May 2016

Future of Insurance Products

By Max J. Rudolph, FSA CFA CERA

There are a lot of discontinuities coming for insurers. Much is being offered recently about drones and driverless cars, but just as much is happening on the life insurance side. Low interest rates have made it extremely hard to compete when guaranteed credited rates are high enough to wipe out the spread created by government manipulated rates.

But are pundits looking in the right direction? Recent poor results for auto writers was initially said to be due to distracted drivers, which is an increasing risk as drivers use their smart phones while driving, but it turned out to be due to the additional miles driven due to low gas prices. Miles driven is extremely elastic based on the price of gas, but premiums are collected as if it is not.

Life insurers with a long strategic time horizon have already recognized from their stress testing that low interest rates are their primary risk and are starting to gravitate away from products with credited interest to those without. This will impact supplemental health writers, increasing the competitive marketplace, as well as potentially increase the M&A activity where life insurers buy casualty writers. Some companies are already struggling (e.g., GNW), and smaller companies will need to consolidate.

Thinking further out, auto writers will move to a miles driven model. This will allow vehicles to be shared and the insurance cost built in. As cars become autonomous, overall collected premiums will become lower. Humans provide the volatility in driving results, so taking them out of the equation will lower claims, lowering premiums and reducing the funds available to cover overhead. Insurers will have to slim down, acquire other businesses and look for similar businesses to enter. One might be flying cars. While we don't yet have the jet propelled vehicles the Jetsons promised us in my youth, drones can provide the lifting ability today to provide freight services. This is being tested by Amazon, third world delivery systems and the neighbor kid up the block. Each will have its own issues, and drone ubers can't be far away. All general insurers will be impacted.

What are life insurers' core competencies? Very few excel at the investment process, especially those that profess to be experts. Those currently seeking yield using alternative asset classes will struggle in the long run. I see insurers focusing more on term life insurance and short term annuities. Mortality over 10-20 years, especially when looking at ages above 60, is especially unknown in today's environment. An obese generation is replacing the one that quit smoking, and the results will surprise those who have not thought it through and even those who think they have. Life insurers should branch out into nearby fields of expertise. The Japanese have done this through purchase of companies that focus on term insurance in other countries, the Chinese are using IPOs to get cash out of the country and out of the yuan. Other countries at risk include Venezuela, Russia, Italy and Nigeria. Perceived safer countries such as Canada, Sweden and Australia may see bubbles form and then burst. Be careful wherever you invest.

The US market has been a safe harbor to date, but our actions and balance sheet do not suggest that this will continue. It would not surprise me to see a Bretton Woods type agreement appear after the election in the US this fall, with unintended consequences everywhere. No position is safe and no result expected. Until then it is a race to the bottom as currency wars explode.

Warning: The information provided in this newsletter is the opinion of Max Rudolph and is provided for general information only. It should not be considered investment advice. Information from a variety of sources should be reviewed and considered before decisions are made by the individual investor. My opinions may have already changed, so you don't want to rely on them. Good luck!