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EXECUTIVE PERSPECTIVES ON STRATEGY AND RISK IN REINSURANCE

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Attitudes on strategy and risk vary according to specific environmental circumstances for most companies. At best, they present insight into people's thinking at a specific point in time. This type of insight was gained at the end of last year through surveys of life reinsurance executives. What follows is an extract from the 2007 surveys in the U.S. market and, where appropriate, contrasts to the survey completed in 2005.

Methodology and Participation

The survey was developed in accordance with the U.S. Safe Harbor requirements of the Federal Trade Commission and the Department of Justice on anti-trust compliance. Simply put, the requirements are that the survey would need to be administered by an objective third party, be based on data that was at least three months old, and have at least five participants, where no single participant's data could present more than 25 percent of any statistic.

There were 16 participants to the survey (12 life reinsurers and 4 professional life retrocessionaires). Based on the data from the 2007 Munich American Re Survey of the U.S. life reinsurance market (which is in this edition of the Reinsurance newsletter), these respondents comprise 60 percent of the new business assumed and 58 percent of the inforce of recurring business in the U.S. ordinary life reinsurance market. The participants to the 2007 survey are as follows:

Reinsurers	Retrocessionaires:
ACE	AXA Equitable
Gen Re	Manulife Re
Hannover Life Re of America	RBC Financial
Max Re	Sun Life Re
Munich American Re	
Optimum Re	
RGA	
SCOR Global Life	
Swiss Re	
TOA Re (through RMA)	
Wilton Re	
XL Re	

STRATEGY: Industry

In reviewing strategy, it is usually of interest to executives to conduct a SWOT analysis (strengths, weaknesses, opportunities, threats) of the industry. In terms of strengths of the industry, U.S. reinsurance executives (including retrocessionaires) believe the greatest industry strength is **capable and experienced staff.** Executives felt that the greatest industry weakness to be the **lack of profitable products and services.**

There was consensus about the greatest industry opportunity as **knowledge of the emergent risks of life insurers.** However, U.S. executives see **entry into the industry of other financial institutions (including banks)** as the greatest industry threat.

STRATEGY: Company

The reinsurance executives were also asked to do the same SWOT analysis, but now focus it on their individual company. Not surprisingly, when compared to the industry SWOT analysis, some results were the same and some differed.

From a company perspective, similar to the greatest industry strength, the greatest company strength is **capable and experienced staff** in their company. The survey participants felt that the **lack of profitable products and services** was the greatest company weakness, similar to the findings from the 2005 survey.

Executives shared consensus about the greatest company opportunity as it is seen to be the development of **new risk management processes** such as securitization. Whereas the **lack of risk diversification (higher concentrations in mortality)** is viewed as the greatest company threat in 2007, the greatest company threat in 2005 was viewed to be the **weakening relationship with life reinsurers.**

STRATEGY: Lines of Business

The line of business credited with creating the most success for the industry and individual companies in the U.S. is Individual Mortality Yearly Renewable Term **(YRT).**

STRATEGY: Stakeholder Management

Among a list, the following was deemed as the most important strategic issue by respondents:

- "We work with **clients** to strengthen relationships into a win-win which recognizes the real costs of underwritten risks."

When respondents were asked to rank the various stakeholder interests that they manage, **shareholders** placed first and clients placed second.

With respect to their shareholders, **actual returns being below target** was the most contentious issue identified by respondents.

Resistance to more explicit treaty language on counter-party risk, data reporting, and underwriting was the most contentious issue of respondents with their clients, as it was in the 2005 survey. With respect to reinsurers dealing with their retrocessionaires, the most contentious issue in the survey was the **increase in rates** for **excess retrocession capacity,** whereas two years ago the most contentious issue was the continuing decrease in capacity.

With respect to reinsurers dealing with regulators, the most contentious issue was **demands** by regulators **for** more or **unnecessary information/data** about the business plan and the company's results, whereas two years ago, it was the lack of understanding of the risks and rewards involved in the company's various business lines.

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RISK MANAGEMENT

Risks

Executives responded that the risk that most needs mitigation in the United States is **mortality risk**. Respondents **purchased catastrophe cover** as the means to best mitigate risk, although having **site concentration limits in treaties** placed a close second.

When asked to rank the greatest risk to be managed in today's reinsurance world, the respondents believe that **excess capacity provided to the market at unsustainable prices** to be the greatest risk, whereas two years ago it had been sustained sub-par returns that taint the industry's risk management reputation.

Respondents were asked to rank a variety of options to improve the evaluation of their business. In 2005, the strengthening of the errors and omissions (E&O) clause in all treaties ranked first among U.S. respondents, whereas in 2007, the expectation of underwriting guidelines and **exception thresholds in the letter of intent and in all treaties** placed first.

Enterprise Risk Management

The measurement of GAAP earnings is the measure most often used to assess a change in risk (earnings or capital) by respondents as it was in 2005. A **decrease of greater than 20 percent** in this

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measure would **require immediate action among more than one-third** of the 2007 survey participants, while half of the 2005 survey respondents would have taken immediate action when there was a greater than 10 percent decrease in earnings or capital using GAAP.

For reinsurers, the **risk appetite is generally developed jointly by company officers and the board of directors**, similar to the 2005 findings.

Sustainability

A **purchase of a block of business that is no longer strategic to the seller** is considered the best means to sustain one's business in the United States. The most likely function to be outsourced by U.S. respondents is **investment management**.

In terms of actions from the client base, the event or action which has most profoundly impacted the sustainability of the reinsurer's business is **clients' interest in retaining more risk and choosing to reinsure on an excess basis rather than a quota share basis which is starting to erode the reinsurer's revenue base.**

In terms of environmental conditions, the event or action which has most profoundly impacted the sustainability of the business is the **success of the alternative investment community in the STranger-Owned Life Insurance (STOLI) or Investor-Owned Life Insurance (IOLI) markets which puts the reinsurer's business at risk.**

Superior execution, knowledgeable staff, and **consistent risk management** are viewed as the criteria that company heads admire most in the life insurance, life reinsurance and life retrocession industries as follows:

Criteria\Industry Sector	Life Reinsurance	Life Retrocession	Life Insurance
Consistent Risk Management	3rd	2nd	1st
Superior Execution	1st	4th	2nd
Knowledgeable Staff	5th	1st	7th

In terms of specific criteria requiring improvement in their own company, reinsurance CEOs and business line leaders felt that **diversified products and services** placed first and **market presence** was a close second.

When applying the above criteria in the second column of the table above to the ranking of a list of retrocessionaires, **Manulife Re** was viewed as **most admired retrocessionaire.** Sun Life Re placed second among U.S. respondents.

When asked the same question regarding applying the criteria in the first column of the table above to a list of life reinsurers, **RGA** was the **most admired life reinsurance company** in the U.S. survey, followed by Swiss Re.

Conclusion

The results of the survey give a glimpse into the thoughts and concerns of life reinsurance executives with respect to the U.S. market. The insights reveal their apprehensions about the market today and how it has evolved over the last few years. The survey results also demonstrate the executives' strategic perspectives on their markets and the challenges of managing diverse stakeholder relationships. Their attitudes toward risk reveal how they choose to manage their businesses. The qualities that they admire in their clients, their peers, and their retrocessionaires provide insight to their pursuit of excellence as a quality and their on-going commitment to achieving this goal.

Despite the challenges in the market, executives in the life reinsurance industry are developing their strategic perspectives, managing various stakeholder relationships, mitigating a broad spectrum of risk, and sustaining their businesses such that a vibrant and dynamic life reinsurance marketplace flourishes in the United States. ✺