Session 64PD: Reinsurance as a Capital Management Tool

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Reinsurance as a Capital Management Tool

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Trends & Challenges

Trends

- Reinsurance vs Bank solutions
- PBR impact on viability of financing new business
- Most recent deals used to replace existing financing
- Surplus relief transactions
- AG 33 deals
- Certified reinsurer status
- Longevity deals

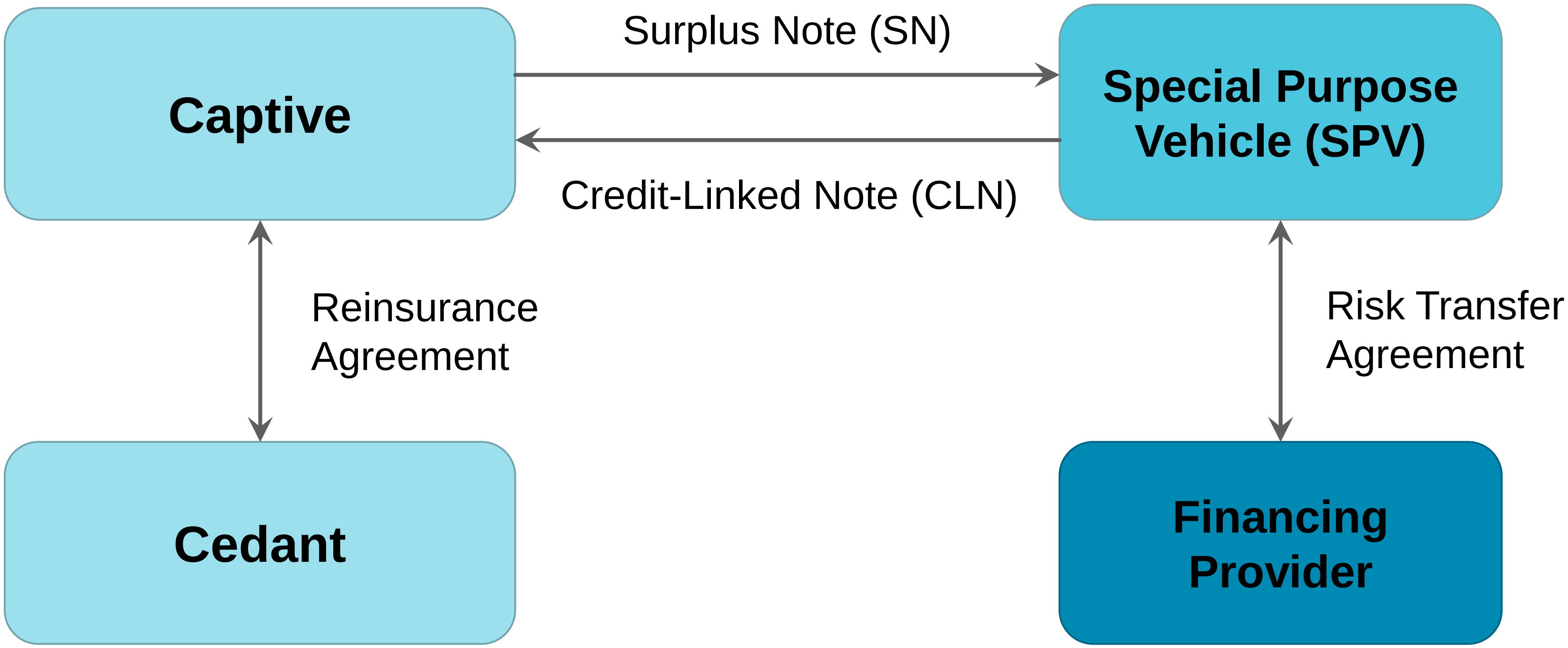
Challenges

- Transactions compliant with AG 48 and PBR
- Regulator approval

Pre-AG 48 Redundant Reserve Financing

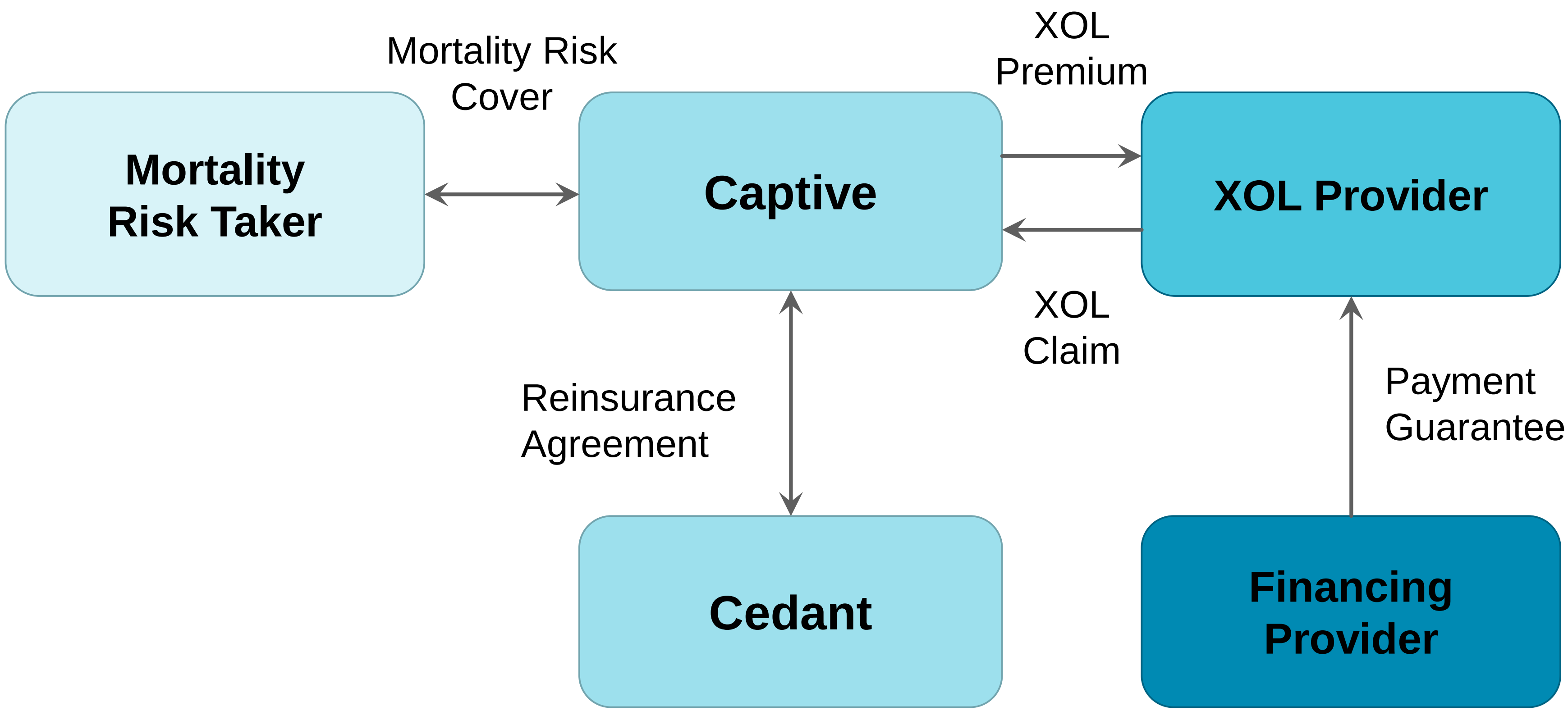
Area	Benefit
Product pricing	▪ Enables insurers to achieve debt-like financing costs for redundant term and universal life reserves ▪ Enhances insurers' ability to pass on favorable economics through competitive product features
Capital management	▪ Creates free surplus that can be used to improve RBC ratios, finance sales growth, or invest in acquisitions
Rating agency relations	▪ Structure can be viewed more favorably by rating agencies than surplus note and holding company senior debt financing

Example of XXX / AXXX Structure – Exchange of Notes



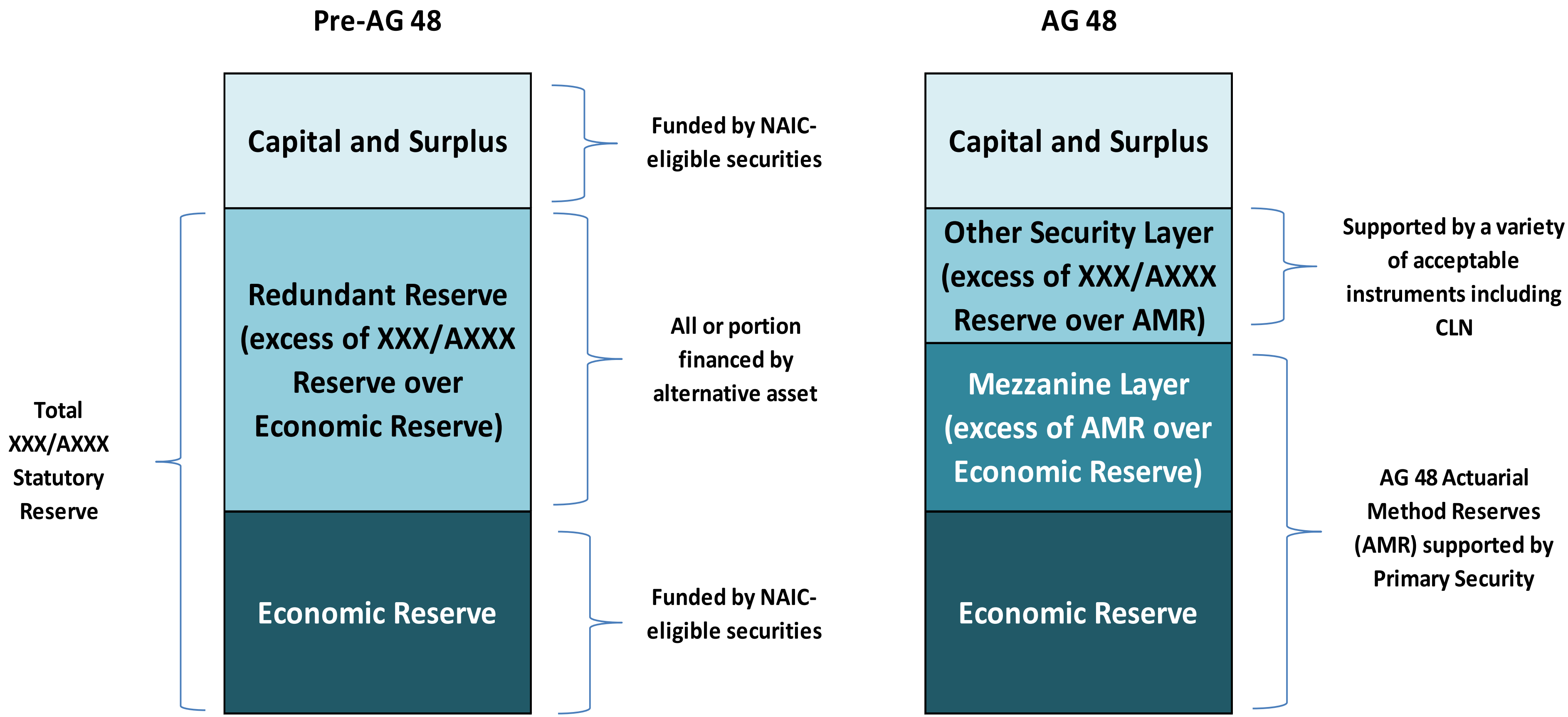
- Risk charge is the difference in coupon rates between the SN and the CLN
- If the Captive redeems the CLN to pay reinsurance claims, the Financing Provider funds the redemption of the CLN

Example of XXX / AXXX Structure – Excess of Loss



- Captive reinsures mortality risk via YRT reinsurance. XOL provider assumes other insurance risks, investment risk, and the Captive's collection risk.
- XOL Provider pays claims up to full Stat Reserves less Qualified Reserves once all other sources have been exhausted.

AG 48 at a Glance



- Actuarial Method Reserve based on modified principle-based reserves as specified in NAIC Valuation Manual (VM-20) is used to set Required Level of Primary Security. Primary Security assets are specified in AG 48.
- Actuarial Method Reserve = max (Net Premium Reserve * Adjustment Factors, Deterministic Reserve, Stochastic Reserve). AG 48 NPR adjustment factors intend to approximate 2001 CSO mortality table update to 2014 CSO; they will not be used once NPR is calculated with 2017 CSO.

AG 48 Compliant Financing Solutions

Other Security Layer Financing	Mezzanine Layer Financing
• Pre-AG 48 arrangements are still viable • Several transactions of this nature have successfully closed	• Funding from cedant's internally generated funds • Financing from cedant's affiliates • Financing provided by reinsurer or other financing provider • Financing provided by a 3rd party, backed by guarantee from reinsurer or other financing provider • Limited success in closing deals of this nature

AG 48 Compliant Financing Solutions (cont.)

A captive reinsurance agreement between a major US life carrier and global reinsurer marked one of the first such transactions in compliance with AG 48 where primary assets are funded by the reinsurer

- Primary assets provided by an affiliate of the reinsurer
- Transaction utilized a securities lending arrangement

Similar non-cedant primary asset transactions are being discussed in the market

- Regulatory approval represents a significant hurdle challenge
- Credibility and reliability of financing provider are important consideration

PBR Impact on Captive Financing

Captive Facility	PBR Impact
Pre-AG 48 Compliant Facility	▪ Restructure of existing facilities to refinance or accommodate block acquisition
AG 48 Compliant Facility	▪ Applicable to insurers choosing 3-year phase-in ▪ Option of companywide exemption ▪ Lower tax reserves under PBR makes reserve financing less attractive

VM-20 Compliant Facility	▪ Financing opportunities still exist post PBR due to perceived redundancy in VM-20
	  ▪ Assumptions
	    ▪ No mortality improvement after valuation date
	    ▪ Explicit PADs
	    ▪ Grading to industry tables
	  ▪ Methodologies
	    ▪ Benefits of reinsurance
	▪ Financing transactions common in other jurisdictions with PBR

Section 8 of VM-20 pertains to the impact of reinsurance on the components of reserves under PBR

	Component	Considerations in determining reinsurance impact
Maximum	**Net premium reserve**	▪ No change as compared to pre-PBR ▪ Coinsurance: The NPR is reduced by the percentage coinsured ▪ Yearly Renewable Term (YRT): The NPR is reduced by the unearned cost of insurance that is reinsured
	Deterministic and stochastic reserve	▪ Requires two separate calculations, pre- and post-reinsurance ▪ Exclusion testing, if elected, must be performed on a pre- and post-reinsurance basis
=	**Final PBR reserve**	▪ The starting asset collar does not apply to pre-reinsurance reserves ▪ Credit = $Max(NPR_{Gross}\,, DR_{Gross}, SR_{Gross}) - Max(NPR_{Net}\,, DR_{Net}, SR_{Net})$

The reserve credit for reinsurance under PBR is materially different from the formulaic approach that insurers have become accustomed