

# Credit Market Pressures on Insurance

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Recent credit market events have produced manageable pressures on insurance.



# Overview

- Recent events in the credit markets
- Consumer concerns
- Securitizations of XXX and UL with Secondary Guarantees
- Right-sizing reserves under PBR
- New York as insurance/financial center

# Recent events in the credit markets

Many do not understand who owes what to whom — or whether they have the ability to pay

- Sub-prime mortgage, mortgage-backed securities of uncertain value / risk / composition
  - Failure / take-over of independent investment banks
- Mortgage crisis continuing
  - Government take-over of Fannie Mae, Freddie Mac
- Financial market focus on credit default swaps and AIG
  - NYSID provides reprieve based on ins co assets
  - Federal take-over of AIG

# Recent events in the credit markets

- \$62 billion Reserve Primary fund dips below \$1 a share
  - Potential redemption flood on money market funds →
  - lack of purchase of corporate commercial paper →
  - companies struggle to finance daily operations
  - Results in federal guarantee of money market funds
- Mortgage-backed securities market disappears
- Lack of confidence in financial market
  - Federal Reserve and Treasury Department propose government facility to hold auctions and buy up distressed assets from financial institutions

# Consumer Insurance Concerns

- Call for more regulation
- Reports: AIG as largest insurance co on brink of failure
  - Problem actually with AIG's financial product area
  - Fed relied on value of AIG's insurance companies
- Consumers misinterpret AIG insurance in trouble based on early news reports
  - Media efforts to clarify safety of AIG insurance entities
  - NYSID, NAIC efforts to reinforce message, minimize churn of AIG policies
  - Consumers calmed with news of hurricane claims paid promptly, soundness of domestic carriers reinforced

# Consumer Life Insurance Concerns

- Advanced marketing arrangements more costly due to increase in cost of credit
  - Split-dollar
  - Deferred compensation
  - Other forms of Premium Financing
- Consumer more likely to split purchases among companies
  - Insurance
  - Annuities
- Concerns likely to diminish over time
  - As companies remain solvent
  - As insurance/annuity purchases perceived as a “safe harbor” for retirement savings

# Securitizations of XXX and UL with Secondary Guarantees

- Review counter-party risk on deals made with failed investment banks, downgraded monoline entities
- Securitization backed by Letters of Credit
  - Cost of Letters of Credit increasing
- Securitizations using capital market funding
  - Cost of funding increasing
  - Availability of funds at completion of new deals is more of a concern for UL with Secondary Guarantees
- Future securitizations will underscore
  - Evaluating material risks of underlying policies
  - Examination of counter-party risk



# Credit Market Crisis makes PBR: More likely?

Unlike mortgage-backed securities, PBR identifies and quantifies material risks — and specifies the funding of the risks

- By right-sizing reserves, PBR avoid higher securitization expenses
- Regulation and transparency provided by Valuation Manual (VM)
  - VM-20 Requirements for Principle-Based Reserves for Life Products
  - VM-30 Actuarial Opinion and Memorandum Requirements
  - VM-31 Reporting and Documentation Requirements for Business Subject to a Principle-Based Reserve Valuation
  - VM-50 Experience Reporting Requirements

# Credit Market Crisis makes PBR: Less likely?

- Credit market crisis brings call for more regulation
  - Some may view PBR as deregulation
    - Regulators set mortality assumptions under current valuation law
    - Companies set mortality assumptions under PBR
  - PBR is designed to provide the best regulation under all economic conditions
- Credit market crisis may lead to modification to PBR
  - Renewed stress on XXX and UL with Secondary Guarantees
  - They may become first products implemented under PBR

# New York as insurance/financial center

- NYSID takes lead in saving AIG and oversight for consumer fair treatment and maintaining insurance company solvency
- Many meetings during Credit Crisis occur at NY Federal Reserve building
  - Regulators and financial companies
  - Meet on weekends
- Foreign markets follow lead developed in NY

# New York as insurance/financial center

- NYSID was showing leadership in restoring “the credibility of municipal bond insurance”, and “how crazy is it that New York State, rather than the federal government, is taking the lead here?”
  - Paul Krugman, NY Times, March 2008
- “the fate of New York as the unquestioned capital of global finance is sealed ”
  - John Authers, Investment Editor, Financial Times, Sept 19, 2008