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Don't Forget Your Reinsurer Revisited – 15 Years Later

by Philip A. Velazquez

I was recently reorganizing my files and came across an article of mine that appeared in the April 1990 issue of *Product Development News*. The title of the article was "Don't Forget Your Reinsurer." It discussed the role that a reinsurer could play during a company's product development process and encouraged companies to consider the reinsurer as a source of advice during the early stages of product development. The article was written before first dollar quota share became the method of choice for allocating reinsurance as opposed to excess retention. It was written during the early years of living benefit riders, joint last survivor policies and the introduction of preferred risk underwriting classifications. Yes, those were prehistoric times. In my article, I even mentioned hospitality suites as a marketing tool of life reinsurance companies!

The article was written to address a concern that I had that reinsurance considerations were being relegated to the back of the product development cycle. I was concerned that reinsurance input on benefit design, underwriting and pricing was not getting into the process. In my article I included a list of items that most reinsurers would like to see when a Request for Proposal (RFP) was sent. The items were:

- Policy and rider forms
- Gross premium rates, current and guaranteed mortality charges
- Actuarial memoranda
- Underwriting guidelines
- Contemplated retention schedules
- Volume estimates
- Historical experience regarding age distributions, mortality and lapse experience

I'm happy to say that the situation has changed since I wrote my article 15 years ago. There is much more interaction and discussion going on between the direct company actuaries and the reinsurance actuaries during the early stages of the product development process. However, there are still some areas that need improvement, primarily caused by recent developments. I'll just touch on a few.

Regulation XXX

Since 2000, many term writers have increased the use of reinsurance as a source of statutory capital. The growth in reinsurance volume assumed (by reinsurers) and ceded (by direct companies) requires additional lead time to develop a reinsurance proposal. More precise new business volume estimates for term insurance are needed to check for both initial capacity and also for ultimate capacity. This also requires precision in estimating volume by plan, underwriting class and issue age. With respect to deficiency reserves, there needs to be ongoing discussions regarding the development and reporting of X- factors, and the actual cost of the extra reserves and how the reinsurer will reflect those costs in its reinsurance rates.

Universal Life Option C Return of Premium Benefit

This benefit is proving to be troublesome to reinsurers, especially when the benefit allows for interest accumulation. The problems include the potential for "pop-up" liabilities for the reinsurer (i.e., no liability until the very late durations and possibly no coverage from retrocessionaires), the risk of exceeding available capacity especially at the older issue ages, and distortion of pricing models. A reinsurer may want to limit its liability at a much lower level than anticipated by the direct company.

No-Lapse Universal Life Policies

The characteristics of this business (e.g., better persistency, older issue ages, level net amount at risk pattern as opposed to one that decreases) are sufficiently different from other UL products that a different set of reinsurance mortality risk charges may be needed. A company should not take for granted that it can cover this type of product under an existing reinsurance agreement that may cover a basket of other universal life plans.

Older Issue Ages

When I wrote my article 15 years ago, the subject of mortality for individuals whose issue ages are 80 and over was of little concern to most life reinsurers. There was little business being automatically ceded at those ages, and we generally relied on the decreasing pattern of mortality risk liability when we established simplified formulas for setting the reinsurance mortality risk charges at those ages.

In recent years many reinsurers have discovered that they have more age 80-and-over business than they are comfortable with and are increasingly giving more scrutiny toward their pricing at the senior issue ages. I encourage direct companies to contact their reinsurers to discuss the reinsurance pricing for mortality risk at the senior ages. They may find sticker shock similar to that experienced during a gasoline fill-up right after Hurricane Katrina.

Extended Maturity Benefits under Universal Life Contracts

It has been my experience that most direct writers expect that reinsurers will participate in the "free" death benefit coverage that is often provided after policy maturity, typically age 100 for 1980 CSO products. The problem is that the coverage is not cost-free and the reinsurers must adjust the pre-maturity reinsurance mortality risk rates to build up a fund to cover the cost. Before entering into a reinsurance contract, both parties need to discuss the incidence and level of these charges, and also the reporting of reserves.

Table Shaving Programs

The late 1990s and the early part of this century saw increased growth of these programs, primarily with support from the life reinsurance community. The life reinsurers are beginning to withdraw their support. They have become frightened by the increasing popularity of these programs within the life settlement market. A company should have discussions with its reinsurers before assuming that an existing program can be extended to a new product series. Perhaps a modification of the program can be worked out that will satisfy any concerns about the impact from life settlements on these programs. Personally I hope these programs go the way of leisure suits and polyester plaid bellbottoms, hopefully never to come back—but that is just my opinion. Maybe we should also extend that wish to floppy jeans that hang way below the waist.

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Life Insurance Life Annuity Contracts (LILACs)

The life reinsurance industry has not been supportive of these programs, which involve the simultaneous purchase of a life insurance policy and a single premium immediate life annuity. Some direct companies initially thought that they could reinsure this business under existing automatic reinsurance agreements. The life reinsurers generally took the position that these programs were not contemplated at original pricing of the reinsurance deals. They expressed concern about the target market (older ages), the mortality anti-selection (arbitrage) and the use of table shaving programs.

The above are just a few examples of the complexities that have developed in the life insurance marketplace in the past 15 years. Ongoing dialogue between direct writers and reinsurers will enable both parties to work together more efficiently. Waiting to hold these types of discussions at treaty negotiation time will cause delays in completing the reinsurance deal and treaty documents. An added benefit for smaller companies is the ability to draw on a valuable resource, gratis.

I wonder what the next 15 years will bring. Let's talk about it soon. ●

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