



SOCIETY OF ACTUARIES

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Winners and Losers

By Scott Meise

Greetings from London! At the time of writing this, it's just past Black Friday in the United States. We didn't get Thanksgiving off, although we get Boxing Day and the Queen's Diamond Jubilee, so I guess I can't complain. I was happy to see that there weren't any major incidents of chaos on Black Friday, until my co-workers pointed out the 100-car pileup in Texas that day. I tried to explain to them that, unlike London, there are places in the United States where traffic actually moves, which is why things like this can happen.

One of the big things going on here is Solvency II, which is supposed to put reserves and capital on a fully principle-based system. It was recently postponed to, at earliest, the end of 2015. Due to the current issues in the EU, there is a lot of debate about discount rates and how to come up with a system that works for everybody.

The underlying issue with discount rates is the risk-free rate used for discounting the liabilities. Many companies over here invest a lot of their assets in sovereign debt, which has lost a lot of its value in the PIIGS (Portugal, Ireland, Italy, Greece and Spain) countries. As a result, unless the risk-free rate used to discount the liabilities is consistent with the "risk-free" rates on their sovereign debt, they'll find themselves very challenged from a capital position.

However, another goal of Solvency II in the EU is to put everyone on a consistent basis, which means that their risk-free rates should be consistent. Otherwise, companies with high discount rates would have a capital advantage over companies with low discount rates if they both had the same strategy.

One other issue with discount rates is allowing for the long-term, illiquid nature of certain liabilities. Solvency II has tried to tackle this with the introduction of a matching adjustment, but many argue this doesn't go far enough. Also, the idea of a "cyclical premium," which allows firms to use higher discount rates in times of stress, has been introduced to help the discount rates be more consistent with the economic environment, but this doesn't solve all of the problems currently being debated.

Regardless of where this eventually comes out, it illustrates how any new regime creates winners and losers—the winners already have a strategy that is more consistent with the new rules, and the losers have to adapt to the new rules or change their strategy.

One of the reasons I like working in the reinsurance industry is that I enjoy being part of the process where we help insurers adapt to the rules,



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rather than having to abandon their strategy. That doesn't mean that I think reinsurers should prop up a strategy that objectively isn't working, but it is good to be a part of relationships that help manage the risk profile of insurers to where they want it to be, while at the same time helping them pursue strategies that are good for them and their clients; to help the "losers" have a chance at winning as well.

As far as current initiatives for the Reinsurance Section go, here are some updates:

LEARN: We're wrapping up another successful year with our LEARN initiative, where we send people out to state insurance departments to give presentations on reinsurance to help keep open the lines of communication between the reinsurance industry and regulators. In 2012 we visited seven states, bringing us to 20 so far. We're in the process of beginning to set 2013 appointments, so if you are or know anyone at a state insurance department that might be interested, I encourage you to discuss it—the schedule fills up fast!

Intro to Reinsurance Boot Camp: As mentioned in previous newsletters, we'll be hosting a boot camp on May 8, 2013 in Toronto, the day after the Life and Annuity Symposium. Look for details on that soon. We're also actively looking into one on June 13 after the Health Meeting, since health and life material don't necessarily intersect for the purposes of the boot camp. We'll keep you posted with details on that possibility.

Research: The Reinsurance Treaty Terms project has a researcher, and good progress is being made.

Please let me and/or the Reinsurance Section know if you have thoughts or questions on the things we're doing or that you'd like us to do! ■