



# Time Bombs: Not Just Investments

*Repercussions of the Economic Turbulence on the Life Insurance Industry*

June 10, 2009





## Disclaimer

*This information is provided for general information purposes only. It does not constitute professional advice and does not create a broker-client relationship. Please consult a HUB International or Pelagos Advisors representative about your specific needs before taking any action.*



## Overview

- State of the industry
- Impact on existing policyholders
- Implications for the future
- Best practices



## Life Insurance Industry Outlook

- Market value: I-Shares of DJ US Insurance Index -52% for 2008 (June 08-May 09: -51%)
- In January 2009, 29 insurers were downgraded or placed on a watch-list; that number grew to 90 in April 2009
- Next shoes to fall
  - High yield bonds
  - Commercial mortgages

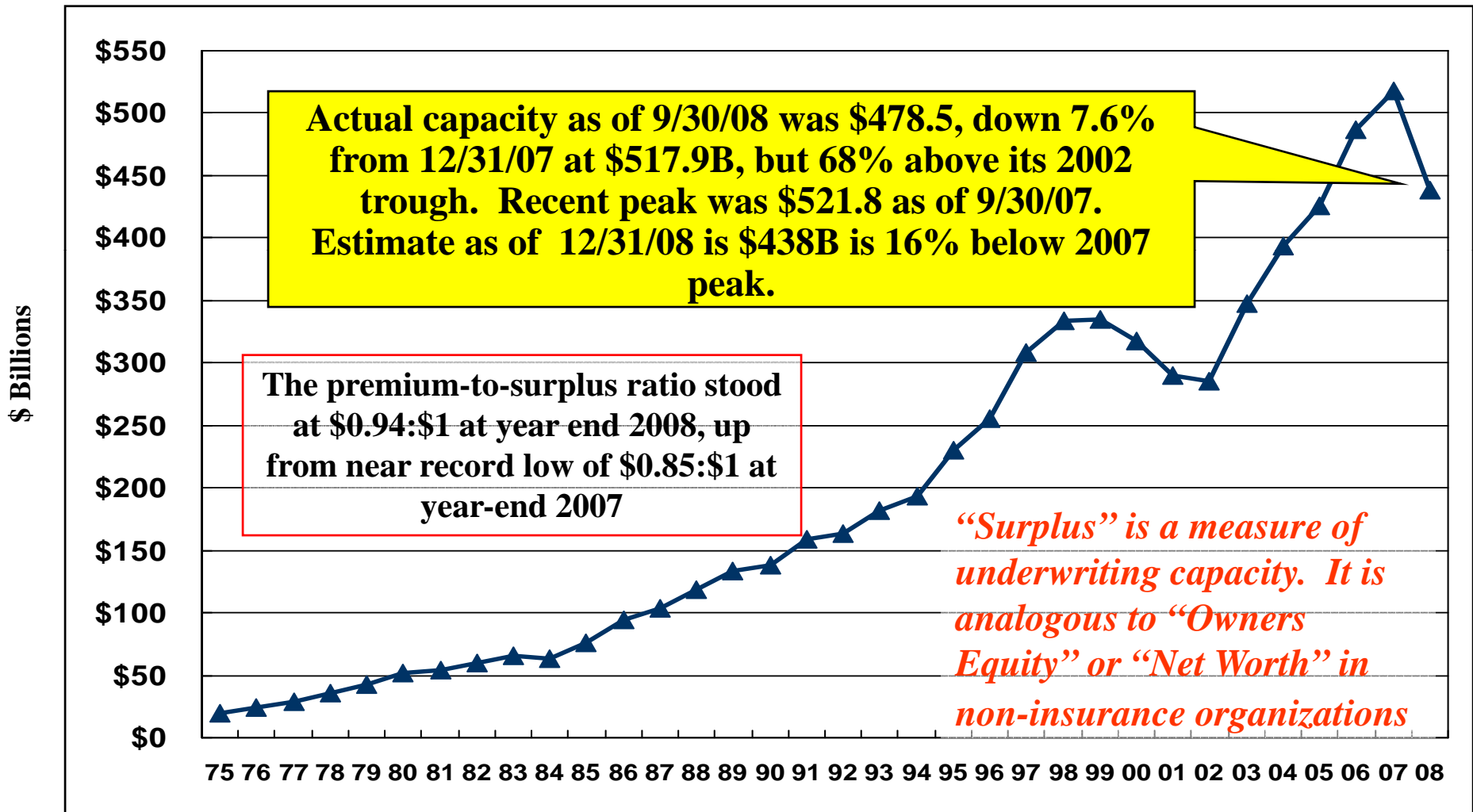
## “Newly Discovered” Risks

Risk	Carrier
Junk bonds	Executive Life
Heavy concentration of commercial real estate	Confederation Life and Mutual Benefit
Mismatching duration of investments and issued financial instruments	Equitable and General American
Reinsurance risks in annuity death benefit	American Skandia
Parent company activity + credit default swaps	AIG
Equity, mortgage and corporate bond losses	????



# Property & Casualty Insurance Industry Outlook

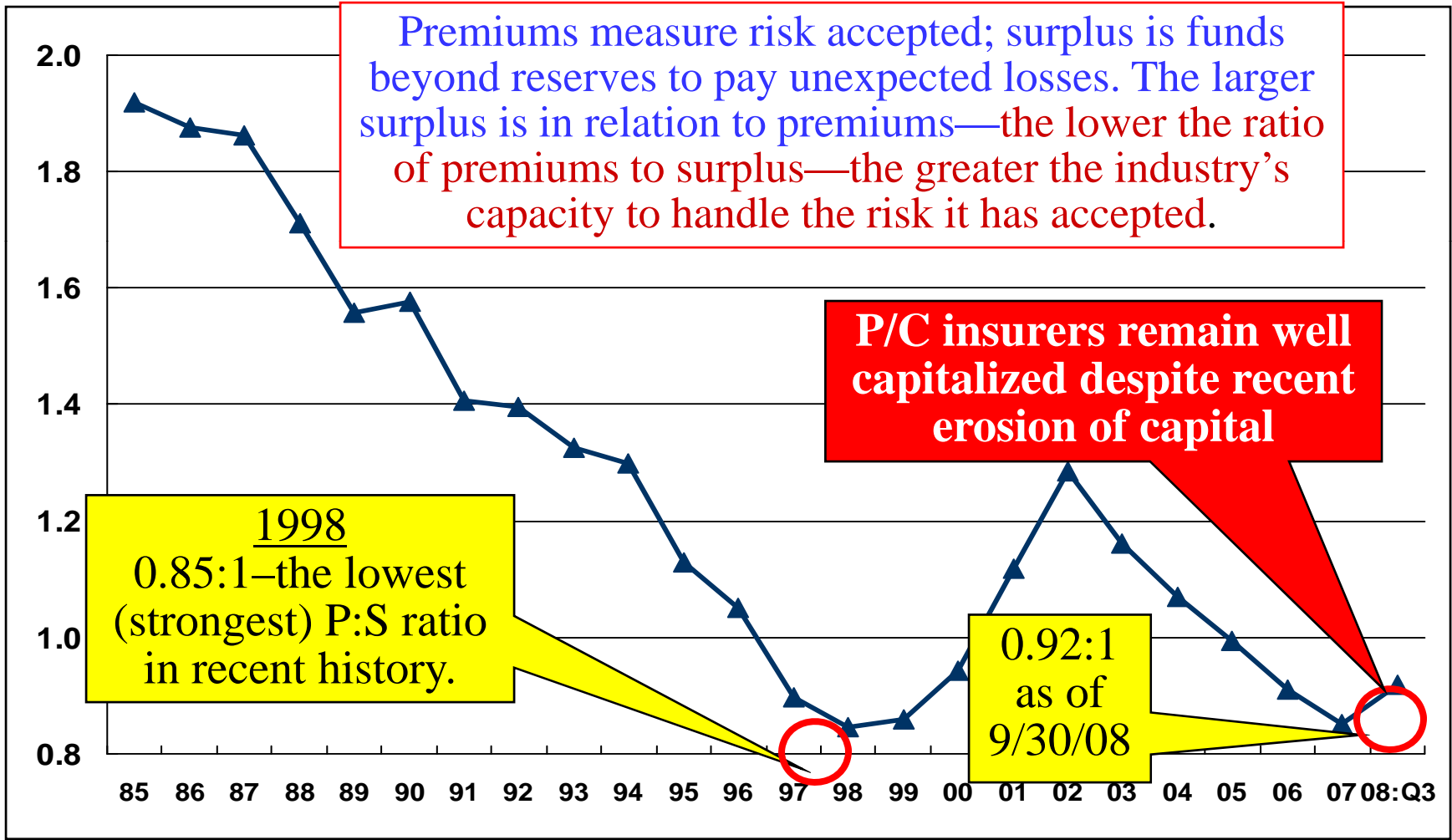
# U.S. Policyholder Surplus: 1975-2008\*



Source: A.M. Best, ISO, Insurance Information Institute.

\*Towers Perrin estimate as of 12/31/08

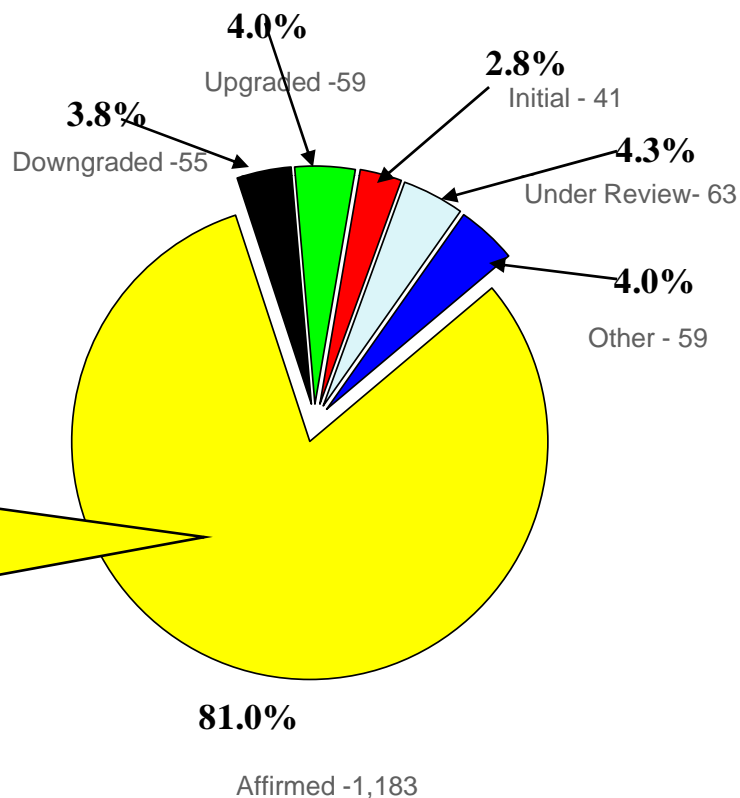
# U.S. P/C Industry Premiums-to-Surplus Ratio: 1985-2008:Q3



## Summary of A.M. Best's P/C Insurer Ratings Actions in 2008\*

**P/C insurance is by design a resilient in business. The dual threat of financial disasters and catastrophic losses are anticipated in the industry's risk management strategy.**

**Despite financial market turmoil, high cat losses and a soft market in 2008, 81% of ratings actions by A.M. Best were affirmations; just 3.8% were downgrades and 4.0% upgrades**



\*Through December 19. Source: A.M. Best.



## **Impact on Existing Policyholders ...Compounded By Misunderstandings**



## Impact on Existing Policyholders ...Compounded By Misunderstandings

*The life insurance industry has not been spared by the economic turmoil over the past year. Though there will be widespread downgrades, an increase in M&A activity and possibly even a few failures, most carriers will survive in some form. Many of the existing policies will not be so fortunate.*



# Impact on Existing Policyholders

## ...Compounded By Misunderstandings

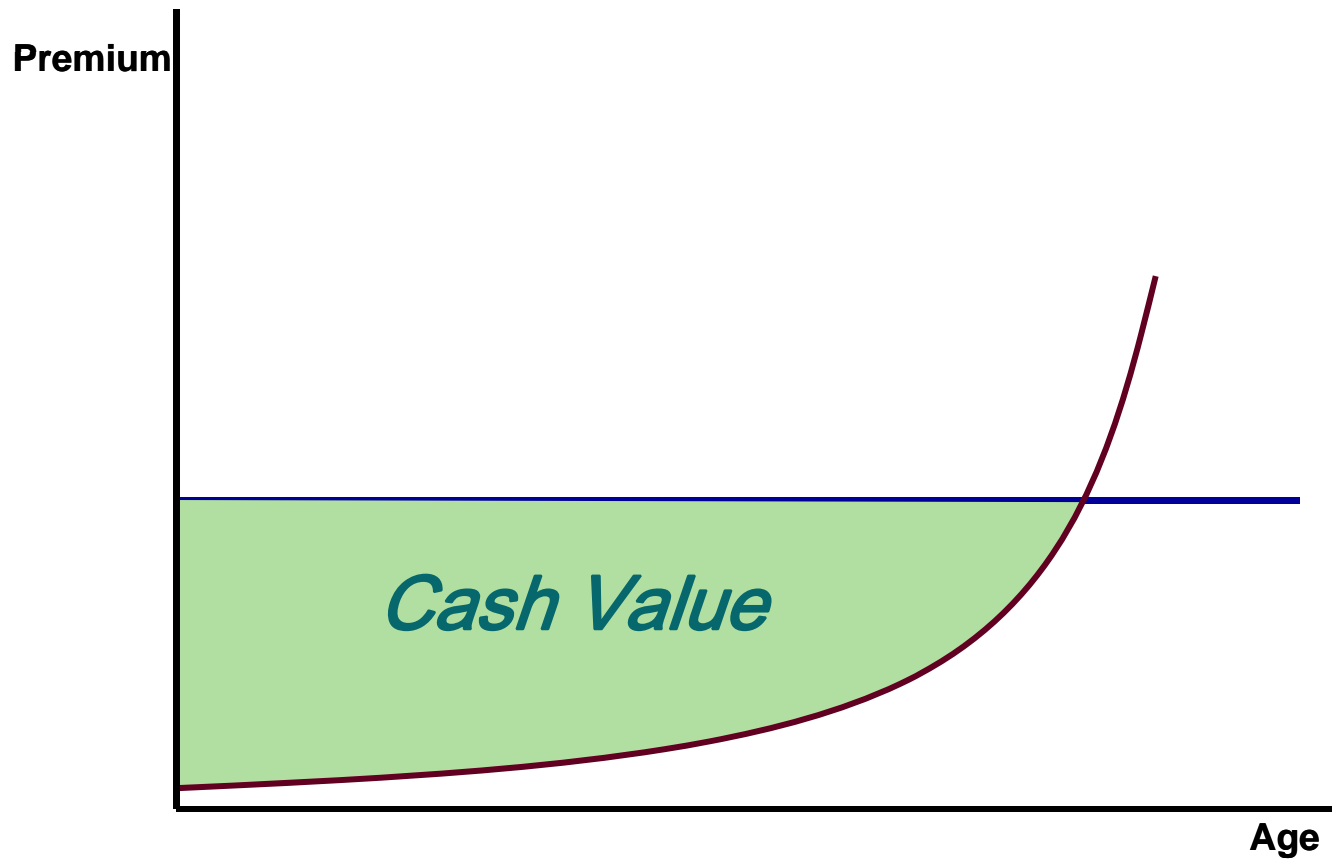
- Bid/quote mentality drives underfunding
  - Illustrations = product
  - Illustrations are comparable
  - Premium = cost
- Paid premium = OK
- Strong carrier = strong product
- Terminology
  - Paid-up = no more premium due
  - Permanent = until death
  - Whole life = guaranteed
  - Variable life = highest risk



## Impact on Existing Policyholders

1. Decreased crediting rate

## Decreased crediting rate

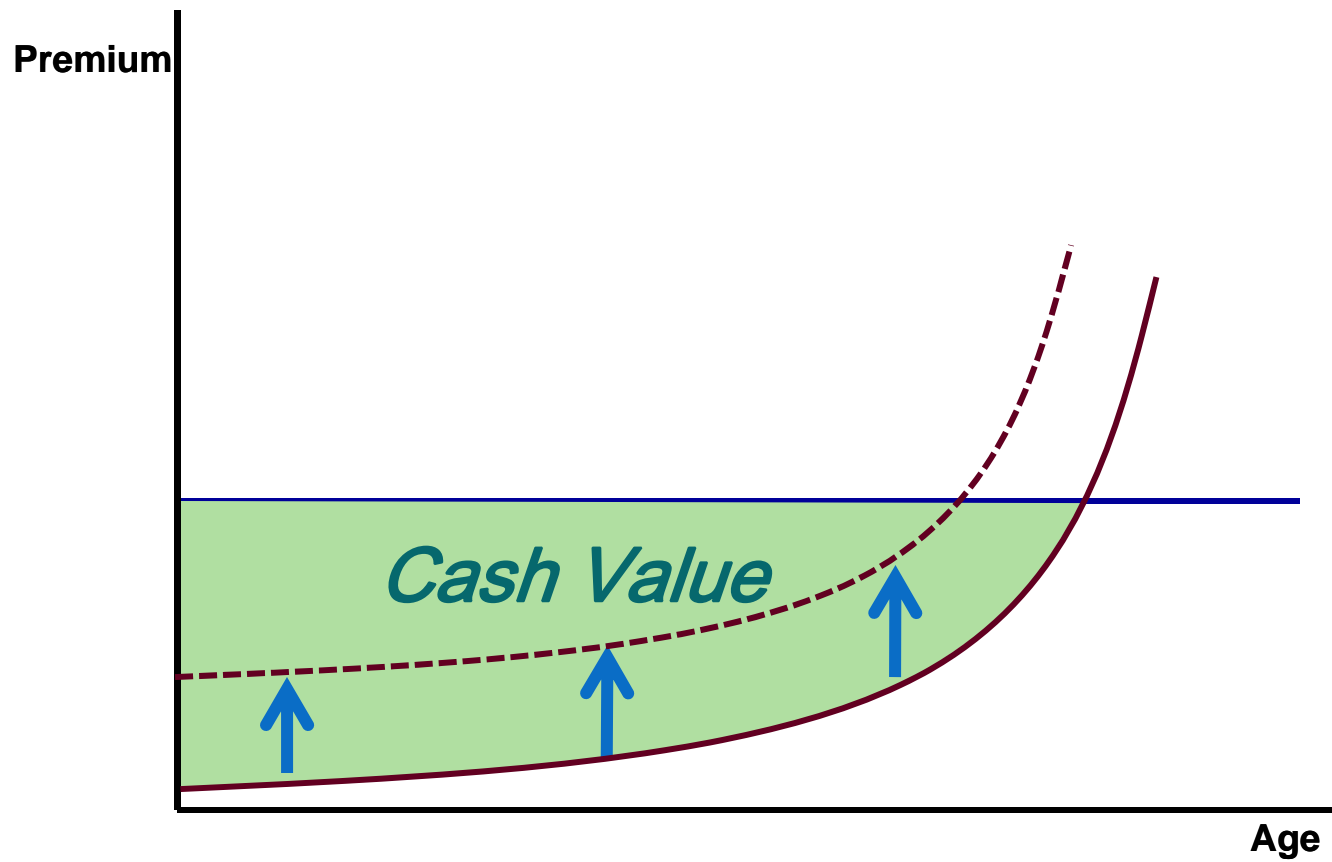




## Impact on Existing Policyholders

1. Decreased crediting rate
2. Potential rise in internal costs

## Potential rise in internal costs



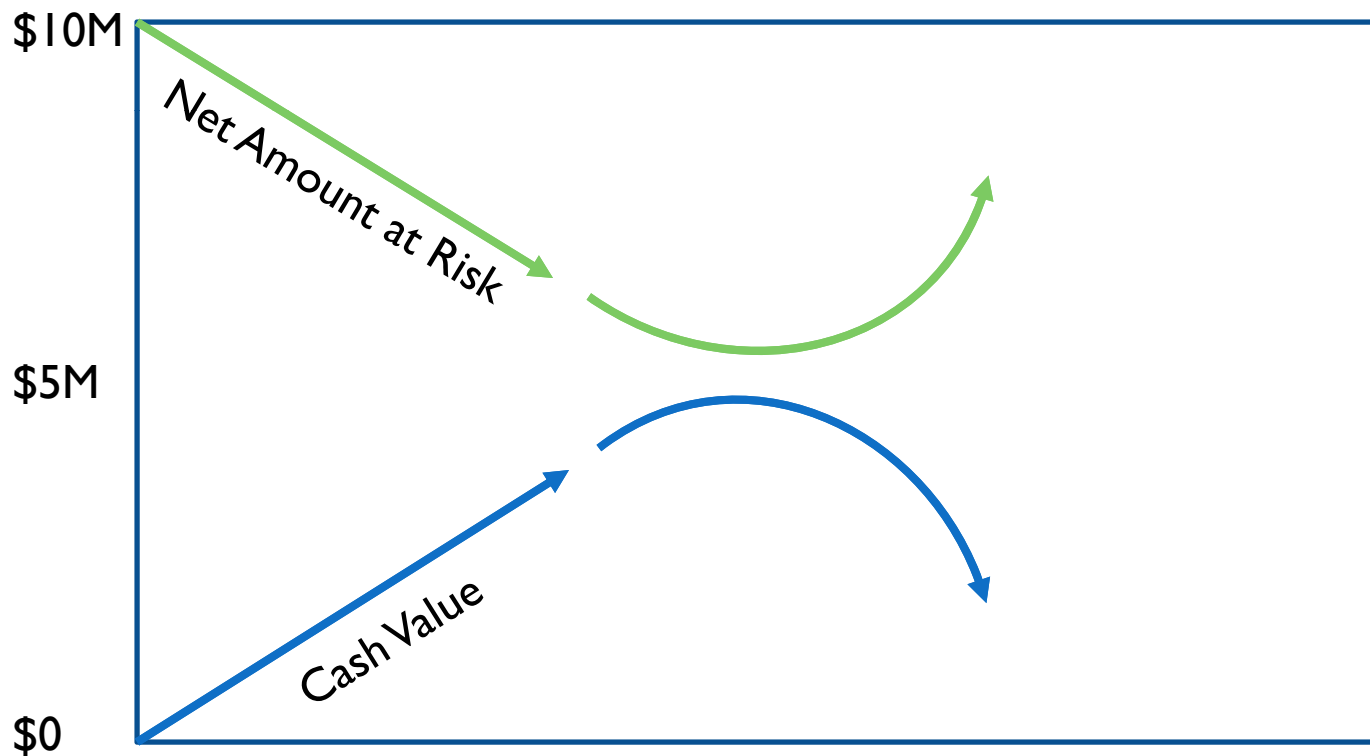


## Impact on Existing Policyholders

1. Decreased crediting rate
2. Potential rise in internal costs
3. Increase in Net Amount at Risk (NAR)

# Increase in Net Amount at Risk

$$\text{Death Benefit} = \text{Cash Value} + \text{NAR}$$





## Specific Risks

*Many existing products were simply not designed to survive today's economic environment*

- Variable Universal Life
  - Single premium/large upfront premium designs
- Universal life
  - Particularly if 200 bps reduction from original projections
- Whole life
  - Term blends or modified premium structures
- Abbreviated premium design
- Policies in later age durations (e.g., >80)
- Time to move to guarantees?

# Trustees Beware



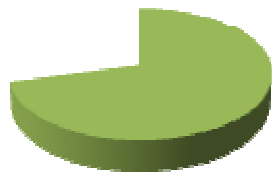
95.4% | No Policy Management Statement



83.5% | No TOLI Guidelines



70-90% | No Assigned Agent



71% | No Policy Review in 5 Years



## Trustees Beware

- Responsibilities and liabilities
  - Are your actions/inactions defensible in court?
- Document due diligence process
  - Beyond illustrations and spreadsheets
  - Plan vs. Product
- Policy Management Statement
- Written performance reporting and management
- UPIA...trustee's lifeline?



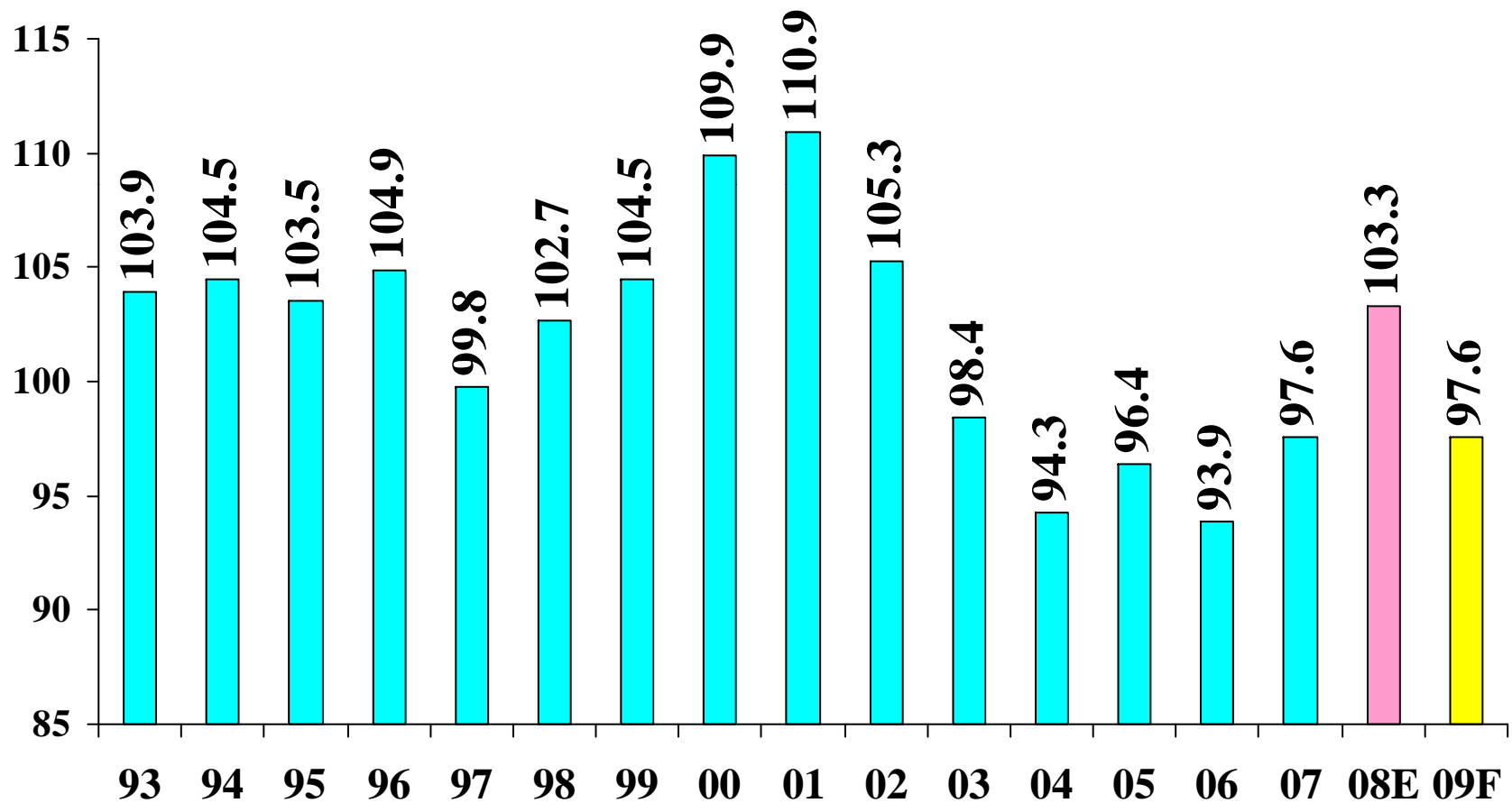
# Property and Casualty Impact



## P&C...Regulation that actually works

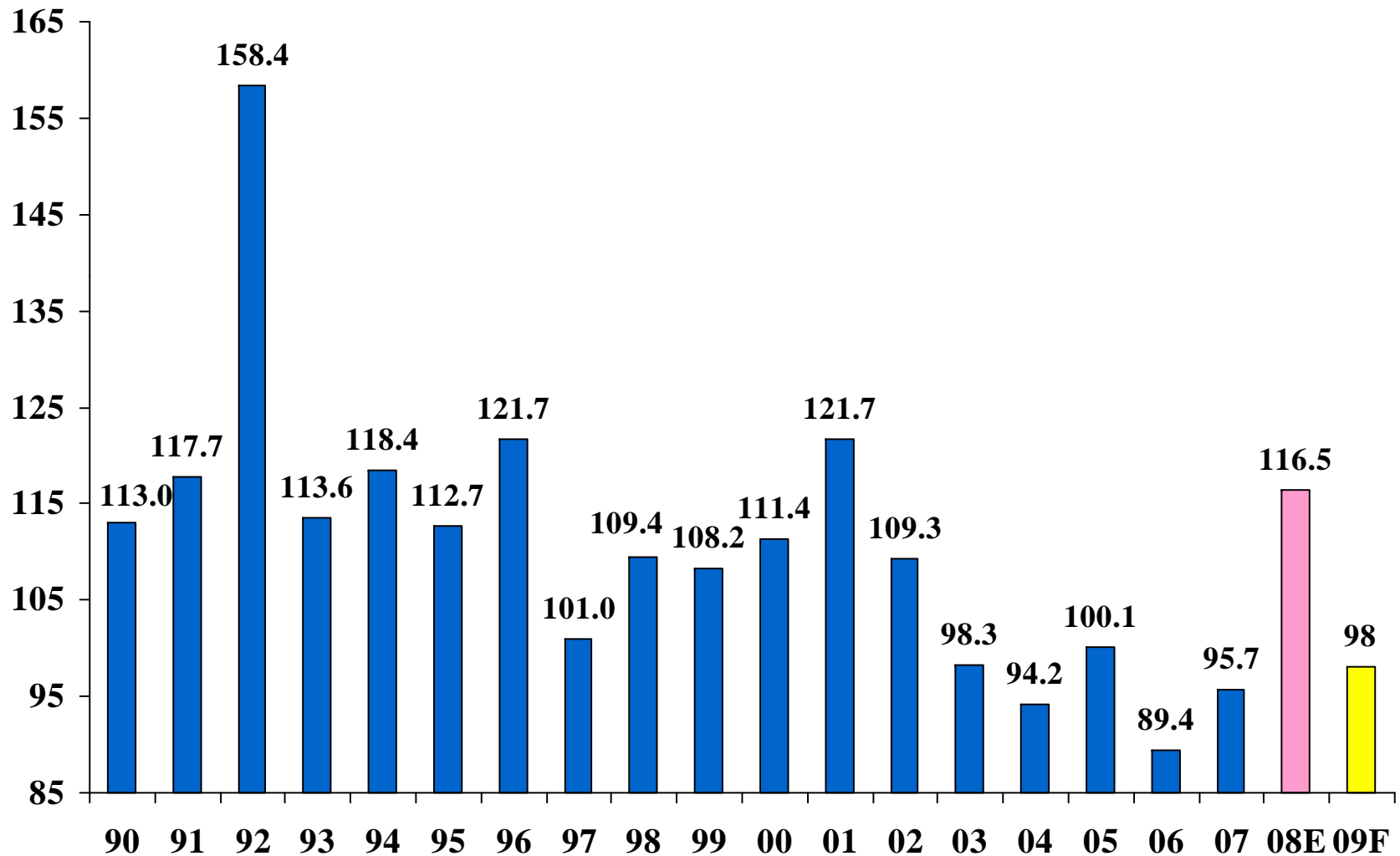
- Impact of the economic down turn – Investment returns and Underwriting
- Rates and long term impact
- The insurance cycles – impending hard market evidence
- Perceptions vs. Realities

## Personal Lines Combined Ratio, 1993-2009



Source: A.M. Best (historical and forecast).

## Homeowners Insurance Combined Ratio



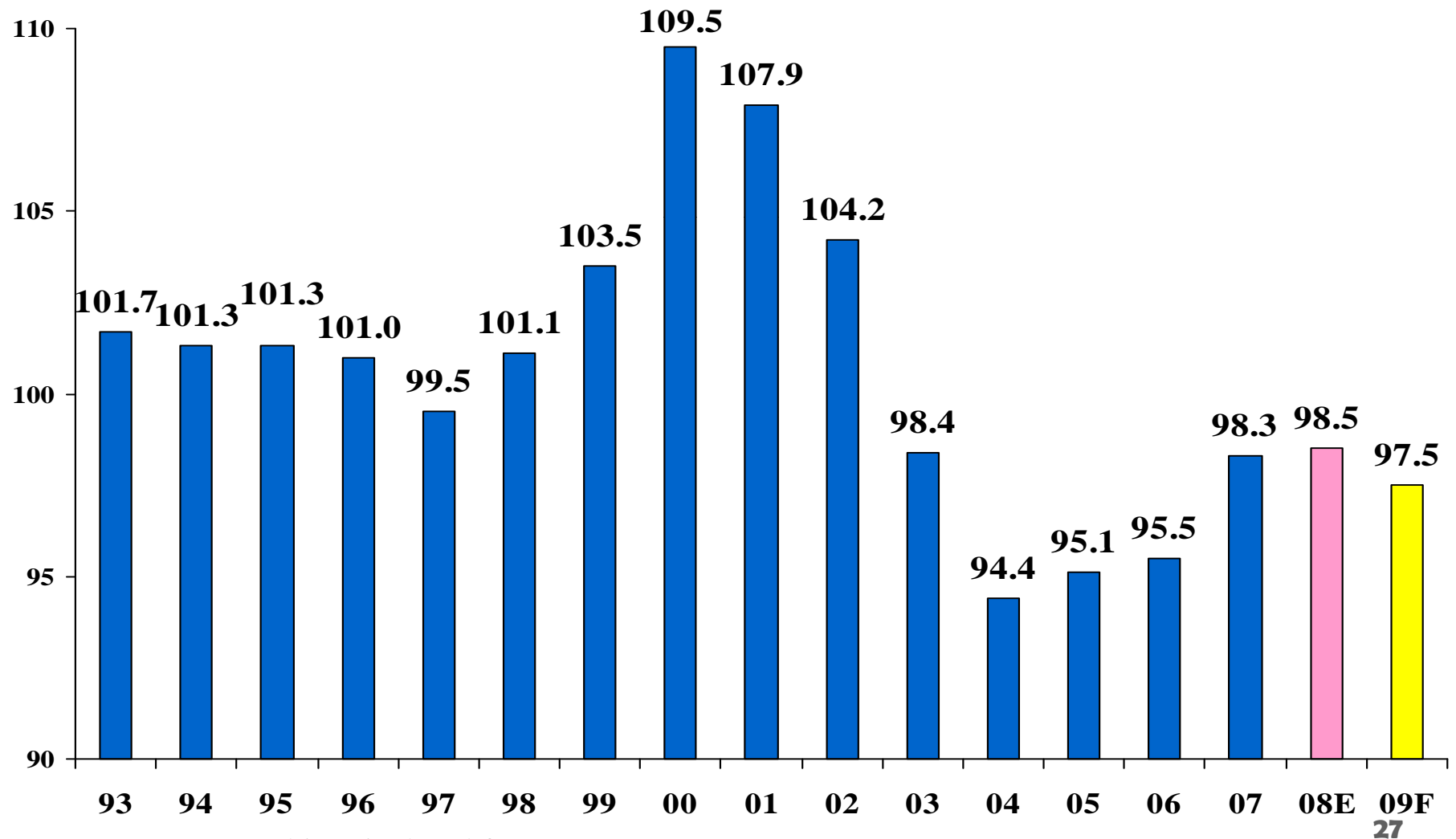
Sources: A.M. Best (historical and forecasts)

# 8 Largest Losses (in 2008 dollars) & Current Pricing (US Windstorm ILWs)



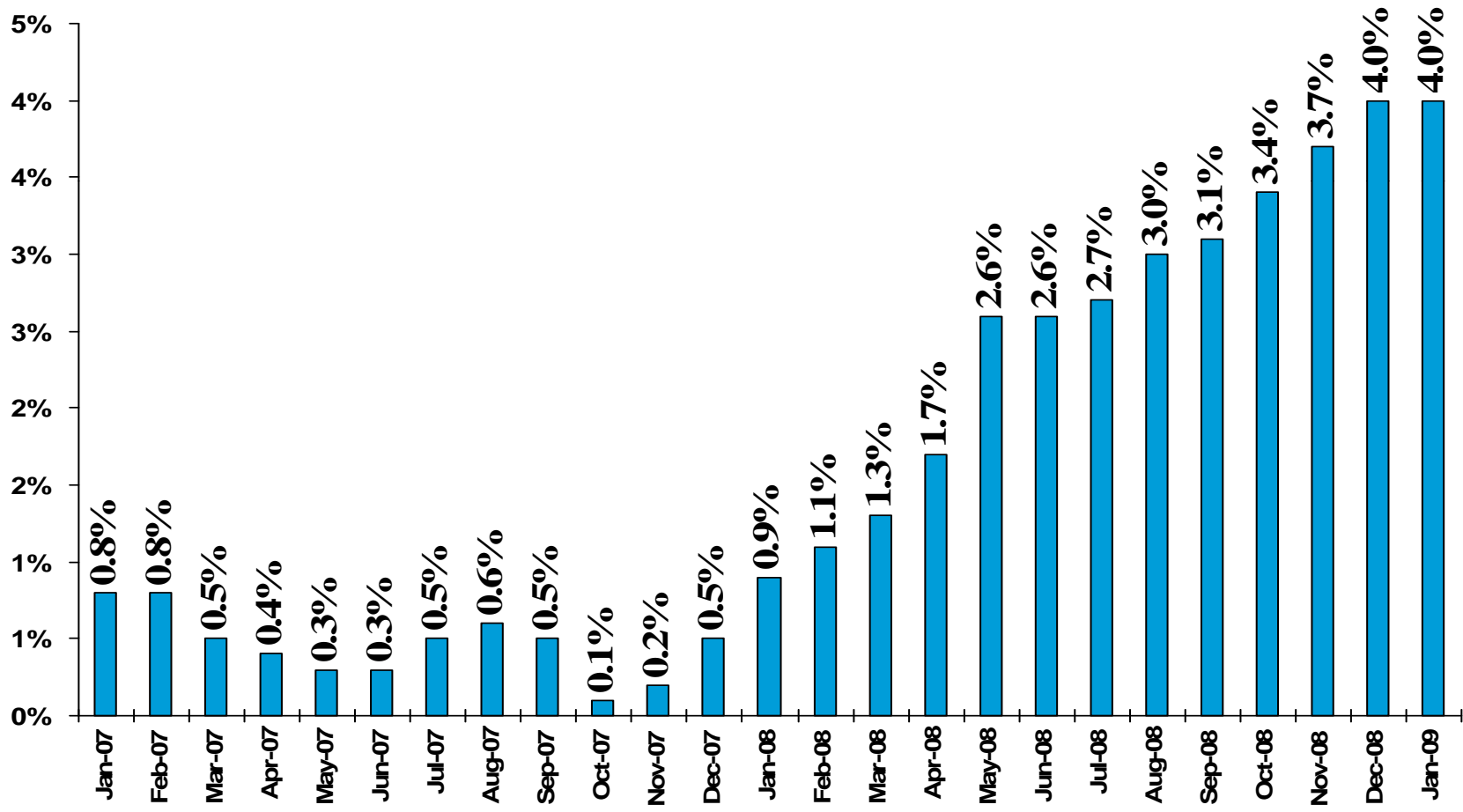
Source: ISO Property Claim Services Unit, Insurance Information Institute

# Private Passenger Auto (PPA) Combined Ratio



Sources: A.M. Best (historical and forecasts)

## Monthly Change in Auto Insurance Prices\*



\*Percentage change from same month in prior year.

Source: US Bureau of Labor Statistics



# Best Practices



## Best Practices

- Get objective review and analysis
- Clearly defined criteria for due diligence
  - Usage, plan, carrier, product, design, advisor
    - Establish Policy Management Statement and written service agreement
  - Ongoing risk identification and management
  - Advisor's business model
    - Fiduciary
    - Transparency and meaningful disclosure
      - Carrier, product and design options, risks, conflicts of interest
    - Resource Allocation



**Questions?**

## Related Whitepapers available

- Reinventing the Life Insurance Industry through the Application of the Uniform Prudent Investor Act
- Time Bombs: Not Just in Investments  
*Repercussions of Wall Street on Life Insurance*
- The Risk of Too Much Guarantee: Avoiding Missteps in Today's Life Insurance Market
- Active Defense of Your Life Insurance Portfolio: Know Your Threats, Know Your Weapons
- The Current State of the Property and Casualty Industry and What it means for your business
- Directors and Officers Liability Insurance for High Net-Worth Individuals
- Buyer Beware: Art and Collecting in a Global Economy
- The Domestic Staffing Cycle from Hiring to Firing
- Cyber Security and Identity Theft



# Introduction



- **Michael J. Brink, CLU, AEP**, is a Principal of Pelagos Advisors, LLC, a national, fiduciary-based, life insurance advisory firm. Pelagos Advisors represents families of significant wealth in the analysis, acquisition, and ongoing management of their life insurance portfolio. As a fiduciary, Pelagos Advisors, LLC offers unique life insurance advisory services by raising the standards to those set forth in the Uniform Prudent Investor Act. As such they are obligated to act in the client's best interest, provide full transparency and disclosure, and minimize costs. This creates an alignment of interests rare in the life insurance industry. [www.PelagosAdvisors.com](http://www.PelagosAdvisors.com)



- **James P. Kane, CIC** joined HUB International in October 2005 following the acquisition of Personal Lines Insurance Brokerage, Inc. (PLI). With more than 20 years of Personal Insurance experience, Jim was named President of HUB International Personal Insurance Ltd., the personal insurance division of HUB International that has over 500 employees dedicated to personal insurance and more than 125 offices throughout North America. [www.hubinternational.com](http://www.hubinternational.com)

## For more information....



**Michael J. Brink, CLU, AEP, Principal**

**PELAGOS ADVISORS, LLC**

**404-419-7107**

[michael.brink@pelagosadvisors.com](mailto:michael.brink@pelagosadvisors.com)

[www.pelagosadvisors.com](http://www.pelagosadvisors.com)



**Jim Kane, President**

**HUB International**

**312-279-4856**

[James.Kane@hubinternational.com](mailto:James.Kane@hubinternational.com)

[www.hubinternational.com](http://www.hubinternational.com)