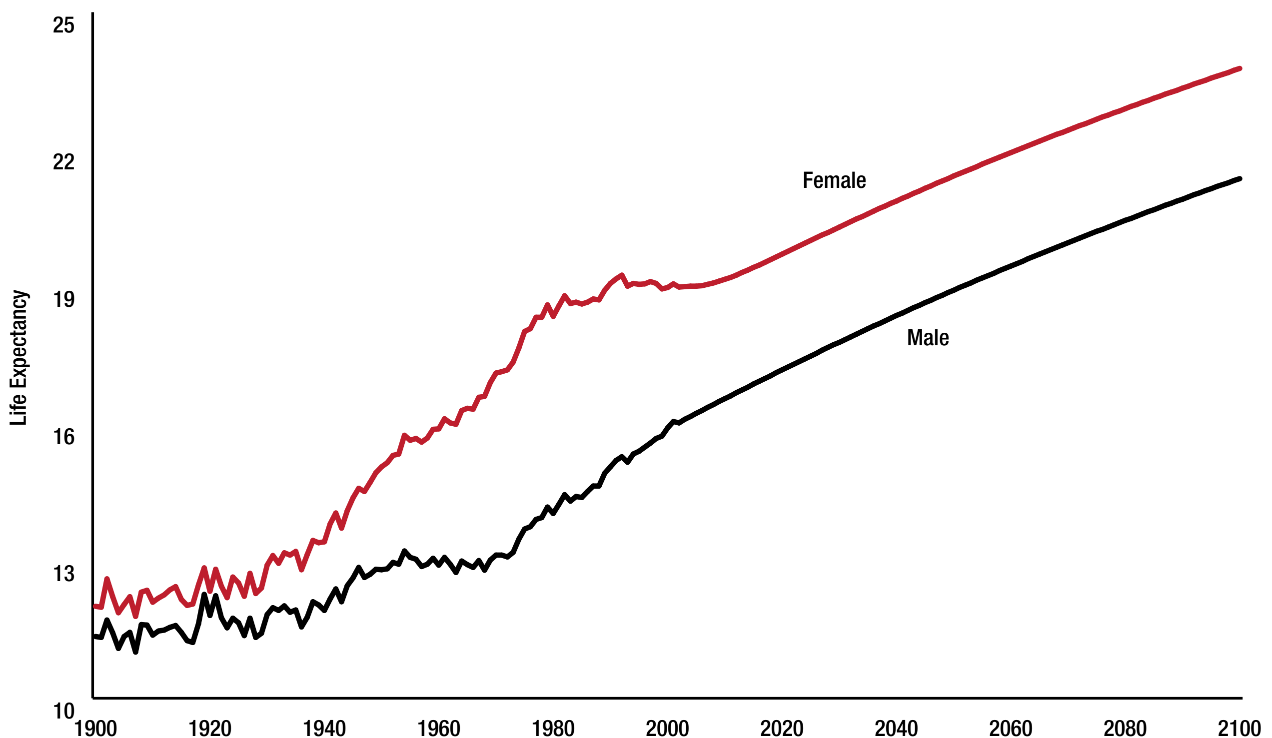
Likewise, increased health care costs often go hand in hand with declines in retiree benefits.

"The historical benefits that were offered at retirement, such as life insurance and health care extensions to augment Medicare, for the most part are no longer offered or are frozen," Bruen said. "Employers and their retirees have to think about how to address this gap and maximize their retirees' savings and assets with protection that would continue into the future."

Measured Response

Life insurers are addressing these issues with combination products that allow consumers to use their benefits in different ways.

Life Expectancy at Age 65
By gender and calendar year



Source: U.S. Social Security

"We continue to refine our approach in many different platforms where we accelerate traditional death benefits for health care events, be they critical illness, chronic illness and mostly recently, longevity," said John Deremo, executive vice president and chief distribution officer, life insurance, of AIG Financial Distributors. The longevity rider option is built on the company's universal life chassis and allows the insured to receive an accelerated portion of the death benefit, in the form of periodic payments, upon the attainment of a certain advanced age and when the terms of the policy have been met. MetLife has developed voluntary group options to cover such needs as final expenses and dental and vision coverage.

"The voluntary retiree life sector is one example where we've developed a solution," Bruen said. "Employers can provide this product which comes with value-added services such as face-to-face will preparation and estate resolution services to their retirees at no additional cost, with all administration managed by MetLife. Separately, MetLife's direct channel also has a guaranteed acceptance life policy with a small face value with no medical underwriting. That can help individuals fund their final expenses in the event of death."

Consultant Devine believes that qualified longevity annuity contracts, or QLACs, are at the forefront of relatively new products that address longevity concerns. QLACs are a subset of deferred income annuities, in which an owner defers payouts until an advanced age. Deferred income annuities are among the fastest growing annuity products, achieving record 22% sales growth to $2.7 billion from 2014 to 2015, according to Limra. The difference between these and QLACs is that the latter are meant to be purchased from retirement plan assets.

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AIG Financial Distributors

Approved in 2014 for use in traditional IRAs and other retirement plans, QLACs allow owners to invest a portion of their prior year IRA balance in a QLAC, therefore avoiding required minimum distributions until the maximum age of 85. These are fixed annuities with no annual fees, and they are indexed for inflation.

"The beauty of a QLAC is that it's simple," Devine said. "You can put up to 25% of your IRA up to $125,000 into this product, and if you're alive at 80 it pays you then or at 85. So if you put $100,000 into a QLAC at age 65, the QLAC would pay a male about $27,400 a year for the rest of his life. Or, if you wait until 85, it will pay you about $55,000. I think the growth is going to be explosive." (For more information on QLACs, see "Here Come the QLACs" in the November 2013 issue of *Best's Review*.)

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Rod Rishel
AIG Consumer Insurance

It seems fairly clear that insurers will continue to create and market products that address longevity concerns, as workplace benefits continue to decrease and pressure builds on entitlement spending, said Rod Rishel, AIG Consumer Insurance's chief executive officer, life, health and disability.

"From everything we've seen from Washington, there has to be more cutbacks in spending, and entitlement programs will probably fall into that in some way or shape or form," Rishel said. "There's a trend toward less reliance on government programs and companies to take care of individuals, and more emphasis on individual readiness for retirement and longevity. This plays right into increased importance of insurance."

Silverman and his colleague Dan Theodore recently published a case study aimed at fine-tuning the generally held actuarial belief that adverse mortality experience on life insurance may be offset by the longevity risk associated with annuity benefits. The paper argues for the value of using stochastically generated mortality rates based on historical levels of mortality rate volatility to examine potential changes in the probability of a combined life and annuity business.

"The point is that mortality rates for different ages move in a correlated basis, but they don't move in a 100% correlated basis. If you look over the last 50 years, you see correlation, but you don't see perfect correlation. So the question is, how can a company examine and quantify that for the purposes of pricing, capital setting and determining appropriate levels of mix of business?" Silverman said. BR