IMPACT OF THE FINANCIAL CRISIS ON LIFE INSURANCE IN ROMANIA

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ABSTRACT: *Whereas both worldwide and locally financial problems aggravate, it is hard to believe that people would search protection in life insurance policy, although in these times people's need to be protected is much higher. Having in mind our possible future situation, when we might be in an economic impasse, the solution could be to contract a life insurance, which could basically provide protection, but on a long term, it might be a means of saving.*

KEY WORDS: *insurance; financial crisis; insurance; investment; protection; risk.*

JEL CLASSIFICATION: *G01, G11, G22*

1. INTRODUCTION

We come from times (before 1989) when "life insurance" meant that the state would provide everything, from workplace to lodging, therefore the Romanians are not yet accustomed to the capitalist concept of this form of protection, and this is clearly seen in the number of life insurances contracted in the first years of democracy. Fifteen years ago, few people knew what a life insurance meant, this would seem not a luxury, but a weird thing.

More and more people understand now what this is about; however, there are many skeptical people when it comes to the acquisition of such a product. Making a simple comparison between the number of CASCO insurances and life insurances, the numbers show that the Romanian value more their cars than their own life, their priorities being to accomplish certain urgent objectives, rather than the acquisition of a life insurance.

The uncertainties of tomorrow make them only think on the short term, therefore investing in medium and long term financial instruments is not of interest,

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and they do not save, thinking that their income is not sufficient for that. Their financial education is low, so the idea that “I do not need life insurance, nothing bad would happen to me” is deeply rooted in our mentality. In Bart Astor’s opinion, life insurance is a unique product, “unlike other insurance products, it is not for you, but for your survivors” (Astor, 1999).

The financial crisis could possibly make us more responsible regarding to our financial protection, increasing the awareness of the necessity and importance of personal actions, to secure our financial future, to change the perspective on saving, to make us understand that nobody will provide financial protection to our loved ones, or grant us a higher pension, but ourselves. We go through a financial crisis, it is neither the first, nor the last, but it is necessary for us to secure ourselves, and go in the direction desired, as far as possible.

This paper endeavors to point out the second valence of the life insurance, the long term saving, the first obviously being the protection of the individual. What is more important, a leasing for a new car or to provide for our retirement. Each will make his own choice.

2. LONG TERM EFFECTS OF THE CRISIS ON LIFE INSURANCE

Global insurance sector was on more powerful positions than the banking sector when the crisis started, and was less affected, due to the specific nature of the business model. Insurance companies manage long term obligations, coordinating them with investments over the same period, in “safe” instruments, while banks do not have the same concordance in time between assets and liabilities, thus being more exposed to liquidity risk and debt overload. Insurance plays a major role in world economy, providing millions of transactions and other economic and non-economic activities.”(Zevnik, 2004)

Insurance was not the source of this economic crisis, this period being well handled, playing in fact an “important part in the attenuation of the effects of the financial crisis by insurances of financial warrants and credits, assisting in restarting crediting, covering for the recorded losses of the banks.”(Ciurel, 2011). Insurance markets became more and more connected to capital markets and financial system in a large sense, insurers offering more and more products of saving and investments similar to banking products and investment funds.

On a long term, insurances will be affected by the prolonged crisis that will affect the consumers’ behavior. Financial education is still low in many countries, so is the understanding of new products, such as the unit-linked ones. Clients’ disappointment regarding policy diminution, as a result of stock exchange fall starting with the year 2008, generates uncertainty regarding products with investment component, which sell well in periods of economic growth, therefore they will experience decline in the following years. These products are profitable only if they are fiscally deductible or have an important insured sum, but in our country the premiums paid for life insurances are not deductible, although in other countries this fiscal advantage has long ago been applied.

The insurance companies that will sell guaranteed life insurance, that is policies where the investment risk is taken over by the insurer, and the profit obtained is shared with the client, will gain in the years to come. In times of crisis, life insurance with significant protection components are required, or else they are not worth being bought. Insurance specialists consider that one of the anti-crisis measures might be the application of deductibility for premiums paid for insurances. In crisis conditions, events such as falling ill are more frequent “if the person that fell ill had insurance, it would no longer be a burden for the state budget, since the expenses would be paid by the insurer. If savings by life insurance were stimulated by deductibility, this money would be transferred to consume."(http://www.zf.ro) The chances for life insurance to benefit from deductibility are rather poor, since a fiscal policy based on unique quota, as in Romania, does not allow such advantages.

The financial crisis will create big differences in the following years between the main life insurances and general insurances in one insurancee company, but these differences will be greater in countries of emerging economies (Ciurel, 2011). In our country, consumers of the life insurance will be redirected towards the protection component of these, giving up, at least for a little while the investment component.

3. PRIVATE PENSION UNDER THE CRISIS – CASE STUDY

The most convincing reason why we would draw up such a policy would be to have experienced such a system, to have seen out parents, our grandparents having taken advantage of the benefits of an insurance or private pension, but this will only be valid for the next generations. In developed countries at the first job, people start saving for their retirement, this being the normal social responsibility of each person. How long will it last for us to take this road?

Our country’s economic revival could be difficult and extend over many years; many people were forced to lower their standard of living. It is quite normal for many of us to fear to buy such a product, instead of building up a vision, a strategy, planning. Hard times make us cleverly manage our income and lay down an action plan, for those that decided to make this; this is what they might gain besides the pension from the state when retired.

We examine the case of a 32 year old person, who draws up an insurance contract with investment component, of private pension type for a 23 year period, with a net monthly premium of 156 RON, of which 100 RON the investment premium.

The insurance plan has two components: protection is represented by covering risk of death for the validness period of the contract and investment, by which the investments premiums are invested in various investment programs, chosen by the policy holder, transformed in unit.

Each investment program matches a certain level of risk, and the amount of risk the policy holder is willing to assume indicates the unit price. We are going to examine three investment programs of different risks, namely risk 2, risk 3, and risk 6 on a scale from 1 to 6.

The first program (risk 2 on the scale) intended to persons with low risk tolerance and short investment horizon, requiring a safe investment. The objective aimed at is to increase capital on a long term and generate stable efficiency by investing 100% in instruments with fixed income.

The evolutions of some type of contracts, with main characteristics previously presented are shown in Table 1.

Table 1. The evolution of the contract taking into account low risk investment program

Year	Insurance premium allocated to investment program	Insurance premium allocated to death risk	Insured amount (for basis insurance)	Assumed account profitability	Account value	Death risk coverage	Surrender value	Inflation adjustment
1	1200	79	15000	7,4%	1225	16225	0	5%
2	2460	162	15702	7,3%	2345	18048	0	5%
3	3783	250	16416	7,3%	3713	20129	2839	5%
4	5172	341	17109	7,3%	5227	22336	4255	5%
5	6631	438	17812	7,3%	6900	24713	5825	5%
6	8162	539	18514	7,3%	8747	27261	7563	5%
7	9770	645	19214	7,3%	10770	29984	9474	5%
8	11459	736	19902	7,2%	12981	32883	11569	5%
9	13232	873	20588	7,1%	15391	35980	13859	5%
10	15093	996	21278	7,0%	17995	39273	16341	5%
11	17048	1125	21958	6,8%	20759	42718	18984	5%
12	19101	1260	22642	6,4%	23674	46316	21781	5%
13	21256	1402	23317	6,0%	26729	50046	23723	5%
14	23518	1551	23995	5,6%	29884	53879	27770	5%
15	25894	1708	24669	5,1%	33145	57814	30932	5%
16	28389	1872	25339	4,7%	36531	61870	34227	5%
17	31008	2045	26015	4,4%	40033	66048	37645	5%
18	33759	2226	26682	4,1%	43599	70281	41135	5%
19	36647	2417	27349	3,7%	47206	74554	44678	5%
20	39679	2617	28012	3,3%	50880	78892	48301	5%
21	42863	2826	28671	3,0%	54712	83383	52092	5%
22	46206	3047	29330	2,9%	58653	87983	55999	5%
23	49717	3278	29749	2,7%	*62753*	*92726*	*62753*	5%

Source: ING, investment program UL BOND

The second investment program (risk 3 on the scale) intended to persons with a little high risk tolerance who want to know their investment safe but seeking the opportunity to obtain a higher yield than investing in instruments with fixed income.

The main objective of this program is to obtain long term capital increase by investing in a diversify portfolio: 75% in instruments with fixed income and 25% in shares. The evolution of some type of contract is presented Table 2.

Table 2. The evolution of the contract taking into account a medium risk investment program

Year	Insurance premium allocated to investment program	Insurance premium allocated to death risk	Insured amount (for basis insurance)	Assumed account profitability	Account value	Death risk coverage	Surrender value	Inflation adjustment
1	1200	79	15000	8,5%	1235	16235	0	5%
2	2460	162	15702	8,4%	2376	18078	0	5%
3	3783	250	16416	8,4%	3778	20193	2884	5%
4	5172	341	17109	8,4%	5339	22447	4340	5%
5	6631	438	17812	8,4%	7078	24980	5967	5%
6	8162	539	18514	8,4%	9010	27524	7781	5%
7	9770	645	19214	8,4%	11143	30357	9790	5%
8	11459	736	19902	8,3%	13489	33391	12008	5%
9	13232	873	20588	8,2%	16064	36652	14449	5%
10	15093	996	21278	8,1%	18864	40142	17114	5%
11	17048	1125	21958	7,9%	21859	43817	19972	5%
12	19101	1260	22642	7,5%	25040	47682	23020	5%
13	21256	1402	23317	7,1%	28399	51715	26248	5%
14	23518	1551	23995	6,7%	31893	55888	29619	5%
15	25894	1708	24669	6,2%	35533	60202	33143	5%
16	28389	1872	25339	5,8%	39338	64677	36839	5%
17	31008	2045	26015	5,5%	43300	69315	40700	5%
18	33759	2226	26682	5,2%	47364	74046	44671	5%
19	36647	2417	27349	4,8%	51505	78854	48773	5%
20	39679	2617	28012	4,4%	55752	83764	52912	5%
21	42863	2826	28671	4,1%	60202	88873	57306	5%
22	46206	3047	29330	4,0%	64804	94134	61860	5%
23	49717	3278	29749	3,8%	*69612*	*99586*	*69612*	5%

Source: ING, investment program UL MIXT 25

Persons with a long investment horizon willing to accept a high risk, and want a high yield on long term will choose the third investment program (risk 6 on the scale). The objective of this program is a long term capital increase by investing 100% in shares.

The evolution of such an insurance contract is presented in Table 3.

Generally, life insurance policy is insure for a period between 5 and 25 years, and nobody can predict what is possible to happen in a so long period of time. However, the history shows us that after a share decreases it can recover and recover the loss. Those who are thinking to a short-time investment should not buy shares, not think to an equity investment. Insurance companies have a long term vision on earnings. A commercial bank is expected on short-time profits, but an insurance company how much profit is obtained later, the better.

Table 3. The evolution of the contract taking into account a medium risk investment program

Year	Insurance premium allocated to investment program	Insurance premium allocated to death risk	Insured amount (for basis insurance)	Assumed account profitability	Account value	Death risk coverage	Surrender value	Inflation adjustment
1	1200	79	15000	11,9%	1266	16266	0	5%
2	2460	162	15702	11,8%	2468	18170	0	5%
3	3783	250	16416	11,8%	3972	20388	3020	5%
4	5172	341	17109	11,8%	5686	22795	4602	5%
5	6631	438	17812	11,8%	7636	25448	6410	5%
6	8162	539	18514	11,8%	9848	28362	8470	5%
7	9770	645	19214	11,8%	12340	31554	10800	5%
8	11459	736	19902	11,7%	15139	35041	13429	5%
9	13232	873	20588	11,6%	18237	38862	16383	5%
10	15093	996	21278	11,5%	21754	43032	19676	5%
11	17048	1125	21958	11,3%	25559	47518	23289	5%
12	19101	1260	22642	10,9%	29692	52334	27229	5%
13	21256	1402	23317	10,5%	34153	57470	31497	5%
14	23518	1551	23995	10,1%	38906	62901	36060	5%
15	25894	1708	24669	9,6%	43969	68638	40939	5%
16	28389	1872	25339	9,2%	49377	74716	46169	5%
17	31008	2045	26015	8,9%	55130	81146	51749	5%
18	33759	2226	26682	8,6%	61169	87851	57624	5%
19	36647	2417	27349	8,2%	67469	94818	63773	5%
20	39679	2617	28012	7,8%	74069	102082	70236	5%
21	42863	2826	28671	7,5%	81104	109775	77147	5%
22	46206	3047	29330	7,4%	88517	117847	84445	5%
23	49717	3278	29749	7,2%	*96391*	*126365*	*96391*	5%

Source: ING, investment program UL EQUITY

Both the account value at the end of the contract as well as the death risk coverage are more substantial for a contract with a high risk (by investing 100% in shares, but the risk is as this can be seen in figure No. 1. During a period of financial crisis it is recommended an investment program with low risk even if the yield is smaller, but is much safer achieved by investing in instruments with fixed income.

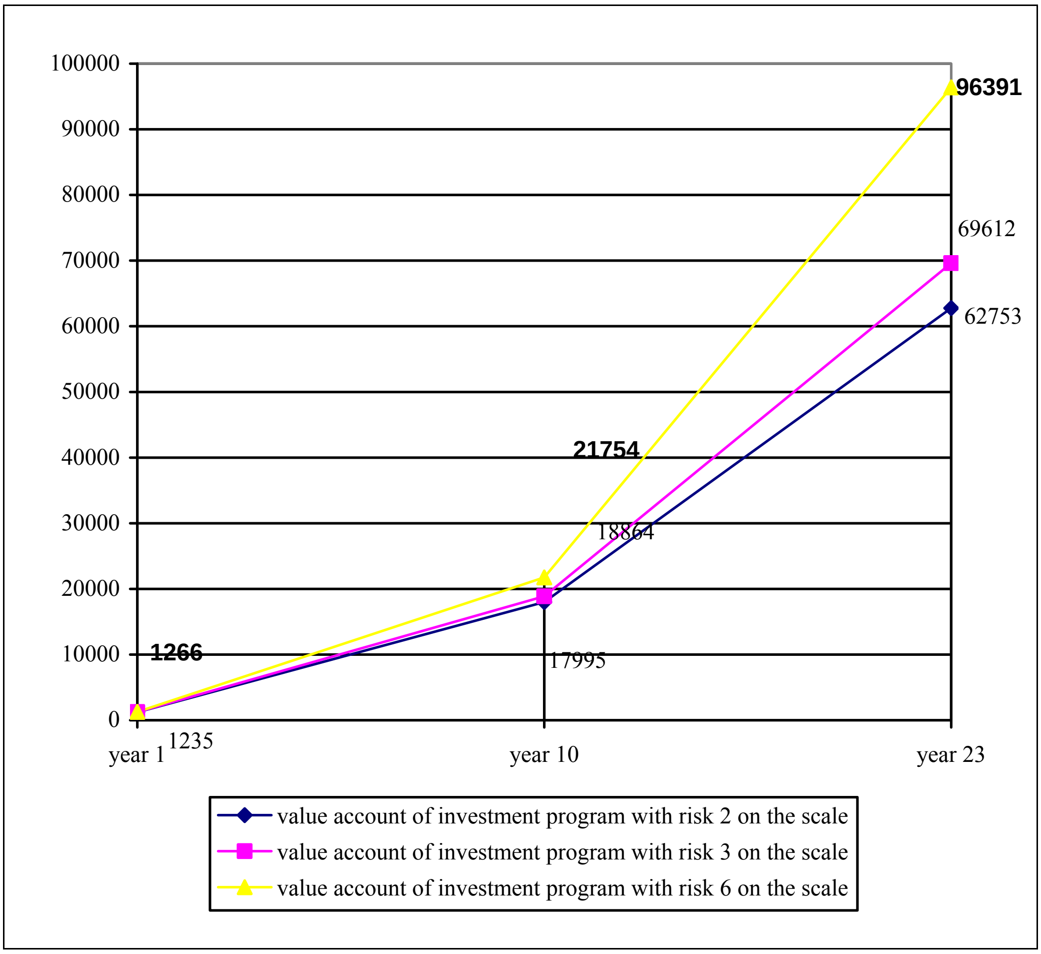

Figure 1. The evolution of the value account

Insurance contracts with investment component are products much more complexes but more risky than traditional life insurance and have much more flexibility in terms of choosing insurance premium, insured amount, type of investment, risk coverage and investment component, direct control on investment component, premium frequency (could be change in time), the possibility to pay anytime an additional premium, the possibility of the insured person to change their units from one investment program to another, the possibility of the insured person to withdraw money from the units account, equity of redemption, the possibility to change the initial contract into another with a reduce insured amount, and many other facilities.

So that, the insured person could choose another investment program, more risky that the initial one, if wants this, but in time of financial crisis it is recommended not to do that and to have a prudential behavior.

Also, if the insured person wants to surrender the initial insurance policy will lose much from the investment made, because the surrender value increase in time and it is appropriate by the value account only in the last 2-3 years of the contract, for any type of investment program. These could be observed in Figure 2.

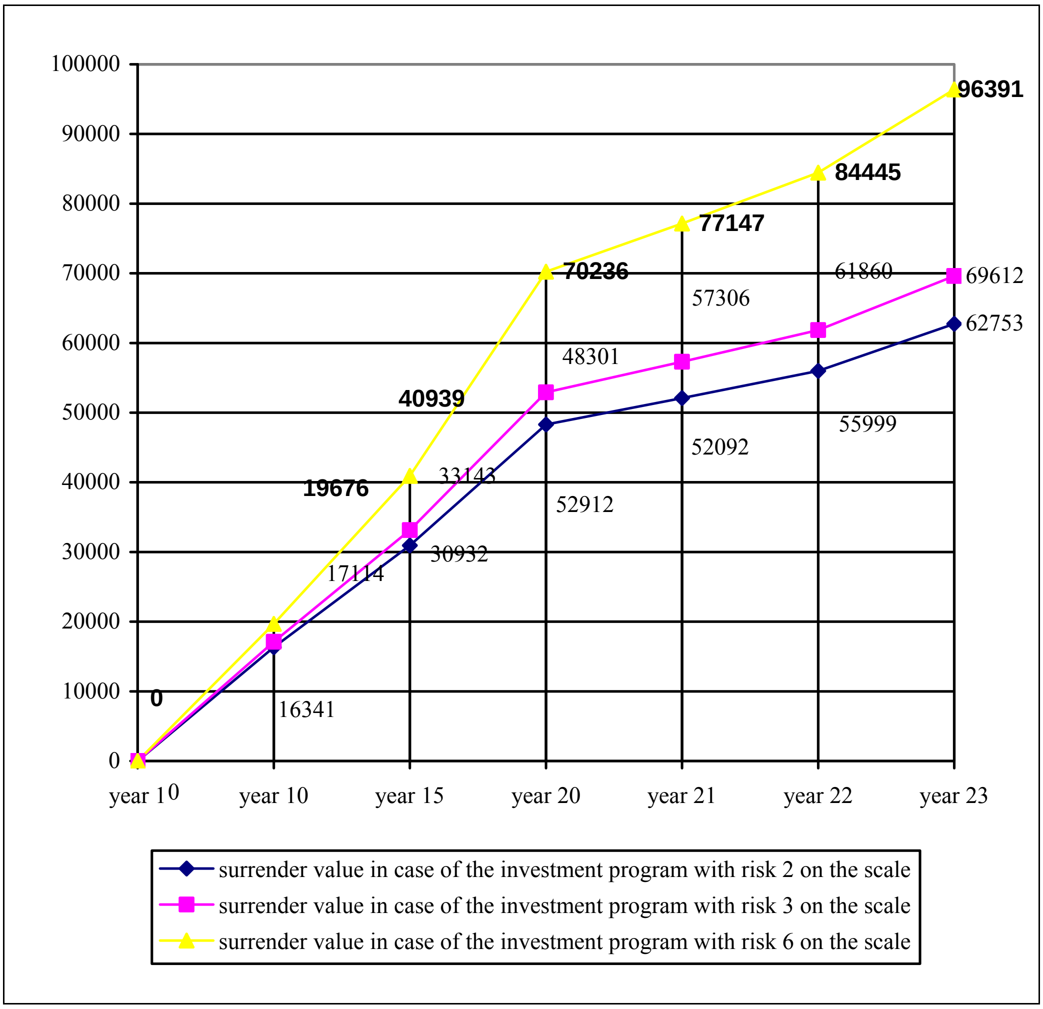

Figure 2. The evolution of the surrender value

4. CONCLUSIONS

Insurance are a key component of world economy based on the value of the collected premiums, the extent of the investments, and more importantly, on the social and economic role played by it, covering various personal and business risks. Life insurance sector felt the financial crisis most acutely, due to the increase of unemployment and decrease of income for insurance products buyers. One of the factors influencing this sector was psychological, in that the fear and incertitude regarding financial security of consumers resulted in cancellations, and postponing the intention of buying life insurance policies.

The financial crisis might make us more responsible for the financial protection, being aware of the necessity and importance of personal actions in order to insure our financial future, changing our perspective on savings, making us understand that no one will insure financial protection to the loved ones or a greater pension than ourselves. We go through a financial crisis, not the first and possibly not the last, either, but we must ensure that, as far as possible, we go in the direction we want.

In this period of crisis, clients pay more attention to what they do with their income, choosing traditional life insurances, leaving insurances with investment components for periods when our country will experience substantial economic growth. This type of insurance will face a decline period.

It is very difficult for the insurance companies today to maintain their clients. In order to obtain the clients' loyalty, they should become more popular, should win the customers' trust, since this is essential especially in life insurance, where the duration of the policyholder - insurer relationship is longer. We believe that present client of an insurance company might attract or repel future clients, their previous experiences are very relevant for the expected level of quality, the insurance companies should offer a higher level of quality than the minimum expected by the client, which I believe is very difficult to achieve by insurers in times of financial crisis.

The field of insurance is characterized by dynamism, due to the diversity of insurance form, and resourcefulness of insurers to offer protection by launching new insurance products, more attractive in the present times of crisis, which involves a permanent study of this field.

Life insurance sector was more affected by the economic crisis than non-life insurance, the population being confronted with reduced living standard, higher unemployment rates, and last but not least with lower confidence in insurance products.

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