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SAFE Pool Provides New Catastrophic Coverage Alternative for Life Insurance Industry

by R. Dale Hall

One of the life insurance industry's residual impacts of the tragic events of September 11, 2001 was some marked changes in the market for catastrophic reinsurance coverages. Reinsurers began re-evaluating their risk profiles, and consequently, changes in the price and availability of this type of coverage were seen. The life insurance writers of the world also began picking up on new sets of insurance vocabulary: terms like "terrorism exclusion" and "federal backstop" became increasingly used in reinsurance discussions.

After 9/11, direct life insurance writers also began evaluating different approaches to catastrophic reinsurance coverages. Companies had choices to make as the cost of single company coverages increased and catastrophic pool arrangements were changing. In some cases, many companies found themselves in a position where maximum exposure limits in catastrophic pools rose to nearly four times their original levels prior to 9/11. At the same time, some companies found themselves in the unenviable position of being mixed in catastrophic pools with other insurers who may have much higher probabilities of having a catastrophic claim. This turn of events found many companies seeking alternative ways to obtain catastrophic reinsurance coverage, and even contemplating the idea of carrying no coverage at all.

One of the ideas to arise out of this evolving situation was the creation of a new catastrophic reinsurance pool arrangement for the life insurance industry. This new pool, the Shared Adverse Fluctuation Experience Pool Agreement (the "SAFE Pool"), was designed to create catastrophic reinsurance coverage for companies with a low concentration of life insurance risk in major metropolitan areas.

The SAFE Pool began operating on July 1, 2003 with American Farm Bureau Insurance Services serving as the pool administrator. Twelve life companies currently are pool members and are contributing approximately $70 billion of mortality risk. With the initial limit of liability set at $0.10 per $1,000 of in force, the initial term provided maximum recovery for each company and for the pool in total of $7 million. Catastrophic claims can be filed by a pool member if the member experiences any type of incident that results in at least four insured deaths. As with other catastrophic pools, no risk premiums are paid and all claims against the pool are funded through assessments against member companies. Claim payments are paid according to the percentage of in force each member contributes to the pool. Annual administrative service fees in 2003 ranged between $3,000 and $4,000 per member depending on the size of the member's in force. New entrants can be added at the beginning of any calendar quarter.

The pool leverages off the idea of "catastrophic underwriting" commonly seen in single company coverages to ensure the pool only accepts members with similar risk profiles. In-force listings by zip code are analyzed to determine the amount of risk concentrated in large urban areas, and questions regarding life insurance risk outside the United States and Canada are commonly asked. While the definition of a "preferred catastrophic risk" is hard to define, pool members are at least ensured that the companies in the SAFE Pool have similar risk characteristics.

At the SAFE Pool's annual Advisory Committee meeting in October, pool members discussed future changes that could further assist the catastrophic reinsurance needs of member companies. Pool members discussed raising the maximum recovery limit to $0.15 per $1,000 in the future and also purchasing a second layer of coverage to expand the total coverage to $20 million. The cost of the additional layer has been seen to be a more cost

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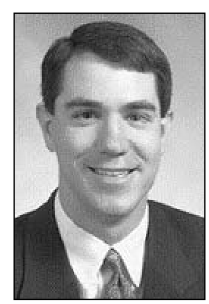

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effective approach due to the large diversification of risk of the member companies and the ability to share the cost of the coverage.

While everyone in the industry hopes the events of September 11, 2001 are a one-time occurrence, it's encouraging to see that new ways to deal with the risk of catastrophic events are evolving. The SAFE Pool appears to be among these new ideas that can help provide stability to the financial strength of its members even if future catastrophic events were to occur.

Capacity in the U.S. Life Insurance Market – A View from the Top of the Pyramid

by Michael DeKoning

For a variety of reasons, insurance companies significantly expanded their use of life reinsurance throughout the late '90s and early '00s. This has meant that volumes being ceded to the reinsurance market have continued to expand (after a brief respite in 2001) through quota share opportunities with direct insurers keeping only a portion of their published retention. The drive for growth and volume led the reinsurers to try to offer more per-life capacity to the market by looking for increasing automatic binding limits and jumbo limits from their retrocessionaires. Through the late '90s, most of the life retrocession outlets including the two full service, professional retrocessionaires (Manulife Reinsurance and Sun Life Reinsurance) were able to offer greater automatic binding limits and jumbo limits to service their life reinsurance clients who, in turn, offered higher limits to their direct writers. Direct writers had access to more than 25 life reinsurers active in the U.S. market and reinsurers and retrocessionaires typically also had access to European and Asian reinsurers not active in the U.S. market, who were willing to provide retrocession capacity on U.S. lives. So what has changed? I will try to give you the perspective of a company at the top of the capacity pyramid.

Clearly, the movement to quota-share reinsurance meant that direct writers were retaining less on a per-life capacity basis. Massive U.S. life reinsurer consolidation (Lincoln Re, AUL Re, Phoenix Re, CNA Re, Cigna Re, Allianz Re, Life Re, to name a few) has resulted in less choice for the Direct writers. It has also resulted in the loss of per-life capacity as the acquiring reinsurers have not, generally, increased their retentions sufficiently to make up for the loss of capacity owing to the acquisitions. This problem will only be further exacerbated by ERC's recent announcement of their withdrawal from accepting new business going forward.

At the same time, many of the retrocession outlets for U.S. lives, smaller European reinsurers with little or no active U.S. operations, have also been acquired by the larger multi-lined and multinational reinsurers who are already active in the U.S. market. Finally, some of same smaller reinsurers have been hurt by large early duration claims that aggregated from their various retrocession relationships to a level that they were uncomfortable with, forcing many of these remaining companies to either stop accepting retrocession on U.S. lives or severly reduce their offered capacity.

I estimate that all of the above factors have resulted in a reduction of per-life capacity in the United States by more than $100 million. Considering the market started with somewhere between $225 and $300 million of capacity, this is a material reduction that is