Under pressure: Coping with low interest rates

Mr Ken Su of **RGA Asia Pacific**, **Mr Marc Sofer** and **Mr Jerome Matrundola**, both from **RGA Reinsurance Company Hong Kong and Southeast Asia**, suggest strategies insurers can look at to thrive under the current low interest rate environment.

Six years of low interest rates coupled with economic sluggishness is not an economic environment that would breed optimism. Although low rates can have some advantages, such as lower asset prices and financing costs, the main disadvantage – lower returns on assets – is making it difficult for insurers to maintain profitability and support current and legacy needs.

Even if rates do rise, the effects of these low rates will continue to affect portfolios. And operating costs and competition are rising as markets continue to evolve, pushing insurers in Asia to seek more effective ways to manage their businesses and maintain profitability.

A broad range of sustainable strategies are currently available that can help insurers generate reliable revenue, maintain profitability and manage operating costs. To do so, however, companies would be well advised to look at ways to: improve capital and asset-liability management; develop, market and distribute products that will meet the needs of growing market segments; and creatively support current and future risk.

Product development/marketing

At this point, options are few for reducing the impact of low interest rates on in-force blocks of business. Sustained low rates have been and will continue to lead to compressed profit margins. Some strategies, however, can provide benefit.

Mortality and living benefit protection business have attractive potential for life insurers in the current environment, as profitability of these products is less sensitive to interest rates than that of savings-orientated products. By refocusing sales efforts on products that are not heavily dependent on investment income to change product mix and meet profitability targets, insurers may be able to reduce the impact from new business flows of savings-type products that may currently have onerous investment guarantees.

In most Asian markets, life insurance sales have been relatively strong due to the introduction of protection products that meet consumer needs and demand. For example, in recent years more than half of the globe's Critical Illness (CI) premiums originated in Asia. Insurers have teamed with reinsurers to develop a multitude of CI products, from ones covering single impairments (cancer or heart-related conditions) to comprehensive products covering 60+ conditions to maximise coverage, catastrophic CI products covering late-stage illness progression, multi-stage severity based CI products covering early stage illnesses not previously covered, and multiple payment CI products that reinstate out the sum assured up to five times, in recognition of increased longevity associated with improvements in medical technology.

Index-linked universal life and underwritten annuities

Two new product types could also be beneficial. Several insurers are now assessing index-linked universal life (IUL), a product popular in the US that provides more growth potential due to a cap that limits upside and a floor that limits downside. IUL sales in the US grew at an astonishing 24% compound rate from 2006 to 2011 while aggregate life sales decreased.

The second product, underwritten annuities, represents about GBP3 billion (US$4.7 billion) of annual sales in the UK. This product targets at or near-retirement lives which have below-average life expectancies, and uses that shortened life expectancy to underwrite annuities that can offer higher payments. These single-premium products, which are targeted for retirement pensions, provide policyholders with longevity protection and manage reinvestment risk due to the shorter payment durations associated with relatively sicker annuitants.

Several Japanese insurance companies have simply stopped paying interest, and instead have been focusing on selling return-of-premium risk protection products such as cancer, hospital cash and long-term care. The idea is that the customer will value the protection element more than the small amount of interest, and will receive their premium back at the end of the policy period (eg 10 years).

Japanese insurers have also had great success in selling foreign currency-denominated savings type products. For example, many insurers offer Australian dollar-denominated UL products, which offer higher guarantees than equivalent Yen-denominated products.

Up-sell and cross-sell initiatives

Up-sell and cross-sell initiatives on in-force mortality savings-type products have also been highly successful in helping to counter the negative spreads associated with these products.

Many insurers across Asia have had phenomenal successes selling protection riders with reduced underwriting requirements to base savings product policyholders. Guaranteed issue and simplified issue up-sell campaigns have specifically been developed in conjunction with reinsurers to target those customers who were underwritten fairly recently, thereby reducing barriers to sale.

Underwriting, distributing, servicing

Asian insurers can benefit from strategic investments in technology as well as new methodologies to improve product sales and operational efficiency, which can help them take steps to mitigate erosion of profitability in the long term.

Ways to reach markets are expanding: in addition to the traditional channels of agents, affinity markets, telemarketers and direct mail, companies are also developing internet portals for consumers and worksites as well as consumer and agent apps for mobile devices such as smartphones and tablets.

Companies in Japan and Singapore have begun to roll out fully integrated platforms for tablet devices, customised for full advisory and sales capacity, and equipping their agents with those tablets. The devices let advisers make client presentations either face-to-face or remotely, take application information right on the tablet and then send it wirelessly to the home office for underwriting, receive a decision on the spot, and accept premium payments.

Automating underwriting and claims processes

In the underwriting segment, speed and simplification have been bywords for some time, with companies undertaking to simplify products in order to make sales faster and easier. Automatic underwriting, as it takes hold, is also speeding up the transaction continuum and enabling further development of products with simplified underwriting processes.

Asian insurers are also starting to look at ways to automate the claims process, from filing to adjudication through to resolution.

Servicing the advisers

An area where insurers can buttress their competitive positions and thereby improve sales is in the service agents and advisers receive. Financial advisers place substantial value on how effectively insurance companies service their sales forces, and so might be more likely to place business with life insurers that consistently provide top-quality service. This might mean providing not just efficient turnarounds for underwriting, queries and claims handling, but also some value-added enhancements, such as concierge services for high-producing advisers. This is particularly relevant for high-net-worth business.

Companies can also use predictive analytics to improve their sales force management. Predictive analytics are already being used with increasing frequency to improve sales models, risk selection and persistency. By using its models to analyse producer books of business as well, companies can develop ways to optimise their sales forces. This can be accomplished by identifying and then developing agents with the strongest books and the most potential, and by building sustainable development programmes where those agents train and mentor other strong-potential agents.

Reinsurers have worked extensively with insurers in Asia to help develop many of these processes, by providing assistance in developing models and automated underwriting engines to work through the large, growing demand for quotes.

Capital management through reinsurance

With low interest rates showing few signs of abating, Asian insurers can benefit from reassessing their fundamental market strategies and look at how reinsurance can buttress their financial health and strategic planning. Capital-efficient reinsurance can provide ways life insurers can improve capital, buttress financial strength, and relieve capital strain.

Several strategies are available. One possibility is using it to ease the strain of in-force business portfolios of products with high guarantees. In Taiwan, life insurers use yearly renewable term (YRT) to reduce their risk-based capital (RBC) charges on mortality, decrease capital requirements and improve solvency ratios.

Japanese life insurers use modified coinsurance with ceding commissions to monetise future profits to cover direct acquisition costs. In modified coinsurance, the ceding company owns and manages policyholder assets. The reinsurer shares all elements of insurance risks, such as mortality and lapses. If the reinsured business has positive embedded value, reinsurers pay ceding commissions to the direct insurers to cover new business strain.

YRT, modified coinsurance and full-risk coinsurance are all utilised by Chinese insurance companies to transfer risks, including investment risks. In full-risk coinsurance, assets are physically transferred to reinsurers, enabling insurers to free up capital. This increases solvency ratios and ultimately improves returns to shareholders.

Reinsurance can also enable insurers to participate in the growing mergers and acquisitions market by providing a simpler and less expensive means to finance transactions. M&A appetite throughout Asia, especially in its emerging markets, is rising in large part due to sizable growth in mass affluent populations throughout the region. Advantages of using reinsurance for M&A are several: no shareholder vote is necessary, external third parties rarely need to be involved, and as reinsurance is already familiar as a risk mitigation vehicle, the learning curve for its use will not be steep.

Conclusion

Management of in-force product and financial portfolios, as well as focusing on protection products and on innovation in product design and distribution, are strategies that can enable Asian life insurers to weather the current low interest rate environment.

Keep in mind that no specific interest rate environment remains constant forever. These strategies can also enable insurers to equip themselves more effectively to manage a broad range of interest rate scenarios.

Mr Ken Su is Executive Director, Business Development, Global Financial Solutions at RGA Asia Pacific; Mr Marc Sofer is Head of Strategic Initiatives, North Asia and India and Mr Jerome Matrundola is Head of Strategic Initiatives, Hong Kong and Southeast Asia, both at RGA Reinsurance Company Hong Kong and Southeast Asia.

RGA is the 2012 winner for Life Reinsurer of the Year at the 16th Asia Insurance Industry Awards.