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Evolving Life Reinsurance Market Keeps Focus on Stability

By Meg Green

Even as financial markets rumble and cession rates fall, life reinsurers remain focused on stability.

The market has evolved dramatically in the past decade. While almost 10 companies used to write 85 percent of the business, today the top five players write 85 percent of the business. In addition to consolidation, life reinsurers have seen their piece of the pie shrink. Cession rates were at their lowest point of the decade in 2009, at 33.9 percent, down from 61.8 percent in 2000, according to an annual life reinsurance survey conducted by Munich Re on behalf of the Society of Actuaries.

Also, retrocession rates tumbled 49 percent in 2009. "It's a result of reinsurers retaining more of their business. Volume amounts have dropped," Dave Bruggeman, assistant vice president at Munich Re, said.

Bruggeman, the author of Munich Re's annual survey, said the drop in retrocession is a symptom of fewer players in the market. "It's such a concentrated market, if one or two reinsurers raise retention, it really impacts the retrocession market," he said.

Recurring life reinsurance—reinsurance written the same year as the primary policies—dropped 9.4 percent, the seventh consecutive annual drop, according to Munich Re.

But, the life reinsurance marketplace remains stable, experts said.

At the beginning of the decade, primary writers were just beginning to come to terms with the new reserving requirements of XXX and AXXX. Many primary writers sought out reinsurers to help carry the increased reserve requirements, or turned to bank solutions, such as letters of credit, or even securitizations.

The structured financial market has stalled since the financial market meltdown, which was caused in part by problems with mortgage-backed securities, said Chris DesRochers, senior managing director of consulting firm LECG.

"To the extent that interest rates are down, structured finance really hasn't been available and the cost of letters of credit has gone up with upheaval in the financial markets. That's created pressure on the term market and term pricing," DesRochers said. "Capital is still a very big driver in the market. The cost of capital has gone up for the industry, and that's played through on the term side."

Indeed, after 15 years of sharp pricing declines, term insurance premiums began to rise in 2009, according to Swiss Re. The premium for a $500,000 policy on a 35-year-old man with rate guarantee for 20 years rose 5 percent on average, while the premium for a policy with a 10-year guarantee was up 6 percent.

Life reinsurance was a factor in that increase, "but more a symptom than a cause," said David Laster, senior economist at Swiss Re. Reinsurers and primary writers "are swimming in the same financial currents," he said.

As a result, primary writers are impacted directly as well as indirectly through reinsurance, Laster said.

About 50 percent of term life writers rely on reinsurance to provide coinsurance. "The client takes the reinsurance credit so they don't have to hold the statutory reserves for business they are ceding off," said Frank O'Neill, managing director of Swiss Re Life & Health America.

The dawn of XXX saw reinsurers becoming more active in coinsurance versus yearly renewable term reinsurance—mortality risk. "One of the key drivers of term life insurance is the reserve costs, not the mortality," DesRochers said. "The emphasis in the market moved from mortality to the capital needed to write the business. It's changed the nature of the reinsurance market."

XXX is still an issue in the life insurance market, and reinsurance has been one of the price drivers in the primary term market, DesRochers said.

While experts expected term rates to rise with the introduction of XXX and the resulting pressure to keep higher reserves, "rates hiccuped, but then continued to fall," Laster said.

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"The sad reality is the reinsurance industry, in part, facilitated that," O'Neill said. "There was a significant amount of reinsurance. The industry was wooed by the significant top line. I would say that was an error in judgment on the part of the industry."

When mortality pricing in the reinsurance market reached unsustainable levels in the mid-2000s, reinsurers responded by raising rates.

"In early 2009, the underlying funding—whether it came from the capital markets, banks and letters of credit, or reinsurance—had become so expensive that the demand for reinsurance outstripped the supply, forcing many primary writers to raise term rates," O'Neill said.

"Credit spreads, which are indicative of letter of credit costs, jumped from about 50 basis points over a U.S. Treasury bond in 2007 to 500 to 600 basis points above in late 2008/early 2009. It's since fallen to about 200 basis points earlier this year," Laster said.

"We're a lot better off than we were 15 months ago, but it's still quite a bit more expensive than in 2007," Laster said in May.

Those credit spreads impact both life insurers and reinsurers, but reinsurers "aren't interested in being a cheap form of funding," O'Neill said. "There is more demand, and we are certainly willing to write coinsurance at a reasonable price—given interest rates and funding costs—but I do not think there's going to be a wholesale shift to cheap reinsurance capacity."

The net effect of primary writers needing more reinsurance and the higher cost of providing that reinsurance has resulted in a tightening of supply. "Reinsurance prices have risen," Laster said. "There's less supply, and more demand. That creates pressure for more expensive reinsurance pricing."

But, primary pricing has probably stabilized, according to O'Neill.

"I don't think primary companies are making the margins they should be making on term life. It's still one of the lowest margin products out there. But we've already seen one of the largest term writers decrease prices this year. The market should be relatively stable unless the euro situation spills over and creates further credit issues in the United States," O'Neill said.

And, it will take awhile for the securitization market to mend, commented Laster.

"With life companies seeking capital relief and affordable solutions from securitization largely unavailable, direct writers have limited options outside of reinsurance," A.M. Best Co. noted in a Feb. 8, 2010 special report. "Reinsurers are more selective in the risks they choose to underwrite, and pricing remains firm."

But, "the competitive landscape in U.S. life reinsurance is now stable after earlier consolidation activity," Best said. ■