WITT Actuarial Services LLC

6010 Preston Lane | New Berlin, WI 53151 | www.wittactuarialservices.com
p 414.525.8212 | f 414.433.1864 | scottwitt@wittactuarialservices.com

# At Witt's End

**Life Insurance in the Financial Crisis - Solvency**
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The current economic crisis has spawned a number of questions about life insurance for you and your clients. Over the next several months, we will address these issues and share our perspectives with you. We believe our objective, unbiased opinion on these highly sensitive subjects will help you and your clients make better decisions regarding life insurance.

As fee-only insurance advisors, we have no vested stake in the decisions that our clients make. We serve in a fiduciary capacity, and client fees are our only source of income.

## Q: Are life insurance policies still safe?

**A:** There is much confusion surrounding this issue because not everyone is clear about whether they are referring to guaranteed or non-guaranteed benefits. Typically, with life insurance policies, the word "safe" is associated with questions about whether or not the guaranteed values of a policy can still be delivered. (Non-guaranteed policies have taken a tremendous hit recently as well, and some policyholders view safety in the context of whether or not they will have to pay more premium than originally hoped for. This topic will be covered in an upcoming newsletter.)

Until the last decade or so, policy guarantees were very conservative. While there have been numerous situations where the cash value guarantees have been compromised, we are not aware of a single instance in U.S. life insurance history where the *death benefit* guarantees have been breached on a life insurance policy. Over the last decade or so, companies have become much more aggressive with guarantees, particularly with so called "no-lapse" policies that have little or no cash value associated with them.

This relatively recent aggressiveness coupled with the current economic environment does place renewed emphasis on the financial security of the insurance company. Despite the use of the word "guarantee," a guarantee is really only as good as the financial security of the company making the promise.

Rating agencies have made a number of downgrades in recent months. We generally prefer that our clients have insurance with companies that receive best or near-best ratings from at least two of the four major rating agencies. In rough terms, that equates to roughly 20% of all life insurance companies. (For new business, we have more stringent standards, and there are far fewer companies that we would recommend for a new purchase.)

We don't necessarily advocate automatically lapsing or replacing a policy that does not fall into that category, but we do believe that an automatic review should be triggered to see if better (and safer) alternatives exist.

**Q: What would happen if an insurance company became insolvent?**

**A:** No two insolvencies are alike, so it is difficult to look for a historical precedent as to what may happen if an insolvency were to occur, especially since companies now have policies with more generous guarantees on the books than ever before.

It is important to recognize that "insolvent" does not mean that the company has no assets; it simply means that assets no longer exceed liabilities by an amount deemed suitable by state regulators.

Generally, if a company cannot regain solid financial footing on its own, the state insurance commissioner (or department) will take control of the company and initiate either a liquidation or a rehabilitation of the company. Segments of the company may be sold or transferred piecemeal, or in extreme situations it is plausible that policy provisions could be altered if assets have plunged below liability levels.

It is virtually impossible to predict if all policyholders would share equally in the pain of restructuring or if the block of policies deemed to be most responsible for the solvency crisis would bear a heavier burden.

**Q: What about State Guaranty Associations?**

**A:** State guaranty associations provide a last resort for policyholders of failed companies that are unable to meet financial obligations. Limits vary from state to state, but the most common level of protection is $300,000 per insured life.

In other words, if you have more than $300,000 of guaranteed coverage with any single insurance company, then you have nothing backing that excess coverage other than the assets of the company. This is certainly an issue to consider when you are creating or reviewing a diversified portfolio of life insurance.