On August 9, 2011, SCOR SE, a global reinsurer with offices in more than 31 countries, acquired substantially all of the life reinsurance business, operations and staff of Transamerica Reinsurance, the life reinsurance division of the AEGON companies. The business of Transamerica Reinsurance will now be conducted through the SCOR Global Life companies, and Transamerica Reinsurance is no longer affiliated with the AEGON companies.

While articles, treaties and some historic materials may continue to bear the name Transamerica, AEGON is no longer producing new reinsurance business.

Archive Materials

Effects of Low Lapse Rates on Level Premium Term Profitability

Reprinted from the March 2007 Messenger newsletter

Level premium term lapse rates have decreased over recent years, which many insurers may see as a positive sign. However, sustained lower lapse rates may exhibit a darker side with respect to level term profitability.

It is easy to understand how more persistent business would permit the recovery of acquisition costs and how a more stable block of insureds will limit the amount of ongoing anti-selection. But those who don’t lapse may increase the likelihood of additional claims and a subsequent downturn in profitability – especially in the later durations when select factors wear off and level premium rates turn in favor of the policyholder.

Considering the importance of lapse rates in our pricing process, Transamerica Reinsurance has recently produced a proprietary lapse study on our underlying business. And as expected, early duration lapse rates on level premium term products appear to have decreased recently. Given these lower lapse rates, we would expect additional claims.

Even though we may anticipate lower lapse rates, it is important to realize that the impact on profitability will differ based on several factors, such as:

**Term Duration:** Shorter term products may experience higher profitability when lapse rates decline, due to the increased recovery of acquisition costs. However, profitability on the longer term products could decrease as lapse rates fall below expected. This may be somewhat offset by the curtailment of ongoing anti-selection that can result from improved persistency.

**Class Distribution:** As lapse rates vary by business segment, the ongoing profitability of the block may also change. Along these lines, our lapse study has shown a significant difference in lapse rates between tobacco and non-tobacco classes, where early duration policy lapse rates for the tobacco class were twice as high as the non-tobacco class.

Consequently, if pricing does not adequately reflect this large differential in lapse rates, then any cross-subsidization or reliance upon smoker class profits would be unrealized. This is reason to price products to be self-sustaining, not
funded by other business segments that may experience unexpected lapse patterns.

In light of Transamerica Reinsurance’s lapse study, we still need to price our reinsurance programs to factor in the expected lapse experience provided by the client. Lapse experience can vary by many factors: gender, issue age, attained age, premium payment mode, risk class, smoking class, underwriting method, average face amount and distribution channel. Since each client company possesses a unique distribution of business based on these factors, it is essential that our clients continue to provide their “best estimate” lapse rates delineated at appropriate levels.

Don’t be surprised to see rates increase when lapse rates decrease. The average mortality on persisting business may improve due to reduced anti-selection. However, this gain may be overshadowed as premiums prove insufficient to fund the additional claims resulting from more persistent business.