SOCIETY OF ACTUARIES

Article from:

Reinsurance Section News

May 2005 – Issue 55

LIFE REINSURANCE – A VIEW THROUGH THE REAR VIEW WINDOW

by Melville J. Young

I remember a time before iced tea lunches, a time of reinsurance suites, a time of Runyonesque characters, a time before politically correct had anything to do with the New York governor's race, a time before New York 102, XXX and the model act for reinsurance, a time when experts actually had the benefit of expertise, a time before P&C edicts were automatically (and in some cases idiotically) applied to life reinsurance, a time of the gentleman's agreement, four-page treaties that were not always signed, a time of business men rather than lawyers directing the business, a time when people were guided by doing the morally right thing rather than the contractually required thing, a simpler time, a fun time, "ah yes, I remember it well."

Since I spend so much of my time thinking about past events, I've come to recognize how far back my past goes. Your editor, recognizing that I have probably served the last term I'm going to serve as your chairperson and that I have been around the life reinsurance

world A VERY LONG TIME, has asked me to pen some anecdotes concerning my career. Though 45 years may seem like an eternity, it seems to have taken about the same amount of time that Superman typically spent in a telephone booth. Telephone booths, remember them? That's proof of how long it's been and how much the life reinsurance world has changed.

In 1971 Herman Schmit and Frank Klinzman, two of the nicest human beings I've had the honor of knowing, took a chance on a young actuary with a very spotty record. In 1971, the market share of my new employer, General Reassurance Life, when rounded, appeared in the charts as zero. We began 1971 with premiums under $10 million. Soon thereafter, I took over the pricing function and was told that I had pretty much free rein, except that we did not do modified coinsurance. That edict was of no consequence since very little modified coinsurance was written in the marketplace at that time. The life reinsurance business was primarily a YRT business done on an excess of retention basis. Most ceding companies did business with either one or two automatic reinsurers and possibly one or two facultative reinsurers and there were 25 to 30 reinsurers to choose from. The profit margin, which was embedded in those YRT rates, was larger than the 10-year term gross premiums charged by many term writers today for a significant percentage of issue ages. Needless to say, direct companies' term rates were not very aggressive and coinsurance of term was rare.

In the early 1970s we at Gen Re realized that for our market share to ever round to a whole number we had to do something dramatic. We introduced a pricing regimen with significantly reduced embedded profit margins and a marketing plan designed to convince potential customers that carving out their term products from their regular automatic reinsurance program would save them a good deal of money and not harm their 40-50 year reinsurance relationships. Our new pricing allowed those companies who decided to do business with us to significantly reduce the premiums they charged on their term policies. The resulting revolution created a business that would be unrecognizable to anyone around in preceding years. So now you and Paul Harvey know the rest of the story…and you know whom to blame for the term wars that may eventually replace the 100-year war in longevity.

I made reference earlier to Runyonesque characters; there is no better way of describing people marketing life reinsurance 30, 40 and 50 years ago. Some of my fondest professional memories involve joint marketing trips with some of these crazy, lovable, talented reinsurance professionals. The names that come immediately to mind are Charlie Frydenborg, Hass Savard and the indomitable Oscar Scofield. I learned a great deal at their respective knees and had more fun than anyone's entitled to during a working lifetime.

In 1971, there were no regulations governing reinsurance and the IRS had not yet realized reinsurance existed. Despite that, financial reinsurance transactions were rare. This all changed dramatically during the late '70s when the three-phase system which governed life insurance company taxation, failed to fairly tax life insurance companies. High interest rates caused the Menge formula to fail. This resulted in unreasonably high taxes imposed on many life insurers. Since the problem proved to be to the advantage of the IRS, corrective action did not occur. This led to the widespread use of Section 820 of the Internal Revenue Code. This section, which had been in existence since the code had been last revised in 1959, had been virtually ignored by the industry until the problem I cited earlier became untenable. What followed over a period of three to four years was a series of modified coinsurance agreements, designed to fully utilize Section 820, resulting in a significant reduction in life insurance taxation. The IRS does not like to hear it, but this did not happen until our industry was strangled by an extremely unfair tax regimen, with no relief in sight.

During this same time period, companies began to be burdened by excessively conservative statutory reserve requirements, which in some cases created unreasonably high deficiency reserves. This, like the burdensome tax situation I mentioned before, led to a sharp increase in the use of various forms of financial reinsurance. Generally, insurers and their reinsurers were responsible in their use of these reinsurance instruments, but there were a handful of abusive situations, which ultimately led to reinsurance regulations. It's my opinion that a more reasonable reserve regimen would have resulted in a significantly reduced use of financial reinsurance.

The frenzy of activity that was spawned in the late '70s and early '80s led to the rapid evolution of new reinsurance vehicles. Terms like "Co/Modco" and "Co Funds Withheld" leapt into our lexicon. Co/Modco was born when Steve Smith of First Colony called with a surplus strain problem caused by their entry into the structured settlement annuity market. He needed surplus relief, but was unwilling to pay the 'usurious' rate I charged for Gen Re's cash. He forced me to develop a "cashless" alternative.

Tax-free Co/Modco was spawned soon thereafter when Denis Loring became a buyer, on a large scale, of surplus relief and was upset at the resulting tax implications. A simple modification of the original design made the transaction tax neutral for all parties.

I haven't talked about the birth of the Reinsurance Section yet. The section was formed in 1982. About two years earlier, the E&E Committee called and asked me to form a task force to review the life reinsurance literature that was then used as part of our exam process. I twisted some arms and a 12-person task force was formed. We decided early on that there were so many holes, it required an effort that reached beyond the exam syllabus. In the ensuing two years, our group wrote a series of white papers on subjects as diverse as the reinsurance treaty and reinsurance law (Tom Heaphy, a guy too smart to be an actuary was the principal author); life reinsurance underwriting (Bill Tyler being the principal author); and reinsurance pricing (the late Mike Winn being the principal author). Mike was a dear friend and is sorely missed. Although we all took part in editing, Denis Loring was the principal editor and grammarian. The SOA incorporated portions of our collective labor into the syllabus, but more importantly these white papers formed the basis of what has become a rich body of literature. This was eventually replaced by a text entitled *Life Reinsurance*, co-written by the first chairperson of the section's Education Committee and her husband (Fagerburg and Tiller). Soon after the conclusion of our effort, the section was formed. Your first officer group was Irwin Vanderhoff, chairman; Mel Young, vice-chairman; and Denis Loring, secretary/treasurer. Unfortunately, due to changing job responsibilities, Irwin stepped down and I served out his term before beginning my own. Irwin, too, has passed on. He was perhaps one of the brightest people to sit for our exams, a dear friend who enriched the profession and all of us who were fortunate to have known him.

I've learned along the way that you can never have too many friends. You can't always count on regulators or tax folks to do the right thing. In excess of 99 percent of the people that I've met in the life insurance industry are well-meaning folks who care about our industry and its customers. This is particularly true of the people that I've come to know in the life reinsurance industry. While competition in life reinsurance continues to be fierce, it has not impacted the respect and strong friendships that have developed among those of us fortunate to have spent our professional lives in this most stimulating and fascinating business.

I would be remiss if I didn't mention the two people I consider mentors: Joe Kolodney, my best friend, and Ron Ferguson. Joe is the guy who took me to Acacia Mutual on my first sales call. Just before walking into their grand building in D.C., Joe stopped and imparted a life's lesson I have always remembered; "We're not here to make a sale today. We're here to build relationships. Reinsurance is a long-term, relationship business." This is one of many life lessons I have learned from this true reinsurance professional.

One of these relationships began over 20 years ago. During my first Tillinghast assignment, I met with Greig Woodring of RGA (General American Re at the time). In the years preceding my time at RGA I traveled with Greig, David Atkinson and other members of the management team on client visits. Some of these trips deserve an article of their own. In my opinion, Greig is the finest CEO of any reinsurance company and he has assembled an awesome group of professionals around him.

When I reached the ripe old age of 13, my rabbi told me "Today you are a man." I believe this really happened the day Ron Ferguson, a giant of a man, told me that I had gained his respect and that I had earned the 'pen' of General Re. Earning Ron's confidence proved to be the pivotal turning point in my career.

By the time I retire, I will have spent almost 40 years working in three great organizations. Gen Re, Tillinghast and RGA have each been blessed by an extraordinary array of insurance people — people who enjoy their jobs, recognize the long-term nature of the business and who are committed to keeping their promises. When I think of working at these three companies the lyrics from a Dean Martin song come to mind: "How Lucky Can One Guy Get".

I suspect that I know many, if not most, of the people reading this article. I'd like you to know that I've enjoyed our professional relationship and I'm honored to have had the opportunity to serve you through your Reinsurance Section Council. ✺

Melville J. Young, FSA, MAAA, is executive vice president and vice chairman of RGA Reinsurance Company in Norwalk, Conn. He can be reached at *myoung@rgare.com*.