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Efficiency gains boost insurers' profits

After some difficult years, the life insurance industry experienced a turnaround in 2003, and the road ahead for 2004 appears relatively smooth. Many of the issues that had beleaguered the sector since the late 1990s appear to have been resolved or at least are being addressed. Credit quality has improved significantly, the financial markets seem to be more stable, and consumers continue to seek insurance and annuity products as attractive options for securing retirement income.

Given our confidence in the industry's potential for top-line growth, we expect companies to focus their resources on generating efficiencies — an area that we believe will be one of the key performance drivers in 2004. We believe that the most competitive companies in the sector will continue to implement aggressive expense control initiatives, particularly in distribution, training, servicing, and asset/liability management. The drive toward increased operating efficiency will also require large investments in technology.

This trend may drive smaller companies to consolidate operations, focus on niche business opportunities, or exit the industry altogether. Therefore, we expect that the gap between the industry's largest and smallest competitors will continue to widen. We do not expect that the industry will experience many mergers of large companies, like Manulife Financial Corp.'s $10.8 billion acquisition of John Hancock Financial Services Inc., which was completed in late April 2004. However, we believe that the trend toward industry consolidation will continue, with large competitors acquiring smaller independent companies.

Review of 2003

For the life insurance industry, 2003 was a turnaround year. At the beginning of the year, several companies were faced with reserving requirements, declining credit quality, and the prospect of weak top-line growth. As 2003 progressed, however, equity markets improved, and concerns about the mutual fund industry made insurance companies' retirement products more attractive. The year ended much stronger than anticipated, and most of the companies in the industry topped analysts' earnings expectations when year-end results were released in early 2004.

Based on the aggregate life insurance industry data collected and published by A.M. Best Co., an insurance reasearch and statistical gathering firm, life insurance net written premiums totaled approximately $520 billion in 2003, up 7.2% from year-earlier levels. This healthy rate of growth was driven mainly by double-digit premium gains recorded by a number of top-tier insurers. For example, Met Life Inc. (the largest life insurer based on year-end 2002 admitted assets) reported an 18% increase in 2003 net written premiums. Prudential Financial Inc. (the seventh-largest life insurer) posted an impressive 12% rise in its written premiums. A "flight to quality" by consumers seeking the safety of large, well-capitalized insurers could be a factor behind these rates of growth. However, some insurers posted declines: UnumProvident Corp., the thirtieth-largest life insurer, saw a 12.0% drop in written premiums. These varying rates of premium growth (or decline) likely are more attributable to individual companies' marketing programs and strategic plans than to their size and market presence.

For many participants, operating margins widened in 2003, as difficulties in 2002 led to significant efficiency initiatives. A record number of credit defaults and writedowns, coupled with a weak equity market, took their toll on the entire industry in 2002. That year, the life insurance industry incurred realized investment losses of $15.7 billion. The industry's unrealized investment losses were also significant, totaling just under $12.0 billion.

The low interest rate environment that existed during 2003 and the attendant rebound in fixed income markets helped boost the value of insurers' bond portfolios. However, the

TOP 20 WRITERS OF ORDINARY LIFE INSURANCE — 2002*

(Ranked by net premiums written)

	COMPANY	PREMIUMS (MIL. $)
1.	American International	10,288
2.	Northwestern Mutual	8,569
3.	Metropolitan Life	6,947
4.	New York Life Group	6,436
5.	Prudential of America	6,010
6.	ING Groep	4,502
7.	MassMutual Financial Group	3,500
8.	AEGON USA	3,459
9.	State Farm Group	2,814
10.	Swiss Reinsurance Group	2,596
11.	Equitable Group	2,373
12.	Citigroup	2,158
13.	Lincoln National	2,059
14.	Guardian Life	1,963
15.	John Hancock Financial Services	1,858
16.	Jefferson-Pilot	1,850
17.	Nationwide	1,754
18.	Hartford Life	1,719
19.	Pacific Life	1,504
20.	Phoenix Life Group	1,481

*Latest available.
Source: A.M. Best Co.

low rate environment also limited gains in net investment income. (For many insurers, investment income constitutes 20% to 30% or more of total revenues.) Fee-based revenues increased in 2003, since much of this business is based on assets under management, which grew along with the equity markets last year.

At year-end 2003, the capital and surplus of the life insurance industry totaled $210.6 billion, up 8% from year-earlier levels. Along with the modest increase in operating profits, this rise likely reflects capital contributions by companies seeking to maintain their claims paying ratings.

Insurance stocks post gains

In 2003, the US equity market posted its strongest gains since 1998, and many segments of the market, including the financial sector (which includes banks, asset managers, insurers, and other financial services companies) posted sharp increases. However, concerns over certain issues in the life insurance sector, such as credit quality, price competition, and reserving requirements, dampened investor's enthusiasm. As a result, the sector narrowly underperformed the broader averages. The S&P Life & Health Insurance Stock Price Index increased 25.2% during 2003, while the broader S&P 1500 SuperComposite Stock Index rose 27.4% and the S&P Financials Sector Index rose 28.3%. Through much of 2003, the insurance sector index lagged the S&P 1500 by 400 to 600 basis points, but picked up momentum in the latter part of the year as companies began to demonstrate increased financial flexibility and as investment income and premium growth began to exceed expectations.

It appears that the market's confidence in the sector continues to advance: strong demand for retirement products and the stable equity environment are driving sales, and efficiency initiatives are beginning to generate noticeable gains in operating earnings. As a result, the life insurance sector outperformed the broader indexes year-to-date through March 31, 2004. After surprisingly strong fourth-quarter results and with indications of a promising first quarter, the S&P Life & Health Insurance Index rose 9.3% in the first quarter of 2004, outperforming both the S&P 1500 (up 1.8%) and the S&P Financials Sector (up 4.5%).

Variable annuities resilient, despite challenges

The variable annuity industry has shown its vitality once again, posting double-digit sales growth during 2003. While this forward momentum is attributable largely to a rebound in the equity markets, variable annuity writers have done an admirable job of countering the challenges of an adverse tax ruling, spread compression, and growing demand for special product incentives and guarantees.

Based on data from LIMRA International, an industry trade organization, sales of variable annuities totaled $129.2 billion in 2003, up 11% from $116.6 billion in 2002. Standard & Poor's projects that variable annuity sales will reach $136.5 billion in 2004 — assuming the US economy continues to recover and that there are no further changes to the tax code.

What is noteworthy is this industry's ability to consistently produce top-line growth in the face of challenges, including the changes in the tax code enacted in May 2003 that have reduced variable annuities' attractiveness relative to other investment vehicles. The tax cut on dividends and capital gains has rendered mu-

TOP 20 WRITERS OF GROUP LIFE INSURANCE — 2002*

(Ranked by net premiums written)

	COMPANY	PREMIUMS (MIL. $)
1.	Metropolitan Life	5,703
2.	Prudential of America	3,040
3.	CIGNA Group	1,684
4.	Hartford Life	1,448
5.	Sun Life Canada Group	1,089
6.	Aetna Inc. Group	1,041
7.	UnumProvident Corp.	951
8.	MassMutual Financial Group	776
9.	Zurich Insurance Group	721
10.	Minnesota Mutual	702
11.	ING Groep	699
12.	New York Life	663
13.	Fortis	625
14.	StanCorp Financial Group	453
15.	AEGON USA	450
16.	American International	441
17.	Forethought Group	434
18.	Health Care Service	384
19.	WellPoint Health Networks	287
20.	CUNA Mutual Group	272

*Latest available.
Source: A.M. Best Co.

tual funds and direct ownership of stocks more attractive relative to annuities. To counter this competitive threat, many variable annuity writers have successfully emphasized the underlying insurance death benefits of the annuity contract. To remain competitive, many other writers have had to include a number of optional living benefits in their contracts.

The growing popularity of product enhancements and guarantees can be seen in the latest available sales numbers. According to data obtained from *The VARDS Report*, published by financial services reasearch firm Finetre Corp., six of the top 25 variable annuity contracts (ranked by year-to-date new sales) had sales ratios in excess of 100% in the first half of 2003. In other words, these annuity products posted higher sales in the first six months of 2003 than for all of 2002. Five of these contracts offered a guaranteed minimum income benefit, while a sixth offered a guaranteed minimum withdrawal benefit. All of the top-selling products offered optional death benefit guarantees.

Product enhancements pressure margins

Until about 10 years ago, variable annuity writers typically provided only a modest minimum death benefit guarantee on variable annuity contracts. The guarantee, also called a "return of premium" feature, usually provided that upon the death of the annuity contract holder, the estate would receive either the account balance at the time of death, or the sum of premium deposits (less partial withdrawals) since inception of the annuity contract, whichever was larger. Because the costs associated with this guarantee provision were not significant, reserving for this type of exposure was never an issue for insurance companies.

By the mid-1990s, however, as both the equity markets and the variable annuity business grew, the underlying account values in many annuity contracts burgeoned. Competition in the variable annuity market also increased, as many insurance companies viewed it as a way to bridge the ever-widening gap between insurance and other financial services products, and to ramp up their growth and return on equity amid a converging financial services playing field. To remain competitive, many variable annuity writers began expanding the scope of the minimum benefit guarantees to include a provision that would reset the value of the guarantee to keep pace with the appreciation of the underlying assets. One of the first adjustments (or enhancements) that was made to the guarantee provision was to redefine the benefit as the larger of two figures: the account value at the time of the contract holder's death, or the account value as of the last "reset" date, plus the sum of premium deposits less partial withdrawals since the reset date.

With equity markets climbing steadily, these guarantees proved to be manageable, since the underlying value of the assets was greater than the amount of the guarantees. However, with the downturn in the equity markets from 2000 through 2002, the guarantee provisions began to be burdensome. Although the recent rally in equity markets has relieved some of this pressure, a number of companies have nevertheless found it very difficult to meet the obligations implied in the guarantee provisions contained in some of their variable annuity contracts. Exacerbating these pressures is the lack of available reinsurance coverage that will enable insurers to offset this risk.

To counter the challenge posed by the May 2003 tax changes, many variable annuity writers have focused on the optional living benefit riders that are available under many variable annuity contracts. These riders usually take one of several forms: a guaranteed income benefit, a guaranteed accumulation benefit, or a guaranteed withdrawal benefit. In the case of the guaranteed income benefit, it is usually marketed as a hedge against equity market uncertainty. In many annuity contracts, the benefit can only be exercised after a waiting period (10 years, in many cases). At that point, the annuity contract provides the annuitant with a guaranteed stream of income. The amount of the "guaranteed fixed lifetime income" is based on a number of variables, including a compounding rate and certain asset valuation reset rates.

Although the terms of variable annuity contracts can vary slightly from company to company and will likely continue to evolve as the industry refines its products to meet ongoing competitive challenges, it is important to note the implications these issues have for the overall industry. While the annuity contract holder absorbs a great deal of the market risk in a variable annuity contract, the emergence of numerous benefit riders and guarantees has shifted a significant amount of risk back to the annuity writer. Annuity writers can offset this risk through reinsurance and hedging strategies, for example, but these options are costly and can further erode insurers' profit margins.

As margins come under pressure, economies of scale become more important. That in turn will likely spur some consolidation with the ranks of annuity writers. Indeed, evidence of substantial concentration can be seen in the latest available industry data. At June 30, 2003, the top 10 companies controlled 71% of the industry's $880.1 billion in assets, while the top five writers controlled 52% of the industry's assets. The top two writers — TIAA-CREF and Hartford Life Insurance Co. (a subsidiary of the Hartford Financial Services Group Inc.) — controlled 37% of industrywide assets at June 30, 2003.

New reserve standards proposed for annuities

Another issue that will likely pressure the financial results of variable annuity writers and could dampen their enthusiasm for variable annuity guarantees is the likelihood that companies will be required to set aside reserves for these guarantees. Currently, insurers are permitted a wide degree of latitude when reserving for this type of risk. However, in July 2003, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants issued a final statement of position (SOP) related to the accounting and reporting by insurance companies for certain "nontraditional and long duration contracts and for separate accounts."

The SOP has a number of provisions affecting variable annuity writers. One recommends recognizing expenses for a variety of contracts and contract features (including guaranteed minimum death benefits and certain annuitization options) on an accrual basis, versus the current method of recognition upon payment. In other words, insurers will have to set aside reserves for these future payments. Companies will have to determine the magnitude of this liability based on a number of assumptions, including (but not limited to) expected market rates of return on the assets underlying these annuity contracts, market volatility, and contract surrender and mortality rates. The SOP is effective for financial statements for fiscal years beginning after December 15, 2003.

The Financial Accounting Standards Board (FASB) is considering adopting a standard of practice in establishing such reserves. The implementation of an accounting standard will bring a degree of uniformity to reported results, but the short-term financial impact on a number of firms could be material.

Positive outlook for 2004

We forecast that 2004 will be a stable year for the insurance industry. The industry is mature, so we expect total revenue growth will be moderate as consumers renew policies. Although we do not see a major catalyst for revolutionary products that will send top-line growth surging, we believe that the aging of the baby boom population will create a strong and growing demand for new product development and design, particularly in the areas of wealth transfer and protection. We project average premium growth in the mid-single digits, largely on modest rate increases, the policy renewal cycle, and moderately higher fee income.

We are currently forecasting that average operating earnings per share will grow 9%

to 11% in 2004. We expect most companies to generate moderately higher efficiency gains stemming from technology improvements, better recruiting and training of agents, distribution advances, and tighter servicing procedures. The larger companies will continue to benefit from economies of scale and are best positioned to post the most significant gains. Given the improving capital position of many of the companies in the sector, we believe that our estimates may be conservative. In addition, several companies will likely exceed our forecast for per-share growth as a result of significant share repurchase programs.

Changing with the times

According to the latest available data obtained from A.M. Best Co. Inc., an insurance research and statistical gathering firm, life insurance in force in the United States at year-end 2002 (latest available) totaled $26.6 trillion, up 6.4% from $25.0 trillion a year earlier. (Life insurance in force is the aggregate face value of insurers' portfolios. Ongoing changes in the universe of companies and certain restatements mean that year-to-year numbers may not always be strictly comparable.) Of the amount in force at year-end 2002, term life insurance accounted for 44%; group life insurance, 30%; whole life insurance, 25%; and credit and other life insurance, the remaining 1%.

Approximately 60% to 70% of US households own some form of life insurance. According to data from A.M. Best, the average ordinary life insurance policy issued in 2002 equaled $119,848, up 4.7% from $114,430 in 2001, but still well below the peak of $133,266 in 2000. Within the overall category of individual life insurance, there are two broad policy types: term life and whole life. Term life provides coverage for a predetermined period: there are no further benefits when the term expires and no build-up of cash value. Whole life provides insurance protection for as long as the policyholder lives. Moreover, these policies have a savings component that increases over time (the build-up of cash value).

TOP 20 LIFE-HEALTH COMPANIES — 2002*

(Ranked by year-end assets)

	COMPANY	ASSETS (MIL. $)
1.	Metropolitan Life	244,975
2.	American International	233,668
3.	Prudential of America	205,733
4.	AEGON USA	144,535
5.	TIAA Group	144,478
6.	Hartford Life	136,833
7.	ING Groep	125,907
8.	New York Life	121,939
9.	Northwestern Mutual	102,935
10.	Nationwide	87,440
11.	MassMutual Financial Group	84,208
12.	John Hancock Financial Services	79,332
13.	Equitable Group	78,706
14.	Principal Life Insurance	78,002
15.	Citigroup	75,021
16.	CIGNA Corp.	72,252
17.	Lincoln National	70,964
18.	GE Financial Assurance	70,110
19.	Allstate Financial	63,792
20.	American Express Financial	55,134

*Latest available.
Source: A.M. Best Co.

In recent years, life insurance companies have expanded their whole life product offerings to include different premium payment patterns and cash value investment options. These alternatives include variable life, universal life, and variable universal life. (A more detailed discussion of these policies can be found in the "How the Industry Operates" section of this *Survey*.)

Although there were approximately 1,500 life insurance companies in business in the United States at the end of 2002, the life insurance market (particularly for "traditional" life insurance products) is dominated by a handful of insurers. According to A.M. Best, the country's three largest life insurers — Metropolitan Life Insurance Co., American International Group, and Prudential Insurance Co. of America — accounted for 20% of the industry's total admitted assets at year-end 2002. The top 10 accounted for 45%.

INDUSTRY TRENDS

Numerous forces, both external and internal, are affecting the life insurance industry today, creating both obstacles and opportunities. Changes in the demographic and competitive landscape are forcing insurers to contend with an aging population's need to save for retirement and with the ongoing competitive threat from banks and securities brokers. The struggling US economy and

TOP 20 WRITERS OF INDIVIDUAL ANNUITIES — 2002*

(Ranked by net premiums written)

	COMPANY	PREMIUMS (MIL. $)
1.	American International Group	17,161
2.	AEGON USA	12,187
3.	TIAA Group	8,001
4.	Allianz Insurance Group	7,993
5.	Metropolitan Life	7,685
6.	Hartford Life	7,509
7.	American Express Financial	6,774
8.	Jackson National	5,664
9.	Citigroup	5,574
10.	GE Financial	5,251
11.	Lincoln National	4,816
12.	New York Life	4,810
13.	Nationwide	4,606
14.	Pacific Life	4,501
15.	ING Groep	4,356
16.	Old Mutual US Life Holdings	3,844
17.	Allstate Financial	3,682
18.	John Hancock Financial Services	3,252
19.	Sun Life of Canada	3,158
20.	Allmerica Financial	2,545

*Latest available.
Source: A.M. Best Co.

weak equity markets that persisted through 2002 and for part of 2003 exacerbated many of these challenges.

Demographic, competitive, and legislative changes

The forces shaping the life insurance industry today stem from a number of demographic changes and from structural changes within the financial services marketplace. Specifically, baby boomers' realization that they may not have the financial safety net of Social Security has led to a heightened awareness of the need to save for retirement. Along with traditional concerns about dying young, people are also worried about the probability of living longer — and outliving their financial resources.

Moreover, a shift in pension trends — from defined benefit plans to defined contribution plans, such as 401(k) plans — has given many Americans a greater sense of financial empowerment. Many people use technology such as the Internet to filter the vast array of information available to them as they plan their financial futures. These factors have greatly changed the selling process and will probably chip away at the old maxim that "life insurance is sold, not bought."

Exacerbating the impact of demographic change is the breakdown of the barriers that once separated the various sectors of the financial services industry. Banks and brokerage houses now sell more annuities than do life insurance agents. Life insurance agents, in turn, now sell investment-oriented products, including mutual funds.

This breakdown of cross-segment barriers has hurt many life insurers' competitive positions in the financial services marketplace. To counter this threat, many have re-evaluated their product mix and distribution channels. Others are joining forces in an effort to gain economies of scale and become more cost-efficient.

Although life insurance remains a mature, relatively slow-growth business, the challenges facing it have sparked some dynamic changes. Many insurers have undertaken major restructuring programs in an attempt to reshape their market image. A number of insurers have launched aggressive variable annuity sales programs in an effort to ramp up growth. However, several years of declining equity markets have dampened enthusiasm for equity-linked products like variable annuities. Coupled with the pending accounting change that will require insurers to post reserves for certain components of their variable annuity contracts, it's likely that insurers will reassess their product mixes. Standard & Poor's anticipates that a number of insurers may pull back from the fee-based products arena and may resume a "back-to-basics" program of focusing on traditional life insurance products.

Many life insurers have also re-evaluated their ownership structures and concluded that being a mutual (owned by policyholders) puts them at a competitive disadvantage. However, several major insurers that converted to a stockholder-owned format (via demutualization) have discovered that operating under the heightened scrutiny given to a publicly owned company is a mixed blessing.

M&A activity picks up steam

During 2003, rebounding equity markets and an increased appetite for growth helped fuel merger and acquisition (M&A) activity in the entire insurance sector. The earlier, rather widespread forecasts of consolidation within the life insurance sector were met with a lull as acquirers showed caution in completing deals and as potential acquisition targets made more aggressive demands. According to data obtained from SNL Securities, a financial services organization, 29 deals valued at $13.7 billion were announced in the life insurance sector in 2003. This contrasts rather sharply with the M&A environment that existed in 2002, when 27 deals valued at $3.1 billion were announced; this was a 10-year low. During 2001, 42 transactions valued at $33.9 billion were announced, though American International Group's $23.4 billion acquisition of American General Corp. skews that year's total.

In 2003, however, a rebound in the equity markets and improving balance sheets throughout the life insurance industry reignited acquisition activity. The number of deals announced increased 30% to 33 and the aggregate value of transactions rose almost 385% to $14.5 billion. Results in 2003 were skewed by Manulife Financial Corp.'s September 2003 announcement of its plan to acquire John Hancock in a deal valued at $10.8 billion. The other notable deal during 2003 was AXA's acquisition of MONY Group Inc., which was valued at $1.5 billion. The remaining deals during 2003 were all valued at $500 million or less.

Year-to-date through April 20, 2004, 12 deals valued at $2.6 billion were announced. Although Standard & Poor's does not anticipate that the transaction value of M&A activity in the sector will pick up significantly, the pace of smaller transactions seems to be building momentum.

Since stock is the currency of choice in most acquisitions, a sustained rebound in the equity markets would continue to help spur a recovery in M&A activity. Also, while many companies are more willing to "do a deal" for stock when their share prices have recovered, the procession of scandals surrounding Enron Corp., WorldCom Inc., Tyco International Ltd., and numerous others has left many companies hesitant to take on any additional risk. In the longer term, consolidation in the life insurance industry will be driven by the need to offset slowing revenue growth, compete in a converging financial services marketplace, cut costs, and achieve economies of scale.

Indeed, some firms are growing almost entirely through acquisitions, figuring that it's more cost-efficient to acquire in-force policies than to build critical mass through a start-up effort. Others are re-evaluating their business mix, narrowing their product focus, and evolving into "purer" life insurance companies. Some have targeted a particular market segment (*e.g.*, middle-class or affluent consumers) and are seeking to offer a broad range of financial services products to that particular group. Indeed, a fair amount of M&A activity going forward may be in the form of restructurings — companies selling off parts of their operations that no longer fit with their long-term strategic initiatives.

Thus, a number of strategic initiatives are boosting M&A activity. Although it is difficult to project the volume and timing of transactions, it's somewhat easier to predict the kinds of companies that might engage in this activity. In general, the most likely acquisition candidates are those firms with a presence in the retirement savings market (*i.e.*, annuities, pensions, and mutual funds), with a solid distribution pipeline, and with a franchise or brand name value. Likely buyers may be firms looking to offset slower growth in their core business, to gain a presence in the US marketplace, or simply to increase their presence in life insurance and retirement savings.

Demutualization's next phase

The trend toward "doing a deal" with stock has left mutual insurers, which do not issue stock, out of the acquisition game. Although most of the large mutual insurance companies have demutualized, a second wave of smaller demutualizations may occur, particularly after the economy and the equity markets recover. Many of these may take the form of sponsored demutualizations.

The concept of a mutual insurance company originated in England in 1696 and migrated to America in 1735, when Benjamin Franklin created the Union Fire Co. in Philadelphia. Mutual insurance companies are owned by their policyholders, who are entitled to vote for members of the company's board of directors. Mutual policyholders may also receive special dividends in the form of capital contributions. The capital base of a mutual insurer is called policyholders' surplus (or statutory capital).

A mutual insurance company exists solely to serve the needs of its policyholders. Consequently, the priorities of these companies are to provide low-cost policies and high-quality service to their policyholder owners. In contrast, stockholder-owned insurance companies must juggle the often-conflicting interests of their policyholder clients and shareholder owners. (For more information on the two forms of insurance company ownership, refer to the "How the Industry Operates" section of this *Survey*.)

Approximately 100 mutual life insurers are in business today, with some $40 billion of statutory capital and 100 million policyholders. Two of the largest life insurers in the United States — Prudential Insurance Co. of America and Metropolitan Life Insurance Co. — were both mutuals. Metropolitan demutualized in April 2000 and Prudential completed its demutualization in late December 2001.

Hancock and Met took the plunge...

On January 26, 2000, Boston-based John Hancock Financial Services Inc. added its name to the growing list of demutualized insurance companies. Formerly known as John Hancock Mutual Life Insurance Co. (the seventeenth largest life insurer at the time it demutualized), the company raised more than $1.7 billion in an initial public offering (IPO) of stock priced at $17 a share. (John Hancock was itself acquired in late April 2004 by Canada-based Manulife Financial; its shareholders received more than $46 a share.)

Hancock's policyholders approved the demutualization in late 1998. In seeking approval for the move, Steven L. Brown, Hancock's chairman and chief executive officer, wrote to policyholders: "Simply put, we are proposing to convert John Hancock from a 'mutual' to a 'stock' life insurance company, for the purpose of gaining access to capital to invest in the growth of our business." Mr. Brown noted that a mutual insurer, unlike its publicly owned competitors, could not fund future growth by issuing stock. "We believe our ability to raise money through the sale of stock is a necessary tool for succeeding in today's competitive financial services marketplace," he wrote.

Although the marketplace's initial reception to John Hancock's stock was rather cool, the shares later recovered. After peaking in late 2001 (along with the shares of many of its peer companies), John Hancock shares declined 48% during 2002. Some of that weakness can be attributed to general market weakness. (The S&P 500 Composite Stock Index was down 23.4% during 2002.) However, concerns over certain of Hancock's fixed-income investments made investors wary of the shares. Although the shares underperformed the broader market during 2002, they recovered in 2003, rising 34%. Their performance was helped by Manulife Financial's takeover bid, which was announced in September 2003; Hancock's stock was valued at approximately $46.19 a share shortly before the deal's completion on April 28, 2004.

In December 1998, New York–based Metropolitan Life Insurance Co. (at that time, the second-largest life insurer, based on admitted assets, behind Prudential) also decided to demutualize. Met Life's policyholders approved the demutualization plan in early 2000. On March 9, 2000, in the wake of Hancock's disappointing IPO, Met amended its filing with the Securities and Exchange Commission (SEC), under which it had announced plans to raise about $4.6 billion through an IPO scheduled for later that month. In early April, the company announced that it had completed the sale of 202 million of its shares at $14.25 a share, for a total of approximately $2.9 billion.

...and Prudential finally followed

Prudential Insurance Co. of America, based in Newark, New Jersey, initially announced plans to demutualize in early 1998. On December 15, 2000, the company announced that its board of directors had adopted a plan of reorganization that included demutualizing and becoming a stock life insurance company. In making this announcement, Prudential's management echoed the growing sentiment among mutual company executives: to remain competitive in the dynamic financial services marketplace, the company needed to increase its financial flexibility and gain access to the equity markets. By demutualizing, Prudential would be able to issue stock and, if it so chose, to make stock-based acquisitions. Prudential completed its demutualization in December 2001.

Several other leading insurers have also announced or completed plans to demutualize. In August 2000, the Principal Financial Group Inc. (parent company of the ninth-largest life insurer, Principal Mutual) announced that its board of directors approved a plan to demutualize. Principal completed its demutualization in October of 2001. The Phoenix Cos. Inc. (formerly Phoenix Mutual) completed a demutualization in June 2001. Indeed, by late 2001, nearly all of the leading mutual life insurers had either demutualized or announced plans to do so.

The second wave may change shape

Now that most of the major life insurance carriers that were mutually owned have demutualized, the next round of activity within this environment may take the form of a sponsored demutualization. A sponsored demutualization is a process of demutualization under which a mutual insurer converts to a stock company ownership structure in order to be acquired by another stockholder-owned company.

In mid-September 2002, shareholders of Nationwide Financial Services Inc., a diversified insurer and financial services firm based in Columbus, Ohio, approved a plan under which Nationwide would acquire Provident Mutual Life Insurance Co., a life insurer based in Berwyn, Pennsylvania, for approximately $1.5 billion. As part of the transaction, Provident would simultaneously convert to a stockholder-owned company. Nationwide Financial completed its sponsored demutualization of Provident Mutual on October 1, 2002.

Standard & Poor's anticipates an increase in sponsored demutualizations, assuming merger and acquisition activity also picks up. Many of the likely buyout candidates are small, mutually owned insurers lacking the critical scale or well-defined niche needed to thrive in an increasingly competitive landscape.

Not all jump ship

The demutualization tide may be strong, but a couple of notable companies are resisting its pull. The sixth-largest life insurer (based on year-end 2001 admitted assets) is Teachers Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF), a nonprofit financial services organization that offers an array of savings and investment plans mainly to the education and nonprofit communities. TIAA-CREF has reiterated its commitment to remain a not-for-profit entity.

MassMutual Financial Group, parent company of Mass Mutual Life, the twelfth-largest life insurer, falls into the "never say never" category. According to a company release, "As the financial landscape evolves, it is sound business practice for any company to examine its organizational structure. At this time, we have determined that Massachusetts Mutual Life Insurance Co. can achieve its objectives and best serve its policyholders and clients using the capital resources and financial flexibility provided by our mutual form of ownership. We will consider converting to stock ownership only when this reality changes."

The motives for the demutualization trend that is sweeping most of the insurance industry differ from those that drove a number of firms, including the Equitable Cos., to demutualize more than 10 years ago. Back then, many insurers needed access to the capital markets to sell equity and debt securities in an attempt to boost their capital levels. Many companies were saddled with illiquid and underperforming real estate loans and assets, which were eroding the strength of their capital bases and threatening their solvency. In order to survive, they needed to raise capital.

Today, however, thanks in part to the rebound in the commercial real estate market, many insurers' fortunes have reversed. They are seeking to demutualize as a way to increase their operating and financial flexibility. Moreover, in this era of rewarding managerial performance with stock options, many mutuals believe they are at a disadvantage in recruiting and retaining top managerial talent.

Of course, the transformation to stockholder-owned status doesn't happen overnight. Indeed, Prudential's demutualization process took almost four years from the time the company first announced its intention to convert to the completion of its initial public stock offering. Central to the process is the arduous task of estimating what the policyholders' shares are worth. Policyholders are typically offered the option of exchanging their interest for cash, stock in the new company, or an increased level of insurance benefits.

Despite its attractions, demutualizing is not a panacea. While it affords the insurer access to capital markets, it may also open a Pandora's box. After operating in a mutual environment, where the goals of the insurer are to serve only the needs of policyholders, many mutual insurance executives may be ill-prepared for the heightened scrutiny and proactive ownership base of a stockholder-based company. In addition, the stock market constantly grades stockholder-owned insurers on their financial performance and exacts a heavy toll from companies that do not perform up to par.

We believe that the demutualization trend will likely hasten the polarization of the life insurance industry. Those firms with managerial skill and financial fortitude will use demutualization to acquire other firms in an attempt to ramp up their growth rates and stay competitive. Others that have heretofore been poorly managed and not as well capitalized will likely be forced to find a merger partner as a means of surviving.

Distribution channels shift

One factor driving consolidation in the life insurance market is the need to cut costs in order to maintain profit margins as revenue growth slows and product mix shifts to more narrowly margined fee-based products. The imperative to boost revenue growth and profit margins has forced many insurers to re-evaluate their distribution channels. Faced with growing competition, insurers are revamping the way they deliver products to consumers.

Among the important shifts in distribution channels, banks and other financial services firms have generated an increasing share of insurance product sales. This is especially true in the annuity marketplace, one of the few areas of growth in the insurance business. (For further discussion of the annuity market, see this *Survey*'s "Current Environment" and "How the Industry Operates" sections.)

Back in the days before securities brokers and banks started to sell insurance, life insurers prospered by selling policies through an agency system. Establishing an agency network was costly, but necessary: the conventional wisdom was that life insurance was sold, not bought. If consumers had to be convinced that they needed life insurance, who better to do this than a friendly insurance agent who could sit down face-to-face with a prospective client and explain the benefits of purchasing a life insurance policy?

Today, the scene is more complex. Some forms of life insurance require higher levels of service than others, and banks and brokerage houses have been adept at providing such service. Indeed, these companies have made major inroads into life insurers' turf by becoming more effective distributors of insurance and annuities. They had pre-established efficient distribution networks through their branch systems or networks of brokers. Moreover, these distribution channels have long recognized what many life insurers have yet to acknowledge — that most life insurance is a commodity. As such, it must be marketed primarily based on price. Companies that deliver this product to consumers in the most cost-effective manner will thrive.

Work site marketing taking hold

Work site marketing is the process whereby an insurer will offer its products or services to a group of employees at their place of work. Typically, these offerings are made via the client company's Web site and/or through direct mailings sent to employees, either at their home or office. Direct, face-to-face solicitation of employees is not typical in this type of situation. (However, follow-up contacts, either to administer a policy or conduct prescreening tests, are possible). A broad array of products is offered, including homeowners' and auto insurance, dental coverage, long-term care, and supplemental life insurance. Savings and retirement products may also be offered.

For the client company, this type of marketing situation enables them to "offer" these choices to their employees. There is an appearance of an enhanced benefit package without added benefit costs for the employer. By offering these services, the employer is also able to help its employees juggle work/life issues.

For the employee, there is an element of convenience with being able to purchase these products and services at work, and often without sitting through a presentation by an insurance sales representative. Moreover, there is an implied endorsement being provided by the client company that may give the employee an added sense of comfort. In essence, some of the screening has already been done.

For insurance companies, this type of marketing is a very productive use of resources.

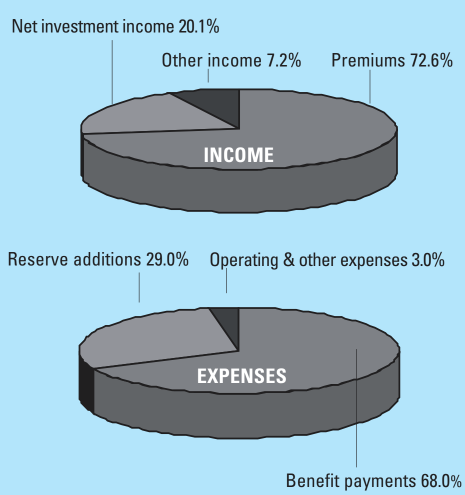
Marketing through this channel offers an insurer the potential to quickly achieve economies of scale and (in some cases) a favorable mix of underwriting risk by insuring (presumably) younger, healthier workers.

The rise in popularity of this marketing channel can be seen in some recent life insurance sales numbers released by Eastbridge Consulting Group, a financial services consulting firm. According to data reported by Eastbridge, sales of life insurance products accounted for 22% of total work site insurance products in 2001. Some other trends noted by Eastbridge include a shift in the composition of the work-site market toward professional and managerial employees employed by large corporations, from blue-collar and lower-level employees and those affiliated with smaller organizations. Standard & Poor's estimates that this marketing channel will continue to grow in importance and will further divide the insurance industry into those that are able to capitalize on these trends and those that will lag behind.

Choice of other channels

Life insurers use a variety of distribution channels, including the agency system, home service, and direct response. Following the rapid growth in annuity markets in the 1990s, a major proportion of life insurance industry sales came to be conducted by banks and brokerage firms. In addition, the Internet represents a promising, and growing, distribution outlet.

LIFE INSURANCE COMPANY DOLLAR — 2002*



*Latest available.
Source: A.M. Best Co.

◆ **The agency system.** An agent acts as the insurer's representative in negotiating, selling, and servicing life insurance policies. Agents may be either independent (offering products from many insurers) or captive (employees of a particular insurer). Some insurers use managing general agents (MGAs), who have broader powers than regular agents. In addition to selling policies, the MGA may be involved in marketing, underwriting policies, and supervising other agents.

◆ **Home service life insurance.** Also called industrial life insurance, home service represents only a small portion of the industry's business. Home service involves actually collecting premiums for policies, either on a weekly or monthly basis, at the home of the insured. This type of service is costly and not very efficient.

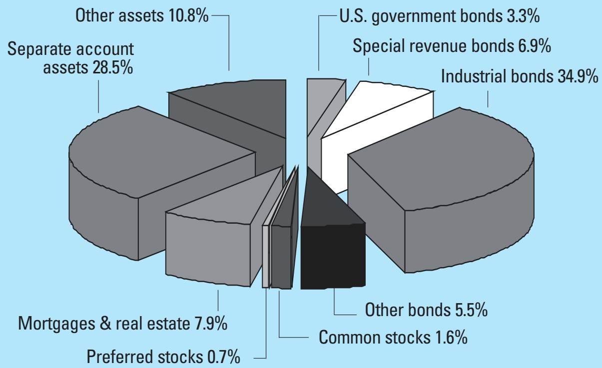
◆ **Direct response.** Of the various channels, the direct response method is the most cost-effective. Under such a system, employees of the insurance company deal directly with potential clients through telephone solicitations, mass mailings, or television advertisements. Some insurers have turned to direct response distribution channels to make their distribution systems more cost-effective.

◆ **Internet sales.** Numerous insurers have turned to the Internet to market their products. Virtually every insurer has a Web site, from which a consumer may access product information, learn how to file a claim, or find the name of an agent. So far, alternative distribution channels such as direct response and the Internet have been used mostly for the sale of term life insurance. They have had some degree of success with that product because term life insurance is fairly simple to understand and the most commodity-like.

HOW THE INDUSTRY OPERATES

The life insurance industry is being transformed by ongoing competitive pressure from banks and other financial intermediaries. At one time, life insurers provided only one thing: financial remuneration in the

DISTRIBUTION OF ASSETS — 2002*



*Latest available.
Source: A.M. Best Co.

event of a policyholder's death. Today, they provide an array of financial services and play an integral role in many people's financial planning, including complex areas such as tax, retirement, and estate planning.

In its simplest form, however, life insurance is still a business of shared risk. Insurers collect premiums from policyholders, invest those premiums, and share some of that income with policyholders in the form of a policy dividend, income from an annuity, or through a policy's cash value. Eventually, insurers give policyholders some sort of financial reimbursement, either upon the policyholder's death or when a policy or an annuity matures.

Although there are more than 1,500 life insurance companies in the United States, the business is dominated by just a handful of them. Based on the latest available comprehensive data from A.M. Best Co., the life insurance industry's admitted assets totaled $3.37 trillion at December 31, 2002. As of year-end 2002, the 10 largest life insurers accounted for 46% of the industry's total admitted assets. (Admitted assets are the assets of an insurer that regulators include when they assess an insurer's financial condition. Such assets are highly liquid; *i.e.*, they are easily converted into cash.)

Moreover, according to A.M. Best, the country's three largest life insurers — Metropolitan Life Insurance Co., American International Group, and Prudential Insurance Co. of America — accounted for 20% of the industry's total admitted assets at year-end 2002: Metropolitan had $225.0 billion, American International had $233.7 billion, and Prudential had $205.7 billion. In comparison, Metropolitan had $224.5 billion, American International had $210.6 billion, and Prudential had $204.1 billion.

Ownership structures differ

A life insurance company's ownership can take one of two basic forms: that of a publicly held stock insurance company, or that of a mutual insurance company owned by policyholders. In addition, a company can be structured as a hybrid mutual holding company.

Stock insurance companies

Stock insurance companies, as their name implies, are owned by shareholders who can buy or sell shares in the public stock market. The capital of a stock insurance company is called shareholders' equity. Since these companies are publicly held, they are required to file quarterly financial reports with the Securities and Exchange Commission (SEC). Thus, obtaining timely financial information about these companies is relatively easy.

Mutual insurance companies

Mutual insurance companies, in contrast, are owned by their policyholders. A mutual insurance company's capital is called policyholders' surplus. Because these companies are owned by their policyholders, they aren't required to publicly disclose financial information. Although some mutual insurers distribute financial information to policyholders, obtaining timely financial information about mutual life insurers can be difficult for analysts and other interested parties. This used to be a problem when mutual companies dominated the upper echelons of the life insurance industry. However, in the wake of numerous high-profile demutualizations — including those by Metropolitan Life, Nationwide Group, and Prudential Financial — only two of the top 10 life insurers in the United States — New York Life Group and Northwestern Mutual Group — were mutual companies as of April 8, 2004.

Mutual holding companies

In some instances, life insurers have formed mutual holding companies (MHCs) to combine the benefits of a mutual ownership with those of public ownership. In this case, the holding company remains in the hands of policyholders while shares in the life insurance subsidiary are sold to the public. The arrangement can lead to conflicting priorities, however, as management seeks to please policyholders, who prefer that the company remain fiscally sound and able to pay benefits, while also satisfying shareholders, who prefer growth and dividends. Most recently, however, insurers looking to demutualize have usually opted for full demutualization, which is a more streamlined process. In addition, we believe that for at least some companies, worries that the market would not be particularly receptive to the hybrid MHC format played a role.

Income and expenses

Based on a survey of 1,015 US stock and mutual life insurance companies conducted by A.M. Best, the life insurance industry's total revenues rose 6.0% to $697.4 billion in 2002 (latest available data) from $657.6 billion in 2001, following a 15% decline from $773.2 billion in 2000.

Insurers derive revenues from two main sources: premiums and investment income. Following a 56% between 2000 and 2001, premiums (including revenues from annuity considerations) for this representative group increased to $506.6 billion in 2002, up 6.8% from $474.3 billion in 2001. (Note: due to a change in certain reporting procedures in 2001, these two numbers are not directly comparable.) Investment income rose 1.5% in 2002 to $140.3 billion, from $138.2 billion in 2002.

Total expenses for the life insurers in the A.M. Best study increased 6.0% to $654.1 billion in 2002, from $616.9 billion in 2001, following a 14.7% decline from $723.0 billion the previous year. The largest single expense component was benefits. During 2002, benefits paid to policyholders and annuitants declined 1.0% to $351.3 billion, from $354.2 billion in 2001. Included in benefits are death benefits, annuity benefits, disability benefits, and accident and health benefits. However, the largest component is surrender benefits, which are paid out to policyholders when they relinquish their policies for their cash surrender value. During 2002, surrender benefits decreased 4.1% to $174.5 billion from $181.9 billion in 2001. Like most other companies, insurers also incur various operating expenses such as staff salaries, insurance, licenses and fees, and other overhead costs.

Additionally, insurers bear expenses related to deferred and uncollected premiums, transfers to variable and separate accounts, and other industry specific costs. After subtracting these expenses from revenues, pretax operating profits for the insurers in the A.M. Best study increased 6.2% to $43.3 billion in 2002, from $40.7 billion in 2001. During the prior year, pretax operating profits had declined 18.9% from $50.2 billion in 2000. After paying policyholder dividends and federal income taxes, net income (including realized investment gains or losses) for the 1,015 life insurers in the A.M. Best survey declined more than 62% to $4.3 billion in 2002, from $11.4 billion in 2001. The primary driver of the decline was a sharp rise in net realized capital losses.

Types of assets

There are stated ways of classifying the assets owned by life insurance companies: as admitted assets, separate account assets, and troublesome assets.

Admitted assets

Admitted assets are those that the state insurance regulators include when determining an insurer's financial condition. They're usually the most liquid, or most easily converted into cash. Things such as office equipment and past-due accounts receivable are two examples of assets that would be excluded from an insurer's tally of admitted assets. The life insurance industry's total admitted assets rose to nearly $3.4 trillion at December 31, 2002, a 3.4% increase from $3.3 trillion at year-end 2001.

Because insurers must be able to pay policyholder claims promptly, they maintain the vast majority of their assets in investments that have a high degree of liquidity. As a result, invested assets constitute the largest portion of an insurer's asset base. Invested assets of the life insurance industry equaled $2.3 trillion at December 31, 2002, or more than 68% of total admitted assets. This figure showed a 9.9% increase from year-end 2001 invested assets of $2.1 trillion (64% of total admitted assets). Of the year-end 2002 invested asset total, bonds constituted 74%, followed by mortgage loans and real estate (12%) cash and short-term investments (4%) and common stocks (3%). The remaining 7% of invested assets were in preferred stocks, cash, and other investments.

Separate account assets

As their name implies, separate account assets are held apart from other assets in the insurer's investment portfolio. These accounts are established by insurers primarily to fund certain annuity and investment-oriented life insurance accounts (*i.e.*, accounts where the policyholder or annuitant bears most of the investment risk). By segregating these assets, an insurer is not restricted by state laws that mandate how the assets in an insurer's general account are invested. As a result, a particular insurer's separate account portfolio may be overweighted with common stocks or real estate compared with the overall industry standard.

After several years of very robust growth, separate account assets began to decline in 2000. At December 31, 2002, separate account assets for the life insurers in the A.M. Best study totaled $958.4 billion, down from $1.07 trillion at year-end 2001, and $1.14 trillion in 2000. Separate account assets declined fractionally during 2000, but grew 24% annually in both 1999 and 1998.

Since they first came into existence in the 1960s, when life insurers used them to fund pension accounts, separate account assets have grown more rapidly than the overall life insurance industry's total admitted assets. According to A.M. Best statistics, the compound annual growth rate (CAGR) for life insurers' separate account assets was 17.7% for the period from 1985 to 1995, versus 9.7% for total admitted assets. The gap in growth rates widened in ensuing years. Between 1990 and 1995, the CAGR for separate account assets was 22.7%, versus 8.8% for total admitted assets; for 1995 to 2000, growth rates were 19.9% and 8.3%, respectively.

This growth was fueled by burgeoning annuity- and pension-related sales, as insurers competed with other financial intermediaries for consumers' savings dollars. However, this change in product mix also entailed a shift in investment risk, with policyholders assuming more of the burden. For insurers, the tradeoff has been a narrowing of profit margins, because most of the upside potential from these investments is passed along to the consumer. However, as results for 2000 through 2002 indicate, this torrid rate of growth waned; the reasons included a slowdown in growth of the products backed by these assets, coupled with mediocre investment returns from these assets. However, the rebound in equity markets in 2003 and 2004 to date will likely boost demand and sales for these equity-linked products. (For a further discussion of annuity sales trends, see the "Current Environment" and "Industry Trends" sections of this *Survey*.)

Troublesome assets

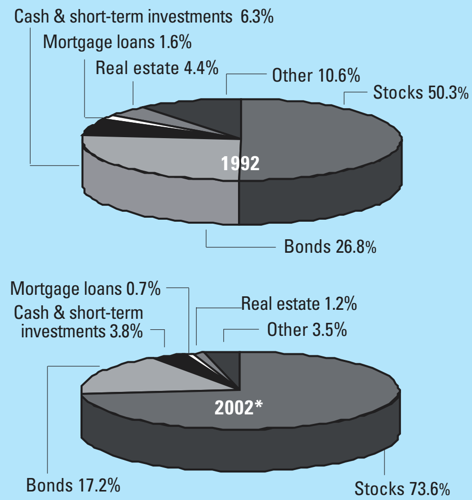
Troublesome assets are defined as invested assets that decline in value while in the ownership of an insurance company. Of course, insurers strive to avoid this, but it happens. Perhaps the most troublesome as-

ASSETS OF US LIFE INSURANCE COMPANIES
(In millions of dollars)

YEAR	TOTAL ADMITTED ASSETS	BONDS	STOCKS	MORTGAGES	REAL ESTATE	POLICY LOANS	CASH & SHORT-TERM INVESTMENTS	SEPARATE ACCOUNT ASSETS	OTHER ASSETS
2002*	3,368,703	1,703,155	79,424	242,927	21,687	104,292	83,441	958,408	175,369
2001	3,259,215	1,517,327	82,160	239,395	22,156	103,073	69,822	1,070,548	154,735
2000	3,172,678	1,393,234	91,495	229,835	23,544	100,727	57,590	1,141,634	134,619
1999	3,105,825	1,345,867	93,280	225,230	25,169	97,586	62,464	1,141,817	114,412
1998	2,823,980	1,311,861	85,564	211,112	27,678	102,161	61,119	922,242	102,243
1997	2,562,833	1,259,018	75,602	201,998	33,060	101,191	60,628	740,481	90,856
1996	2,304,902	1,199,230	64,859	204,018	37,657	98,255	42,142	572,369	86,371
1995	2,127,454	1,135,071	58,162	208,528	40,834	94,131	44,632	460,917	85,178
1994	1,924,929	1,052,097	52,151	211,326	42,316	85,311	49,435	350,563	81,729
1993	1,802,488	977,708	52,579	220,086	43,039	73,778	45,562	312,505	77,232

*Latest available.
Source: A.M. Best Co.

DISTRIBUTION OF SEPARATE ACCOUNTS
(In percent)



*Latest available.
Source: A.M. Best Co.

set class for life insurers in the past has been mortgage loans and other real estate holdings. However, in the wake of a number of high-profile telecom and media company bankruptcies, there will likely be a rise in fixed-income troublesome assets. Evidence of this trend can be seen in the writedowns a number of life insurers took to their fixed income portfolios in 2003.

In the early and mid-1980s, many life insurance companies began enlarging their real estate holdings, spurred by the need to improve their investment returns in a declining interest rate environment. When the commercial real estate market imploded in the late 1980s, however, many insurance companies were stuck holding nonperforming assets. After reaching a peak of more than 27% of invested assets at year-end 1986, real estate and mortgage holdings trended downward as a percentage of invested assets, as insurers sought to reduce their holdings of this once-troubled asset class. More recently, however, amid more favorable real estate market conditions, a number of companies have increased their real estate holdings. Together, mortgage loans and other real estate holdings accounted for about 12% of invested assets at year-end 2002.

Mortgage and real estate portfolios vary widely among insurers: many life insurers hold little or no real estate, while others are laden with it. Typically, the firms with the largest holdings (on an absolute basis and in relation to their capital bases) have tended to be those with sizable pension- or annuity-related books of business.

Finding funds for investment

Insurers derive funds for investment from three primary sources: policy reserves, the liability for unearned premiums and deposited funds, and separate account liabilities. Policy reserves, which are the funds set aside to pay future claims, are by far the largest liability on an insurer's books; for the companies in the A.M. Best survey, they totaled slightly less than $1.7 trillion at December 31, 2002, or about 53% of the industry's total liabilities of roughly $3.2 trillion.

The liability for deposit-type contracts (like annuities) equaled $256.3 billion at December 31, 2003, or 8.1% of life insurers' total liabilities. The liability for separate account funds totaled $956 billion at year-end 2002, or about 30% of total liabilities. Capital and surplus at year-end 2001 totaled $194.6 billion, up 4.8% from year-end 2000's capital and surplus level of $185.7 billion.

Loss reserves and profitability

Because loss reserves are the largest component of an insurer's liabilities, they have the greatest impact on its financial results. A life insurer's prosperity depends largely on its ability to quantify the ultimate cost of claims from the risks that it assumes. If an insurer's reserve levels are too high — that is, if it has set aside too much money to pay future claims — profits will appear lower than they actually are. Consequently, an insurer may raise its rates unnecessarily because it believes its premium rates are not high enough to cover losses.

Conversely, if reserves are too low, profits will be inflated and an insurer may lower its rates. Moreover, inaccurate reserve levels will ultimately have to be adjusted once losses develop. These accounting adjustments may make the insurer's financial position seem erratic and unstable. Reserving for losses and setting premium levels involves estimating the ultimate value of future claims. This quantifying process, however, is extremely difficult. Forecasts of future losses are subject to a number of variables, including but not limited to real economic growth, inflation, interest rates, and sociopolitical events, including judicial rulings.

Two accounting methods

Many insurers report their financial results using two types of accounting principles. For results submitted to regulators, insurers use statutory accounting principles (SAP). For results given to investors, they use generally accepted accounting principles (GAAP). However, many analysts also use SAP financial statements when they evaluate an insurer.

The primary difference between the two accounting systems lies in a concept known as the matching principle. Under GAAP accounting, expenses are supposed to be charged to the period in which they were used to generate revenues. Under SAP accounting, expenses are recognized immediately.

This means that under SAP accounting, expenses associated with writing an insurance policy — such as commissions and other underwriting expenses — are immediately deducted from income. Under GAAP accounting, these same charges are treated as assets — referred to as "deferred policy acquisition costs" — and are amortized over the insurance policy's life.

Hence, under the more conservative SAP method (which emphasizes a company's solvency), income and surplus tend to be lower than under the GAAP method (which emphasizes a firm's ongoing profitability). Because regulators are primarily concerned with an insurer's solvency and its concurrent ability to meet policyholder obligations, they tend to scrutinize a company's financial statements using statutory accounting principles. Investors, however, are usually more interested in an insurer's ability to earn a profit. They tend to view an insurer's financials using GAAP figures.

Types of products

Life insurance products are available with a variety of coverage options and terms. Still, the following general types of products constitute the bulk of life insurance sales.

Whole life

Whole life policies combine a death benefit with a forced savings plan. Premium levels remain constant: a policyholder effectively overpays during the early years of his or her coverage, when the risk of death is relatively low. The interest earned on that overpayment goes to build the policy's cash value, against which money may be borrowed at a relatively low interest rate. A whole life policy also carries a surrender value. This is the amount available in cash upon voluntary termination of the policy by its owner before it becomes payable, which would normally occur upon the policy's maturity or the policyholder's death. The death benefit is exempt from income taxes.

A variant of this product, called endowment insurance, provides a death benefit plus cash accumulation. The cash accumulation is payable either to the policyholder at the maturity date or to the beneficiaries upon the policyholder's death.

According to data obtained from A.M. Best Co., US sales (or new policies issued) of whole life and endowment life amounted to $548.7 billion in 2002, or about 19% of the more than $2.9 trillion of all new policies issued in 2002. This represented a 6.2% decrease from 2001 sales of $584.8 billion. Whole life policies contain a savings feature, so they compete with other investment vehicles (such as bank certificates of deposit and mutual funds) for consumers' savings dollars. Of course, competition from banks and brokerage houses is nothing new. However, the distinctions that once separated the life insurance industry from the banking and securities brokerage industries have faded over the past 10 years. They will likely continue to erode in the aftermath of the late 1999 repeal of the Glass-Steagall Act, the 1933 law that established high barriers between banking and securities businesses.

Consequently, the life insurance industry's traditional product offerings have been sorely tested. During the late 1970s and early 1980s, high inflation and rising interest rates prompted customers to terminate their policies in droves. At that time, conventional whole life policies yielded a mere 5% on their savings feature, while new money market funds were paying upward of 15% interest. This discrepancy led insurance buyers to shift to less expensive (and, for the insurer, lower margin) term insurance and to invest their savings elsewhere at higher rates.

To stem the tide of policy terminations in the wake of rising interest rates, underwriters scrambled to devise new ways to attract and keep customers' whole life insurance dollars. One result was the creation of two new types of insurance policies: universal life and variable life.

◆ **Universal life.** Introduced in 1979, universal life policies combined a term life insurance policy with a savings feature that offered interest rates comparable to those of money market accounts. Universal life insurance policies let a policyholder vary the amount of his or her premium, the amount allotted to the death benefit, and the policy's investment portion. In addition, the policy's cash value can be used to subsidize premium payments. Universal life also provides the same federal income tax advantages as whole life: the death benefit is exempt from income taxes. If the policy is surrendered, the cash value of the "inside build-up" is taxable only if that build-up and the dividends used to buy more coverage exceed the total amount paid in premiums.

◆ **Variable life.** This relatively recent product innovation is even more investment-oriented than universal life. Variable life lets the policyholder choose among alternative investment vehicles, including stock funds, corporate or government bond funds, and money market accounts. These policies typically offer fixed premiums and a minimum death benefit. Variable life policies entail some risk to the policyholder, because the face value of the investment portfolio fluctuates with the selected fund's performance. And unlike universal life insurance, variable life policies do not guarantee a minimum return on the inside build-up of cash value.

◆ **Universal variable life.** Still another product — universal variable life insurance — combines the premium flexibility of universal life with a death benefit that changes according to the investment performance of the underlying assets.

Term insurance

As its name implies, term life insurance is life insurance that remains in effect for a set time period, or a set term, such as five or 10 years. If the policyholder survives during that period, the policy coverage ceases. Unlike a whole life policy, term life insurance does not build up any cash or forfeiture values. Consequently, it's usually the least expensive type of life insurance coverage available.

According to A.M. Best, term life insurance accounted for approximately 42% of all new life insurance issued in 2002, or about $1.20 trillion of the more than $2.9 trillion of new policies issued that year. That represents an 18.8% increase from 2001's volume of $1.01 trillion.

Group life

This is life insurance coverage provided under a group or association program that provides each plan participant with life insurance by issuing a certificate to a master plan contract. Most of these plans provided by corporations to their employees, but sponsors can also include associations, fraternities, and the like. Group life policies usually consist of annual renewable term policies. (By comparison, "ordinary" life insurance sales are made to individuals rather than to a group representative.)

According to A.M. Best, group life insurance sales equaled roughly $1.01 trillion in 2002, or approximately 35% of all new life insurance issued that year. This represented an almost 12% decline from sales of $1.15 trillion in 2001.

Other policies

This category comprises credit life insurance and industrial life insurance. Credit life insurance, which accounted for most of this segment's policies, is term life insurance designed to cover the repayment of a loan, installment purchase, or other financial obligation. Industrial life insurance is a relatively low-value form of life insurance whereby the premium is collected by the salesperson at the home of the insured on a weekly or monthly basis. This type of life insurance is also known as home service life insurance.

Together, sales of credit life insurance and industrial life insurance totaled approximately $120.4 billion in 2002, down 26% from $161.6 billion in 2001; such insurance accounted for slightly more than 4% of new policies issued in 2002.

Annuities

An annuity is an insurance contract that provides for a series of payments to the annuity holder, also called the annuitant. These payments may begin at once (as is the case with an immediate annuity) or at some future date (with a deferred annuity). During the time before the commencement of benefit payments (referred to as the accumulation period), money deposited in an annuity earns income on a tax-deferred basis. After withdrawals begin, the remaining balance continues to be tax-deferred; money that is paid out — or annuitized — is taxed.

In exchange for this tax deferment, investors give up liquidity, or easy access to their money. Surrender charges, expenses, and certain tax penalties ensue if investors withdraw funds before an annuity matures.

Nevertheless, the tax-deferred build-up of assets has been a primary attraction for investors. In addition, while investors can contribute only limited amounts to tax-deferred individual retirement accounts (IRAs), 401(k)s, and similar accounts, they can put as much as they want into annuities. For insurers, selling annuities has been a profitable undertaking in recent years.

Annuities can be structured in a variety of ways. Fixed annuities offer a guaranteed interest rate that will be paid on the principal amount deposited in the annuity. Under a variable annuity, in contrast, the level of investment income isn't guaranteed: it can fluctuate depending on the investment results and income earned on assets that are held in a separate account for the annuitants' benefit.

Other types of annuities also fit within these broad categories. Flexible-premium deferred annuities give the contract holder the option of making periodic (usually monthly) premium payments during the accumulation period. This is in contrast to single-premium annuities, in which premiums are paid in one lump sum at the outset. Single-premium annuities are available with either an immediate or a deferred payout option.

During the early 1990s, declining interest rates helped to propel sales of fixed annuities, creating a boon for insurers. According to A.M. Best, individual annuity premiums totaled $71.7 billion in 1990, up 13% from $63.4 billion in 1989. During periods of declining interest rates, when returns on money market accounts and certificates of deposit are falling, fixed annuities are popular because investors can "lock in" a set interest rate. In the fixed annuity marketplace, insurers primarily compete based on credited interest rates, which is the rate they're willing to pay on the principal deposited in an annuity.

As soon as interest rates began to stabilize, however, investor interest turns to variable annuities. Individual variable annuity premiums jumped to almost $17 billion in 1992 from just less than $9 billion in 1991, according to data obtained from A.M. Best. This surge was most likely attributable to investors' desire to capture some of the more stock market-like returns available under these variable-rate products. After peaking at $31 billion in 1993, variable annuity premiums began to slip as uncertain equity market conditions forced

OPERATING DATA OF US LIFE INSURANCE COMPANIES

	LIFE INSURANCE IN FORCE, IN BILLIONS OF $			PREMIUMS, IN MILLIONS OF $						
YEAR	ORDINARY	GROUP	**TOTAL	LIFE	ANNUITIES	HEALTH	†TOTAL	RESERVES (MIL. $)	NET INVESTMENT INCOME (MIL. $)	RETURN ON REVENUES (%)
2002*	18,234	8,038	26,556	133,869	268,437	105,261	506,569	1,582,328	140,395	2.85
2001	16,920	7,799	25,018	124,771	250,374	97,444	472,730	1,439,945	138,243	2.41
2000	15,566	7,232	23,138	131,533	303,823	100,189	548,208	1,545,032	137,260	2.95
1999	14,092	6,897	21,314	120,156	270,184	93,981	494,118	1,496,675	131,481	2.82
1998	12,645	6,609	19,583	125,940	229,471	91,749	453,498	1,456,797	129,482	2.46
1997	11,052	5,994	17,380	113,525	197,650	85,708	401,058	1,409,894	127,685	3.46
1996	10,020	5,536	15,881	104,680	178,299	83,814	370,138	1,373,248	121,268	3.12
1995	9,095	5,167	14,562	99,806	158,262	84,511	345,638	1,329,142	118,014	2.97
1994	8,431	5,016	13,735	96,434	152,868	79,533	331,217	1,274,139	108,356	2.56
1993	7,804	4,849	12,927	91,466	143,904	77,937	313,562	1,203,375	107,359	3.02

*Latest available. **Includes industrial and credit. †Includes miscellaneous premium receipts.
Source: A.M. Best Co.

investors back into safer investment havens.

By 1995, equity markets began to strengthen. Yet, unlike prior market escalations, investors did not immediately rush back into the variable annuity market. Variable annuity premiums totaled $27.9 billion in 1995, down 8.8% from $30.6 billion a year earlier. However, by 1997, investors began flocking to variable annuities, and sales growth continued in 1998 and 1999. According to data from *The VARDS Report*, published by financial services research firm Finetre Corp., variable annuity sales jumped 23% between 1998 and 1999, from $99.8 billion to $122.9 billion. Sales slowed somewhat in 2000, rising 11.9% to $137.2 billion, and declined to $112.8 billion in 2001. Sales inched upward just under 2% in 2002, to $115.0 billion. However, a rebound in the equity markets in 2003 helped produce a 9.6% increase in variable annuity sales, which totaled $126.0 billion.

There's been a great deal of publicity over the competition from banks entering the annuity marketplace. However, the threat to insurance companies from brokerage houses is potentially greater, particularly as the lines that separate insurance from investment products continue to blur.

Because of their tax-deferred status, insurance company annuities — both fixed and variable — will continue to be an important vehicle in many individuals' savings and retirement plans. A particularly attractive target market for annuities is the baby boom segment of the US population.

Distribution

Banks and brokerage firms have accounted for a growing proportion of annuity sales, facilitated by sales agreements with insurers.

The systems

Life insurance and annuity products are distributed primarily through a direct-selling system or through an agency system. A third channel, the Internet (in the form of both insurer and aggregator Web sites), has accounted for only a small portion of sales and is used particularly for term insurance.

◆ **The direct-selling system.** In a direct-selling distribution system, the insurer (sometimes referred to as a direct writer) deals individually with the insured, or customers, through its own employees. A number of marketing techniques are used within this distribution framework, including direct response (the sale of policies directly to consumers using direct mail, mass mailings, and cable and/or television advertising) and sales through company-run agencies.

Home service, which is on the decline, is another means of directly marketing insurance products. Here, insurance company representatives collect premiums on an installment basis (usually monthly or even weekly) by going in person to the homes of the insured.

◆ **The agency system.** Under an agency system, the insurance company contracts with outside parties, or agents, to sell its policies in exchange for a commission. Agents may be "captive" to a particular insurer, selling only that insurer's policies. Agents may also be independent, offering an array of policies from various insurance companies.

The pros and cons

While each sales channel has advantages and disadvantages, the tradeoff for an insurance company is cost versus control. A direct-selling system may be expensive to establish and operate, but it gives the insurer control over the distribution process. Conversely, the agency system reduces the amount of control an insurer has over every aspect of the distribution system, but it usually offers an insurer an established network through which it can distribute its products. Many factors determine which kind of distribution method is best to use.

In addition to the resources an insurer must devote to distribution, its product mix will likely have a major influence on the type of distribution it employs. For example, a life insurer that sells simple, low-value term insurance could easily offer its products through various direct-response channels. In contrast, a company whose products are investment-oriented may need to use a full-service agency sales force.

Regulating the industry

Regulation of the life insurance industry is done on a state-by-state basis. All 50 US states and the District of Columbia have an elected insurance commissioner. Each state grants operating licenses to insurers, giving them permission to conduct business within its borders. State regulators serve three primary functions. First, they monitor the financial condition and claims-paying ability of companies operating in their state. Second, they serve as consumer "watchdogs," ensuring that policyholders aren't overcharged or discriminated against. Finally, regulators try to ensure that essential coverage is readily available.

The state also must approve insurance products and license qualified agents to sell them. Insurance agents, including individuals that work for banks or brokerage firms, must pass a comprehensive state test to be licensed to sell insurance. In most states, agents must pursue continuing education in order to maintain their license.

The activities of the insurance commissioners are coordinated under a national organization, the National Association of Insurance Commissioners (NAIC), which was founded in 1871 as the National Convention of Insurance Commissioners. One of the organization's first actions was to formulate uniform accounting procedures. Today, one of the NAIC's main functions is to develop and improve insurance reporting and accounting standards and practices in an attempt to enhance state regulators' knowledge of the financial condition of the insurers in their state.

Every year insurance companies are required to file a set of financial statements with the regulators in each state in which they operate. These records, called annual statements, outline (in statutory accounting terms) a company's profit-and-loss position and its overall financial condition. Moreover, all 50 states have laws requiring solvent life insurance companies to pay assessments to state guaranty associations. These guaranty associations, or guaranty funds, are established to ensure that policyholder claims are paid in the event an insurer becomes insolvent.

To comply with the Financial Services Modernization Act of 1999, which called for a reform of the inefficient state-by-state system, the NAIC has approved a uniform product filing form and is working on a national agent licensing plan. Although a national regulatory body may ultimately be established, many have been calling for just such a group for most of the last decade, and nothing has happened.

Other forms of regulation and control govern the insurance industry. For example, publicly held companies (those that issue shares of stock) are also subject to regulation by the Securities and Exchange Commission (SEC).

Finally, the intense level of competition among industry participants also enforces a measure of control. Competition helps keep pricing in line and prevents any one participant from becoming too powerful.

KEY INDUSTRY RATIOS AND STATISTICS

The following four ratios are derived from the statistics available in A.M. Best's annual publication, *Aggregates and Averages*. For purposes of formulating industrywide benchmarks, Standard & Poor's defines the industry as the universe of companies that report financial results to A.M. Best. In 2002, the latest full year for which comprehensive statistics are available, there were 1,015 such stock and mutual life insurance companies in the United States.

▶ **Return on assets (ROA).** Calculated by dividing net income by average total assets, ROA is a measure of profitability. The ROA for most life insurers typically ranges from 0.4% to 0.9%. In 2002, the industrywide average was 0.6%, up from 0.5% the prior year. A.M. Best estimates that the ROA for 2003 was 0.6%.

▶ **Return on equity (ROE).** Another measure of profit performance, ROE is usually considered in tandem with return on assets. For a stockholder-owned life insurance company, ROE is calculated by dividing net income by average shareholders' equity.

To calculate the ROE for the entire life insurance industry (which includes mutual life insurance companies), the denominator in this equation would be policyholders' surplus, not shareholders' equity. Policyholders' surplus is a statutory accounting term that is generally analogous to shareholders' equity. The return on equity/surplus for most life insurers typically averages between 10% and 15%. Typically, there is a disparity between the ROE of a stock life insurer (which tends to average 12% to 15%) and that of a mutual life insurer (which tends to average between 9% and 12% and is typically referred to as return on capital).

In 2002 (latest available), the ROE for the stockholder-owned industry rose to 10.6% (from 8.4% in 2001). For mutual insurers, the return on capital was 10.0% (versus 9.3% in 2001). The total 2002 industry average was 10.5%, compared with 8.6% in the prior year.

▶ **Return on revenue (ROR).** This measure is another gauge of profitability; it's equal to net income divided by total revenue (premium income plus net investment income). The ROR for most life insurers typically ranges from 2% to 5%. In 2002 (latest available), the industrywide average was 2.9, up from 2.4% in the prior year.

▶ **Net investment yield.** This ratio measures investment performance. It's typically calculated as net investment income divided by average invested assets. Typically, investment yields range from less than 4% to almost 10%, depending on the mix of invested assets in an insurer's portfolio. For the industry as a whole, the net investment yield was 6.56% in 2002 (latest available), compared with 7.02% in 2001.

HOW TO ANALYZE A LIFE INSURER

Three primary factors are important to consider when analyzing a life insurer: profitability (its ability to make money), liquidity (its ability to convert assets into cash to pay policyholder obligations), and leverage (the extent to which the insurer uses its capital to produce business).

These three points should be considered against a backdrop of two important macroeconomic indicators that affect life insurance sales: interest rates and demographics. We'll discuss those two indicators first.

Macroeconomic indicators

◆ **Interest rates.** Changes in the direction of interest rates affect life insurers on a number of fronts. First, in a period of declining interest rates, growth in net investment income — an important revenue source for a life insurer — will slow, as yields on insurers' bond portfolios slide. However, falling interest rates also increase the value of the underlying assets (usually fixed-income securities) that produce the investment income.

In addition, as the life insurance industry has evolved into a more investment-oriented business, life insurers must compete with other financial institutions (such as banks and brokerage houses) for consumers' savings dollars. One primary way they compete is on the yield they offer on their respective products. For example, an insurer selling a whole life or variable life policy may have to compete with banks and the interest rates they pay on money market funds or certificates of deposit.

Finally, changes in interest rates affect insurers differently, depending on their business mix. There's a difference between the cash flows from a company's interest-earning assets and the cash flows related to its liabilities that mature or are re-priced within a specific time frame. Consequently, many life insurers employ a variety of hedging techniques to help insulate themselves from changes in interest rates.

◆ **Demographics.** The well-publicized aging of the US baby boomer generation is affecting demand for life insurance products. According to US Census Bureau estimates, some 82 million people (approximately 28% of the US population) were born between 1946 and 1964, the period of the postwar baby boom. As the baby boomers — who are now in their early forties to mid-fifties — plan for their retirement, they do so with a much lower level of faith in the Social Security system. As a result, many are turning to life insurers to provide not only traditional death-benefit types of life insurance, but also savings-oriented life insurance products and annuities to help fatten their coffers for retirement.

Profitability

Life insurers' profits consist of two components: underwriting income and investment income. For purposes of this discussion, we'll analyze both of these as components of an insurer's operating income, which is net income excluding after-tax realized investment gains or losses.

The profitability of underwriting

When analyzing underwriting results, consider the company's rate of premium growth, its fee income, and whether it uses reinsurance. The company's benefits and other expenses and its selling costs are then examined. These measures can then be compared with aggregate industry data to see how a company stacks up against its peers.

Some companies report fee income separately from premium income; others combine the two and call them "premiums and equivalents." Either way, these two revenue components must both be considered when analyzing underwriting results.

◆ **Rate of premium growth.** Pay careful attention to the circumstances surrounding the rate of premium growth. For example, if a company increases its premium base 10% while the overall industry is growing by 5% a year, that company would appear to be outperforming its peer group. Presumably, the stock market would award that firm a higher valuation than would be given some of its slower-growth peers.

However, if the insurer is achieving premium growth by adopting risky practices — such as offering unusually high rates of return on certain investment-oriented life insurance products — that insurer's valuation would be adjusted downward accordingly.

A company expanding its premium base at a rate slower than that of the overall industry could be doing so because it's limiting its exposure to certain types of less attractive business or trying to manage its asset-liability mix. Often, insurers that are very prudent in their underwriting practices show lower-than-average premium growth, but above-average profit growth.

◆ **Fee income.** As the life insurance industry's product mix shifts from one that generates only premium revenues (from so-called traditional life insurance products) to one with a growing level of fee income (from fee-based products like annuities), the level of overall revenue growth may be masked by declining or flat premium growth. In many cases, this is offset by rather robust growth in fee income.

◆ **Reinsurance.** Another factor that affects the rate of premium growth is the extent to which an insurer uses reinsurance. This is the practice of transferring some risk — and premium income — to reinsurance companies. To offset slowing premium growth, some insurers have reduced the level of premiums that they cede (or transfer) to reinsurers. Because using less reinsurance lets an insurer keep more of each premium dollar, a reduced level of reinsurance may enhance year-to-year premium growth comparisons. However, using less reinsurance removes a safety net of protection and leaves a primary insurer more exposed to large claims.

◆ **Benefits and other expenses.** The largest expense facing most life insurers is policyholder benefits. These include: death benefits to life insurance policyholders; accident, health, and disability benefits to health insurance policyholders; and annuity benefits. Benefits also include surrender benefits, which arise when policyholders and annuitants terminate their policies or annuities.

Clearly, a sharp rise in any of those benefits should trigger a further investigation into the causes behind the rise. Again, an insurer's business mix will greatly influence its level of benefit expenses and the growth rates therein. For example, an insurer that writes a large amount of fixed-rate annuities — insurance contracts that guarantee a set interest rate that will be paid on the principal amount deposited in the annuity — may see its surrender rates increase if investors can obtain higher rates of return on their investment dollars elsewhere.

However, one should closely examine an insurer whose surrender rates rise sharply during a period of stable surrenders for the industry. This could indicate that policyholders and annuitants have lost faith in the company's ability to meet its obligations and have pulled out their money in a move similar to a "run" on a bank.

Two factors that influence the level of policyholder benefits are trends in mortality and morbidity. Mortality is the ratio of deaths to a specific population. Morbidity is the frequency of the incidence of disease, illness, or sickness. Insurers use various mortality and morbidity assumptions in pricing their policies; these assumptions usually are not disclosed. However, in the annual report, a section called "management's discussion and analysis of financial condition" often includes the insurer's discussion of general mortality and morbidity trends. It's important to note whether actual mortality and morbidity trends were in line with the insurer's assumptions.

◆ **Selling costs.** Aside from assorted policyholder benefits, costs to produce new business or acquire policies — including agent commissions and other related selling expenses — also take a big bite out of insurers' budgets.

To measure how effective an insurer is at marketing its products, a "lapse ratio" is used. This is the number of life insurance contracts that have lapsed (or terminated due to nonpayment) within a specific period, divided by the number of policies in force during that period. A lower lapse ratio is usually better for an insurer's profitability, due to the high level of expenses (primarily agent commissions) that insurers incur to produce new business. Conversely, one would also look for a high level of persistency — the percentage of life insurance policies remaining in force or that have not been canceled for premium nonpayment — during the term.

Investment profitability

Investment income is an important revenue source for life insurers; in some cases, it provides almost half of an insurer's total revenues. One should review the insurer's asset allocation strategy, then calculate such measures as yield and total return. Two standard financial ratios — return on assets and return on equity — also help the analyst assess a company's profitability.

◆ **Asset allocation strategies.** When evaluating an insurer's investment portfolio, review its asset allocation strategy, making sure the mix of invested assets is appropriate for the type of business it writes. For most insurers, the investment process is fairly straightforward. Most life insurers keep the bulk of their invested assets in relatively liquid fixed-income or equity securities that can be easily converted into cash to pay policy or annuity obligations.

For each asset class, such as stocks or bonds, a review of asset quality and diversification is prudent. To help in the analysis of asset quality, insurers usually provide the debt rating of bonds in their portfolio or an average debt rating for their entire portfolio.

Life insurers' obligations tend to be relatively long-term in nature; the amount of time from a policy's inception to the payment of a benefit or claim is often lengthy. Because of this, some life insurers invest a portion of their invested assets in relatively illiquid (but theoretically higher-yielding) mortgage loans and real estate. A review of this asset class should include an analysis of the reserve levels, the level of delinquencies (in the case of mortgage loans), and the diversification of the real estate portfolio (both by property type and by geographic location).

◆ **Measures of investment success.** Two industry-specific ratios that help the analyst measure a company's investment success are yield and total return. Yield is usually calculated as the net investment income during a certain period, divided by the portfolio's average value during the same period. Total return is usually calculated as net investment income plus or minus realized and unrealized gains, divided by the portfolio's beginning market value plus or minus the weighted average of additions or dispositions.

◆ **Measures of profitability.** Two broader measures of profitability that are applicable to life insurers are return on assets (ROA) and return on equity (ROE).

Return on assets is equal to net income divided by average total assets. A typical range of ROAs for the life insurance industry is somewhere between 0.6% and 0.9%, with the average somewhere around 0.75%. This ratio may appear low relative to other industries; it is due to the capital-intensive nature of insurers' business.

Return on equity is calculated by dividing net income by average shareholders' equity. For the life insurance industry, ROE typically ranges from 9% to 15%, with the average somewhere around 12% or 13%.

Liquidity

Liquidity is another necessary performance benchmark to consider when analyzing a life insurer, because the insurer must be able to pay policyholder claims promptly. An insurer's sources of liquidity arise from underwriting cash flow, investment cash flow, and asset liquidation cash flow.

For the most part, underwriting cash flow tends to be positive for life insurers. Combining this with the cash flow from investment activities, most insurers usually produce a substantial, positive cash flow.

Another measure of liquidity is the quick ratio. This is calculated by dividing quick assets (*i.e.*, cash, trade receivables, and marketable securities) by current liabilities. Sometimes referred to as the acid-test ratio, the quick ratio is designed to measure an organization's ability to pay all its current liabilities promptly without resorting to selling long-term investments or assets. This ratio typically ranges from 9% to 11%. An insurer with a business mix that contains mostly shorter-term obligations would need to maintain a higher quick ratio — *i.e.*, greater liquidity — than one whose business mix is predominantly longer-term obligations.

Leverage

For life insurers, leverage usually measures the extent to which a firm utilizes its capital base (policyholders' surplus or shareholders' equity) to produce business. The ratio of premiums to surplus is a good gauge of leverage. However, for an accurate picture of leverage, premium equivalence should also be included in this calculation. The ratio of adjusted capital and surplus to liabilities gauges the relative strength of an insurer's capital base compared with its obligations. This ratio — calculated as capital and surplus funds plus the asset valuation reserve, divided by total liabilities, excluding the asset valuation reserve — typically ranges from 8% to 10%.

Operating, GAAP, and Core earnings

When life insurance companies report earnings, Wall Street analysts primarily focus on operating earnings, in order to analyze the trends and performance of core businesses. The main drivers of operating earnings consist of revenues, including insurance premiums and fees, advisory fees, and net investment income, and expenses that are associated with benefits, underwriting, acquisitions, insurance, and core business operations. In comparison, net earnings generally consist of profits derived from operations, in addition to realized investment gains and losses, the change in the fair value of the interest rate component of cross-currency swaps, and nonrecurring items (minus interest expense and taxes).

Although reporting in the life and health insurance industry is not always as transparent as it is in other segments of the economy, such as industrials or consumer cyclicals, analyzing operating results provides trends that are more discernable and results that are less volatile than would an analysis of net income. For example in the years between 1999 and 2003, Lincoln Financial recorded operating earnings of $475 million, $683 million, $644 million, $413 million, and $592 million. In contrast, the company's net income was reported as $460 million, $585 million, $546 million, $49 million, and $512 million. The operating earnings have a variance of $252 million, while the net income figures under GAAP accounting have a variance of $634 million.

In May 2002, Standard & Poor's announced a new methodology for calculating companies' earnings that will enable investors to make apples-to-apples earnings comparisons. The computation of Standard & Poor's Core Earnings™ excludes certain nonrecurring items: goodwill impairment, gains/losses from asset sales, pension gains, unrealized gains/losses from hedging activities, merger and acquisition charges, and litigation settlements. Included as valid costs of doing business are employee stock option expense, restructuring charges, writedowns of depreciable or amortizable operating assets, purchased research and development, and pension costs. (A detailed explanation of Core Earnings can be found at www.standardandpoors.com, in the Analytical Methodology section under Equity Research.)

For companies in the life and health insurance industry, Core Earnings tend not to differ much from operating earnings, which already discount both realized and unrealized gains and losses. The most notable difference in reported earnings and Core Earnings comes from pension plan gains or losses and options expense.

For example, recalculating the 2002 results of Lincoln Financial using the Core Earnings definition shows the following changes. Including pension and option expenses would have reduced per-share earnings by about $58 million. When Lincoln Financial's results are recalculated using the Core Earnings definition, the result is income of $2.23 per share. In comparison, the company reported per-share operating earnings of $2.56, a difference of about 13%.

Glossary

Accumulation period — The time period during which an insured makes premium payments on a life insurance policy; also, the time prior to the commencement of income payments under an annuity contract.

Acquisition cost — The cost to a company of obtaining business, including commissions to agents and brokers and, in some cases, field supervision costs.

Actuary — A person in the profession of calculating statistical risks, premium levels, and other technical aspects of insurance.

Adjustable life — A flexible life insurance policy that gives the policyholder the option of changing protection from term life insurance to whole life insurance and back again. Within limits, the policyholder can raise or lower the face amount, increase or decrease the premium, and/or shorten or lengthen the protection period.

Administrative services only (ASO) agreement — An agreement under which an insurer provides only such services as actuarial work, benefit plan design, claims processing, financial advice, and report preparation to an employer or other eligible group, which accepts the underwriting risk; also known as self-insurance.

Admitted assets — Assets that regulators include when determining an insurer's financial condition. Admitted assets are usually those that have a high degree of liquidity (can be easily converted into cash).

Adverse selection — The tendency of persons with poorer-than-average health risks to apply for or maintain insurance coverage.

Agent — A person who acts as the representative of an insurer to sell insurance policies; can be independent (representing two or more underwriters) or captive/exclusive (an employee or commissioned representative of a single company).

Annuity — A contract providing income at regular intervals for a specified period, such as a set number of years.

Annuity consideration — The payment, or one of the regular periodic payments, made for an annuity.

Assignment — The legal transfer of one person's interest in an insurance policy to another person.

Broker — A producer who legally represents the buyer of insurance rather than the underwriting company. The broker deals with other agents or underwriting companies to arrange the required coverage.

Business life insurance — Life insurance that a business enterprise or partnership purchases on the life of a member to protect against losses that would result from the insured's death.

Capacity — The level of underwriting business an insurer can support, based on its ability or willingness to accept risks within certain protection limits.

Captive insurer — An insurance organization that a company establishes to insure its own risks.

Cash surrender value — The amount of cash available to a policyholder upon the voluntary termination of a life insurance policy before it becomes payable by death or maturity.

Convention statement — Documents filed with state insurance departments detailing the financial statistics of individual insurance companies. Convention statements are prepared using statutory (rather than GAAP) accounting methods.

Convertible term insurance — Term insurance that can be exchanged for another insurance plan at the policyholder's option, without evidence of insurability.

Declination — The rejection by a life insurance company of a life insurance application, usually for reasons related to the applicant's health or occupation.

Demutualization — The process by which a mutual insurance company converts to a stock insurance company. In the conversion process, the mutual insurer offers policyholders cash or stock in the new company. The demutualized company may also make a public stock offering.

Disability benefit — A feature of some life insurance policies that provides for the waiver of premiums if the policyholder becomes totally and permanently disabled; a monthly income payment is sometimes provided as well.

Earned premium — Portion of a premium for which the insurer has already provided protection for the policyholder.

Fixed annuity — An annuity that contains a fixed, guaranteed minimum rate of interest that will be paid on the principal deposited in the annuity.

Flexible-premium deferred annuity (FPDA) — An annuity under which the purchaser can make periodic (usually monthly) payments during the accumulation period.

Generally accepted accounting principles (GAAP) — An accounting method that, among other things, attempts to match a company's income and expenses by prorating costs over an insurance policy's assumed life. The GAAP method is employed in the audited financial statements of publicly held companies. (Also see "statutory accounting.")

Guaranteed investment contract (GIC) — A product offered by life insurance companies that guarantees a specified rate of return over the life of the contract. GICs are sometimes offered by corporations as part of a 401(k) plan.

Insurance examiner — The representative of a state insurance department assigned to participate in an insurance company's official audit and examination.

Insurance in force — The potential maximum claim against an insurer.

Lapsed policy — A policy terminated for nonpayment of premiums. This term is sometimes limited to termination that happens before the policy has accumulated a cash or other surrender value.

Managing general agent (MGA) — A special type of insurance agent who, unlike a regular agent, has "binding authority" in certain insurance and reinsurance markets. MGAs have contractual agreements whereby they can accept entire books of business on behalf of insurance and reinsurance underwriters.

Morbidity — Frequency and severity of sickness and accidents in a well-defined class or classes of persons.

Mortality — The ratio of deaths to a specific population; also, the number of deaths resulting from specific types of illness or disease.

Mutual insurance company — An insurance company that has no capital stock, but is owned by its policyholders, who also elect its governing body. Earnings of the mutual company belong to the policyholders and are distributed to them in the form of policy dividends or reduced premiums.

Net premiums written — Premium income retained by insurance companies, directly or through reinsurance, less payments made for business reinsured.

Nonforfeiture option — One of the choices available if a policyholder discontinues premium payments on a policy with a cash value. The cash value, if any, may be taken in cash, as extended term insurance, or as reduced paid-up insurance.

Nonparticipating policy — An insurance policy that does not pay policy dividends. Premiums for nonparticipating policies are usually lower than those for participating policies.

Participating policy — An insurance policy that distributes its dividends by cash payments, reduced premiums, or units of paid-up life insurance.

Policy loan — A loan made by a life insurance company from its general funds to a policyholder, using the policy's cash value as security.

Policy reserves — Funds held by an insurer specifically for the fulfillment of its policy obligations.

Premium — The payment, or one of the periodic payments, a policyholder agrees to make for an insurance policy.

Premium loan — A policy loan made for the purpose of paying premiums.

Producer — A person or firm that sells insurance; may be an agent or a broker.

Rated policy — A policy issued at a higher-than-standard premium rate to cover extra risk — for example, if an insured has impaired health or a hazardous occupation. Sometimes called an "extra risk" policy.

Reserves — Funds set aside to cover obligations to policyholders; the amount may represent both actual and potential liabilities.

Rider — A special provision or group of provisions that may be added to a policy to expand or to limit the benefits otherwise payable.

Risk-based capital — The amount of capital an insurer needs to meet its obligations to policyholders. State regulatory bodies calculate risk-based capital levels, taking into account various types of risk, and compare them with companies' actual capital.

Separate account — An asset account established by an insurer and segregated from other funds; used primarily for pension plans and variable life products. This arrangement permits wider latitude in the insurer's investment choices, particularly in equities and real estate.

Single-premium deferred annuity (SPDA) — An annuity contract under which the premium is paid in one lump sum at the beginning of the contract. Benefit payments begin at a later date.

Single-premium immediate annuity (SPIA) — An annuity contract under which the premium is paid in one lump sum at the outset. Benefits begin immediately.

Statutory accounting principles (SAP) — An accounting format used by state insurance regulators, SAP is essentially cash-oriented (rather than accrual-oriented, as GAAP is) and has such requirements as immediately expensing all costs related to writing business. More conservative than GAAP, which focuses on profit growth, statutory accounting focuses on solvency — a firm's ability to meet its obligations.

Stock insurance company — An insurance company owned by its stockholders, who receive profits in the form of stockholder dividends and who elect a board to direct the firm's management.

Supplementary contract — An agreement between a life insurer and a policyholder or beneficiary whereby the company retains the cash sum payable under an insurance policy and makes payments in accordance with the chosen settlement option.

Surrender charge — A fee levied on a policyholder when a life insurance policy or annuity is surrendered for its cash value prior to its maturity date or contract termination date. Such fees are meant to discourage early retirement of policies and annuity contracts and are typically structured to recover the costs an insurer undertook to write the policy, known as the policy acquisition costs.

Term insurance — Life insurance payable to a beneficiary only when the insured dies within a specific time period.

Underwriting profit/loss — Profits or losses resulting from insurance activities, calculated on a statutory basis.

Universal life — A policy that lets the policyholder change the death benefit from time to time. Subject to certain minimums, the holder can also vary the amount or timing of premium payments. Universal life policies usually increase in value each year according to the amount of interest earned.

Vanishing premium policy — A life insurance policy with large premium payments in its early years; these payments are used to build up the policy's cash value. After an adequate cash value has accumulated, future premiums are paid by borrowing against the policy's cash value.

Variable annuity — A type of annuity under which the amount of each benefit payment isn't guaranteed or specified in the contract. Rather, benefit payments fluctuate depending on the investment results of the assets held in the account.

Variable life — Life insurance that's similar to whole life in that its premiums are fixed. The variable aspects are the death benefit and the cash surrender value. The death benefit is based on the value of assets behind the contract at the time the benefit is paid, above a guaranteed minimum. The cash value is similarly determined, but no minimum is guaranteed. The assets underlying variable life policies' benefits are usually held in separate accounts.

Variable premium life — A whole life policy under which premiums decrease when interest rates and investment income rise.

Whole life — Life insurance payable to a beneficiary at the death of the insured. Premiums may be payable for a specified number of years (limited payment life) or for life (straight life).

PERIODICALS

Aggregates & Averages: Life Insurance
A.M. Best Co. Inc.
Ambest Rd., Oldwick, NJ 08858
(908) 439-2200
Web site: http://www.ambest.com
Annual publication providing financial and underwriting data on the life insurance industry.

Best's Review
BestWeek
A.M. Best Co. Inc.
Ambest Rd., Oldwick, NJ 08858
(908) 439-2200
Web sites: http://www.bestreview.com
http://www.bestweek.com
A monthly magazine and a weekly newsletter, respectively, covering issues in the life insurance industry.

National Underwriter: Life & Health/Financial Services Edition
The National Underwriter Co.
5081 Olympic Blvd., Erlanger, KY 41081
(800) 543-0874
Web site: http://www.nunews.com/lifeandhealth
Weekly news and information on the life and health insurance and financial services industries.

BOOKS

The Annuity Handbook, 3rd ed.
Darlene K. Chandler
Cincinnati, OH: The National Underwriter Co., 2002

Glossary of Insurance Terms
R.W. Osler and J.S. Bickley, Eds.
Santa Monica, CA: Insurors Press Inc., 1972

Rupp's Insurance & Risk Management Glossary, 2nd ed.
Richard V. Rupp, CPCU
Chatsworth, CA: NILS Publishing Co., 1998

RESEARCH FIRMS

SNL Financial
One SNL Plaza
P.O. Box 2124, Charlottesville, VA 22902
(434) 977-1600
Web site: http://www.snl.com
A comprehensive source for financial services industry data and analysis.

VARDS
2350 Corporate Park Dr., Ste. 600, Herndon, VA 20171
(703) 234-0150
Web site: http://www.vards.com
Acquired by Finetre Corp. in 2003, VARDS provides sales tracking and product information for variable annuities data and publishes *The VARDS Report*.

TRADE ASSOCIATIONS

American Council of Life Insurers (ACLI)
101 Constitution Ave. NW, Ste. 700
Washington, DC 20001
(202) 624-2000
Web site: http://www.acli.com
Publishes the *Life Insurance Fact Book*, an annual compilation of life insurance statistics.

America's Health Insurance Plans
601 Pennsylvania Ave. NW, South Bldg., Suite 500
Washington, DC 20004
(202) 778-3200
Web site: http://www.aahp.org
Publishes information and conducts conferences on a wide range of issues affecting the health insurance industry.

LIMRA International
300 Day Hill Rd., Windsor, CT 06095
(860) 688-3358
Web site: http://www.limra.com
Provides research, consulting, and other services to companies marketing annuity, disability, health, life, mutual fund, and retirement savings products.

National Association of Health Underwriters
2000 N. 14th St., Suite 450, Arlington, VA 22201
(703) 276-0220
Web site: http://www.nahu.org
Publishes *Belth's Annual Carrier Ratings Report*, which provides facts about all US life and health carriers and information on the financial strength of each.

National Association of Insurance Commissioners
2301 McGee St., Suite 800, Kansas City, MO 64108
(816) 842-3600
Web site: http://www.naic.org
Publishes information on issues relevant to both the life and health and property-casualty segments of the insurance industry.

National Association of Variable Annuities (NAVA)
11710 Plaza American Dr., Ste. 100, Reston, VA 20190
(703) 707-8830
Web site: http://www.navanet.org
Publishes information and conducts conferences on the variable annuity and variable life insurance industries.

COMPANY INFORMATION

The investor relations departments of insurers can provide annual and quarterly reports, 10Ks, and 10Qs.

AFLAC Inc.
1932 Wynnton Rd., Columbus, GA 31999
(706) 323-3431
Web site: http://www.aflac.com

American International Group Inc.
70 Pine St., New York, NY 10270
(212) 770-7000; (877) 638-4244
Web site: http://www.aig.com

AXA Financial Group
1290 Ave. of the Americas, New York, NY 10104
(212) 554-1234
Web site: http://www.axa-financial.com

The Hartford Financial Services Group
Hartford Plaza, Hartford, CT 06115
(860) 547-5000
Web site: http://www.thehartford.com

HCC Insurance Holdings Inc.
13403 Northwest Freeway, Houston, TX 77040
(713) 690-7300
Web site: http://www.hcch.com

Horace Mann Educators Corp.
1 Horace Mann Plaza, Springfield, IL 62715
(217) 789-2500
Web site: http://www.horacemann.com

Jefferson-Pilot Corp.
100 N. Green St., Greensboro, NC 27401
(336) 691-3000
Web site: http://www.jpfinancial.com

John Hancock Financial Services Inc.
200 Clarendon St., Boston, MA 02117
(617) 572-6000
Web site: http://www.johnhancock.com

Lincoln Financial Group
1500 Market St., Ste. 3900, Philadelphia, PA 19102
(215) 448-1400
Web site: http://www.lfg.com

MetLife Inc.
One Madison Ave., New York, NY 10010
(212) 578-2211
Web site: http://www.metlife.com

Principal Financial Group
711 High St., Des Moines, IA 50392
(800) 986-3343
Web site: http://www.principal.com

Protective Life Corp.
2801 Highway 280 S., Birmingham, AL 35223
(205) 268-1000
Web site: http://www.protective.com

Prudential Financial Inc.
751 Broad St., Newark, NJ 07102
(973) 802-6000; (800) 778-2255
Web site: http://www.prudential.com

Torchmark Corp.
2001 Third Ave. S., Birmingham, AL 35233
(205) 325-4200
Web site: http://www.torchmarkcorp.com

Definitions for Comparative Company Analysis Tables

Operating revenues

Net sales and other operating revenues. Excludes interest income if such income is "nonoperating." Includes franchised/leased department income for retailers and royalties for publishers and oil and mining companies. Excludes excise taxes for tobacco, liquor, and oil companies.

Net income

Profits derived from all sources, after deductions of expenses, taxes, and fixed charges, but before any discontinued operations, extraordinary items, and dividend payments (preferred and common).

Return on revenues

Net income divided by operating revenues.

Return on assets

Net income divided by average total assets. Used in industry analysis and as a measure of asset-use efficiency.

Return on equity

Net income, less preferred dividend requirements, divided by average common shareholder's equity. Generally used to measure performance and to make industry comparisons.

Price/earnings ratio

The ratio of market price to earnings, obtained by dividing the stock's high and low market price for the year by earnings per share (before extraordinary items). It essentially indicates the value investors place on a company's earnings.

Dividend payout ratio

This is the percentage of earnings paid out in dividends. It is calculated by dividing the annual dividend by the earnings. Dividends are generally total cash payments per share over a 12-month period. Although payments are usually calculated from the ex-dividend dates, they may also be reported on a declared basis where this has been established to be a company's payout policy.

Dividend yield

The total cash dividend payments divided by the year's high and low market prices for the stock.

Earnings per share

The amount a company reports as having been earned for the year (based on generally accepted accounting standards), divided by the number of shares outstanding. Amounts reported in *Industry Surveys* exclude extraordinary items.

Tangible book value per share

This measure indicates the theoretical dollar amount per common share one might expect to receive should liquidation take place. Generally, book value is determined by adding the stated (or par) value of the common stock, paid-in capital, and retained earnings, then subtracting intangible assets, preferred stock at liquidating value, and unamortized debt discount. This amount is divided by the number of outstanding shares to get book value per common share.

Share price

This shows the calendar-year high and low of a stock's market price.

In addition to the footnotes that appear at the bottom of each page, you will notice some or all of the following:

NA—Not available.

NM—Not meaningful.

NR—Not reported.

AF—Annual figure. Data are presented on an annual basis.

CF—Combined figure. In this case, data are not available because one or more components are combined with other items.

Operating Revenues

			Million $							Compound Growth Rate (%)			Index Basis (1992 = 100)				
Ticker	Company	Yr. End	2002	2001	2000	1999	1998	1997	1992	10-Yr.	5-Yr.	1-Yr.	2002	2001	2000	1999	1998
LIFE & HEALTH INSURANCE‡																	
AFL	* AFLAC INC	DEC	10,257.0	9,598.0	9,720.0	8,640.0	7,104.0	6,983.5	3,986.5	9.9	8.0	6.9	257	241	244	217	178
AMH	† AMERUS GROUP CO -CL A	DEC	1,428.4 F	1,287.5A,F	813.4 D,F	734.1 F	690.6 F	360.8 A,F	NA	NA	31.7	10.9	**	**	**	**	NA
DFG	§ DELPHI FINANCIAL GRP -CL A	DEC	761.4 F	594.4F	512.9 F	640.5 D,F	626.6 A,F	535.6 F	355.5	7.9	7.3	28.1	214	167	144	180	176
JP	* JEFFERSON-PILOT CORP	DEC	3,480.0	3,330.0	3,238.0	2,561.0 F	2,610.0 F	2,578.0 A,F	1,202.3	11.2	6.2	4.5	289	277	269	213	217
JHF	* HANCOCK JOHN FINL SVCS INC	DEC	8,388.3	9,052.6	7,454.3	7,792.4	6,832.0	NA	NA	NA	NA	-7.3	**	**	**	**	NA
LNC	* LINCOLN NATIONAL CORP	DEC	4,644.4	6,362.1	6,851.9	6,797.9	6,083.7 A	4,898.5 A,C	8,034.1	-5.3	-1.1	-27.0	58	79	85	85	76
MET	* METLIFE INC	DEC	33,147.0 D,F	31,928.0A,F	31,947.0 F	25,426.0 A,F	27,106.0 F	NA	NA	NA	NA	3.8	**	**	**	**	NA
MNY	† MONY GROUP INC	DEC	2,094.5 D	2,108.9	1,251.8	1,245.6	1,856.2	1,976.4	NA	NA	1.2	-0.7	**	**	**	**	NA
PLFE	§ PRESIDENTIAL LIFE CORP	DEC	204.7 F	284.4F	284.5 F	278.1 F	242.2 F	247.7 F	209.0	-0.2	-3.7	-28.0	98	136	136	133	116
PL	† PROTECTIVE LIFE CORP	DEC	1,920.7 A	1,614.2D	1,734.0	1,533.9	1,366.4 A	1,147.3 A	626.0	11.9	10.9	19.0	307	258	277	245	218
PRU	* PRUDENTIAL FINANCIAL INC	DEC	26,675.0 D	27,177.0A	26,544.0	26,568.0	NA	NA	NA	NA	NA	-1.8	**	**	**	**	NA
SFG	† STANCORP FINL GROUP INC	DEC	1,750.3	1,585.4	1,462.7	1,234.5	1,232.6	1,146.2	NA	NA	8.8	10.4	**	**	**	**	NA
TMK	* TORCHMARK CORP	DEC	2,738.0	2,707.0C,D	2,515.9	2,226.9	2,157.9 D	2,282.4	2,045.8	3.0	3.7	1.1	134	132	123	109	105
UCI	§ UICI	DEC	1,485.1 D	1,106.6D	1,025.1 D	1,013.2 D	1,179.9	955.8 A	NA	NA	9.2	34.2	**	**	**	**	NA
UNM	* UNUMPROVIDENT CORP	DEC	9,613.0	9,394.8	9,432.3	9,329.6 A	4,641.4	4,004.1	2,641.2	13.8	19.1	2.3	364	356	357	353	176
MULTI-LINE INSURANCE‡																	
AFC	† ALLMERICA FINANCIAL CORP	DEC	3,316.6 C	3,311.8	3,087.9	3,145.2 D	3,432.5 A	3,395.6 A	NA	NA	-0.5	0.1	**	**	**	**	NA
AFG	† AMERICAN FINL GROUP INC	DEC	3,751.1	3,923.6	3,767.1	3,334.5	4,063.2	4,026.3	1,796.7	7.6	-1.4	-4.4	209	218	210	186	226
AIG	* AMERICAN INTERNATIONAL GROUP	DEC	67,482.0	62,402.0A,C	45,972.0	40,656.0 A	33,239.0	30,488.7	19,441.1	13.3	17.2	8.1	347	321	236	209	171
HIG	* HARTFORD FINL SVCS GRP INC	DEC	15,907.0	15,147.0A	14,703.0	13,528.0	15,022.0 A	13,305.0	NA	NA	3.6	5.0	**	**	**	**	NA
HCC	† HCC INS HLDGS INC	DEC	669.4 A,F	505.5A,F	466.2 C,F	337.0 A,F	308.0 A,F	318.4 A	NA	NA	16.0	32.4	**	**	**	**	NA
HMN	† HORACE MANN EDUCATORS CORP	DEC	771.9	804.5	781.2	775.4	779.4	747.0	704.3	0.9	0.7	-4.1	110	114	111	110	111
LTR	* LOEWS CORP	DEC	16,827.8 D,F	18,799.1F	20,669.9	20,952.6 F	20,713.0 F	19,647.8 F	13,308.9 F	2.4	-3.1	-10.5	126	141	155	157	156
UTR	† UNITRIN INC	DEC	2,298.2 A	1,971.7	1,953.2	1,813.6 A	2,085.9 A	1,530.1 A	1,362.6	5.4	8.5	16.6	169	145	143	133	153

Note: Data as originally reported. ‡ S&P 1500 Index group. * Company included in the S&P 500. † Company included in the S&P MidCap. § Company included in the S&P SmallCap. # Of the following calendar year. ** Not calculated; data for base year or end year not available. A - This year's data reflect an acquisition or merger. B - This year's data reflect a major merger resulting in the formation of a new company. C - This year's data reflect an accounting change. D - Data exclude discontinued operations. E - Includes excise taxes. F - Includes other (nonoperating) income. G - Includes sale of leased depts. H - Some or all data are not available, due to a fiscal year change.

Net Income

			Million $							Compound Growth Rate (%)			Index Basis (1992 = 100)				
Ticker	Company	Yr. End	2002	2001	2000	1999	1998	1997	1992	10-Yr.	5-Yr.	1-Yr.	2002	2001	2000	1999	1998
LIFE & HEALTH INSURANCE‡																	
AFL	* AFLAC INC	DEC	821.0	687.0	687.0	571.0	487.0	585.0	183.4	16.2	7.0	19.5	448	375	375	311	266
AMH	† AMERUS GROUP CO -CL A	DEC	62.9	79.3	51.1	66.7	62.8	58.1	NA	NA	1.6	-20.7	**	**	**	**	NA
DFG	§ DELPHI FINANCIAL GRP -CL A	DEC	60.9	-0.9	-3.3	64.1	87.0	75.0	24.6	9.5	-4.1	NM	247	-4	-13	260	353
JP	* JEFFERSON-PILOT CORP	DEC	450.0	512.0	512.0	470.0	418.0	370.0	203.2	8.3	4.0	-12.1	221	252	252	231	206
JHF	* HANCOCK JOHN FINL SVCS INC	DEC	499.5	611.5	838.9	256.5	460.2	NA	NA	NA	NA	-18.3	**	**	**	**	NA
LNC	* LINCOLN NATIONAL CORP	DEC	91.6	605.8	621.4	460.4	509.8	22.2	362.9	-12.9	32.7	-84.9	25	167	171	127	140
MET	* METLIFE INC	DEC	1,155.0	473.0	953.0	842.0	1,347.0	NA	NA	NA	NA	144.2	**	**	**	**	NA
MNY	† MONY GROUP INC	DEC	-20.8	-60.8	262.3	250.6	191.2	130.4	NA	NA	NM	NM	**	**	**	**	NA
PLFE	§ PRESIDENTIAL LIFE CORP	DEC	-69.3	-7.7	40.9	48.2	49.2	61.3	24.0	NM	NM	NM	-289	-32	170	201	205
PL	† PROTECTIVE LIFE CORP	DEC	178.8	141.1	153.5	153.1	130.8	112.0	42.5	15.5	9.8	26.7	421	332	361	360	308
PRU	* PRUDENTIAL FINANCIAL INC	DEC	256.0	-170.0	321.0	1,213.0	NA	NA	NA	NA	NA	NM	**	**	**	**	NA
SFG	† STANCORP FINL GROUP INC	DEC	111.0	106.0	94.7	84.4	75.6	63.8	NA	NA	11.7	4.7	**	**	**	**	NA
TMK	* TORCHMARK CORP	DEC	383.4	390.9	361.8	258.9	255.8	337.7	265.5	3.7	2.6	-1.9	144	147	136	98	96
UCI	§ UICI	DEC	51.4	48.4	29.1	33.3	58.8	86.5	NA	NA	-9.9	6.2	**	**	**	**	NA
UNM	* UNUMPROVIDENT CORP	DEC	408.3	582.1	564.2	-182.9	363.4	370.3	248.8	5.1	2.0	-29.9	164	234	227	-74	146

Net Income (continued)

			Million $							Compound Growth Rate (%)			Index Basis (1992 = 100)				
Ticker	Company	Yr. End	2002	2001	2000	1999	1998	1997	1992	10-Yr.	5-Yr.	1-Yr.	2002	2001	2000	1999	1998
MULTI-LINE INSURANCE‡																	
AFC	† ALLMERICA FINANCIAL CORP	DEC	-302.4	0.1	199.9	345.1	201.2	209.2	NA	NA	NM	NM	**	**	**	**	NA
AFG	† AMERICAN FINL GROUP INC	DEC	125.0	-4.8	-47.0	147.0	125.2	199.5	62.1	7.2	-8.9	NM	201	-8	-76	237	202
AIG	* AMERICAN INTERNATIONAL GROUP	DEC	5,519.0	5,499.0	5,636.0	5,055.0	3,766.0	3,332.3	1,625.0	13.0	10.6	0.4	340	338	347	311	232
HIG	* HARTFORD FINL SVCS GRP INC	DEC	1,000.0	549.0	974.0	862.0	1,015.0	1,332.0	NA	NA	-5.6	82.1	**	**	**	**	NA
HCC	† HCC INS HLDGS INC	DEC	105.8	30.2	55.4	25.1	72.3	49.8	NA	NA	16.3	250.5	**	**	**	**	NA
HMN	† HORACE MANN EDUCATORS CORP	DEC	11.3	25.6	20.8	44.5	85.3	87.1	71.8	-16.9	-33.5	-55.7	16	36	29	62	119
LTR	* LOEWS CORP	DEC	982.6	-535.8	1,876.7	521.1	464.8	793.6	-22.1	NM	4.4	NM	NM	NM	NM	NM	NM
UTR	† UNITRIN INC	DEC	-8.2	380.9	91.0	201.0	510.8	117.9	163.3	NM	NM	NM	-5	233	56	123	313

Note: Data as originally reported. ‡ S&P 1500 Index group. * Company included in the S&P 500. † Company included in the S&P MidCap. § Company included in the S&P SmallCap. # Of the following calendar year. ** Not calculated; data for base year or end year not available.

			Return on Revenues (%)					Return on Assets (%)					Return on Equity (%)				
Ticker	Company	Yr. End	2002	2001	2000	1999	1998	2002	2001	2000	1999	1998	2002	2001	2000	1999	1998
LIFE & HEALTH INSURANCE‡																	
AFL	* AFLAC INC	DEC	8.0	7.2	7.1	6.6	6.9	2.0	1.8	1.8	1.7	1.6	13.9	13.6	16.0	15.0	13.5
AMH	† AMERUS GROUP CO -CL A	DEC	4.4	6.2	6.3	9.1	9.1	0.3	0.5	0.5	0.6	0.6	5.0	7.7	6.5	8.4	7.1
DFG	§ DELPHI FINANCIAL GRP -CL A	DEC	8.0	NM	NM	10.0	13.9	1.7	NM	NM	1.9	2.6	9.6	NM	NM	12.0	16.2
JP	* JEFFERSON-PILOT CORP	DEC	12.9	15.4	15.8	18.4	16.0	1.5	1.8	1.9	1.9	1.8	13.0	15.6	17.3	16.2	14.5
JHF	* HANCOCK JOHN FINL SVCS INC	DEC	6.0	6.8	11.3	3.3	6.7	0.5	0.7	1.0	0.3	NA	8.3	10.5	15.9	5.3	NA
LNC	* LINCOLN NATIONAL CORP	DEC	2.0	9.5	9.1	6.8	8.4	0.1	0.6	0.6	0.5	0.6	1.7	11.9	13.5	9.5	9.8
MET	* METLIFE INC	DEC	3.5	1.5	3.0	3.3	5.0	0.4	0.2	0.4	0.4	NA	6.9	2.9	6.3	5.9	NA
MNY	† MONY GROUP INC	DEC	NM	NM	21.0	20.1	10.3	NM	NM	1.1	1.0	0.8	NM	NM	13.6	13.9	12.3
PLFE	§ PRESIDENTIAL LIFE CORP	DEC	NM	NM	14.4	17.3	20.3	NM	NM	1.5	1.8	1.9	NM	NM	9.4	10.4	9.6
PL	† PROTECTIVE LIFE CORP	DEC	9.3	8.7	8.9	10.0	9.6	0.9	0.8	1.1	1.2	1.2	11.5	11.2	15.5	16.9	15.4
PRU	* PRUDENTIAL FINANCIAL INC	DEC	1.0	NM	1.2	4.6	NA	0.1	NM	0.1	NA	NA	1.2	NM	1.6	NA	NA
SFG	† STANCORP FINL GROUP INC	DEC	6.3	6.7	6.5	6.8	6.1	1.4	1.5	1.5	1.5	1.5	10.4	11.2	10.7	10.1	9.6
TMK	* TORCHMARK CORP	DEC	14.0	14.4	14.4	11.6	11.9	3.1	3.1	2.9	2.2	2.3	14.3	16.6	17.2	12.2	12.2
UCI	§ UICI	DEC	3.5	4.4	2.8	3.3	5.0	1.5	1.5	0.9	1.1	2.9	9.2	9.8	6.8	6.6	10.4
UNM	* UNUMPROVIDENT CORP	DEC	4.2	6.2	6.0	NM	7.8	0.9	1.4	1.4	NM	2.6	6.4	10.1	10.7	NM	14.1
MULTI-LINE INSURANCE‡																	
AFC	† ALLMERICA FINANCIAL CORP	DEC	NM	0.0	6.5	11.0	5.9	NM	0.0	0.6	1.2	0.8	NM	0.0	8.6	14.7	8.3
AFG	† AMERICAN FINL GROUP INC	DEC	3.3	NM	NM	4.4	3.1	0.7	NM	NM	0.9	0.8	7.8	NM	NM	9.6	7.4
AIG	* AMERICAN INTERNATIONAL GROUP	DEC	8.2	8.8	12.3	12.4	11.3	1.0	1.4	2.0	2.2	2.1	9.9	12.0	15.5	16.7	14.7
HIG	* HARTFORD FINL SVCS GRP INC	DEC	6.3	3.6	6.6	6.4	6.8	0.6	0.3	0.6	0.5	0.7	10.1	6.7	15.1	14.5	16.2
HCC	† HCC INS HLDGS INC	DEC	15.8	6.0	11.9	7.5	23.5	3.1	1.0	2.1	1.2	4.9	12.9	4.7	11.2	5.6	17.9
HMN	† HORACE MANN EDUCATORS CORP	DEC	1.5	3.2	2.7	5.7	10.9	0.3	0.6	0.5	1.0	2.0	2.3	5.8	5.0	9.9	17.0
LTR	* LOEWS CORP	DEC	5.8	NM	9.1	2.5	2.2	1.3	NM	2.7	0.7	0.7	9.4	NM	17.7	5.2	4.7
UTR	† UNITRIN INC	DEC	NM	19.3	4.7	11.1	24.5	NM	5.7	1.5	3.4	9.4	NM	21.1	5.3	11.4	30.4

Note: Data as originally reported. ‡ S&P 1500 Index group. * Company included in the S&P 500. † Company included in the S&P MidCap. § Company included in the S&P SmallCap. # Of the following calendar year.

			Price / Earnings Ratio (High-Low)					Dividend Payout Ratio (%)					Dividend Yield (High-Low, %)				
Ticker	Company	Yr. End	2002	2001	2000	1999	1998	2002	2001	2000	1999	1998	2002	2001	2000	1999	1998
LIFE & HEALTH INSURANCE‡																	
AFL	* AFLAC INC	DEC	21-15	28-18	29-13	26-18	25-12	14	15	13	13	14	1.0-0.7	0.8-0.5	1.0-0.4	0.7-0.5	1.1-0.6
AMH	† AMERUS GROUP CO -CL A	DEC	25-16	17-12	13-7	13-7	20-8	25	19	20	18	21	1.6-1.0	1.5-1.1	3.0-1.5	2.5-1.4	2.8-1.1
DFG	§ DELPHI FINANCIAL GRP -CL A	DEC	15-11	NM-NM	NM-NM	18-9	14-7	10	NM	NM	0	0	0.9-0.6	1.1-0.7	0.0-0.0	0.0-0.0	0.0-0.0
JP	* JEFFERSON-PILOT CORP	DEC	17-12	15-11	15-10	18-14	20-12	39	32	29	29	29	3.3-2.2	2.8-2.2	2.9-1.9	2.1-1.6	2.4-1.5
JHF	* HANCOCK JOHN FINL SVCS INC	DEC	25-15	21-16	14-5	NA-NA	NA-NA	19	15	11	NA	NA	1.2-0.8	1.0-0.7	2.2-0.8	NA-NA	NA-NA

			Price / Earnings Ratio (High-Low) (cont'd)					Dividend Payout Ratio (%) (cont'd)					Dividend Yield (High-Low, %) (cont'd)				
Ticker	Company	Yr. End	2002	2001	2000	1999	1998	2002	2001	2000	1999	1998	2002	2001	2000	1999	1998
LNC	* LINCOLN NATIONAL CORP	DEC	NM-50	16-12	17-7	25-15	19-13	256	38	36	47	41	5.1-2.4	3.2-2.3	5.1-2.1	3.1-1.9	3.1-2.1
MET	* METLIFE INC	DEC	21-13	57-39	30-12	NA-NA	NA-NA	13	31	16	NA	NA	1.0-0.6	0.8-0.5	1.4-0.5	NA-NA	NA-NA
MNY	† MONY GROUP INC	DEC	NM-NM	NM-NM	9-5	6-4	8-7	NM	NM	8	8	0	2.1-1.1	1.5-0.9	1.7-0.9	1.7-1.2	0.0-0.0
PLFE	§ PRESIDENTIAL LIFE CORP	DEC	NM-NM	NM-NM	14-9	13-10	16-9	NM	NM	29	22	19	6.9-1.5	2.7-1.8	3.1-2.1	2.2-1.7	2.0-1.2
PL	† PROTECTIVE LIFE CORP	DEC	13-10	17-12	14-8	17-12	20-14	23	27	22	20	21	2.3-1.7	2.2-1.6	2.7-1.6	1.7-1.2	1.5-1.0
PRU	* PRUDENTIAL FINANCIAL INC	DEC	26-19	NA-NA	NA-NA	NA-NA	NA-NA	29	NA	NA	NA	NA	1.6-1.1	0.0-0.0	NA-NA	NA-NA	NA-NA
SFG	† STANCORP FINL GROUP INC	DEC	16-12	14-10	17-8	12-8	NA-NA	11	9	9	5	NA	0.9-0.7	0.8-0.6	1.2-0.5	0.6-0.4	NA-NA
TMK	* TORCHMARK CORP	DEC	13-9	14-10	15-7	19-13	27-17	11	12	13	18	23	1.2-0.9	1.1-0.8	1.9-0.9	1.5-0.9	1.4-0.9
UCI	§ UICI	DEC	20-11	16-6	19-5	40-13	29-9	0	0	0	0	0	0.0-0.0	0.0-0.0	0.0-0.0	0.0-0.0	0.0-0.0
UNM	* UNUMPROVIDENT CORP	DEC	18-10	14-9	14-5	NM-NM	23-16	35	24	25	NM	22	3.6-2.0	2.7-1.7	4.9-1.8	2.3-0.9	1.4-1.0
MULTI-LINE INSURANCE‡																	
AFC	† ALLMERICA FINANCIAL CORP	DEC	NM-NM	NM-NM	20-9	10-7	22-11	NM	NM	7	4	6	0.0-0.0	0.7-0.3	0.7-0.3	0.5-0.4	0.5-0.3
AFG	† AMERICAN FINL GROUP INC	DEC	17-10	NM-NM	NM-NM	18-10	22-15	27	NM	NM	41	49	2.8-1.7	5.4-3.3	5.4-3.4	4.1-2.3	3.3-2.2
AIG	* AMERICAN INTERNATIONAL GROUP	DEC	38-23	47-31	43-22	35-23	29-18	8	8	6	6	6	0.4-0.2	0.2-0.2	0.3-0.1	0.2-0.2	0.3-0.2
HIG	* HARTFORD FINL SVCS GRP INC	DEC	18-9	31-20	18-7	17-10	14-9	26	44	22	24	19	2.8-1.5	2.2-1.4	3.3-1.2	2.5-1.4	2.3-1.4
HCC	† HCC INS HLDGS INC	DEC	17-11	57-39	24-10	49-16	16-10	15	47	20	39	11	1.3-0.9	1.2-0.8	2.0-0.8	2.5-0.8	1.0-0.7
HMN	† HORACE MANN EDUCATORS CORP	DEC	86-49	36-23	44-24	31-18	19-13	150	67	82	35	17	3.1-1.7	2.8-1.9	3.5-1.9	2.0-1.2	1.3-0.9
LTR	* LOEWS CORP	DEC	14-8	NM-NM	6-2	22-12	27-19	13	NM	5	21	25	1.6-1.0	1.4-0.8	2.6-1.0	1.7-1.0	1.3-0.9
UTR	† UNITRIN INC	DEC	NM-NM	7-6	31-21	15-11	6-4	NM	28	114	51	20	6.0-3.9	4.7-3.8	5.5-3.6	4.6-3.3	4.7-3.5

Note: Data as originally reported. ‡ S&P 1500 Index group. * Company included in the S&P 500. † Company included in the S&P MidCap. § Company included in the S&P SmallCap. # Of the following calendar year.

			Earnings per Share ($)					Tangible Book Value per Share ($)					Share Price (High-Low, $)				
Ticker	Company	Yr. End	2002	2001	2000	1999	1998	2002	2001	2000	1999	1998	2002	2001	2000	1999	1998
LIFE & HEALTH INSURANCE‡																	
AFL	* AFLAC INC	DEC	1.59	1.31	1.30	1.08	0.92	12.43	10.40	8.87	7.28	7.09	33.45-23.10	36.09-23.00	37.47-16.78	28.38-19.50	22.66-11.34
AMH	† AMERUS GROUP CO -CL A	DEC	1.57	2.15	2.44	2.20	1.88	26.76	24.98	21.67	17.51	20.86	39.98-25.69	37.00-26.81	32.38-16.50	28.81-16.31	36.75-14.38
DFG	§ DELPHI FINANCIAL GRP -CL A	DEC	2.93	-0.04	-0.16	3.06	4.12	20.35	20.26	18.85	17.55	21.78	45.12-32.80	42.25-26.45	42.19-22.94	55.81-26.43	59.37-30.45
JP	* JEFFERSON-PILOT CORP	DEC	3.07	3.37	3.31	2.97	2.63	22.61	20.53	13.58	9.68	14.20	53.00-36.35	49.67-38.00	50.58-33.25	53.08-40.79	52.25-32.44
JHF	* HANCOCK JOHN FINL SVCS INC	DEC	1.71	2.01	2.67	0.82	1.39	19.01	17.47	18.52	NA	NA	42.30-25.84	42.00-31.50	38.25-13.44	NA-NA	NA-NA
LNC	* LINCOLN NATIONAL CORP	DEC	0.50	3.21	3.25	2.33	2.54	15.62	14.11	11.06	5.59	10.16	53.65-25.11	52.75-38.00	56.38-22.63	57.50-36.00	49.44-33.50
MET	* METLIFE INC	DEC	1.64	0.64	1.23	1.11	NA	23.75	21.60	20.62	NA	NA	34.85-20.60	36.63-24.70	36.50-14.31	NA-NA	NA-NA
MNY	† MONY GROUP INC	DEC	-0.44	-1.25	5.64	5.31	4.05	42.61	42.66	44.08	38.67	37.63	41.99-21.79	51.38-29.91	50.00-26.19	33.81-23.25	32.75-27.56
PLFE	§ PRESIDENTIAL LIFE CORP	DEC	-2.36	-0.26	1.36	1.55	1.53	13.59	14.57	15.88	13.19	16.49	26.30-5.78	22.57-14.94	18.63-12.69	20.75-16.00	23.88-14.00
PL	† PROTECTIVE LIFE CORP	DEC	2.56	2.02	2.33	2.34	2.06	24.39	19.74	13.39	10.03	11.51	33.90-26.00	35.00-24.80	32.25-19.00	40.75-27.81	41.25-28.00
PRU	* PRUDENTIAL FINANCIAL INC	DEC	1.36	NA	NA	NA	NA	37.94J	35.05J	NAJ	NAJ	NA	36.00-25.25	33.74-29.00	NA-NA	NA-NA	NA-NA
SFG	† STANCORP FINL GROUP INC	DEC	3.77	3.47	2.97	2.51	NA	35.55	32.69	29.29	25.68	NA	61.20-45.14	48.50-35.60	51.00-23.00	30.00-20.94	NA-NA
TMK	* TORCHMARK CORP	DEC	3.19	3.12	2.83	1.95	1.83	20.91	17.24	14.34	12.05	13.48	42.17-30.02	43.25-32.56	41.19-18.75	38.00-24.56	49.81-31.81
UCI	§ UICI	DEC	1.08	1.04	0.62	0.72	1.27	10.28	9.61	7.64	5.49	10.48	21.22-12.25	17.00-5.75	11.88-3.38	29.00-9.38	36.75-11.63
UNM	* UNUMPROVIDENT CORP	DEC	1.69	2.41	2.34	-0.77	2.63	25.57	21.74	20.29	17.79	19.74	29.70-16.30	33.75-22.25	31.94-11.94	62.50-26.00	60.06-41.75
MULTI-LINE INSURANCE‡																	
AFC	† ALLMERICA FINANCIAL CORP	DEC	-5.72	0.00	3.75	6.27	3.36	36.69	45.20	45.71	41.33	41.96	50.80-7.04	71.75-36.70	74.25-35.06	64.81-46.06	75.25-38.38
AFG	† AMERICAN FINL GROUP INC	DEC	1.82	-0.07	-0.80	2.46	2.04	21.37	17.31	18.24	17.25	23.54	30.30-17.90	30.75-18.35	29.00-18.38	43.63-24.50	45.75-30.50
AIG	* AMERICAN INTERNATIONAL GROUP	DEC	2.11	2.10	2.43	2.18	1.91	20.32	19.94	16.98	14.33	13.78	80.00-47.61	98.31-66.00	103.75-52.38	75.25-51.00	54.73-34.60
HIG	* HARTFORD FINL SVCS GRP INC	DEC	4.01	2.31	4.42	3.83	4.36	35.31	29.81	32.98	25.16	28.25	70.24-37.25	71.15-45.50	80.00-29.38	66.44-36.50	60.00-37.63
HCC	† HCC INS HLDGS INC	DEC	1.70	0.52	1.11	0.51	1.51	8.78	7.07	5.23	3.97	7.29	28.95-19.11	29.65-20.50	27.19-10.94	25.13-8.00	23.94-15.63
HMN	† HORACE MANN EDUCATORS CORP	DEC	0.28	0.63	0.51	1.08	1.97	10.53	9.17	8.29	7.26	9.40	24.08-13.61	22.40-14.80	22.19-12.00	33.00-19.13	37.63-26.06
LTR	* LOEWS CORP	DEC	4.49	-2.75	9.44	2.40	2.03	59.63	48.70	54.82	45.79	43.13	62.30-37.50	72.50-41.05	52.47-19.13	52.25-29.25	54.13-39.00
UTR	† UNITRIN INC	DEC	-0.12	5.64	1.32	2.76	6.55	21.56	23.27	19.93	18.98	20.06	42.80-27.85	41.95-33.90	41.13-27.19	42.38-30.50	37.06-27.78

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