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REINSURANCE IN 1990: IS IT PROFITABLE?

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- What are the current marketplace dynamics?
- Are companies making money?
- How do foreign companies view the U.S. market?
- How do we view opportunities in Europe and Asia?
- Are there new uses of reinsurance to replace other less profitable uses?
- Reinsurance as a source of flexible capital

MR. MELVILLE J. YOUNG: The first person talking will be Mike Tine and Mike is pinch-hitting for Mike Magsig who had a medical emergency, not life threatening but enough to keep him from being here, unfortunately, and we'll miss Mike, but I'm fortunate to have the other Mike with us. Mike's with Cologne Life Reinsurance and I'll get into formal introductions of each of the speakers in turn. Dan Van Wormer is in charge of a marketing venture at Capital Holding called Marketing Partnerships, which we'll tell you more about sometime later. And the third person is Frank Alvarez who runs the financial reinsurance, the special reinsurance operation for ITT Lyndon Life.

Both the life insurance industry and the life reinsurance industry have gone through or have been constantly going through an evolution, or perhaps a revolution, since I've been involved in these industries for almost 30 years. But this is the first time that I could remember so many revolutions simultaneously taking place. You probably could add to my list, but since we only had three speakers, I only had room for four revolutions at this time. Mike's going to be talking about, number one, the internationalization of our businesses and, certainly, one recognizes that we are in the throes of a revolution there. He will also address the revolution that goes on and has been going on for some time as we learn to deal with the sudden changes in our products and how we do business in the regular course of business. Dan is going to be talking about a revolution that's been taking place, and it's been sort of subtle, so I don't know how many people recognize what's been happening. And that's in the area of what I would call joint ventures where virtually every company in the country seems to be willing to entertain or at least accept

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the concept that they cannot be all things to all people and are willing to enter into or consider entering into joint ventures with other companies where the fit is right. And I think that's a revolution because I think five years ago virtually no one was willing to accept that Frank is discussing concerns at least for most product lines. And the fourth revolution to be discussed by Frank concerns what's happening to our capital structure, and some of the alternatives that we have available to us to help us deal with some capital problems today.

We'll start with Mike, who is relatively new to the reinsurance business. He joined Cologne recently from Travelers. He was with Travelers for 22 years, and while he was there he most recently was in charge of life, health, and annuity lines of business as a profit center. He left Travelers to join Mike Magsig in an effort to move Cologne, they hope, into a more forward position in the life reinsurance market in the U.S. Mike is in charge of the individual life reinsurance line at Cologne. He's a graduate of Wesleyan University. He's on the LOMA Board and he told me to tell you he's just an all around good guy, which I know and I hope as you get to know him, you'll recognize as well.

MR. MICHAEL P. TINE: For those of you who came in a little late, you'll realize that I am a stand-in for Mike Magsig. Hope you have a little bit of sympathy and patience with me. Mike had emergency surgery over the weekend and I was enlisted to do this. I wasn't aware and it's kind of true that usually I work for Mike. It's too bad that like many bosses, he hadn't asked me to write his speech because if he had, it would have been easy for me. But since he didn't, I spent most of my lunch time kind of preparing for this. So I have a challenge in giving someone else's speech. But I'll certainly do my best to capture the messages that he certainly wanted to deliver. As I was preparing for this, I was struck by the fact of how much similarity there is between the remarks that he had prepared about reinsurance and the remarks that I might have prepared just a few months ago from the perspective of the direct business. So I think no matter what side or what part of the business you're in, reinsurance or insurance, I think you'll find these comments quite profitable.

What are the current marketplace dynamics? The word which immediately comes to mind in describing the current marketplace dynamics is "dislocation." Reinsurance companies, and this is, perhaps, also true with direct writers, are in general, pushing products are but not identifying new opportunities. What's happening, however, is that formerly distinct areas of service are overlapping and other marketing opportunities may be going unmet. Examples of unmet marketing opportunities from the reinsurance perspective would include affluent seniors, those older than 70 years who have legitimate life insurance needs arising from estate or inheritance problems, and mature adults, those in the 50-60-year-old bracket whose parents are aging and outliving their income, and whose children are having difficulty in buying their first home and becoming financially independent. The pre-need business continues to grow nicely and a greater percentage of direct premium is shifting to health and annuities. Yet reinsurers continue to place the greatest attention on the ever-shrinking, more highly competitive individual life reinsurance business. Instead of concentrating on some of these very clear changes in the marketplace, reinsurers are attempting to creatively or perhaps not so creatively shave rates and many are inadvertently succumbing again to the seduction of volume while the entire individual life market shrinks. That's what I meant by the description of a market dislocation. Unless we get religion it could be, as Yogi Berra said, "Deja vu, all over again."

But back to the topic of the session. Are companies making money? The earnings patterns in the reinsurance marketplace probably mirror the direct marketplace. I can tell you that having come from that side of the market myself just recently, I can say that it does. In my frame of reference the question posed by our board at Cologne Life Reinsurance becomes, "Is Cologne able to show a consistent emerging trend of earnings which exceed our cost of capital?" The industry is making money but returns are not consistent with what would be expected from an attractive performing industry. Few direct writing companies are really making the cost of capital on new business. So it becomes a challenge of the reinsurer to identify those companies which are making money and strive to create alliances with them. It's not far fetched to envision direct writing companies and reinsurers creating Japanese style relationships now being emulated by U.S. industrial firms and their suppliers. Squeezing the last nickel out of reinsurers may be replaced by preserving reinsurance relationships for stability and capacity. These alliances are similar to those being pursued by companies in other industries, such as Boeing and Ford Motor.

Are there new uses of reinsurance to replace other less profitable ones? Frankly, I'm not sure if some less profitable uses can be replaced because a legitimate need for their services continues to exist. The problem is that there are too many reinsurers chasing too little business with the traditional market. I've already mentioned in my earlier discussion several possible opportunities, such as seniors and adults. New possibilities also appear to be emerging in providing stop loss covers where the management of risk of certain government programs has been privatized and in quota-sharing specialty group health capitation programs. Demographics dictate that the long-term care business should be becoming an attractive opportunity, but as we all know, that market is emerging very, very slowly. And additional opportunities may exist if life reinsurers are willing to assume more investment risks.

Within this dislocated and struggling scenario then, how do foreign companies view the U.S. market? Before I can specifically try to answer this question, I need to make some general comments to set the stage. First, companies from similar cultures will not judge the U.S. market using the same factors, but they usually will share consistent overall views. Second, reinsurers having an active U.S.-based presence will view the market differently from international companies attempting to maintain a presence from offshore. Companies involved from afar tend to desire a retrocession involvement as opposed to a reinsurance involvement. Third, international reinsurers generally take a longer-term view toward the business and most believe it is absolutely necessary to be in the U.S. market to be considered a worldwide reinsurer. With all that said, I am convinced that a global reinsurance marketplace will be a reality by the end of the decade. In essence, we may not be able to pick the music, but the songs still sound a lot like "God Bless America."

Let's cite one example of a longer-term outlook. Up until a year ago Mike Magsig's entire career had been spent with a competitor of Cologne. That company, a very prominent U.S. stock life insurance company with a major reinsurance operation, viewed the business in a much different context than Cologne's current owners. I'm not here to say that one view is right and the other's wrong, but I merely intend to reinforce the conclusion that international reinsurers do take a longer-term outlook than most U.S.-based companies. Prior to Cologne, because of the pressures arising from investment analysts, corporate staffs, etc., it was necessary for Mike to spend two or three days a month explaining the previous month's earnings, prospects of the current month, and the outlook for the remainder of the current fiscal year. I can personally add that I, too, came from a U.S. stock life insurance company and experienced the same monthly pattern. Obviously, those discussions do have some bearing on the operational and strategic decisions which are made in running a line of business.

Now, Cologne's principal owner takes a much different view of the business. While financial performance is of considerable interest, more attention is paid to the strategies which are being created and the trends which will emerge from those strategies three to five years out. It's perhaps similar to the difference between an NFL coach making player cut decisions based on preseason game performance or making those decisions based on the prediction of what he'll need five games into the season. Who can say at any one point which is better? But who can deny that the approach to the game and to the team strategy will be different in each case? What I can say is that through the mid-1990s, if it's even possible to project reasonably out that far, the U.S. market is not viewed by foreign companies as highly attractive. The reasons are apparent. Our margins are poor. Competition is tight. There's little distinction between competitors. Competition is highly price sensitive and the risk to premium ratio is very high. Add to this that the U.S. legal system is a shock to foreigners, even more than it is to those of us who have watched it evolve into the American version of the Loch Ness. We never know when it's going to strike, but we feel it's lurking around and creating waves. With as many as 52 different regulatory bodies, compliance is unwieldy and an extra complication to any new entrant.

U.S. demographics also create some uncertainty for many international reinsurers. While on the surface our changing demographic patterns should be quite attractive, the immediacy of Americans needing to meet material desires is found to be quite perplexing and troubling to foreigners as our population ages. The climate I mentioned before contributes to a lack of business collegiality among competitors in the U.S., an unfavorable factor to those who look for respectful interchange, if not, cooperation.

Longer-term the U.S. marketplace may have an allure despite itself. First, there needs to be a better, more favorable supply and demand alignment among reinsurance suppliers and buyers. Second, the sheer size of the U.S. market will have an appeal. For reinsurance it's the largest market in the world and will continue to be one of the largest throughout the decade of the 1990s. Third, the level of innovativeness in our market will cause certain major international players to stay close to it. If international reinsurers are intent on growth and such growth must include the U.S. marketplace, they may need to reexamine their comfort levels in reinsuring risks which are foreign to them, excuse the pun.

Thus, the U.S. market will have an allure to several types of international reinsurers. First it will be attractive to those who are cash rich, due perhaps to limitations on profit distributions in their homelands or special government preferences. Previously, the price to operate in the U.S. life insurance market compared with the cost of an insurance operation in other foreign lands was relatively high. This made it difficult for foreign insurers to gain a presence in the U.S. With the decline of the dollar value and the stock market crash in October 1987, the U.S. insurance companies have become much more attractive to foreign buyers with strong currency value. Japanese investors have slowly crept into financial institutions recently. It's probably only a matter of time before we will see their presence in the U.S. life insurance market. Second, the U.S. market will be an allure to reinsurers seeking long-term protection against fluctuations in other worldwide markets. Third, it will be an allure for those looking for markets with few barriers to entry or exit. And, finally, it will be attractive for those possessing considerable capacity, which may, indeed, be the competitive battle field of the 1990s.

How do we view opportunities in Europe and Asia? I think you'll find that many of these comments consistent with those made by James Schlesinger. Here, again, I can only speak for Cologne. We view opportunities in Europe and Asia favorably but, perhaps, in different time horizons than some others. Obviously, our parent is quite close to the scene in Europe, being located in Germany, and we have several branch offices throughout Asia. U.S. companies must, of course, realize the considerable barriers to entry in foreign markets present in many places. In 116 countries worldwide, U.S. reinsurers are effectively barred from competing. Recent forays into Asian markets have opened through the persistent diligent efforts of U.S. trade officials, and they must have our continued support.

Despite all these barriers, I believe that globalization of reinsurance will be a reality before the end of this decade. I believe and I wish I could emphasize this point strongly enough, that opportunities for U.S. reinsurers in a new international marketplace will be best realized through alliances drawing on existing relationships with other global players.

With respect to Europe, 1992 is not viewed for life reinsurers in the same context as other U.S. firms typically see that opportunity. Simply put, it's not an immediate windfall. Europe isn't and it may never be a true common market. In Western Europe, the life reinsurance business is highly controlled through a consortium of old-line traditional reinsurers. It would be very difficult for a U.S. player with minimal existing ties to crack those relationships in which the most profitable deals are consummated. Some have tried but they have not been met with a great deal of success. In addition, a growing class of wealthy individuals may emerge after 1992. That may play into the expertise of U.S. life reinsurers with Italy and Spain offering interesting prospects. And, of course, product underwriting variances may minimize the value that U.S.-based companies can bring to the European marketplace.

Opportunities may exist on the health insurance side as there is definite movement in Europe to private health care. Any expansion in health insurance would require a computerized administration system. A company that can export for some of the technological advantages, such as expert systems, and provide fast and efficient service will be very successful on the health insurance side.

With respect to Eastern Europe, opportunities may exist but they're much farther off in the future. Even before life insurance becomes a viable product, levels of disposable income among these emerging socialists and capitalists must grow and that takes time. Again, reinsurers based in Western Europe seem particularly well positioned to take advantage of those longer-term opportunities.

With respect to Southeast Asia and the Far East, prospects there look good and fairly immediate. Emerging middle classes in Taiwan, Korea, Singapore, Malaysia, and Thailand bode well for reinsurers. As we all know, the Japanese market is dominated by perhaps six to eight companies, all the size of Metropolitan and Prudential, so the reinsurance needs there are minimal; but deregulation may drive new product development and it will provide opportunities for international business. But the state-owned reinsurance company is very dominant, and international reinsurers based outside of Japan have difficulty breaking into that market, as do other foreign concerns in different businesses.

The author W. Somerset Maugham said it best. "There's only one thing about which I'm certain and that is there's very little about which one can be certain."

I've answered a series of questions without, I'm sure, giving you any easy solutions. However, I believe through diligence, prudent management practices, creative leadership, and downright hard work we can persevere. Our business will be global. Successful companies will be alliance builders and more sophisticated marketers with a longer-term view. There's no reason why U.S. companies can't be successful once we realize that we don't make the rules and the rules have changed.

MR. YOUNG: After a seven- or eight-year effort for some of us, we've got a new textbook on life, health, and annuity reinsurance. It was written by John Tiller and Denise Fagerberg, and it was commissioned I think perhaps by me the first year we had a reinsurance section counsel. The only problem is, with all of these revolutions going on, we probably need somebody to volunteer to start writing the next reinsurance text; the new book would address some of the subjects we're talking about now.

The next speaker is Dan Van Wormer. As I mentioned before, Dan's with Capital Holding. He's Vice President and Chief Marketing Officer of an operation called Marketing Partnerships and I'll let him describe that to you. Dan's basically been with one company his whole career. He's been with Capital Holding or one of its subsidiaries for 27 years. He started with People's Life Insurance before it was part of Capital Holding and has worked his way up the corporate ladder, been involved in many divisions of the company, and even spent some time out in the field in 1974. I think he was the leading agent for Capital Holding. When Capital Holding decided to look into joint ventures four or five years ago, Dan was put in charge of the marketing effort and began looking into the feasibility of that venture. And I think he's going to tell us a little bit about his experiences since.

MR. DAN VAN WORMER: It's really a pleasure for me to have the opportunity to address this group, a marketer before a group of actuaries. I do have to confess though when Mel first asked me to take on this responsibility, I felt more like the mosquito flying over the nudist colony. I didn't know where to begin; now I've realized that's not so funny. I see there's an encephalitis scare down here. I thought I should do what I do everyday really. I talk to companies about joint ventures and reinsurance or forms of reinsurance and the role it plays. And I also thought I should take one other step in case you all threw a question my way. I invited my friend Bill Phillips, our chief pricing actuary from Capital Holding to be hidden in the audience to help me if something comes up that I may be unfamiliar with. I'm going to take you through the story of marketing partnerships and how we use reinsurance in that I think it is a new form of reinsurance that is really emerging. It's been around for a long time, but I believe we're seeing more and more companies take advantage of that now.

Capital Holding is certainly not a name that you usually would associate with a reinsurer. We are what I would consider a nontraditional reinsurer. We use reinsurance in joint ventures and that makes sense and I'll try to explain why that makes sense as I go through this presentation. We use co-insurance or, in some cases, Modco, depending on the particular arrangement.

Let me tell you a little about how we got into this. If you read the *National Underwriter* or the periodicals that come out from time to time, these words are probably not at all unfamiliar. You're reading a lot, and we have been for quite awhile, about manufacturer distributor relationships, about private labeling, cross marketing, joint ventures, and our program, Marketing Partnerships. In fact, we were in *National Underwriter* recently with an article about one of our marketing partnerships that we've had in place for about six months. So this seems to be a growing trend that we noticed in 1986. In 1985, Capital Holding was taking a strategic look at itself and if you're familiar with our organization, all our agents are in the southeastern part of the U.S., and we have 4,500 of them there. And we have a pretty good market share in some of those southeastern states. However, there's a big part of the U.S. that we miss out on. So we were looking for ways to expand our capabilities beyond the southeast. At the same time, we had spent an embarrassing amount of money on computer systems and a very reasonable amount of money on our actuaries.

Being a holding company, we develop products for all the companies within Capital Holding, so we have a very good manufacturing capability. So w surmised, maybe the best way to expand is through joint ventures with companies positioning ourselves as a manufacturer. And so I was asked to look into this, and the first thing I started doing was talking to people, going to meetings like this, other meetings, reading, and trying to find out what was going on. And what I was reading about is companies needing to get product to the marketplace quickly. There's that old priority queue that you get hung up in and I've talked to some companies that say it takes two years to get a product out. And that's because there's so many other things going on.

This environment of change we're in really breeds a lot of work. Some companies need the administrative capability to handle particular products. Others need systems. There are companies out there that don't have systems that can handle universal life. I'm sure that doesn't surprise you when you read every now and then about companies deciding to get out of the universal life market. You hear a lot about companies wanting to be able to somewhat control their field force by providing the products to their agents, their contracted agents, whichever type, rather than having them go out shopping all around for products that could come to that particular company. Some companies want to get to new states where they are not admitted. And there's always need for help with financial strains of a growing business. Obviously, if you come out with a new program and it's successful, you may have some surplus strain you want to prepare for. Strong technical support and, finally, a partner willing to take a vested interest are things that I still hear when I go out and talk to people. And I probably talk to two or three companies a week about this concept.

There's another phenomenon that's come about; agent-owned companies. I'm seeing more and more of these. Usually they're small companies. The most notable company would be Life U.S.A., Bob McDonnell's company. He seems to have had quite a bit of success with his company from what I can see in his production. But most of these companies are usually new. They don't have much surplus. They really truly believe in sharing profits and they can make money, however, on commissions alone. If you did a deal with a small company like this and they just took a little pinch of the risk, they could still afford to write bad business and end up coming out ahead. And so you've got to position the risk sharing to protect yourself. One of the things that always fascinates me is a lot of times I talk to marketing guys that have really made it big in the world of marketing and they've made enough money to buy their own insurance company. They'll buy a little shell and start it up and they're always so enthusiastic and so convinced that now they're really going to make a lot of money by having an insurance company. And they'll come out and pick me up in their Lamborghini and all these kinds of things. They've really made it where they've been, but they really do have a burning desire to get into the insurance business all the way and they're sincere about it. A lot of times, as you get to know these people, you find out they learn the real money for them was in marketing, not participating as an insurance company.

Well, with that kind of a backdrop, companies working together for a competitive advantage, small companies coming along, agent-owned companies, there's a need to have some way to do business with a focus on profitability. We can provide a lot of support services from our menu of resources we have at the Capital Holding Corporation. But we need a way to make sure that we're writing good business together and we believe that co-insurance really makes a lot of sense. And that's the kind of reinsurance business that Capital's in today. It allows you to share risk and reward. In the case of the distributor, if you make it heavy enough, there is incentive for profitability, and as a manufacturer I can tell you there is motivation to try to really sharpen our pencil as we put together products for our partner and sometimes when we provide other services for our partners. We want to do a good job so that together we'll have a successful program.

Now these profitability considerations come from real experience and we've had some bad ones and we've had some good ones. And since we're talking profitability, I wanted to share these with you. Now, remember that you've priced the product and it's a co-insurance deal, so there's no way you shouldn't make your priced profits on each product you sell. However, you've got to make sure you do several things. One is to make sure the product is priced for the target market. At Capital Holding, we target a middle income market. We've priced our products that way. Often we're talking to some companies that target a slightly higher market than we are in and we have to go and do some repricing to make our products competitive. At the same time, we've got to make sure we aren't offering products that we price in an environment where the pricing wouldn't work. The co-insurance partners must have the financial strength to share risk and reward. I guess now I'd tell you this is the most important issue based on a recent experience, but if you get involved with a company and all of a sudden they've run out of surplus, you're going to end up inheriting the whole thing. And so you've got to be really careful to look at the financials and the ability of your partners to perform, to be there, to do a good job so you all make out on it. And you want to look at that financial side to make sure you're getting into bed with somebody that's got staying power with you.

Seek expertise in unfamiliar waters. We've gotten into a few partnerships that are things Capital Holding Corporation never heard of before we got into them and actually some of them have been good to us. But we've done it with companies or people that know something about the market. An example, and we're no longer in it because of some political reason, is HMO reinsurance. Now there's a risky market for you. And what we found out is that no matter what the contract says, if an HMO becomes insolvent, the insurance commissioner of that state is looking to find some deep pocket somewhere. You can forget what you've written into your contract. So you have to be careful of some of these things. We did have good partners in this and we made money, but because of some concerns that were raised by an insurance commissioner and some of the financial analysts, we decided to move out of that particular market. What you can do if a company wants to come to you and use your paper to get into one of these markets, is collect a ceding fee that will also give you some cushion against adversity. If you can get a 3-5% ceding fee on the business, let them use your paper. Participate in the management and risk of the business. At the same time, bring in some expertise, and we searched the country in that HMO reinsurance business to find an actuary that had that kind of experience. You can do okay, but you've got to be careful. Make sure you've got the right people in your partnership and get all the ceding-fees you can just in case something goes wrong. You may find you need them.

I wanted to tell you what a very typical partnership with Capital Holding looks like and I decided to pick the first one we put together in 1986. This particular company, which is also in the southeast, came to us and was concerned. They were going to have to get out of the universal life market. Their marketers were saying their product wasn't competitive. The investment department was saying we can't invest behind these kind of credited rates you want. We're going to lose money. And the administrative people were saying it's costing too much for us to administer this business on the system we're using. And they were in an arrangement that was rather costly on the administrative side. And so we thought, good, here's an opportunity. Capital Holding has a lot. We have five million policies we process on our system. A lot of that is interest sensitive both whole life and universal life. We have a product which has made money for us because we think you do have to have sane interest crediting tactics when you go to the market and we use an indexed interest rate that assures us some spread between what we credit the insured and what we get. We talked to these people and showed them how we did it. We offered them our systems, our products, and we ended up with something that looked like this. They're using our products, interest-sensitive whole life and universal life. We provided those to -- we'll call it company X. By the way, we're transparent in a lot of our deals so you may not hear about us. It's only the smaller companies that want to talk about the fact that we're a partner. The bigger ones kind of keep that in the background. Company X does all the processing on our systems. So what they have is a dedicated cable from their office, a thousand miles away to our office in Louisville, Kentucky. And they're sitting down there just as if that computer and that whole system were in their basement, or on their fourth floor, or whatever it might be, processing the business. Company X does all the marketing of our products using its agents and the products have been put on their paper. So this is the term we call private labeling. You're probably all familiar with that. That's the way the deal looks and here's how the money gets split up.

Basically through a ceding or a cession, premiums are shared 50/50. This happens to be an even-Steven deal. We pay this partner 50% of the total market allowances and 50% of the total administrative allowances because they're doing those functions. Basically our deal is here's what we're priced in our product. We lay down all our pricing in front of a partner and we say, okay, how do you want to divide it up, what do you want to do, what do you want us to do? Whoever does it gets the money that's been priced for that work in the pricing. One of the pieces of pricing is the expense to utilize a data center. And we've priced that into our products. In this particular case, they're using our data center, so each month they pay us a computer utilization charge. We're not a service bureau. We're not trying to make any profits on this piece. What they pay us is the same thing our own companies pay for computer utilization. And the implementation expenses on this particular partnership were evenly shared between us when we put this thing together.

Essentially I believe that describes the way it works and that in a nutshell is a summary of how we're using reinsurance in a new way, or an old way, or however you'd like to look at it, co-insurance to put partners both on some risk and, hopefully, on some reward and share the business together. Obviously, if you're able to do this you should be able to meet your profitability standards that you priced into your products and I'm pleased to say that so far we have. We will not dabble in what you might think of as the traditional reinsurance. We won't be getting into Mike's business. In fact, we do some work with Mike from time to time. So we're not trying to set ourselves up as a reinsurance competitor. Really what we're trying to do is find ways of combining strengths for a competitive advantage in a way that's good for both of us.

I want to move on to the international market, and I don't pretend to be an expert in that area, but I had a few things I wanted to share with you and essentially the agenda called for some comments. I thought I would talk about some experience I've had. A little different maybe than what you said, Mike. I have found some of the international players to be pretty aggressive in the health insurance market. In fact, I've had representatives of foreign companies call me and want to use our paper so they can come into the U.S. market. And we have not done that, by the way. But there's a lot of foreign companies, some large, some smaller. Usually the way we run into them is through reinsurance intermediaries. They're on your line slips. A word of caution: I would try to know who they are, make sure they'll be there when you need them. We've had a real good relationship with the foreign reinsurers we've used and, in fact, we have an annual meeting where we all get together and talk about the businesses that we share. And we are sharing business with foreign companies in a co-insurance relationship similar to what I described. The biggest one we've had used 12 different companies all taking a piece of the action on what you would consider a line slip. Risky business? Nobody wants to be in there up to their neck, but everybody think it looks pretty good and wants a piece of the action. So it seems to me that the foreign companies are looking pretty hard at the U.S. I see them a lot in the health business, particularly, from Europe on the health side. Obviously, we've all seen the acquisitions of the Dutch. Everybody knows Amev, and Aegon. You know those companies are going to be heard from over here. In fact, they are being heard from now and they do a good job. The Dutch, for example, have their market so saturated (my own opinion from what I've heard) that they see the U.S. as a good opportunity market for them. So I think you'll see growing interest from the foreign companies.

Now one of the true nice experiences I've had in my work was a chance to go to the Pacific rim to explore for partnership opportunities with companies and we focused on Hong Kong and Taiwan. I truly believe that there's some joint venture opportunities available. I think when you deal with people in that part of the world, you have to be patient. These deals take a while to bring together. They really want to know who they're working with. And you can stay in touch with these people for years and have a great relationship and never do anything. That's kind of been my experience. I think in Taiwan, particularly, they are allowing two U.S. companies now per year to be admitted in that market. Everybody's trying to play on the same field. Shin Kong and Cathay Life are the two largest companies over there. I have visited in both and was treated tremendously well. Had the great experience of talking through an interpreter which I found fascinating. They're interested in a lot of resources that we can bring to the table. They're interested in our systems. What they're not interested in, obviously, are our universal life and interest-sensitive whole life because who needs those margins. Now they're getting big margins on their product. They're still selling ten pay life kind of products and these big companies aren't going to be forced out of that market until they have to. But I believe Prudential is over there. I won't name them all. You probably could remember them as well as I could, but there are quite a few U.S. companies now starting to get into that market. So far the U.S. companies are trying to do the same thing the foreign companies are doing. But there are a few renegades over there writing bootleg business and so we're seeing some of the more sophisticated products introduced to the marketplace and the more sophisticated upscale people in those countries are buying these kinds of products. Now that speaks of Taiwan. Hong Kong is completely different. They've got some really tough products and you need to have your act together if you're going to try to go over there and compete.

We feel the risk is how long such relationships will last. Will they use you, and abuse you, and toss you aside after they've learned everything they need to know? No, I think not in every case and I think if you do a good job of picking your partners you can do okay. But maybe more importantly is how well you can manage business thousands of miles away. There you've got to really start thinking about how you do that and the cost considerations that may be in place to have somebody in those areas.

Where competitive products are in place, as we found in Hong Kong, we found much different circumstances; smaller companies were coming to us, to talk to us while we were there. They heard about us through somebody or another along the way and we were there for about a week and a half. They wanted to talk to us because the smaller companies are just like the smaller companies in the U.S. They don't have all the resources and thought here may be a way to do this. There I think the risk is can you really generate enough business to afford a venture like that. So that's kind of what I see on the international side. It's been interesting and I hope we'll do some more of it.

MR. YOUNG: Dan mentioned the foreign market and Mike mentioned the foreign market and I thought -- before we break up here, those of you that are here representing non-North American companies should introduce yourselves.

The third speaker is Frank Alvarez. Frank is Executive Vice President and Director of the Reinsurance Division for ITT Lyndon. He's been there for about seven years, and he was hired basically to establish ITT Lyndon's reinsurance operation. He has provided us with some details of their financial growth. Lyndon has grown to be a company with statutory surplus of about a billion dollars and a face amount in force of 30 million. We're all familiar with their operation. It's one of the most professional in their market.

Frank can take much of the credit for the growth. Prior to being with ITT, he was with Lincoln National Life, as Chief Financial Officer of the Reinsurance Division. And prior to that he was Treasurer and Chief Investment Officer of Acceleration Life. He's got a Bachelor's degree from Ohio State and he's got an MBA in finance from Miami University.

MR. FRANK A. ALVAREZ: Helping me is Rollie Anderson who was in the insurance area at Lyndon about three years ago and was promoted to chief actuary. And he's gotten back in the reinsurance area probably in a way he didn't expect to get back into it.

Is reinsurance in 1990 profitable? Our specialty is financial reinsurance. Is it profitable to the ceding company, and is it profitable to the reinsurer? I plan to discuss more specifically financial reinsurance and its strategic use in developing a capital plan for life insurance companies. I will provide an overview of its historical definition and how it has evolved to 1990. I will then try and discuss its strategic benefit to the ceding company and its strategic benefit to the insurer.

Financial reinsurance in 1990, after all, is nothing more than a method of viewing and a method of potentially using reinsurance. The reinsurance industry has long been a strategic source of capital to the insurance industry. The ability to spread insurance risk through reinsurance has indirectly affected the amount of capital an individual company needed to maintain to be prudently capitalized. This form of insurance risk sharing led to the development of reinsurance contracts which more fully shared in the expenses of issuing and distributing insurance and more directly supplied capital to support growth. Reinsurance in this manner served a primary role in redistributing capital flexibly and efficiently throughout the insurance industry.

This natural progression led to current forms of financial reinsurance which gained its name from the emphasis on the capital sharing aspect of reinsurance. These transactions have been and continue to be in a constant state of evolution. The last 15 years have witnessed broad changes in both the concepts and the acceptability of reinsurance as a capital generating mechanism.

Financial reinsurance in 1990 has evolved to be a very sophisticated method of raising capital while maintaining the risk sharing necessary to be considered a sound reinsurance method. Sources of capital to the insurance industry have never been more important and the use of reinsurance should grow in importance as a method of serving in its traditional role as the efficient redistributor of capital. It is this efficiency which really refers to flexibility, convenience, and its general acceptance which has historically been the catalyst for the development of increasing the use of reinsurance to support growth in the industry.

Efforts by the NAIC and the various state insurance departments have improved regulation and greatly standardized acceptable forms of financial reinsurance. Current regulation was begun in 1985, when New York promulgated Regulation 102. And this was followed in 1986, when the NAIC issued a model regulation for life reinsurance agreements to serve as the basis for future state regulation. These changes in regulation have served to eliminate many unsound methods and legitimize more sound and acceptable treaty processes. This effect on a company's capital position has become a matter of concern when combined with unsound methods, and the industry has made tremendous progress in realizing the change necessary to meet the appropriate requirements of the capital generating device.

Traditionally, reinsurance has been an integral part of the insurance process and by design mirrored the ceding company statutory accounting treatment and, consequently, its tax treatment. This simple approach has been complicated by continual changes in both tax regulation and tax law, which have greatly complicated the tax treatment and cost implications of reinsurance transactions. The Colonial American Supreme Court Decision in 1989 was the most recent change and forced the amortization of many tax deductions, which were fully tax deductible prior to the decision. This altered the position of the reinsurer and no longer matched the treatment provided the ceding company. This has added a level of sophistication which may have a significant potential impact on the related cost of individual reinsurance transactions.

This market for providing reinsurance to meet capital needs has become more specialized. The number of both specialty departments within existing reinsurers and new specialty reinsurers has increased to meet the rising demand for capital-oriented reinsurance transactions. Financial reinsurance has been increased by the larger number of professional reinsurers attempting to meet the growing need of this market. The growth in the number of companies and brokers attempting to fill this need has steadily increased competition over the last ten years. This competition has aided in the efficient reemployment of excess surplus by a broader group of heavily capitalized companies to meet the increasing capital needs of rapidly growing companies.

Increased regulation of reinsurance as well as increased sophistication of the reinsurers has led to sounder contracts and more demanding terms to meet the needs of generating statutory surplus. Supply has been increased by the greater utilization of non-U.S. insurance companies or their affiliates by established international reinsurers and by brokers. This continued development has increased the supply of capital, but has often limited the short-term needs and has been subject to continued scrutiny by state insurance departments and, in some cases, taxing authorities.

The increased supply has led to generally lower costs and more competitive terms for ceding companies in 1990. The number of companies providing financial reinsurance has continued to grow, although this now seems to be peaking and probably some shake out or reduction will occur over the next few years. However, there is the possibility that any one of a number of additional large, well-capitalized non-U.S. companies may enter this market.

Reinsurers have worked to develop treaties which meet the changing needs of ceding companies. Meeting demand is a key element of any competitive system. Financial reinsurance has had to remain flexible to meet changing demand while developing acceptable and logical reinsurance programs. These programs have emphasized the ceding company and the reinsurer as financial partners. The financial standards for solvency of both companies have never been more important and this responsibility is shared by both companies. Many contracts have to be designed to meet specific regulatory requirements which continue to change, although at a somewhat slower pace, hopefully. The risk transfer and capital improvement is often at question, which only serves to emphasize more so than ever before the financial strength of both companies before and after the transaction.

These considerations have influenced the types of methods which can be used in the transaction and new approaches have had to be utilized to meet the needs of both the ceding company and reinsurer while retaining the integrity of the reinsurance contracts. Each transaction seems to be increasingly more individualized to meet these needs and regulatory requirements.

Is it profitable for the ceding company? Reinsurance has always been a method of improving the performance of a ceding insurance company by providing a more stable company through the spreading of risk while being able to offer increased services, products, and insurance limits which would not be available without reinsurance facilities. Reinsurers have developed expertise by dealing with a broad group of companies in the industry which would be difficult at best for individual companies. This sharing of spreading of risk, information services, and, ultimately, capital has allowed companies to improve their efficiency by selling services, improving per unit expenses, and otherwise generating income which has improved the return earned on existing equity. This improvement has often been subtle but has nevertheless been an important element in successful insurance companies. We often concentrate on the costs associated with reinsurance as opposed to the benefit of having a strong financial partner necessary to meet potential opportunities. These opportunities may generate income which a successful company needs to maintain or improve its financial performance. Access to capacity when the opportunity presents itself will generate income utilizing the reinsurer's capacity, and this creates an efficiency which often improves the ceding company's return on equity when these needs or opportunities are sporadic or unpredictable.

This access to the capacity of the reinsurer has long provided the opportunity to take advantage of new or expanded marketing opportunities. The prudent use of reinsurance can provide expanded profit opportunities through sales which may have been impeded by, lack of capital, or through lower per unit sales costs created by these expanded sales. This issue of capacity is often a capital issue which can be solved at least in part through reinsurance. The need for capital may be overcome in certain situations more efficiently by the use of a flexible financial partner.

The reinsurer's role in flexibly meeting the risk sharing and capital needs of clients can help insurance companies to eliminate or reduce carrying large amounts of excess capital. By substituting the reinsurer's capital for a portion of the ceding company's capital requirements, it will allow the ceding company to raise capital when they can justify it financially. By developing sound relationships with financially strong reinsurers, these relationships only add strength to the capital structure required.

Carrying this discussion one step further would be to develop transactions that would allow ceding companies greater flexibility as to either recapture privileges or other means of controlling the carrying costs of reinsurance. This could be important as circumstances change and either access to or the creation of capital with the ceding company changes. This type of flexibility is one of the important aspects of managing a company's sources of capital and, ultimately, its return on equity.

Companies may want to develop capital plans which meet short-term needs with short-term sources of capital. These can be matched with longer-term alternatives to develop greater efficiency in managing returns. These flexible sources of capital may also provide needed time to develop sources of new capital without losing current marketing momentum. Or it may substitute flexibility while capital markets improve or are developed. There is a cost for this kind of flexibility, but when compared with the cost of other sources of capital at disadvantageous times or the cost of the loss of profits created only by additional sales or profitable business, these costs are often more than justified.

Once again, since reinsurance affects statutory income and, ultimately, the taxes paid by both the ceding company and the reinsurer, these tax effects need to be carefully considered in the ultimate financial analysis of this source of capital. Federal income taxes present one of the most difficult tasks in evaluating financial reinsurance as a source of capital due to the continually dynamic atmosphere affecting insurance and reinsurance taxation. This continues to be increasingly difficult to predict and this is, once again, demonstrated by the changes proposed by Congress recently.

Is it profitable for the reinsurer? Why do we do this? The reinsurer represents a slightly different aspect of the insurance business since its basic customer is other insurance companies as opposed to a policyholder. This focus allows a strong company with excess capacity, or capital, or access to markets with excess capacity or capital to develop large transactions or cover large risks more efficiently than most ceding companies. By specializing a reinsurer may even increase its efficiency and, thus, develop a more competitive pricing structure. Most industries have seen this appreciation for specialization and a gradual return to more specialized suppliers. Reinsurance is no different in this respect, and there is an emergence of specialty reinsurers with an emphasis on increasing their marginal income by becoming a financial partner with other successful insurance companies through reinsurance. These relationships and the additional income produced allows the reinsurer to improve their return on underemployed or excess capital and, consequently, their return on equity.

A reinsurer's improvement in return on equity is also influenced by the likely duration of the capital support provided since risk is not only a function of potential amount at risk, but of the amount of time that is at risk. Although the duration is always controlled by the ceding company to provide for a sufficient commitment to justify the capital generated, the profit sharing is much lower if the transaction ends up being short term. The cost of this type of short-term financial reinsurance transaction is often expressed as a risk fee and only payable from profits on the business reinsured. This fee is normally increased as the duration of the contract is extended. The ceding company controls this extended duration by having liberal rights to recapture, and although the costs are less early in the contract, they become an increasing percentage of profits and consequently would have a higher cost if the duration of the contract is extended.

This type of mechanism allows for a flexible source of capital which permits the ceding company to renegotiate or recapture the treaty if the capital is no longer needed or a less expensive source of capital is available. The reinsurance treaty, thus, becomes a flexible source of capital which can be utilized for a short term need or under the ceding company's control as a long-term contract for which less expensive capital may be substituted.

In summary, financial reinsurance is nothing more than an emphasis on the capital generating aspects of a reinsurance transaction. It provides a highly flexible tool to the ceding company which often increases capacity, improves efficiency and, ultimately, improves return on equity, in many cases, through the use of reinsurance. If used properly, it will provide less expensive capital backed by highly solvent financial partners and provide a natural mechanism for efficiently redistributing excess surplus within the industry.

MR. YOUNG: We'll open up for questions. Can somebody give us an update on the new Deferred Acquisition Cost (DAC) tax and the implications on reinsurance?

MR. JOHN J. PALMER: As far I know, it's the same as it was late last week when they changed the percentages a bit on the pseudoacquisition costs. Basically, a percentage of all premiums varying by line of business which is to be spread over 10 years. There seems to be a slight modification for small companies. They can spread it over five years. Percentages went up a little bit to I think 6.75 for life and noncancellable A&H, 1.85 I think for annuities, and I forgot what group life is.

FROM THE FLOOR: It was 1.4 the last I saw.

MR. PALMER: So, 1.4 I think that stayed the same in the last round.

FROM THE FLOOR: Is nondomestic reinsurance no longer going to be deductible?

MR. PALMER: They've noticed the reinsurance possibilities of getting it offshore to a non-U.S. taxpayer and have words in the write up that suggest that you get to net off your reinsurance premiums unless they're going to somebody who doesn't pay tax under Part I of Subchapter L, meaning a life company for U.S. purposes.

FROM THE FLOOR: If you're a U.S.-owned company that owns a company overseas that deals in more than one market, you've got to pay the tax on their premium income as well, right?

MR. PALMER: That I don't know. The description is not statutory language. It's more intent and wish than it is legal language.

FROM THE FLOOR: It's not a pleasant tax, particularly for reinsurers. I've heard some reinsurers tell me some real horror stories of what their tax is like.

MR. PALMER: It's a kind of premium tax. I think the big danger is shown by the manipulation of the number just within the last four weeks that it's been talked about. It's a totally arbitrary number which can just as well be some other arbitrary number as the one that's there now.

FROM THE FLOOR: A footnote: somebody pointed out to me that these rates apply to business in nonlife companies as well as life companies and the 20% of unearned premium reserve that was in P&C companies also applies in life companies to "cancellable" A&H.

MR. YOUNG: Yes, there was a loophole for a short period that basically if you were taxed as a nonlife company you were excluded, but they found that one.

FROM THE FLOOR: A couple of other points. It's supposed to supersede Colonial American and it's supposed to supersede the capitalization of acquisition cost in the Alterative Minimum Tax (AMT). So it simplifies things at some price.

MR. YOUNG: It creates some uninteresting unequal burdens, too. Any other questions?

MR. ALAN W. LOCKIE: I'm from Victory in London. Could I just make a couple of comments about some of the European ventures? As a point of information, European reinsurers have, in fact, had freedom of service since 1964, so we're quite able to go across borders and transact business now. We don't have to wait for 1992. I found speaking with other European reinsurers, well, most of them, that they are interested in U.S. reinsurance, not necessarily the risk business. You can see a lot of them twitch quite visibly when you mention second to die business. When you see the margins in there it's not too surprising. But they are quite interested in financial reinsurance, particularly. To reinforce one of the points made, they have different objectives, longer time scales, and quite often lower return on capital requirements. And so some of the financial reinsurance deals that are available to them are quite attractive. I'm a little bit surprised about people being interested in health insurance. American health insurance is legendary for not providing a lot of profit to the people that write it directly. Those of us that sit 4,000, 5,000 miles away have even less chance of trying to keep control of it and my attitude to American health insurance offers is always thanks, but no thanks.

MR. YOUNG: I don't think too many of us would disagree. Anyone else that wants to introduce themselves from some other location?

MR. COURTLAND C. SMITH: I have some domestic comments if I may or perhaps questions. I must say that I thought Frank Alvarez was going to really give us something interesting and he did, indeed, but something a little different let's say on the profitability of reinsurance today to the ceding company and to the reinsurer. He outlined the areas in which there may be profitability. Is there any profitability or how much profitability in broad terms would he say there is at present in reinsurance to the extent that he can respond, nonquantitatively? I'd be interested in a reply.

MR. ALVAREZ: Well, I guess this will answer your question. Financial reinsurance I think has continued to be profitable over the last few years. I think risk fees have gone up and down. The amount of risk and the amount of business have remained relatively constant over the last seven or eight years. We've kind of gained an exposure as we've gone out and visited a lot of additional companies and changes in the tax law, changes in some other aspects of our business have affected that, but we still find it very profitable from the standpoint of what we're trying to do. Now we've looked at some other methods and I didn't mean to be so esoteric, but I really felt that the way to present financial reinsurance is the way I look at it. And my background is finance and so I really look at financial reinsurance as a financial tool and when I presented the ceding company from a profitability standpoint, I looked at methods to use reinsurance and view reinsurance to improve profitability. So the key issue was really if you have an opportunity how do you take advantage of it? What are the tools that are available to you from a capital standpoint to take advantage of it? I think one of the major tools you have available to you is reinsurance.

MR. ARMAND M. DEPALO: I would ask only one question. I would like to know what is the tendency of marketing companies in your status in the financial service? Still aggressive? Do you know what I mean by marketing companies? I mean companies, mainly banks, which finance the new business of life insurance companies.

MR. ALVAREZ: Well, no, I don't -- You know I think that the entry of banks into this whole area of reinsurance was kind of a situation where they weren't insurance companies entering into what they thought were reinsurance transactions and I don't really know how to define it in any other way. I mean the ability of a bank to enter into this kind of business and create a tremendous capacity without the equity supporting that is something that I've always felt financially is the leveraging tool that could get out of hand. I think the NAIC to some extent realized that and that's why maybe there have been some restrictions placed on that kind of financing. But I don't feel that the same types of leveraging possibilities occur in reinsurance, especially, financial reinsurance today under the restrictions that we're under.

FROM THE FLOOR: I'd like to go back to that. Can I go back to the first question?

MR. YOUNG: Sure.

FROM THE FLOOR: Is reinsurance profitable? Having come from the direct side not too many months ago and now seeing the reinsurance side, I'm amazed at how similar the two sides are -- More amazed than I thought I was going to be on how similar the two sides are. Obviously, one's a mirror image of the other. The issue of profitability as we actuaries ought to realize to a large degree is a matter of assumptions. I mean ultimately it's not a matter of assumptions, but going in it's a matter of assumptions. And if your assumptions are aggressive enough you can think that everything is going to be profitable. I kind of sense and have seen both on the direct side and the reinsurance side that perhaps the assumptions that many of us are using are not realistic enough and, therefore, perhaps we're fooling ourselves. But as I view it, there's only so much money to go around. The customer's going to pay a certain amount of money for a $1,000 of insurance; the direct company or the reinsurance company can't create more profit than is started out with by that customer, at least not in dollar terms. Maybe the ROE can vary depending on how you do the denominator, but there's only so much money to go around and with the direct companies pricing so thinly I don't see how the reinsurance companies can make any more unless the direct companies are contributing something to our pot which they tend not to like to do. I would say, we're profitable in one sense but, certainly, below the cost of capital. So in that sense I think the whole industry, both direct and reinsurance, is right now pricing unprofitably.

FROM THE PANEL: I don't think we have too much trouble with that.

MR. YOUNG: One of the points that Mike made in his talk, and I was hoping we could get some discussion on it, is that U.S.-owned reinsurers and foreign-owned reinsurers have different perspectives, long term versus short term. We have some representatives in the room with companies of foreign ownership. I was wondering if we could get a perspective from one of you and then perhaps from somebody from a domestic company to get their perspective.

MR. JAMES W. PILGRIM: I've been with Frankona for seven years, following 23 years with the Connecticut General. And, yes, at Frankona we have a much different time horizon and perspective of the business and it's refreshing to have a longer time relation. I hasten to add, however, by the same token, we're subjected to the same quarterly demands to produce profits or minimize losses, let's say. But the time horizon is much different. It's not on a quarter by quarter basis as I had experienced before being with the U.S. corporation. On the other hand, we have other situations where we have a shorter time frame to deal with and I think that part of the conflict and the reason why I view it in U.S. corporations as being more short term oriented could be a whole other subject and that is how we compensate our management. Because I think in U.S. corporations we have many managers. While they believe they have a compensation system that is well balanced between short-term and long-term goals, in fact, what they're worried about is making their quarter earnings as opposed to a longer time horizon. And I think this plays a major role in how U.S. corporations view the business as maybe U.S.-based foreign-owned corporations might.

MR. DAVID M. HOLLAND: Since the theme of the meeting is international opportunities, I have to say that reinsurance in and of itself has been globalized for quite some time. Our company, the Munich Re, has done business for more than 100 years now and we operated in the U.S. since prior to 1900. And there are many other companies like Cologne, which we have represented here, especially the European reinsurers, Swiss reinsurers which have been globalized for quite some time. We do business in 140 different countries. We have openings, I believe, in our Kuwait City office and other places around the world. But given that, we have that kind of experience and we are not just a life company; we are very heavily into the property and casualty business. We understand that there are cycles in markets. There are soft markets and hard markets, good markets and bad markets. And I think the U.S. market has gone through a very long cycle on the life insurance side where the focus, and the demand, and actually the driving force has been marketing. Where we have concentrated not so much on the profitability of the business, but on what the sales are, what the production requirements are, what the growth rates are.

I had a comment from the Vice Chairman of the Munich Re when he came over for one of our board meetings. He walked into my office and he saw the personal computer behind my desk. And he said, "You know our business was a lot more profitable before you guys got these things." And I think there's an element of truth there, because we now have the tools and the mechanisms where we can split the bone and the marrow and look at the various parts and be extremely precise. Maybe we have to measure the minuscule margins that we may be dealing with. So I think we have different tools today that affect this as well. I also think that we see cycles in the market in terms of production, in terms of what is that we've talked about in the reinsurance section newsletter, where we will see companies participating in the traditional area that will for a period grow very rapidly, increase to a very substantial level of production, and then at some time realize that things may not be working out according to their expectations and for whatever reasons we'll see changes in direction in terms of leadership of the traditional market. And I guess I feel comforted working for a European company or a parent company which does take a long-term view, which understands that we're going to go through these cycles, good times, bad times and wants to be positioned in the world's largest insurance market. And we have a commitment to stay here, but an understanding of the difficulties and challenges that will face us.

MR. YOUNG: Anybody that wants to talk about the U.S. market? I've got a volunteer.

MR. GABRIEL L. SHAHEEN: I guess I was trained as an actuary, Mel, but I don't practice it everyday now. I don't have a finance background and I don't have formal marketing training and maybe that's why I'm having a hard time understanding a little bit of what we're saying, but as a domestic reinsurer I guess Lincoln National is supposed to have a short-term view. But our short term started in 1905 and it's continued steadily and I view that as a long-term view of the business.

MR. YOUNG: That's the way I would have answered if I was you. I was waiting for you to say it. I'll call on one other friend if we don't have questions. Although he's no longer with a U.S. domestic, he was there long enough to give us maybe a view of the U.S. domestic company's viewpoint. Michael, do you want to say a word and then we'll break.

MR. MICHAEL R. WINN: I think from our perspective, looking at it on a micro level, the production in the U.S. market today is flat or down at best and so under that scenario you would expect to see profits at a high level, statutory profits at a high level and I don't think we're seeing that on a macro basis. I'm obviously not pointing at any one company, but just in general. You're not seeing large statutory earnings in conjunction with the flat or decreasing production. So that would give you the impression that the business that's been written over the last five to eight years didn't have any profit in it when it was being written or otherwise that profit would be coming off quite heavily right now. And I think that's true in the direct market as well as probably being true in the reinsurance market over here.

MR. YOUNG: Can't get blood from a stone. That's why they just raised our taxes by 50%.