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Small Talk

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Smaller Life Insurance Companies and Smaller Life Reinsurers: The Partnership Solution

By Jay M. Jaffe

Editor's Note: *Volunteer editors of Society of Actuaries' section newsletters are always happy to receive quality articles to fill their respective publications. While topics usually vary, there are times when articles cover the same subject, but take a somewhat different approach. We received two articles on access to reinsurance for smaller insurance companies—both are published in this issue. Jay Jaffe's article outlines multiple possible solutions at a high level, while Clark Himmelberger's article drills down into one possible solution in detail. Jaffe also suggests that the Smaller Insurance Company Section facilitate a think tank to further develop solutions to limited reinsurance opportunities. We hope these two articles provide you with solid information on the reinsurance topic. I'd also like to note that currently, Karen Rudolph, FSA, MAAA, of Milliman Inc., is chairing a project oversight group to perform a research project examining current problems and potential solutions regarding access to reinsurance for smaller insurance companies. This research is sponsored by the Reinsurance Section and the Committee of Life Insurance Research. Results of that research should be available in the near future. We'll keep you posted.*

—Robert Hrischenko

The most recent listing of recurring reinsurance premiums published in *Reinsurance News* shows that in 2009 about 85 percent of the U.S. life reinsurance market was controlled by just five reinsurance companies.[1] The situation in Canada is even more limited with just three reinsurers having about 95 percent of the life reinsurance market.[2]

The concentration of the life reinsurance business reported in the *Reinsurance News* report should not be startling to anyone who has been involved with life or health reinsurance during the past several decades. There have been numerous consolidations of life reinsurers over the years and more are likely to occur in the near future.

For small life insurance companies (direct writers) the impact of fewer life reinsurance companies (reinsurers) is significant for many reasons. Unlike their larger sized brethren, smaller direct writers need reinsurance to make many of their products possible. They usually don't have the capital and number of insureds to cover larger amounts of life insurance; they may not have the underwriting expertise needed to evaluate larger risks; and they may need surplus relief when production is good, etc.

In circumstances when the number of providers of a needed service to a market is limited, the availability and cost of the services is inevitably going to increase if for no other reason than larger service providers generally don't have the cost structure and mentality to deal with smaller production sources.

But finding a solution or solutions to the vanishing reinsurance market isn't only a problem for smaller direct writers. Virtually the same problem is also being faced by the smaller reinsurers. The direct writing life insurance industry is also concentrated with the top 25 groups having about 80 percent of the life insurance in force in the United States and it can be difficult for smaller life reinsurers to get their feet in the door of the larger direct writers.[3] Thus, smaller life reinsurers also need to find a way to compete against the five (and possibly in the near future just four) major life reinsurance carriers.

If the life reinsurance market continues to contract, smaller direct writers are going to face a hard decision: ***if they want to operate independently, can they continue to afford to offer products that require reinsurance?*** The smaller life reinsur-

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ers face a similar question: ***what do we have to do to compete against the major life reinsurers?***

If the smaller direct writers conclude that under current conditions they can't afford to offer products which require reinsurance, then they are going to have to consider alternative survival strategies including:

- Restricting their portfolios to products with limited face amounts (e.g., the senior market);
- Limiting their products to those that fit smoothly into a standard reinsurance system offered by reinsurers;
- Accepting larger retentions and the experience fluctuations that follow;
- Paying higher reinsurance premiums which may lead to lower profit margins; and/or
- Developing creative solutions to expand life reinsurance capacity.

The best strategy from the above options depends on each company's circumstances and may even involve combining multiple solutions as needed in a situation. There may be other solutions that emerge over time which also should be considered.

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At the same time, the smaller reinsurers still remaining are going to have to decide whether they can exist in a market without smaller direct writers. If they conclude that the future for both smaller direct writers and reinsurers is interdependent, then they, too, will have to develop strategies for preserving the universe of smaller direct writers.

Given the common interests between smaller direct writers and smaller reinsurers, it is logical to expect that some relationships or partnerships between these two groups will form. But what will these arrangements look like? Here are some possibilities:

a. Small life reinsurers become active solicitors of major distribution sources on behalf of a consortium of smaller direct writers.
b. Reinsurance pools led by and guaranteed by smaller reinsures become available.
c. Smaller direct writers become shareholders of smaller reinsurance companies.
d. Smaller reinsurers and direct writers completely consolidate operations to achieve expense efficiencies but without surrendering their independence.
e. Smaller life reinsurers create new forms of reinsurance and services specifically geared to the needs of smaller direct writers.

None of the above or any other solutions will happen overnight. One way to get started would be for the Smaller Insurance Company Section to sponsor a "think tank" conference call attended by members from both direct writers and reinsurers. Write to your SOA Section chairperson or newsletter editor with your ideas.

But if something isn't done to find ways to develop strong symbiotic relationships between smaller direct writers and smaller reinsurers, the probable end result is that both of these types of entities will vanish or become even more immaterial to the life insurance market. While there are laws to save endangered species, there will likely not be a campaign to save either small life insurance or reinsurance companies so something better start to happen soon to increase the likelihood that both breeds of smaller insurance entities will survive.

END NOTES

1 *Reinsurance News,* Society of Actuaries Reinsurance Section, July, 2010, p.7.
2 *Ibid,* p.8.
3 Best's Statistical Study "U.S. Ordinary Life—2009 In Force.' As a further indicator of the concentration of the U.S. life insurance industry, the top 50 groups control 90 percent of the market and the top 100 groups control almost 100 percent of the U.S life insurance market.

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