Runoff or Redesign? Alternative Guarantees and New Business Strategies for Participating Life Insurance

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Abstract

Portfolios of traditional participating life insurance contracts with year-to-year (cliquet-style) guarantees are continuously under pressure in the current situation of persistently low interest rates when valued in market consistent valuation framework.

For an insurance portfolio with a fixed technical interest rate and a market framework corresponding to current observations, it has been shown in Reuß et al. [1] that product designs with alternative guarantees are generally able to increase capital efficiency.

In this paper, we consider interactions between new contracts and an existing book of insurance contracts. We consider an insurer that has built up a portfolio over a long term under changing guaranteed interest rates and market conditions. Then, we analyze different new business strategies for this insurer and the resulting risk exposure. We show that – if all contracts are covered by the same pool of assets – switching to carefully designed alternative participating contracts typically beats a runoff scenario and substantially reduces financial risk within a few years.

Keywords: Participating Life Insurance, Interest Rate Guarantees, Capital Efficiency, Portfolio Mix, Solvency Capital Requirements, Solvency II, SST, Market Consistent Valuation, New Business Strategy, ORSA

Reference:

[1] Reuß, A., Ruß, J., Wieland, J. (2015) Participating Life Insurance Contracts under Risk Based Solvency Frameworks: How to increase Capital Efficiency by Product Design. *Innovations in Quantitative Risk Management, Springer Proceedings in Mathematics & Statistics, Vol. 99,* p. 185-208.