

Thriving in an Economic Downturn: What Lies Ahead?

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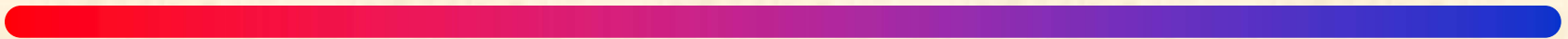
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Presentation Outline

- Isn't the Downturn Over?
 - The Housing Market: Still a Source of Downward Pressure
 - A Full-employment Economy? It's Many Years Away
- Interest and Inflation Rate Expectations
- The New Financial Anxiety
- Individual Life Insurance: Status Report
 - Sales, Lapse, Policy Loan Trends
- A Financial Security Budget Target?
 - Q & A

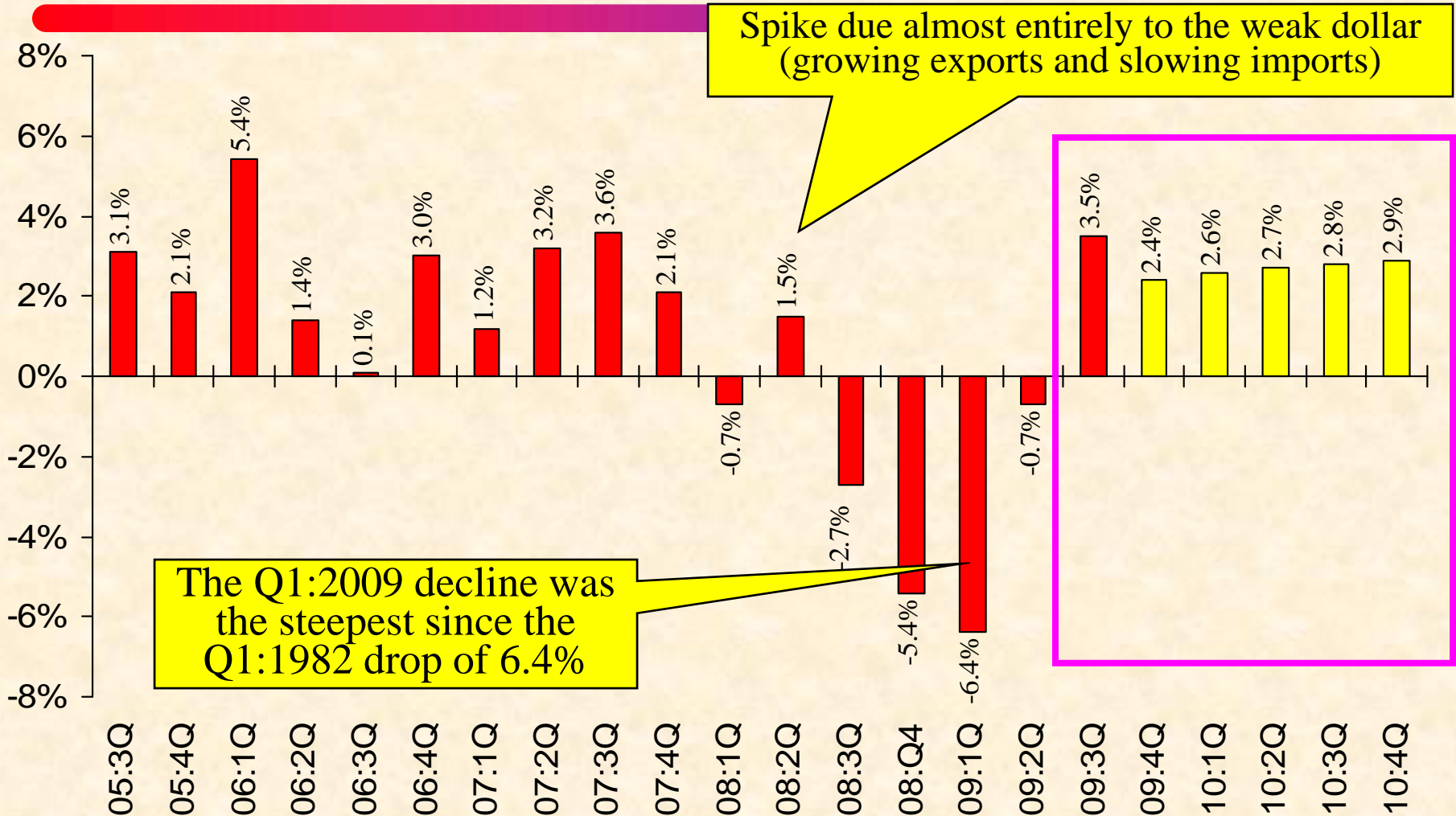
**Wait a Minute:
Isn't the
Downturn
Over?**





Real Quarterly GDP Changes (annualized), 2005:Q3-2010:Q4F

Red bars are actual; Yellow bars are forecasts/estimates



Sources: US Department of Commerce, Bureau of Economic Analysis (actual) at

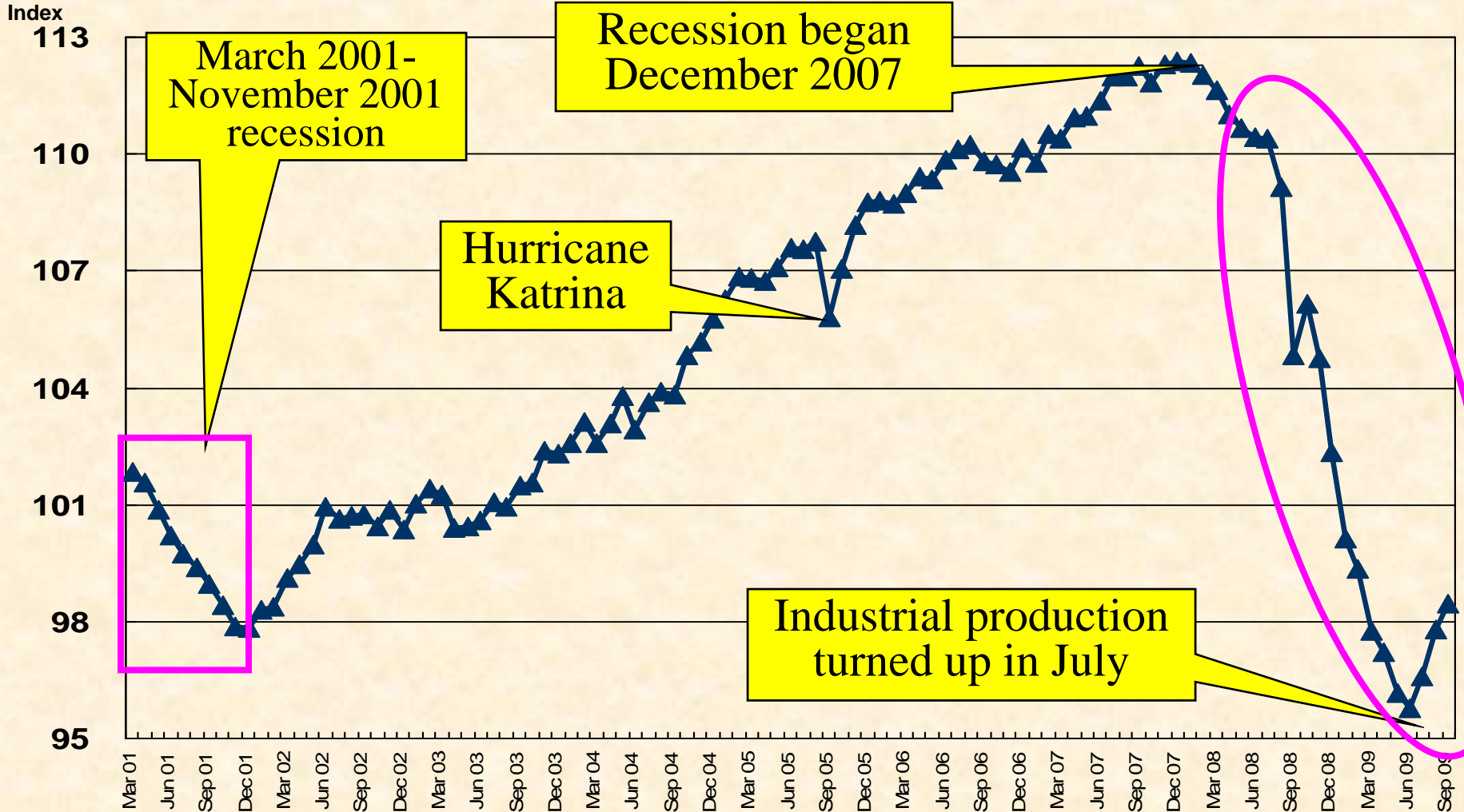
<http://www.bea.gov/newsreleases/national/gdp/gdpnewsrelease.htm>

Blue Chip Economic Indicators 10/09 issue (forecasts).



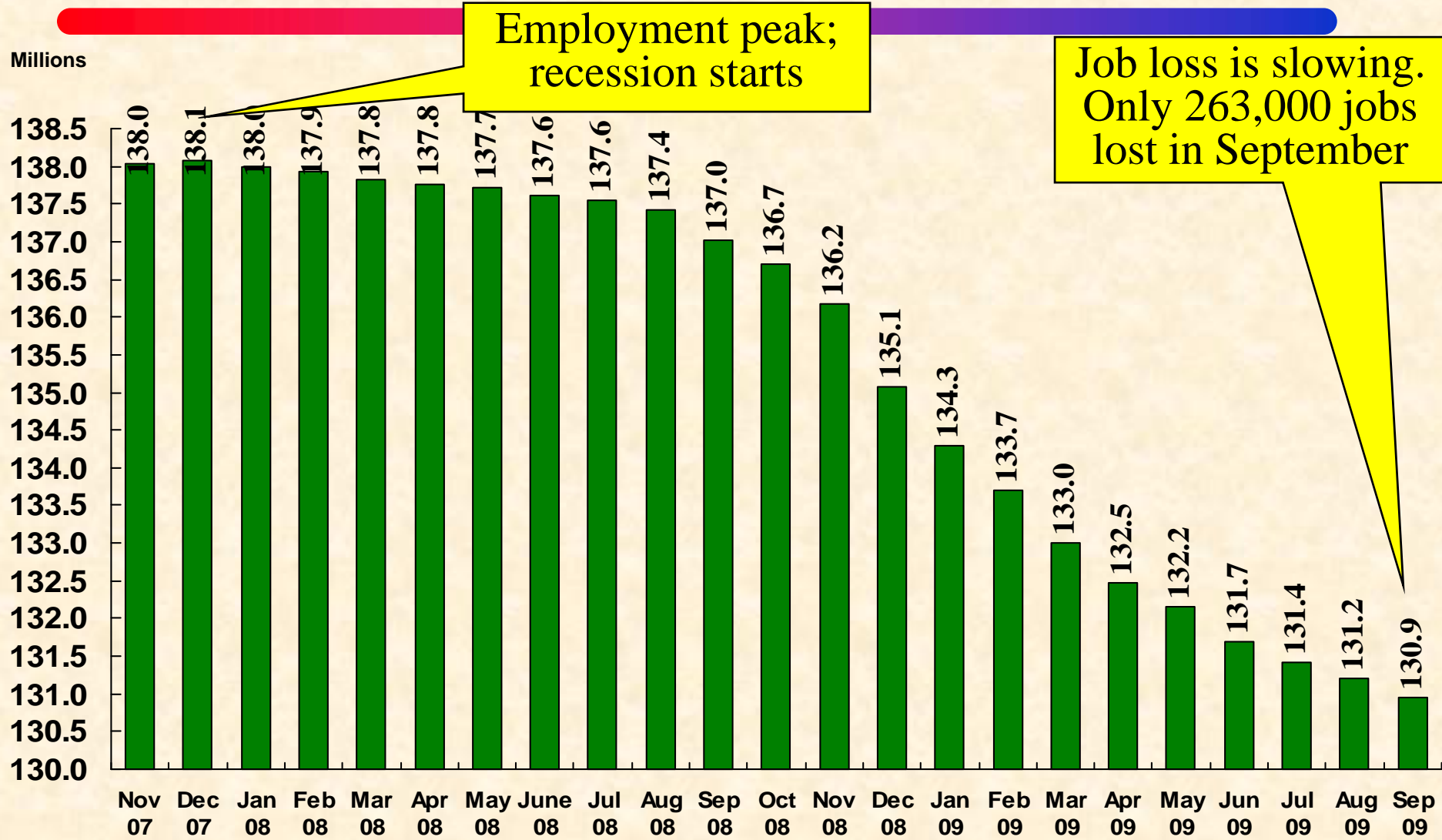
Total Industrial Production, monthly

Mar 2001-Sept 2009 (Index 2002=100)*



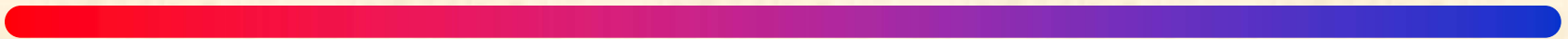


U.S. Nonfarm Private Employment, Monthly, Nov. 2007 – Sept. 2009



Seasonally adjusted. Source: US Bureau of Labor Statistics

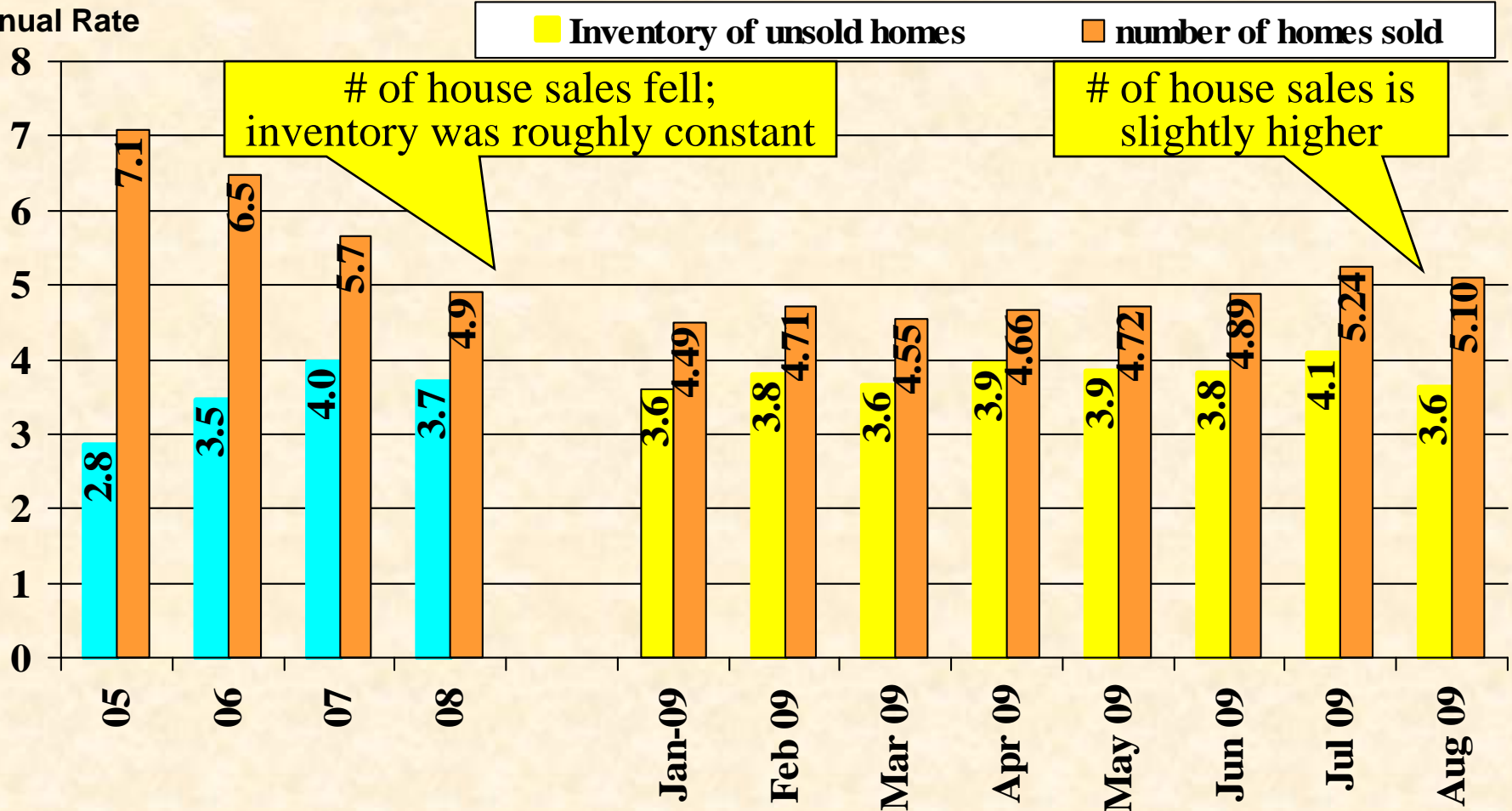
But Problems Remain
Housing is
Still a Source
of Downward Pressure





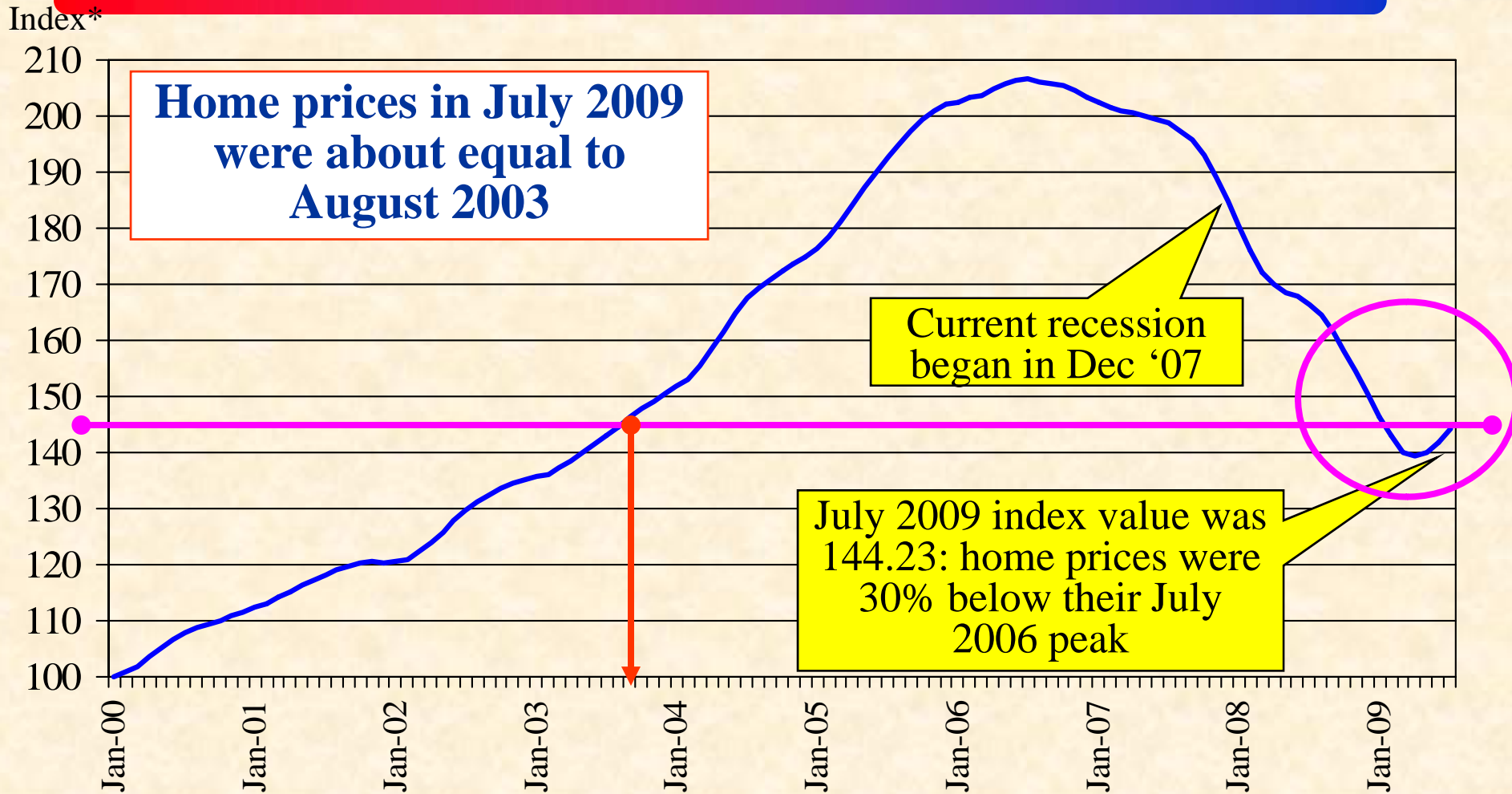
High Ratio of Unsold-Homes Inventory to Sales Will Likely Keep Prices Falling

Millions of Homes,
Annual Rate





Many People's Main Asset (Their Home) Has Lost 6 Years of Appreciation



*Case-Shiller Home Price Index (20-city composite); January 2000=100. Not seasonally adjusted

Source: http://www2.standardandpoors.com/spf/pdf/index/CSHomePrice_History_072820.xls



“Shadow” Inventory of Unsold Homes: It’s Worse Than You Think

- Zillow.com’s latest Homeowner Confidence Survey (published August 18, 2009) asked homeowners how likely they would put their homes on the market if they saw signs of a turnaround in the next 12 months:
 - *Very likely*, 8% (7.5 million homes)
 - *Likely*, 9% (7.5 million homes)
 - But Adam York, economist for Wells Fargo Securities, “contends that the amount of homes that have not yet been listed for sale could be around 4-5 million.



“Millions” More Foreclosures are Likely

- “[A]ny modification program seeking to avoid preventable foreclosures has limits, HAMP included. **Even before the current crisis, when home prices were climbing, there were still many hundreds of thousands of foreclosures.** Therefore, even if HAMP is a total success, **we should still expect millions of foreclosures,** as President Obama noted when he launched the program in February.”

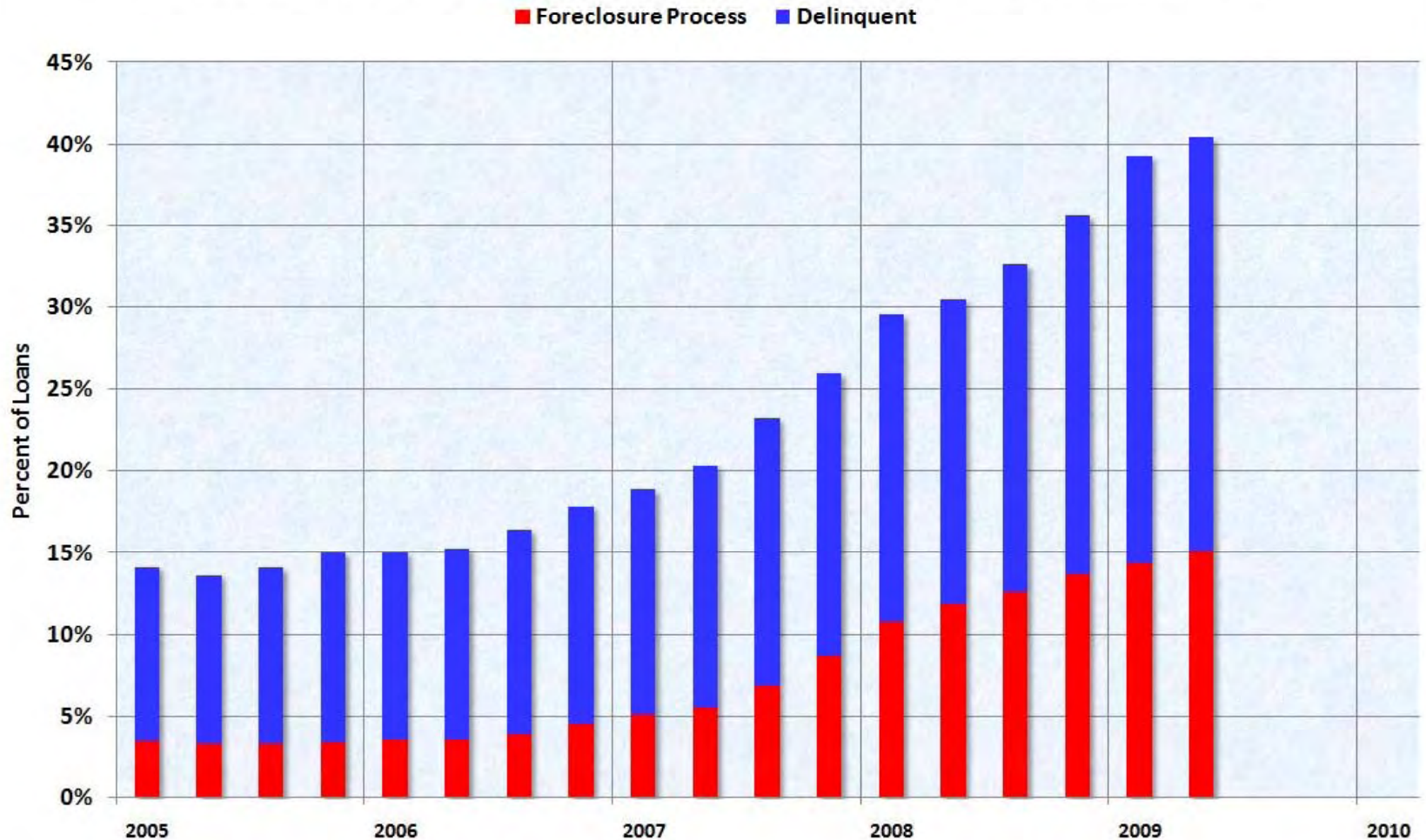
Source: Treasury Assistant Secretary for Financial Institutions Michael S. Barr, Written Testimony on Stabilizing the Housing Market before the House Financial Services Committee, Subcommittee on Housing and Community Opportunity (emphasis added)



At Midyear 2009, Over 40% of Subprime Loans Were Delinquent or in Foreclosure

(2005:Q1-2009:Q2)

U.S. All Subprime Loans Delinquent and in Foreclosure: Source: MBA Q2 2009 Delinquency Survey



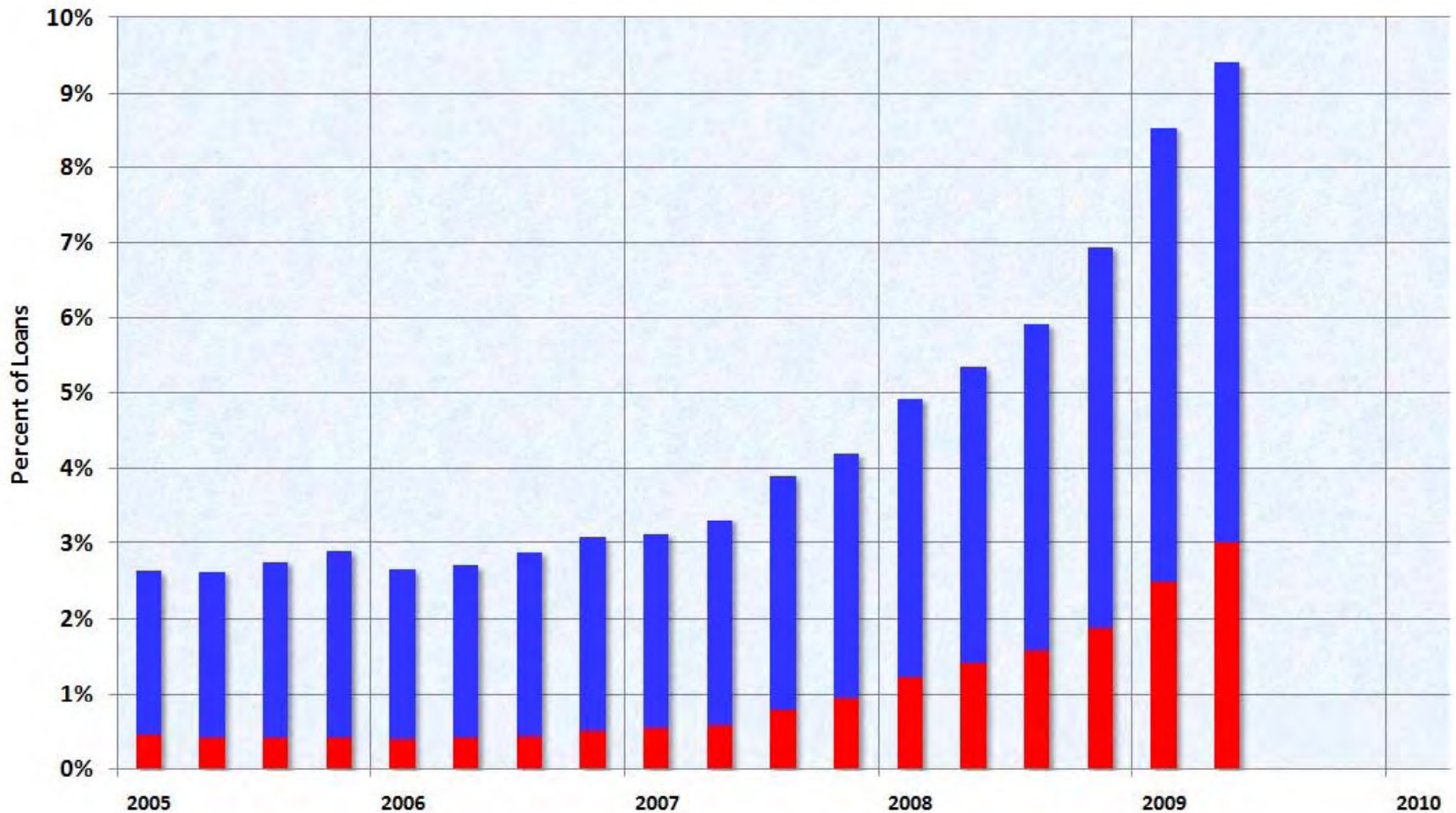


The Percent of Delinquent Prime Loans and Prime Loans in Foreclosure Is Still Rising Sharply

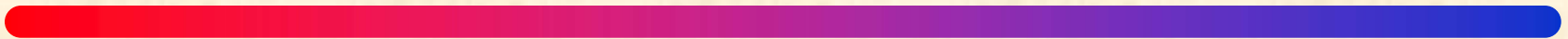
(2005:Q1-2009:Q2)

U.S. All Prime Loans Delinquent and in Foreclosure: Source: MBA Q2 2009 Delinquency Survey

■ Foreclosure Process ■ Delinquent



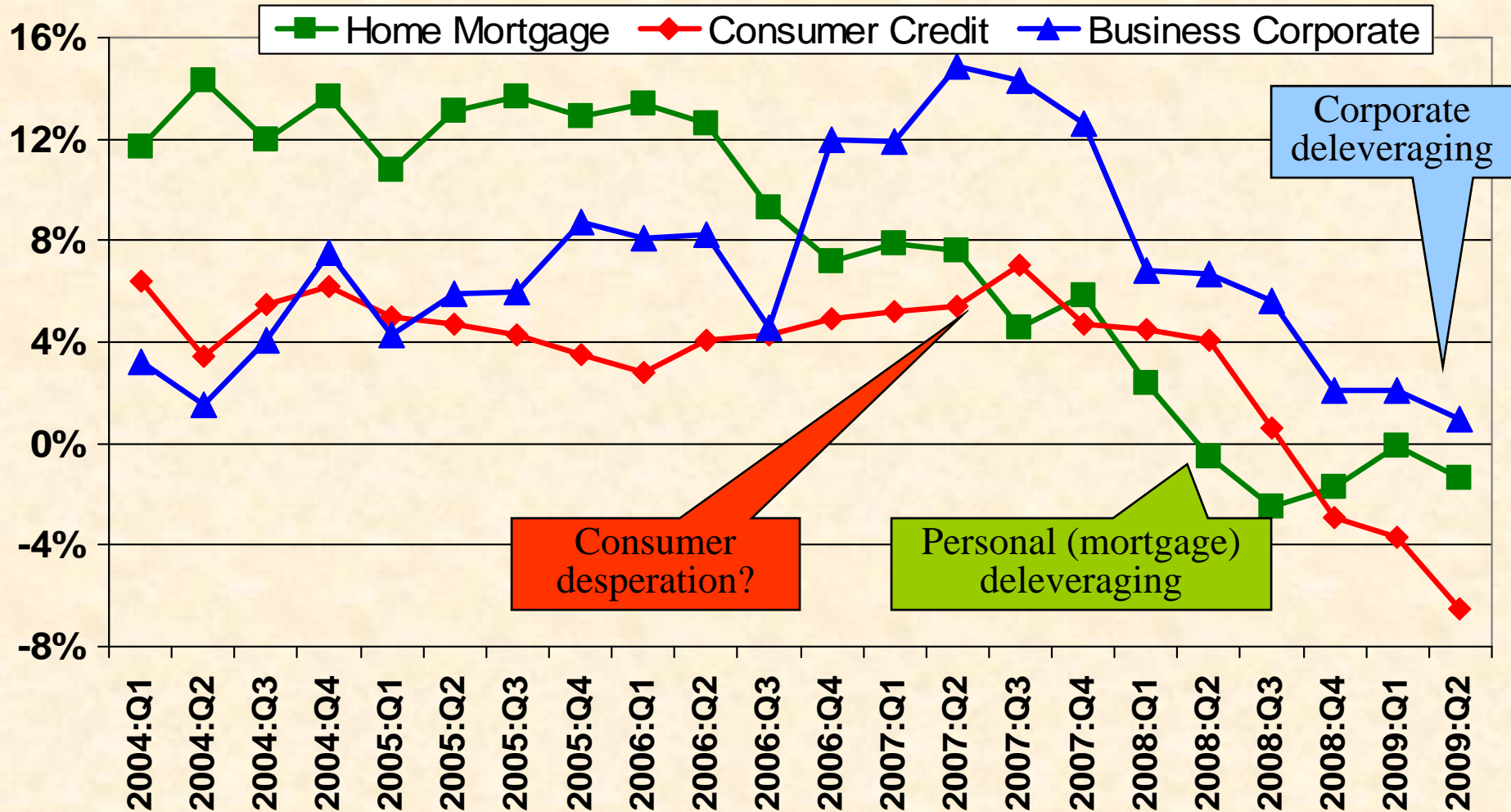
Fewer People/ Organizations are Borrowing





Households and Businesses Are Still “Deleveraging”

Percent Change in Debt Growth (Quarterly since 2004 at Annualized Rate)

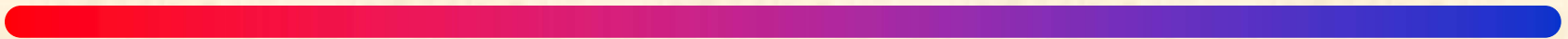


Corporate deleveraging

Consumer desperation?

Personal (mortgage) deleveraging

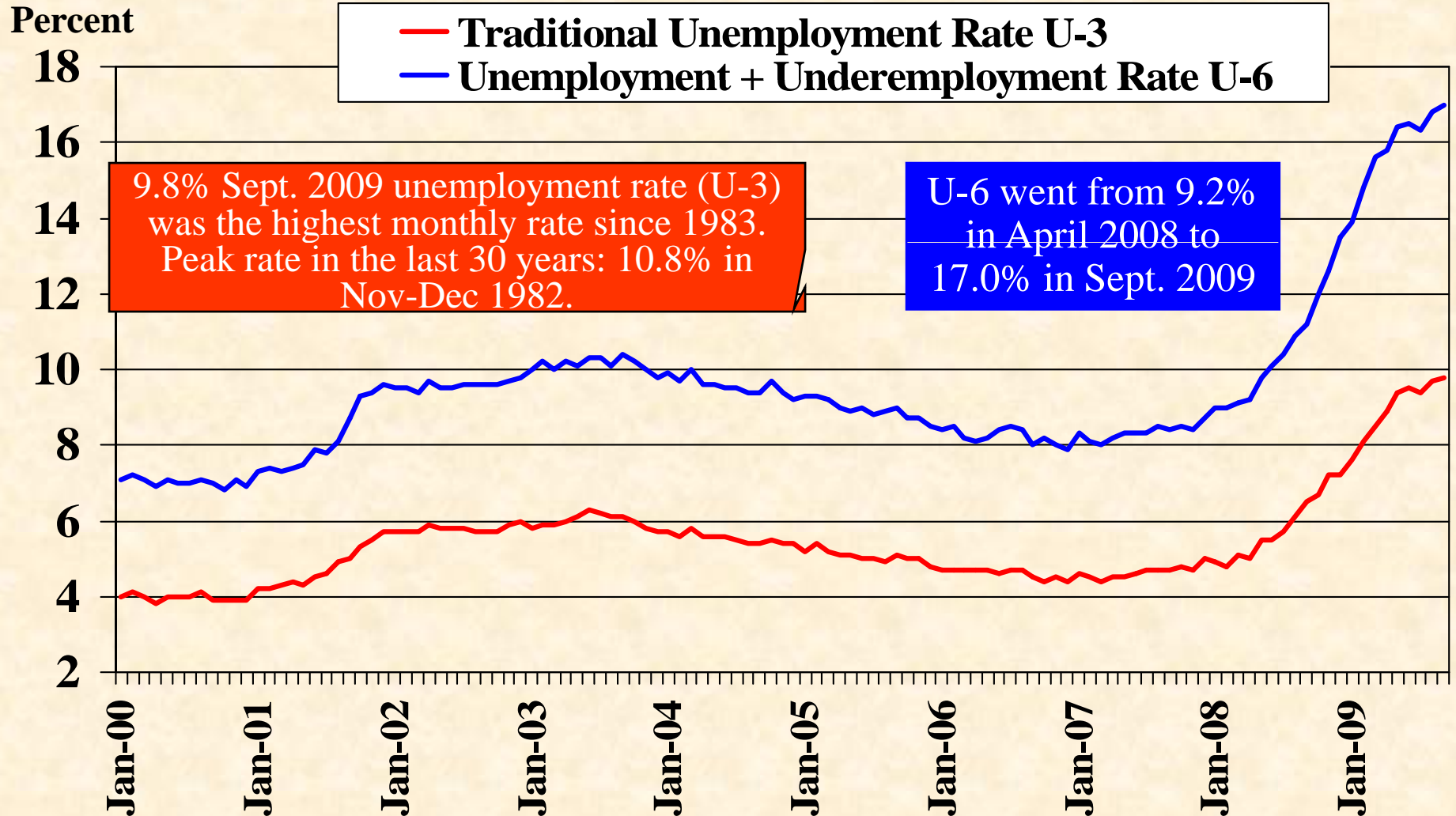
A Full-Employment Economy is Still Many Years Away





Unemployment and Underemployment Rates: Rocketing Up in 2008-9

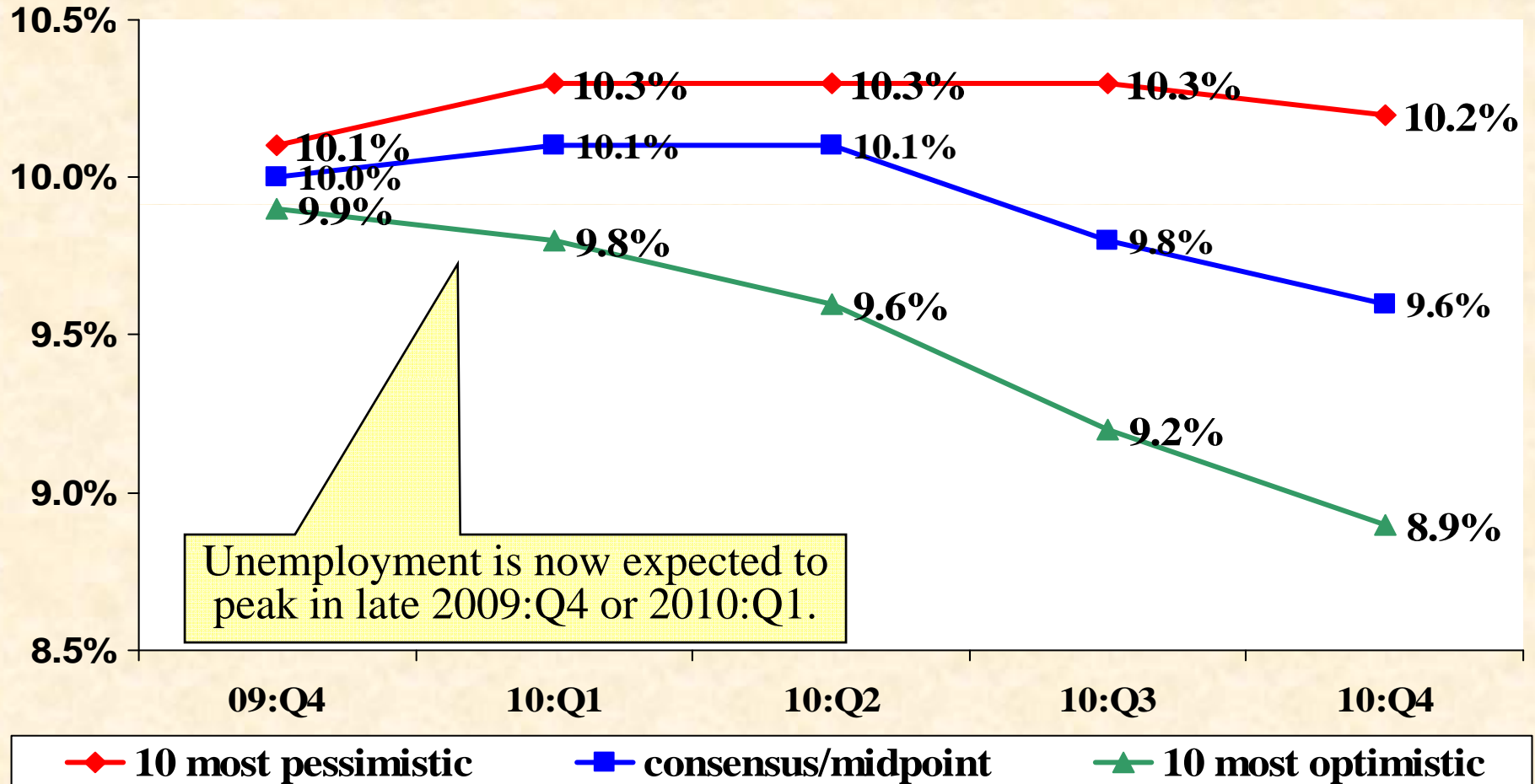
January 2000 through September 2009, seasonally adjusted





U.S. Unemployment Rate Forecasts

Quarterly, 2009:Q4 to 2010:Q4

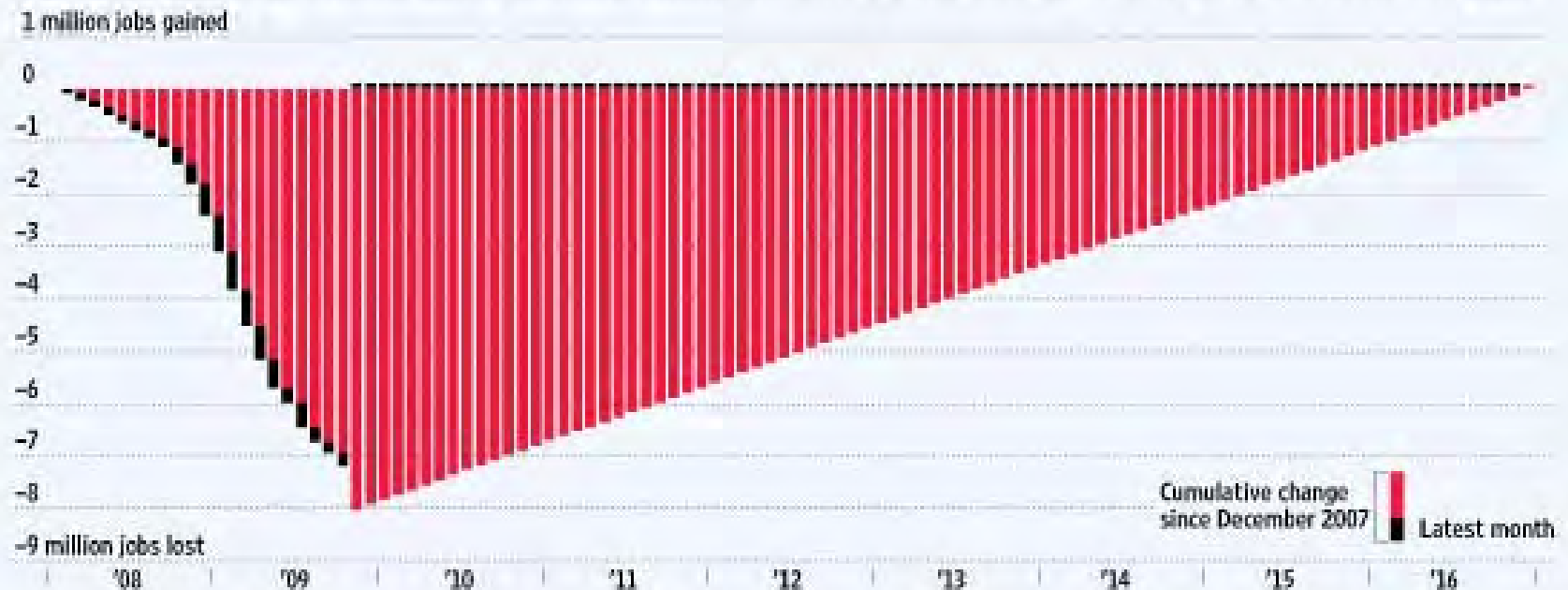




When Might All of the Lost Jobs Be Regained? 2016?

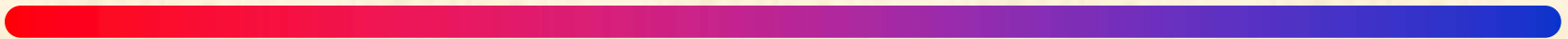
Long Road Back | How long it would take to regain the job level at the start of this recession?

Assuming the average monthly pace of the most recent expansion, it would take 86 months, or not until December 2016



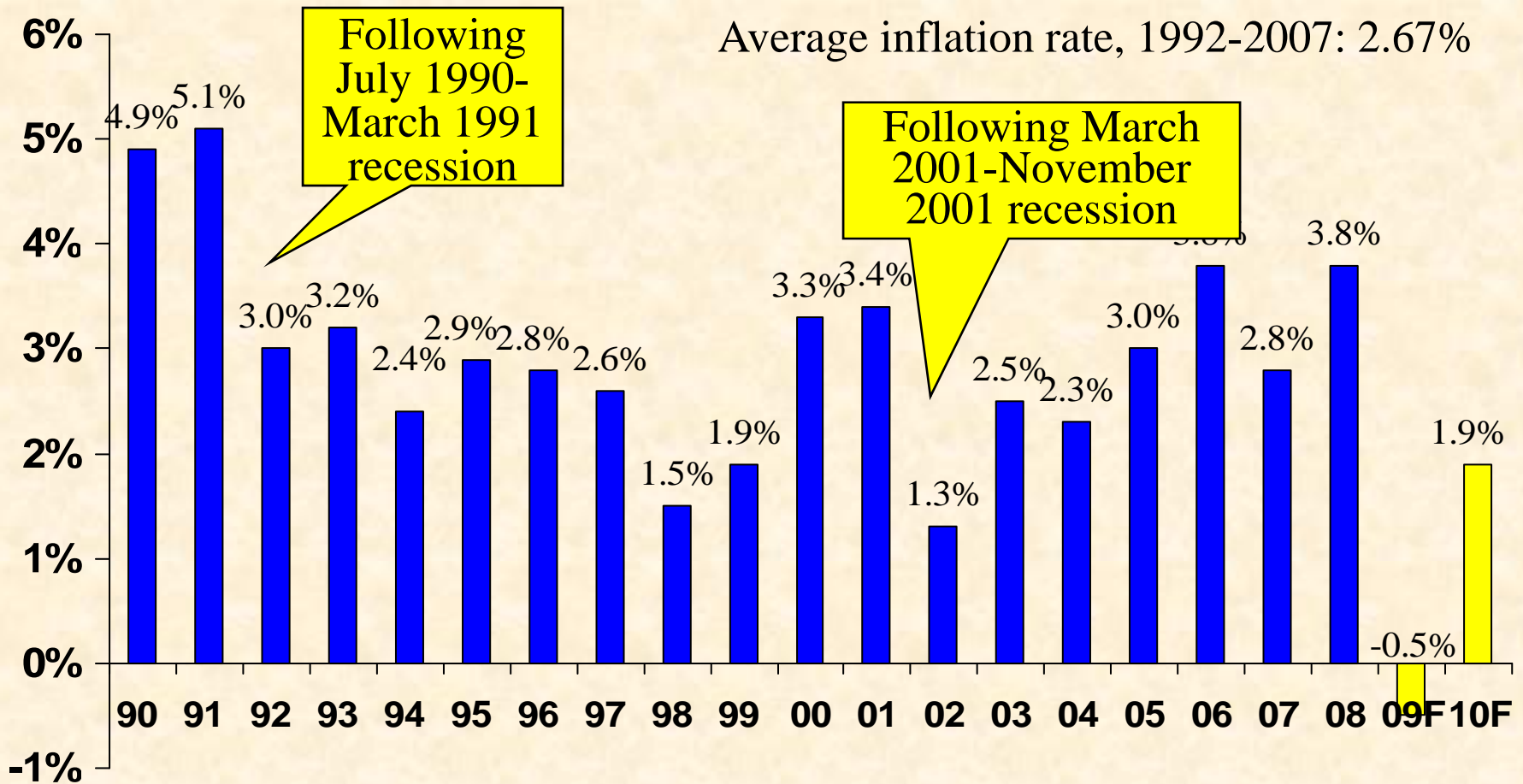
Note: The starting point for adding jobs back includes 824,000 jobs lost between March 2008 and March 2009 announced Friday by the Labor Department
Source: Labor Department (payroll figures)

Interest Rates Will
Likely Stay Low for
the Foreseeable
Future





2009-2010 Inflation Forecast: Low Rates Ahead



Sources: US Bureau of Labor Statistics (actual, blue bars); Blue Chip Economic Indicators, 10/2009 issue, (forecasts, yellow bars)

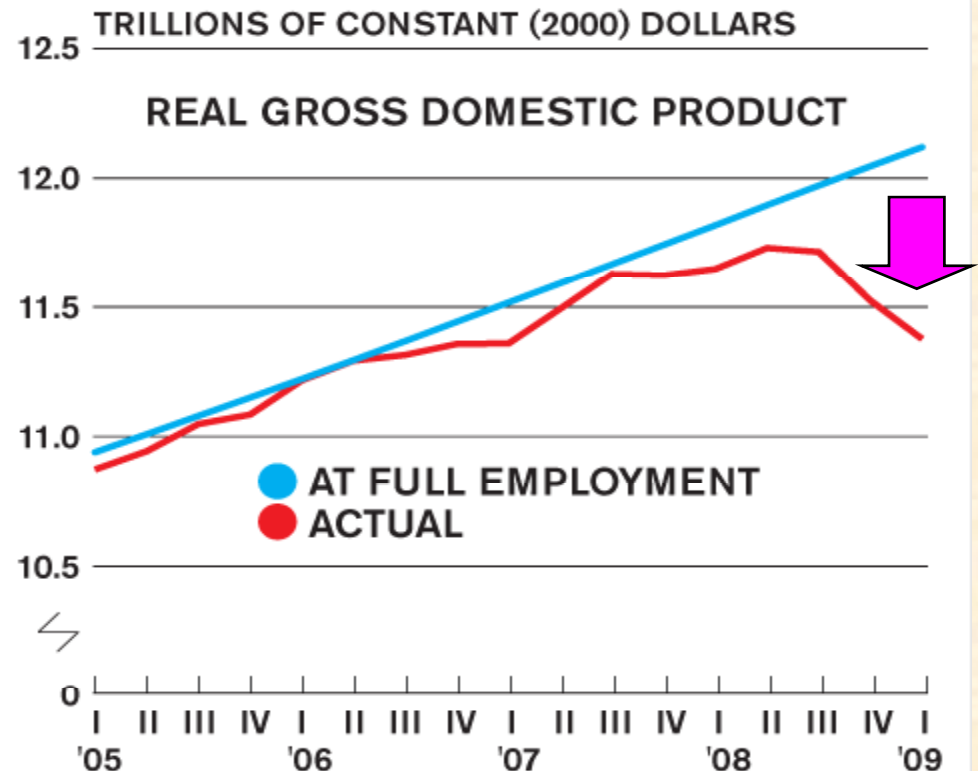


Theory: Re-ignited Inflation Won't Threaten Until the Economy Returns to a Full-Employment Level—Likely a Few Years Away

The markets are starting to worry that the flood of money for the recovery will re-ignite inflation (the spread between 10-Year TIPS and 10-Year T-Notes is widening).

Source: Cooper, "Hints of Recovery—And Fears of Inflation," *BusinessWeek*, May 11, 2009, p. 8

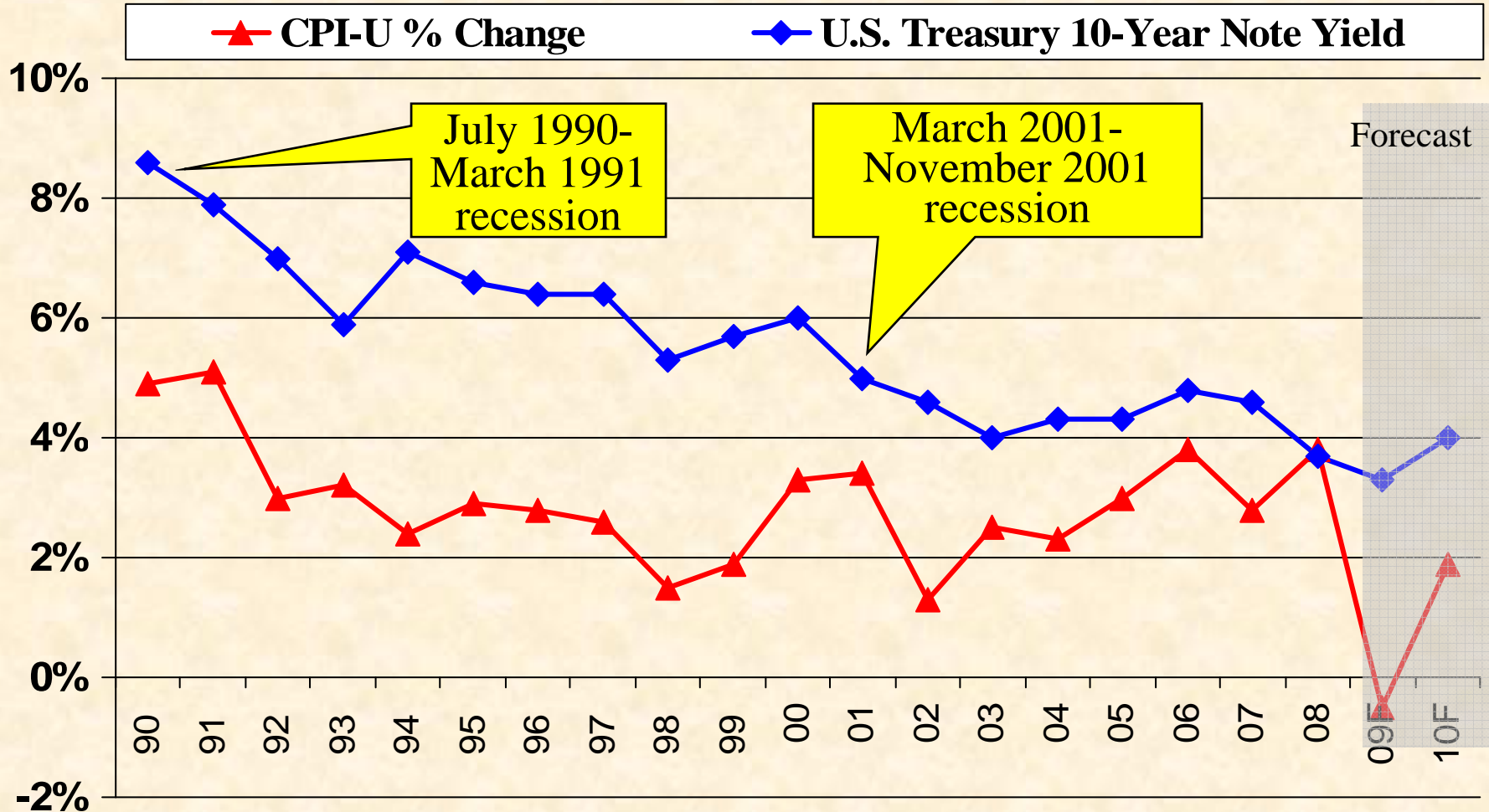
A GAP THIS BIG WILL TAKE A LONG TIME TO CLOSE



Data: Bureau of Economic Analysis, Congressional Budget Office, IHS Global Insight



Bond Yields Tend to Reflect Expected Inflation, but the Relationship is a Loose One

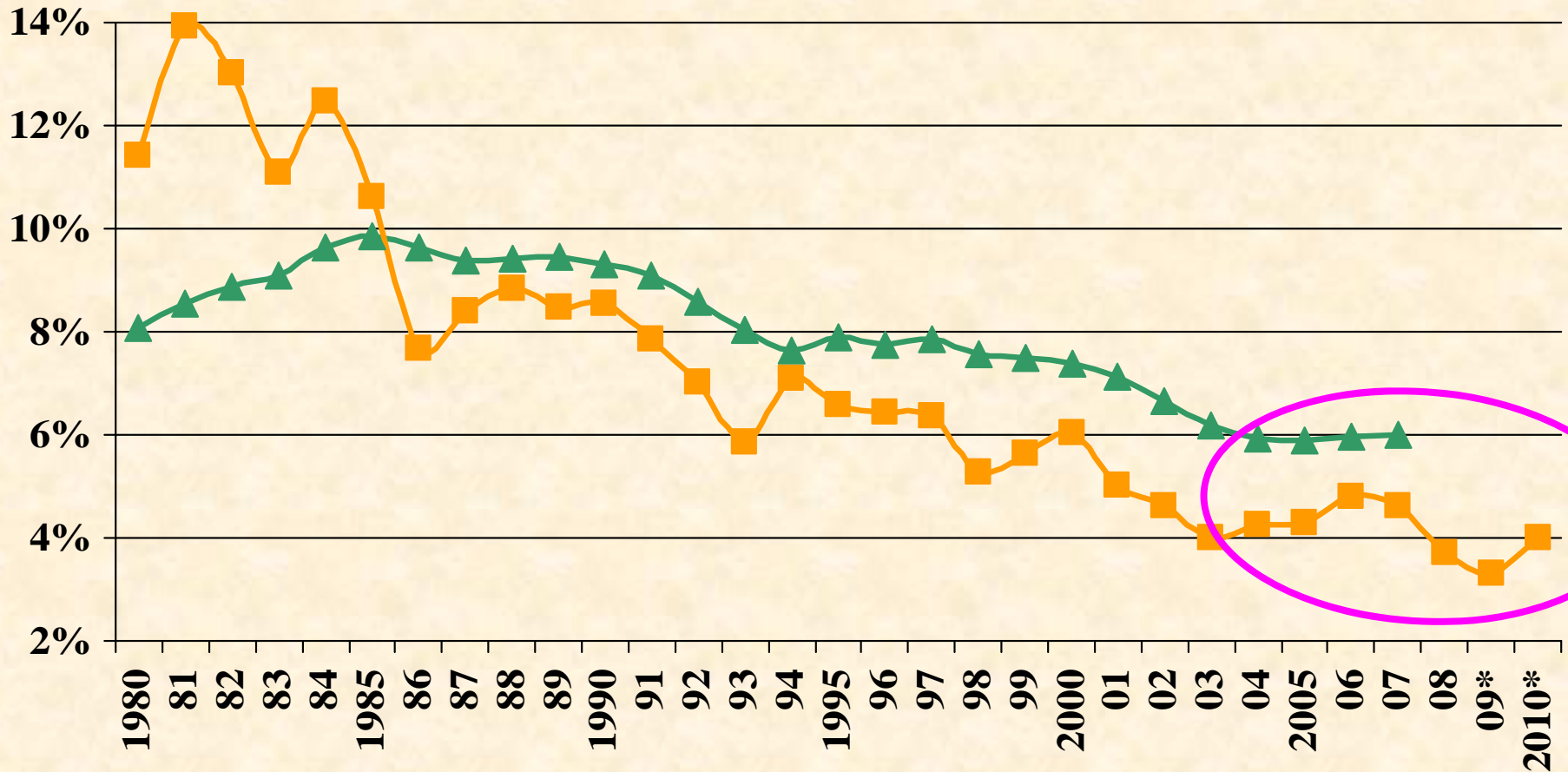


Sources: US Bureau of Labor Statistics (history); Blue Chip Economic Indicators, 10,/2009 issue (forecasts)



Net Rate on L/H General Account Assets Tends to Follow 10-Year US T-Note

▲ L/H Net Rate, Gen'l Acct ■ 10-Year Treasury Note

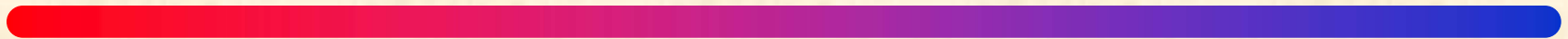


*estimates/forecasts from October 2009 issue of Blue Chip Economic Indicators

Sources: ACLI Life Insurers Fact Book 2008, p. 34;

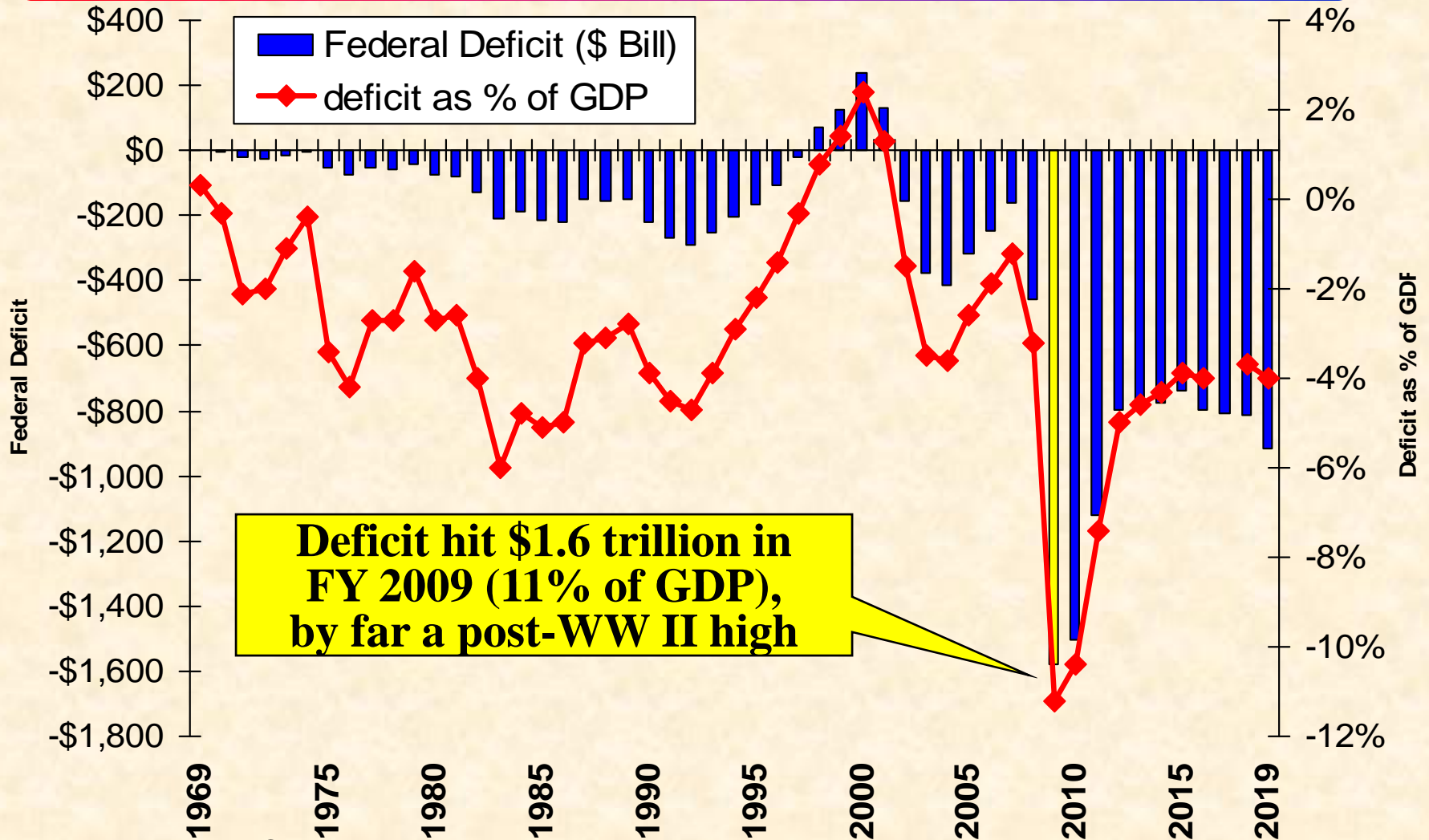
http://federalreserve.gov/releases/h15/data/Annual/H15_TCMNOM_Y10.txt

What's the Longer-Term Forecast for Interest Rates?





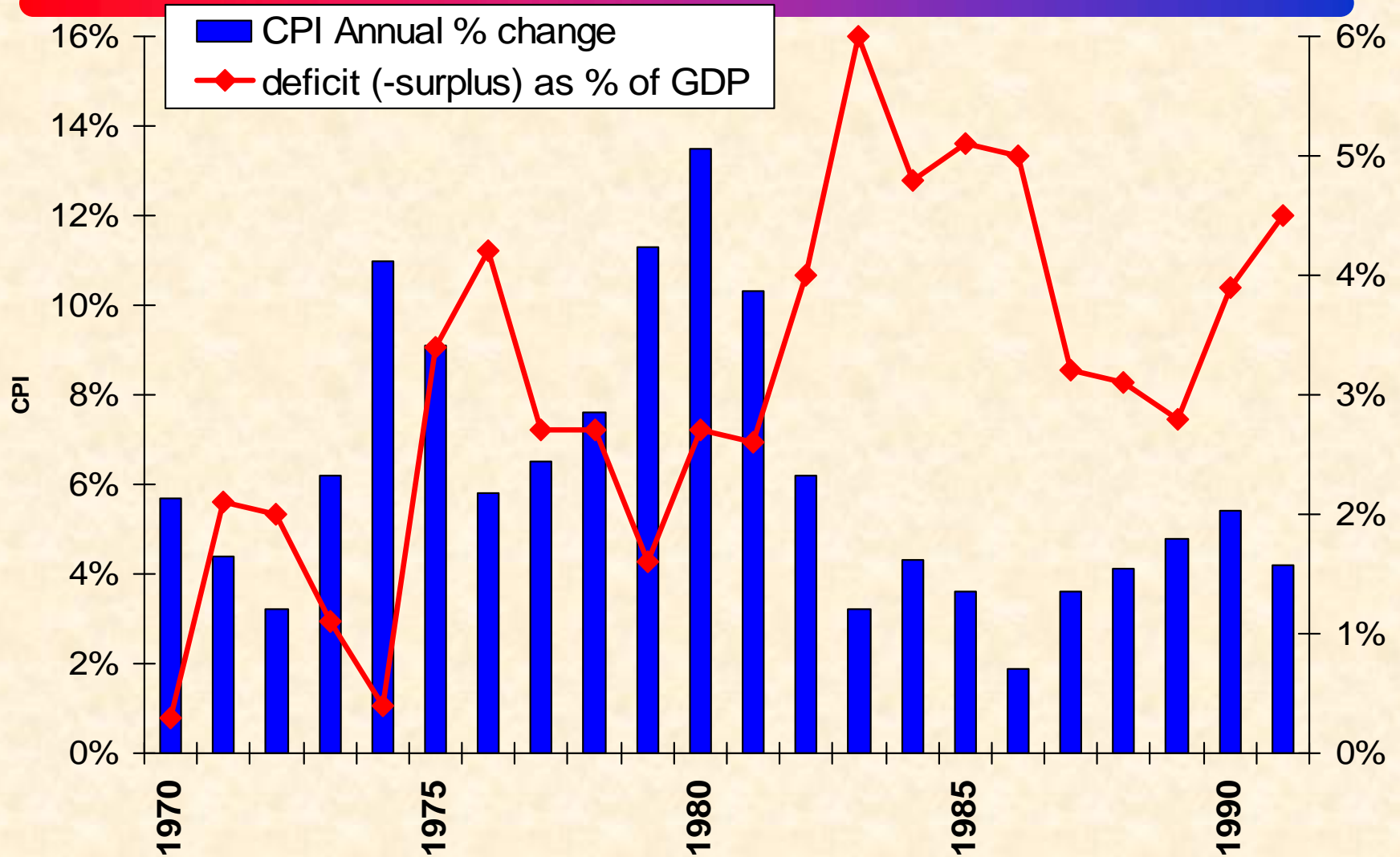
Will Federal Deficit Spending Ultimately Re-ignite Severe Inflation?



Deficit hit \$1.6 trillion in FY 2009 (11% of GDP), by far a post-WW II high



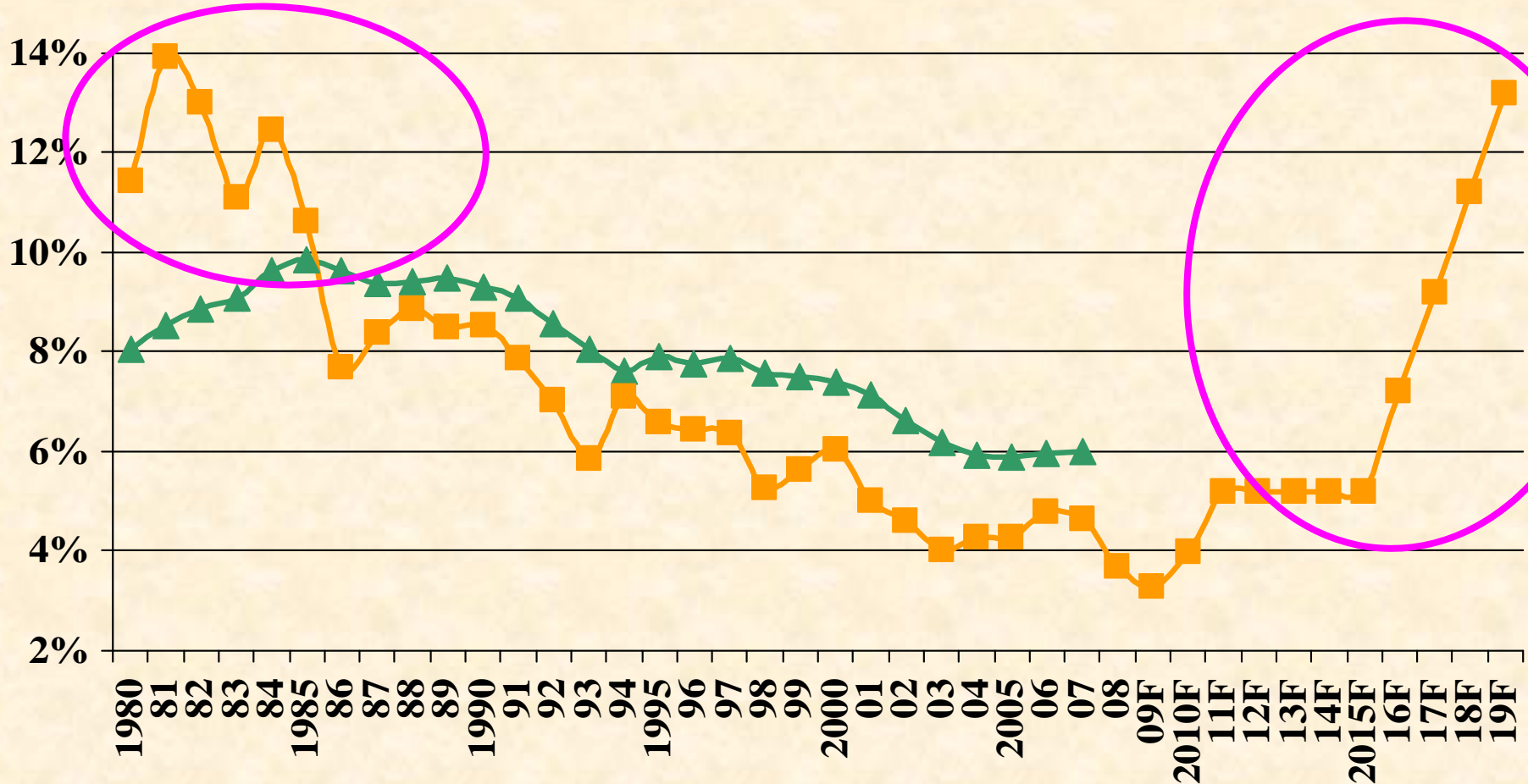
In the 70s and 80s, When the Deficit Rose, Only High Interest Rates Dampened Inflation





Will Inflation and Interest Rates Repeat the 1980-85 Pattern?

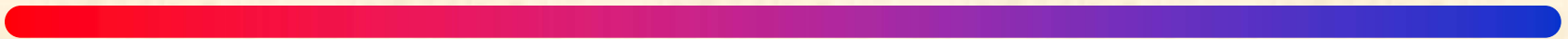
▲ L/H Net Rate, Gen'l Acct ■ 10-Year Treasury Note



Forecasts: Office of Management and Budget, *Mid-Session Review, Fiscal Year 2010*.

http://federalreserve.gov/releases/h15/data/Annual/H15_TCMNOM_Y10.txt ; I.I.I. speculation for 2016-19

How Well Are Most People Handling Recent Circumstances?



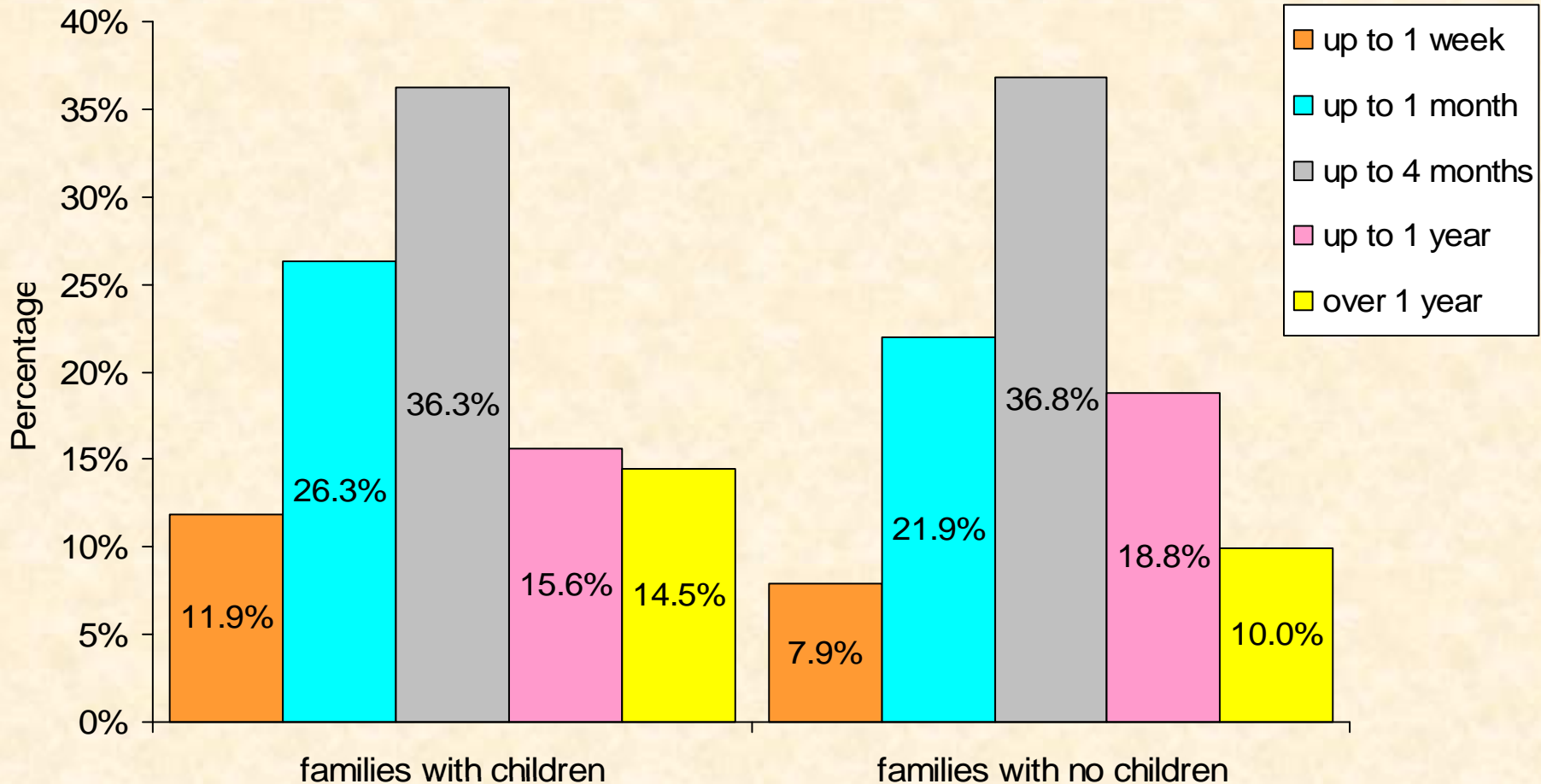


Not Well

They're Living
Close to the Edge



“How Long Could You Go Without Your Job Before Experiencing Significant Financial Hardship?”



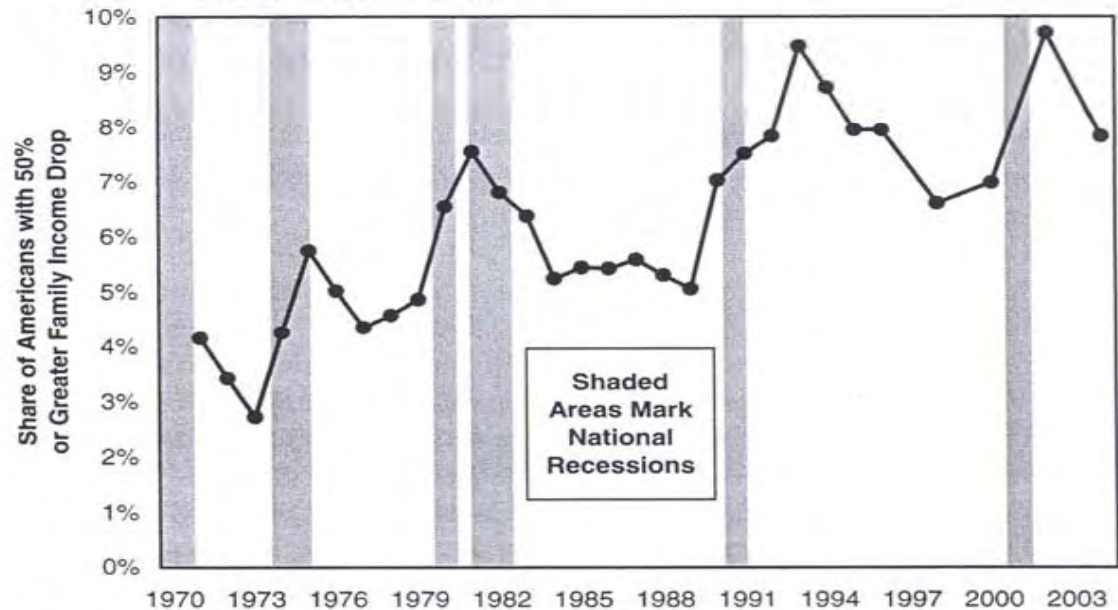
Source: Jacob Hacker, *The Great Risk Shift*, rev. ed., Oxford University Press, New York, p. 102, citing a Gallup survey published in April 2003. Hacker notes that these results are after controlling for demographic variables such as age, income, race, education, and gender.



Trend: Growing Chance That a Family's Income Will Drop By 50% or More

- The income instability risk has been rising for three decades
- Even at its most recent “best” (at the height of the prosperity of the 1990s), the risk level exceeded all pre-1980 levels

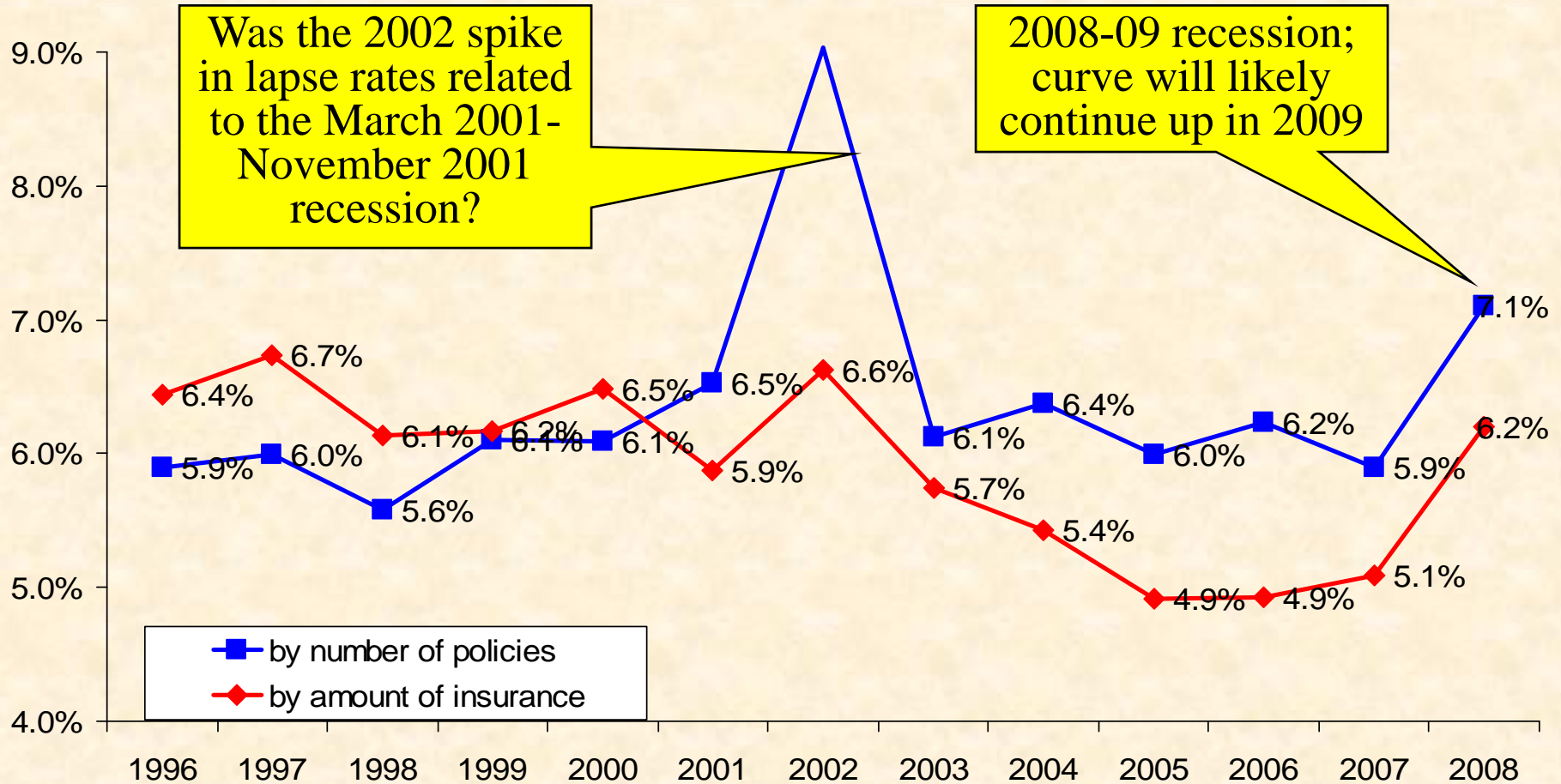
Figure 1.4: Working-Age Americans' Chance of a 50 Percent or Greater Income Drop



Source: Panel Study of Income Dynamics. The line traces the share of individuals aged 25 to 61 experiencing at least a 50% drop in family-size-adjusted real family income from one year to two years afterward.



Ordinary Life Insurance Lapse Rates, 1996-2008

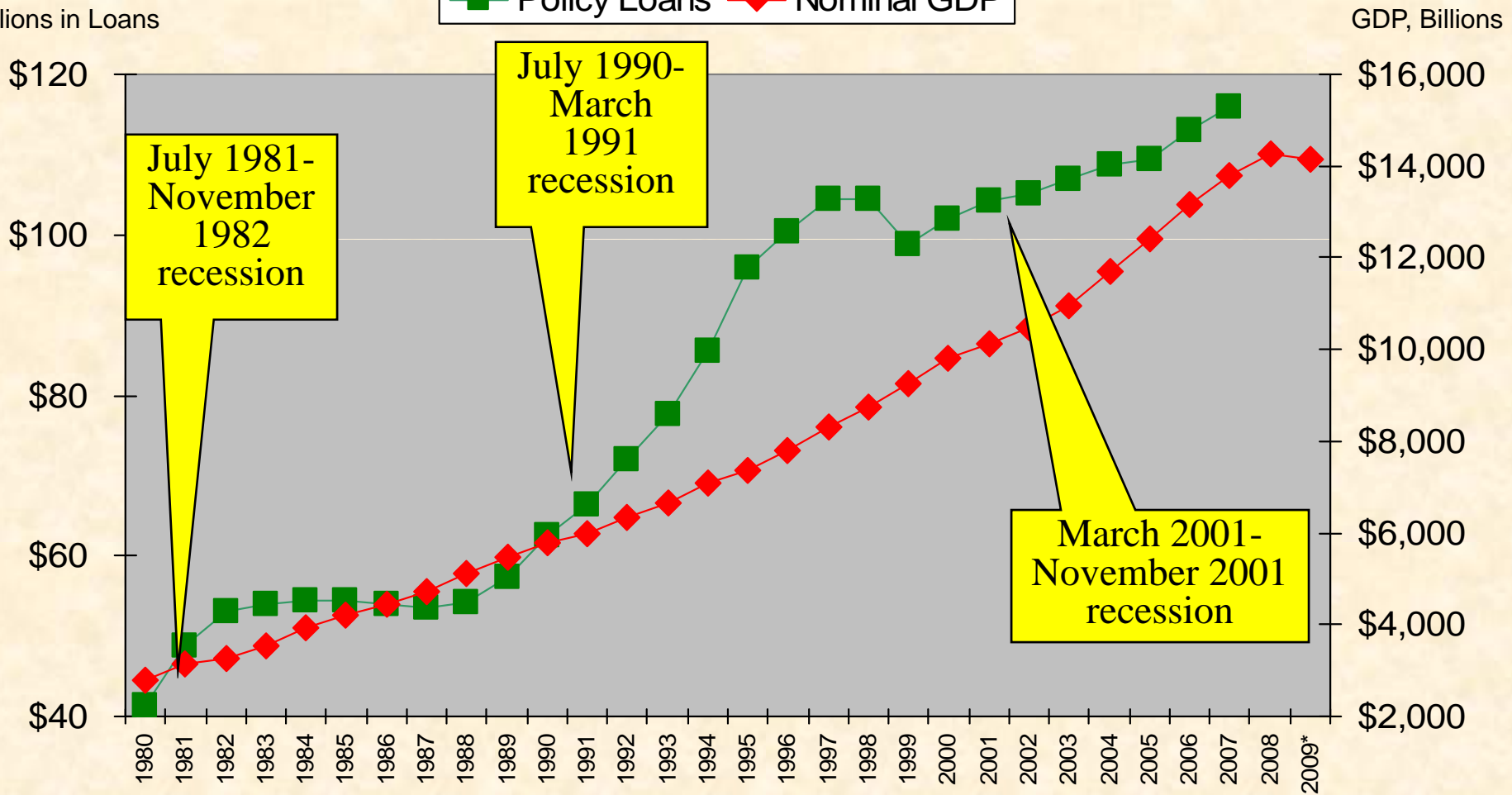


Sources: NAIC Annual Statements, p. 26 line 15 (lapses) and average of lines 1 and 21, from National Underwriter HighlineData; I.I.I. calculations



Policy Loans Increase During/Following a Recession, but Also in Boom Times

■ Policy Loans ◆ Nominal GDP



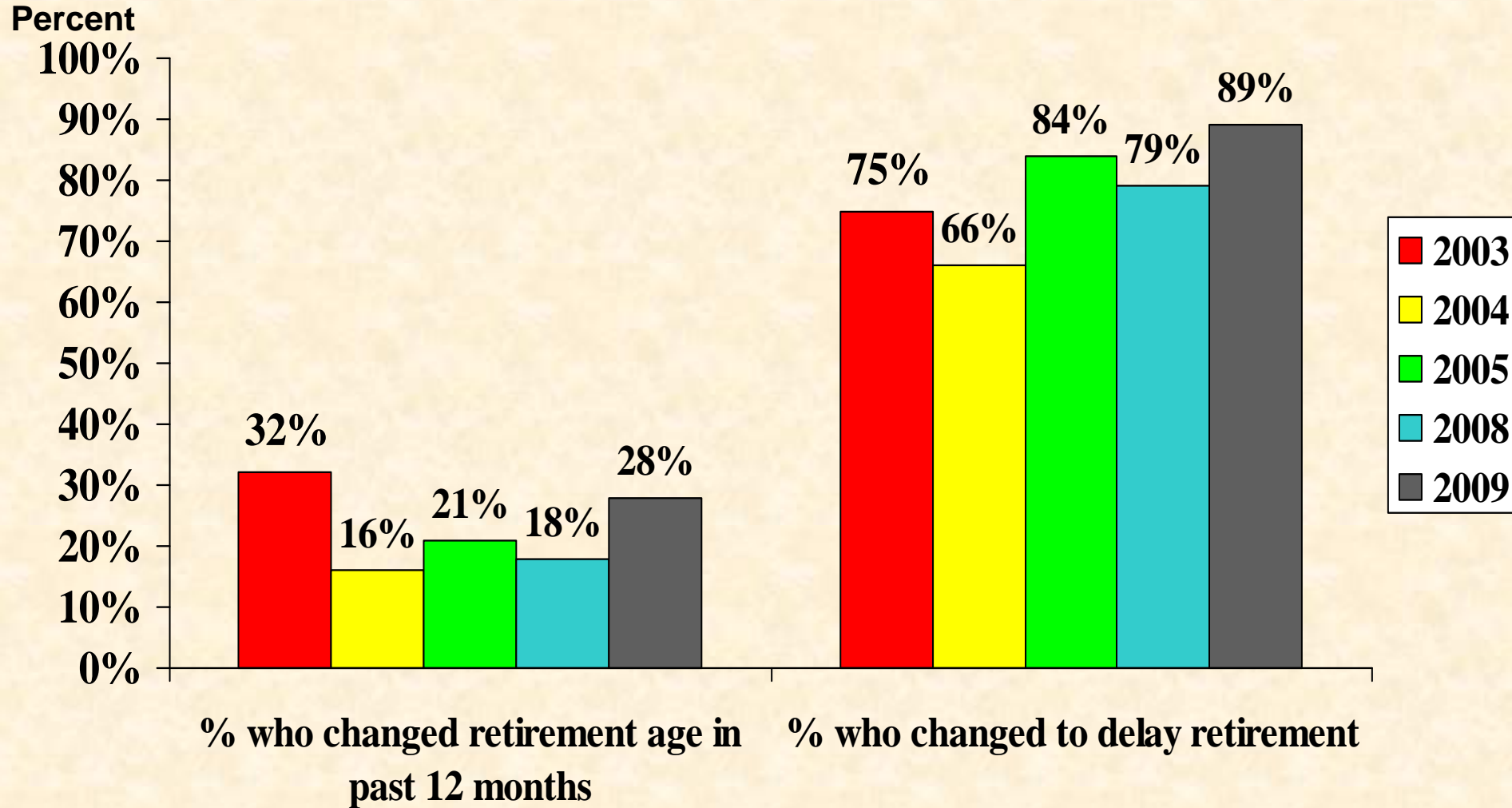
Sources: <http://www.bea.gov/national/xls/gdplev.xls> , ACLI Life Insurers Fact Book 2008, p. 11.



The Older Generations Might
Boost Economic Growth and
Life/Annuity Purchases
by Continuing to Work

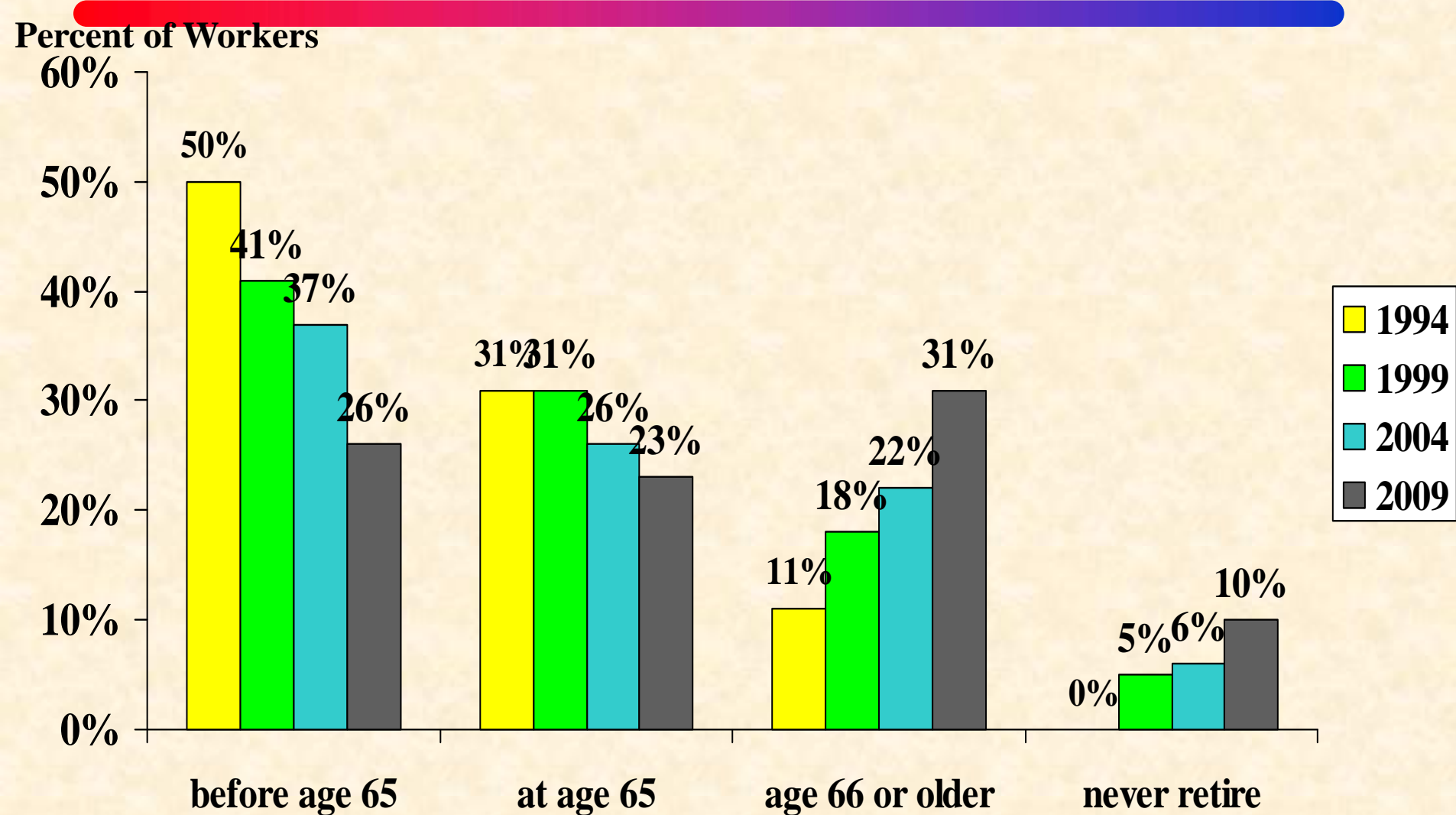


More Workers Are Delaying Their Planned Retirement





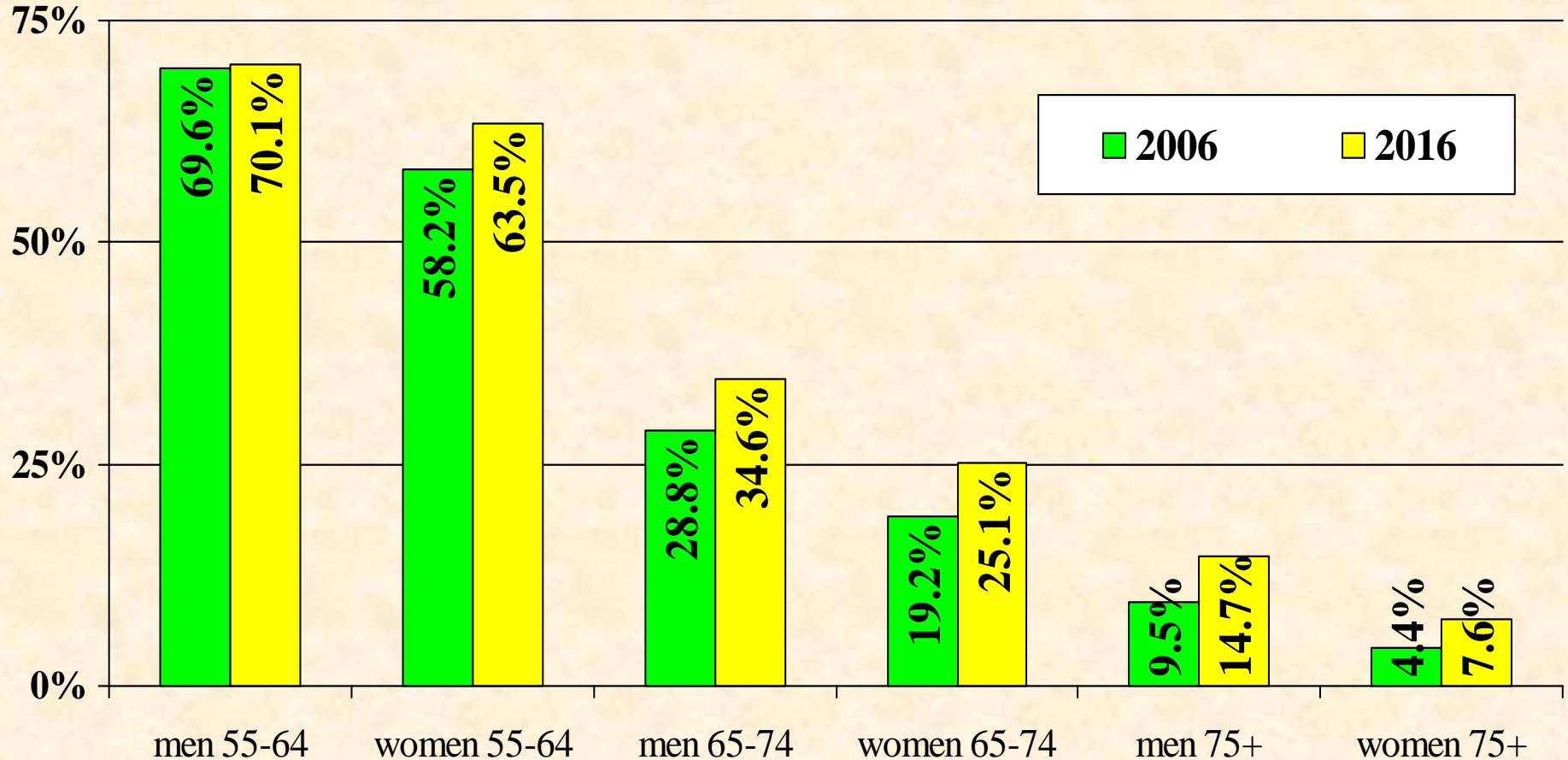
Age When Workers Plan to Retire





Past and Projected Labor Force Participation Rates, by Age Group

Participation Rate



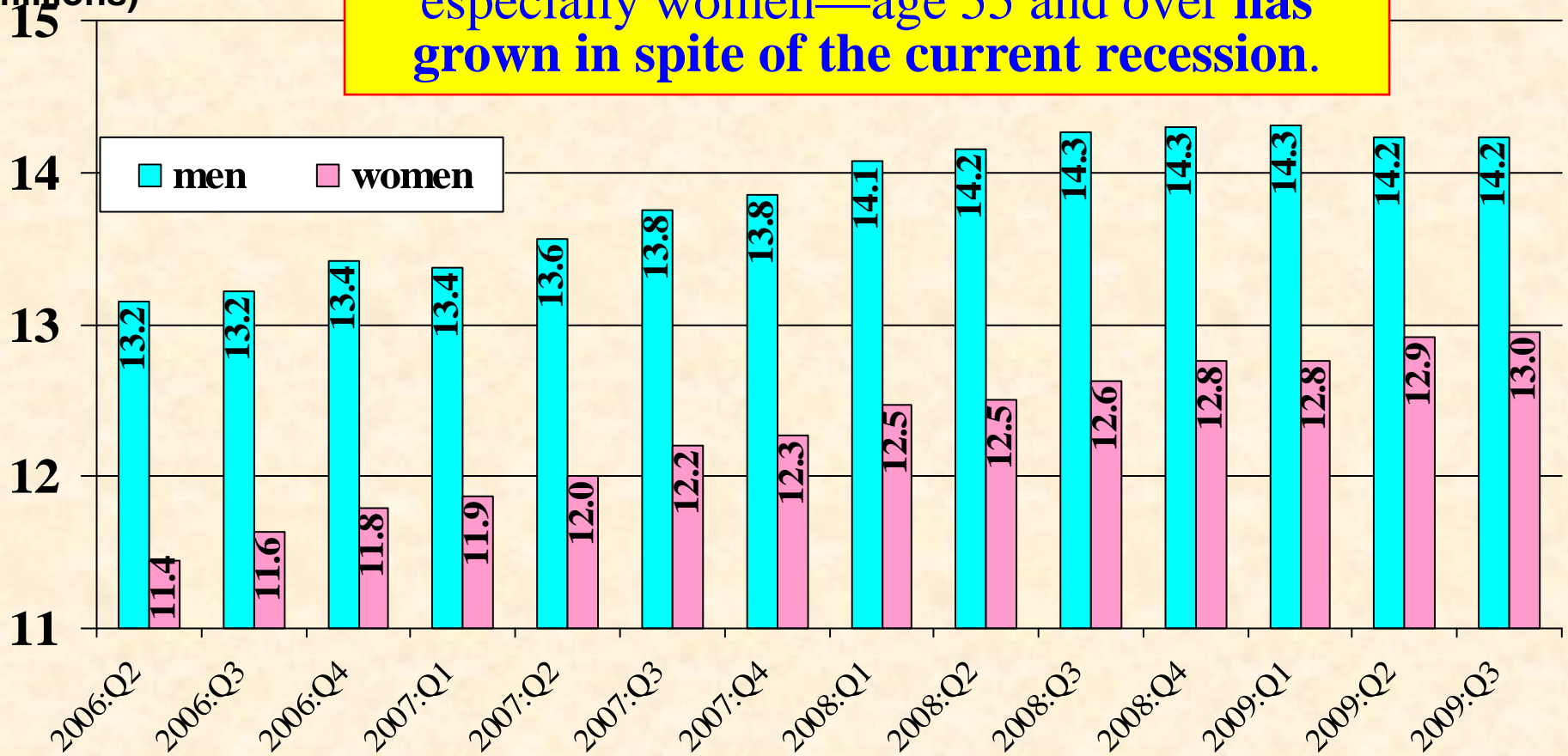
Source: Mitra Toossi, "Labor force projections to 2016: more workers in their golden years," *Monthly Labor Review*, November 2007, Table 3.



Labor Force Participation, Ages 55 and Over, 2006:Q2-2009:Q3

Labor force participation by workers—especially women—age 55 and over has grown in spite of the current recession.

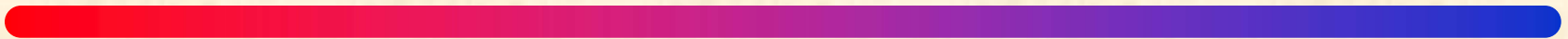
Labor Force (millions)



Source: US Bureau of Labor Statistics, <http://www.bls.gov/web/cpseed6.pdf>
seasonally adjusted quarterly averages

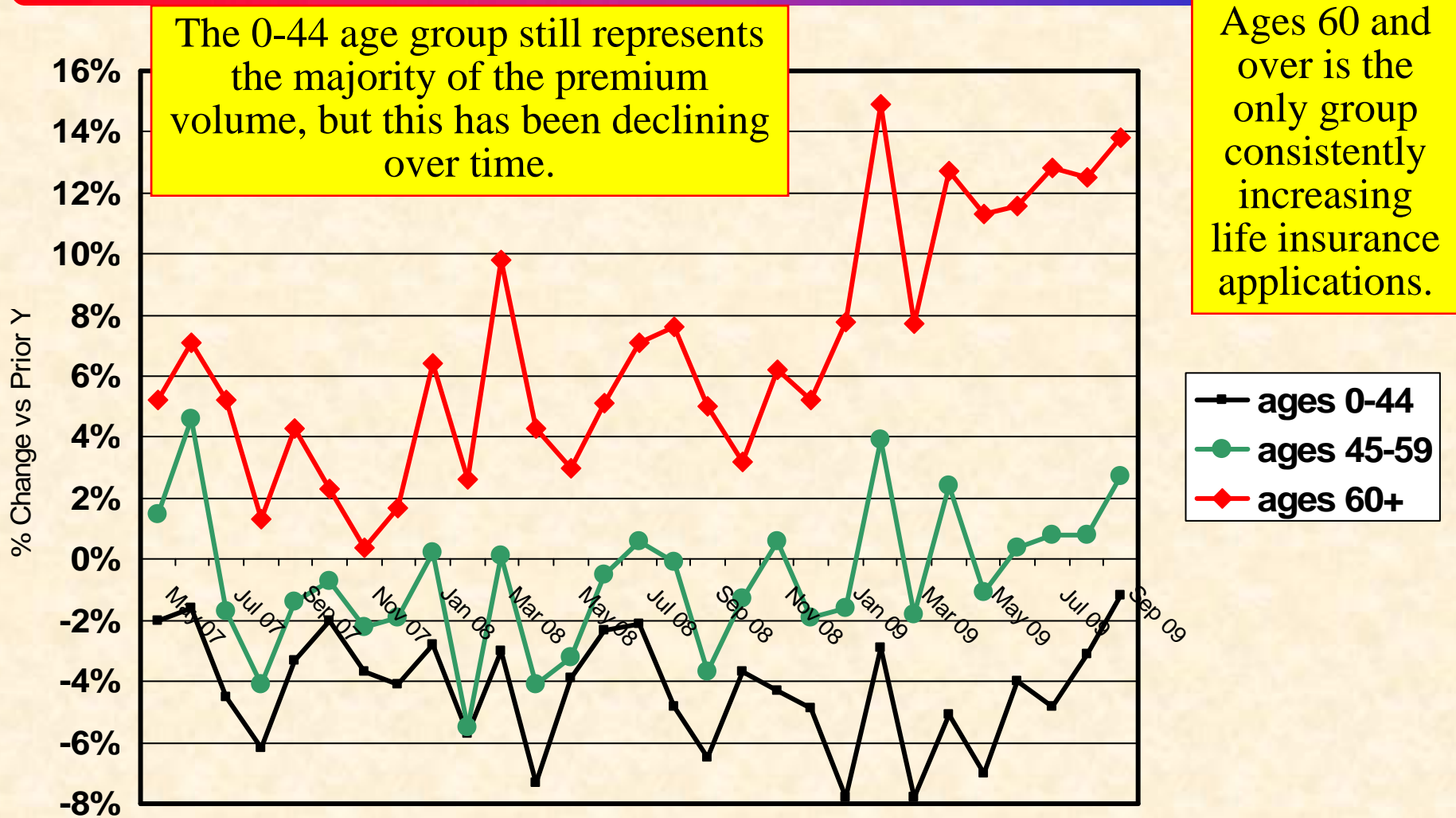
People Over 60 are Increasingly Buying Individual Life Insurance

They're the only age group like this





Percent Change* in Applications for Individual U.S. Life Insurance Policies, May 2007- Sep 2009



The 0-44 age group still represents the majority of the premium volume, but this has been declining over time.

Ages 60 and over is the only group consistently increasing life insurance applications.

—■— ages 0-44
—●— ages 45-59
—◆— ages 60+

*vs. same month, prior year
Source: MIB Life Index, monthly releases



*Not Just Retirees: Many People Don't Know
Where They're Going or How to Get There*

Retirees Need A Financial Roadmap



Source: National Underwriter (L/H), June xx, 2008, p. xx



Cover Art for July/August 2008 Issue of AARP Bulletin





Conclusion:
People Need Help
Constructing Their Own
Financial Safety Net

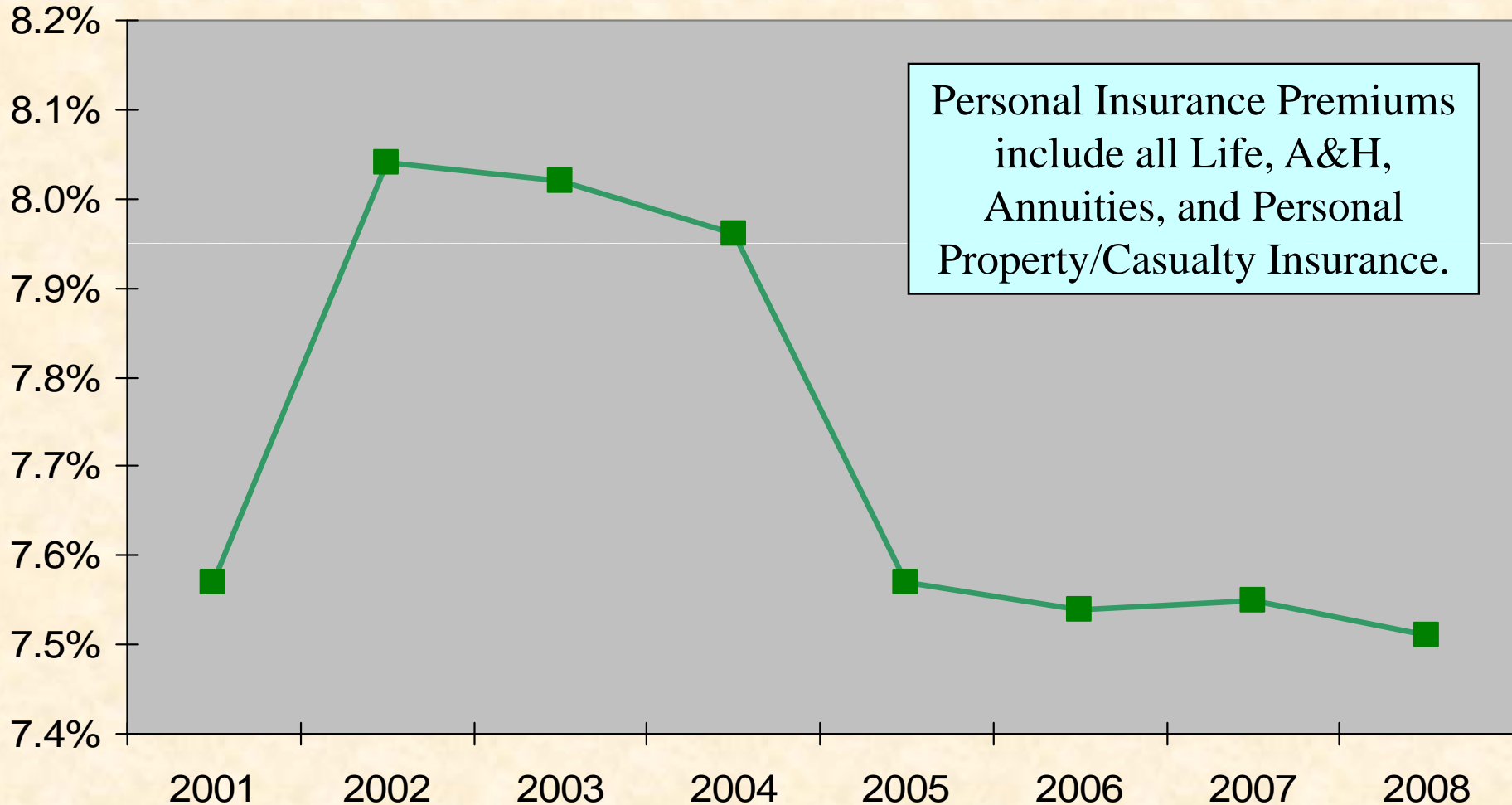


Step 1:
Give Them a Spending Target

*What Percent of Income
Should People Spend
to Assure
Their Financial Security?*



As a Percent of Personal (Gross) Income, Personal Insurance Premiums Are Down



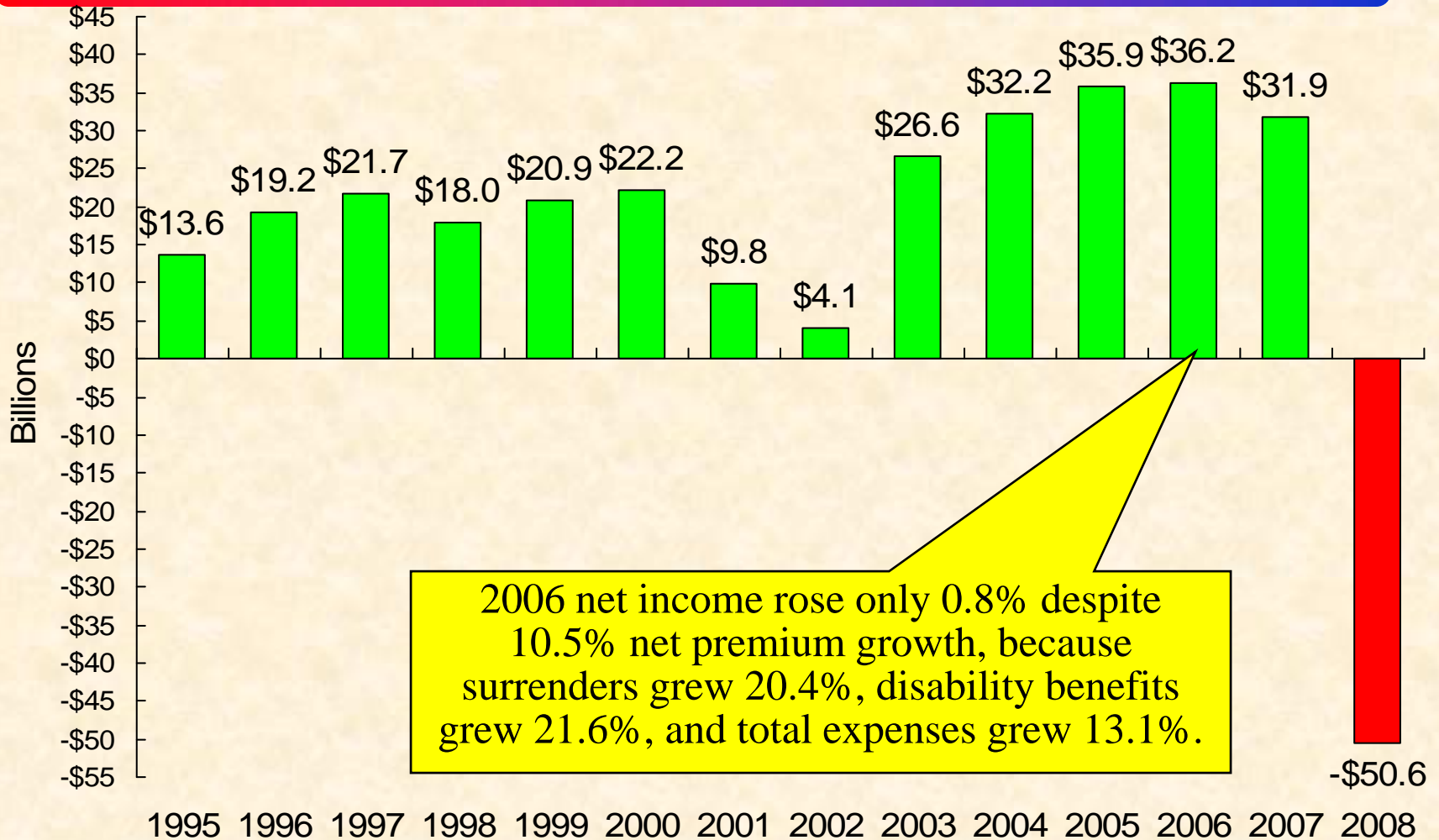
Sources: <http://www.bea.gov/national/xls/gdplev.xls> , *Best's Aggregates and Averages, Life/Health, 2009 Edition*, p. 173 and *Property/Casualty 2009 edition*, p. 573., I.I.I. calculations



L-H Industry Profitability

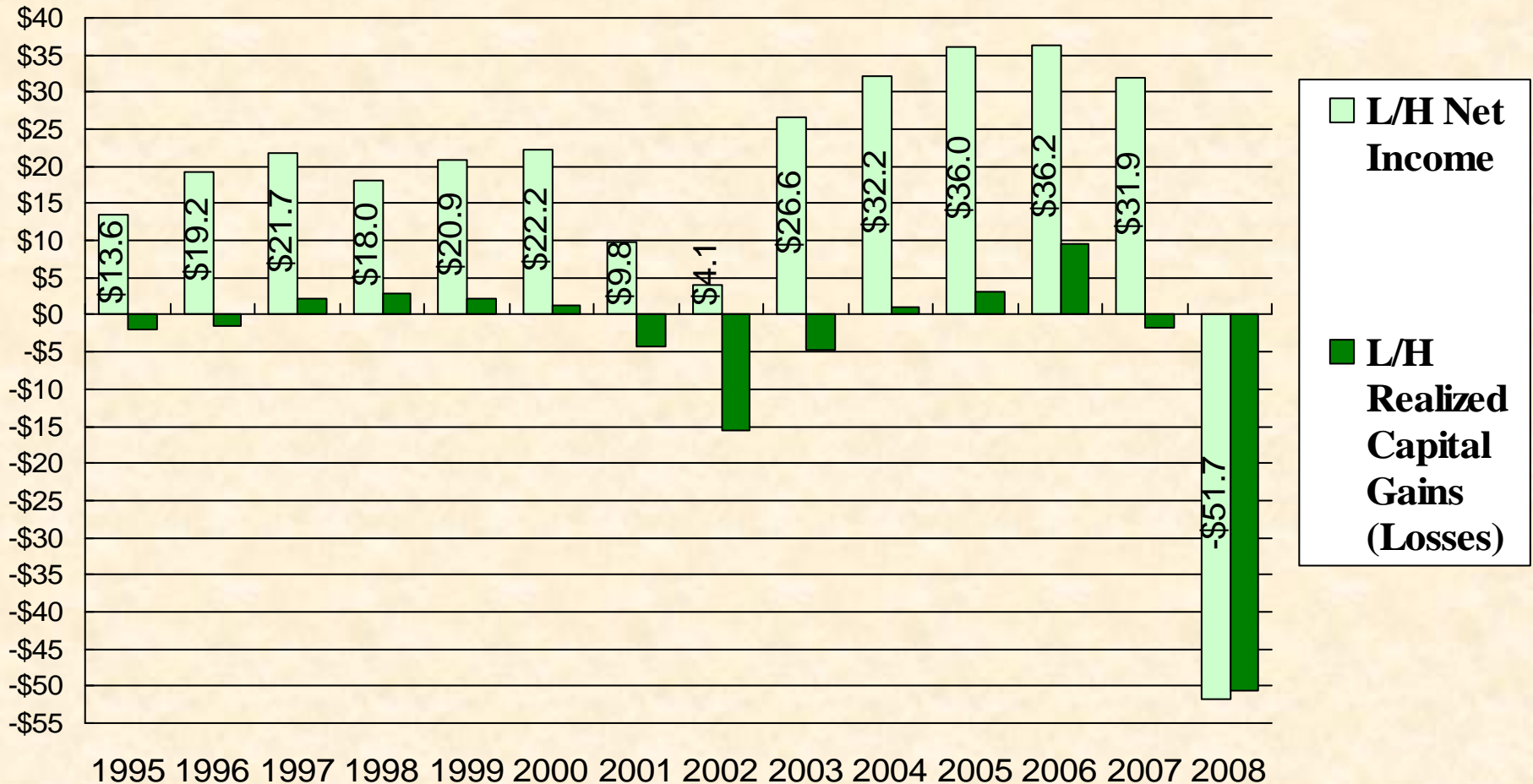


L/H Industry Net Income, 1995-2008





Effect of Realized Capital Gains/ Losses on Net Income, 1995-2008

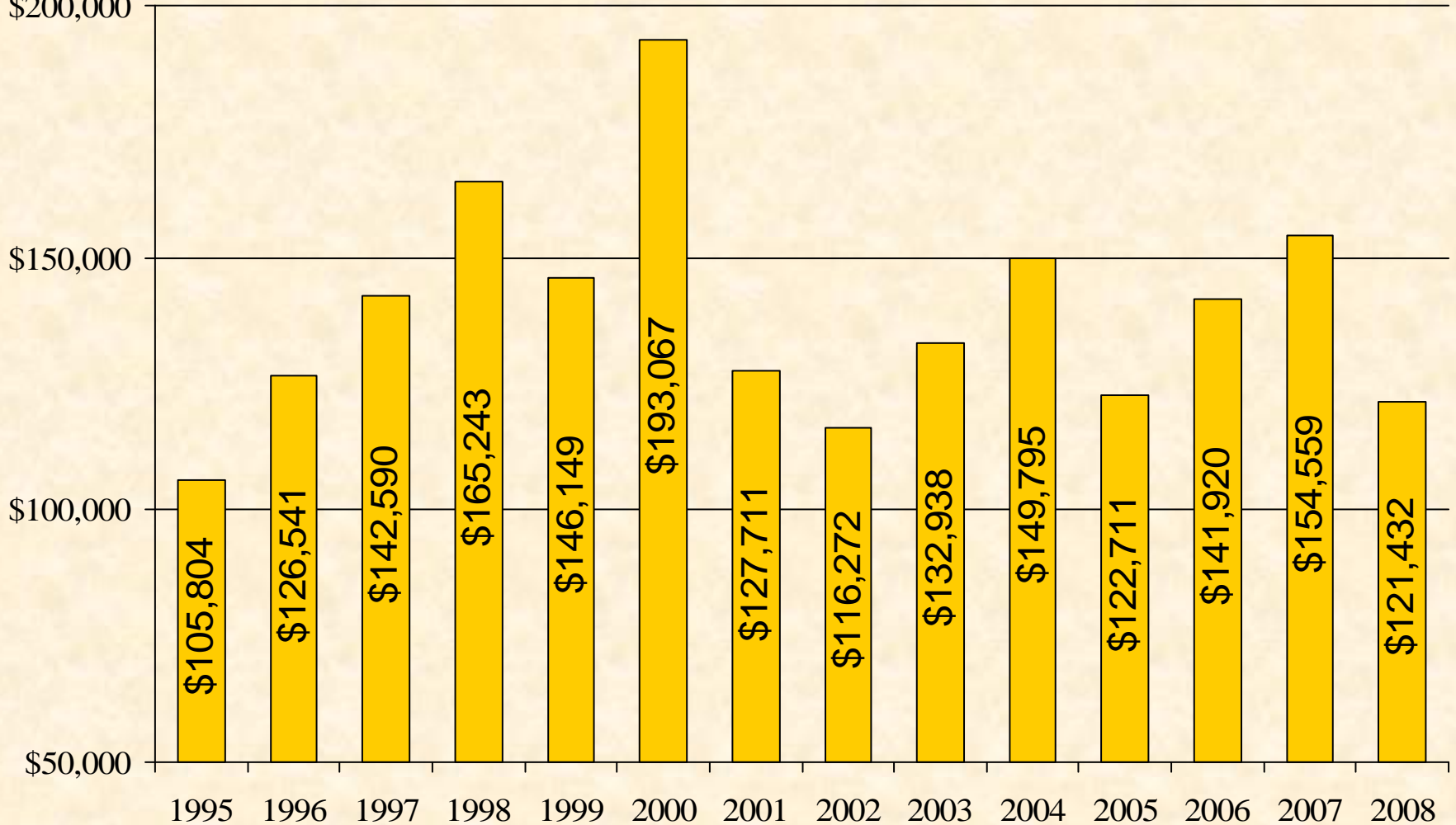


Source: NAIC Annual Statement data, Summary of Operations and Exhibit of Capital Gains (Losses) from Highline National Underwriter



Life Insurer Operating Expenses, (excl. Commissions) 1995-2008

\$ Millions
\$200,000



Source: Best's Aggregates and Averages, Life/Health, 2009 Edition



Summary & Conclusion

- The capital markets are still weighed down by the housing market and lenders' reluctance to lend
- Given the present and likely future unemployment picture, the economy is unlikely to show signs of recovery in the near term
- Sales of individual life insurance policies have been trending down for 6 years
- Trend toward increasing labor force participation by those over 55 seems likely to continue
 - These people have been increasingly buying life insurance



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