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

Term Life Pricing and Design: A New Day?
Reprinted from the June 2009 Messenger newsletter

by Bill Winterman, Second Vice President & Pricing Leader
Life insurers have been taking small steps to address the performance of their term life portfolios for the past few years. They have been tightening underwriting guidelines, raising rates in specific pricing cells and, more recently, increasing policy fees. But as a whole, they have avoided the big steps that would signal an end to the era of cheap term life insurance. Not anymore, it seems. Recent rate increases suggest the beginning of a new era for term life. This article looks at some of the driving forces behind the movement.

Change agents. Mortality and lapse assumptions may be the primary considerations when pricing a term portfolio, but other forces also influence pricing decisions – namely XXX reserve financing costs and investment returns. For the past decade or so market competition has continuously pushed down premium rates, sometimes to levels below target returns on investment (ROI). Gaps in ROI were filled in with low reserve financing costs and favorable investment performance. However, with the downturn in financial markets – and a concern that current conditions may be with us for some time – many term life insurers are revisiting their pricing and product design strategies.

Today we are seeing a significant level of activity around term portfolios. For example, some companies have halted sales of 30-year products or are looking at alternatives to guaranteed level premium term. Others are raising premiums on their longer duration products and raising premiums on 10-year products by much greater amounts. Perhaps the most significant movement underway is the suspension of cross cell subsidization, which may explain the amount of rate increase we’re seeing in 10-year level term.

Impact of Financial Markets
Life insurers are preparing for the possibility that capital scarcity and low current yields may be with us for some time. These conditions have greater impact on the performance of 20- and 30-year products with their larger XXX reserve requirements. However, to the extent that these longer duration products have been subsidizing the 10-year product, anything that alters their performance will, by extension, affect 10-year term as well.
**Interest Rates.** Reserve capital does not sit idle. Companies invest mostly in fixed income assets priced at a spread to Treasury rates to reflect their relative risk. The better the asset yield, the less additional capital which companies must allocate to support reserves. In the third quarter of 2007, the market peak, 10-year Treasury yields averaged 4.73 percent. In the first quarter of 2009, the average yield was 2.71 percent.

Lower interest rates mean that carriers must now set aside more capital to cover policy risks, and the larger reserves of longer-term products are most affected. A one percent decline in the discount rate can generate a three percent increase in the net present value (NPV) of reserves for 20-year policies, and a six percent increase in NPV for 30-year term. This is just the change in reserve expense. The impact of interest rates on profitability is even greater.

**Cost of Capital.** At the same time that term writers are setting aside more reserves, they are dealing with declining asset portfolio results and competition for increasingly limited external financing. In the past, many companies relied on financing arrangements (some with effective funding costs of zero percent and less) to maintain competitive pricing of term products. These deals are nowhere to be found today. Due to uncertainty in the capital markets, banks remain hesitant to enter into collateralized financing deals; 700 basis point counterparty risk spreads are not unheard of. Reinsurers, who face the same capital challenges as direct writers, are managing their capacity more closely as well.

**Lapse Risk.** Rising premiums may also reflect emerging lapse experience, which has been trending lower for some time. Lower than expected lapse can be helpful in recouping commissions and other acquisition costs in early policy years, but in later durations it means higher-than-expected mortality expenses. Underestimating lapse can be a reserving issue, too. If lapse rates come in less than expected, insurers may need to top off their reserves.

Lapse rates have more of an impact on longer-duration policies. A one percent drop in actual experience from the expected ultimate lapse rate will barely affect the ROI on a 10-year product. However, a one-point difference can cost seven to eight percent ROI on 30-year term.

In the past, it was considered prudent to assume a four or five percent ultimate lapse on a 30-year term product. Emerging experience suggests it may be more appropriate to assume two or three percent ultimate lapse rates.

**Cross Cell Subsidization**
Overall, we are seeing rate increases of about five-15 percent, but these changes are unevenly distributed across cells, as shown in the chart below. This pattern may reflect a move away from cross cell subsidization, especially for 10-year term. Insurers may no longer be able to subsidize 10-year term and conserve the viability of their 20- and 30-year products at the same time.

<table>
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<th>Std Plus NT</th>
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<td>30 yrs</td>
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<td>8%</td>
<td>4%</td>
<td>3%</td>
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**Chart 1: Sample Pattern of Recent Price Changes**
This chart is based on the average increase for a sample of five large term writers (age 35, nonsmoker, $500K face).

**Loss Leader Strategy.** Ten-year term is often the product that first-time policyholders buy. If there is a product that life insurers are willing to sell as a loss leader, it is 10-year term. However, the margins that once helped support this strategic play are no longer available as they are needed to support increased reserve requirements (where companies choose to continue selling longer-term issues) or are no longer available (where companies choose to stop selling longer-term issues).
**Preferred Risk Class.** As companies revise their pricing across all cells for stand-alone profitability, they are addressing other weaknesses as well. Insurers are tightening preferred criteria such as blood pressure and cholesterol count. In the past, margins on standard and substandard risks subsidized pricing strategies for preferred and preferred plus risks. As these subsidies are removed, preferred premiums are being raised significantly.

**Face Amount Band.** Mortality rates for face amounts under $250,000 can be as much as 40 percent higher than for face amounts greater than $1 million. More stringent underwriting accounts for much but not all of this difference. As companies improve their understanding of factors that appear to contribute to these higher mortality rates, some are using relatively higher mortality assumptions when pricing these bands.

**Anti-selection.** Technology has also undermined the strategy of cross cell subsidization. This practice began when distributors were still using rate cards. Because finding the lowest rate for every sales opportunity was practically impossible, insurers could be very competitive in a few cells and still have good performance on the block overall.

With today’s technology and quote services, agents can instantaneously find the cheapest rates across the board. Moreover, agents can match applicant data to qualification criteria to obtain the most favorable underwriting classification for their clients. Life insurers who have incorporated significant cross-subsidies into their term portfolios can find themselves overweighted in their least profitable cells.

**Conclusion**

A year ago, many life insurers were employing aggressive pricing assumptions in order to compete with the top tier term writers. Today, instead of letting the marketplace set premium rates, we are starting to see a return to the practice of developing prudent assumptions and then solving for rates. Companies are factoring in the true cost of capital and getting out of the cell subsidy game. All this adds up to one thing – rising premium rates.

If your company is repricing and redesigning your term portfolio to operate in today’s environment, consider the insight and expertise of the Transamerica Reinsurance team. We can help you manage through the current challenges and take your risk management to a higher level of effectiveness.