SOCIETY OF ACTUARIES®

2019 ANNUAL MEETING & EXHIBIT

October 27-30
Toronto, Canada

Session 026: Reinsurance 101

[SOA Antitrust Compliance Guidelines]
[SOA Presentation Disclaimer]

2019 ANNUAL MEETING & EXHIBIT

Session #26 – Reinsurance 101

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Antitrust Compliance Guidelines

Active participation in the Society of Actuaries is an important aspect of membership. While the positive contributions of professional societies and associations are well-recognized and encouraged, association activities are vulnerable to close antitrust scrutiny. By their very nature, associations bring together industry competitors and other market participants.

The United States antitrust laws aim to protect consumers by preserving the free economy and prohibiting anti-competitive business practices; they promote competition. There are both state and federal antitrust laws, although state antitrust laws closely follow federal law. The Sherman Act, is the primary U.S. antitrust law pertaining to association activities. The Sherman Act prohibits every contract, combination or conspiracy that places an unreasonable restraint on trade. There are, however, some activities that are illegal under all circumstances, such as price fixing, market allocation and collusive bidding.

There is no safe harbor under the antitrust law for professional association activities. Therefore, association meeting participants should refrain from discussing any activity that could potentially be construed as having an anti-competitive effect. Discussions relating to product or service pricing, market allocations, membership restrictions, product standardization or other conditions on trade could arguably be perceived as a restraint on trade and may expose the SOA and its members to antitrust enforcement procedures.

While participating in all SOA in person meetings, webinars, teleconferences or side discussions, you should avoid discussing competitively sensitive information with competitors and follow these guidelines:

- Do not discuss prices for services or products or anything else that might affect prices
- Do not discuss what you or other entities plan to do in a particular geographic or product markets or with particular customers.
- Do not speak on behalf of the SOA or any of its committees unless specifically authorized to do so.
- Do leave a meeting where any anticompetitive pricing or market allocation discussion occurs.
- Do alert SOA staff and/or legal counsel to any concerning discussions
- Do consult with legal counsel before raising any matter or making a statement that may involve competitively sensitive information.

Adherence to these guidelines involves not only avoidance of antitrust violations, but avoidance of behavior which might be so construed. These guidelines only provide an overview of prohibited activities. SOA legal counsel reviews meeting agenda and materials as deemed appropriate and any discussion that departs from the formal agenda should be scrutinized carefully. Antitrust compliance is everyone’s responsibility; however, please seek legal counsel if you have any questions or concerns.

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Overview of Presentation

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Outline of Presentation

- Review of Learn Program (Larry Stern)
- Types of Reinsurance (Mike Mulcahy)
- Risk Transfer (Larry Stern)
- Treaty Provisions (Mike Mulcahy)
- Reserve Credit Security (David Addison)
- Life Reserves (David Addison)

LEARN – What is it?

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LEARN – What is it?

- Life Education And Reinsurance Navigation
  - Provide continuing education about reinsurance topics/current issues to regulators
- Established as a service of Reinsurance Section in 2009
  - Ronnie Klein's visit to DE Department of Insurance
- Launched in 2010 with 3 volunteers, now a team of up to 10
- Presentations in 40 jurisdictions
  - Full day sessions, most attendees are analysts, examiners and a few actuaries – commissioners and deputy commissioners attend
  - Approved by NAIC for continuing education credit
  - 36 state regulators (7 repeats)
  - 4 offshore – Bermuda, Cayman Islands, Puerto Rico, Trinidad & Tobago

Types of Reinsurance

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Types of Reinsurance

What is Reinsurance?

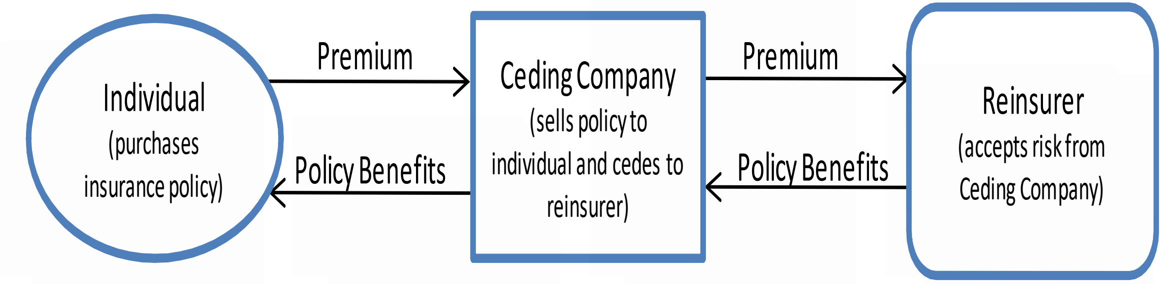
- Insurance purchased by an insurance company to cover all or part of certain risks on policies issued by that company

Definitions

- Ceding company: An insurer which underwrites and issues an original policy to an insured and transfers (cedes) a portion of the risk to a reinsurer
- Reinsurer: A company that contractually accepts a portion of the ceding company's risk
- Reinsurance Intermediary: Agent or broker to ceding company that facilitates placing and binding of reinsurance with reinsurer.
- Retrocessionaire: A reinsurer's reinsurer.

Typical Reinsurance Structure

- The ceding company sells a policy to an individual and transfers a portion of the risk to the reinsurer



Ways to Classify Reinsurance

- By Legal Status of policyholder
  - Assumption/Indemnity
- By Purpose
  - Risk/Business Management/Financial
- By UW Type
  - Automatic/Facultative
- By Structure
  - Coinsurance/Modified Coinsurance/YRT/Stop Loss
- By Business Reinsured
  - In Force/New Business

Types of Reinsurance

Why Reinsurance?

- Mortality/Morbidity Risk Transfer: Ceding Company only retains risk up to a certain limit (called retention limit) or as a percentage (called quota share)
- Lapse or Surrender Risk Transfer: Mainly used for products with large first year commissions
- Investment Risk Transfer: Utilize benefits of reinsurer's investment facilities or to shift part of risk to reinsurer
- New Business Financing: Shift costs of acquiring business to reinsurer
- Mergers and Acquisitions: Increase capital through transferring risk of an inforce block
- Underwriting Assistance: Reinsurers can assist with complicated cases and provide facultative reinsurance
- Entering New Markets: Utilize reinsurer's expertise
- Divesting a Product Line: Reinsure inforce business to exit certain businesses

John E. Tiller, *Life, Health, & Annuity Reinsurance*, Third Edition

Types of Reinsurance

Why Reinsurance? (continued)

- Increase Profitability of Product: Differences in cost structures between cedant and reinsurer could cause the product to be more profitable when reinsured
- Financial Planning/Capital Management: May need to increase capital levels through reinsurance
- Reduce Volatility of Returns: Reinsurance can reduce the cedant's exposure to large claims
- Tax Planning: Done to maintain Life/non-Life status or utilize an expiring tax loss carry-forward
- Enterprise Risk Management: Reduce concentration of risk or utilize a reinsurer's lower cost of capital

John E. Tiller, *Life, Health, & Annuity Reinsurance*, Third Edition

Life Reinsurance Underwriting

- Life Reinsurance Risks Can Be Accepted on an Automatic Basis
  - Reinsurer takes a share of all policies written of a specific description without reviewing individual risks
  - Reinsured typically reports new business after the fact on a periodic basis
  - No affirmative action is required on the part of the reinsurer to reinsure the policy
  - The reinsurer does not get individual information about the risk at the time the policy becomes reinsured

Life Reinsurance Underwriting

- Life Reinsurance Risks Can be Accepted on a Facultative Basis
  - Available for business which does not meet parameters for automatic reinsurance
  - Reinsurer reviews individual risks and accepts or rejects the policy for reinsurance
  - If reinsurer accepts, the risk, then the policy becomes reinsured
  - Reinsurer typically receives a great deal of information about the insured life to enable its decision-making

Types of Reinsurance (Structure)

Coinsurance

- Reinsurance coverage ceded to the reinsurer on an individual policy is in the same form as that of the policy issued to the policyholder
- "Same form" means that the ceding company and reinsurer are exposed to the same risks, they are essentially sharing the responsibility of insuring the policy, hence the name co-insurance.
- Since the cedant generally continues to maintain the policy administration, the reinsurer will allocate a portion of the premium to return to the cedant to cover a portion of these administration expenses.
- In addition to covering the administration expenses, the reinsurer will also return a portion of the premium to the cedant to cover agent commissions and underwriting expenses.
- The total returned premium is called an expense allowance.
- The absolute level of the expense allowance can vary from reinsurer to reinsurer
- The larger the expense allowance, the more attractive the reinsurance quote

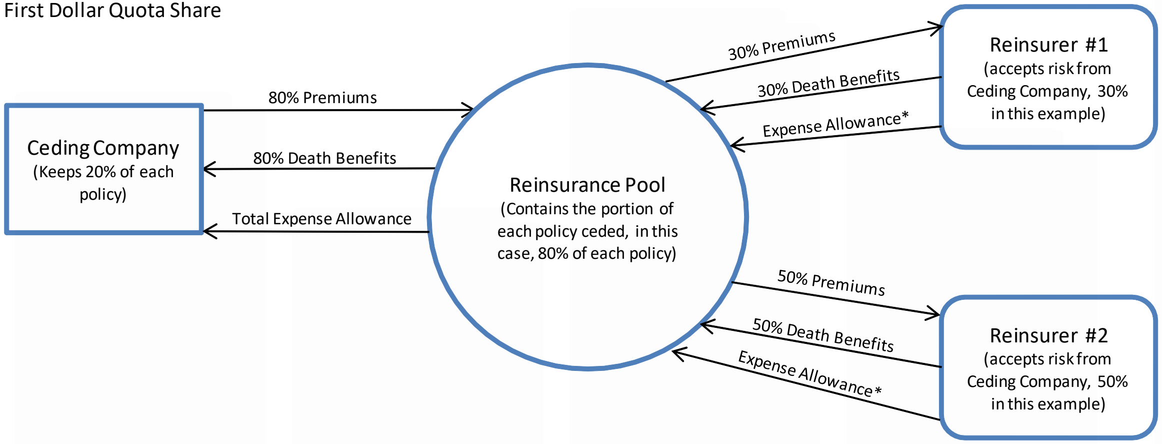
John E. Tiller, *Life, Health, & Annuity Reinsurance*, Third Edition

Types of Reinsurance

Coinsurance

- Typical arrangements are for term life insurance where the cedant retains a percentage of each policy and sends the rest of the policy to several other reinsurers through the use of a "pool."

Coinsurance Example
80/20 First Dollar Quota Share



*The expense allowances will often vary by reinsurer.

Types of Reinsurance

Yearly renewable term (YRT)

- Reinsurance coverage for which the premium rates are not directly related to the premium rates of the original plan of insurance
- The premium rates are typically set as a percentage of an industry mortality table and are multiplied to the Net Amount at Risk (NAAR)
- NAAR is defined as the excess of the death benefit of a policy over the policy reserve
- Since a mortality rates generally increase each year, the premium rates per $1,000 will be increasing
- There is generally not an expense allowance
- The reinsurers reserves under a YRT arrangement are typically much smaller than those produced under a coinsurance arrangement (to be explained in the reserve section)
- YRT is generally thought of as "mortality only" reinsurance and is one of the cheapest forms of mortality risk transfer

John E. Tiller, ***Life, Health, & Annuity Reinsurance,*** **Third Edition**

Types of Reinsurance

YRT (continued)

- Can easily be utilized for any type of life contract
- Actual rates charged to the cedant are only guaranteed for one year, and the reinsurer has the right to increase rates
- Utilizes a reinsurance pool concept without an expense allowance
- One alternate version of YRT is called zero-first year premium (ZFY)
    - In ZFY reinsurance, no premium is paid to the reinsurer
    - This helps cedants recover a portion of first-year acquisition costs

John E. Tiller, *Life, Health, & Annuity Reinsurance*, Third Edition

Other Reinsurance Types

Modified Coinsurance (Modco) Arrangements

- Same as the coinsurance plan, except ceding company retains the assets with respect to all the policies reinsured
- Establishes and retains the total reserves on the policies
- The assuming company (reinsurer) is paid the gross investment income on the assets retained by the ceding company.
- Periodic settlements are made between the two companies for premiums collected and for death benefits, surrenders, dividends, etc., at the end of the year
- Reinsurer is charged by the ceding company for its proportionate part of the increase in reserves on the reinsured policies.
- This modification removes one of the major disadvantages of strict coinsurance in that the original insurer’s assets are not diminished.

Other Reinsurance Types

Funds Withheld Arrangements

- A provision in a reinsurance treaty under which some or all of the premium due the reinsurer, usually an unauthorized reinsurer, is not paid but rather is withheld by the ceding company
- Either to enable the ceding company to reduce the provision for unauthorized reinsurance in its statutory statement or to be on deposit in a loss escrow account for purposes of paying claims.
- The reinsurer's asset, in lieu of cash, is funds held by or deposited with reinsured companies.

Life Catastrophe Covers

Multi-Life Warrantees vs. Clash Covers

Multi-Life Warranty

- An excess of loss reinsurance agreement with cedant purchasing protection whereby one event results in multiple death claims (e.g., plane crash).

Clash Cover

- An excess of loss reinsurance agreement with cedant purchasing protection in case one death results in multiple death claims (e.g., reinsurer reinsures multiple ceding companies and the one individual is insured under multiple policies by multiple insurance companies).

Catastrophe Coverages

- Large Limit and Retention
- Type of “event” limited by hours clause
- Per Occurrence coverage rather than Per Risk
- The Reinstatement issue

Inforce Reinsurance

Inforce vs. New Business

Inforce Reinsurance

- Reinsurance agreement on a block of existing business where all policies were written and inforce previous to the effective date.

New Business Reinsurance

- Reinsurance agreement which may or may not have policies inforce at inception, but is open to covering new policies written after the effective date.

Inforce Reinsurance

Differences in Pricing and Treaty Documentation

Pricing

- Additional data will often be available for inforce blocks of business allowing for more precise pricing and modeling efforts.
  - Historical trends on the obligations including premium, claims and surrenders
  - Experience studies for mortality, morbidity, persistency, and production
  - Historical portfolio yields (earned and credited)
  - Term Conversion Experience
  - Statutory Income and Income by source

Treaty Documentation

- Potential for customization of treaty provisions based on whether or not the agreement is open to new business.
  - Incurred but Not Reported amounts
  - Effective dates of coverage for inforce and new business production
  - Caps on new business production - reserves or face amounts
  - Financial Triggers

Risk Transfer Rules

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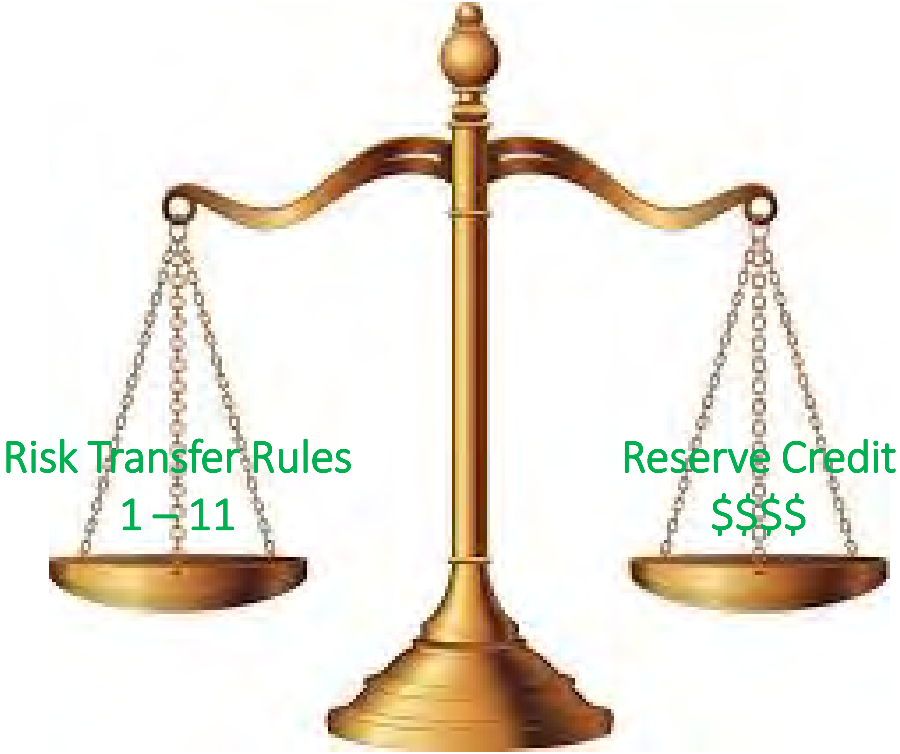
Balance between Risk Transfer and Reserve Credit

Risk Transfer is the equitable transfer of all significant risks and responsibility for payment of future benefits, from the cedant in exchange for reserve credit, to the reinsurer in exchange for compensation.



Risk Transfer Statutory Requirements (1 – 4)

In order for a ceding company to take statutory reserve credit, the reinsurance agreement must meet the following requirements:

1. Renewal expense allowances to the ceding company by the reinsurer must be sufficient to cover anticipated renewal expenses of the ceding company on the portion of the business reinsured. (In some jurisdictions, a liability may be established for the present value of the shortfall.) 👎 YRT
2. Reinsurer cannot deprive cedant of surplus or assets (for example, by termination of in force reinsurance) automatically upon the occurrence of some event (except for nonpayment of reinsurance premiums or other amounts due.) 👍 YRT
3. Reinsurer cannot require the ceding company to reimburse the reinsurer for negative experience under the agreement. Offsetting experience refunds against current and prior years' losses or payment of an amount equal to the current and prior years' losses upon voluntary termination by the ceding company shall not be considered such reimbursement 👍 YRT
4. No termination or automatic recapture, in full or in part, can be scheduled in the treaty. 👍 YRT

Risk Transfer Statutory Requirements (5 – 11)

5. Reinsurance payments must only come from income realized by the reinsured policies. (Reinsurance premiums should not exceed direct premiums collected by the ceding company.) YRT
6. The treaty must transfer all the significant risks of the reinsured business. Such risks include: morbidity, mortality, lapse, credit quality, reinvestment, and disintermediation. See chart. YRT
7. For business with significant asset risk, underlying assets must either be transferred to the reinsurer or legally segregated by the ceding company. (Some specified health and life business assets may be held by ceding company without segregation.) YRT
8. Settlements made at least quarterly. YRT
9. Ceding company must not be required to make representations or warranties that are not reasonably related to the business reinsured. YRT
10. Ceding company must not be required to make representations or warranties about the future performance of the business reinsured. YRT
11. The reinsurance agreement should not be entered into for the principal purpose of producing significant surplus aid, typically on a temporary basis, while not transferring all the significant risks inherent in the business reinsured (i.e. the expected liability to the ceding company remains unchanged.) YRT

Risk Transfer Statutory Requirements #6 Chart

Risk categories:

(a) Morbidity

(b) Mortality

(c) Lapse

This is the risk that a policy will voluntarily terminate prior to the recoupment of a statutory surplus strain experienced at issue of the policy.

(d) Credit Quality (C1)

This is the risk that invested assets supporting the reinsured business will decrease in value. The main hazards are that assets will default or that there will be a decrease in earning power. It excludes market value declines due to changes in interest rate.

(e) Reinvestment (C3)

This is the risk that interest rates will fall and funds reinvested (coupon payments or monies received upon asset maturity or call) will therefore earn less than expected. If asset durations are less than liability durations, the mismatch will increase.

(f) Disintermediation (C3)

This is the risk that interest rates rise and policy loans and surrenders increase or maturing contracts do not renew at anticipated rates of renewal. If asset durations are greater than the liability durations, the mismatch will increase. Policyholders will move their funds into new products offering higher rates. The company may have to sell assets at a loss to provide for these withdrawals.

+ - Significant   0 - Insignificant

Risk Transfer Statutory Requirements #6 Chart

RISK CATEGORY

	a	b	c	d	e	f
Health Insurance - other than LTC/LTD*	+	0	+	0	0	0
Health Insurance - LTC/LTD*	+	0	+	+	+	0
Immediate Annuities	0	+	0	+	+	0
Single Premium Deferred Annuities	0	0	+	+	+	+
Flexible Premium Deferred Annuities	0	0	+	+	+	+
Guaranteed Interest Contracts	0	0	0	+	+	+
Other Annuity Deposit Business	0	0	+	+	+	+
Single Premium Whole Life	0	+	+	+	+	+
Traditional Non-Par Permanent	0	+	+	+	+	+
Traditional Non-Par Term	0	+	+	0	0	0
Traditional Par Permanent	0	+	+	+	+	+
Traditional Par Term	0	+	+	0	0	0
Adjustable Premium Permanent	0	+	+	+	+	+
Indeterminate Premium Permanent	0	+	+	+	+	+
Universal Life Flexible Premium	0	+	+	+	+	+
Universal Life Fixed Premium	0	+	+	+	+	+
Universal Life Fixed Premium dump-in premiums allowed	0	+	+	+	+	+

*LTC = Long Term Care Insurance
LTD = Long Term Disability Insurance

Treaty Provisions

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Reinsurance Contract/Treaty

- Parties in the Agreement
  - Ceding Company
  - Reinsurer(s) & Retrocessionaire(s)
  - Other: Reinsurance Intermediary, TPAs, MGAs, MGUs
- Business Covered
- Term and Cancellation
- Exclusions
- Reinsurance Premium
- Access to Records
- Arbitration
- Intermediary Clause
- Commissions & Contingent Commissions
- Offset Provisions
- Insolvency Clause (Cedant vs Reinsurer)
- Entire Agreement Clause
- Other Provisions – MGU Agreement, Retrocession Coverage

Treaty Provisions: Important Considerations

Critical provisions

- Automatic reinsurance
- Premium
- Claims

Required provisions

- Entire agreement
- Insolvency
- Arbitration (not always)

Keys to effectiveness

- Completeness
- Clarity

Treaty Provisions: Automatic Reinsurance Requirements

Normal underwriting standards	Age and rating ranges	Retention limit
Automatic binding limit	Jumbo limit	Other: US citizen; no prior fac; etc.

These can be viewed as conditions precedent to reinsurance coverage.

Treaty Provisions: Facultative Reinsurance

Cedant sends underwriting papers to reinsurer

Reinsurer underwrites; may make offer

Reinsurer must make an offer and cedant must accept for reinsurance to occur

- Standard principles of contract law
- Cedant must notify reinsurer of acceptance – variety of ways to do so
- Facultative not covered by errors and omissions provision (see below)

Reasons for facultative submissions

- Cases outside normal limits
- Underwriting opinion from reinsurer desired
- Cedant looking for best offer

Contract Types: Automatic vs. Facultative

AUTOMATIC

- A Block or Class of Business
- Usually Obligatory
- Reinsurer Not Involved In Risk Decisions
- Long Term Relationship

FACULTATIVE

- One Risk At a Time
- Underwriter Can Accept or Reject
- Risk Underwriting
- Short Run (Usually one Year)

Treaty Provisions: Premiums

Usually detailed in schedule

May state they are not guaranteed by reinsurer, or for only one year

Must be paid within stated time period

Reinsurer may typically cancel treaty in its entirety for failure to pay premium

For coinsurance, reinsurance premium may not exceed retail premium

Treaty Provisions: Claims

Rules on when cedant must consult with reinsurer

- Amount
- Duration
- Contestability
- Cause
- Location

Reinsurer may have right to opt out of claim contests

Allocation of routine expenses

- Cedant salaries vs. external investigators

Sharing of extraordinary expenses

- Particularly extra-contractual or punitive damages

Ceding Commissions

What costs does this cover?

- Cost of Ceding Company Administrative Expenses
  - Payroll & Other Administrative Expense
  - Retail Brokerage Commissions
  - Premium Taxes
  - Other expenses for the Underlying Program
- For Quota Share Arrangements, these expenses are shared pro-rata
  - Fixed Percentage vs. “Up to” Percentage
- Ceding Commissions including underlying components are defined in the agreement
- Ceding Commissions may be tracked by the individual underlying business
- Potential Contingent Commissions (or Profit Commission) based on reinsurer profit

Treaty Provisions: Administration

Vast majority of US life reinsurance is self-administered by cedant

- Cedant prepares billings and submits with premium
- Cedant prepares listings of inforce risks
- Cedant prepares listings of transactions affecting reinsurance
- Cedant prepares statutory reserves
- Netting of claims against premium may be permitted

Vast majority of data transmission is electronic

Cedant’s have staff/units devoted to reinsurance administration

Challenge for reinsurers is lack of uniformity of cedant data

Packaged software is available from multiple firms

Investment Strategies/Guidelines

- Book Value vs. Market Value
- Rating Agencies for Assets
  - S&P, Moody's, Fitch
  - A M Best, DBRS
- Reinsurance Transactions & Guidelines
  - Funds Held – Cedent, Reinsurer(s), Asset Allocator/Manager
  - Assets in Kind
- Rating Translations for Bonds
  - NAIC 1 = AAA/Aaa, AA/Aa, A/a
  - NAIC 2 = BBB/Baa
  - NAIC 3 = BB/Ba
  - NAIC 4 = B/B
  - NAIC 5 = CCC/Caa
  - NAIC 6 = in or near default

Treaty Provisions: Inspection of Records

This is the provision that gives the reinsurer the right to audit the ceding company's records related to the reinsurance treaty. It may also give the cedant the right to audit the reinsurer's records related to the treaty, although this is much less common.

- Reinsurers will typically audit in three areas"
  - Underwriting
  - Claims
  - Administration
- Audits take place routinely every so often, and also when the reinsurer feels it has reason to audit

Treaty Provisions: Errors and Omissions

Definitely intended to cover unintentional errors in administration once reinsurance is properly in force

- Incorrect premium rate loaded into system
- Cedant over-billed reinsurer for claim

Lack of universal agreement on whether/when it covers errors in underwriting or other treaty requirements necessary for establishment of reinsurance

- Underwriting mistakes
- Waiving of underwriting requirements
- Underwriting business decisions

Parties restored to positions they would have occupied without the error

- This is not always possible
- Difficult area: jumbo limit
- Difficult area: claim on risk never ceded

Treaty Provisions: Boilerplate

Offset

Insolvency

- Of cedant – dictated by statute
- Of reinsurer – per negotiation

Entire Agreement

Arbitration

Other Reinsurance Considerations

- Counsel and Concur: Reinsured company's obligation to obtain the counsel and concurrence of the reinsurer in making claims decisions.
  - Usually applies to claims decisions made in connection with extra contractual obligations or judgments (losses to be paid) in excess of policy limits coverages.
  - Ceding company might be required to make payments due to intentional or negligent conduct, so does a reinsurer required to follow this as well?
- "Follow the Fortunes" Provision: Reinsurer generally required to indemnify the ceding company for all claims paid in good faith and reasonably within the coverage provided under the reinsured policy and not to second guess the settlement decisions made by the ceding company.
  - Doesn't necessarily create coverage where no coverage would otherwise exist under the ceding company's policy
- Utmost Good Faith: Has this been fulfilled in the placement/underwriting of business and the submission of claims to a reinsurer?
- Ambiguities: How are ambiguities handled in the agreement?
- Representations: What was represented by ceding company, reinsurer and other parties?

Other Reinsurance Considerations (Continued)

- "Cut-Through" Provisions
  - Allows a party not in privity with the reinsurer to have rights against the reinsurer under the reinsurance agreement
  - Cut-through rights generally limited and triggered only by specific events enumerated in the cut-through provision
  - Clause applies when the ceding company becomes insolvent and triggered when ceding insurer's default in payment, insolvency, or upon entry of a liquidation or rehabilitation order.
- Reporting Requirements: Did ceding company meet its reporting obligations under the reinsurance agreement?
- International Contracts: For international reinsurance arrangement with cedant and reinsurer in different countries:
  - What Currency is the Agreement?
  - Governing Country?
  - Arbitration Structure?
  - Language of Policy (English? Spanish? French? Chinese? Other?)

Reserve Credit Security

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Reserve Credit Security

What risk does reinsurance introduce?

- Reserves help the insurance company honor policyholder commitments
- Reinsurance transfers a portion of the risk from the insurance company (cedant) to the reinsurer
- However … the insurance company is still liable to the policyholder
- ….. Even in the event of a reinsurer insolvency

- Because the reserve provides additional protection to the policyholder, the insurance company needs to have certainty that it can access the assets backing the reserve in the event of a reinsurer insolvency

What does Reserve Credit mean?

- When an insurance company sells a policy, it establishes a reserve to ensure payment of death benefits
- When the insurance company cedes a portion of the risk through reinsurance, the insurance company will be able to reduce the amount of reserves it needs to hold, assuming certain conditions are met by the reinsurer

Reserve Credit Security

NAIC Model Act on Credit for Reinsurance

- Establishes conditions that a reinsurer must meet for a domestic ceding company to take credit for reinsurance, either as an asset or as a reduction in liability for reinsurance ceded
- Credit is allowed under *any of* the following conditions:
  - Reinsurer is licensed in the state
  - Reinsurer is accredited as a reinsurer in the state
  - Reinsurer is domiciled and licensed in a state that has substantially similar standards as the Model Act
  - Reinsurer maintains a trust for the payment of claims
  - If any of the above items are not met *(e.g. unauthorized reinsurer)*, credit can be taken if:
    - The insurance contract was written in a jurisdiction where such reinsurance is required by law
    - The reinsurer agrees to submit to US court in event that it fails to perform
    - The reinsurance contract utilizes a funds withheld arrangement
    - The reinsurer provides a clean, irrevocable, unconditional letter of credit by a qualifying US institution

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Reserve Credit Security

Schedule S (Blue Book) - Ceded Reinsurance Reporting Requirements

- NAIC Company Code
- Federal Tax ID
- Effective Date
- Name of Reinsurer
- Domicile of Jurisdiction
- Type of Reinsurance Ceded
- Is (Re)Insurer Authorized (Y or N)?
- Letters of Credit, Assets in Trust, Funds Withheld

Reserve Credit Security

Authorized/Unauthorized Reinsurer

Authorized Reinsurer

- Either licensed or accredited in the ceding company's state of domicile or a state with substantially similar laws as the ceding company's state
  - Licensing: Obtain a certificate of authority from the state that specifies the lines of business that the company is licensed to write
  - Accreditation: (all 4 must be met)
    - Meets financial conditions of the ceding company's state of domicile
    - Is licensed in one state
    - Submits to that state's jurisdiction
    - Senior management is of acceptable character

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Reserve Credit Security

Authorized/Unauthorized Reinsurer

Unauthorized Reinsurer

- Neither licensed or accredited in the ceding company's state of domicile
- As stated in the Model Act, unauthorized reinsurers are required to provide security through:
  - Assets in trust or escrow accounts
  - Letters of credit
  - Funds withheld
- This additional security allows ceding companies to take credit for the reserves that the reinsurer is contributing

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Reserve Credit Security

Reserve Credit Security Provided by Unauthorized Reinsurers

Assets in Trust and Escrow Accounts

- The beneficiary, normally the ceding company, must have a right to withdraw assets from the trust account at any time without notifying the reinsurer
- Assets deposited in the trust must be valued according to their market value
- The assets must consist of only the following
    - Cash
    - Certificates of Deposit
    - Investment as specified by the individual State's Insurance Code
- The reinsurance agreement may state the trust assets could be withdrawn only for reimbursing the ceding company for amounts due from the reinsurer

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Reserve Credit Security

Reserve Credit Security Provided by Unauthorized Reinsurers

Letters of Credit

- A letter of credit (LOC) is a document issued by a qualified bank on the orders of one party which provides that the beneficiary will be able to withdraw funds up to a specified limit
- Rules covering the use of letters of credit in reinsurance vary from state to state
- Section 11 of Credit for Reinsurance Model Regulation state LOCs must be
  - Clean: Beneficiary only needs to present a demand for payment
  - Unconditional: There can be no further qualifications outside of the letter of credit
  - Irrevocable: Can be modified only with consent of both parties
  - Evergreen: The LOC will renew automatically unless the issuing bank gives advance written notice of non-renewal

John E. Tiller, ***Life, Health, and Annuity Reinsurance*****, Third Edition**

Reserve Credit Security

Reserve Credit Security Provided by Unauthorized Reinsurers

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Secure - 3	A	A+, A	A1, A2	A+, A
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Secure - 5	B++, B+	BBB+, BBB, BBB-	Baa1, Baa2, Baa3	BBB+, BBB, BBB-
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Financing Excess of Statutory vs Economic Reserves

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Statutory/Economic Reserves

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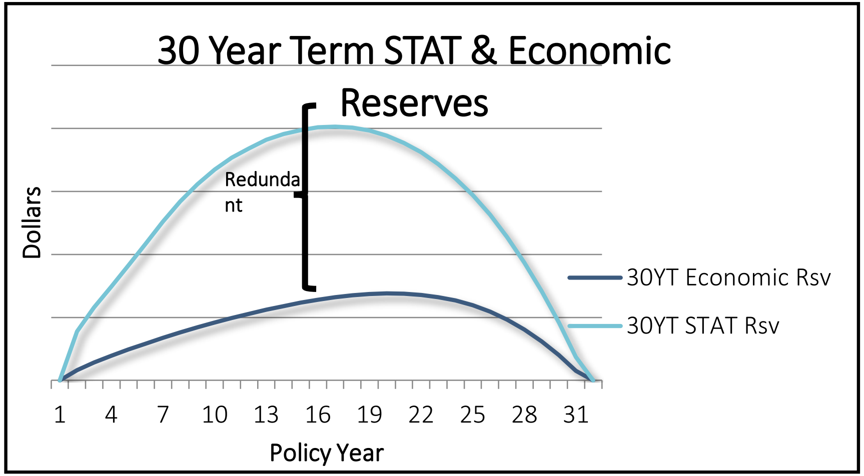

Statutory/Economic Reserves

Insurance and reinsurance companies have considered reserve and capital financing in a broad variety of forms

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October 28, 2019

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Overview of Presentation

Outline of Presentation

- Review of Learn Program (Larry Stern)
- Risk Transfer (Larry Stern)
- Types of Reinsurance (Mike Mulcahy)
- Treaty Provisions (Mike Mulcahy)
- Reserve Credit Security (David Addison)
- Life Reserves (David Addison)

Section 4
Reserve Credit Security

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Reserve Credit Security

What risk does reinsurance introduce?

- Reserves help the insurance company honor policyholder commitments
- Reinsurance transfers a portion of the risk from the insurance company (cedant) to the reinsurer
- However … the insurance company is still liable to the policyholder
- ….. Even in the event of a reinsurer insolvency

- Because the reserve provides additional protection to the policyholder, the insurance company needs to have certainty that it can access the assets backing the reserve in the event of a reinsurer insolvency

Reserve Credit Security

What does Reserve Credit mean?

- When an insurance company sells a policy, it establishes a reserve to ensure payment of death benefits
- When the insurance company cedes a portion of the risk through reinsurance, the insurance company will be able to reduce the amount of reserves it needs to hold, assuming certain conditions are met by the reinsurer

Reserve Credit Security

NAIC Model Act on Credit for Reinsurance

- Establishes conditions that a reinsurer must meet for a domestic ceding company to take credit for reinsurance, either as an asset or as a reduction in liability for reinsurance ceded
- Credit is allowed under *any of* the following conditions:
  - Reinsurer is licensed in the state
  - Reinsurer is accredited as a reinsurer in the state
  - Reinsurer is domiciled and licensed in a state that has substantially similar standards as the Model Act
  - Reinsurer maintains a trust for the payment of claims
  - If any of the above items are not met *(e.g. unauthorized reinsurer)*, credit can be taken if:
    - The insurance contract was written in a jurisdiction where such reinsurance is required by law
    - The reinsurer agrees to submit to US court in event that it fails to perform
    - The reinsurance contract utilizes a funds withheld arrangement
    - The reinsurer provides a clean, irrevocable, unconditional letter of credit by a qualifying US institution

John E. Tiller, *Life, Health, and Annuity Reinsurance*, Third Edition

Reserve Credit Security

Schedule S (Blue Book) - Ceded Reinsurance Reporting Requirements

- NAIC Company Code
- Federal Tax ID
- Effective Date
- Name of Reinsurer
- Domicile of Jurisdiction
- Type of Reinsurance Ceded
- Is (Re)Insurer Authorized (Y or N)?
- Letters of Credit, Assets in Trust, Funds Withheld

Reserve Credit Security

Authorized/Unauthorized Reinsurer

Authorized Reinsurer

- Either licensed or accredited in the ceding company's state of domicile or a state with substantially similar laws as the ceding company's state
  - Licensing: Obtain a certificate of authority from the state that specifies the lines of business that the company is licensed to write
  - Accreditation: (all 4 must be met)
    - Meets financial conditions of the ceding company's state of domicile
    - Is licensed in one state
    - Submits to that state's jurisdiction
    - Senior management is of acceptable character

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Reserve Credit Security

Authorized/Unauthorized Reinsurer

Unauthorized Reinsurer

- Neither licensed or accredited in the ceding company's state of domicile
- As stated in the Model Act, unauthorized reinsurers are required to provide security through:
  - Assets in trust or escrow accounts
  - Letters of credit
  - Funds withheld
- This additional security allows ceding companies to take credit for the reserves that the reinsurer is contributing

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Reserve Credit Security

Reserve Credit Security Provided by Unauthorized Reinsurers

Assets in Trust and Escrow Accounts

- The beneficiary, normally the ceding company, must have a right to withdraw assets from the trust account at any time without notifying the reinsurer
- Assets deposited in the trust must be valued according to their market value
- The assets must consist of only the following
  - Cash
  - Certificates of Deposit
  - Investment as specified by the individual State's Insurance Code
- The reinsurance agreement may state the trust assets could be withdrawn only for reimbursing the ceding company for amounts due from the reinsurer

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Letters of Credit

- A letter of credit (LOC) is a document issued by a qualified bank on the orders of one party which provides that the beneficiary will be able to withdraw funds up to a specified limit
- Rules covering the use of letters of credit in reinsurance vary from state to state
- Section 11 of Credit for Reinsurance Model Regulation state LOCs must be
    - Clean: Beneficiary only needs to present a demand for payment
    - Unconditional: There can be no further qualifications outside of the letter of credit
    - Irrevocable: Can be modified only with consent of both parties
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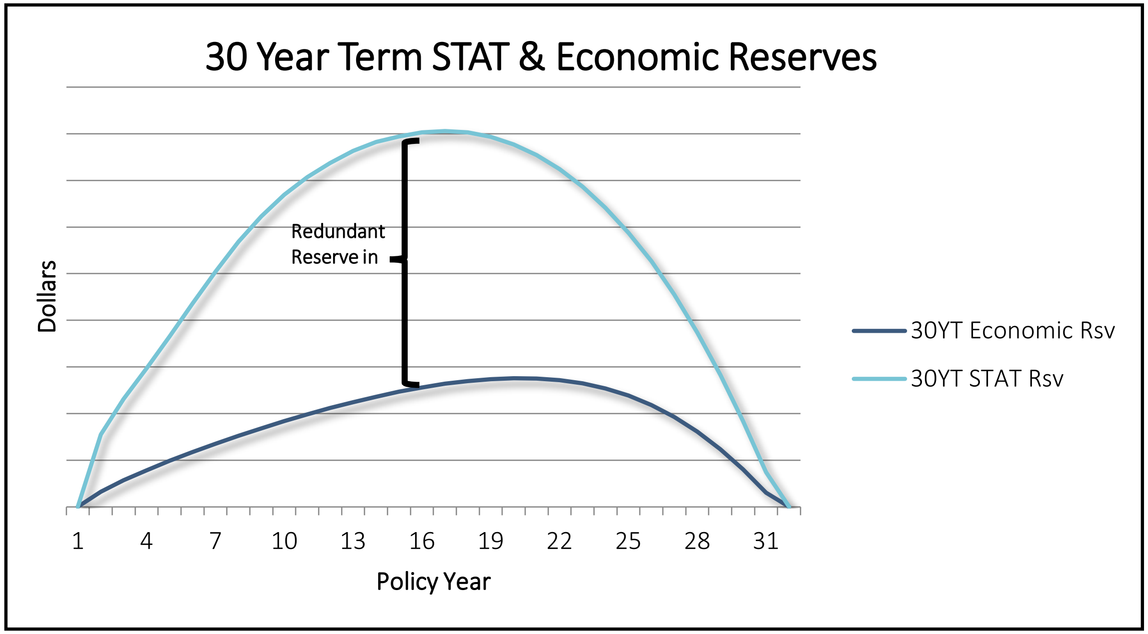

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