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Life Reinsurance— A Time of Increasing Relevance

By Mark Prichard

Over the last five years, companies active in the life and health reinsurance segments have experienced challenging conditions globally.

Reinsurers have faced growth challenges in the largest individual segments:

- The individual mortality market in the United States is the world's largest. Since 2008, U.S. insurers have ceded reducing levels of face amount, opting instead for higher attachment points. In-force reinsurance face amount peaked in 2011. Given also the long-term transition from co-insurance to YRT structures, ceded premiums in respect of new business have fallen even more sharply.

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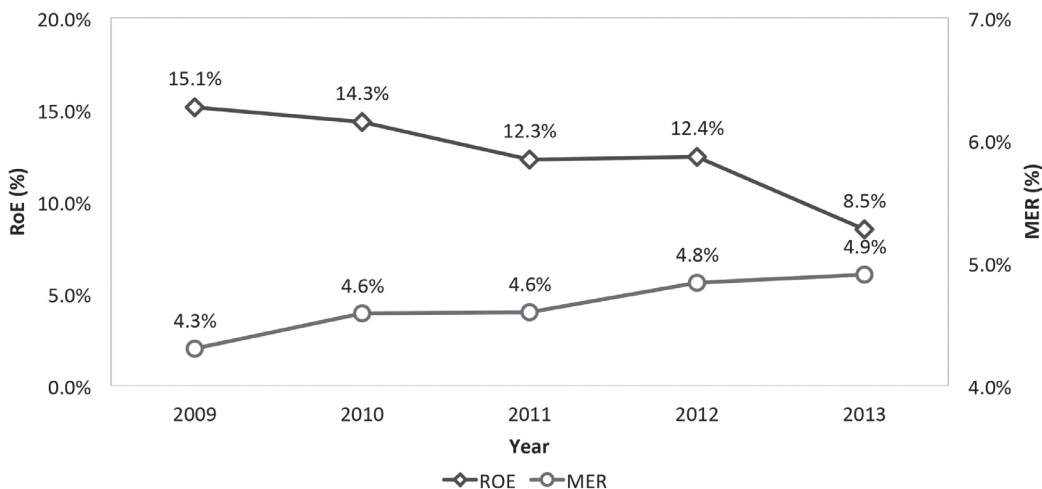
- In the United Kingdom and Ireland, the world's second largest reinsurance market for individual business, cession rates remain as high as reinsurers will permit (~90 percent). Risk amounts ceded have also remained broadly stable. The underlying primary protection market has however been impacted by the financial crisis of 2009, and also new regulation (in the form of the Retail Distribution Review) which has significantly impacted sales volumes through certain channels (such as bank financial planning). Reinsurance new premiums have also fallen significantly due to regular tendering, which has produced consistently lower pricing. Similar to their U.S. counterparts, U.K. insurers have steadily replaced level premium reinsurance structures with YRT arrangements.
- Generally attractive levels of growth in emerging markets (Asia is now producing more life reinsurance new business than the United States or the United Kingdom), as well as robust growth in some group segments, have been unable to offset the impact of reduced flows from the largest markets.
- "Early-2000" blocks of individual mortality business in the United States have proved either "low margin" or significantly loss-making, with reported losses in the order of US\$1 billion.
- The sum of announcements in respect of "reserve strengthening" in the Australian market reached c. US\$2 billion, primarily stemming from the group segment (across all risk classes, although most acute for total and permanent disability (TPD)). There were also meaningful contributions from the individual segment where income protection business produced actual termination rates far lower than any insurer or reinsurer had priced or provisioned for.
- Reinsurers are generally concerned about the level of individual rates in the United Kingdom, particularly for critical illness (one-third of ceded risks by premium), but also mortality (where rate differentials are largely premised on differing views of the rate of future longevity improvements).

Fierce competition on pricing and other commercial terms in the largest segments over the past decade has manifested in reinsurers needing to apply significant reserve strengthening over the past three years:

The scale of these losses is significant by any measure. The combination of these effects, and a period of low investment yields following the global financial crisis, has seen RoEs fall sharply for the life and health reinsurance segment. Reinsurers have also seen operational (i.e., maintenance) expenses rise as a percentage of pre-

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Figure 1: "Global Six" life and health reinsurers' profits, return and expense ratio (2009 – 2013)



Notes: Top six includes Swiss Re, RGA, Munich Re, Gen Re, Hannover Re, SCOR; Profits shown are before tax; ROE is calculated as a ratio of profits before tax to average net assets; Expense ratio (MER) is calculated as management expenses to net earned premiums

Source: Company accounts, analyst reports

miums over the past five years, although while there are significant differences between competitors, the average MER still lies in a reasonable range

For a number of different reasons, these headwinds have not necessarily been reflected in reinsurance company share price movements, which have seen share prices increase by ~30 percent over the same five years. Reinsurers still trade at relatively low price-to-earnings ratios compared to other sectors, however.

Despite this period of transformation, and unlike the underlying life insurance industry in many markets (where the focus is largely on savings and investments), the proposition of life and health reinsurance is not fighting a battle for relevance. Indeed, it is my personal view that life reinsurers are becoming ever more relevant to life insurers.

This hypothesis is underpinned by three key ideas.

1. LIFE REINSURERS ARE INCREASINGLY CAPABLE

With margins and volumes under attack, life reinsurers have not sat idle. Acquisitions have allowed smaller reinsurers within the “Global Six” to achieve further scale. Reinsurers have also diversified their businesses

into new segments including living benefits and longevity risks, and globalized their capital solutions capabilities.

Investments have also been channelled into client-facing teams, as well as new capabilities and technologies.

These efforts and investments have been recognized in greater satisfaction ratings from direct insurers around the world (measured in NMG analytics in the form of a Business Capability Index (BCI)).

Perhaps of greatest strategic relevance is the fact that reinsurers have developed a more expansive view of their ability to deploy their capabilities and solutions across the value chain. This expands significantly the opportunity set for reinsurers, creating avenues for reinsurers to have a direct hand in the development of the underlying life protection markets in many countries around the world.

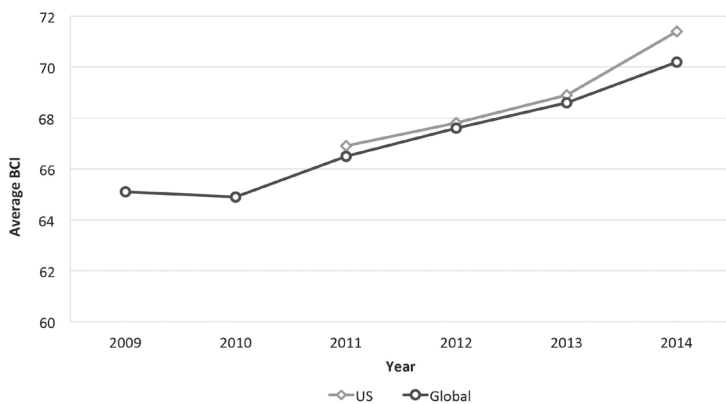
2. PRIMARY DISTRIBUTION SYSTEMS ARE EVOLVING

Particularly in Anglo-Saxon markets, direct channels have enjoyed significant increases in market share of the sales of new protection products. In Australia, where almost 90 percent of personal lines sales for motor and home insurance are via direct channels, and where life protection products are sold on a stand-alone basis, the proportion of life and health insurance new sales sold through direct channels has lifted by nearly 20 percent over the past five years. The United Kingdom and South African markets have also seen significant lifts. In addition, in NMG’s multi-country study of consumer buyer preferences, non-advice purchasing intentions suggest significant further shifts in favor of direct channels. Our study of customers in the United States suggested similar trends, albeit from a lower starting point.

Challenged by static life insurance customer bases in a growing population, life insurers in America recognize that existing distribution channels have been unable to meet the needs of some sizeable customer segments (typically younger persons, and/or those without a significant need for asset protection).

NMG’s 2014 life reinsurance study of the individual mortality segment in the United States, in which we interviewed 125 insurance executives, indicated the degree to which life insurers are mobilizing behind

Figure 2: Business Capability Index (BCI) – Client Satisfaction (2009 – 2014)



Source: NMG Global Life & Health Reinsurance Program.

finding solutions to address these under-served and under-insured segments.

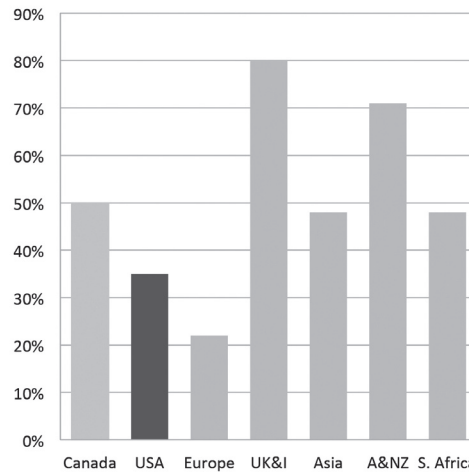
Approximately 80 percent of insurers considered the “under-insured” segments a central component of their distribution strategy, and more than half of companies indicated that they had already launched initiatives focused on these segments. The majority of these programs are pilot studies and relatively small scale, and hence still of limited immediate commercial relevance to insurers that have implemented them. Nevertheless, their significance cannot be underplayed in a market where currently sales of life protection via direct channels significantly lag that of peer markets.

New channels, and new distribution processes focused on the sale of stand-alone direct products are good news for reinsurers, since nearly 90 percent of insurance executives consider reinsurers as logical partners with which to explore and exploit the opportunities of these underserved customer segments.

3. REINSURERS HAVE ACTIVELY INVESTED IN TECHNOLOGY

A key enabler of direct channels is an automated underwriting solution focused on streamlining and simplifying the new business acquisition process. For the past decade, reinsurers have actively invested in the automation of the underwriting process; collectively reinsurers have more than 100 installations globally, and are well-positioned to support insurers in these new endeavours.

Figure 4: Proportion of Insurers with meaningful AUS investments or plans



Source: NMG Global Life & Health Reinsurance Program, 2014.

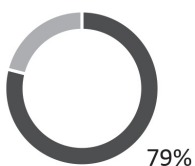
U.S. insurers are relative latecomers in terms of the adoption and implementation of automated systems, both for direct channels and in the support of advised channels. This is significant as the potential applications of automation, and the linkage to new “selection assets” (such as pharmacy prescription databases, and new risk scoring algorithms produced by some vendors, together with MIB, and Motor vehicle record data and a host of other “big data” opportunities) are greater in the United States than any other market globally.

As opposed to the technology itself, U.S. insurers see greatest value in the underwriting algorithms, which underpin the decision logic.

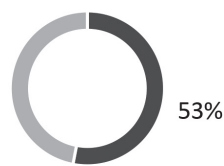
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Figure 3: Insurance decision makers’ views on the role and relevance of reinsurance (US, 2014)

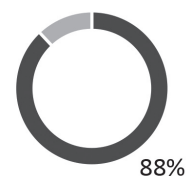
3A: Insurers that consider under-insured segments a key component of their distribution strategy



3B: Insurers that have already launched a proposition for the under-insured segment



3C: Insurers viewing reinsurers as significant partners in accessing new growth segments



Source: NMG U.S. Individual Mortality Reinsurance Program, 2014



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U.S. insurers may well close the gap to comparable markets within just 18 months, with probably 15 reinsurer-supported automated underwriting systems expected to commence implementation in the next 12 months. The U.S. market has become the hotspot for automation implementations globally.

A key challenge facing insurers in respect of these new channels and segments, lies in how best to leverage these new selection assets. More specifically, how can insurers enable underwriting and acceptance at competitive rates (presumably with a whole new set of preferred thresholds), without recourse to the expensive, invasive and time consuming information insurers have come to rely upon. Insurers face the prospect of a brave new world of underwriting without bodily fluids!

THE ROAD AHEAD

Having endured a particularly difficult period since 2009, the life reinsurance industry still meets muster in terms of its relevance to insurers. While the operating environment will continue to be challenging, reinsurers can now see clear opportunities ahead in helping to create new distribution channels, reducing redundancy in existing adjacent channels, all while helping to reshape the new business process and even the underlying philosophy of underwriting. In no market will this be more impactful than the U.S. individual mortality market.

But opportunities extend beyond new distribution and automation. Globally, capital solutions are set to have particularly high relevance in Continental Europe as well as several Asian markets. And emerging markets, which account for relatively small markets currently, will continue to grow in relevance.

Profitability concerns for certain segments will continue to capture significant bandwidth of reinsurance executives, but with a few exceptions, the scale of these effects is mostly understood, and “green shoots” of profitability may return quickly to some of the more problematic segments.

Reinsurers are increasingly circumspect about the attractiveness of current rate levels in the United Kingdom and Irish markets, and the cycle of relentlessly decreasing rates seems at last to have come to an end, as market incumbents have limited appetite for additional shares.

Reinsurance competitors are better organized than five years ago to adapt to these challenges, and have sufficiently distinct strategies not to pursue these opportunities uniformly. It would be hard to imagine, however, that any mainstream reinsurer would not include an automated underwriting proposition within its broader offer in the years ahead. ■