REINSURANCE SECTION
"A KNOWLEDGE COMMUNITY FOR THE SOCIETY OF ACTUARIES"

Reinsurance News

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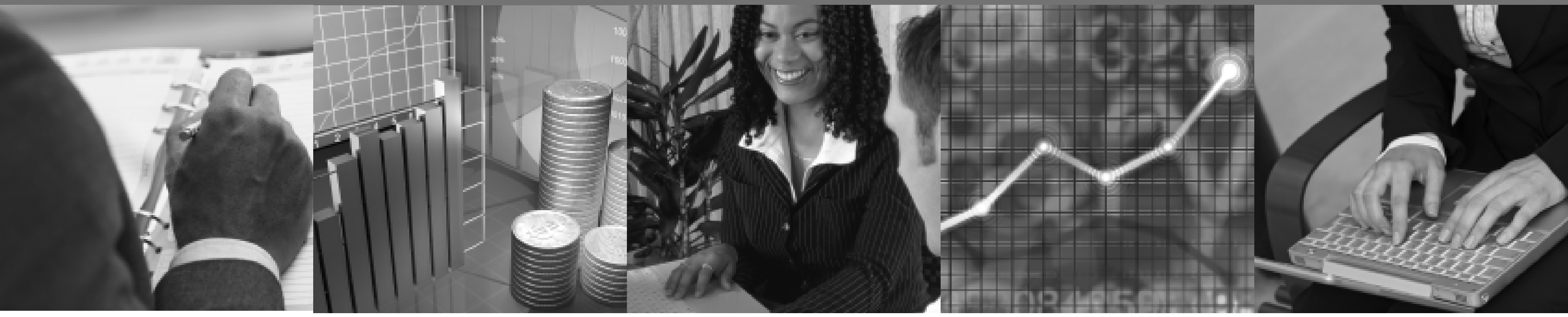
newsletter for members of the reinsurance section



LIFE REINSURANCE DATA FROM THE MUNICH AMERICAN SURVEY

by David M. Bruggeman

Munich American's annual survey, which is conducted on behalf of the Society of Actuaries, Reinsurance Section, covers Canadian and U.S. ordinary and group life reinsurance new business production and in force. The ordinary numbers are further subdivided into:

1) Recurring reinsurance:[1] conventional reinsurance covering an insurance policy with an issue date in the year in which it was reinsured,

2) Portfolio reinsurance: reinsurance covering an insurance policy with an issue date in a year prior to the year in which it was reinsured, or financial reinsurance, and,

3) Retrocession reinsurance: reinsurance not directly written by the ceding company.

Complete survey results can be found at Munich American's Web site: *www.marclife.com* (look under Publications).

Life Reinsurance Production

U.S. life reinsurers reported another drop in new business production in 2006. Compared to 2005, life production in 2006 decreased 10.2 percent overall. Decreases were recorded in recurring and retrocession while portfolio and group did record an

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[1] Included in the definition of recurring category is business assumed from the direct side of companies that also have a reinsurance division. Business assumed from the reinsurance division would fall under the retrocession category.

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Actuaries
Risk is Opportunity.[sm]

REINSURANCE NEWS
NEWSLETTER OF THE REINSURANCE SECTION

Number 60 • July 2007

Society of Actuaries
475 N. Martingale Road, Suite 600 • Schaumburg, IL 60173
ph: 847.706.3500 • f: 847.706.3599 • Web: *www.soa.org*

SOCIETY OF ACTUARIES

Life Reinsurance … from page 1

increase. In Canada, increases in recurring and group outweighed the decreases in portfolio and retrocession and a 6.4 percent overall increase was reported—this same pattern was seen in Canada in 2005.

Life reinsurance production results for 2005 and 2006 are shown in the table, "Life Reinsurance New Business Production" on page 3.

U.S. Recurring: Going Down … Again!

It was another down year for U.S. recurring business. In total, $724.2 billion was reported in 2006 compared to $844.5 billion in 2005. This marks the fourth straight year and the fifth time in the last six years that recurring production has decreased. Further, for the second straight year, the decrease was in the double-digits. The 14.2 percent drop in 2006 follows the 18.6 percent decrease reported in 2005—which is one of the largest recurring decreases ever recorded by the survey.

The chart "Annual Percentage Change in U.S. Recurring New Business" on page 3 shows the annual percentage change in U.S. recurring new business since 1996. The late 1990s were a time of competitive reinsurance pricing and the direct writers were induced to reinsure more of their business. During this time, 80/20 and 90/10 first dollar quota share (FDQS) arrangements became the norm. In 1999, there was the term "fire sale" as direct writers prepared for Regulation XXX. The increase in term sales helped fuel the increase in reinsurance production.

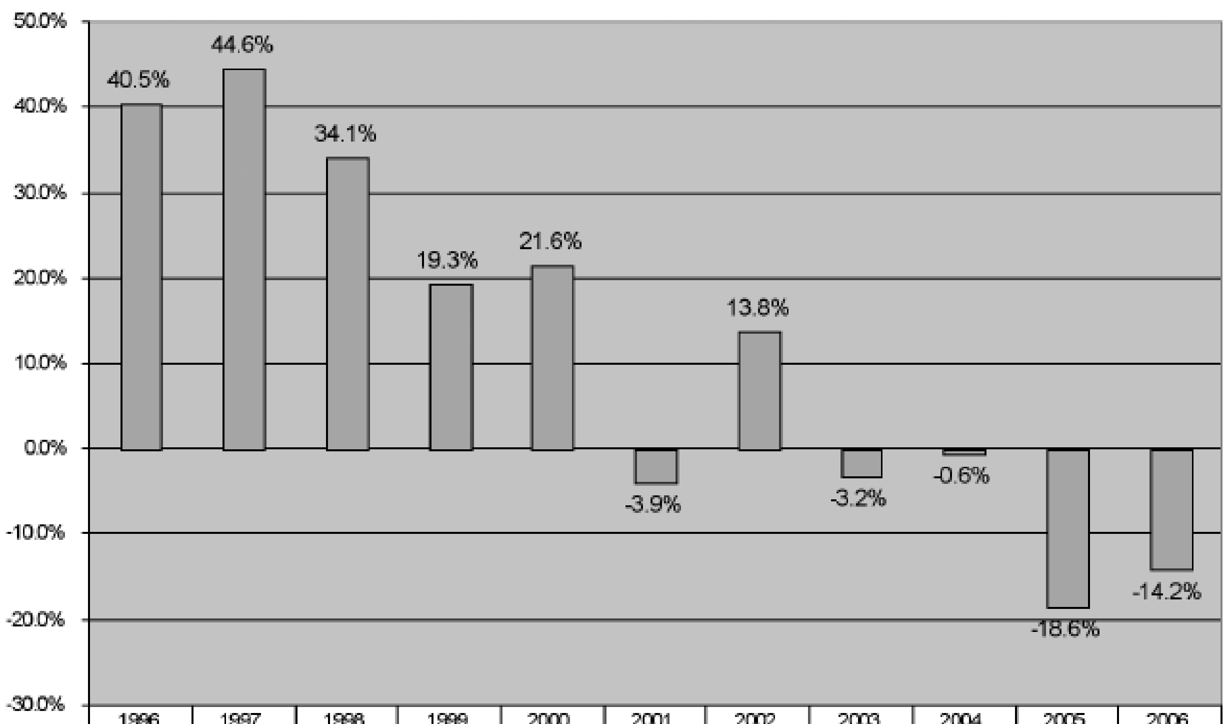
The life reinsurance market received another booster shot in 2000 when Reg. XXX became effective and reinsurance companies stepped in to provide the surplus relief needed by the direct writers to fund the new reserve requirements. This was primarily accomplished via 80/20 or 90/10 FDQS coinsurance arrangements. But after a few years, many of the larger term writers began exploring other solutions to finance their reserve strain and some were able to find solutions that were either more cost efficient than what the reinsurers were offering, or provided a better fit for their needs. With their reserve issues solved, the direct writers' need for low retention coinsurance, and reinsurance in general, lessened and some direct companies began moving away from FDQS coinsurance arrangements to excess YRT arrangements or retaining a larger FDQS

Life Reinsurance New Business Production

	U.S.			Canadian		
	2005	2006	Change	2005	2006	Change
Ordinary Life						
Recurring	844,520	724,260	-14.2%	129,057	141,445	9.6%
Portfolio	38,747	65,126	68.1%	1,459	140	-90.4%
Retrocession	42,595	34,159	-19.8%	8,258	3,828	-53.6%
Total Ordinary	925,862	823,545	-11.1%	138,775	145,412	4.8%
Total Group	41,078	45,226	10.1%	25,700	29,613	15.2%
Total Life	966,940	868,771	-10.2%	164,475	175,025	6.4%

U.S. figures are in $US, Canadian figures are in $CAN

Annual Percentage Change in U.S. Recurring New Business (1996-2006)



	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
% Change	40.5%	44.6%	34.1%	19.3%	21.6%	-3.9%	13.8%	-3.2%	-0.6%	-18.6%	-14.2%

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Life Reinsurance … from page 3

percentage. In hindsight, the U.S. life reinsurance market in the early 2000s could be compared to an elevator at the top floor—nowhere else to go but down.

The decreases experienced over the last few years are also a result of the life reinsurance market experiencing the full effect of repricing efforts and the general hardening of reinsurance prices. Direct writers have reacted to the repricing and firmer prices by retaining more of their business—either by shifting from FDQS to excess basis, raising their overall retention limit, or increasing their FDQS retained percentage. While it appears that reinsurance pricing may be beginning to soften up a bit, it is unknown what level it will need to reach before direct writers will start to consider lowering their retention. In fact, the recent Flaspöhler survey revealed that only 2 percent of the direct writers polled were contemplating a change to a smaller retention, however 38 percent were contemplating a change to a larger retention.

The 2006 U.S. recurring numbers by company appear in the table, "U.S. Ordinary Recurring Reinsurance" below. The market remains very concentrated with the top five companies making up 77 percent of the market share. Breaking the companies into three different groups based on production level reveals some interesting observations:

1) Group One: These five reinsurers: RGA, Transamerica, Swiss, MARC and Generali were the top recurring new business writers in 2006. As mentioned above, these companies accounted for 77 percent of the market in 2006. RGA was the top producer with $165 billion in recurring new business—this represents a 9.6 percent decrease in production from 2005. Transamerica continues to steadily increase

U.S. Ordinary Recurring Reinsurance (U.S. Millions)

	2005		2006		
Company	Assumed Business	Market Share	Assumed Business	Market Share	Change in Production
RGA Re. Company	183,491	21.7%	165,892	22.9%	-9.6%
Transamerica Re	129,600	15.3%	146,324	20.2%	12.9%
Swiss Re	97,245	11.5%	102,241	14.1%	5.1%
Munich American Re	105,294	12.5%	81,231	11.2%	-22.9%
Generali USA Life Re	61,584	7.3%	63,149	8.7%	2.5%
Scottish Re (US)	130,974	15.5%	56,506	7.8%	-56.9%
Canada Life	44,824	5.3%	26,005	3.6%	-42.0%
General Re Life	21,559	2.6%	20,009	2.8%	-7.2%
SCOR Life Re	27,796	3.3%	15,554	2.1%	-44.0%
Revios Re	17,232	2.0%	15,150	2.1%	-12.1%
Hannover Re	8,319	1.0%	11,887	1.6%	42.9%
Wilton Re	6,116	0.7%	9,447	1.3%	54.5%
Optimum Re (US)	5,010	0.6%	5,521	0.8%	10.2%
Ace Tempest	4,200	0.5%	4,465	0.6%	6.3%
GE Ins. Solutions (ERC-US)	1,276	0.2%	677	0.1%	-46.9%
XL Re Life America	0	0.0%	202	0.0%	100.0%
TOTALS	844,520	100%	724,260	100%	-14.2%

their new business writings and took over the number two position with $146 billion. Swiss Re's $102 billion, a 5 percent increase from 2005, put them in the third position, while MARC's $81 billion allowed them to maintain the fourth position—despite this being a 23 percent decrease in production from 2005. Generali reached the top five for the first time by writing $63 billion—a modest 2.5 percent increase over 2005. Collectively, these five companies experienced a 3 percent decrease in recurring production—well below the total market's drop of 14 percent.

2) Group Two: The second group is made up of five companies who all experienced decreases in their recurring new business writings. Heading this group is Scottish Re, who reported a 57 percent decrease in production. Canada Life followed next with a 42 percent new business drop. General Re (7.2 percent decrease), SCOR (44 percent decrease), and Revios (12 percent decrease) round out the second group. Together, these five companies accounted for an 18.4 percent market share in 2006. However, these same five companies also recorded a collective 45 percent decrease in production. Interestingly, over 90 percent of the difference between 2005 and 2006 total new business production can be found in this group. One final observation that illustrates how concentrated the reinsurance market remains is that the top seven reinsurers (the five companies from group one and the top two from group two) represent almost 90 percent of the 2006 market share.

3) Group Three: The third group includes six reinsurers whose total 2006 market share was 4.4 percent. The good news for this group is that, collectively, they recorded a 29 percent increase in recurring new business.

In looking at these three groups it is easy to see that the middle group was hit hardest in 2006. The top five new business producers (Group One) reported only a small decrease while the lower six producers (Group Three) reported a sizable increase.

Canada Recurring Business: UP, UP, UP!

(Please note that in order to eliminate the impact that the exchange rate has on Canadian results, the Canadian survey results presented are now being reported in Canadian dollars. This differs from past surveys where the Canadian business was reported in U.S. dollars.)

In Canada, recurring new business increased by 9.6 percent. A total of C$141 billion was written in 2006 versus C$129 billion in 2005. Recent estimates of individual life sales in Canada had direct sales increasing 8 percent in 2006. Assuming these numbers hold, the percentage reinsured rate (cession rate) in Canada should have grown again in 2006, albeit just slightly. If you think the U.S. market is concentrated, take a look at its northern neighbor where just three companies accounted for over 95 percent of the Canadian market share in 2006. Munich Re Canada led the Canadian market with C$53 billion of recurring new business writings. Compared to 2005, this represented a 6.5 percent decrease. RGA Re (Canada) was the second leading recurring writer in Canada with C$43 billion—an almost 20 percent increase from 2005. Finally, Swiss Re's production jumped 24 percent in 2006. They wrote C$37.4 billion in recurring new business.

Totals for Canadian recurring ordinary reinsurance assumed in 2005 and 2006 are as shown in the table "Canada Ordinary Recurring Reinsurance" on page 6.

Portfolio and Retrocession Business

Thanks to Wilton Re, U.S. portfolio experienced a 68 percent increase in 2006. Wilton's acquisition of the Chase block and several blocks from New York companies led them to single-handedly capture the vast majority (80 percent) of the total portfolio new business in 2006. Outside of Wilton Re, the U.S.

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Life Reinsurance ... from page 5

Canada Ordinary Recurring Reinsurance ($CAN Millions)

Company	2005 Assumed Business	2005 Market Share	2006 Assumed Business	2006 Market Share	Increase in Production
Munich Re (Canada)	57,156	44.3%	53,448	37.8%	-6.5%
RGA Re (Canada)	36,547	28.3%	43,722	30.9%	19.6%
Swiss Re	30,441	23.6%	37,787	26.7%	24.1%
Optimum Re (Canada)	3,826	3.0%	3,970	2.8%	3.8%
SCOR Global Life	826	0.6%	2,195	1.6%	165.7%
Revios	223	0.2%	322	0.2%	44.4%
Canada Life	16	0.0%	1	0.0%	-93.8%
General Re Life	22	0.0%	0	0.0%	0.0%
TOTALS	**129,057**	**100.0%**	**141,445**	**100.0%**	**9.6%**

market saw minimal portfolio activity. With the decrease in U.S. recurring business, it was not surprising to see U.S. retrocession production also fall in 2006. But what is noteworthy is that the percentage drop for portfolio (19.8 percent) was higher than the recurring drop (14.2 percent).

In Canada, both portfolio and retrocession business fell considerably in 2006. Portfolio business fell 90.4 percent and retrocession business dropped 53.6 percent. The drop in retrocession business may seem in contrast to the increase in recurring, but much of the retrocession growth in recent years has been due to taking on in force blocks and not necessarily new business. The in force activity apparently cooled off in 2006. Similarly, the same could be said about in force business coming from Canadian direct writers as portfolio business was close to nil.

Comparison with Direct Market

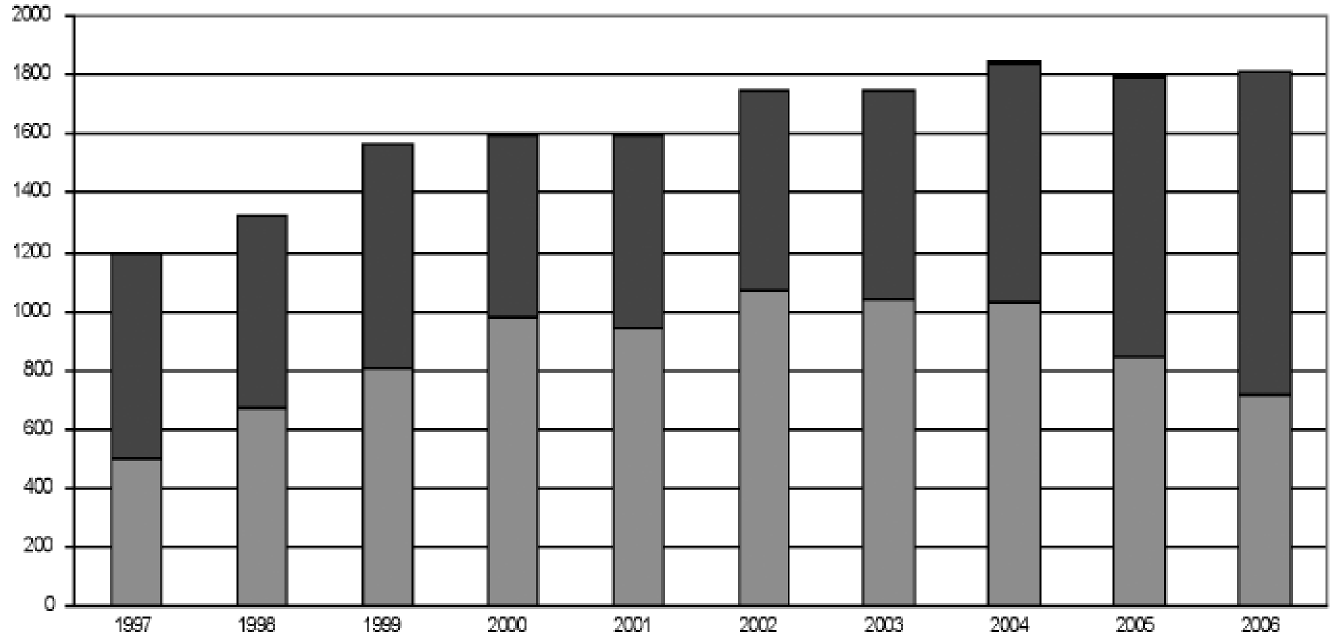
Based on preliminary estimates from the American Council of Life Insurers (ACLI), U.S. ordinary life insurance purchases increased 0.8 percent in 2006. Assuming this estimate holds true, this would mean that the percent reinsured rate in the United States is now at 40 percent—the lowest level in 10 years and further confirmation that direct writers are retaining more now than they have in the last decade. Looking ahead, LIMRA has forecasted modest increases in life sales (3-5 percent) over the next few years. While this is good news for direct writers and reinsurers alike, reinsurers will be challenged to find ways to persuade the direct writers to reinsure more of their business.

The graph on page 7, "U.S. Ordinary Individual Life Insurance Sales," compares ordinary life new business totals with the recurring life reinsurance totals for the United States.

Conclusion

The full impact of the reinsurance repricing efforts that began a couple of years ago, the general hardening of the reinsurance market and the direct writer's ability to find alternate XXX reserve financing solutions, were a triple whammy for the U.S. reinsurance industry in 2006. With decreases reported in five of the last six years, it would seem that the days of 50-60 percent cession rates are now just a distant memory. It may likely take either: (1) a return to competitive reinsurance pricing from the perspective of the direct writers—as seen in the 1990s, or (2) a major change in the insurance industry (i.e., Reg. 'XXX'), to return to the "glory days" experi-

U.S Ordinary Individual Life Insurance Sales



	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
% Reinsured	42.1%	51.3%	51.5%	61.8%	59.2%	61.5%	59.7%	56.2%	47.0%	40.0%
Amt Retained	696	645	763	609	653	675	705	809	952	1088
Amt Reinsured	507	679	811	985	947	1078	1043	1037	844	724

enced in the past. While the life reinsurance market has matured and may not experience the explosive growth it had in the past, there are a few positive factors for U.S. reinsurers. First, recent surveys indicate that insurer/reinsurer relationships are improving. Second, ordinary life sales are expected to increase over the next few years. Third, life reinsurance prices appear to have loosened up a bit lately. These factors should help stabilize the U.S. reinsurance market in 2007 and beyond. Meanwhile in Canada, all is well as the reinsurance market continues to enjoy increases in production and percent reinsured.

Finally, we would like to thank all of the participants for their continued support with the survey—without their help, there would be no survey!

Disclaimer:

Munich American Reassurance Company prepared the survey on behalf of the Society of Actuaries Reinsurance Section as a service to section members. The contributing companies provide the numbers in response to the survey. These numbers are not audited and Munich American, the Society of Actuaries and the Reinsurance Section take no responsibility for the accuracy of the figures. ✷

David M. Bruggeman, FSA, MAAA, is assistant vice president and actuary with Munich American Reassurance Co., Atlanta, Ga. He can be reached at dbruggeman@marclife.com.

THE FIVE MOST IMPORTANT FINDINGS FROM THE 2007 FLASPÖHLER SURVEY

by Rick Flaspöhler

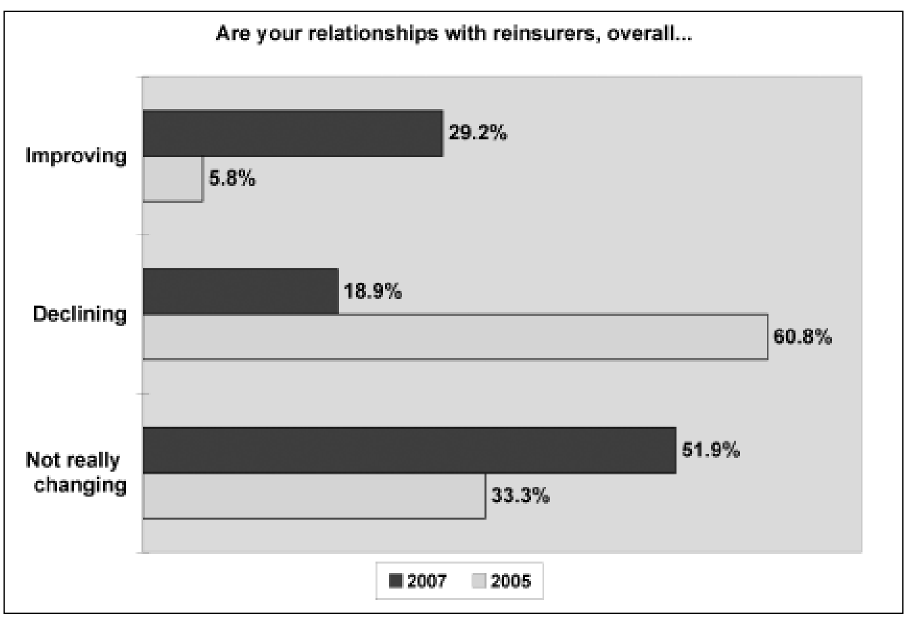
Editor's Note: The Flaspöhler Research Group has been conducting the biennial survey of life company attitudes about reinsurance and reinsurers since 1993. The results of these surveys are used by major life reinsurers to develop marketing and service strategies. The following article is based on input received from reinsurance buyers in these surveys—especially the 2007 survey completed in late 2006.

"Everything is lovely and the goose is hanging high."

When my five brothers and sisters and I were growing up, and heard my grandfather softly but repeatedly singing that line, we were certain of just two things: one, that everything was not lovely and two, (thankfully for the goose!) that there was not one anywhere in sight.

Immediately upon hearing this song, everyone stopped whatever they were doing and seriously examined whether any action on their part was the "inspiration" for my grandfather's sudden serenade.

Those of you who favor nurture in the "nature versus nurture" debate will not be surprised to hear that when I first saw the 2005 survey results showing a dramatic drop in scores for cedant satisfaction with reinsurers, I suddenly found myself humming my grandfather's warning song.



Something big was happening. Cedant satisfaction with reinsurers, which has been in a steady decline since 1995, suddenly and dramatically dropped from 46 percent in 2003 to just 15 percent in 2005. Here at Flaspöhler Research, we have been conducting surveys for 25 years and have never seen a drop in a satisfaction rating by 31 percentage points. Not even close.

The 2007 survey has now been published. Many things have changed in the past 24 months, but not all the changes are equal in importance. What follows are what we believe are the five most important results from the 2007 Flaspöhler Survey (Life/Direct Writer).

(Can't Get No) Satisfaction

The proportion of direct writers indicating that they are "Very Satisfied" with the reinsurers they use has leveled off at 17.4 percent. This figure is not statistically different from the 14.9 percent "Very Satisfied" that was reported in the 2005 survey.

The good news is that we can now say, with a high degree of statistical certainty, that the proportion of direct writers who are very satisfied with the reinsurers they use is no smaller than the proportion that was very satisfied in 2005.

Trust me; this is a very good result, especially from our viewpoint of the last 20 years, during which time we saw relationships between reinsurers and direct writers go from being the very best of any industry in which we have worked to become the very worst of any industry that we have worked with.

The bleeding appears to have stopped.

Hope Springs Eternal

Perhaps the most positive finding from the 2007 study is that the proportion of direct writers who believe that relationships with reinsurers are improving climbed from just 5.8 percent in 2005 to 29.2 percent in 2007—an increase of almost 23 percentage points.

Simultaneously, the proportion of direct writers who believe that relationships with reinsurers are declining dropped from 60.8 percent in 2005 to just 18.9 percent in the most recent study.

Those direct writers that indicated relationships are improving, attribute the improvement to "better communications" (36.8 percent), "better service, support and responsiveness" (27 percent), and "better mutual understanding of problems facing each other" (20.2 percent).

In spite of the dramatic improvement, there remains a significant and vocal proportion (18.9 percent) of direct companies who believe that relationships continue to decline. As one respondent noted:

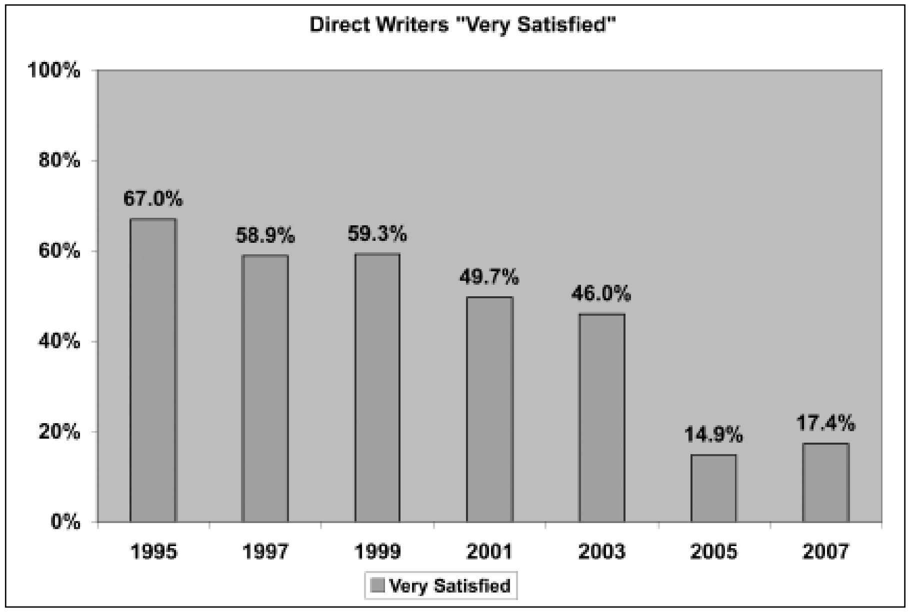
"Reinsurers are using claims' reviews as (an) excuse to get off the risk on automatic business. Reinsurers are unable to provide capacity and are blaming it on (the) retros—who don't care. (They are forcing) intrusive and time-consuming audits (and) changes in treaty language that favor the reinsurer at the ceding company's expense".

The Distance Between Knowledge and Understanding Can Be Infinite

Almost one-half (44.3 percent) of direct writers now believe that reinsurers truly understand the challenges faced by direct writers.

What is remarkable about this figure (and, consequently, causes this finding to be number three on our most important list,) is that we also asked reinsurers (in a separate but simultaneous survey) to tell us if they felt that they truly understood the issues facing reinsurers. Eighty-five percent of reinsurers responded that they do, today, truly understand the issues facing direct writers.

What is inescapable is that many more reinsurers believe that they understand the key challenges faced by direct writers than are recognized by direct writers as truly understanding those challenges.



Since we did not ask this question in the 2005 survey, it is impossible to know what degree of change this represents, but based on the leveling out of cedant satisfaction scores and the increase in the proportion of direct writers who believe that relationships are improving, we can surmise that this number is an improvement over what we might have measured 24 months earlier.

Here are the greatest challenges as identified by direct writers today:

Reinsurer consolidation	46.9%
Distribution	42.5%
Preferred criteria & UW exceptions	40.9%
Treaty terms and conditions	33.6%
Mortality cost	25%

New Capacity in the Market?

We do not know if there is a causal relationship present, but over the past 10 years we have certainly seen a correlation between the decrease in direct writer satisfaction with reinsurers at the same time that the number of reinsurers writing business in North America decreased.

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New interest in the life reinsurance market may be helping to change satisfactions levels. Today, over 50 percent of survey respondents indicate that they continue to strongly consider Swiss Re, RGA Re, Munich American Re, Generali USA Life Re, Transamerica Re and Gen Re for all or some of their life reinsurance needs.

Direct companies in the most recent survey indicated they have added new reinsurers to the list of those reinsurers that they strongly consider, including Optimum Re, Hannover Life Re and Wilton Re.

Add in other consistent players including Canada Life Re and SCOR Global Life and the result is that there are now more choices for direct writers than in 2005.

As further evidence of the capacity that is interested in the life reinsurance market, we can report that 11 different reinsurers were committed enough to the North American life reinsurance market that they subscribed to the Flaspöhler survey results for 2007.

Primary Product Pricing (Please, No Hate Mail!)

The final of the five most important results from the 2007 Flaspöhler Survey is not based on a single survey question. In fact, any good actuary might suggest that what follows is not a "finding" at all, but instead is unfounded conjecture based on little more than a strong feeling, a fine scotch and a good cigar.

And if you say that after examination of the following argument, then you are at least 66.66 percent accurate! The result that I am referring to is that more people seem willing to discuss the subject of primary product pricing (than ever before?).

Here's the thing. While at the AHOU meeting in Las Vegas, I attended a presentation by a well-known industry figure who, if I remember correctly, indicated that the average annual income of a life insurance agent is about $25,000.

Rick Flaspöhler is president of Flaspöhler Research Group located in Kansas City, MO. He can be reached at rflaspohler@frsurveys.com.

The results of the 2007 direct writer survey show that the most common responses to the question, "What do reinsurers not fully understand about the challenges you face today?" are:

1. Competition/Pricing (38.4 percent)
2. Sales & Growth (22.4 percent)
3. Staying Profitable (18.2 percent)
4. Distribution (16 percent)

Finally, when I receive the weekly, uninvited call from a life agent telling me he can save me money on a life policy, I am over the edge.

Life insurance is already one of the most underpriced products that exists.

If the price of the primary product were to be increased, wouldn't more quality agents earn a decent living? Wouldn't better sales people be attracted to the industry? Wouldn't direct writers be more profitable? Wouldn't reinsurers be easier to get along with? (OK, but three out of four is still pretty good!).

And, perhaps most importantly, if the price of the product were increased, wouldn't those agents incapable of doing justice to an exceptionally good product on the basis of something other than price move on to other professions, no longer holding direct writers hostage to the "lowest possible price" mentality that is so prevalent in the industry today?

Now that the dust is beginning to settle and reinsurers and direct writers are again working together, isn't it inescapable that something has to be done to begin to move away from the "lowest price" model?

Then again, maybe it's just the cigar talking. ✺

Dear Editor:

I just received the February issue of *Reinsurance News* and I have a quick comment on the lead article. While I know Stambler well and LeBlanc a little, and I know them to be quite good at what they do, I did not know they had purchased advertising space in the Reinsurance Section newsletter.

Stambler and LeBlanc tell only one side of the story (theirs) and mention only one monoline (theirs). They do not mention that the expenses increase because the issuer has to pay for two actuarial consultants, two sets of legal fees, and other expenses such as travel to visit the client. In addition, there is no mention that by not wrapping, the issuer can attract a different set of investors. Finally, when I assisted in the development of the first mortality bond, the issuing spread exactly equaled the cost of wrapping plus the 'AAA' spread at 135 bps.

In short, there is a real value to wrapping transactions and the best deals probably have some wrapped and some unwrapped paper—this article did not describe the benefits of not wrapping. Therefore it becomes more of an advertising piece than an unbiased educational article. We can do better.

Sincerely,

Ronnie Klein, FSA, MAAA
Vice President, Life Reinsurance
American International Group

Response from Dimitry Stambler

Dear Ronnie,

Thank you for your comments on the article. I agree with you, we should have been more careful and not mentioned the names of any monolines in the article.

As far as advantages versus disadvantages of a wrapped deal, that was intentional. We wanted to explain and give readers as much detail as possible about the process of wrapping a bond from a monoline perspective. The challenges faced by all parties involved were mentioned briefly in the article.

Of course, there are alternative methods of dealing with 'XXX' and 'AXXX' reserve redundancy, some of which were utilized in the past (e.g., coinsurance) and others being currently contemplated in the industry (e.g., long-term Letter of Credit; private funded solutions; etc.). Our article merely focused on securitization and specifically wrapped issues.

Dimitry Stambler is director, Structured Solutions Group with Citigroup Global Markets Inc. in New York. He can be reached at *dimitry.stambler@citigroup.com.*

Response from Richard Leblanc

The aim of the article was to provide insight into why the majority of issuers have found it advantageous to have their life insurance linked securities wrapped by a financial guarantor, and to demystify the underwriting approach followed by the financial guaranty industry. As the reader highlights, there certainly are alternative risk transfer and financing strategies available and, while not within the scope of the recent article, a comparative analysis could make for an interesting follow-up article.

It should be noted that the article talks in general terms about the role of financial guarantors in these transactions, and at no point attempts to "advertise" one particular provider over others. The section of the article entitled "*Choosing a Financial Guarantor*" clearly highlights the key competitive factors that are typically considered.

Richard Leblanc is first vice president with Ambac Assurance Corporation in New York, NY. He can be reached at *rleblanc@ambac.com.* ✺

PRESIDENTIAL ADDRESS

Bylaws Changes and Effective Governance

Fellow Members:
This August, in conjunction with the annual election of directors and officers, the SOA Board will seek approval of the voting Fellows for changes to the governing documents of the Society. Specifically this action will replace the dated SOA Constitution and bylaws with a new set of bylaws that align with current and best practices in not-for-profit association management and promote and institutionalize effective governance.

You can expect to see regular communications about these changes through the summer and will have an opportunity to vote on them using the electronic (or paper, if you have requested) procedure that is used to elect officers and directors. Voting will begin on Aug. 9 and end at 5:00 p.m., Central time, on Sept. 10.

The proposed bylaws are available for your review online at *www.soa.org/bylawsvote*, and your questions are welcomed at *soabylaws@soa.org*. We will reply to all questions, and common ones will be published, with answers, in future communications on this subject.

On behalf of your Board of Governors, I thank you in advance for taking the time to review the proposed changes and for voting on this important matter later this year.

Sincerely,

Edward L. Robbins, FSA, MAAA
President

WHAT IS YOUR VIEW?

by Graham Mackay

Think about it. Few people go through life without developing a view on an issue that they frequently come across.

Having a view, like any principle, will drive many of your actions related to that activity. I want to use this column to talk about some of the changes that are underway within our market and the role of the Reinsurance Section Council. I'll start by sharing some of my views. Later on, I will ask you to share yours.

The role of reinsurance is changing: We are going through another shift in the drivers behind the use of commercial reinsurance. The ERM discipline is giving companies the tools to better define their tolerance to all risks. Reinsurance remains an important tool available to a company to shift risks and manage capital. The use of reinsurance, however, may not always involve the commercial market; for example, insurers are becoming less dependent on reinsurers for capital and are going directly to the capital markets. There are few mysteries left.

Employment opportunities will continue to exist for those that have upgraded their skills: Think about it. The use of reinsurance is flourishing despite the consolidation in the reinsurance sector and despite the contraction in reinsurance cession rates. It is true that opportunities are contracting within the traditional reinsurance company community, but demand continues to grow with retail companies and their independent advisors. Jobs are plentiful if you have the right skills.

The Reinsurance Section Council can support the evolution of this discipline through research and education, delivered in a manner that enhances each member's personal value: Reinsurance is a blend of art and science that requires continuous learning from actuaries at all stages in their career. Don't stop. If you have thought of a new trick, so has someone else; be able to execute and be able to reinvent.

Well, that's it—some of my views on shifts within our industry and the role that the Reinsurance Section Council plays within it. Now I want to hear from you. There are many ways to do this: write a letter to the editor; write an article on an issue that you are close to; roll up your sleeves and get involved in shaping and executing your council's activities.

And vote. We have a Reinsurance Section Council election coming up and we are fortunate to have a very strong field of candidates, but offer only three open seats. Think about the future of our section and vote for the candidates that you believe will best serve you for the next three years. I am looking forward to hearing from you and to having your voices heard. ✺

Graham Mackay, FSA, FCIA, MAAA, is director with Navigant Consulting, Inc. in Chicago, Ill. He is also chairperson of the Reinsurance Section Council. He can be reached at gmackay@navigantconsulting.com.

REVIEW REINSURANCE SECTION PRIORITIES AND PROGRAMS

by Mark Troutman

"Seek first to understand, then to be understood."

This is the first principle of Steven Covey's *Seven Habits of Highly Effective People*. Everything begins with being a good listener. The Reinsurance Section Council took this to heart at the Society of Actuaries' Annual Meeting Reinsurance Section hot breakfast. Part of the session involved breaking into small groups to solicit input on how the Reinsurance Section can best meet the needs of its members. We've taken that feedback and reviewed our programs and priorities for 2007.

Graham Mackay, Reinsurance Section chairman, provided feedback to all those who provided input at the hot breakfast. The purpose of this article is to share that feedback with the entire Reinsurance Section.

First, let's step back and outline the main benefits of being a member of the Reinsurance Section. These benefits include:

- Promoting and influencing the reinsurance industry
- Networking with peers
- Speaking and publishing opportunities
- Access to new marketplace information
- Basic and continuing education materials and seminars
- Research
- Institutional archive

All that for $20? Not bad!

OUR GOAL IS TO CREATE A LARGER REINSURANCE SECTION WITH MORE DIVERSITY. THIS WILL BENEFIT ALL MEMBERS OF THE SECTION.

Although Reinsurance Section members are generally satisfied with the benefits that they are receiving in these areas, there is always room for improvement.

The Reinsurance Section Council is divided into a variety of committees. The following summarizes your feedback and our plan of action by the committee structure responsible for delivering content.

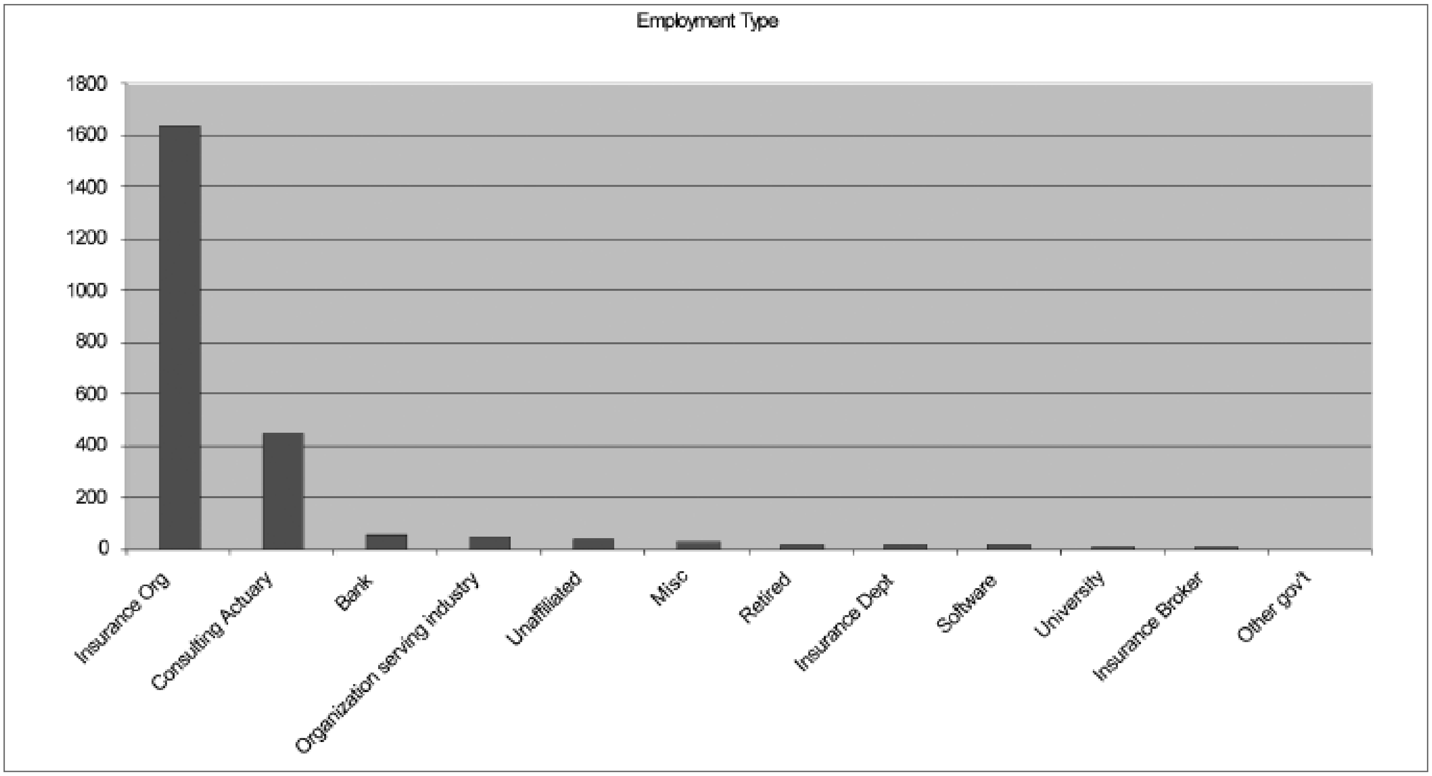
Research Committee—The number one request was for additional information for reinsurance treaty language issues. This could involve a specimen treaty template or simply a discussion of the pros and cons of various provisions from the viewpoint of the cedant and reinsurer.

Another area of high interest was a request for more data on what ceding companies are doing currently, such as: ceding more or less business; how they are dealing with concentration of risk; the type of coinsurance that they are using (YRT/coinsurance); and the results of their pricing assumptions. There is also a strong interest in capital management techniques.

Lastly, members are always interested in various research projects dealing with topics such as preferred and substandard mortality, older ages, high face amounts, securitization, lapses, Regulation XXX, principles-based reserving, and accounting and regulatory issues.

Marketing and Membership Value Committee—Though the chart on page 15 outlines the breakdown of the Reinsurance Section members by employment type, it doesn't really provide much insight into the split called "Insurance Organization." Most Reinsurance Section members are actuaries working for reinsurance companies. The chart chronicles the segmentation of the Reinsurance Section membership by the employment type they identified in the Society of Actuaries database.

Members providing feedback indicated a strong desire for more interaction with other professionals. These include a wide variety of product fea-



ture focuses (e.g., life, annuity, health, property casualty); industries, (e.g., insurance companies, reinsurers, investment banks and rating agencies); and professions (e.g., actuaries, underwriters, lawyers, accountants, risk managers and administrators).

Our goal is to create a larger Reinsurance Section with more diversity. This will benefit all members of the section. There is strength in numbers and diversity. Please forward this document to others who might increase the membership and diversity of the Reinsurance Section. New member contact information is at the end of this article.

Communications and Publications Committee— People are satisfied with our hard copy Reinsurance Section newsletter and electronic version, *Re-News*. They like the content and frequency. They would always like more information on regulatory and accounting developments. Some even want *Re-News* more frequently.

Basic and Continuing Education Committee— Members are satisfied with the reinsurance content at the various Society of Actuaries meetings throughout the year. They are interested in understanding the syllabus material dealing with reinsurance and other materials educating other non-reinsurance professionals, such as rating agencies. The committee helps educate regulators and other non-actuaries regarding reinsurance practices, and plans to review the syllabus for appropriateness, and report back to members on what is there so they can use it as a resource material. Once again, an emphasis on reinsurance treaty language issues was highlighted.

The Reinsurance Section Council is responding to these member requests in the following ways:

1. Major new reinsurance conference—The inaugural ReFocus 2007 reinsurance conference was designed to provide a major focus on the reinsurance industry for all professions and disciplines to increase networking, and to provide basic and continuing education. For more information, please see the other articles in this newsletter for a summary of the ReFocus conference.

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ReView Reinsurance Section ... from page 15

2. The council has started a project to look at life reinsurance treaty wording. The initial aim is to start with an older ACLI document and update and strengthen it for new practices and ideas. The objective is to provide a discussion tool, not an industry standard prototype. The A&H treaty project is completed. Some of that work is included in this newsletter and the rest will be included in the following newsletter.

3. The Basic and Continuing Education Committee, in addition to sponsoring the ReFocus conference, provides a consistent schedule for webcasts and also supports reinsurance content at other non-SOA meetings, such as those presented by the ACLI, AHOU and LIMRA.

4. The Communications and Publications Committee will continue to publish the print version of the Reinsurance Section newsletter, at least twice annually, with a third issue in 2007, and the electronic *Re-News* for more time-sensitive topics.

5. The Basic and Continuing Education Committee also provides reinsurance boot camps for newcomers to the reinsurance industry and those who interact with the reinsurance industry, such as regulators and rating agencies. Contact the Basic and Continuing Education Committee for more information on these programs.

As you know, we are a volunteer group and your contributions of time and talent make a huge difference to our ability to deliver this content to the Reinsurance Section members. Over the last few months, the Reinsurance Section Council has reviewed its goals and priorities based on prior surveys and feedback at the Annual Meeting. If you'd like to work on a particular initiative, please feel free to contact me or any member of the Reinsurance Section Council. We would love to have you on our team. Our most recent call for volunteers produced several new volunteers. We are going to put them to work serving the members of the Reinsurance Section.

In summary, the Reinsurance Section Council aims to meet the challenges of a constantly changing environment head-on through activities centered on basic and continuing education, communications and publications and research to maximize the value to the membership. ✷

To become a new Reinsurance Section member, please go to the following link: *http://www.soa.org/professional-interests/files/pdf/SOAMembershipForm.pdf* or contactact anyone on the Reinsurance Section Council.

Mark Troutman, FSA, MAAA, is team leader, marketing and membership value team and president, Summit Reinsurance Services, Inc. He can be reached at MTroutman@Summit-Re.com.

RE-FOCUS 2007 RECAP:
NEW INDUSTRY EVENT ATTRACTS SENIOR REINSURANCE LEADERS

by Mel Young and Craig Baldwin

Editor's note: This article originally appeared in the National Underwriter and is reprinted with their kind permission.

Four of the U.S. life industry's leading life reinsurers recently spoke at one of the life reinsurance industry's newest events, ReFocus 2007. Presenting at the conference were: Paul Rutledge, president and CEO of Transamerica Reinsurance; W. Weldon Wilson, CEO, Swiss Re Life & Health America, Inc.; Greig Woodring, president and CEO, RGA Reinsurance Co.; and David Holland, president and CEO, Munich American Reassurance Co. Their topics addressed risk management, capital markets convergence, principles-based reserving and the challenges to growing a reinsurer in today's global markets.

In addition, on the second day of the conference another general session featured insightful presentations on securitizations by: John Johns, chairman and CEO, Protective Life; international expansion issues by Fred Sievert; president, New York Life; the opportunities for growth via domestic market by Edward Zore, president and CEO, Northwestern Mutual; the opportunities of growth through mergers and acquisitions by Dennis Glass, COO, Lincoln Financial Group; and finally the challenges for small carriers in today's market by Gary Eisenbarth, president and CEO, Mutual Trust.

The conference included five general sessions and 13 breakout sessions on topics including financial reinsurance, long-term care, middle market opportunities, international business and principles-based reserves.

ReFocus2007
SEE THE FUTURE FIRST

During the opening reception of the conference, ACLI President Frank Keating introduced the first "Legends of the Industry" inductees. Inductees included Stan Tulin, retired vice chairman of AXA Financial; Ozzie Scofield, retired chairman and CEO of Scottish Re; Peter Mullin, chairman of Mullin TBG; Art Ryan, chairman and CEO, Prudential; and Ron Dolan, former chairman of First Colony.

Co-sponsored by the Society of Actuaries and the American Council of Life Insurers, the inaugural event was held March 4-7 in Las Vegas. Craig Baldwin and Mel Young co-chaired the event.

"Our attendance of 270 was better than expected. We received compliments on the presentation's topics and quality. And we raised $30,000 for the Actuarial Foundation, so I call our first event an all-around success," Baldwin said. "Reinsurance requires a big picture perspective to serve its market. ReFocus provides a forum for senior life reinsurance and insurance leaders to discuss emerging U.S. and global issues confronting the industry."

The planning committee for the conference has already begun looking toward next year and beyond, Baldwin said. "In the long term, we see this as an international forum and plan to invite our colleagues from South America, Asia, Europe and other international markets to join us both as attendees and presenters." ✺

Mel Young is executive vice president and vice chairman for RGA Reinsurance Company located in Norwalk, Conn. He can be reached at myoung@rgare.com.

Craig Baldwin is vice president with Transamerica Reinsurance in Charlotte, NC. He can be reached at craig.baldwin@transamerica.com.

RE-FOCUS SESSION SUMMARIES

Global Demographics and its Impact on Product Placement—India, China and the U.K.

Moderator:
Ronnie Klein,
vice president, life reinsurance, AIG

Speakers:
William Hogan,
vice president and actuary, MetLife
Ed Martin,
vice president, Swiss Re Life & Health America
Mike Molesworth,
managing director, Gen Re Life Australia

Ronnie Klein began the session with some interesting facts about India, China and the United Kingdom versus the United States. China and India have huge populations, low median ages, low Gross National Products (GNP) but large growth in real GNP, compared to the United States. The United Kingdom is a more mature market with the highest life expectancy, but lowest GNP real growth rate.

Mike Molesworth then discussed the market premium growth for India, China and the United Kingdom, concluding that China is the key to world growth in insurance sales for the near future. In addition, Mike showed demographic trends in these countries along with the major writers of insurance—both foreign and domestic. Finally, Mike described the differing distribution channels and the keys to success in these countries.

Bill Hogan explained the product life cycle and how products are developed to specifically meet these needs in each country. Building on the demographics already discussed, Bill showed how the ageing population of the United Kingdom and the one-child policy in China causes companies to develop differing products by country. Finally, Bill described pricing and expected returns for these products by country.

Ed Martin discussed the need for reinsurance in the emerging markets of India and China as well as for the mature market of the United Kingdom. The United Kingdom recently changed regulations giving reinsurers an advantage with respect to capital required. The days of direct companies reinsuring a large percentage of their business to leverage the lower capital requirements are now over, causing reinsurers to rethink their business model. Reinsurer services are in great demand in China and India for underwriting support and product expertise as well as risk mitigation.

A lively discussion pursued after the formal presentations, where the presenters were challenged on other countries besides those covered by the session descriptions. Since each presenter had actual foreign experience, all questions were expertly addressed.

Principles-Based Reserving (PBR) and its Potential Impact on Direct Writers and Reinsurers

Moderator:
James D. Atkins,
chief actuary–life insurance, Genworth Financial

Speakers:
Tim Tongson,
senior v.p. and chief actuary, Swiss Re Life & Health America
James D. Atkins,
chief actuary–life insurance, Genworth Financial
Elinor Friedman,
principal, Tillinghast Towers Perrin

This session related how the impact of the current proposed PBR standards will affect the business relationships between direct writers, reinsurers and third party consultants (advising organizations and regulators about PBR). Panelists represented the perspectives of a direct writer, a reinsurer and a third party advisor. The interactive discussion covered the following PBR issues:

- **Market Impact**—will PBR increase or decrease the demand for reinsurance? Some reinsurance today is driven by the need for XXX relief. This demand would likely decrease. As with the

Illustration Regulation, reinsurance prices could be a substitute for a ceding company's assumptions at least on the portion reinsured. Big companies could easily use their own experience. whereas small companies might lack credible experience. In order to maintain competitiveness, small companies might be forced to increase their use of reinsurance. Reinsurers may shift marketing efforts to smaller/medium size companies. To control mortality and expenses, reinsurers could impose tighter underwriting and process standards on these companies. As a result, small/medium companies may become even more homogenous and "average."

- **New Product Services**—PBR will allow reinsurers to reinvent themselves in alignment with new opportunities. Reinsurers will aggregate blocks of business and use innovative tax/capital market structures to bring improved efficiencies to their financial statements. Reinsurers will use financial retrocession to improve overall economics, transferring portions of pooled risks and related reserves to select companies having excess capital. Relative to the past, data requirements will increase, whether for reinsurance or for capital market securitizations. Reinsurers will charge for administrative services and successfully compete with consultants.

- **Cost of Compliance**—PBR impact on companies' actuarial departments will be profound. Actuarial departments will need to be reorganized. Many companies do not have enough modeling expertise in their valuation areas to support the new PBR framework. This may be even truer for reinsurers. Reinsurance companies will need more in-depth product knowledge. There will be an increase in software and hardware requirements and greater strain on resources to perform year-end work.

- **Financial Reporting Issues**—PBR will impact reserve credit, experience data and interaction with regulators. Will the ceding company be able to take reserve credit if the reinsurer's reserve calculation is dissimilar to the ceding company's reserve calculation? Under the current proposal, the reinsurance reserve credit is defined as the "notional gross reserve" for the ceding company less the reported reserve. The reserve would be calculated based on the ceding company's assumptions/experience. The reserve for the reinsurance assumed would be based on the reinsurer's assumptions/experience or at least adjusted for the reinsurer's experience. These results may well differ and could be a problem in states requiring mirror reserving. Reinsurers will need more data to do their valuations. While they are at it, they might as well get an automatic feed of all the underwriting data on a seriatim basis. Very quickly they will amass enough experience to revamp the way underwriting is done. PBR will allow regulators to gain a better understanding of what companies are doing. This will be driven by higher costs and use of company's resources.

- **Other Issues/Potential Impacts**—Reinsurer credit-worthiness will be less uniform and more important. Reinsurers with more aggressive mortality assumptions will calculate lower reserves and enjoy a pricing advantage over more conservative companies. Higher reinsurer ratings might actually justify higher reinsurance pricing. But hasn't this always been the case—both for direct writers and reinsurers? Will PBR amplify the advantage or will the peer review requirements tend to reduce this effect? The impact of the proposed PBR structure on tax reserve calculations is unclear. Will the structure introduce new tax advantages/disadvantages? Better communications within the pricing and valuation area of direct writers and reinsurers will be required. Most companies price on a statutory basis. Under the proposed PBR framework, early agreement on valuation assumptions and margins will be required to ensure new products being developed meet company profitability targets.

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Convergence of Capital Markets and Reinsurance

Moderator:
Graham Mackay,
director, Navigant Consulting

Speakers:
Chris Stroup,
chairman and chief executive officer, Wilton Re
Chris Brockwell,
senior vice president, Swiss Re Capital Markets

Of interest is the displacement of conventional reinsurance solutions in the term life insurance market by capital market solutions delivered directly to retail companies. This trend is examined from an investment banker's and a reinsurer's perspective. The presenters' slides and supplemental information serve as valuable reference materials for insurance professionals interested in this topic.

Reinsurer's perspective: Insurance companies must understand their capital structure and develop a strategy that allows them to most efficiently manage their business. Reinsurance should be considered as a valuable tool to the insurers as it serves to transfer reserve and capital strain to the reinsurer, eliminating the need for the insurer to consider alternate financing structures offered by the capital markets. There is, however, a full recognition that the reinsurance buying practices are shifting with insurers preparing to deal more directly with the capital markets for the financing of reserves redundancies. The reinsurance marketplace will trend toward aggregation of smaller blocks and mortality-basis risk.

Investment Banker's perspective: Alternate capital sources will continue to be driven through financing structures. A XXX financing structure was presented as background with comments provided on AXXX and Embedded Value securitizations. Additional insights were shared on the impact of financial guarantors, extreme mortality and the considerations of rating agencies. In the future, the market will become more comfortable with life securitizations, economic terms and execution constraints will ease, and insurers will receive credit in their capital models for solutions that reduce risks to extreme mortality events.

Challenges of Asset-Intensive Reinsurance

Moderator:
Larry Carson,
vice president and actuary, RGA Re

Speakers:
Don Lyons,
second vice president, Sammons Financial Group
Steve Zonca,
senior vice president and chief actuary, RGA Re
Harrison G. Starrett,
General RE-New England Asset Management

Don Lyons, Harry Starrett, and Steve Zonca and Larry Carson spoke about the nuts and bolts of asset-intensive reinsurance. After comparing and contrasting this type of reinsurance with more "traditional" reinsurance, the panelists walked through all the steps involved in an asset-intensive reinsurance transaction, from marketing and initial steps to negotiations and ongoing management.

Financial Reinsurance in the Post-Spitzer World

Moderator:
David Addison,
vice president and marketing actuary, RGA Re

Speakers:
Jeff Burt,
vice president marketing, Hannover Life Re
Mary Ellen Luning,
consulting actuary, Ernst & Young
Jeff Poulin,
executive vice president, London Life Re
Bill Pargeans,
assistant vice president, A.M. Best

Jeff Poulin, Jeff Burt, Mary Ellen Lunning, and Bill Pargeans, spoke at a panel discussion on "Financial Reinsurance in the Post-Spitzer World", moderated by David Addison. After brief (some more so than others) presentations by the panelists, David led a spirited discussion touching on accounting treatment of transactions, the role of investment banks, the reaction of ratings agencies and other related topics. There were a number of vocal opinions heard from the floor—thanks to Jimmy Atkins, Alex Cowley, Dianne Wallace and others, and the discussion could easily have continued for much longer. Based on the very positive feedback, many of the participants will be taking part in a similar forum, intended to take the discussions further, at the Annual Meeting.

The Impact of Emerging Medical Advancements on the Future of the Life, Health and Annuity Insurance/Reinsurance Industry

Moderator:
Mark Troutman,
president, Summit-Re

Panelist:
Dr. Phil Smalley,
vice president and medical director,
RGA Re International
Dieter Gaubatz,
vice president, Swiss Re
Ross Morton,
RGA Re

The presentation on emerging medical trends was built on the perception of three experienced insurance executives from three diverse backgrounds—actuarial, medical and reinsurance risk management. They explored the various and complex world of medical leaps in diagnosis and treatment, the realities of statistical trends in longevity and mortality complimented by the nuances of pricing assumptions, and the actual implementation of change in the risk selector's role where expense management and staff shortages override assumptions. The session was very much a three-dimensional real look at what is happening in medicine and risk selection by the disciplines most involved.

The Reinsurer Role in Long-Term Care Insurance

Moderator:
Jim Glickman,
president and CEO, LifeCare Assurance

Speakers:
Dan Cathcart,
senior consultant, Towers Perrin
Tim Hale,
assistant vice president, Munich American Re
Barry Eagle,
vice president, Marketing, GenRe LifeHealth

Dan Cathcart, Barry Eagle, Tim Hale and Jim Glickman provided the audience with a wide ranging overview of the long term care insurance marketplace and the reinsurer's role in that marketplace. Dan started with a presentation on the actuarial aspects of long term care insurance together with some cautions on the highly volatile results that can come from some rather small changes between actual and assumed assumptions. He also provided a bit of product history and discussed the opportunities versus the risks.

Barry Eagle then followed that discussion with an overview of the risks and mistakes that have been made during the early years of this line of business, by both reinsurers and direct writers from marketing, underwriting and claims perspectives. He also discussed some of the legal problems that have occurred and focused the audience on key issues to include in any agreement.

Tim Hale then discussed the challenge for both the direct writers and the reinsurers of trying to create a successful program. He also focused on the recent changes that have made the outlook for long-term care insurance programs look much brighter,

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especially the general knowledge in the industry that has created a much higher price level, changes in the risk-based capital formula that have greatly reduced some of the capital requirements and, perhaps most importantly, the recent federal legislation that likely will make long-term care insurance more attractive to the consumer. Finally, he compared various reinsurance approaches to the market and discussed the relative advantages and disadvantages of them.

Jim Glickman completed this session with a case study of one reinsurer's approach to this market and what they did to create a successful program. He described the factors that led to the particular approach used, why it was expected to succeed and how it differed from the traditional approach that was generally less successful.

At the end of the presentation, a lively question and answer period ensued.

U.S. Medical Market Update

Moderator:
Mark Troutman,
president, Summit Re

Speakers:
Dan Wolak,
senior vice president, GenRe LifeHealth
Dr. Richard Migliori,
executive vice president, United Health Corporation
Dan Lebish,
president and chief executive officer, HM Life Insurance Company
Robert Trainer,
president, Munich Re America HealthCare
Jeff Argotsinger,
medical expense group leader, Swiss Re

A distinguished group of panelists from five different carriers provided their perspectives on the status of the U.S. medical market.

Dr. Richard Migliori—Dr. Migliori is executive vice president for business initiatives and clinical affairs for United Health Corporation. He indicated that centers of excellence, episodes of care and employee empowerment are the keys to fixing the broken health care system. He placed the blame for many of the health care costs as a variance in clinical judgment and disparity in surgical activity. Centers of excellence minimize these discrepancies from appropriate standards of care.

Core requirements for competitive health care models include:

- An ability to stratify clinical performance on the basis of quality.
- An ability to establish a competitive "global" price for the entire episode of care.
- An ability to demonstrate comparative price and quality data to the patient in need.
- For the patient—access to America's best clinicians.
- For the physician and hospital—promotion on a national scale.
- For the payor—protection against unmitigated trend.

Dan Lebish—Dan chronicled the "have and have not" aspect of our system where the employees who have health care basically have little accountability for their expenditures and those who have little or no health care have no ability to pay for these expensive services.

Insurance and reinsurance carriers can improve the health care system and capitalize on opportunities by providing the following:

- Products that provide health risk solutions for employers, employees, carriers and providers.
- Self-funding and/or supplemental health products can be packaged together to provide consultative solutions and limit employer exposure.
- New and creative approaches to alternative funding and risk sharing that align risk incentives among all parties.

Jeff Argotsinger—Jeff chronicled the elements of a good strategy for addressing the catastrophic medical market or any business plan. A good strategy is clearly understood by everyone at every level in the organization. A good strategy addresses:

- industry structure.
- desired customer value proposition.
- competitive landscape.
- business capabilities.

Bob Trainer—Bob shared a few slides on health care costs that demonstrated that catastrophic claim frequency and severity are increasing. He chronicled the rise in claims above $1 million, organ transplant frequency, prescription office visit frequency and frequency of multiple births and premature births, all of which are leading to increased insurance and reinsurance costs.

Dan Wolak—Dan focused on the future of health reinsurance by referencing material in two books: *Reinsuring Health* by Katherine Swartz and *Redefining Healthcare* by Michael Porter and Elizabeth Olmsted Teisberg. The Porter and Teisberg book suggested that health care could be fixed by following principles that include:

1. Focusing on value, not just cost.
2. Result-based competition.
3. Competition in medical delivery based on the full cycle of care rather than discrete services.
4. High quality care should be less costly (centers of excellence again).
5. Widely distributing data on results and (transparent) pricing.

Porter and Teisberg did not suggest that any of the current players would be eliminated from the market, but their principles would be of greater benefit to some, but not others.

In looking at the future of health care reinsurance, Mr. Wolak concluded that fundamental shifts in the marketplace have occurred in each of the past three decades. The current fundamental shift is the consolidation of health insurers into national players. As we move into the next decade, the use of information by health care plans and users will lead to another fundamental shift. The fundamental shift that we may be beginning now is a move to transparent pricing, which is the key for the smaller and regional health insurance players to remain viable. With such a movement to a transparent pricing system, the difference in prices charged between health plans may narrow significantly or be eliminated.

The Paradigm Shift in Health Plan Direction

	Old Paradigm	New Paradigm
Choice	Restrict patient choice through in-network features	Promote choice by providing patient and provider information to improve health
Provider management	Micromanage provider process	Reward providers based on results
Cost	Minimize cost per treatment through nework fees and out-of-network limits	Maximize the value of care across the care continuum
Administration	Complex paperwork and administrative requirements	Minimize paperwork and administration
Competition among health plans	Compete on costs and network fee structures	Compete on member health results

Source: Redefining Healthcare *by Porter & Teisberg*

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Enterprise Risk Management and the Role of Reinsurance

Facilitator:
Steve Minsky,
chief executive officer, LogicManager

Moderator:
Michael Shumrak,
senior vice president, Scor Global Life Re U.S.

Speakers:
Michael L. Greer,
senior vice president & chief pricing officer, Wilton Re
Enna Pietrantoni,
manager risk management & audit, Hannover Re

Steve Minsky kicked off this session by presenting a very interesting introduction of the RIMS Risk Maturity Model (RMM). This is a framework Steve has developed in cooperation with RIMS to help financial services companies map and prioritize their current enterprise risk situation. Steve illustrated how RMM works by providing a number of summarized real life case studies.

Moving from the general ERM framework to an actual life reinsurance case study, Enna Pietrantoni took us through an ERM process she led at Hannover. Enna emphasized how buy-in and continued support from senior management was key in providing the drive, direction and prioritization for their ERM to be successful.

Mike Greer wrapped the session up with an excellent presentation focused on his view of an enterprise-wide financial risk management framework one could use to decompose risks within and across product silos.

Michael Shumrak, senior vice president, SCOR Global Life Re US, moderated the panel.

Disability Reinsurance Marketplace—Capacity vs. Demand

Moderator:
Tom Penn-David,
vice president, Munich American Re

Speakers:
Tom Penn-David,
vice president, Munich American Re
Bob Greving,
executive vice president, chief financial officer & chief actuary, UnumProvident
David Mitchell,
vice president business development, DRMS
Andronico Castillo,
vice president & actuary, Munich American Re

The disability session was well attended and focused on the very specific needs for reinsurance of group and individual disability products. Bob Greving presented the view from a large direct carrier whose company faces a range of market challenges and who is looking for very substantial and specialized reinsurance support to meet his needs. Greg Dulac discussed the turnkey LTD market and how the landscape has changed from the MGU pools of the '90s to the current, very focused providers of services for smaller disability players. Andy Castillo discussed the very challenging individual disability market, the list of those no longer in the disability direct or reinsurance market and the changes that the market has made in response. All three presentations made the point that capacity is available in one form or another, but that expertise is critical to longevity.

Regulatory Environment World Changes

Moderator:
Monica Hainer,
president and chief executive officer, London Life Re

Speakers:
Robert Stein,
chairman global financial services, Ernst and Young
Stan Tulin,
vice chairman & chief financial officer, AXA Financial
Dan McCarthy,
consulting actuary, Milliman Inc.

"The Future as We See It" was a presentation by three of our industry leaders. Bob Stein provided a vision of the market in which we work—dominated by consolidation, an explosion of overseas back offices with sales and strategy remaining in the United States. There continued growth of secondary markets, is with banks pushing into the high net worth market, while on the regulatory front we can hope to see convergence of the U.S. regulators with the rest of the world and the adoption of OFC.

Dan McCarthy made his comments on a much more personal level. He presented statistical data to show that in the mid-90s the average wage earner spent 3 percent of his (and yes it was generally his!) income on insurance. Today this has dropped to 1.5 percent. From the agent's perspective, the income generated by these sales is insufficient to make a living. So where does that leave the industry?

Stan Tulin, who proclaimed himself the least optimistic of the group, talked about dramatically increasing sales above age 70, increasing replacement activity and the wonderful world of STOLI/BOLI. Put it all together and real sales are down in a marketplace where the under-50s have real need. This leads to the question of the social value of our products and a poses challenge to all to develop creative solutions to the issues we face. ✷

LIFE SETTLEMENTS: WHO BENEFITS?

by Bradley M. Smith

Editor's Note: This article is based on comments made by Brad Smith as part of a luncheon debate at ReFocus 2007 on the merits of policies sold in anticipation of being "life settled" a couple of years after issue. A number of those in attendance suggested that Mr. Smith put his thoughts in writing and this article is the result.

A life settlement is a transaction involving a number of parties. Specifically, it involves the owner of a life insurance policy selling his or her ownership rights, including the right to name the beneficiary of the policy, to a third party investor. The investor typically has no insurable interest in the individual whose life is insured by the policy. That is, there is no economic or emotional benefit in the continued life of the insured by the acquiring owner.

Some life settlements involve the sale of policies purchased many years ago that are no longer needed by the original owner. Such a sale may enable the owner to extract value in excess of what he or she would receive if the policy were surrendered for its cash value. Such transactions are not particularly controversial.

However, some potential insureds are currently applying for life policies in anticipation of selling those policies to a third party investor shortly after the incontestable period of the policy has expired (typically two years). Such transactions have created significant controversy and are the subject of this article.

Rendering a judgment of any transaction is a matter of perspective. So let's examine the participants in such a transaction and determine their view, both from a short-term and long-term perspective.

Originators

Typically, the originator of a life settlement pool puts together a number of policies that are offered to investors for purchase. For their efforts, they receive an origination fee. They are paid up-front, regardless of whether a particular investment works out. Thus, the existence of the life settlement market is positive from the originator's standpoint, at least in the short run. As will be explained later, their long-term view may be altered if they face legal action brought by investors who are unhappy with the returns that are actually realized.

Life Insurance Agents/Brokers

Life settlements provide an easy source of potential sales for a life insurance agent/broker. In the short-term, many agents view the existence of this market as a positive development. In the long run, the existence of these "easy" sales may actually erode an agent/broker's ability to sell life insurance to those who truly need it. In my view, any additional legislation that is enacted as a reaction to the life settlement market might diminish the value of insurance to the general public and, thus, would hurt those who sell life insurance as a profession.

Policyholders

In the short run, policyholders who purchase insurance on their own lives and subsequently sell the policies in a life settlement transaction are rewarded financially. In all likelihood, they view the existence of this market positively. Nonetheless, how might they feel a few years removed from the purchase and subsequent sale of such a policy knowing that a stranger or group of strangers would benefit financially from their death? How will they feel knowing these investors are being hurt financially due to their continued life? For most people, that is not a very comfortable position to be in.

Likewise, future generations of life insurance buyers could be hurt by actions taken by life insurance companies or by the enactment of legislation that limits the value of a life insurance policy to the consumer. Companies may tighten their underwriting procedures or raise the premiums charged for their policies due to the existence of the life settlement market. More onerous ownership provisions limiting the transfer of a policy from one owner to another could be incorporated into the provisions of a life insurance policy. Companies may become more aggressive in their examination of claims for fraud in the policy application process, even after the incontestable period. If life insurance policies become tradable securities in the open market, Congress may decide to reconsider or eliminate the tax-free buildup of the cash value within a life insurance policy. Any or all of these eventualities would make a life insurance policy less attractive to the future generation of life insurance applicants.

Life Insurance Companies

In the short run, the generation of additional sales that are presumably profitable would be viewed positively by life insurance companies. However, policies sold for redemption in the life settlement market may result in higher than expected claims or artificially low ultimate lapse rates. That, in turn, may result in significant losses for the issuing life insurance company. Similarly, any changes enacted by Congress limiting the tax-free buildup of the cash value within a life insurance policy would severely damage the value offered by a product.

Investors

Involved as I have been in the pricing of life insurance policies for nearly 30 years, it is difficult for me to believe that investors in policies that are designed to be "life settled" a couple of years after issuance will be happy with their returns. It is quite possible, if not probable, that many investors will experience negative returns. Let me explain.

IF LIFE INSURANCE POLICIES BECOME TRADABLE SECURITIES IN THE OPEN MARKET, CONGRESS MAY DECIDE TO RECONSIDER OR ELIMINATE THE TAX-FREE BUILDUP OF THE CASH VALUE WITHIN A LIFE INSURANCE POLICY.

A typical life insurance policy is priced to have somewhere between a 50 to 60 percent loss ratio. That is, on a present value basis, policyholder benefits will consume 50 to 60 percent of the premiums paid over the life of the policy. Two years after issue of the policy this may increase, but not significantly. Since life settlement investors pay the premiums due after they purchase the policies, policyholder lapse becomes nonexistent.

This may cause the loss ratio of the policy to increase as much as 20 percent, depending upon the lapse assumption utilized in the original pricing of the product. Thus, the loss ratio may increase to 70 to 80 percent. While this may cause the policy to become unprofitable for the life insurance company, it is not enough to make the investor's return positive. The investment only becomes positive once the death claims paid exceed the premiums paid. Thus the loss ratio must approach 140 to 160 percent if there is to be a positive return produced for the investor, taking into account the origination expense of putting the block of policies together including paying the original policyholder something for applying for the insurance.

Clearly, no life insurance company would willingly sell a policy with a 140 to 160 percent anticipated loss ratio. Such a block of business would create significant losses for any company that did so. Thus, the underlying premise of life settlement blocks that consist of policies sold a couple of years earlier in anticipation of being life-settled, must be that life

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insurance companies routinely make significant errors in their pricing or underwriting processes. In order to be profitable to an investor, such errors would have to be of a magnitude to increase expected losses paid on such policies by approximately 100 percent. I do not believe that such errors exist with much frequency. If they did, companies would eventually recognize this and alter either their underwriting or pricing processes accordingly.

CONSEQUENTLY, I BELIEVE THAT THIS MARKET WILL BECOME LESS AND LESS ATTRACTIVE, AS INVESTORS BECOME DISAPPOINTED WITH THEIR RETURNS.

Another problem concerns the volatility of such blocks of business. The number of policies in some life settlement blocks is typically not large enough to avoid random statistical fluctuations that can cause the returns on these investments to be quite uneven. A small block of policies that includes a few large individual policies can result in significantly fluctuating returns.

Consequently, I believe that this market will become less and less attractive, as investors become disappointed with their returns.

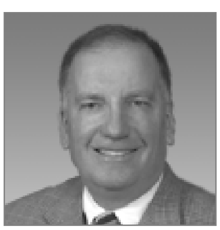
Society

Some originators of these vehicles attempt to "arbitrage" the limitations placed upon the underwriting practices of life insurance companies by laws currently on the books. Laws enacted by legislatures reflect the mores of society. Thus, limitations are placed upon insurance companies with respect to differentiation of premiums by race and sexual preference. As the science surrounding the predictive value of genetics becomes clearer, it is foreseeable, due to privacy concerns, that limitations on the use of genetic testing will be placed upon insurance companies. However, such limitations do not exist for the originators of life settlement blocks. This creates the existence of asymmetric information within the transaction, a condition that has not been allowed in other transactions (i.e., insider trading). Is it really in the best interest of society to allow the use of such knowledge after the issuance of a life insurance policy to "arbitrage" the limitations placed upon the insurance company by society? Is society well served in such a circumstance? Legislators must maintain a level playing field between the participants in such a transaction, while reflecting the mores of the society they serve.

Conclusion

In the long run, assuming that life insurance companies maintain fundamental pricing and underwriting practices, I believe the practice of selling policies with the intent of taking them to the life settlement market a couple of years later, will dry up. Financial needs analysis for the older age insureds targeted by this market must become a critical component of the underwriting process. Table shaving programs utilized in the underwriting process must be consistent with the mortality assumptions used in the pricing process. Lapse support of the pricing of these products must be examined by the companies. Business produced by agent and agent groups should be reviewed for focus in this market and corrective action taken when identified. Companies must reconsider their participation in "trial app" programs in which brokers put together detailed underwriting packages and send them to multiple companies, looking for one company to make a mistake. Companies willing to participate in these programs expose themselves to issuing policies in anticipation of being life-settled shortly thereafter.

The existence of this market has the potential to give all involved, including the life insurance industry, a black eye, causing legislatures to take precipitous action affecting the value offered by life insurance policies to the consumer. Consequently, life insurance companies must begin the process of educating legislators about the dynamics of such transactions and the need to maintain a level playing field among all participants before draconian measures are enacted. Failure to take each of these steps could have dire consequences for the life insurance industry and the products it sells.



Brad Smith is consulting actuary with Milliman, Inc., in Dallas, Texas. The opinions expressed in his article are his alone. He can be reached at brad.smith@milliman.com.

ACTUARIAL FOUNDATION GOLF RECAP

by Eileen C. Streu

Editor's Note: One of the objectives of the ReFocus 2007 conference was to raise funds for The Actuarial Foundation, who wrote the attached letter as thanks for the more than $35,000 raised by the conference, conference sponsors and delegates.

As The Actuarial Foundation continues to further its mission "to develop, fund and execute education and research programs that serve the public by harnessing the talents of actuaries," we wish to thank the ACLI, SOA and the Reinsurance Section of the SOA for creating the Insurance Legends' Golf Classic, an event established to underscore the importance of developing industry leaders for tomorrow by honoring industry leaders of today.

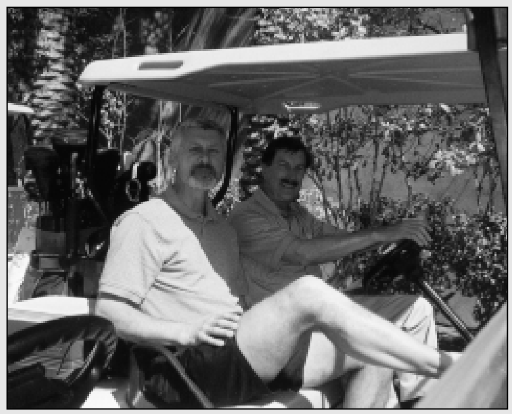
The 2007 Legends are: Stanley B. Tulin, vice chairman emeritus of AXA Financial; Oscar R. Scofield, retired chairman and CEO of Scottish Re; Arthur F. Ryan, chairman and CEO of Prudential Financial; Peter W. Mullin, chairman of MullinTBG and Ronald V. Dolan (1942-2005), retired chairman of First Colony Life Insurance Co.

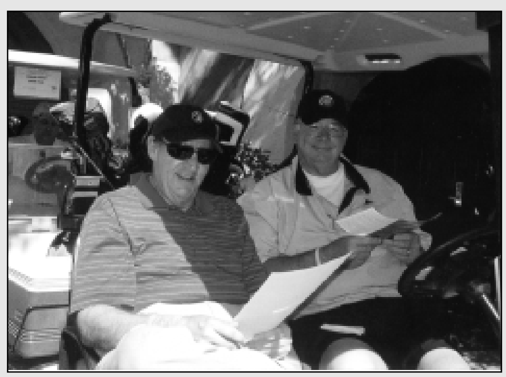
The Actuarial Foundation's youth education initiatives to enhance the mathematics education of today's students are the cornerstone of our mission. The Insurance Legends' Golf Classic raised over $35,000 in support of our youth education programs through the efforts of the 2007 ReFocus Program Committee and the generous support of many corporate sponsors.

A special note of thanks to the Banner Sponsor of the Golf Classic – Heidrick & Struggles.

On behalf of the Foundation's Board of Trustees, staff, and the schools and students across the country our programs benefit, thank you. ✷

Eileen C. Streu, CAE
Executive Director,
The Actuarial Foundation





REINSURANCE TREATY PROVISIONS FOR MEDICAL EXCESS BUSINESS

by Mark Troutman

The Reinsurance Section Council is pleased to announce the availability of insurance policy or reinsurance treaty discussion documents for various catastrophic medical excess lines of business.

The SOA Reinsurance Section Web site *http://www.soa.org/professional-interests/reinsurance/papers-presentations-research-and-resources/reinsurance-treaty.aspx* now includes four articles providing discussion of specific insurance policies of reinsurance treaty provisions for the following lines of catastrophic medical excess business:

- HMO Excess
  Mark Troutman, *mtroutman@summit-re.com*

- Provider Excess
  Greg Demars, *gdemars@hcclife.com*

- Employer Stop Loss
  Mark Troutman, *mtroutman@summit-re.com*

- Carrier Medical Excess
  Dan Wolak, *dwolak@genre.com*

These documents are written in a conversational tone, rather than a simple listing of legal terms. They are designed to provide a basic understanding of specific coverage issues associated with each product line. These documents are not legal agreements and are not intended to create an industry standard insurance policy or reinsurance treaty.

Those involved as reinsurance purchasers and sellers can benefit from a discussion of these items and examples of coverage. They can serve as a training and education tool for staff and also for senior managers not generally involved in daily activities of insurance or reinsurance. They can serve as a checklist for those of us who work on these lines day-to-day.

The articles address the nuances of each coverage.

Mark Troutman, FSA, MAAA, is team leader, marketing and membership value team and president, Summit Reinsurance Services, Inc. He can be reached at MTroutman@Summit-Re.com.

For example:

Employer Stop Loss—this is an insurance policy provided to a self-funded employer with an ERISA plan document. This is one of the rare coverages where there is an aggregate (125 percent) stop loss component of protection as well as one for large individual claims.

HMO Excess—coverage focuses on provider agreements for contracted facilities and provider agreements. Coverage is often for hospital inpatient coverage only with some limited step-down facility coverage (hospice, home health, skilled nursing). A treaty typically has an average daily maximum or a per diem limit on reimbursements by the reinsurer. Continuation of benefits/insolvency coverage is often required by various state regulations.

Provider Excess—this policy also emphasizes risk assumed by providers and their managed care contracts. It's important to match the insurance coverage to the grid of responsibilities for capitation accepted by the providers as evidenced by a "division of financial responsibilities matrix."

Carrier Medical Excess—coverage is comprehensive for all services with few, if any, inside limits.

We hope you find these documents useful. Comments should be provided to the authors of the documents as these are works of the individuals rather than the opinions of the Society of Actuaries or the Reinsurance Section Council. ✹

Editor's Note: Mark Troutman spearheaded this effort as the designated health member of the Reinsurance Section Council. His term expires this year. Individuals interested in joining the Council with a health background should take note. At least one seat on the Council is reserved for a Health candidate.

Special thanks to Mark Troutman of Summit Reinsurance Services, Inc.; Greg DeMars of HCC Life and Dan Wolak of Gen Re Life and Health for their significant involvement on this project.

EXCESS REINSURANCE TREATY CONSIDERATIONS

by Dan Wolak

The most important consideration in the reinsurance purchasing decision is determining the risk objectives of the organization. This article addresses the issues when purchasing medical excess reinsurance on a medical portfolio. The proper risk analysis performed by the carrier, or in conjunction with its reinsurer, will address the following considerations:

- What is predictable risk versus unpredictable risk?
- Is coverage purchased just for the rare catastrophic claim or for more frequent types of large claims?
- What is the appropriate reinsurance deductible for the health carrier and how is it stated?
- How is the maximum reinsurance benefit stated?
- Is coverage purchased for losses occurring during a 12-month calendar period or for policies/risks that attach during a 12-month period?
- How do any special deductibles impact the reinsurance layer?
- Does the carrier want risk fully transferred on a non-participating basis or does the carrier want to retain a portion of the risk through a participating or other type of basis?
- Are lower deductibles desired for certain types of claims (such as premature infant claims)?
- How are costs for claims management shared?
- How is the reinsurer involved with claim disputes with the carrier's policyholders?

Medical excess normally covers all claim charges from an individual that exceed an annual excess deductible. The reinsurer's liability mirrors the claim liability of the carrier. In other words, the liability of the reinsurer shall begin and end with the liability of the company. This contrasts with HMO excess reinsurance which may not cover all claims on an individual; just those that fall within the limits of coverage as stated in the reinsurance treaty. As a result, the reinsurer will be very interested in how the carrier and its third party administrators manage large claims and the networks that they utilize. A poorly managed claim can result in a large claim liability for the reinsurer. The following discusses the considerations in designing a reinsurance agreement.

Reinsurance Design Considerations

1. *Predictable risk versus unpredictable risk.* Predictable risk arises from claims that can be expected to occur each year within a range of deviation. Unpredictable risk, which usually is not fully considered, refers to claims that may arise once every five, 10 or more years. Examples of unpredictable risk include a medical claim that exceeds $2 million or more during a year; catastrophic claims from a multiple premature birth; a jumbo claim from a procedure that borders on being experimental, but is deemed as covered under a program; claims from a catastrophic event, or claims arising from extra-contractual damages.

2. *Working layer coverage versus catastrophic coverage*. A working layer is defined as an excess deductible level for which the carrier, with relative certainty, will have at least several claims exceed that deductible each year. Claims in a working layer can have some volatility, but the volatility as a percent of premium is usually in a smaller range. By purchasing reinsurance at a working layer, the carrier has more predictable experience for a product than just purchasing coverage for claims at a catastrophic level. However, the downside is that the carrier is paying more in reinsurance premiums and possibly dollar margins to the reinsurer for this lower deductible layer.

   A catastrophic coverage layer is one where the carrier expects, at most, to have just a few excess claims a year, and in some years will have no claims that exceed the deductible. The cost of such coverage is much less than at a working layer, and the reinsurance recovery received when a claim exceeds that high layer is reduced by the high deductible. Therefore, the cost to the carrier is less than when purchasing reinsurance for a catastrophic level, but it is important to note that the potential recovery is less as well.

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3. *Reinsurance deductible.* A reinsurance excess deductible is established based on a review of carrier goals and risk tolerance. The setting of the deductible is a blend of quantitative risk features and qualitative risk tolerance. In many cases, a lower reinsurance deductible may be desired from a subjective risk tolerance level, though quantitatively a higher level could be purchased. Defining the deductible is also important when purchasing excess medical reinsurance to cover claims arising from an employer stop loss program. One approach is to purchase an excess deductible that includes claims paid both by the plan up to the specific deductible and the carrier above the specific deductible. The other option is to include only claims paid by the carrier in excess of the specific deductible.

4. *Reinsurance maximum.* The maximum benefit reinsured can be different than that covered under the medical plan. Frequently, the medical plan provides a lifetime benefit. The reinsurance treaty will provide a maximum benefit that is the lesser of an annual maximum or the insured's available lifetime maximum.

5. *Loss occurring or risk attaching.* The deductible can be determined on a calendar-year basis for losses occurring during a period or for risks that attach during a calendar year. The decision depends on the type of risks covered. For insured medical, where an incurred date for each claim is clearly established, the medical excess coverage can be on a 12-month loss occurring period, such as a calendar year. A risk attaching coverage period is used frequently for group coverage. During the 12-month agreement period for the reinsurance, each underlying group is covered beginning on their next anniversary date or the effective date for a 12-month period.

6. *Impact of special deductibles.* Special deductibles arise in several ways:

   a. For employer stop loss, a higher specific deductible may be set on an individual as a way to underwrite known or projected claims in lieu of higher premiums. This practice is called lasering. The excess medical treaty should define how the excess medical reinsurance deductible is impacted by *lasering*. One such approach is to have the reinsurance deductible increase by the same dollar amount that the laser exceeds the employer group's specific deductible.

   b. Another option under an employer stop loss policy is offering an aggregating specific deductible. An aggregating specific deductible requires the employer's plan to not only pay claims up to the specific deductible on each person, but also to self-insure claims in excess of the specific deductible until the aggregating specific deductible is met. Following is an example of such a situation:

      i. Carrier sells stop loss policy with a $200,000 specific deductible;
      ii. Stop loss policy has aggregating specific of $500,000;
      iii. Carrier purchases excess medical reinsurance for claims of more than $500,000 (on a first dollar basis);
      iv. If one person has a $650,000 claim, the self-insured plan is responsible for the first $200,000 as part of the specific deductible. In addition, $450,000 of claims in excess of the deductible satisfy a portion of the $500,000 aggregating specific deductible. In such a case, assuming no other claims from that employer group, neither the stop loss carrier nor the reinsurer would have a claim liability.
      v. If this example was changed so that one person has a $650,000 claim and two people each have $300,000 in claims, the stop loss carrier would have a $150,000 claim. The reimbursement under the excess medical reinsurance

could be handled one of several ways.

The reinsurance could be designed to:

- Pay the $150,000 since this is the amount in excess of the $500,000 deductible and is not in excess of the carrier's liability;
- Have no claim liability for this particular example;
- Pay a percent of claims determined by dividing the excess claim liability ($150,000) by the amount of claims exceeding the $200,000 deductible (i.e., $150,000 divided by $650,000).

7. *Risk transfer options*. A carrier can decide whether a non-participating or a participating arrangement is desired.

   a. A non-participating arrangement is desired when the carrier wants to lockin the cost and not have future earnings positively or negatively impacted by the excess reinsurance experience. With a non-participating arrangement, the carrier does not realize positive experience results in a year directly; rather the impact of any positive results would be potentially recognized in current and future renewal premiums. From an accounting perspective, a non-participating arrangement is easier since future experience refunds need not be accounted for or projected. For a participating arrangement, there is a risk of prematurely accounting for a refund, which increases reported earnings in a quarter. Subsequently, this releases the accrued refund asset when a large claim is reported, thereby creating a charge to earnings.
   b. A participating arrangement is selected by a carrier that desires to reduce its costs when experience is favorable. Participation can arise in several forms:

      - Profit commission: A traditional way is that a percent of the experience gain is paid back to the carrier, after providing for the reinsurer's risk margin and expenses;
      - Swing rate: In such a case, the carrier pays a "minimum premium rate" until claims exceed a defined percent of that rate. At this point, the premium rate swings up proportionately to claims, but does not exceed a ceiling "maximum rate." A swing rate allows the carrier to have reinsurance costs that are proportional to normal claims fluctuations, but also locksin the cost in case of an unusually high claim level;
      - Aggregating specific deductible: Another common way for a carrier to have a participating arrangement is to have a second deductible—that being an aggregating specific deductible—for claims in excess of the deductible. The reinsurance does not begin to pay until excess claims exceed this second deductible. The coverage frequently is non-participating once claims exceed the aggregating specific deductible and become the liability of the reinsurer.

DEFINING THE DEDUCTIBLE IS ALSO IMPORTANT WHEN PURCHASING EXCESS MEDICAL REINSURANCE TO COVER CLAIMS ARISING FROM AN EMPLOYER STOP LOSS PROGRAM.

8. *Lower deductibles for defined conditions*. In some cases, a lower excess deductible is offered by the reinsurer or requested by the carrier for certain conditions; e.g., an organ transplant where a network is established with preferred pricing. Another example may be a benefit that has a lower maximum limit.

9. *Claim management expenses*. Many times on large medical claims, a third party auditor or vendor will be utilized to review the hospital

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charges and to further negotiate a reduction in charges. The manner in which these expenses are shared needs to be defined in the reinsurance agreement. Following are several approaches:

a. Claims management expenses are shared proportionately based on the amount of the billed claims;
b. Claims management expenses are covered in the same manner as any other claims cost. Therefore, if the final amount of claims exceeds the excess layer, the reinsurer pays all of the claims management expenses. If the final claims amount is reduced to below the excess deductible, the carrier pays the claims management expenses in combination with the underlying claims up to, but not exceeding, the excess deductible.

THE CARRIER SHOULD NOTIFY THE REINSURER OF ITS INTENTION TO CONTEST OR COMPROMISE A CLAIM THAT MIGHT EXCEED THE EXCESS DEDUCTIBLE.

10. *Contested claims*. The carrier should notify the reinsurer of its intention to contest or compromise a claim that might exceed the excess deductible. If the reinsurer chooses not to participate in a contested claim, the reinsurer shall pay its full amount of reinsurance liability on such claim and shall thereby be relieved of all future liability with respect to such contested claim. If the reinsurer joins the carrier in a contest or a compromise, the reinsurer shall participate in the same proportion that the amount at risk reinsured with the reinsurer bears to the total amount at risk to the carrier on the claim, and shall share in the reduction in liability in the same proportion.

Dan Wolak is senior vice president, Group Division with Gen Re. He can be reached at dwolak@genre.com.

Carrier Decision Process

In selecting excess deductible and reinsurance options, the reinsurance decision maker may consider the following:

- Frequency and severity of claims at various deductible levels. What has been the carrier's recent experience with excess claims?
- Risk profile of carrier's membership.
- Risk tolerance and budget considerations. How will management respond to a claim reported in a quarter that is in excess of $500,000? $1 million? $2 million or more?
- Carrier size and coverage type. Is the standard insured maximum benefit $1 million or is it $5 million?
- Underwriting margin and results. If the program is marginally profitable, one large claim may result in a loss for the year. If the program is very profitable, the carrier may want to retain risk rather than pay potential reinsurance margins to a reinsurer.
- Carrier's financial strength and parental support.
- Capital requirement of product. Excess products such as employer stop loss require more capital than first dollar products.
- Relative size of medical block within a company compared to other insurance products.
- Reinsurer's expertise and market knowledge.

Renewal Process

Most agreements are one year in duration and must be amended each year as part of the renewal activity. Unlike underlying carrier policies, the reinsurance treaty does not provide for a 30-day notice of rate change. To change rates, the treaty must be changed by mutually agreeing to amend the current terms. To change the treaty, notice must be provided 90 days in advance by either party. One way to provide a shorter notice of rate change and to allow for proper time to evaluate experience is for the reinsurer each year to send to the carrier a preliminary notice of termination more than 90 days prior to the treaty anniversary. The reinsurer will then prepare renewal terms and normally present to the carrier 30 to 45 days prior to anniversary. If the offer is accepted, the reinsurer will send a treaty amendment to the carrier that reflects the renewal terms and rates. ✺

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475 N. Martingale Road
Suite 600
Schaumburg, Illinois 60173
Web: www.soa.org