Expert Views

Impact of the Pandemic on Life Insurance Lapses

US Lapse Survey Report

SCOR
The Art & Science of Risk

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Introduction

The Covid-19 pandemic impacted many aspects of the life insurance industry. While it initially caused significant disruptions to the business, life insurance sales recorded double-digit growth, driven by increased consumer needs for protection and accelerated digitization. The pandemic transformed consumer behavior and attitudes toward life insurance purchases. But what about its impact on existing life insurance policies? Were there any significant changes to policyholder behavior, such as lapse rates?

In spring 2022, SCOR conducted a survey among US life insurance companies investigating policyholder behavior during the Covid-19 pandemic. The purpose of the survey was to identify how lapses changed during 2020-21 and how these extraordinary years affected the insurance industry. The insights from this survey will help companies put their experiences in a larger context and prepare for what comes next as we shift to the post-pandemic world.

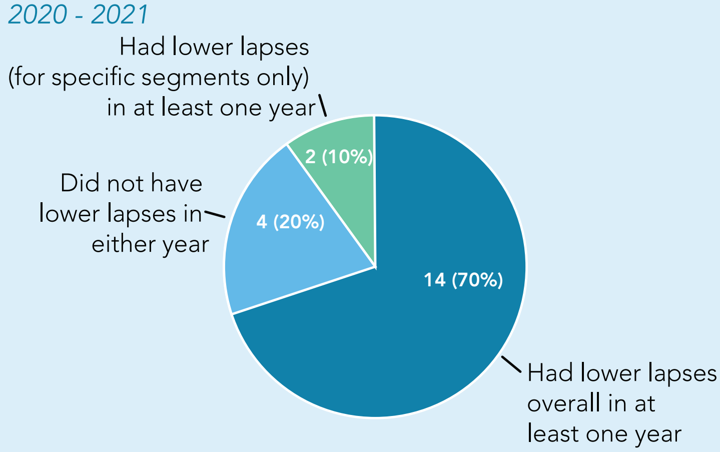
Results: 2020 Lapses

The results of the study were split between the 2020 and 2021 experiences. For lapses in 2020, 13 companies out of 20 (65%) saw lower lapses compared to prior years. One other company identified lower lapses only for the agent-sold business, attributing the distribution channel difference to the additional value an advisor can communicate rather than what develops naturally from online internet marketing sales.

For the 14 companies that saw lower lapses during 2020, we asked for more details about whether they noticed any differences in lapse rates by product type, age groups, face amounts, durations, or other significant factors. In regard to product type, most companies saw lower lapses across the board. Even those that identified differences between Perm and Term suggested that lapses were lower for both, although they might have been comparatively more so for one line. For these companies, there wasn't consistency in whether Term or Perm lapses were lower - some noted lower lapses for policies with cash values, while others noted a bigger decrease in their Term book.

Of the companies who analyzed their lower 2020 lapses at a more granular level, a small number of companies noted variation by age. However, the results were varied — two participants suggested they had the lowest lapses at older ages, while two other companies identified specific segments having higher or lower lapses. Meanwhile, four companies confirmed seeing lower lapses across

Figure 1: Lapse Rates 2020 - 2021



all age groups. As for durations and face amounts, companies that commented noted lower lapses at all durations and across all face amounts.

Overall, the main finding from the 2020 experience section tells us that lapses decreased in the first year of the pandemic compared to pre-pandemic norms. Most companies noted this decrease across the board, with little consistent variation in subgroups.

Results: 2021 Lapses

Next, we examined the 2021 lapse experience to identify if this effect lasted across the two years of the pandemic or if 2021 was different from 2020.

Of those 14 companies that saw lower lapses in 2020, six (43%) reported that 2021 was similar to 2020, i.e., they maintained their lapse rates lower than the pre-2020 level throughout the pandemic. Meanwhile, three companies saw their lapses decreased in 2020 and fell further in 2021.

Three other companies saw changes for specific segments. Product differences were the most common deviation noted, with some identifying higher lapses for universal life products and lower lapses for whole life. One company identified the lowest renewal lapses on record while also seeing lower first-year lapses.

Another company identified a delayed lapse due to the end of the accommodation programs and extended grace periods. While they saw lower lapses in 2020, their 2021 lapses were higher.

How did those six companies that did not experience lower 2020 lapse rates do in 2021? Three of them continued to see no change from prior years. The other three had a variety of different experiences mainly attributed to product lines. One company noted higher lapses in 2021 than in pre-pandemic years—they saw this at early policy durations.

Overall, across the two years when the pandemic was a dominant part of the landscape, 14 companies (70%) saw lower lapses in at least one year (Figure 1). Two other companies saw lower lapses for specific segments in either 2020 or 2021 or both. This leaves only four companies (20%) that did not see lower lapses during the pandemic.

Conversions, Post-Level Term, and Grace Periods

Our survey also asked about conversions, post-level term (PLT), and the impact of grace period extensions to get a more rounded view of policyholder behavior. Half of the respondents saw no conversion behavior change in 2020 or 2021 compared to prior years. Three companies said they did not track conversion behavior. The seven who observed changes in conversion behavior reported a mix of increases and decreases in the exercising of conversions during the pandemic.

On PLT, only six companies (30%) tracked this information, of which, four reported lower lapses; two of them identified no change in shock lapse at the end of the term, with lower lapses coming later in the PLT period. This supports the idea that the premium increase at the end of the term is the more significant driver of the policyholder behavior than the influence of the pandemic. One company saw lower PLT lapses in 2020 and a return to usual in 2021, while the remaining company noted higher lapses attributed to more active searching at the end of the term.

Grace period extensions were among the policyholder protections brought in during the pandemic. They varied in duration in different states, with many continuing through Q2 and even into Q3 2020.

Understandably, the most common impact of these measures identified by companies was administrative complexity. However, most companies noted limited take-up of these accommodations. As a result, there was not a significant uptick in lapses after the end of the extended protection, as one would expect if the grace period extensions had been driving the lower lapse rates at the start of the pandemic. Though they were not widely utilized, three companies identified that these programs successfully retained those that would have lapsed otherwise due to affordability.

Reasons for Lapse

Our survey asked respondent companies about reasons for their policyholders' lapses. We found that most participants do not track this type of information. Those who tracked noted affordability as the main driver of lapses, followed by the changing needs of the consumer.

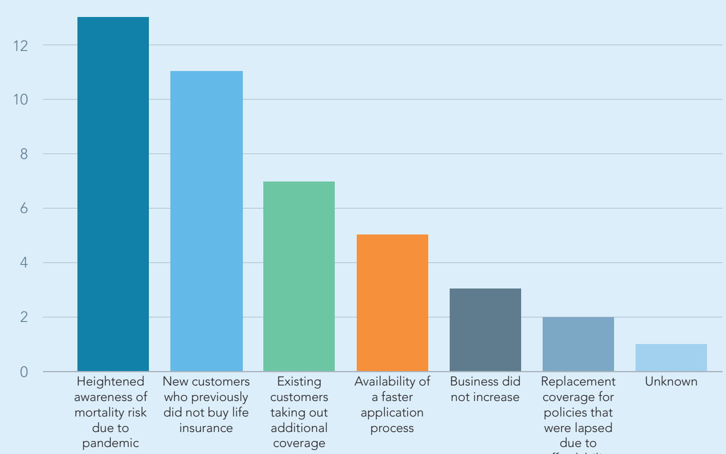
New Business

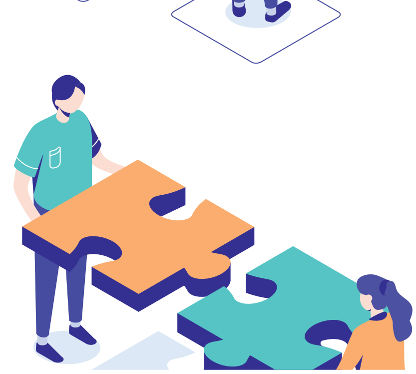
Let us shift our focus from lapses to new business sales. Our survey results and external sources both confirmed an increase in new business sales through 2020 and 2021. MIB reported that the increases in application activity in 2020 and 2021 were the highest ever over the past 10-year period. LIMRA International also reported significant increases in life insurance sales in 2020 and 2021.

Multiple factors could have contributed to this increase in new business. From a behavioral science perspective, one factor could be availability bias, which is the tendency to be strongly influenced by the information that is most easily available. The constant news of the soaring death toll from the pandemic people were exposed to in the past years may have led to the heightened awareness of mortality risk and the increased interest in life insurance. Improved accessibility of life insurance through online channels and the expansion of accelerated underwriting also contributed to the increase in life sales.

To gain a deeper understanding, we asked the survey participating companies that experienced a new business increase during the pandemic (85% of all respondents) what contributed to the growth. Their answers are shown in Figure 2. Thirteen companies (65%) said pandemic awareness was one reason for the increase. Only five (25%) said increased accessibility was a driver. Based on this result, we consider this was a temporary increase driven by the pandemic and the trend will not likely be sustainable. We anticipate that the pace of life sales growth will reduce as the pandemic becomes endemic.

Figure 2: Reasons for New Business Increase in 2020-2021





Future Outlook

In our discussions with participant companies following the survey, we asked how they were planning to treat these lapse data gathered in 2020 and 2021. Are these years best considered an exception to be ignored when setting long-term expectations? Or will the changes caused by the pandemic affect the lapse experience far beyond the current period?

Many companies expressed their skepticism about integrating pandemic-related trends in their long-term assumptions, viewing the pandemic years as a 'hiccup.' However, some companies are considering using short-term adjustments to their models to account for the effect of Covid. In addition, some companies identified potential long-term changes coming out of the impact that could be considered in setting future lapse assumptions to include trends such as lifestyle changes and increasing accessibility of insurance. The changing economic environment will also be a factor to monitor. No matter which direction each company takes, one thing is for certain – the pandemic has brought a dynamic change in consumers' attitudes toward life insurance. This offers both challenges and opportunities to the industry. As the pandemic effect has faded and new threats and volatilities emerge, it is critical more than ever, that insurers have a deep understanding of policyholder behavior and reflect it on their long-term risk models.

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