

Advantages

When an inforce block of business is reinsured, coinsurance may be the simplest to administer if a quota share method is used. Once previously reinsured amounts have been identified and removed, the quota share percentage can be applied to all premiums, claims, surrenders, and reserves. Under this method, the ceding company can easily provide the reinsurer with the information necessary for preparation of its statutory financial statements.

From a regulatory viewpoint, pure coinsurance may be the cleanest form of reinsurance, because there tend to be fewer questions regarding risk transfer in coinsurance.

Disadvantages

The chief disadvantage of coinsurance is the need to transfer assets. The ceding company must transfer control of the assets equal to the reserves to the reinsurer. In the case of the reinsurance of an inforce block, this may represent a significant portion of the assets of the ceding company. In the case of an interest sensitive or participating product, the ceding company may have to give the reinsurer control of or veto power over the dividend or interest rate determination. In addition to creating regulatory concerns, this could be a distinct disadvantage in competitive situations.

Another disadvantage is that it requires the reinsurer to manage the assets, subjecting it to additional investment risk which some reinsurers might find undesirable. Also, if the reinsurance is terminated, the reinsurer must transfer assets in an amount equal to the reserves to the ceding company. There is always a risk that capital gains or losses in an asset transfer may result in unfavorable cash, statutory, tax, or GAAP consequences.

If the reinsurer is not licensed or admitted in the ceding company's state of domicile, the ceding company may be unable to take credit in its statutory annual statement for the reserves being held by the reinsurer unless the reinsurer provides some specific form of security acceptable to the state. This could be expensive and burdensome. Failure to secure the right to a reserve offset would defeat the surplus relief. In fact, if the desired reserve credit were greater than the intended surplus relief, the surplus position would be worsened.

Coinsurance also subjects the ceding company to an additional credit risk. Should the reinsurer become insolvent, the ceding company may be unable to obtain full reimbursement for benefits reinsured and, on termination, may not receive the full amount of policy reserves.

Coinsurance Illustrations

If ABC Life did not have at least \$100 of available surplus in the first year, it would need reinsurance. Assume that ABC Life enters into a coinsurance treaty with XYZ Re on December 31, reinsuring 100% of this block of business, and XYZ Re grants ABC Life an allowance equal to 10% of the premium.

First Year Results Tables 5.3A and 5.3B show the first year results of the coinsurance transaction.

ABC Life has ceded \$1,000 of premium to XYZ Re, leaving it with a net premium of \$0. The \$100 of reinsurance allowances from XYZ Re gives ABC Life total revenue of \$100. This \$100 is used to offset the \$100 of commissions and expenses incurred in issuing the policies. This leaves ABC Life with a gain of \$0. XYZ Re now has \$1,000 of accepted premium and a \$1,000 of reserve increase. Its commissions are \$100, leaving it with a gain of \$(100).