***Insurance Times*:** S&P: Life insurers depend on efficiencies to maintain earnings

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NEW YORK — Efficiency gains in traditional business are the mainstay of improved operating performance among U.S. life insurers, according to Standard & Poor's midyear report on the sector. The industry continues to generate solid earnings, despite falling interest rates, a depressed stock market, and record defaults on corporate debt, and remains well capitalized with high-quality investments.

Insurers selling traditional products were the best performers in 2001.

Traditional whole-life sales increased 5%, boosted by a surge in demand following Sept. 11. In the fourth quarter, sales were 15% greater than in the equivalent 2000 quarter. The increase also reflects one key fundamental of the industry: that the population is aging and demand is increasing with it.

Individual life coverage is a consistent earner and less susceptible to short-term volatility. As such, it reaps the highest dividends from efficiency gains in an industry where overall fundamentals have been on a long-term upward track in terms of improving expense efficiency.

And there is plenty of scope for that to continue. On average, the top U.S. life insurers have average ROE levels of 6% (though with huge variance), whereas the top U.S. banks are around 14%. Standard & Poor's expects the gap to close through efficiencies of scale, assisted by continued consolidation in the industry, through increased use of securitization (in which an insurer can convert future income into present value), and variable compensation to agents.

However, companies that are heavily reliant on equities, both as an asset base for variable products (which the insurer holds in a separate account), and for their own investment portfolios, "will continue to feel the pinch", according to the report.

Variable annuity assets under management declined 7.7% in 2001, following a 1.6% decline in 2000, and new sales were down 18%. Insurers feel the impact through a decline in management fees as underlying assets lose value, and through reduced sales.

The decline in sales was largely offset, however, by increased sales of fixed annuities. Traditionally the domain of a few large players, these sales are now being generated by dozens of insurers using banks as a distribution channel. In 2001, banks accounted for 38% of fixed annuity sales and 63% of the $20 billion increase.