SOCIETY OF ACTUARIES Reinsurance Section

Reinsurance news

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A Snapshot of Large-Retention Companies' Reinsurance Needs

By Ronald Klein

In 1932, a brilliant Harvard University dropout named Edwin Land began a company called Land-Wheelwright Laboratories marketing his innovative polarizing technology which is used in sunglasses, windows and photography. Land's company was renamed in 1937 to Polaroid which is probably best known for "instant" photographs that developed in 60 seconds. Anyone aged over 40 will remember with delight seeing photographs in full color in just seconds as opposed to submitting film to a developing store and seeing the results in a few days.

While most people associate the name Polaroid with photography, the company actually played an integral part in World War II technology developing heat-seeking missiles, binoculars, gun sights, dark-adaptation goggles and target finders. In short, this was an innovative company that could only expand. Instant photography will always be necessary

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This newsletter is free to section members. Current issues are available on the SOA website (www.soa.org).

To join the section, SOA members and non-members can locate a membership form on the Reinsurance Section Web page at http://www.soa.org/reinsurance.

Reinsurance news

Issue 72 | March 2012

Call for Articles for next issue of Reinsurance News.

While all articles are welcome, we would especially like to receive articles on topics that would be of particular interest to Reinsurance Section members.

Please e-mail your articles to Richard Jennings (*richardcjennings@gmail.com*) by April 30, 2012.

Some articles may be edited or reduced in length for publication purposes.

If you would like to assist in the editing process of the *Reinsurance News*, please contact Richard Jennings, Editor, *Reinsurance News*, or H. Michael Shumrak, Section Communications Leader at *Michael@H-MichaelShumrak.com*.

Outgoing Chairperson's Corner *By Kelly Levy*

What's in a Word?

By the time this article is published we will be well into the New Year. Were you at all aware that in addition to the end of the year top-40 music countdowns, most popular baby names of the year, year's top newsmaker, athlete of the year, the list goes on, that there is actually a word of the year?

I had no idea of this contest. I'd stumbled across this quite randomly upon coming across a reference to "austerity" as the Merriam – Webster 2010 word of the year. What word won the prize for 2011? Depending on the authority naming the victor, historically the word of the year has ranged from the likes of "app"' and "tweet" to "hybrid" and "footprint." I do however have a particular affection for the Merriam-Webster 2011 Word of the Year … "pragmatic."

Why does this victorious word of the year have appeal both to me and clearly others? In life, in business and in the workplace, the pragmatic approach to problems may have a more established successful track record than that of the visionary approach. Is being pragmatic something we value in policymakers, business leaders and even ourselves? If so, how might we foster these behaviors particularly in those reinsurance professionals who, certainly in actuarial science, may have spent much time learning the established methods and become accustomed to staying within those familiar boundaries of comfort? I do not have the answer today, but I appreciate that Merriam-Webster's 2011 champ caused me pause to at least take the time to think a little in this direction.

At the time of this newsletter's publication, the 2012 Refocus conference will be days away (March 4 – 7, 2012). The tagline of this year's global gathering of the reinsurance industry is "Industry at a Critical Crossroads." Now, not to belabor this Word of the Year theme, but at the time of penning this article the American Dialect Society had not yet named their 2011 Word of the Year winner, but had disclosed one of the front runners in their contest. Although I won't provide a definition of the front runner, I will provide a clue. It involves football, specifically a certain individual on the Denver Broncos team. Could the Criticial Crossroads theme of Refocus at all be confused with "It's Tebow Time!"?

On a more serious note, I'll leave you with some section-related research news (see below). Over the last half of 2011 we posted some completed research to the section website. Thank you to the many researchers and Project Oversight Group members who contributed to this research. Our strength is truly in our many volunteers.

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Chairperson'Corner … (cont.)

Mortality Comparisons and Risk Exposures in the Older Age U.S. Financial Services Market – Dec 2011

This research examines mortality expectations between life insurance, annuity, and pension products at older issue ages. The authors further discuss the potential impacts these mortality differences may have on managing the risk assumed for these products.

Access To Reinsurance By Smaller Insurers: Perils, Pitfalls and Solutions – Oct 2011

This report discusses challenges encountered by smaller insurers in obtaining life reinsurance, the challenges and opportunities life reinsurers face in servicing these companies, and considers some possible solutions that might help to resolve the challenges encountered.

Global Mortality Improvement Experience and Projection Techniques – June 2011

The historical rates of improvement are examined for both the general population and the insured population from a global perspective. ■

Footnote:
Definition from the Cambridge Advanced Learner's Dictionary & Thesaurus
Pragmatic - solving problems in a realistic way which suits the present conditions rather than obeying fixed theories, ideas or rules

Letters To The Editor

From David Bruggeman, FSA, MAAA, Assistant Vice President & Actuary, Munich American Life Reassurance Co.

Hannover Life Re noted an inaccurate statement in my life reinsurance survey article (Issue 71, published November 2011) and has requested a correction be noted in the next issue of Reinsurance News.

"*In the Life Reinsurance Data from the 2010 Munich Re survey article which appeared in the November 2011 issue of Reinsurance News, it was incorrectly stated that Hannover Life Re would acquire the rest of the Scottish Re life reinsurance block in 2011. In fact, Hannover Life Re only acquired a specific block of Scottish Re's business."*

Editor's note : The online version was updated upon receipt of this correction.

From Pete Hitchcock, Vice President and Corporate Actuary, Life Financial Operations, Motorists Life Insurance Company

I just wanted you to know that the most recent issue of Reinsurance News was great. As always, Dave Bruggeman did a great job at summarizing the annual Life Reinsurance data. In addition there were many other meaningful and practical articles.

I know being the editor can be time consuming and challenging.

I just wanted you to know that I really appreciated the newsletter.

Keep up the good work!

Thanks,

Pete

Editor's Note : Thanks Pete for the kind words. Glad you enjoyed it!

Call for Articles

We are always on the lookout for articles of interest to the Reinsurance Section. Please send your articles to either Michael Shumrak at michaelshumrak@gmail.com or myself at richardcjennings@gmail.com.

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especially for "professionals like police officers" and Polaroid enjoyed being a household name.

Then, one-hour photo stores started to pop up and people could buy higher quality results in a reasonable time. Polaroid began to lose some steam. Next, digital photography was invented and Polaroid was all but dead. After reaching an all-time high of USD 60.31 per share in July, 1997, the stock dropped to just under USD 0.30 per share a few years later. Polaroid filed for bankruptcy in October, 2001.

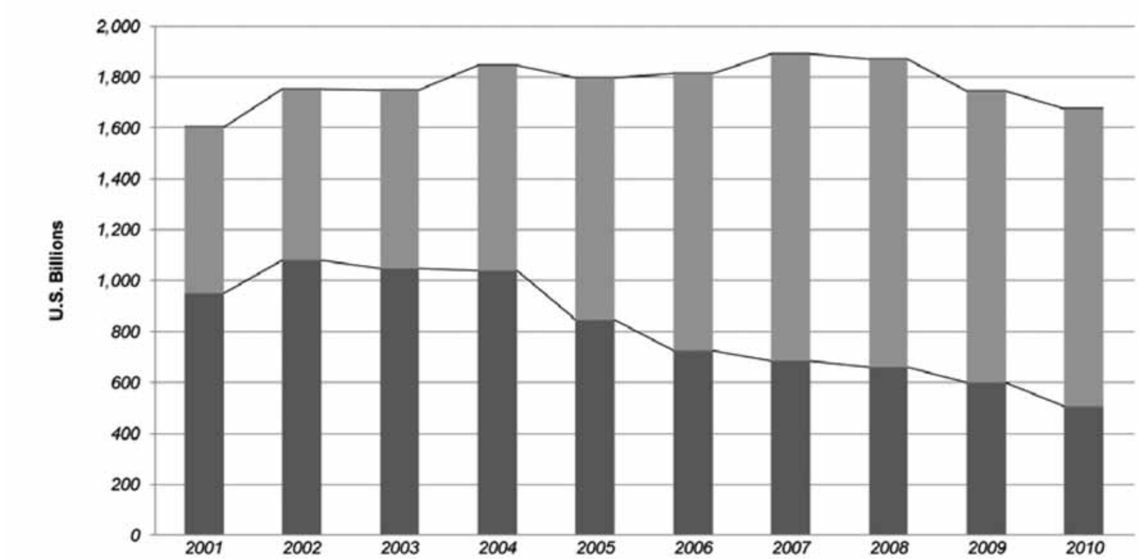
While an interesting history lesson on keeping up with the needs of your clients, you are probably asking yourself what Polaroid has to do with reinsurance. It is quite simple—if life reinsurers do not listen to the needs of their clients, could these companies fall to a similar fate?

Let's take a look at life insurance sales from 2001 through 2010 as shown in the November 2011 Reinsurance Section Newsletter:

From the chart below it appears that U.S. life insurance sales have been relatively flat during the past 10 years, while reinsurance sales have basically been cut in half. Admittedly the chart does not tell the entire story, however it should be an indication to reinsurers that their product offerings must change. Another way to look at this is simply to view a list of the life reinsurance companies that are active today. Has anyone ever heard of M&G Re, Life Re, Lincoln Re, Transamerica Re, ERC, Annuity and Life Re, Scottish Re, Gerling Global or Convarium? And how about the in retrocession markets—does anyone recall ManuLife, Sun Life or Equitable?

Life reinsurers have done a relatively good job in competing with banks for market share of structured solutions, yet one might conclude that life reinsurers have not done a good job competing with an even bigger and more powerful competitor—the client company's own retention limit. Is there anything a life reinsurer can do to change its business model to serve the needs of a large-retention life insurance company?

U.S. Ordinary Individual Life Insurance Sales



	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
% Reinsured	59.2%	61.5%	59.7%	56.2%	47.0%	39.9%	36.1%	35.2%	34.2%	30.2%
Amt Retained	653	675	705	809	952	1,089	1,207	1,212	1,148	1,170
Amt Reinsured	947	1,078	1,043	1,037	844	724	683	658	596	505

> **"I LIKE TO ASK THE HEAD OF THE LIFE INSURANCE LINE WHAT KEEPS HIM OR HER UP AT NIGHT? USUALLY THE FIRST REPLY IS 'NOTHING—I SLEEP QUITE WELL!'"**

The best way to answer this question would be to speak to decision-makers at large-retention insurance companies. With the benefit of working for two of these companies during the past five or six years, I have done just that. Basically, as the life reinsurance officer, I like to ask the head of the life insurance line what keeps him or her up at night. Usually the first reply is, "Nothing—I sleep quite well." I guess there are some things money can buy! Digging a bit deeper, usually the reply is, "… something that will destroy earnings for the year or, even worse, eat into shareholder equity." One large loss is not even on the radar screen of these executives. So, what is the best way to protect a large life insurance company from destroying earnings or eating into shareholder equity?

Larger life or multi-line insurance companies no longer need traditional quota-share reinsurance, and excess (above large retention limits) reinsurance is not appealing to reinsurers. The solution is for reinsurers to begin adopting a non-life reinsurer product offering. Products such as Stop Loss and Catastrophe covers can really assist large-retention insurers to manage their earnings and protect their balance sheets. It is not so long ago that Stop Loss was a standard product offered by reinsurers. Then came the days of large quota-share reinsurance arrangements and Stop Loss all but disappeared. The reason is simple—reinsurers did not want to cannibalize their own business. If a reinsurer offered a Stop Loss, the direct company would not need to reinsure on a quota-share basis.

Catastrophe covers are quite common in the life insurance industry and protect against natural or man-made events such as earthquakes or terrorism. While these covers are quite useful in protecting shareholder equity, the large deductible causes a large loss of earnings before the benefits are triggered. Stop Loss can be set at a level that actually protects some of the corporate earnings. Typically, a Stop Loss cover would trigger at 1+X percent of expected claims during the year (for example, 110 percent). X can be set by examining the variance of the loss curve and determining the desired trigger.

The benefit of Stop Loss is that all claim events are in scope. For example, pandemic flu or simply a very unlucky mortality year would be covered, whereas Catastrophe cover only pays in the case of a major event. Of course the price of the Stop Loss cover will depend upon the quality of the data, the variance of expected losses, the attachment point (that is, the value of X) and the amount of coverage. There is one important note to discuss which is the companies that need this type of cover would typically require a very large coverage amount. Not many reinsurers would be willing to offer coverage of USD 1 billion, for example. Therefore Stop Loss covers may require pools of reinsurers to complete a transaction.

In the current market, quota-share percentages have decreased drastically and have all but vanished for large-retention insurers. Therefore, it is time to reinstate the Stop Loss offering. Just think, life reinsurers can become more like non-life reinsurers by always worrying about renewals. "Do you have time to talk?" "No, I am working on the May renewals!" Renewals are like the full employment act for reinsurers. Also, the life industry will once again have to rely on intermediaries to place large layers of Stop Loss covers.

There are other needs for large-retention insurers and, in general, it is my experience that most life reinsurers do a very good job fulfilling the following needs.

- Assistance with products in certain regions where the direct company lacks expertise;
- Assistance with risks that are relatively new to the company or the market;
- Cheaper access to capital for certain products/country specific arbitrage; and
- Surplus relief reinsurance in certain countries.

While these are important aspects of reinsurance, I do not think that the above-listed opportunities will drive the growth necessary to satisfy shareholders of life reinsurers.

It is interesting that Standard and Poor's (S&P) released a similar opinion in its Global Credit Portal report of Sept. 23, 2011:

"*We expect that the low mortality reinsurance cession rates in the U.S., the potential contraction of*

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the European life reinsurance market under Solvency II, and the continued slow long-term growth of the dominant but mature mortality markets (primarily the U.S. and U.K.) are significantly increasing the pressure on life reinsurers ***to seek out nontraditional risks and expand into less-saturated markets to sustain growth."*** (Emphasis added)

Whether or not S&P considers Stop Loss as a nontraditional risk can be debated, but I am not too sure that I would lay much credence to an organization which rated securities as AAA and then downgraded companies that held these securities! However, S&P does see some short-term benefits as the Solvency II era unfolds. This opportunity may exist until the regulation is better understood by the industry as seen by another statement in the same article:

"In the short term there could be ***increased demand for reinsurance as*** *it is likely to be one of the main options available to insurers that* ***need to improve capital positions under Solvency II.*** *This would likely boost life reinsurance business opportunities, and many reinsurers have already set up special teams to exploit these opportunities."* (Emphasis added)

I also see other short-term opportunities for reinsurers as banks will be stressed for capital under Solvency II and will probably look to sell off any life insurance holdings to boost solvency ratios. Reinsurers that can effectively buy companies or blocks of business might outperform their peers for a few years, however direct insurers will also be vying for these properties.

Will selling Stop Loss and Catastrophe covers solve all the problems of life reinsurers? Obviously not. The main point of this article is to highlight that certain life reinsurers seem to be caught in the first phase of terminal illness (according to Dr. Kuebler-Ross) which is denial—for those of you that did not go through the exams at the same time as I did, the other phases after denial are anger, bargaining, depression and finally acceptance. The life reinsurance market is evolving and life reinsurers will have to be more creative to sustain growth. One way to do this is to service the needs of client companies that once were the main source of income for life reinsurers—the larger insurance companies—which are now large-retention insurers.

To summarize, life reinsurers must begin to change their business models to continue to service large-retention insurance companies in today's market. While Stop Loss and Catastrophe covers do not have the premium volume or longevity of traditional quota-share and excess reinsurance, the profit margins are much higher and reviewable premiums cause the business risks to be much lower. This, in conjunction with servicing mid- to smaller-sized insurers in more traditional ways, could be a viable solution to future growth in the industry. Add in some surplus relief, underwriting support, mortality analysis and expertise in emerging markets and you may just have a recipe for success.

Large-retention insurers need a strong and competitive reinsurance market. Hopefully life reinsurers will begin to offer more products geared toward their clients' needs. If this happens, both industries will develop into a beautiful (digital) picture. ■

Emerging Trends in Life Reinsurance: Non-Traditional Players **Enter Global Longevity Risk Transfer Market**

by Cynthia Crosson

Cynthia Crosson is director, Insurance with Fitch Ratings, New York, NY. Cynthia can be reached at cynthia.crosson@fitchratings.com

Historically low interest rates, historically high equity market volatility and ever increasing life spans have made pension funding a hot topic and actuaries sexy. Financing the lifestyles of the superannuated through steadily improving investment performance is no longer a given. Market realities and stricter regulatory funding requirements are forcing plan sponsors to reduce overly optimistic assumptions about how well their investments will perform and increase assumptions about how long they will have to last. A growing number of well known corporations are looking for help in trying to make the math work.

Traditional reinsurers, including Swiss Re and Reinsurance Group of America, Inc. (RGA), have been active in taking on longevity risk—the risk of having to make annuity type payments to a retiree for a longer period than priced for, because the person lives longer than expected. Their appetite, however, is finite. Meanwhile, demand for alternative ways to manage longevity risk is expected to keep growing. In response to the unmet demand, some life insurers/reinsurers are teaming up with investment banks to help fill the void. A notable recent transaction involved Deutsche Bank and Prudential Financial Inc., who helped Rolls Royce transfer longevity risk on $3 billion of its pension liabilities.

MARKET POTENTIAL

There appears to be no official tracking of data in the global longevity risk transfer market, but reports indicate significant growth potential for almost anyone willing to stick their toe in. A Swiss Re estimate reported by Reuters puts global longevity exposure at about 21 trillion USD of asset protection, with 90 percent of that figure related to pension funds and 10 percent insurance contracts.

The exposure dwarfs any current solutions and is only growing. The world's largest 100 multinational corporations reported one trillion Euros of defined benefit pension liabilities going into 2011, according to a 2011 survey conducted by Lane, Clark & Peacock LLP (LCP), a London-based actuarial, investment and business consulting firm specializing in corporate pensions. The funding deficit for these 100 corporations was 290 billion Euros as of Sept. 30, 2011—almost double the 170 billion at the end of 2010—despite record company contributions of 80 billion Euros in 2009 and 2010, according to LCP. Other reports indicate that improvements in life expectancy over the past 15 years have added significantly to pension liabilities.

The UK market seems to be ground zero for longevity risk. This may be because, in addition to its legacy final salary (defined benefit) pension plan exposure, individuals in defined contribution type plans have been required to purchase payout annuities by age 75 to provide income for life. That requirement was apparently eliminated in 2011. Longevity risk, however, is a global problem, and more stringent regulatory funding requirements in a number of countries are likely to drive increased demand for alternative and capital markets solutions.

RECENT ACTIVITY

2011 was reportedly a record year for longevity risk reinsurance transactions. One of the most notable transactions involved Rolls Royce, Deutsche Bank and Prudential Financial, Inc. (PFI—no relation to Prudential plc). The transaction, which was completed in December of 2011, allowed Rolls Royce to transfer longevity risk associated with 3 billion GBP (4.7 billion USD) of defined benefit plan liabilities to Deutsche Bank through a longevity swap. Deutsche Bank in turn transferred pieces of the risk to a group of insurance/reinsurance companies, including PFI. PFI is reinsuring 500 GBP (over $780 million USD) of the risk. This was the largest of three longevity risk transfer transactions completed by PFI in 2011.

Rolls Royce is expected to have plenty of company in 2012. While many corporations did away with their defined benefit plans years ago, they are still dealing with difficult markets and increased life expectancies for existing members.

The capital markets have been skeptical about taking on longevity risk, due in part to complexity, illiquidity and very long durations. Starting in 2010, however, a consortium of banks, insurers and pension experts took significant steps toward developing a longevity risk transfer market with the formation of The Life and Longevity Markets Association (LLMA).

"THE BOTTOM LINE IS THERE WILL BE NO SHORTAGE OF OPPORTUNITIES FOR ALL WHO WANT TO TAKE ON LONGEVITY RISK."

Swiss Re, a member of LLMA, issued the first longevity risk bond in December of 2010, which passed on $50 million of its own longevity exposure to the capital market in the form of an eight-year catastrophe bond sold via a special-purpose vehicle, Kortis Capital. Further development of the market will require good data and standardized indices, something which may grow out of increased activity.

THE ROLE OF TRADITIONAL LIFE REINSURERS

Traditional life reinsurers have limited appetite and capacity for taking on longevity risk. They are part of the solution, however. One example is U.S. reinsurer, Reinsurance Group of America (RGA), which has concluded longevity risk transfers together worth more than 3 billion GBP with the UK arm of French insurer AXA and with London-based Pension Insurance Corporation (PIC).

RGA views longevity risk as a way of diversifying, since it is essentially the flip side of what is traditionally known as mortality risk—the risk that an insurer/reinsurer has to pay a death benefit sooner than expected and priced for. RGA's primary focus is traditional mortality risk, and it limits longevity risk to a percentage of that.

An impetus for traditional life reinsurers to participate in the longevity risk market is the extended slide in one of their largest primary markets—the direct and retrocession market for individual life reinsurance in the United States. The U.S. market posted a 15 percent decline in recurring new business production in 2010, according to the Munich Reassurance Co. survey report. This was the eighth straight year of decline and the largest decrease since 2005. Retrocession business was down 50 percent in 2010 and has reached historic lows, according to the report. These declines are driven to a large extent by direct writers retaining more risk and redesigning products after reinsurers raised prices or stopped altogether assuming statutory reserve financing risk related to term and universal life products.

THE IMPACT OF INCREASED REGULATORY REQUIREMENTS ON THE LONGEVITY RISK TRANSFER MARKET

Plan sponsors in Europe are sounding the alarm that pension deficits could soar if Solvency II type rules are applied to defined benefit pension plans as proposed. LCP estimates that Solvency II would increase the liability measure used as the funding target in the United Kingdom and Ireland by 20 percent to 40 percent or about 50 billion Euros in aggregate for the 14 UK multinationals included in its survey. Solvency II is therefore expected to drive further reinsurance and capital markets activity in 2012, although it is likely to be a drop in the bucket.

In the United States, the Pension Benefit Protection Plan of 2006 increased funding and reporting requirements for defined benefit plans over the past several years. This combined with the financial crisis to highlight the gap between what many public and private pension plans have promised and what they may be able to deliver. Declaring bankruptcy and restructuring contracts has been the option of choice for seriously deficient plans, but that may change. It is very likely that stricter requirements growing out of Solvency II will have an impact on the U.S. market, which seeks equivalency with the European market. It is also very possible that new requirements will be imposed on defined contribution plans, which include the bulk of more recent hires. The bottom line is there will be no shortage of opportunities for all who want to take on longevity risk. Those who do, however, can and should be very selective about how they do it to protect their own bottom lines. ■

High Pressure

By Miriam Kaufman and David Nussbaum

*Editor's note: *This article was previously published in Best's Review, April 2011, and appears with permission by A.M. Best Company Inc. http://www.hlramerica.com/news/Media/High_Pressure_BR_0411.pdf*

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Employer medical stop-loss reinsurance was quite an innovative program for reducing skyrocketing health costs when first introduced in the early 1980s.

This product allowed employers to take risks while also encouraging and introducing cost-saving programs without sacrificing coverage. In addition to avoiding the excessive overhead costs frequently associated with fully insured plans, employers also receive some tax benefits from self-funding. And there are further cost savings as a result of Employee Retirement Income Security Act plans, which allow for opting out of state-mandated benefits.

High-retention programs were offered by managing general underwriters, who marketed, managed and underwrote such programs. Most MGUs worked in conjunction with third-party administrators, who administered and paid claims for the self-insured portion. For the risk portion, an insurance company typically would "front" the business, receiving a fee for providing their "paper"—in other words, their policy forms or certificates—in addition to accepting a minimum share of the risk that ranged from zero to 20%. The remaining portion of the risk would be reinsured by several reinsurers using equal or varying quota share splits.

The medical stop-loss market operates in much the same way today: MGUs generate, underwrite and manage the business. With increased competition from large, direct insurance companies, MGUs are being pressured to lower rates. Although part of these rate reductions come from reduced MGU expenses or broker/TPA compensation, in reality most have come from reduced reinsurance profitability.

Although MGUs are supposed to underwrite risk and leave the pricing to actuaries (or more typically to pricing manuals), in actuality MGUs also make pricing decisions via a mechanism called underwriter's discretion. This allows the underwriter to increase, or more typically, to decrease, manual rates based on underwriting criteria.

Such underwriting is far from clear. Most MGUs do have written underwriting guidelines but those guidelines are just for underwriting, not for pricing. One MGU, or even one underwriter within an MGU, might offer a discount of 10%, while another can just as easily offer a 25% discount, based on exactly the same information. Further, most rating manuals have up to a dozen factors that are evaluated to produce a final rate, including age, gender, plan design, geographic area factors and trend, among others.

A VITAL SAVINGS FACTOR

Most of these factors are fully determined by the manual. But several factors are actually items that the manual does not consider. The most important of these is the preferred provider organization factor.

In the wake of increasing health care costs, PPOs have become very important to the profitability of health care insurers. PPOs are a vital component of cost savings for stop loss. Savings can range from 5% to 70%. Discounts depend on the specific PPO contract with hospitals and medical providers. In addition, within a specific PPO, savings will vary by geographic area. Finally, many PPO contracts can also vary by what are called outliers; at a certain level of claim, the discount will change.

All this sounds complicated, and it is. The individual underwriter decides what the PPO discount should be for each group. There are PPO manuals available in the market. However, each has its own problems, such as not including a significant percentage of PPOs, or being outdated. Further, often credible data is not available to the manual producers to calculate an appropriate discount by narrow geographic area.

Another factor that underwriters are asked to determine is the credibility of the group's claim experience. Reinsurers often hear that a group is "clean," meaning it has good experience and no individual is currently at risk to exceed the group's self-insured retention. But actuarially speaking, this may be typical, not unusual. Credibility should be based on group size, deductible amount, number of experience years and expected number of claims exceeding the SIR. Some groups will never be credible, regardless of their experiences.

In determining an appropriate rate, underwriters also need to understand that medical stop-loss is a highly leveraged product. An extra dollar of claims for stop-loss is much greater as a percentage of claims than it is for first-dollar medical. (See "Small Change" graphic.) Therefore, a group with superior criteria will result in better experience and should be offered a lower rate, and vice versa for a worse group.

It is critical that all parties' interests are aligned—the MGU's, insurer's and reinsurer's. Typically, MGUs are paid based on premiums; reinsurers based on profitability; and insurers on a combination based on the percentage of risk taken and premium. However, to align interests, MGUs and sometimes insurance carriers are asked to place fees at risk; for instance, if the business is not profitable, some of the fees will be reduced.

MARKET SHARE EROSION

Unfortunately, as the medical stop-loss business has evolved over the past 30 years, MGUs have suffered. While MGUs once controlled more than 75% of the market, large direct writing companies, retaining 100% of the risk, have overtaken them. Direct writers have lower expenses, better PPO access and more sophisticated claim management. These insurers often capitalize on administrative fees by leveraging their internal or affiliated operations, rather than pay an independent TPA. And they require a lower profit margin, which is ultimately subsidized through profits achieved at the administrative level for the same or affiliated entity.

Most importantly, MGUs are no longer driving the stop-loss market. MGUs are attempting to hold their own, but they need to fully understand the key considerations involved in the rating process.

Here are 11 key ways MGUs can improve their rating/underwriting processes:

1. Fully document underwriting/ pricing decisions. List each positive and negative aspect and offer a quantitative assessment. This also allows the underwriter to review actual vs. expected results at each renewal.

2. Ask questions whenever underwriters are asked to re-evaluate a quote based on a competitor's offer. How is this being done without reducing profitability? Who else is sharing in the rate reduction? Are all parties willing to reduce fees—the broker, MGU, insurer and reinsurer?

Small Change

How the effect of a smaller increase or decrease in claims results in a larger effect on the cost of stop-loss coverage.

Example 1 — Leveraged Savings

Original Claim: $200,000

	Savings	Insured's Retention	Reduced Claim	Percent Savings
First-Dollar Medical:	$20,000	$0	$180,000	10%
Stop-Loss Medical:	$20,000	$100,000	$80,000	20%

Example 2 — Leveraged Trend*

Original Claim: $250,000

	Increase	Insured's Retention	Increased Claim	Percent Increase
First-Dollar Medical:	$25,000	$0	$275,000	10%
Stop-Loss Medical:	$25,000	$100,000	$175,000	17%

* Trend is the total increase in claims costs due to inflation, increased utilization of medical services, new medical technology, etc.
Source: Kaufman and Nussbaum

3. Work up a rate without knowing the current rate or what the competition is offering. Do a comparison only afterwards—that is, calculate the rate according to the manual and underwriting guidelines.

4. For a particular PPO, have the TPA demonstrate actual cost savings for all or a large sample of large claims within its portfolio. First-dollar savings are usually irrelevant for a stop-loss portfolio. Most PPO's will have lower discounts for very large claims. These are called outliers. Therefore, the savings for a large claim, which stop-loss is meant to cover, will not be in proportion to the savings for overall claims.

5. Perform experience studies by producer (TPA or broker). The MGU should discuss these results with the producer and, if they are positive, encourage more business or be a little more liberal with the rates. If the results are negative, investigate if the producer is sending requests to the MGU for all their cases or just the

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Key Points

The Situation: Medical stop-loss reinsurance continues to play a vital role in containing employers' health care costs.

The Issue: Managing general underwriters, who originally handled these programs, have lost market share to large direct writers.

The Way Ahead: Health care reform and highly disciplined underwriting tools offer growth opportunities to MGUs.

problem ones. Understanding what percentage of the producer's business is being quoted by the MGU may also be useful in determining if there is an anti-selection problem by the producer.

6. Except for very large groups with relatively smaller retentions, the underwriter should always realize that the claims experience of a group is not credible and should not be used as rationale for further discounting off the manual rates. Over the long run, unwarranted discounting will lead to unprofitable business.

7. Playing the leverage game can lead to better results. That is, a group with several positive factors (such as a young group in a low cost area with an excellent PPO) will be equal to more than the sum of its parts.

8. An MGU who has been in business for a while and has good reporting systems can perform studies that demonstrate which factors make their business profitable. Some examples include studies on age, rate-to-manual bands, and retention bands or group size, among others.

9. To compete with major carriers, MGUs must have excellent cost-containment programs, both within their shops and in conjunction with TPAs. Such programs include large case management, specialty care programs, data mining and hospital audits.

10. Medical underwriting by itself is a critical component. Reviewing disclosure statements, case management notes and historic claim experience for known claimants can help set lasers, if appropriate, or increase stop-loss premiums to cover the costs of known claimants. (Lasers are a means of covering members who are expected to cause large claims due to their medical conditions. Each such member's condition is evaluated and an expected claim amount for the renewal year is calculated. This amount becomes the higher specific deductible for that individual in lieu of the lower group specific deductible.) Manual stop-loss rates contemplate new or unknown claimants, not ongoing claims.

11. Health care reform will have a definite impact on employer medical stop-loss programs. How, where and when is still uncertain. Things to watch for include: unlimited maximums, family coverage to age 26, rescissions, exchanges, and state-mandated minimum loss ratios for fully insured medical plans, among others.

MGUs have always been key players in the employer medical stop-loss market and they will continue to see opportunity as health care evolves in our nation. However, it is crucial that MGUs become more sophisticated with their underwriting/pricing tools and decisions. ■

Access to Reinsurance by **Smaller Insurance Companies**

By W. Michael Reese

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Life reinsurance is a universally recognized risk management tool protecting insurance company surplus levels. Smaller insurance companies, who oftentimes benefit the most from establishing prudent risk management practices, have reported unique challenges in securing life reinsurance. Commercially feasible life reinsurance risk management solutions for smaller insurers are in the best interest of the life insurance industry as a whole because of the value in protecting company surplus and solvency.

A research project, sponsored by the Committee on Life Insurance Research, the Smaller Insurance Company Section and the Reinsurance Section, was kicked off in late 2010 to investigate the challenges on both sides of this issue. The final report was released in October 2011 and is available on the SOA website.

The purpose of the research was to: (1) identify the challenges and successes encountered by smaller insurers in obtaining life reinsurance, (2) identify the challenges and opportunities life reinsurers face in servicing smaller companies, and (3) explore solutions to resolve the challenges identified. The knowledge from this research is intended to assist actuaries, smaller insurers, reinsurers and others in optimizing their respective success in future reinsurance endeavors.

Two surveys were designed and used to gather information for the study. The first was sent to reinsurance companies and brokers, and the second was sent to smaller insurance companies. For the purposes of this research study, smaller company was identified as any company that sells life policies and has assets of $2.5 billion or less.

Information requested in the reinsurer/broker survey included:

- Benchmarks used to identify prospective clients;
- Types of reinsurance treaties available above and below benchmarks;
- The amount of individual life risk assumed from companies above and below the established benchmarks;
- Other services available above and below the established benchmarks; and
- Issues reinsurers have experienced with smaller insurers.

Information requested in the smaller insurance company survey included:

- Company size in total assets;
- New business ceded 2007 – 2009;
- Direct and ceded in-force as of 12/31/2009;
- Maximum retention limits;
- Reasons for buying reinsurance;
- Types of reinsurance used to cede risk; and
- Identification of challenges experienced.

As a follow up to the surveys, telephone interviews were conducted to clarify responses and dig deeper into the information gathered in the survey responses.

I encourage you to refer to the final report on the SOA website for the nitty-gritty details of the survey responses, but the following are highlights I pulled from those details:

REINSURANCE SURVEY

1. Some reinsurance companies use benchmarks to select viable business partners and some do not. In addition, one of the reinsurers said they make exceptions to the benchmarks when the right opportunity comes along.
2. Generally, the benchmarks are related to minimum annual new business requirements coupled with due diligence—e.g., company ratings, staff and administrative capabilities, etc.
3. Typical reinsurance treaties (e.g., YRT, Coinsurance, Bulk ADB) are available for client companies without regard to benchmarks. More sophisticated coverages, like surplus relief and stop loss, are only available above benchmarks.
4. Services other than risk sharing are available to client companies without regard to benchmarks, like use of the reinsurer's underwriting manual and access to underwriting, claims and actuarial staff. However, product design and development of underwriting guidelines are only available above benchmarks. In no case was there an indication that the reinsurer charged a fee for these additional services.
5. Regardless of benchmarks, the top two challenges reported by reinsurers were low sales volume and no mortality or persistency experience.

SMALLER INSURANCE COMPANY SURVEY

1. Just over half of the respondents said they have experienced reinsurance challenges.
2. About half of the responding companies were Fraternals.
3. Of the 23 responses we received, the four largest companies averaged $1.9 billion of assets, and the remaining 19 companies averaged $332 million of assets.
4. The average face amount issued in 2007 – 2009 was $90,181 for companies that said they experienced challenges (challenge companies), and $64,294 for companies that said they did not experience challenges (no-challenge companies).
5. In 2007 – 2009, the challenge companies ceded 36 percent of their new face amount, and the no-challenge companies ceded 16 percent of their new face amount. Follow-up interviews showed that the no-challenge group sold more simplified and guaranteed issue business, which certainly helps explain why their average face amounts and ceded amounts were lower.
6. The average face amount in force for the challenge companies as of 12/31/2009 was $139,833, and for the no-challenges companies the average was $39,372.
7. The maximum retention amounts for the two groups are very similar—$194,000 for the challenge companies and $220,000 for the no-challenge companies.
8. The top four reasons indicated for "why reinsurance is needed" are:
   a. Limit per policy risk;
   b. Control claim fluctuations;
   c. Get facultative underwriting support; and
   d. Gain access to the reinsurer's underwriting manual.
9. Regarding types of reinsurance used, no discernible difference exists between the challenge companies and no-challenge companies.
10. The number one challenge for smaller insurance companies was that the price of reinsurance was too high.

SUMMARY AND SOLUTIONS

In general, there was a fairly low response rate to both surveys. Perhaps the reinsurers that did not participate simply are not interested in the small company market. However, there is at least one reinsurer out there that is very willing to work with smaller insurers, and at least one that will work with companies below their benchmark when the right deal comes along. Also, I know from my own experience that other reinsurers (that did not participate) will do business with smaller companies when the right opportunity presents itself.

Does the low response rate from smaller insurers mean that there is no issue? That is certainly a possibility, but the survey responses show that challenges are out there. Of course, all business deals may present challenges, and it is evident from the numbers that even the companies within the challenges group have found ways to deal with the market as it currently exists. This fact was reinforced at the annual meeting during Session 135 where these research results were presented, when 91 percent of the direct writers in attendance indicated they have had challenges, but 83 percent of those said the challenges were overcome.

During Session 135, 70 percent of reinsurers in attendance (they made up 58 percent of the audience)

CONTINUED ON **PAGE 18**

indicated that they have benchmarks, but they make exceptions, and 25 percent said they don't use benchmarks at all.

So, one solution is—keep trying. There is a reinsurance market for smaller insurers. As one of the reinsurers pointed out during the follow-up interview, smaller insurers may sometimes have to pay a little more for their reinsurance versus the larger companies who can demonstrate that they have very low and stable mortality results, but with careful product development those costs can certainly be priced into a viable product.

A second solution, since we know there is a reinsurance market for smaller insurers, is to make sure you are prepared when you approach the market for reinsurance placement. Don't be reluctant to seek the help of a broker or consultant, and if you do approach the market on your own, make sure you are prepared. A list of items you may want to consider having available before you ask for a quote is included at the end of this article. Reinsurance actuaries, just like all actuaries, love getting too much information. The more you can provide up front, the better the negotiations should progress.

Another possible solution is a pool approach for smaller insurers. During discussions and interviews, the researcher heard of two instances where development of pools has been attempted. One was an attempt by the American Fraternal Alliance (then the NFCA) to get some of the larger Fraternals to set up a risk-sharing pool for smaller Fraternals. However, it is the understanding of the researcher that this idea did not come to fruition.

Another attempt to set up a small company reinsurance pool was made around 2005 by a consulting actuary. At least two reinsurers were approached with the idea, but again the attempt did not gain any momentum.

While attempts to establish a small company reinsurance pool have been made, this idea remains a potential solution. The following structure for a pool might work if the right people and companies support the approach:

1. Use a standardized full medical application and provide specific instructions to be used during the marketing process;
2. Develop two or three standardized life products (pre-filed for use in all states) that are available only for policies ceded into the pool (e.g., WL, 10-year term, 20-year term, UL);
3. Each specific company, once approved by the pool reinsurers, would be allowed to put its logo and company-specific information on the pool application and products;
4. Use a TPA for all underwriting and claims;
5. Allow each company to issue and administer the policies on their system once the issue decision has been made by the TPA. This is an important point for most companies, but especially for Fraternals who want to make sure they are connected with and engage their clients in their specific fraternal endeavors; and
6. A decision would have to be made regarding ongoing administration of the reinsurance, including reinsurance premium billing, settlements and quarterly reporting. It is likely that only the very smallest insurers will not be able to handle the administration issues.

Things to Think of and Prepare Before You Approach the Reinsurance Market

The following is a suggested list of information you should consider providing prior to asking a reinsurer to provide a reinsurance quote;

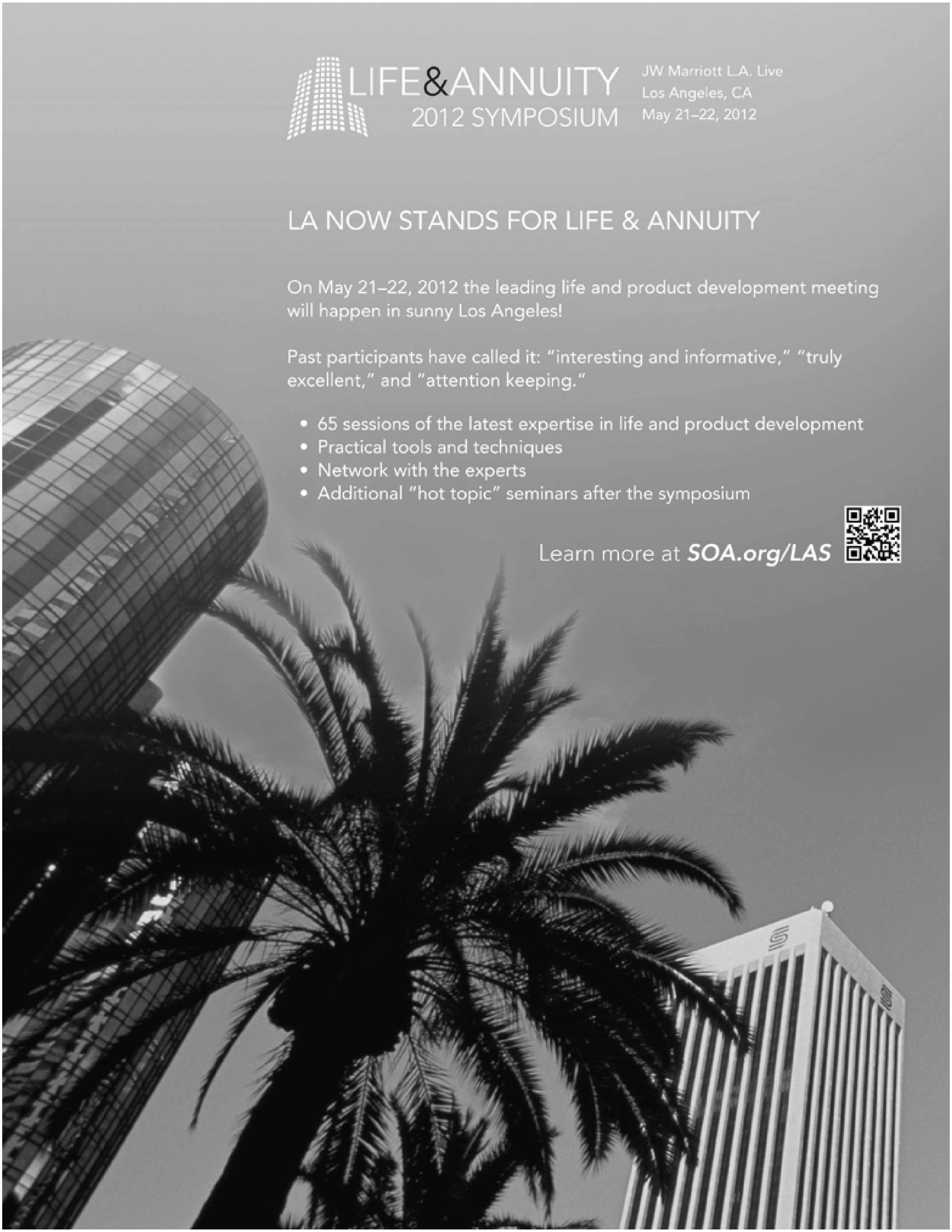
1. Provide a copy of the basic policy forms, riders and applications you want included in the reinsurance treaty. If state specials are significantly different, make sure you provide those as well;
2. Provide premium rate tables and policy fees/factors used to calculate policy premiums;
3. Have available an actuarial report on the product development and pricing results and assumptions, should the reinsurer ask for it;
4. A copy of your actuarial state filing memorandum provides a good product summary for the reinsurance pricing actuary—along with reserv-

"MAKE SURE YOU ARE PREPARED WHEN YOU APPROACH THE MARKET FOR REINSURANCE PLACEMENT."

ing methods and information about underlying guaranteed elements;

5. A summary of your underwriting rules and methods;
6. Information regarding your claims and underwriting staff is important. If possible, arrange a conference call and introduce your staff. It will help build a comfortable relationship with your potential reinsurer;
7. Make sure you have some idea of the type of arrangement you are looking for (YRT, coinsurance; excess or quota share) and communicate that preference to the reinsurer. They may suggest alternate approaches, but it is very helpful to provide a starting point. Some companies even let the reinsurers know what YRT rates or coinsurance allowances they are looking for, and this helps provide a framework for the negotiations; and
8. Provide information about how your product will be marketed (e.g., captive agents, brokers, direct marketing, etc.) and provide an estimate of the first two to three years of production. If possible, the production estimates should provide by issue year, age range, gender, underwriting class, average face amount and projected net amount at risk for universal life business.

In conclusion, it is clear that challenges do exist for smaller insurance companies. However, with the right approach you should be able to find reinsurance solutions to all your risk sharing needs. ■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Reinsurance Research—**What's New**

By Edward Hui

Edward Hui is the Chief Underwriting Officer at Caldwell Funding in Stamford, Conn. Edward can be reached at edward.hui@caldwell-ls.com.

Recently, the Reinsurance Section's research team completed a number of excellent reports, so I thought it would be a good time to briefly note what they are and how they could be of interest to you. I will review reports completed in the recent past, near future (those in the pipeline), and look ahead to new possible projects.

I am also happy to note each of the recently completed projects has garnered a broad degree of interest outside of the Reinsurance Section as well. While the projects were overseen by the Reinsurance Section, it was also nice that funding and participation were provided through other sections such as product development, financial reporting, and the Committee on Life Insurance Research.

RECENT PAST

Global Mortality Improvement Experience and Projection Techniques (6/2011: The report provides a literature review, but also a summary of past improvement levels whether by country, age, gender, and general population versus insured population. It then goes on to describe possible ranges for future improvement, and modeling techniques. I found it interesting that most recent improvement levels have been materially higher than the average, and wonder whether the trend will continue. It will also be interesting to observe the basis risk dynamic where insured improvement could differ from general population improvement, as the insured demographic continues to become healthier and wealthier. http://www.soa.org/research/research-projects/life-insurance/research-global-mortality-improve.aspx

New Medical Markers in Life Insurance Underwriting (12/2011): The report explores what new medical markers are being explored by the three main labs, and provides considerations as to whether they could be implemented to medical underwriting. A calculation spreadsheet also determines the cost-benefit factors in implementing the new markers. Overall it looks like some of the markers (not widely used in the industry) could provide additional benefit starting as low as $100k policy sizes. http://www.soa.org/research/research-projects/life-insurance/research-medical-markers.aspx

Access to Reinsurance by Smaller Insurers: Perils, Pitfalls and Solutions (10/2011): The report examines challenges encountered by smaller insurers in obtaining life reinsurance, the challenges and opportunities life reinsurers face in servicing these companies, and considers some possible solutions that might help to resolve the challenges encountered. http://www.soa.org/research/research-projects/life-insurance/research-2011-11-access-rein.aspx

Mortality Comparison and Risk Exposures in the Older Age U.S. Financial Services Market (12/2011): The report compares the pricing assumption mortality of 15 companies surveyed by insurance, annuity, and pension product lines. It then identifies possible reasons for the different mortality expectations by product such as the underwriting, target market, and degree of selection. Finally the report explores whether there could be possible exposure to arbitrage, at the individual policy or portfolio level. http://www.soa.org/research/research-projects/life-insurance/research-mortality-comparisons.aspx

NEAR FUTURE (IN THE PIPELINE)

Mortality at the High Face Amounts: The report will provide the analysis of mortality of amounts $1m and over, by band, in relation to amounts under $1 million. Both univariate and multivariate analysis will be done using the variables age, gender, duration, smoker status, product, and cause of death, etc. The study will analyze more than 7000 claims for amounts of $1 million and more, certainly a much greater number than the older large amount reports done in the 1990s where typically a maximum of hundreds of claims were analyzed. Hopefully we can determine more information such as whether the 'J' curve (eventually higher mortality at the highest bands) exists and why.

Key Issues in Reinsurance Treaty: While still in the early stages of development, the report will likely identify what reinsurers and direct companies feel are the most difficult treaty issues and provide possible solutions to all parties. The report may be conducted as a survey or Delphi study, and will likely address key terms such as errors and omissions and binding limits.

CONTINUED ON **PAGE 22**

Extreme Event Risk: While still in the early stages of development, the report will likely examine different methods of assessing capital charges for extreme event risks as well as strategies to manage these risks.

LOOKING AHEAD

Over the early part of the second quarter of 2012 the Reinsurance Section's research team will be brainstorming and finalizing what the new set of projects ideas will be for the coming year. I encourage you to get involved. You can suggest an idea, volunteer for a project, or volunteer to be part of our research team. While serving as the research head over the past three years, I have definitely learned a lot and really enjoyed my time. If you volunteer, I am sure you will feel the same. We have a very friendly and insightful research team, including an excellent SOA staff, and this is true even though most members have not volunteered in this way before.

If you have an idea or interest contact myself (edward.hui@caldwell-ls.com) or Ronora Stryker of the SOA (rstryker@soa.org). Often, all it takes is for you to say, "wouldn't it be nice if we knew more about ..."? We look forward to hearing from you!

Special thanks to the research volunteers who participated in the project oversight group or the actual research, the researchers, and the SOA staff. Their names are listed in the research reports.

Current RSC research team volunteers: Mike Bertsche, Greg Brandner, Audrey Chervansky, Maple Cheung, Ing Chian Ching, Tom Edwalds, Clark Himmelberger, Edward Hui, Achille Lanang, Stephen Manly, Gary Pauline, Michael Shumrak, Kevin Trapp, Jean-Marc Fix. Past RSC research team volunteers (since 10/2008): Bill Briggs, JJ Carroll, Gaetano Geretto, Bob Lau, Kelly Levy, Jim Sweeney, Karen Tan. SOA staff: Mike Boot, Christy Cook, Jack Luff, James Miles, Jan Schuh, Ronora Stryker. ■

Join us April 18, 2012 for the **56th Annual CRC Conference**

METRO TORONTO CONVENTION CENTER

by Sharon Ludlow

The CRC is the largest annual life reinsurance gathering in the world, attracting over 500 delegates from insurance, reinsurance and retrocession companies and others engaged in supporting reinsurance transactions. Delegates attend from Canada, the United States and other countries, to experience a unique combination of education and networking opportunities, in a concentrated one-day format. ■

Sharon Ludlow is President & CEO, Swiss Reinsurance Company Ltd in Toronto, Canada. Sharon can be reached at sharon_ludlow@swissre.com.

THE 2012 CANADIAN REINSURANCE CONFERENCE:

cREating opportunities admist change

In the midst of turbulent times, the (re)insurance industry is seeking to create new opportunities in a changing environment. The most successful companies will be those that can identify and create opportunities amidst change.

The regulatory framework is under review in all jurisdictions and higher capital requirements are a likely outcome. Accounting convergence is still underway with Canada at the centre of the international debate.

Technology and predictive analytics are becoming the norm as companies attempt to gain competitive advantage. Product development is now firmly under the lens of risk management as risks are evaluated long before going to market.

The spotlight on mortality and morbidity risk is now shared with longevity risk as companies grapple with the effects of modern medicine and the impact on their balance sheets and pension funds.

To top it all off, we live in a world becoming ruled by social media. Are we prepared as an industry to leverage it in our everyday business?

Plan to attend the 2012 CRC where our speakers will share their perspectives and experiences on these issues, focusing on how to cREate opportunities amidst change. We have an impressive agenda that includes our keynote Don Stewart of SunLife who will share his reflections on the industry. As always, you will have ample time to network with your peers.

2012 CRC April 18, 2012
www.crconline.ca

Brazilian Reinsurance Regulation **Changes Again**

By Ronald Poon Affat

Ronald Poon Affat, FSA, FIA, MAAA, CFA is both a VP of Tempo Assist (a Sao Paulo based heath conglomerate) and a member of the Board of the Society of Actuaries. He can be reached at ronald.poon@tempoassist.com.

In November 2011, a number of associations, including the American Council of Life Insurers (ACLI), filed comments with the Brazilian regulatory authority urging Brazil to stop restricting reinsurance access to only domestic reinsurers in one of the world's leading emerging markets for insurance. This article examines the background and legitimacy of this complaint.

In 1939, the Brazilian Reinsurance market was closed to direct access by international reinsurers. It was officially reopened in April 2008 and is now home to 75 multinational reinsurance groups including the State Reinsurer, Instituto de Resseguros do Brasil (IRB-Brasil Re). Please note that several reinsurers (e.g., ACE) have multiple registrations, so records will show that there are 92 approved companies in total.

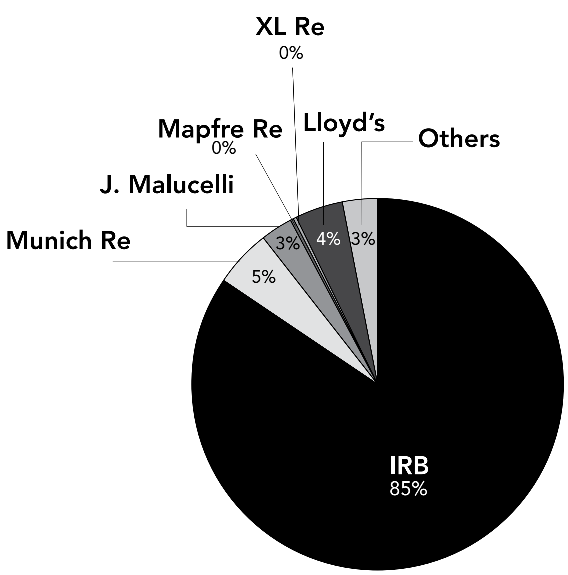
However, Brazil is still not an open reinsurance market; rather it's in the process of opening. At the moment, it's like a three-ring circus. Reinsurers may apply for classification as local, admitted or occasional reinsurers. Each classification requires different levels of capital and provides access to varying percentages of ceded risks.

The graphs below and on pg. 25 set out Gross Premium Market Share percentages of the local reinsurers over the period 2008 to 2010.

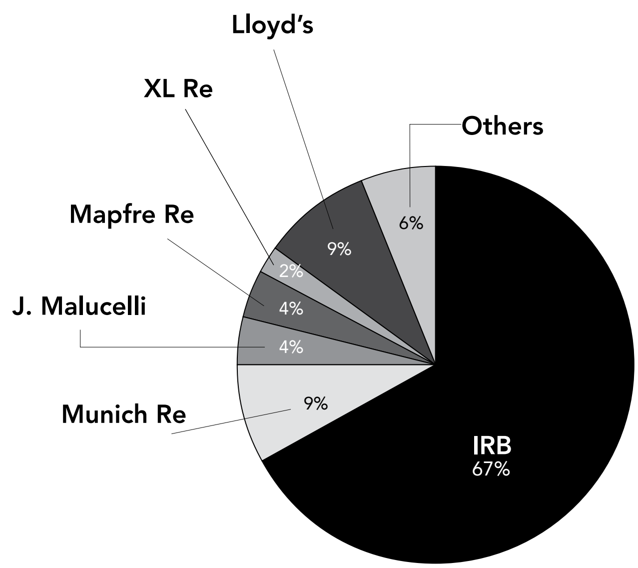
We can clearly see that the IRB-Brasil Re's share has declined from 85 percent to 25 percent over a three-year period. So let's summarize what it means to be a local or non-local reinsurer Brazil, and what were the altercations since the opening of the market that led to the ACLI's complaint.

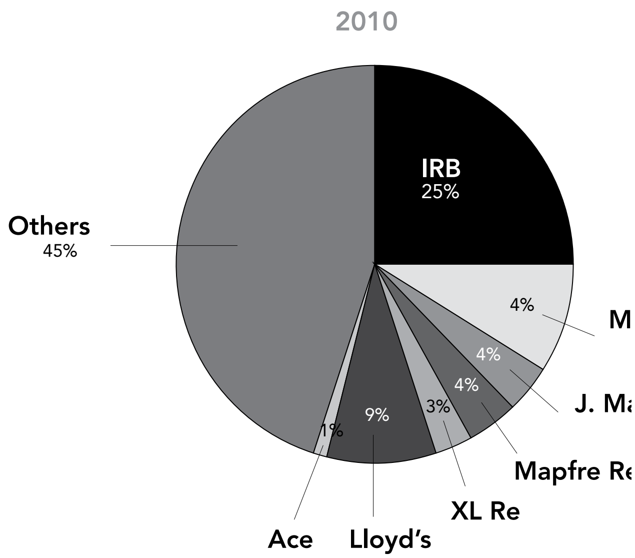
The charts below show the variation in market share percentages, measured by Gross Premium 2008 - 2010."

2008



2009





1939 TO 2008

IRB-Brasil Re was the only show in town. For a multinational reinsurer to obtain any risk they either had to be a registered retrocessionaire of IRB-Brasil Re or IRB-Brasil Re needed to give their explicit written permission that such a risk/treaty could be executed between the said client/ceding company and reinsurer. There was also no official law that regulated Reinsurance. The IRB-Brasil Re's decision was the law. IRB-Brasil Re could decide to assume a share of the risk that ranged from 0 to 100 percent, e.g., for life business, the IRB-Brasil Re maintained a majority percentage of the cession, health business was retroceeded 100 percent and certain special risks, e.g., petroleum companies, were given special dispensation and were allowed to work directly with foreign reinsurers.

2008 – 2010

In January, 2007 the monopolist regime was abolished with the establishment of new legislation (Law 126/07). This legislation defined the regulation of the reinsurance, retrocession and coinsurance markets and also transferred to SUSEP (Brazilian Insurance Regulator) all regulatory responsibilities formerly held by IRB-Brasil Re. According to the new legislation, reinsurers would be classified as "local," "admitted," or "occasional." Each classification requires different levels of capital and provides access to varying percentages of ceded risks.

Specifically, the definitions of these three tiers were the following:

1. Local—have the right of refusal for at least a minimum percentage of all reinsurance cessions. During the first three years, insurance companies would have to offer local reinsurers 60 percent of their reinsurance cessions, with this requirement reducing to 40 percent after this period. These companies have to be locally established as a joint stock company with a minimum mandatory capital of BRL60 million (about USD34 million). Company is regulated by SUSEP.

   Local reinsurance companies could retrocede up to 50 percent of their portfolio's premium. There was no law regarding inter-company transfers.

2. Admitted—needs to have a representative office in the country and set up an escrow account with USD5 million for all lines or USD1 million for life reinsurance only. Minimum rating of Baa3/BBB-.

3. Occasional reinsurers—do not need to set up a local office, but there is a limitation for insurance

CONTINUED ON PAGE 26

companies to cede only up to 10 percent of premium to them; they must have a minimum rating of Baa2/BBB.

Both the Admitted and Occasional effectively maintained 100 percent of the risk offshore with no reserves held in Brazil.

RESOLUTIONS 225 AND 232

When the market eventually opened in 2008, the reinsurance regulator (SUSEP) advised of this tiered structure, so all players choosing to enter the market would have been aware of the restrictions. However, the main reason behind the recent complaint is the fact that the Government keeps changing the rules and it always appears that the revised rules are aimed at frustrating the multinationals with the main benefactor being the state reinsurer (IRB-Brasil Re) companies made their capital allocation decisions based on the initial rules. However, the way in which regulation has been conducted just creates uncertainty. The ACLI complaints were triggered by two new rules that came into effect during 2011, namely:

225—Cession of 40 percent to Local (licensed to operate reinsurance in Brazil) reinsurers is now mandatory for all facultative and treaty business. Prior to the new resolution, any type of business had only to be "offered" to Local reinsurers but not necessarily placed with them (Formerly the local reinsurers had a right of first refusal, which if they did not exercise it, the ceding company could cede 100 percent abroad).

232—No reinsurance cessions or retrocessions will be allowed to cede more than 20 percent to any company from the same economic group, if the receiving company is located abroad. This limits cessions from any multinational insurance companies directly to their home office. (The original resolution was numbered 224 and initially forbid any inter-group cession). What is further complicating the market with this rule is "20 percent" is not clearly defined. No one knows if it is on a portfolio, line of business, or risk basis or if it is measured by premium, limits, or some other value.

SO WHY ARE ALL OF THESE CHANGES HAPPENING?

There is no doubt that the rapid decline of fortunes of IRB-Brasil Re is the main reason for the changing regulatory landscape.

The pie-charts on pgs. 24 and 25 confirm that the main share of the reinsurance market has gone to the multinational reinsurance companies who are registered as admitted or occasional. These companies are transferring risk between their locally based direct writing companies and their overseas reinsurance arms. No local company is even in the double digits regarding market share. It would appear that the objective of the regulation is to discourage the retroceeding to the admitted and ccassionals and to insist on the formation of more local reinsurers and hence ensure that the majority of the risk is kept in Brazil. This of course defeats one of the primary functions of reinsurance which is to pool risks from many countries in one centralized location rather than maintaining reserves in every single country where it has risk exposure.

The local reinsurers include IRB Re, Munich Re, XL Re, ACE Re, Mapfre Re, Chartis Re, Austral Re and JMaluchelli. Since these controversial resolutions (224 and 232) were effected, Swiss Re, Terra Brasis and Argo Re have formally announced that they will be forming local reinsurers ... and several others are in the pipeline.

I would like to suggest that there may be four main reasons why the rules keep changing in Brazil:

1) Share ownership

Lets not forget who owns the IRB-Brasil Re. Fifty percent is owned by the Banco do Brasil, 21 percent by Bradesco, 15 percent by Itau Unibanco and the remainder by a variety others.

As of August 2011, http://www.relbanks.com/worlds-top-banks/market-capitalization-2011 ranked the three major shareholders of the IRB-Brasil Re within the top 25 of the world's banks by market capitalization. The sudden decline of premium/profits and ultimately value of their joint venture would no doubt have concerned these three financial powerhouses.

2) INdeR—Argentina

The Argentinian reinsurance market opened in the late 1980s and their state reinsurer, Argentina's Instituto Nacional de Reaseguros (IndeR), saw its final demise in 1992. The cumbersome tiered structures in Brazil seem to have had the objective of maintaining the IRB-Brasil Re as a going business concern in the face of stiff competition from the world's professional reinsurers. Recently new regulations have been passed in Argentina that copies parts of the Brazilian Reinsurance model thus making it very difficult to do business there; but this is a topic for another article.

3) Paternalistic ideology

Politically, Brazil still has very strong roots in socialist ideology and there is the belief that the primary responsibility of government is to protect the population and its resources. The political rhetoric is certainly slanted to the left and the government will always try to ensure the success of a state entity within this political environment.

4) Lack of Lobbying

As soon as the Reinsurance law was passed, the multinationals should have taken an active role in lobbying the government for a truly free and open reinsurance market. This did not happen. Instead the multinationals adopted a rather passive approach to work within the rules.

" ... THE WORLD'S EYES ARE ON BRAZIL AND FRANKLY ... THE WORLD EXPECTS MORE."

CONCLUSION

With the emergence of Brazil as the world's 6th largest economy (dethroning the UK), frenetic preparations are on the way for the 2014 World Cup and 2016 Olympics and of course the steady and sustainable projected growth of the economy; the insurance industry will undoubtedly be a direct benefactor.

The recent changes have clearly shown that the regulators/politicians have not kept up with the fact that Brazil is now considered to be an international economic powerhouse. There needs to be a paradigm shift in transitioning anachronistic state-dominated thinking to the modern reality.

The ACLI's complaint is a useful reminder that the world's eyes are on Brazil and frankly that the world expects more.

The views expressed in this article are solely those of the author and not those of his employers or organizations with which he is affiliated. ■

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