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Life Insurance Policy Re-Pricing 2.0: Life Insurance Companies Adjust Quickly to 2020 Covid-19 Driven Impact

By Vernon W. Holleman, III, CLU and Chelsea Maeda
Winged Keel Group
Washington, D.C. and Portland, OR

After completing years of work re-pricing their products to comply both with new Reserving requirements and the 2017 Commissioners Standard Ordinary Mortality Table (CSO Tables), by January 1, 2020 (as reported in the March 12, 2020 issue of this publication),[1] United States life insurer pricing actuaries had just settled in for a long winter's nap when the Covid-19 effect on the economy prompted the Federal Reserve to lower interest rates to nearly 0%. The nap was over.

OVERVIEW

Shortly after the Federal Reserve's decision to reduce rates to 0.25% in March, life insurance companies almost immediately began what has proven to be a long list of product pricing adjustments and underwriting changes that (as of the publishing of this article) has yet to cease; arguably this has been the most change in the shortest period of time the industry has ever experienced. Although Covid-19 deaths have been numerous (over 180,000 lives lost in the U.S. to date),[2] they have not had a material impact on the mortality experience of life insurance companies. It is the low interest rate environment that is having a dramatic effect and leading to a multitude of capacity restrictions and repricing to both existing and new life insurance contracts.

The objective of this article is to describe Covid-19's impacts on life insurance companies and how those have driven changes, both positively and negatively, for the consumer. In addition, we will look to potential challenges and innovations that are surely ahead.

COVID-19'S IMPACT — OVERVIEW

The impact Covid-19 has had on the life insurance industry was felt almost immediately after it was declared a pandemic. The impact has been swift and far reaching — effecting every aspect of the life insurance industry, from the acquisition process (underwriting) to the servicing of policies; but, most importantly, it affected insurance companies' ability to generate reasonable profits. Life insurance companies, like all insurance companies, are in the risk mitigation business and much of the portfolios that support both operations and claims paying are supported by investment grade fixed-income securities, which simply return less when rates are down. Further compounding this challenge, Covid-19 added a number of new and unknown risks and questions life insurance companies had to factor, such as: when will the pandemic end, will there be a material impact on mortality, will working from home prove as efficient and effective, what will the demand be for service on existing policies, how will this pandemic effect new coverage demand, and, last, how will life insurance companies underwrite new risks while America is being quarantined? Striking a balance between continuing to write new business (coverage) and adjusting to cover both

[1] Holleman and Maeda, *Life Insurance Policy Re-Pricing: What Drove the Changes and What It Means for Policy Owners and the Marketplace*, 45 Tax Mgmt. Est., Gifts & Tr. J., No. 2 (Mar. 12, 2020).

[2] Covid-19 Dashboard by Center for Systems Science and Engineering (CSSE) at John Hopkins University (JHU), https://gisanddata.maps.arcgis.com/apps/opsdashboard/index.html#/bda7594740fd40299423467b48e9ecf6.

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new and old risk was paramount. The financial impact of Covid-19 has resulted in pricing changes for both existing (in-force) and new policies. The health and safety concerns due to Covid-19 has brought unprecedented procedural changes to the insurance underwriting process.

ECONOMIC IMPACT: PRODUCT RE-PRICING AND AVAILABILITY

As noted, lower interest rates, driven by the Federal Reserve's decision to backstop the economy through aggressive monetary policy puts pressure on life insurance companies to produce the returns. In order to manage their balance sheets, and manage profitability, insurance companies moved swiftly to adjust the non-guaranteed elements of their existing products, while repricing their new products with little to no transition period, and limiting the amount of new coverage they would write, especially on individuals over the age of 65.

One example, of many, includes one major insurance company at the end of March announcing it was removing its 30-year term policy from the market, effective immediately. In this case, it needed time to assess how it would invest and reserve for the liabilities such a product creates. Further, it announced it was reducing the caps and crediting rates for its Index Universal Life (IUL) products, i.e., it lowered the upside potential of its IUL products. Changes to product pricing and the removal of products is not new to the life insurance business, but the speed at which products were removed from the market during the pandemic was unprecedented.

Further, insurance companies across the industry have been restricting up-front payments that can be made into new policies (including payments received through tax-free §1035[3] exchanges) on products that offer a guaranteed insurance benefit, again due to significant decreases of current interest rates. Additionally, while some insurance companies halted the issuance of guaranteed products all together, nearly every insurance company implemented price increases of 5% to 20% on their Guaranteed Universal Life (GUL) and Guaranteed Variable Universal Life (GVUL) products.

Another notable change that occurred as a result of Covid-19 is a significant reduction to the amount of life insurance each insurance company, or reinsurance company (the companies that life insurance companies off-load risk to), will place on their books. As an example, one of the largest U.S. life insurance companies went from retaining up to $20MM of risk to only retaining $10MM of risk, while one of the largest global reinsurers reduced their capacity from $50MM of risk per insured to $15MM. Reductions of this magnitude were the rule, not the exception.

Thankfully, as the pandemic has evolved, we are seeing some of that capacity start to come back. However, it is being increased in a very controlled manner, and we believe it will be a number of years before total market capacity reaches pre-Covid-19 levels. Additionally, there is still very limited capacity for individuals over the age of 65, with many insurers and reinsurers being unwilling to write any coverage on that age group. For older insureds with inforce coverage, it is important to do a deep analysis before letting any term insurance coverage expire or dropping policies. It is unclear when that capacity will be available again.

UNDERWRITING IMPACT

Another change that has impacted the U.S. consumer, during the pandemic, has been the ''Underwriting'' aspects of new policy acquisition. Underwriting is the process insurance companies use to approve or qualify the consumer for life insurance coverage, thereby managing their mortality risk pools. As the seriousness of Covid-19 grew, insurance companies temporarily restricted or delayed new coverage for insureds at greater risks of Covid-19 complications, and in some cases declined to consider. Both the medical and lifestyle aspects of the Underwriting process have been impacted.

The medical Underwriting of life insurance commonly involves the collection and review of existing doctor records (Attending Physical Statements or APSs), as well as a third-party insurance physical. With the country placed in quarantine, many doctors' offices were closed or short staffed. This created real challenges for obtaining records to be reviewed by the life insurance company underwriters, who were also making the challenging adjustment to working remotely. Additionally, with shelter in place orders, and people adhering to social distancing guidelines, it was very challenging to have clients complete insurance physicals. Thus, there were clients that wanted to secure insurance that were unable to do so as medical records could not be obtained and insurance physicals could not be completed.

In addition to challenges with securing the requisite medical information, insurance companies implemented additional protective measures, including: temporarily not offering coverage to people over a certain age (typically 70 or 80 years old); restricting coverage amounts for people over age 65; delaying

[3] All section references herein are to the Internal Revenue Code of 1986, as amended (the ''Code''), or the Treasury regulations promulgated thereunder, unless otherwise indicated.

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coverage for people who have traveled to certain countries or that live in so called ‘‘hotspots;’’ delaying coverage on people with respiratory or other Covid-19 high-risk conditions; requiring additional statements of good health prior to issuing policies; and imposing temporary reinsurance limitations.

As challenges emerge, so do opportunities for evolution and enhancement. We saw more clients than ever before utilize the conversion feature on ‘‘Term’’ life insurance policies to secure permanent insurance without medical underwriting. While the Term conversion feature has great value, it only helps those individuals who already own convertible Term insurance from companies with attractive permanent products.

In order to be responsive to the broad consumer base, many insurance companies are evolving their current medical Underwriting process to accommodate clients during this time. For instance, insurance companies are developing guidelines that will allow them to issue new life insurance policies without requiring a new insurance physical, recognizing that during the pandemic many insureds will not be able to complete an insurance physical. If the insured has had a thorough annual physical from his or her personal physician in the past 12-24 months, insurance companies are considering accepting this in lieu of an insurance physical. Other insurance companies are allowing individuals' personal physicians to complete the medical exams rather than an exam company. Additionally, there has been an expansion of accelerated Underwriting programs for specific low-risk demographics that require no medical records or lab samples.

The other element may have a long-lasting positive effect for the consumer is that many insurance companies are now accepting electronic signatures, e.g., DocuSign, rather than wet signatures. The industry has been woefully slow in adopting electronic signatures, and it is expected insurers will continue to evolve their processes to be responsive to both market conditions and consumer demand.

ROAD AHEAD — PRO-ACTIVE CONSUMER PROTECTIONS

In order to protect the consumer, some insurance companies have increased the grace period following the premium due date to allow additional time to make a payment and maintain life insurance coverage. In New York, Governor Cuomo issued an executive order to extend grace periods from 30 days to 90 days if the consumer can demonstrate financial hardship due to Covid-19.[4]

There is nothing quite like a global pandemic to prompt individuals to seek clarity on their life insurance, or to desire additional coverage. Add to this market volatility, continued uncertainty, and a presidential election around the corner, and the result is higher demand for both new products and service on existing policies. Although insurance companies have been inundated with service requests since March, and most have experienced delayed response times for requests such as in-force projections, the current climate has the consumer focused on their financial security. This is a positive result, given recently repriced product updates and the impact of Covid-19, as it often results in the conducting of a comprehensive review of one's life insurance needs and policy portfolio.

A review helps determine the effects of recent performance changes on the longevity of the policy and if premium obligations are the same or changed. Further, it allows a review of whether ownership and beneficiary designations are optimal, as well as determining if policy coverage amounts remain appropriate.

Reviews of Whole Life (WL) insurance will prove particularly important as mutual life insurance companies declare dividends late in the calendar, for the following year. Dividend amounts greatly affect the performance of WL policies. This declaration is determined after the company has reviewed its total asset picture, balance sheet, mortality experience, and investment performance. Given the decrease in interest rates, it is expected that mutual insurance companies will lower dividend crediting rates on WL policies to compensate for current bond yields. This is may affect the long-term performance of these policies and understanding this will be important for owners of WL.

Also expected are changes to floor and cap rates associated with IUL policies to compensate for current market volatility. As with WL, this affects the long-term performance of these policies and consumers will want to know early what to expect and determine what, if any, action to take.

Even Term life insurance should be reviewed because most term contracts have a conversion feature. This feature allows the policy owner to switch from a term to permanent policy without having to qualify medically. With pricing increases imminent, this is a time to consider the conversion options, as it could be an advantageous time to convert to permanent life insurance.

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[4] https://www.dfs.ny.gov/industry_guidance/coronavirus/model_producer_notice/life_annuity_fraternal.

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CONCLUSION

Although in some cases the consumer is paying more today for their life insurance than at the start of 2020, Covid-19 has forced life insurance companies to adapt to a technology driven and more safety conscience world, and these evolutions should lead to positive long-term changes to further streamline the medical underwriting and application processes.

The life insurance industry has weathered many storms during its hundreds of years, and it will do so again; continuing to pay insurance benefit claims. That said, the current challenges do behoove policy owners to be pro-active in seeking clarity on the policy performance effects of the current interest rate environment. With innovations abounding in Underwriting, it is an ideal time to review coverage.

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