

“Low” Interest Rate Environment and Industry Responses

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AIG American General

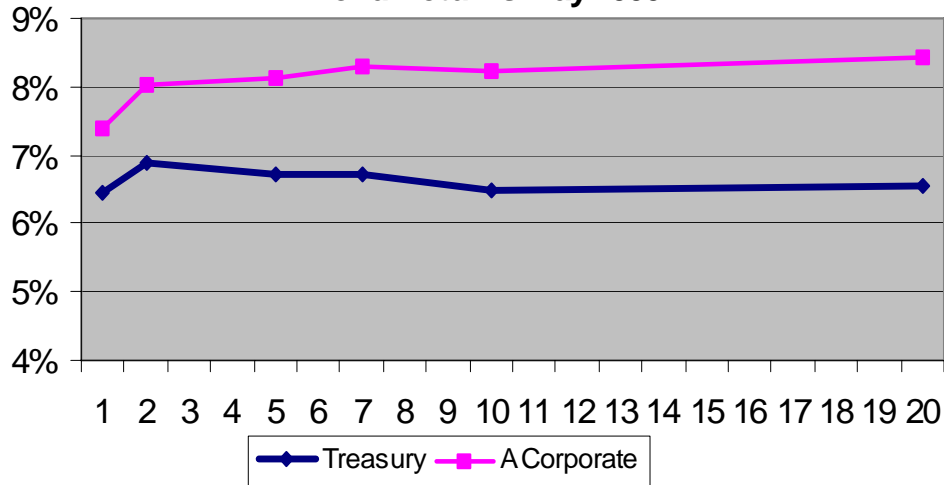
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Agenda

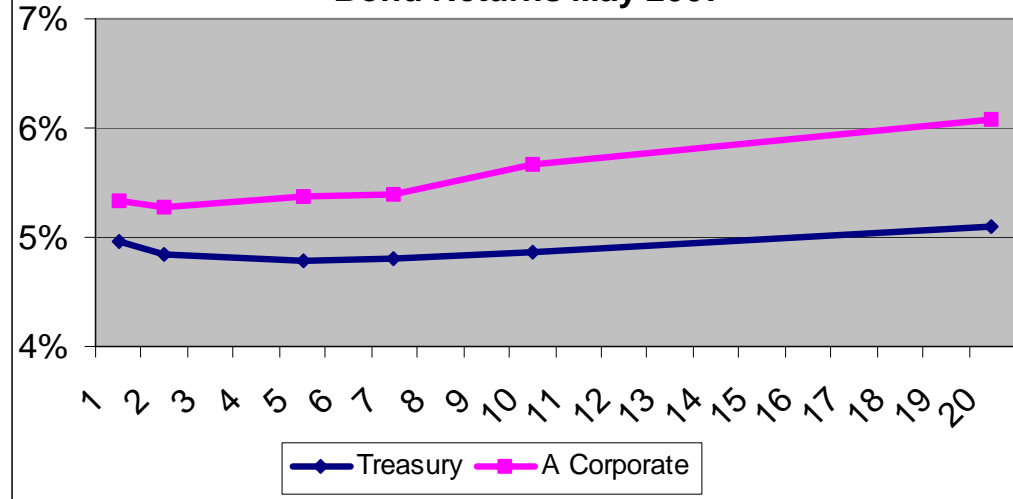
- **Interest Rate History along with Key Economic Indicators**
- **Company Responses to the Low Interest Rate Environment**
- **Interest Rate and Product Outlook**

Interest Rates

Bond Returns May 2000



Bond Returns May 2007



- What caused the flat yield curve?
- Why have we experienced spread compression?
- How can the curve become “normal” again?

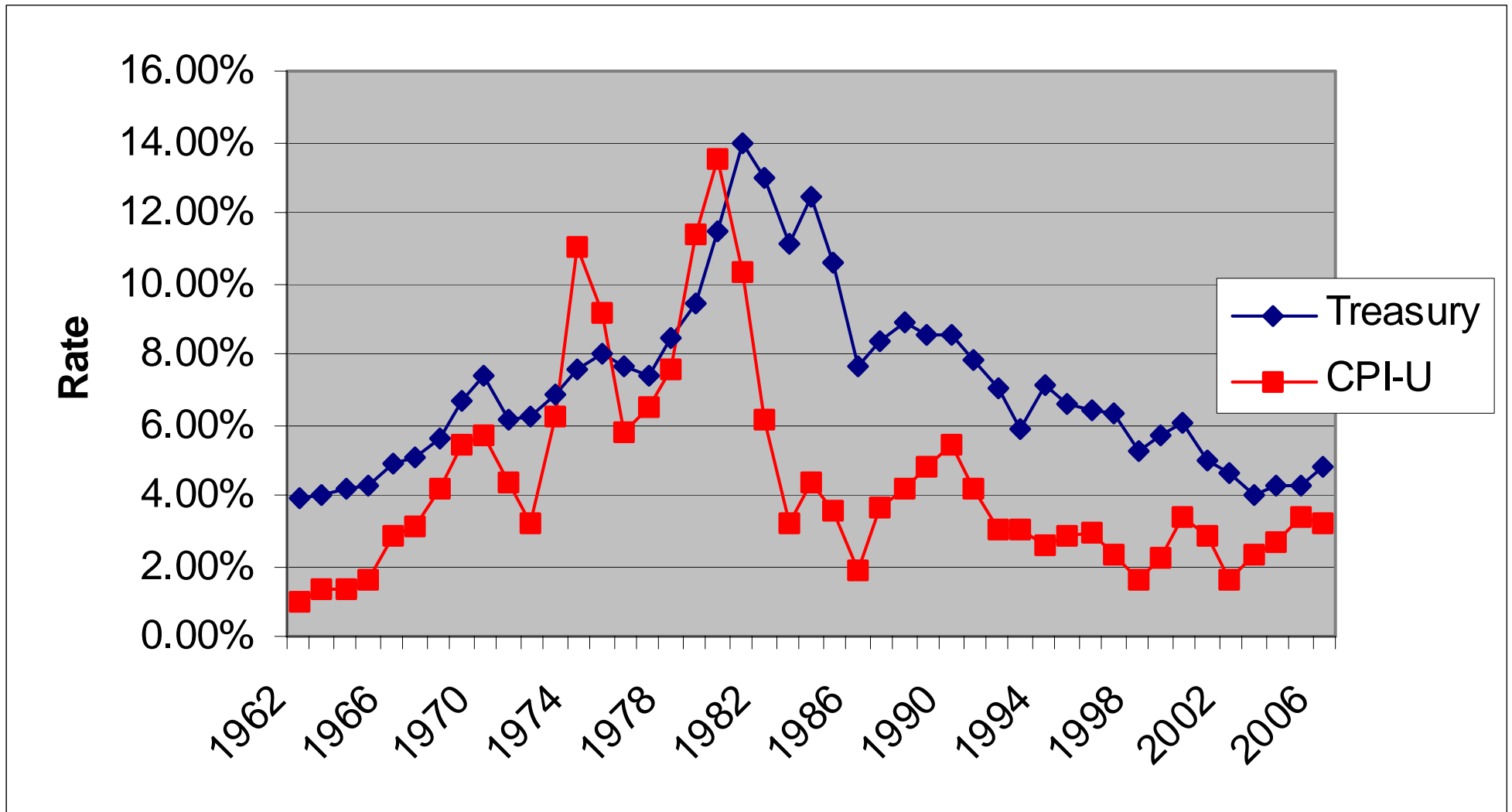
Economic Terms

- **Nominal Interest Rate – Total interest rate**
 - **Equals sum of the real interest rate and the inflation expectation**
 - **Short-rate set by the Fed**
 - **Long-rate determined by the market**
- **Real Interest Rate – Real cost of borrowing money**
- **GDP – Generally, GDP growth leads to inflation pressure**

Current Economic Outlook

- **Stuck in a “Goldilocks” economy**
 - **Poor housing market offset by strong earnings, employment data**
- **Fed continues to closely monitor core inflation with a 1-2% target.**
 - **Currently, 2.3%**
- **Fed Funds Rate: 5.25%**
- **10-Year Treasury: 4.86%**
- **GDP – projected 2.5% – 3.0%**

10-Year Treasury vs. Inflation



How Will Interest Rates Increase?

- **We are currently experiencing relatively low inflation and real interest rates**
 - **The real interest rate could increase from 2.5% to 3.0%**
 - **Not too much of a chance that we will see a significant increase in inflation**

This leads to a 6.5% long-term rate, not 8.25%

Company Responses to Low Interest Rates

Low Interest Rate Product Challenges

- **“Typical” fixed universal life plans become less attractive**
- **Policyholders are reluctant to turn to variable products due to recent history of poor market returns**
- **Deferred Annuities are running into CD’s and Money Market Accounts**
- **Distribution – Maintaining profitability and achieving sales targets amid stiff competition**

Company Responses to Low Interest Rates

Guaranteed UL

- **Designed to protect a policy from lapsing regardless of interest rate movements**
- **Gained more share of the market than typical Fixed UL**
- **Advanced age sales dominated premium inflows – IOLI and SOLI**
- **Most companies have increased rates at older ages**

Variable Guarantees

- **Market started with simple GMIB's**
- **Moved towards GMAB's and GMWB's**
 - **GMWB's for life**
- **Utilization is extremely high – industry sources state more than 80%**
- **Similar options are now offered on life products – utilization is not as strong**

Risk Management

- **Companies are extremely diligent to better understand and control risks**
 - **SOX controls**
 - **Internal Audits**
 - **Underwriting**
 - **Pricing**
- **Economic Capital**
- **Market Consistent Embedded Value**

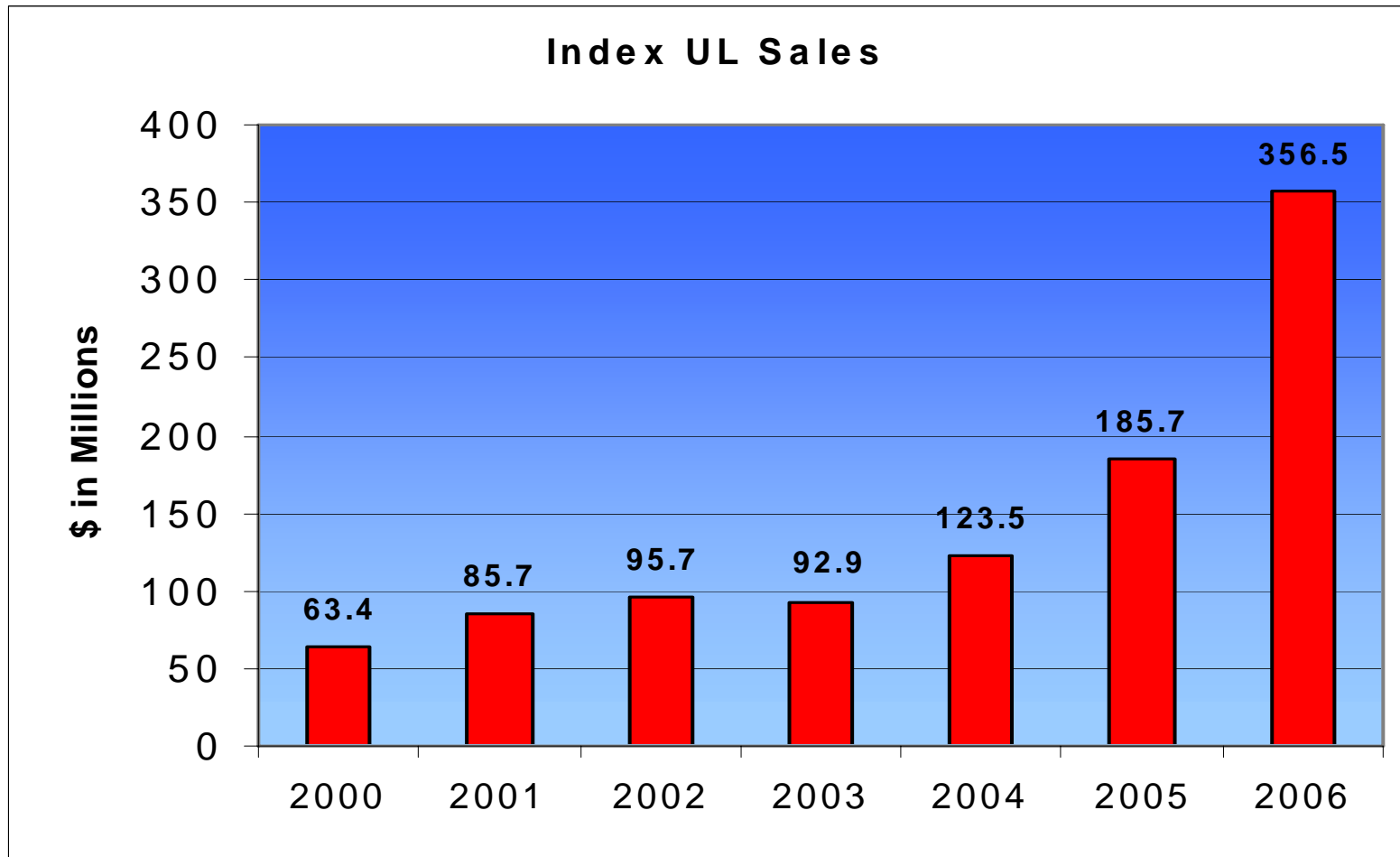
Term Insurance

- Experienced a period with few rate decreases
- ROP Term was introduced
- Companies age beginning to lower rates again
 - Already 5 “top tier” companies in 2007
 - Some just cut rates
 - Other are selective

Index Products

- **A few carriers in the market in 2000**
 - **More than 15 in 2007**
- **Only vanilla options offered in 2000**
 - **“Participation” products were originally offered**
 - **Companies switched to “cap” products**
 - **More exotic clique’s and structured options are becoming common**
- **Companies are adding multiple indices**
- **GMWB’s are offered on annuities**

Indexed UL Market Growth

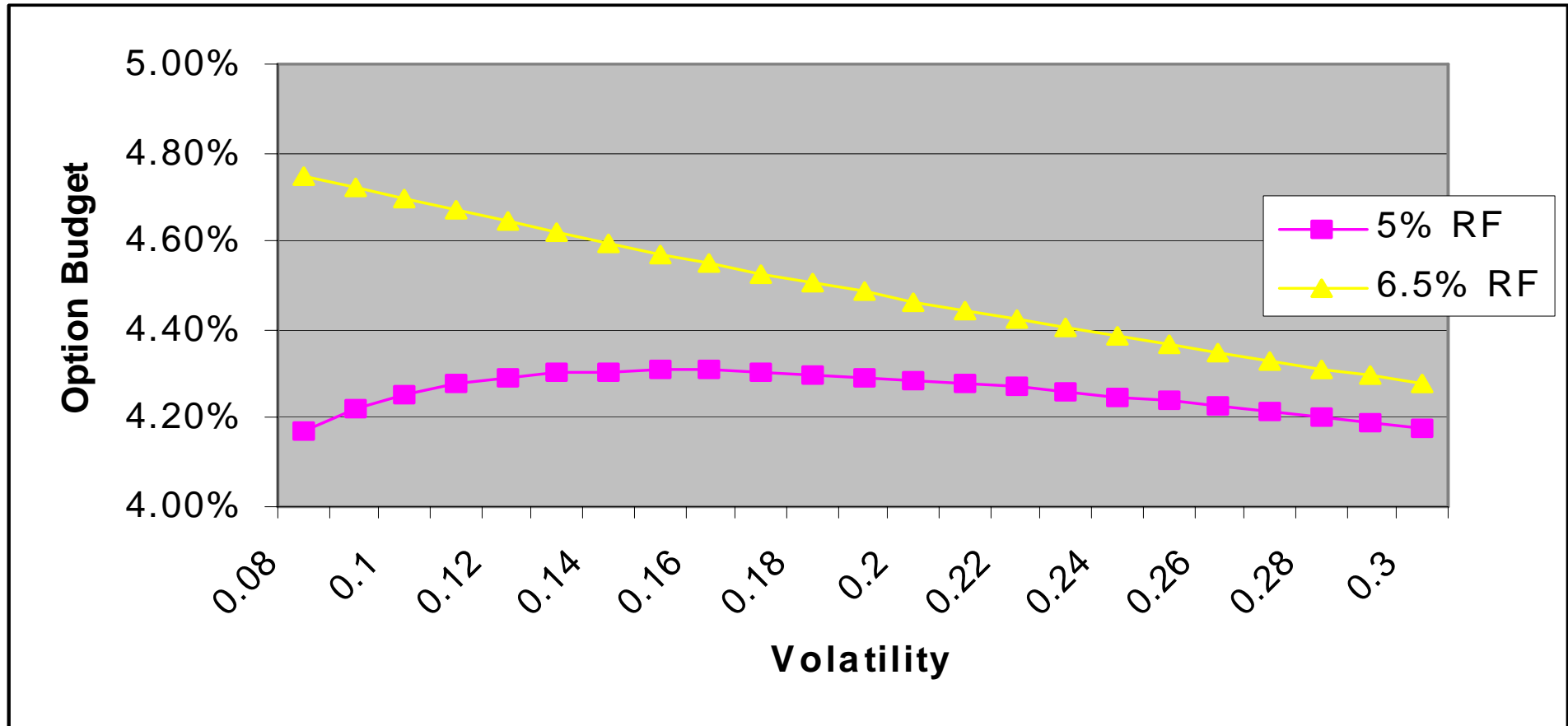


•Source: Advantage Compendium

Indexed Annuities

- **Are extremely popular and have experienced similar growth as Index UL...except for 2006**
 - **NASD 05-50**
 - **Suitability concerns**
- **Companies are redesigning products**
 - **Fewer two-tier**
 - **Restructuring compensation**
 - **Lower first-year bonuses**
 - **Lower surrender charges**
 - **Shorter surrender charge period**
 - **Annuity Value at death**

Index Option Pricing



I expect more companies to move to “cap” designs

Interest Rate Outlook

- **Economic pressures will keep real interest rates close to their current levels (within 50 bps)**
- **Fed vigilance will keep the inflation component low**
- **Expect similar levels of corporate spreads**

Therefore, don't expect things to change!

Product Outlook

- **Continue to put pressure on interest sensitive products – particularly Deferred Annuities because of the flat yield curve**
- **See more development in the index life and annuity marketplaces**

Questions?