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The Cost of Financial Frictions for Life Insurers

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Article Information

Abstract

During the financial crisis, life insurers sold long-term policies at deep discounts relative to actuarial value. The average markup was as low as -19 percent for annuities and -57 percent for life insurance. This extraordinary pricing behavior was due to financial and product market frictions, interacting with statutory reserve regulation that allowed life insurers to record far less than a dollar of reserve per dollar of future insurance liability. We identify the shadow cost of capital through exogenous variation in required reserves across different types of policies. The shadow cost was

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G22 Insurance; Insurance Companies; Actuarial Studies

G28 Financial Institutions and Services: Government Policy and Regulation

G32 Financing Policy; Financial Risk and Risk Management; Capital and Ownership Structure; Value of Firms; Goodwill

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