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Access to Reinsurance by **Smaller Insurance Companies**

By W. Michael Reese

W. Michael Reese, ASA, MAAA is a consulting actuary with Hause Actuarial Solutions in Overland Park, Kansas. Mike can be reached at miker@ hauseactuarial.com

Life reinsurance is a universally recognized risk management tool protecting insurance company surplus levels. Smaller insurance companies, who oftentimes benefit the most from establishing prudent risk management practices, have reported unique challenges in securing life reinsurance. Commercially feasible life reinsurance risk management solutions for smaller insurers are in the best interest of the life insurance industry as a whole because of the value in protecting company surplus and solvency.

A research project, sponsored by the Committee on Life Insurance Research, the Smaller Insurance Company Section and the Reinsurance Section, was kicked off in late 2010 to investigate the challenges on both sides of this issue. The final report was released in October 2011 and is available on the SOA website.

The purpose of the research was to: (1) identify the challenges and successes encountered by smaller insurers in obtaining life reinsurance, (2) identify the challenges and opportunities life reinsurers face in servicing smaller companies, and (3) explore solutions to resolve the challenges identified. The knowledge from this research is intended to assist actuaries, smaller insurers, reinsurers and others in optimizing their respective success in future reinsurance endeavors.

Two surveys were designed and used to gather information for the study. The first was sent to reinsurance companies and brokers, and the second was sent to smaller insurance companies. For the purposes of this research study, smaller company was identified as any company that sells life policies and has assets of $2.5 billion or less.

Information requested in the reinsurer/broker survey included:

- Benchmarks used to identify prospective clients;
- Types of reinsurance treaties available above and below benchmarks;
- The amount of individual life risk assumed from companies above and below the established benchmarks;
- Other services available above and below the established benchmarks; and
- Issues reinsurers have experienced with smaller insurers.

Information requested in the smaller insurance company survey included:

- Company size in total assets;
- New business ceded 2007 – 2009;
- Direct and ceded in-force as of 12/31/2009;
- Maximum retention limits;
- Reasons for buying reinsurance;
- Types of reinsurance used to cede risk; and
- Identification of challenges experienced.

As a follow up to the surveys, telephone interviews were conducted to clarify responses and dig deeper into the information gathered in the survey responses.

I encourage you to refer to the final report on the SOA website for the nitty-gritty details of the survey responses, but the following are highlights I pulled from those details:

REINSURANCE SURVEY

1. Some reinsurance companies use benchmarks to select viable business partners and some do not. In addition, one of the reinsurers said they make exceptions to the benchmarks when the right opportunity comes along.
2. Generally, the benchmarks are related to minimum annual new business requirements coupled with due diligence—e.g., company ratings, staff and administrative capabilities, etc.
3. Typical reinsurance treaties (e.g., YRT, Coinsurance, Bulk ADB) are available for client companies without regard to benchmarks. More sophisticated coverages, like surplus relief and stop loss, are only available above benchmarks.
4. Services other than risk sharing are available to client companies without regard to benchmarks, like use of the reinsurer's underwriting manual and access to underwriting, claims and actuarial staff. However, product design and development of underwriting guidelines are only available above benchmarks. In no case was there an indication that the reinsurer charged a fee for these additional services.
5. Regardless of benchmarks, the top two challenges reported by reinsurers were low sales volume and no mortality or persistency experience.

SMALLER INSURANCE COMPANY SURVEY

1. Just over half of the respondents said they have experienced reinsurance challenges.
2. About half of the responding companies were Fraternals.
3. Of the 23 responses we received, the four largest companies averaged $1.9 billion of assets, and the remaining 19 companies averaged $332 million of assets.
4. The average face amount issued in 2007 – 2009 was $90,181 for companies that said they experienced challenges (challenge companies), and $64,294 for companies that said they did not experience challenges (no-challenge companies).
5. In 2007 – 2009, the challenge companies ceded 36 percent of their new face amount, and the no-challenge companies ceded 16 percent of their new face amount. Follow-up interviews showed that the no-challenge group sold more simplified and guaranteed issue business, which certainly helps explain why their average face amounts and ceded amounts were lower.
6. The average face amount in force for the challenge companies as of 12/31/2009 was $139,833, and for the no-challenges companies the average was $39,372.
7. The maximum retention amounts for the two groups are very similar—$194,000 for the challenge companies and $220,000 for the no-challenge companies.
8. The top four reasons indicated for "why reinsurance is needed" are:
    a. Limit per policy risk;
    b. Control claim fluctuations;
    c. Get facultative underwriting support; and
    d. Gain access to the reinsurer's underwriting manual.
9. Regarding types of reinsurance used, no discernible difference exists between the challenge companies and no-challenge companies.
10. The number one challenge for smaller insurance companies was that the price of reinsurance was too high.

SUMMARY AND SOLUTIONS

In general, there was a fairly low response rate to both surveys. Perhaps the reinsurers that did not participate simply are not interested in the small company market. However, there is at least one reinsurer out there that is very willing to work with smaller insurers, and at least one that will work with companies below their benchmark when the right deal comes along. Also, I know from my own experience that other reinsurers (that did not participate) will do business with smaller companies when the right opportunity presents itself.

Does the low response rate from smaller insurers mean that there is no issue? That is certainly a possibility, but the survey responses show that challenges are out there. Of course, all business deals may present challenges, and it is evident from the numbers that even the companies within the challenges group have found ways to deal with the market as it currently exists. This fact was reinforced at the annual meeting during Session 135 where these research results were presented, when 91 percent of the direct writers in attendance indicated they have had challenges, but 83 percent of those said the challenges were overcome.

During Session 135, 70 percent of reinsurers in attendance (they made up 58 percent of the audience)

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indicated that they have benchmarks, but they make exceptions, and 25 percent said they don't use benchmarks at all.

So, one solution is—keep trying. There is a reinsurance market for smaller insurers. As one of the reinsurers pointed out during the follow-up interview, smaller insurers may sometimes have to pay a little more for their reinsurance versus the larger companies who can demonstrate that they have very low and stable mortality results, but with careful product development those costs can certainly be priced into a viable product.

A second solution, since we know there is a reinsurance market for smaller insurers, is to make sure you are prepared when you approach the market for reinsurance placement. Don't be reluctant to seek the help of a broker or consultant, and if you do approach the market on your own, make sure you are prepared. A list of items you may want to consider having available before you ask for a quote is included at the end of this article. Reinsurance actuaries, just like all actuaries, love getting too much information. The more you can provide up front, the better the negotiations should progress.

Another possible solution is a pool approach for smaller insurers. During discussions and interviews, the researcher heard of two instances where development of pools has been attempted. One was an attempt by the American Fraternal Alliance (then the NFCA) to get some of the larger Fraternals to set up a risk-sharing pool for smaller Fraternals. However, it is the understanding of the researcher that this idea did not come to fruition.

Another attempt to set up a small company reinsurance pool was made around 2005 by a consulting actuary. At least two reinsurers were approached with the idea, but again the attempt did not gain any momentum.

While attempts to establish a small company reinsurance pool have been made, this idea remains a potential solution. The following structure for a pool might work if the right people and companies support the approach:

1. Use a standardized full medical application and provide specific instructions to be used during the marketing process;
2. Develop two or three standardized life products (pre-filed for use in all states) that are available only for policies ceded into the pool (e.g., WL, 10-year term, 20-year term, UL);
3. Each specific company, once approved by the pool reinsurers, would be allowed to put its logo and company-specific information on the pool application and products;
4. Use a TPA for all underwriting and claims;
5. Allow each company to issue and administer the policies on their system once the issue decision has been made by the TPA. This is an important point for most companies, but especially for Fraternals who want to make sure they are connected with and engage their clients in their specific fraternal endeavors; and
6. A decision would have to be made regarding ongoing administration of the reinsurance, including reinsurance premium billing, settlements and quarterly reporting. It is likely that only the very smallest insurers will not be able to handle the administration issues.

Things to Think of and Prepare Before You Approach the Reinsurance Market

The following is a suggested list of information you should consider providing prior to asking a reinsurer to provide a reinsurance quote;

1. Provide a copy of the basic policy forms, riders and applications you want included in the reinsurance treaty. If state specials are significantly different, make sure you provide those as well;
2. Provide premium rate tables and policy fees/factors used to calculate policy premiums;
3. Have available an actuarial report on the product development and pricing results and assumptions, should the reinsurer ask for it;
4. A copy of your actuarial state filing memorandum provides a good product summary for the reinsurance pricing actuary—along with reserv-

> **"MAKE SURE YOU ARE PREPARED WHEN YOU APPROACH THE MARKET FOR REINSURANCE PLACEMENT."**

ing methods and information about underlying guaranteed elements;

5. A summary of your underwriting rules and methods;
6. Information regarding your claims and underwriting staff is important. If possible, arrange a conference call and introduce your staff. It will help build a comfortable relationship with your potential reinsurer;
7. Make sure you have some idea of the type of arrangement you are looking for (YRT, coinsurance; excess or quota share) and communicate that preference to the reinsurer. They may suggest alternate approaches, but it is very helpful to provide a starting point. Some companies even let the reinsurers know what YRT rates or coinsurance allowances they are looking for, and this helps provide a framework for the negotiations; and
8. Provide information about how your product will be marketed (e.g., captive agents, brokers, direct marketing, etc.) and provide an estimate of the first two to three years of production. If possible, the production estimates should provide by issue year, age range, gender, underwriting class, average face amount and projected net amount at risk for universal life business.

In conclusion, it is clear that challenges do exist for smaller insurance companies. However, with the right approach you should be able to find reinsurance solutions to all your risk sharing needs. ■