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**THE CHANGING FACE OF REINSURANCE**

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Recorder: LE ROY H. CHRISTENSON

- How are reinsurers needs and goals changing?
- How are they adapting to changes driving direct writers?
- Is globalization of reinsurance having a major effect?

MR. LE ROY H. CHRISTENSON: This topic has been apropos for some time. But it's especially so now. Change seems to be our only constant. For example, the direct market continues its frenetic rate of change and has needs far greater than just the traditional indemnity reinsurance and surplus relief. Reinsurers and reinsurance agreements are facing unprecedented regulations.

North American reinsurers are exploring overseas markets, and international reinsurers are readdressing and refocusing their efforts in North America. Each of these areas are worth extended discussion. And that's the purpose of this panel. Too often we cling to our traditional roles as reinsurer rather than exploring new ones.

Brian Holland will speak on the topic, "How Reinsurers are Adapting to Changes Driving Direct Writers." Brian is regional vice president of marketing for Transamerica Reinsurance and is responsible for all marketing activities in the Eastern U.S.

Ross Morton will speak on the topic, "How Reinsurer Needs and Goals are Changing." Ross is vice president, life reinsurance, of Manufacturers Life. He is responsible for its North American life operations as well as expansion into the Asian Pacific and European markets. Ross's experience prior to Manu includes multiple roles at Store-Brand Reinsurance Company, National Life of Canada, and Capsco Software in Canada. He's been involved on multiple levels in various industry and social organizations as well.

Jim Sweeney will discuss the topic, "Is Globalization of Reinsurance Having a Major Effect?" Jim is senior vice president and actuary at Munich American. He is responsible for marketing, pricing, and treaty administration for all its products. He has participated in the ACLI Reinsurance Subcommittee (which now, as you know, has been elevated to a full committee) and the industry advisory committee on reinsurance to the NAIC.

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MR. BRIAN G. HOLLAND: I'm privileged to address such an influential group of life insurance professionals. And you are an influential group. The life insurance industry draws upon actuaries more than any other professional group, to provide leadership, vision, and technical expertise that's needed to move forward successfully. I look forward to Ross' and Jim's remarks.

I like the way Lee posed the question on our agenda, "How are insurers adapting to changes driving direct writers?" Implicit in this question is the notion that life reinsurers are adapting to changes driving direct writers, and we are. As a group, we're not adapting at the same pace, or to the same extent. But I think every serious life reinsurer in the market today understands that our future is tied directly to our ability to help direct writers meet the challenges they face. I will review how some life reinsurers are expanding the definition of a reinsurable risk. We're moving beyond mortality and persistency risk transfer. And we're providing new services to help direct writers meet marketing and financial objectives.

Finally, I want to comment on the relationship between reinsurer and direct writers, and how this relationship can be leveraged to assure a mutual success. My assignment is to talk about change or, in some cases, lack of change within the life reinsurance industry. But reinsurers exist only for direct writers. And so change within life reinsurance can only be seen and understood within the broader context of what's happening in the direct market. At the risk of belaboring points about which you're only too familiar, I'll quickly identify some of the significant changes in the direct market.

Just about everything that could change in the direct market has. Since the mid-1970s, life insurance products have changed entirely. So have marketing objectives, distribution systems, competitors, profit margins, investment strategies, and the role of government. One could even say a primary reason for buying insurance has changed. Today, the fastest growing products are annuities. And they are purchased for asset accumulation. Because I don't have time to discuss all the changes, let me go directly to the most obvious, as well as the most promising change in the direct market. That, of course, is what's in our product portfolios.

The market is dominated by investment-oriented products, and one cannot overemphasize the enormity of the change ushered in by these new products. They've redefined our business to the point where one can truly say that life insurance is a new insurance. In the early 1980s, investment-oriented products were hailed as the answer to the industry's disintermediation problems. We're less exuberant about them now, because they've replaced some of our more profitable business. And we know they'll never deliver the returns of traditional products. Nevertheless, the market for investment-oriented products is exploding. We're wrestling to manage this new industry. We're showing remarkable resilience and adaptability; but investment products will always be complex to administer. Their profit margins are always going to be narrow. The competition will always be intense; and the jury is still out on persistency, although product developers have addressed that issue with features that discourage replacement.

The challenge for direct writers is to manage within the constraints imposed by the new products that have reshaped this industry. As the industry transformed itself

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from protection products to investment-oriented contracts, it increased the level and types of risks that need to be managed. New products bring new risks. Direct writers must manage risks that didn't even exist ten years ago, five years ago, or even last year in some instances.

Mortality and persistency still need to be managed. But these traditional risks are overshadowed by the more urgent challenges facing direct writers: challenges like distribution. This has been a controversial issue for a long time. Today, however, direct writers must confront more than cost and productivity issues. Marketing executives must answer tough questions about the compatibility of their products with the distribution system. Because today, more than ever before, the success of a product is linked to the way it's distributed. For example, if you use the wrong distribution system to market your new annuity, you'll doom the product to failure. If your agents don't understand the product completely, if they're not thoroughly comfortable with it, then you'll have a major distribution risk to manage. Even if your agents are annuity experts, you need to consider distribution alternatives, such as banks and investment houses. That's changing, but insurance companies can't afford to wait for public perception to catch up with us. The success of a product has always been linked to distribution. But never has the link been so critical or the risks so high.

Competition that has confronted direct writers for years is more powerful than ever. This pressures profit margins and product portfolios. Products are proliferating faster than ever. This is true for traditional, as well as investment contracts. Developers face the task of delivering competitive, profitable products in time to exploit short-lived opportunities in the market.

The industry's low-margin environment also has forced companies to control and reduce expenses. Companies must implement tough cost-control measures or face the strong possibility of being offered for sale. Perhaps the most urgent challenges facing direct writers today involves these three issues. It's hard to separate investment performance, financial stability, and regulation, because you can't tell where one leaves off and the other begins. One thing we do know is that competition is the force behind these issues; competition within and external to the insurance industry.

The scenario has been replayed all too often. So I won't go into detail. It's sufficient to say that direct writers, in order to provide competitive rates, employed aggressive investment practices, and we're paying the price today. It's beginning to feel like the storm has been weathered. But many companies continue to feel the impact of depressed assets and lower interest rates. More than that, we're feeling the impact of new regulation. It's ironic that in the past, when regulators worried, it was that insurance companies made too much money. Today they worry that insurance companies don't make enough. I suppose it's harsh testimony to just how much change our industry has endured in the past few years.

The new regulatory environment is a constant reminder that confidence in the financial strength of our industry is diminished. Many companies must take deliberate steps to adjust to new regulations; especially risk-based capital, asset-valuation reserves, and investment-maintenance reserves.

So now that I've set the stage, let's go back to the question on the agenda. How are life reinsurers adapting to changes driving the direct market? That's a very legitimate question, and the answer, frankly, is "all the above." Twenty years ago mortality fluctuation was the only risk that would significantly affect the life company's bottom line. Today the mortality risk is arguably one of the lesser challenges facing direct writers. Nevertheless, many life reinsurers continue to adhere to this definition of risk management. They invest the bulk of their time and resources designing and pricing reinsurance arrangements that pick off only the mortality and persistency risk. They leave the rest of the business exposure for the direct writer to deal with.

There's no question that mortality and persistency still are a critical risk. And the expertise that life reinsurers bring to this area is extremely valuable. We continue to support these risks with greater expertise than ever before. But this narrow interpretation of risk limits the reinsurer's role in today's market. It threatens to eliminate us from the most dynamic aspects of the life insurance industry. Reinsurance is risk-sharing. As a risk-sharing device, reinsurance has become one of the principal methods for protecting the strength and stability of the life insurance industry.

So what happened to many reinsurers is that, over the course of time, we began to think we were in the mortality business. We got very comfortable with the mortality risks; we became the mortality experts. No life was too big or too substandard for a reinsurer. But our business is not mortality. It's risk-sharing. We must acknowledge that, or we'll make the same mistakes the railroads made. They thought they were in the railroad business. Had they realized they were in the transportation business, some of those companies might still be around today manufacturing cars, or buses, or operating fleets of tractor trailers.

Reinsurance is a flexible risk-sharing tool, with strategic applications far beyond mortality risk management. A few companies are marketing reinsurance that way. They've discarded old notions; they've developed and acquired the skills and expertise needed to help customers manage new risks. They've redefined the reinsurance risk and expanded services. In short, they reflect what's going on in the direct market. If there's a new product, a new regulation, a tax concern, or any new trend, they're involved, often right from the start. If you examine the business of this new breed of reinsurer, you'll see represented every major risk facing direct writing companies.

Let me review some of the nontraditional risks reinsurers are participating in. I also want to review some services not traditionally provided by reinsurers, but which reinsurers are uniquely equipped to deliver.

Annuity reinsurance is one of the likeliest ways for a direct writer to share the risks associated with interest rate spread and production growth. New risk-based capital requirements have increased the need to manage these risks. Annuity reinsurance is very complicated because of fund management and rate-crediting issues; few reinsurers have the financial strength and the risk expertise to apply to reinsurance and to the annuity risk. Transamerica participates in several special annuity ventures. In addition to sharing the investment risk, we actively participate in developing investment philosophies and implementing programs to manage the investment risk.

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Besides risk transfer, annuity coinsurance enables a direct writer to better manage its surplus. Annuity business is capital intensive, and direct writers have always had to guard against surplus drain due to production growth. Now risk-based capital (RBC) requirements are intensifying the challenge. Companies must be certain that product growth does not result in surplus drain that prevents them from meeting the risk-based capital requirements. Perhaps the single greatest threat to a company selling annuities is the ratings downgrade. Consumers buying any type of insurance today are concerned about the long-term financial security of the company. People purchasing annuities are even more concerned. They also tend to be more sophisticated buyers. They're aware of rating agencies and what financial analysts are saying.

Today's environment often demands more than a single company can deliver on its own. Consequently, many companies are turning to strategic alliances to do things that in the past they would have done alone or not at all. In the past, insurance companies aimed for total horizontal integration. Direct writers believed in doing everything by themselves: product development, distribution, underwriting and risk management, policy issue, policyholder service, systems development, processing, maintenance, and investment management. Many companies now accept the fact that complete horizontal integration may be impossible. They accept that it's no longer necessary. In fact, it may even be counterproductive. Alliances with other companies are being formed to accomplish several objectives. This is a way to diversify product lines, enter new markets, increase client services, and reduce expenses.

Reinsurers are natural brokers for strategic alliances. We work with hundreds of individual companies. Our big-picture perspective is very useful when it comes to matching the needs of one company with the products and services of another. At Transamerica, we've been orchestrating strategic alliances for about five years now.

Another nontraditional service Transamerica is involved in is product development. In today's marketplace, product life cycles can be very short. By the time a company is ready to offer a new product, the opportunities may have peaked. Our product development capability enables customers to get a tailor-made product on the street in four months. Product development is hardly a typical service from a reinsurer, but it's a logical one. Reinsurers have extensive exposure to the market. We know what products are working. We know the impact of different product features, whether it involves pricing, underwriting, or marketing.

We also integrate reinsurance into the development process. This creates a significant financial advantage. Normally, reinsurance arrangements are negotiated near the end of the process, when it's too late to gain the full advantage of a flexible, innovative arrangement. The reinsurance approach to product development reduces surplus drain associated with the new production, and it generally improves ROI and accelerates break-even years. Products we've developed are performing very well in the marketplace. In fact, some of our customers have booked record production numbers with products we've developed for them. There's no cost for a consultation or implementation. Our payback lies in the exclusive reinsurance treaty we have in the products we develop.

Historically, direct writers and reinsurers enjoyed a mutually beneficial relationship. We've shared the risks and rewards of doing business together. More than ever before, reinsurers must focus on helping direct writers succeed, because that's how reinsurers succeed. The uncomplicated, profitable days of protection products are a memory. Direct writers have had to adjust their needs to those of the consumer; reinsurers must apply a similar needs-based approach to marketing our risk management services. We must develop strategies that are focused on the needs of the direct writer. Investment-oriented products are more complex: the risks are greater, the profits are narrower.

Direct writers need strategic support. They need a partner with as much stake in their success as they have. They need a partner who understands the industry, the products, the investment practices, and the complexity of regulation and taxation. When direct writers seek annuity reinsurance, they need a risk-management partner that truly strengthens their position. A reinsurer must provide financial capacity, but it must bring much more to the table than that. It must be able to help direct writers manage all the risks associated with these investment-oriented vehicles.

Just as reinsurers must move beyond our traditional role, direct writers must move beyond their traditional view of what a reinsurer can deliver. Obviously, reinsurers must demonstrate value and earn the privilege of being a decision-making power. To a large extent, it requires new thinking on both our parts.

In conclusion, I'd like to go back to my earlier remarks about the actuarial profession and the critical role you play. As a profession, you face a tremendous responsibility. The insurance industry has always looked to actuaries, more than any other professional group, to provide the technical expertise as well as the vision to move us forward. Direct writers are looking beyond their own companies to achieve success. They're turning to a variety of consultants, to other direct writers, to other service organizations. Progressive reinsurers have a valuable strategic contribution to make, and it's much more than traditional mortality risk management. To maximize the natural alliance between direct writers and reinsurers, both of us must move beyond past definitions and work together toward building a stronger, more valuable future together.

MR. ROSS A. MORTON: I'm going to run through where reinsurance has been and try to paint a picture. Has it changed much? I don't think it has. I've been in this business 23 years, with a two-year sabbatical toward the latter part of those years. And coming back to reinsurance after the sabbatical, I don't think reinsurance has changed much. It's still dominated by the actuary. The actuary controls the marketplace. The actuary and the reinsurance company control pricing, which controls profits.

It has changed from the point of view that the word "profit" is now used. When I started in the business, the only number I ever saw until 1978 was volume. I started in the business in 1969, but it wasn't until 1978 that a chairman of the board said to me, "Can you redo your numbers with profit instead of in volume?" Up until that point, every number I had seen at two different reinsurers had been in terms of volume of risk assumed. There was never a mention of the bottom line. That was a

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sad commentary on the time. I think everyone thought that volume was the be-all and end-all, until bad results hit.

In the 1970s, reinsurance retrocession coverage for reinsurers was very simplistic. Reinsurers could operate on their own. They needed capacity on large cases from other companies. This was not even known as "retrocession." The word almost wasn't in existence. These large cases were very few and far between. To get that capacity they were quite content to go to a number of reinsurers or direct writing companies that were quite willing to assume reinsurance. It would sometimes take 20 or 25 small companies to cover a \$2 or \$3 million risk. At that time, reasonable price was all that was needed. Often the actuary did not look at the price they were receiving and then ceding off. There was no balance. It was an insignificant number. Retrocession had not been invented per se.

What did those who were active in retrocession supply in those days? They provided a lackadaisical attitude! They would take most anything. As I stated earlier, there was a multiplicity of outlets for capacity. They were all kinds of companies: small, medium-sized, and large companies. In Canada, Manufacturers Life had one of its first reinsurance agreements with Maritime Life in Halifax. And that agreement lasted for almost a hundred years. Not that any lives lasted that long!

There was poor time service because retrocession wasn't important. Nobody cared. It was a big case, so there wasn't anybody putting any pressure on it. The rates were often high, often much higher than the rate being taken in. There was a trading mentality. If I give you \$50 million of business in volume, will you give me \$50 million back? Everybody was happy. Nobody looked at the mix of age, rates, etc.

It was during the late 1970s when I saw my first example of smart people in reinsurance. On a very large case, a man died about one day before the first renewal of his policy. The claim was \$15 million. Many actuaries met in one airport and decided on the course of action. Their announcement to the press was, "We believe the man died of suicide." Now the problem with that announcement and the lack of information was that he had two bullet holes in his head. It hurt the case thereafter. I realized right then, as a young man in reinsurance, that my superiors were not all that smart. Neither were the claims and actuarial types. But that announcement hurt their case, and in the end, they paid half.

With very cheap term insurance, many small to medium-sized companies reinsured large volumes. Four percent of all business was reinsured in Canada in 1969. By 1979, the number was 20%. With the aggressiveness in the direct marketplace and the entry of dozens of European reinsurers into the Canadian and U.S. marketplaces, rates had to become more reasonable. The reinsurer needed a bit better pricing from the retrocessionaires. They also needed faster service. A reinsurer was being asked to give a decision on a \$2, \$3, or \$5 million case, just as fast as a \$500 thousand case. This was unheard of in the past.

Both facultative excess and shopping facilities were being tested by the reinsurer just as they were supplying this service to their direct writing companies. They demanded that of their retrocessionaires. Very few retrocessionaires were able to provide those services with any true capacity. Also, reinsurers tried to get the retrocessionaires to

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take the AIDS risk. They thought that somebody in the retrocession market would be quite open to new and innovative ideas. Why not reinsure all our AIDS mortality?

What did the retro supply? In the 1980s, three big players entered this market. They were able to offer the industry larger case capacity. Because of that, most of the reinsurers could now offer automatic capacity of \$10, \$12, and \$15 million. Both facultative excess and shopping were being supplied, but often, unfortunately, without a lot of expertise in the areas of underwriting and pricing. Their internal staffs were not really equipped to handle these large cases. I like to describe this period as the blind following the visually impaired. The aggressive pricing and the aggressive underwriting in the retrocessionaire's shop were equal to or greater than any reinsurer's.

The megadeals came along. No one reinsurer or group of reinsurers were able to handle some of the deals. One big company was producing billions of dollars of reinsurance. This business was spread all over. The large companies again stepped in with the retrocession facilities and were able to take large quantities of this business, helping many reinsurers.

Also during the 1980s, retrocession started to supply an override to cover the reinsurer's expenses. Some reinsurers were as smart as, or smarter than, direct writers and were able to make money on retrocession through the override expense. Facultative obligatory capacity grew. Again, as the numbers of large cases grew, 20 million became commonplace, and the retrocessionaires wanted to be able to cover this market. There were still restrictive jumbos. Retrocessionaires were petrified of being involved in cases where the amount of risk was \$20 million or more.

By the early 1990s, the reinsurers' feeding frenzy was almost coming to an end. This time they needed much larger case capacity. They needed to be able to cover 25 million or 35 million. The jumbo limits escalated. They needed this capacity fast. The rates in the retrocession market, just like in the reinsurance market, became overly aggressive. Again, it was a game of volume, played by, at this stage, many Europeans who were entering the field. They had virtually no expenses and were able to do it as a sideline. They were taking on large quantities of North American business. Jim's going to talk about that later. So the Europeans played a dominant role in pushing the price down. The fact that retrocession is dominated by three players makes the competition among them ferocious.

The retrocessionaires were nondomineering at that time. In my opinion, and as a consumer in the 1980s, no retrocessionaire really stood up and said, "Stop," or "Think about what you're doing." Basically, they were nondomineering. They stayed back, and that's exactly what the reinsurer wanted. They wanted the retrocessionaires to ask no questions. The reinsurer almost always wanted financially secure retrocessionaires. I say almost, because at times, if the price was right, they would forget about this requirement.

There was a lot of pressure for unlimited jumbo in the early 1990s. We now have basically a jumbo of more than \$100 million. Direct writers were starting to write people that were aged 70-80. They really wanted to take very little of the risk. They



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went to the reinsurers, who in turn were smart enough to say they didn't want any of the risk. They turned to the retrocessionaires.

One of the problems is, nobody will take a lot of this business, maybe because it's still really experimental. We don't know how many people are going to live and die. Underwriting is very rudimentary in the large-amount category. We don't know how to handle it. We don't know how to price it. For example, in my family, other than two people, everyone has lived past age 90. In fact, my Uncle Billy married a 23-year-old in his third marriage. Again, he beats all the actuarial statistics.

What did retrocessionaires supply in the early 1990s? It is now fairly common to find pools of upward of \$20 or \$25 million. This came along with the pricing that has become aggressive, possibly too aggressive. There's a wide variety of capacity. A reinsurer today can choose from the North American, licensed, rated capacity, to the unlicensed, overseas capacity. The retrocessionaire has also supplied the role of devil's advocate. More and more reinsurers are asking the retrocessionaires for an opinion. A minority are asking, but it is a minority that hopefully will grow.

Retrocessionaires were starting to complain. They were complaining about the results. They were giving automatic capacity on much larger cases. They learned that it was much better to leave the underwriting to the direct writing company and the reinsurer, without getting involved. There was much, much larger case facultative obligatory capacity. There was much, much larger facultative capacity. The market almost became endless in where, and how big a case, you could cover. What we've seen in the early 1990s is retrocessionaires supplying no jumbo limit.

The life reinsurance market, from all sources for retrocession reinsurance, 1992 over 1991, diminished by 0.6%. So there was a 1% decrease in the amount of reinsurance volume in the U.S. market. That puts a lot of pressure on retrocessionaires and reinsurers to come up with ways to succeed in the future as it gets tighter and tighter.

Three big companies are in the U.S. retrocession market. (I was told I couldn't use names, so I'll use randomly chosen letters.) (See Table 1.) This is their percentage market share of the retrocession market as recorded by the Munich study, which is sponsored by the Society of Actuaries. It shows that there have been some changes. In 1987, 1988, and 1989, some very large companies dominated the amount of retrocession that was being ceded. The Milico business played a major role in one of those companies. Since that company stopped doing business with Milico in 1989, you can guess which one it is. The numbers have changed a little bit since 1992; that could change in 1993. *The market share is very dependent on whether you win a big deal as a retrocessionaire; that is, whether you help a reinsurer win a very large deal.*

The life market – that is, recurring reinsurance and retrocession – did indeed grow by 4% in the U.S. The retrocession inforce market shares haven't changed a great deal. It's a tight race between M and E. I wouldn't discount S. It's growing, but like a tortoise. It's slow and sure, growing its way to the top. 'Others,' though, have dropped off tremendously; much of that, again, because of one large account that

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was producing a lot of retrocession business in the U.S. market. That is the Milico business. It's disappeared and so has a lot of the retrocession.

TABLE 1  
Retro New Business – U.S. Marketshare  
(% of Total Volume)

	1987	1988	1989	1990	1991	1992
Company M	28.4	33.0	34.9	26.5	27.6	38.3
Company E	18.9	19.9	27.8	34.3	33.5	26.9
Company S	6.7	10.6	15.4	16.5	21.8	28.8
Others	46.0	36.5	21.9	22.7	17.1	6.0

SOA Reinsurance Section's Survey of Reinsurance for North America

Plus, I think actuaries learned how to code recurring, retrocession, and reinsurance in the right category. So the numbers are starting to look a little better.

What does the future hold? Reinsurers need partnerships or strategic alliances. Much of that is true between retrocessionaire and reinsurer as well. Our clients are the 24 companies in North America that do business with professional retrocessionaires. We see our clients targeting, "niching," or whatever term you want to use today. Some go after only the large companies. Some go after the small companies. Other reinsurers are going after the forgotten middle company.

The retrocessionaires are basically supplying a risk-management or a risk-sharing facility. The mortality is not the be-all and end-all for a reinsurer. For a life retrocessionaire, it basically is. We become the manager of risk and almost pure risk. We're involved in almost nothing else. We supply wholesale mortality management. This also means that you can have wholesale claims. The margins are very thin by the time you get to the retrocessionaire.

Retrocessionaires are being asked to provide more of a service called "listening." Clients want to bounce ideas off someone, in confidence, to find out where they should go with their customer or with a group of customers. The retrocessionaire has proven to the reinsurance industry that we can keep that confidence, regardless of which retrocessionaire it is. We have proven that we can help, we can give advice. We may or may not be asked then to play a role, as many times it depends on our advice.

Many of the reinsurers that we do business with want more production with less overhead. Others want less overhead and more production. They're stripping out the value added. We see the historical role of most reinsurers as providing many extra services. When I started in the business, a reinsurer had to provide computer assistance, underwriting assistance, pricing assistance, and administration assistance, and do that for the same price as any other reinsurer. It was a long list. And now you're seeing those things gradually being stripped out. The computer assistance is long gone, the administration assistance is long gone, and I think you're going to see more and more of that. Companies just cannot afford to provide the extra value when the price isn't there.

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We also see, as a retrocessionaire, many companies trying to find a way to survive. Some companies are willing to do it at any cost. It's amazing how many reinsurers are still willing to price low to stay in the market. If they survive the next few years, then they will win. Others say they will only do business on their terms. As a retrocessionaire, we're torn because we want to help both. Both have good philosophies. But we often cannot support both. We have to go with our price. And our price today is probably fixed. Reinsurers want a bigger and better spread of business, more predictability. Again, that's exactly what a retrocessionaire wants. Most reinsurers want to have fewer dominant accounts. They want to have their business spread around companies, as well as within the company. The retrocessionaire wants that. We want more lives, more predictability.

Our average size case being underwritten was \$6.6 million U.S. three years ago. The average cession was close to \$600,000. We have driven the average cession down to about \$300,000, while keeping the total the same. We have driven down and out much of the jumbo facultative underwriting.

Retrocessionaires must be flexible. We have to look at new avenues that may not be traditional. Traditional reinsurance may not be the answer. As a retrocessionaire, you have to provide the ability for a company to solve a problem for its customer through things like financial reinsurance, special risk reinsurance, or a combination thereof. I see the lines between conventional reinsurance and financial reinsurance becoming very blurred. To a retrocessionaire, it shouldn't matter how you label it, as long as you end up helping the customer and getting their business.

Reinsurers want to make money. Retrocessionaires want to make money. That's not that old a phenomenon. As I said, it wasn't until 1979 that I heard the word "profit." Another thing is that reinsurers now have to make their parent or owner happy. They're either owned by a large conglomerate that is deciding where to put capital based on returns, or they are owned by a European reinsurer that has been struggling lately in the property/casualty market and must come through with a profit.

There are partnerships between the direct writer and the reinsurer. Three-way partnerships are emerging; there are partnerships in which the retrocessionaire lends its financial resources to a reinsurer to go ahead.

Global risk-taking is changing the market in that people are buying insurance in various countries, even though they are not residents there anymore. The retrocessionaire can quite often be the depository and the control for these cases, because these cases often pop up in Europe and they get written in the U.S. The retrocessionaire has quite often seen it in both places, and is able to direct both companies as to what's going on. The retrocessionaire can lend a hand in experimental aspects, such as old-age underwriting and underwriting a special new lab test.

MR. JAMES L. SWEENEY: Both of these gentlemen have talked a little bit about the driving forces. My talk is more about numbers and not why. Perhaps if we do have some time afterward, people may want to comment on why the face of reinsurance has changed or on my topic, "Is globalization of reinsurance having a major effect?"

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When I first was asked to give the talk, I really didn't know where to begin. So I began to look at things. We examined the quantity of reinsurance leaving the U.S. and Canada. (Throughout the talk, when I mention "foreign" I mean outside North America). We looked at the types of reinsurance that are being ceded. We looked at the assumed market as well. We looked at locations – where in the world the reinsurance is coming from or is being ceded to – and any recent trends that are emerging. We looked at the statistics from the U.S. Department of Commerce. We also looked at the companies that are reporting in A.M. Best for the year 1991. We also performed a survey of 41 different insurers and reinsurers based on their 1992 Schedule Ss.

The answer to the question, "Is globalization having an effect?" is yes. The U.S., as a country, cedes a fair amount of business to foreign reinsurers. The statistics from the U.S. Department of Commerce show a net reinsurance premium paid outside the U.S. of \$10.4 billion U.S. The Department of Commerce does not distinguish between life and health, so that was a large amount of what we tried to do.

The NAIC has studied the Schedule Ss filed with it by the property and casualty companies. And the manager of their Reinsurance Section told us he's estimated \$5 billion is the net outflow of reinsurance premiums outside the U.S. for property and casualty companies. For those who are not aware, there have been some problems with retrocessionaires in the property and casualty business going broke. The Reinsurance Association of America (RAA), in a recent talk before the Senate, estimated 40% of the domestic market as being ceded reinsurance. That was one of the numbers that we tried to either agree or disagree with.

U.S. companies do not assume as much business as they cede. We get \$2.3 billion in reinsurance premiums from areas outside the U.S. The Canadians, who have always taken a more international look at their business, tend to assume more business internationally than they cede. Our office in Toronto believes that the regulatory environment has something to do with this.

I did look at the balance of trade for reinsurance between the U.S. and Canada, and I'll show you some statistics there. U.S. and Canadian companies are looking at Mexico because of NAFTA. Mexico does cede a large percentage of its business to branches of foreign-owned companies. It was reported in *Global Reinsurance* that 120 reinsurance writers are registered with the CNSF, which is the National Insurance and Bond Commission. There are also some local reinsurance pools.

I mentioned briefly before that Frank Nutter of the RAA made a statement before the Senate Government Affairs Committee. I agree with the RAA with that it is "highly improbable that the U.S. reinsurance market could cover the nation's risks without the alien market." We estimate that roughly 10% of the U.S. reinsurance market is leaving the U.S. and Canada. Our number is different than what the RAA estimated in the domestic market.

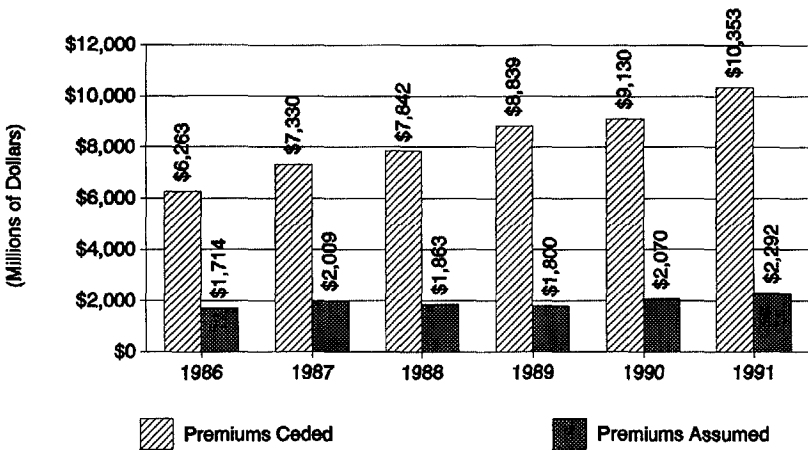
The RAA also made a further statement. "It is of interest to note that after having remained stable at around 30% for ten or more years, the foreign share of the U.S. reinsurance market has substantially increased since 1986." Again, we believe the

## THE CHANGING FACE OF REINSURANCE

number is 10% for the U.S. and Canada, and the total premium volume is about \$3 billion.

These statistics are from the U.S. Department of Commerce (Chart 1). The premium ceded from the U.S. to other countries has grown from a \$6 billion market to about a \$10 billion market in the last six years. The premiums assumed by U.S. insurers have remained at roughly the \$2 billion mark. We can see that there was roughly a \$4.5 billion deficit in 1986. The deficit grew to about \$6 billion in 1988 and was a little more than \$8 billion in the last year that was reported.

CHART 1  
U.S. Reinsurance Premium Ceded to and  
Assumed from Foreign Companies



Source: *Survey of Current Business—September 1992*

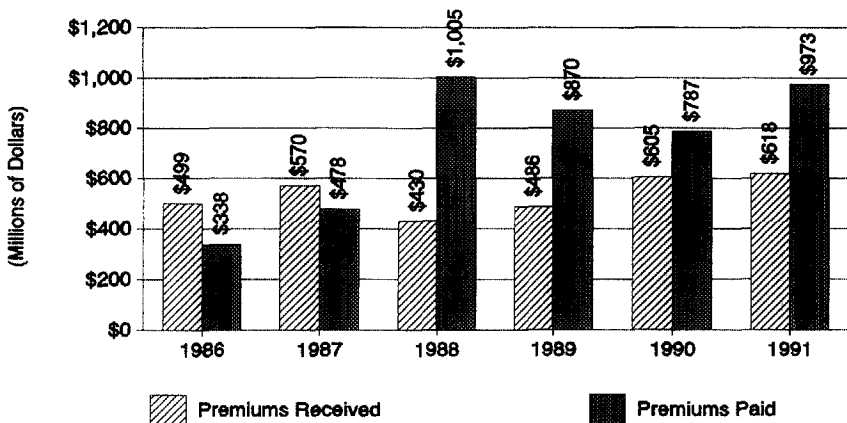
I then wanted to look at the balance of trade between the U.S. and Canada to determine how much business was leaving the U.S. and going up to Canada. Chart 2 shows the premium received from and paid to Canada. We can see that in the years 1986 and 1987, the U.S. enjoyed a small trade surplus. Since 1988, there has been a trade deficit, with the Canadians assuming more business from the U.S. than U.S. companies are taking in Canadian business. The net deficit is something in the nature of \$300 million, and nowhere close to the \$8 billion figure that was leaving the U.S. So I was certain that U.S. business is not going to Canadian reinsurers. I began to look further.

We next examined the retrocession from foreign-owned reinsurance companies (Chart 3). According to the most recent survey of U.S. business, the foreign-owned reinsurance companies accounted for a 28% share of the market. Even if all of that were retroceded, it would be nowhere near the \$3 billion of life reinsurance premium ceded that we estimated in total. Although there is some natural retrocession going

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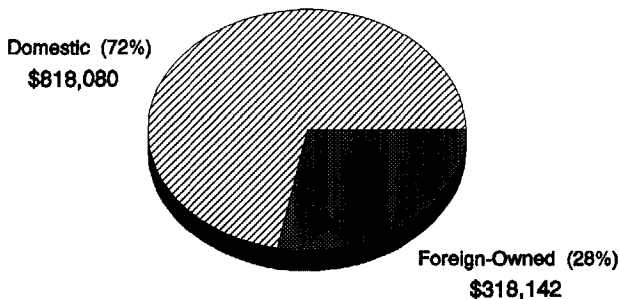
to Europe from foreign-owned companies operating in the U.S. and Canada, most of the business is retained, and it's not the source of reinsurance ceded out.

CHART 2  
U.S. Reinsurance Premiums Received from and Paid to Canada



Source: Survey of Current Business—September 1992

CHART 3  
U.S. and Canadian Life Reinsurance Market of Foreign-Owned Reinsurance



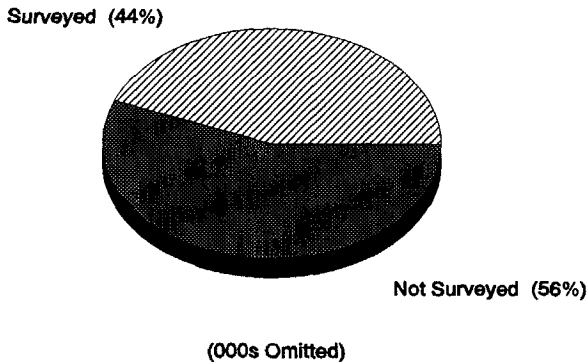
Amounts In Force (\$U.S. Millions)  
In Force Total = \$1,136,222

Source: 1993 SOA Life Reinsurance Survey

## THE CHANGING FACE OF REINSURANCE

I've mentioned the \$3 billion of life reinsurance ceded outside the U.S. How did I get to that figure? We looked at all the companies that reported to A.M. Best in 1991. The industry total, as you can see in Chart 4, is \$27.8 billion of reinsurance premium ceded. We also looked at the reinsurance premium assumed by companies reporting to A.M. Best. It is about \$24.4 billion (Chart 5). If nothing left the U.S., the assumed and ceded amounts of reinsurance reported in A.M. Best would be identically the same. To the extent that \$3.1 billion is leaving those reporting to A.M. Best, we believe that may be escaping outside the U.S. There will be affiliate transactions, and perhaps others, but that's where most of it goes.

CHART 4  
Surveyed Companies vs. Industry Total Ceded Premium



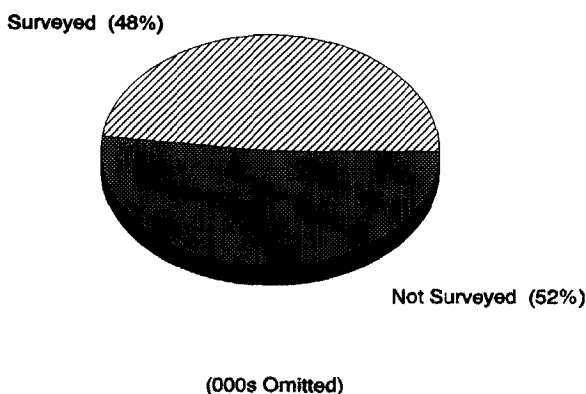
Survey Total - \$12,151,190  
Industry Total - \$27,958,229

Industry Total Source: A.M. Best

I also mentioned that we did a survey. We looked at 41 large consumers of reinsurance. They either bought a lot of reinsurance or they ceded a lot. So it was not truly an unbiased survey. We looked at the reinsurance that they assumed, as well as the reinsurance ceded. We identified the date of the treaty, the treaty type, the country to which it was sent, or from which the reinsurance was assumed. Our survey covered roughly \$12 billion or 48% of the assumed premium (Chart 5), and 44% of the ceded premium (Chart 4). Again, if you look at these charts, the total assumed premium by the U.S. companies reporting to A.M. Best is \$24.4 billion versus \$27.8 billion ceded. This again indicates that about \$3 billion is leaving the industry. That's closer to the 10% figure than the 40% figure that Mr. Nutter used in his testimony before Congress.

The rest of the presentation will go into our survey. We were interested in the types of reinsurance, where it was going, and if there are any new trends. We believe that by covering roughly half the market (with 41 companies), we fairly represent the entire marketplace.

CHART 5  
Surveyed Companies vs. Industry Total Assumed Premium



Survey Total = \$11,824,879  
Industry Total = \$24,401,606

Industry Total Source: A.M. Best

Chart 6 shows premium numbers in millions. We have \$9 billion of ceded life premium in our study. We identified a little more than a billion dollars of life premium that was ceded outside the U.S. and Canada. We looked at \$8.6 billion of assumed life, but found only \$478 million of premium that was assumed from companies domiciled outside the U.S.

We also identified roughly \$3 billion of health business. Chart 7 shows that U.S. companies are ceding a fair amount of business outside North America. That is, 8.4% of A&H business and 11.4% of life business were ceded outside North America. North American companies were not as interested in looking outside North America for reinsurance to assume, with less than 1% assumed in A&H and 5.5% assumed in life. When we examined this 5.5%, it looked a little peculiar to us. We noticed that one reinsurance deal was assumed from an English company and ceded to a European company on the same date for the same amount. We decided to take that one deal out.

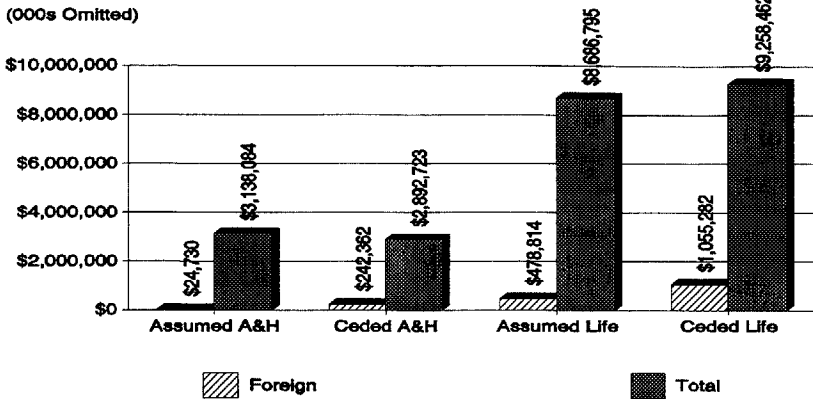
We looked again at a total of \$1.3 billion of reinsurance ceded (Table 2). And the biggest single type of business ceded outside the U.S. was the annuity business. That one deal was a lot of that. Group, which includes life and health, but mostly health, is the second largest type of business with roughly \$300 million. Ordinary coinsurance and YRT are another \$300 million in total. Catastrophe and other types round out the total amount.

When we took that one single deal out (Table 3), the order changed; the group health market was the largest single amount. Much of that is going into the London markets. Annuity dropped down to second place.



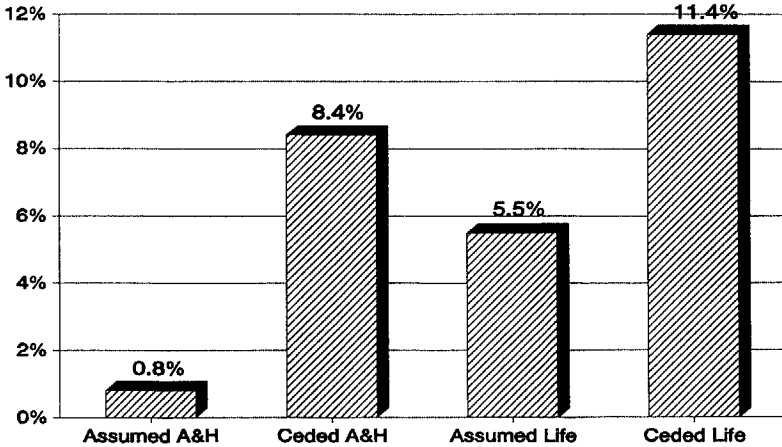
# THE CHANGING FACE OF REINSURANCE

CHART 6  
Amount of Foreign Premium of Surveyed Companies



Source: Schedule Ss of Surveyed Companies

CHART 7  
Percentage of Foreign Premium of Surveyed Companies



Source: Schedule Ss of Surveyed Companies

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TABLE 2  
Premium Ceded to Foreign Companies by Type

Type	Amount
Annuity	\$687,535,319
Group	276,583,478
Coinsurance	223,317,411
YRT	125,844,783
Other	1,398,442
<b>Total</b>	<b>\$1,297,645,112</b>

Source: Schedule Ss of Surveyed Companies

TABLE 3  
Premium Ceded to Foreign Companies by Type

Type	Amount
Group (Life and A&H)	\$276,583,478
Annuity	228,309,644
Coinsurance	223,317,411
YRT	125,844,783
Other	1,398,442
<b>Total</b>	<b>\$838,419,457</b>

Source: Schedule Ss of Surveyed Companies

Then on Chart 8 we took out the one deal. We see again that U.S. and Canadian companies are not assuming too much, \$24 million and \$19 million, or \$44 million together of premiums coming into our countries. But, significant amounts of reinsurance are going out.

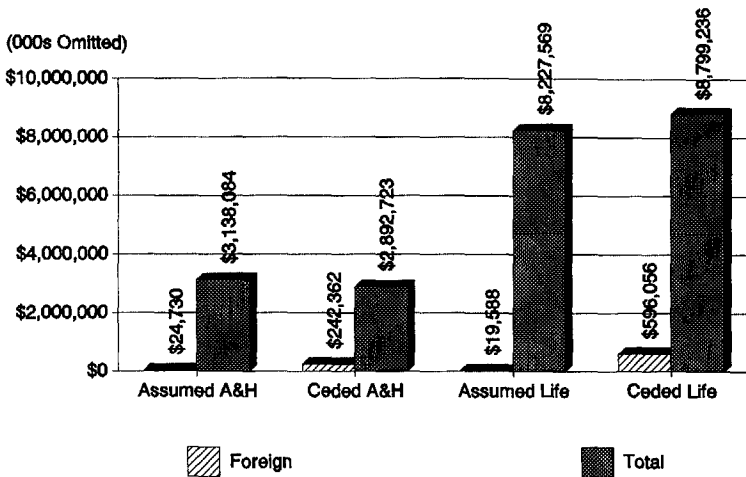
Chart 9 shows the same thing in percentages. The issue here is that the percentages are in the 5-10% range that we estimated, nowhere near what has been reported on the property and casualty side. Chart 10 shows the types; again, group being the largest and annuities second.

Then we were interested in where the reinsurance was going (Chart 11). This was interesting. The largest, single spot is European countries. The second is "sunny spots," places where we'd like to be in the wintertime, with beaches, palm trees and things of that nature; offshore types of places. That's the second largest home for reinsurance outside North America. England is third; a surprising 5.6% goes to Asia; Latin America takes a very small share.

We also wanted to look at the premium assumed (Table 4). We could identify only \$44 million, even though we studied about \$12 billion of reinsurance assumed. We found that the market is dominated by the group line of business, which took \$35 of \$44 million. U.S. and Canadian companies are assuming roughly half of it from Europe, with other large shares coming back from England and the sunny spots (Table 5).

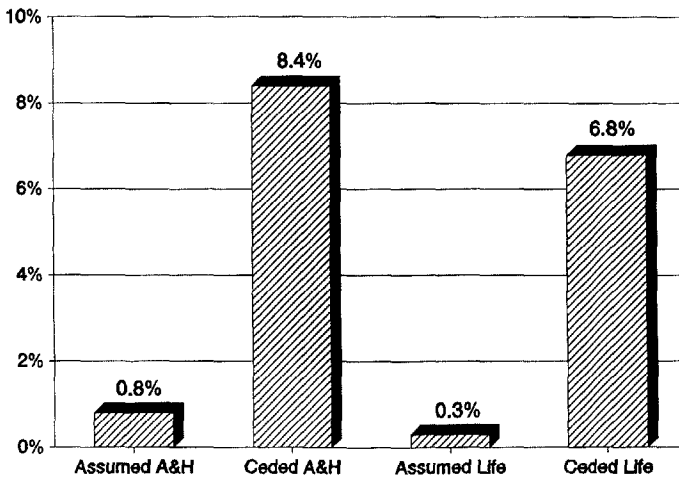
# THE CHANGING FACE OF REINSURANCE

CHART 8  
Amount of Foreign Premium of Surveyed Companies



Source: Schedule Ss of Surveyed Companies

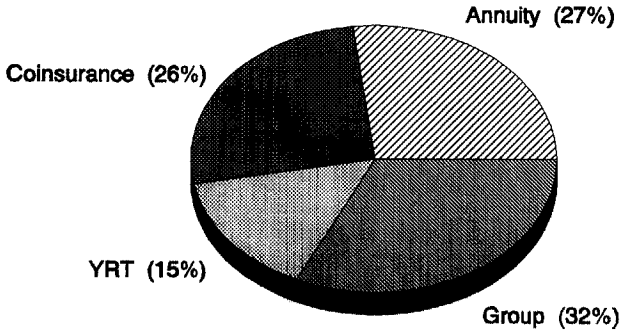
CHART 9  
Percentage of Foreign Premium of Surveyed Companies



Source: Schedule Ss of Surveyed Companies

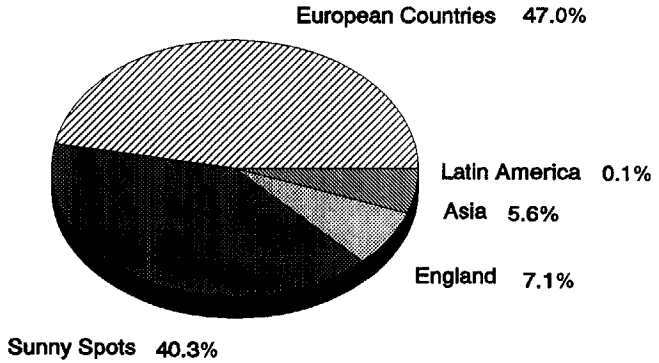
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CHART 10  
Foreign Premium by Type Ceded



Source: Schedule Ss of Surveyed Companies

CHART 11  
Premium Ceded to Foreign Companies by Country



Source: Schedule Ss of Surveyed Companies

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TABLE 4  
Foreign Premium Assumed By U.S./Canadian Companies by Type

Type	Amount
Group	\$32,159,561
YRT	3,328,752
Other	8,830,764
<b>Total</b>	<b>\$44,319,077</b>

Source: Schedule Ss of Surveyed Companies.

TABLE 5  
Foreign Premium Assumed By U.S./Canadian Companies by Country

Country	Amount
European Countries	\$22,355,581
England	16,177,493
Sunny Spots	5,033,907
Latin America	752,096
<b>Total</b>	<b>\$44,319,077</b>

Source: Schedule Ss of Surveyed Companies.

The last thing we wanted to look at was trends. We plotted the number of foreign treaties. I used number of foreign treaties, rather than premium ceded, because the older treaties are going to have much more premium in an ongoing treaty relationship. The newer treaties may also be ongoing. If you wanted to look at trends, we thought it was far better to look at the number of treaties. The number of treaties is steadily increasing (Chart 12). One foreign-owned reinsurance company apparently restructured numbers of treaties or rewrote a number of its treaties in 1991. That's why that number appears to be out of line. You can definitely see there's much more interest among U.S. and Canadian companies to go outside North America.

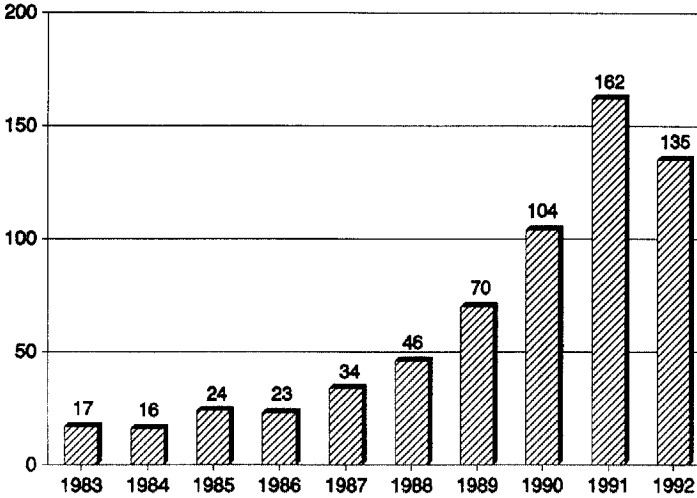
We were interested in the types of business being ceded (Chart 13). We looked at the last five years and found that in every year, except 1991, the predominant number of treaties were group treaties being written outside of the U.S. and Canada. YRT was the predominant type in 1991. We believe that was due to the one rewrite we discussed earlier. Other than that, the group number is always way ahead, and the coinsurance number is smallest.

Chart 14 shows the last two years. Group treaties appear to be the most common, with traditional YRT second by number of treaties.

We wanted to look at where the treaties were being written (Chart 15). Again, in all years, the European countries were predominant. More treaties were written there. The foreign reinsurer I was talking about does have a European parent; that makes 1991 unusually high.

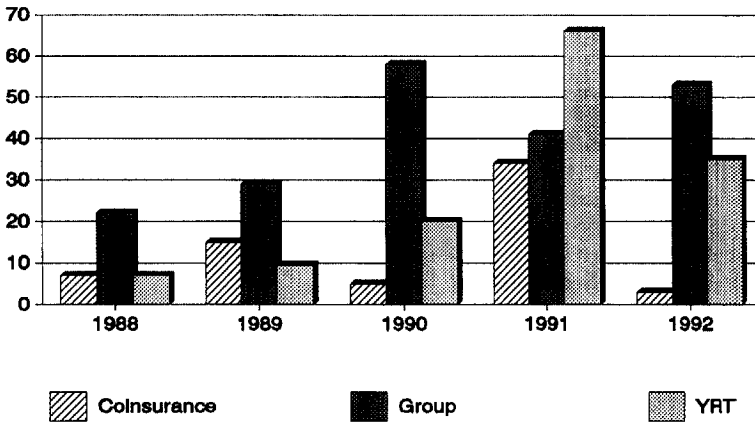
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CHART 12  
Foreign Treaties by Number



Source: Schedule Ss of Surveyed Companies

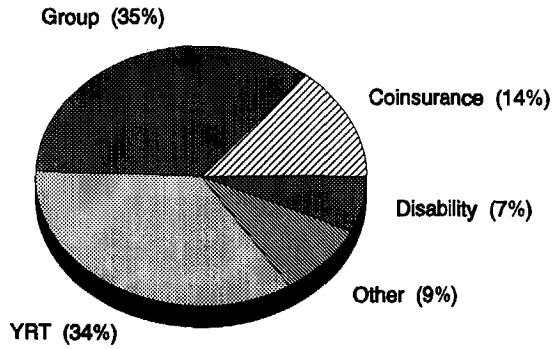
CHART 13  
Number of Foreign Treaties by Type  
1988-92



Source: Schedule Ss of Surveyed Companies

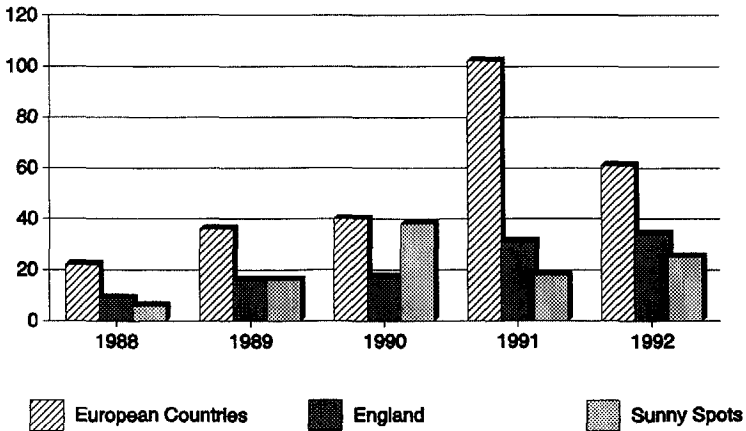
THE CHANGING FACE OF REINSURANCE

CHART 14  
Percentage of Treaties Written by Type  
for 1991 and 1992



Source: Schedule Ss of Surveyed Companies

CHART 15  
Number of Foreign Treaties by Country  
1988-92

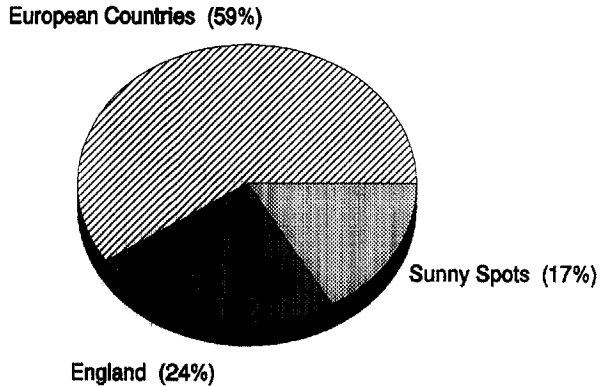


Source: Schedule Ss of Surveyed Companies

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England appears to be the second most common area; however, in 1990, sunny spots took a close second with almost 40 treaties. The changes in the regulatory climate in the U.S. with certain regulations by California and other states may be the reason. Looking at it as a percentage (Chart 16), 60% of the treaties are going to Europe, 24% are to England, and sunny spots are taking 17%.

CHART 16  
Percentage of Treaties Written by Country for 1991 and 1992



Source: Schedule Ss of Surveyed Companies

Retrocession capacity from foreign-owned companies is an answer but is not the whole answer. The current regulatory environment obviously has to be another part of the answer. The relaxed accounting treatment of offshore may be a part of it. The large-case capacity that Ross talked about may be yet another area. We did not interview companies. The statistics I showed you here are publicly available from Schedule Ss.

FROM THE FLOOR: For overseas business, I was wondering if you have any feel for the impact if the gatekeeper legislation were enacted, requiring a company to have at least \$20 million net worth, and subject itself to U.S. accounting, and so forth.

MR. HOLLAND: Yes, there are a number of regulatory developments. The NAIC has proposed certain gatekeepers. I think Senator Dingell has reintroduced his bill, and I think there may be some elements in the Kennedy bill that would change the regulatory environment. Without knowing exactly the purposes of the reinsurance, it would be hard to speculate as to whether those kinds of changes would affect U.S. business. A European reinsurer that has to put in another \$20 or \$50 million or more into the U.S. would have a much smaller return on equity for that deal. You have to do a lot of business to generate equity under those new conditions. Whether it looks attractive to them, I'm not privileged to know exactly.