



*somewhat  
different*

# Introduction to Financial Reinsurance

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*hannover* **life re**<sup>®</sup>

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# CONTENT

- Terminologies
- Financing Reinsurance
- Motivation and drivers
- Reinsurance structures
- Legal and regulatory aspects

**Focus is on Life Insurance and Life Reinsurance Business**

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# TERMINOLOGIES

Buzz Words

Finite Re

Securitisation

ART

Reinsurance Financing

Financial Re

Non-traditional Reinsurance

Financial Solutions

...

Fin Re

# TERMINOLOGIES

## Financing Reinsurance

### "Definition"



- Reinsurance, with primary focus to generate a financial benefit
- Risk transfer / risk management purpose rather a side aspect
- Financial benefit could be a(n)
  - monetary
  - economic
  - tax
  - accounting
  - rating
  - or some other kind of "desired" effect

**A Matter of Perspective**

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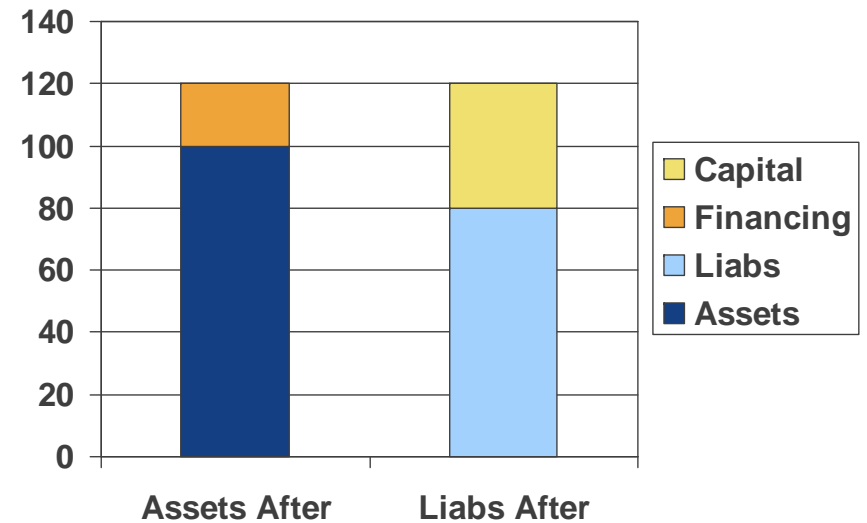
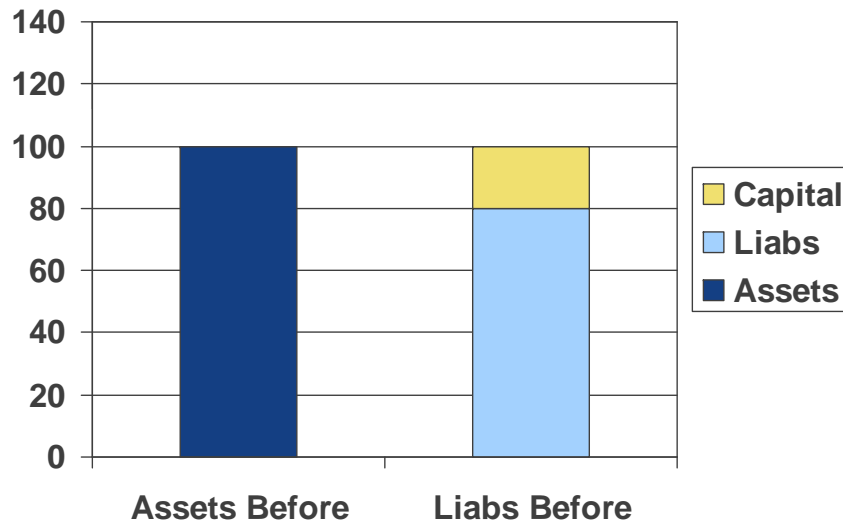
# FINANCING REINSURANCE

## Illustration 1

Financing Reinsurance enhances the surplus of a company

### Cedant's Balance Sheet

(simplified, statutory reporting)





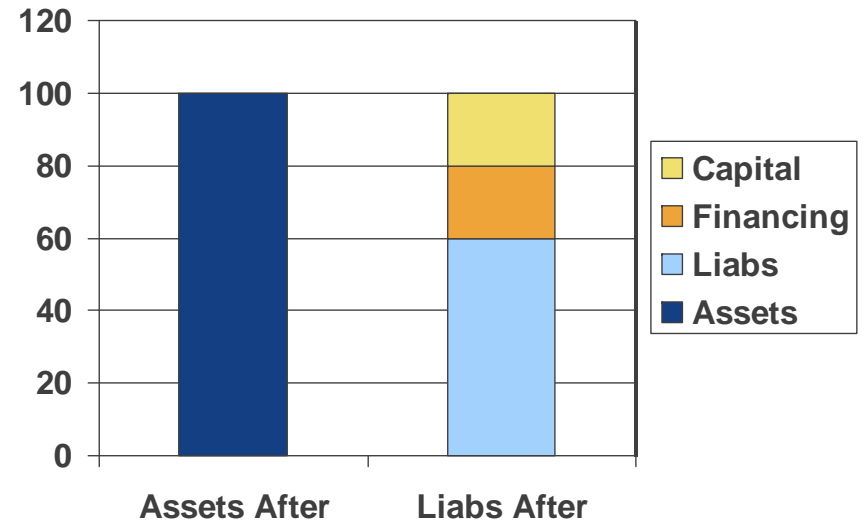
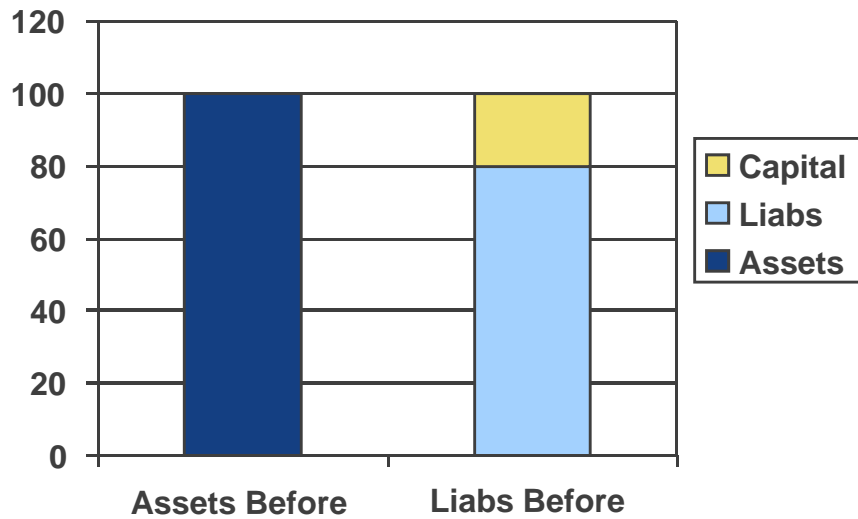
# FINANCING REINSURANCE

## Illustration 2

Financing Reinsurance enhances the surplus of a company

### Cedant's Balance Sheet

(simplified, statutory reporting)



# FINANCING REINSURANCE

## Classifications

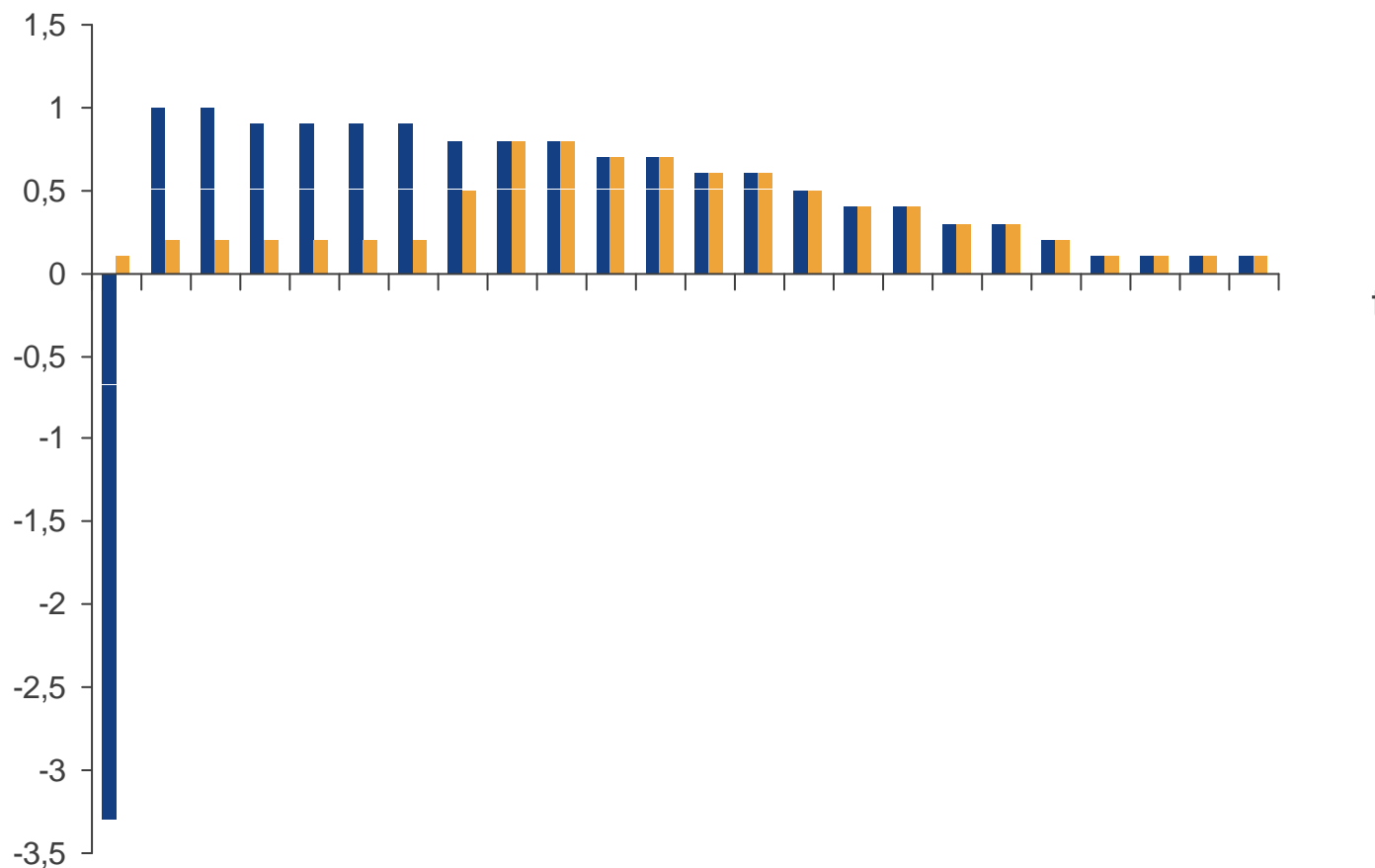
- **New business financing or Block Assumption Transaction (BAT)**
- **Asset or liability financing**
  - Increase of assets or reduction of liabilities
- **Cash or non-cash financing**
  - Transfer of liquidity or not
- **Immediate versus deferred financing**
  - Financing at inception or – later – in the course of the transaction
- **Optional, contingent, contingent-optional financing**
  - Cedant may opt to draw on financing subject to certain caveats
  - Financing rendered upon certain trigger events
  - Hybrid forms

# FINANCING REINSURANCE

## New Business Financing

### Technical results **before** and **after** financing of new business

#### Results



## **FINANCING REINSURANCE**

### New Business Financing

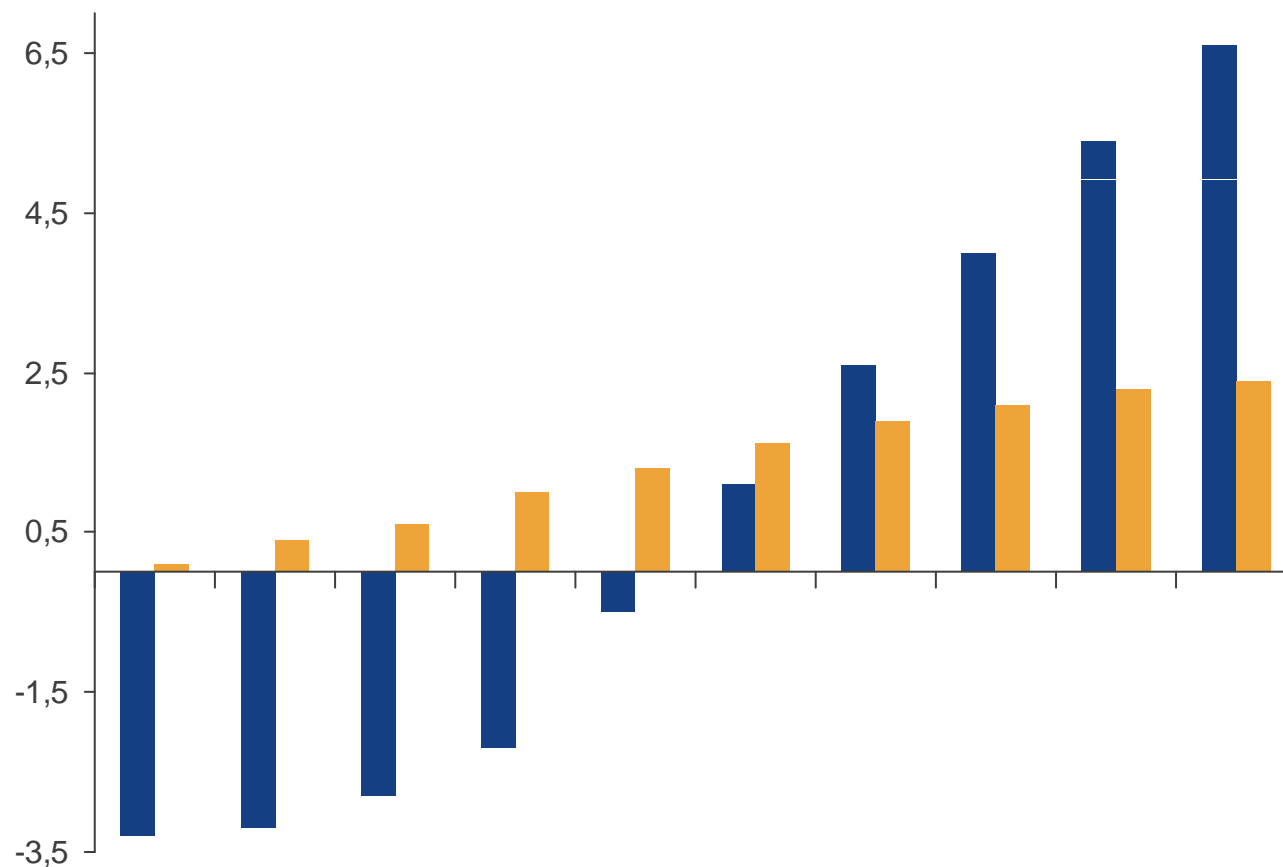
- **Initial strain is taken over through high first year ceding allowance**
- **Expense allowance to Cedant to support renewal commissions and administration expenses**
- **Popular: Recuperation of the initial financing monitored via a Deficit Account**
- **Recapture option or conversion to traditional YRT arrangement possible after recuperation of financing**

# FINANCING REINSURANCE

Multiple years' new business financing

## Technical results **before** and **after** financing of multiple years

### Results



# BLOCK ASSUMPTION TRANSACTION

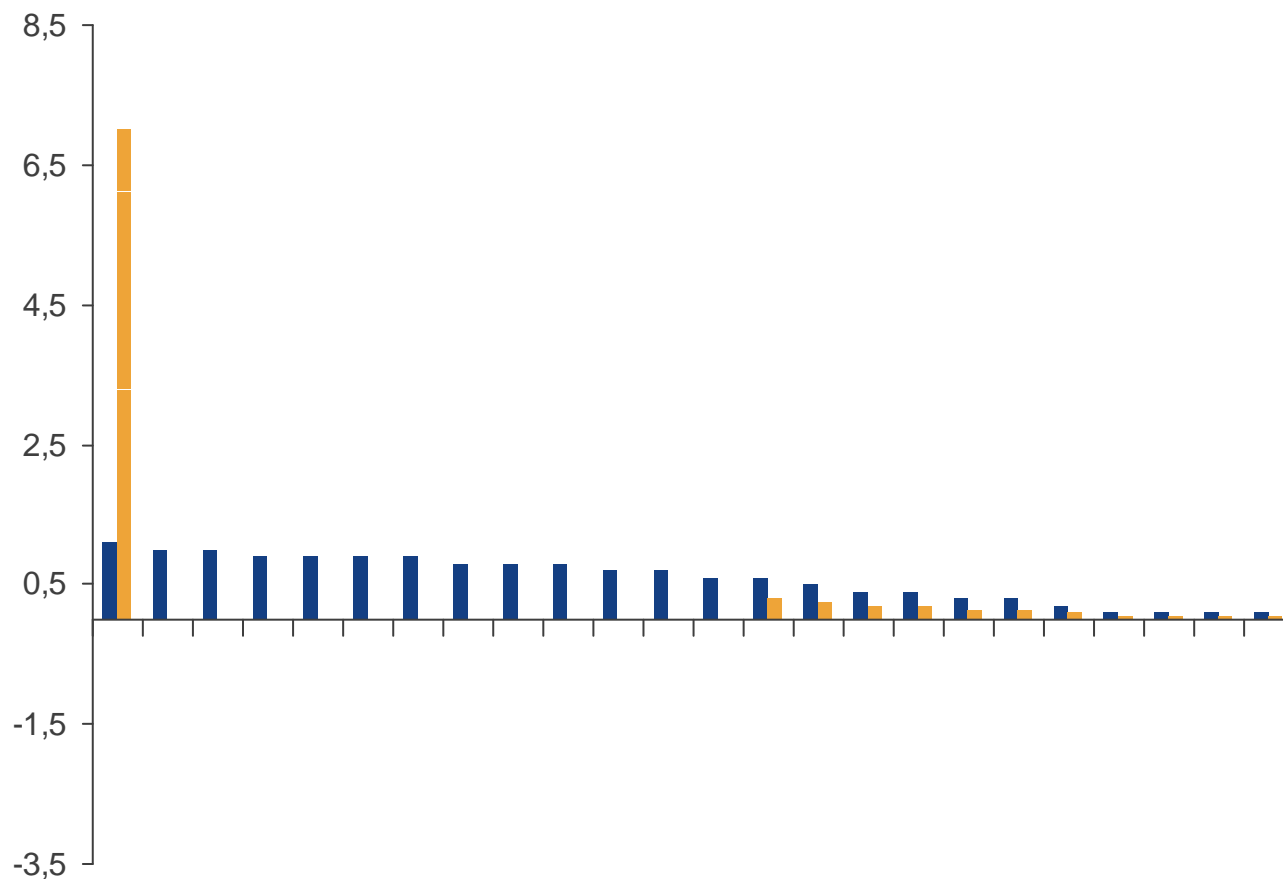
- Reinsurance of an inforce block of business
- Initial financing (ceding allowance) generates an immediate gain
- Liquidity increases (if cash transaction)
- Future gross margins reduced by cession of future margins
- Recuperation contingent on the emergence of margins
- Allows for a substantial immediate gain since inforce volume is available
- Recapture option possible after recuperation of financing

# FINANCING REINSURANCE

## Block Assumption Transaction

### Technical results **before** and **after** Block Assumption Transaction\*)

#### Results



\*) 100% reinsurance share for illustration purposes only

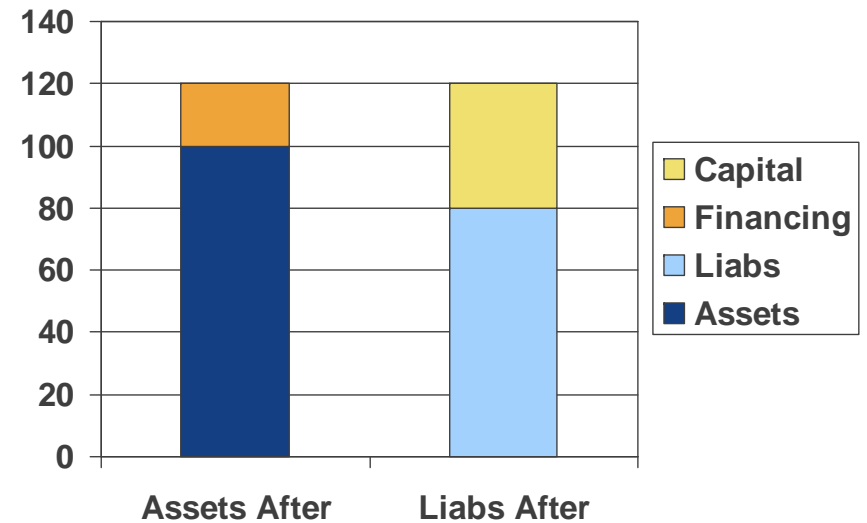
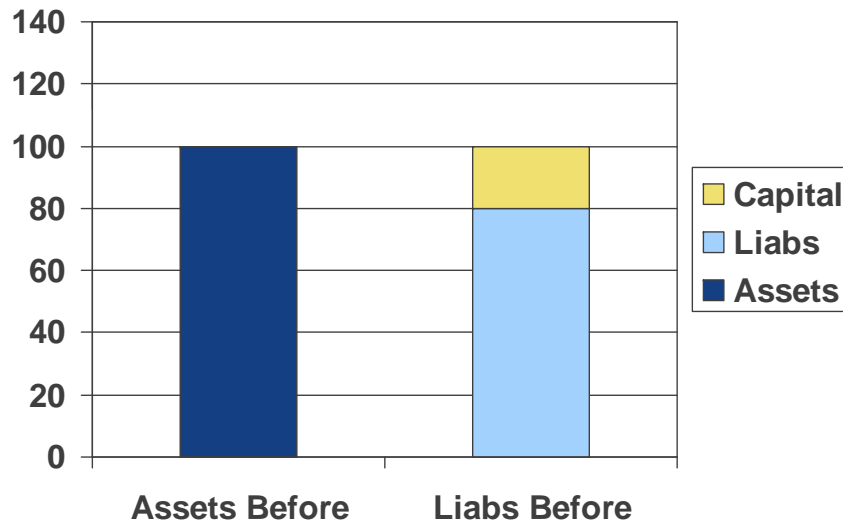
# FINANCING REINSURANCE

## Illustration

### Asset financing

### Cedant's Balance Sheet

(simplified, statutory reporting)





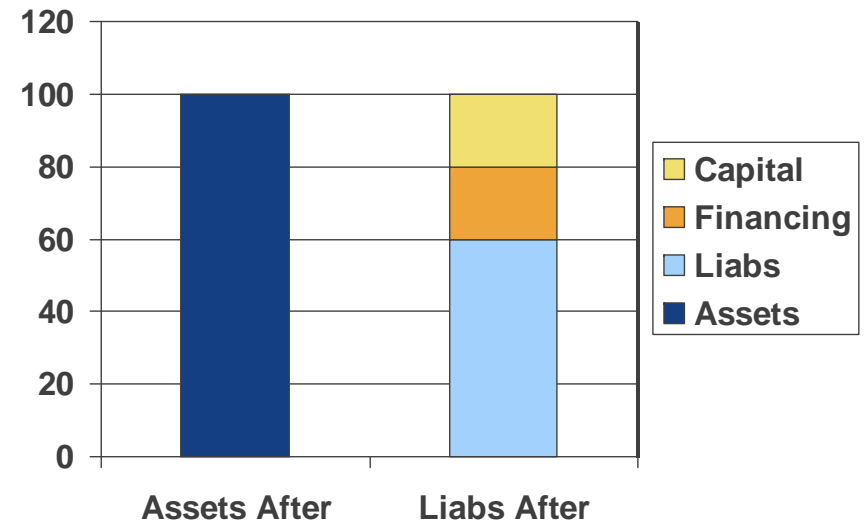
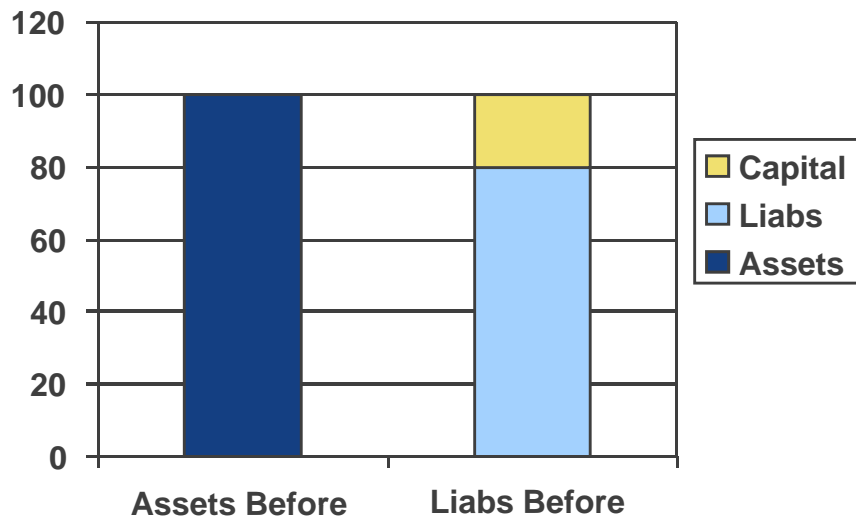
# FINANCING REINSURANCE

## Illustration

### Liability financing

#### Cedant's Balance Sheet

(simplified, statutory reporting)



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**Focus is on Life Insurance and Life Reinsurance Business**

## **MOTIVATION AND DRIVERS**

### Reasons for using Financial Reinsurance

- **Reduce new business strain (balance sheet, surplus, cash, reserve)**
- **Surplus enhancement**
- **Boost return on capital**
- **Strengthen ratings**
- **Support Mergers & Acquisitions, New ventures**
- **Improve solvency ratios (capital adequacy, RBC)**
- **Avoid investment restrictions (e.g. limits on derivatives)**
- **Tax management (e.g. utilisation of tax loss carried forward)**
- **Arrange with changes in regulation (reserving, solvency)**
- **Smoothing or stabilising of results**

# MOTIVATION AND DRIVERS

## Product Offerings and Provider of Financing

	Banking	Reinsurance
<b>Products</b>	Debt or Equity	YRT, Coinsurance, ModCo, Coins Funds withheld, Hybrid forms
<b>Duration</b>	Short	Flexible
<b>Covenants</b>	Restrictive	Flexible
<b>Appetite for (insurance) risk</b>	LOW	HIGH
<b>Execution time</b>	3-6 months	1-3 months
<b>Insurance experience</b>	Low – few actuaries and underwriters	High – similar business and risk
<b>Accounting</b>	Non-insurance	Insurance

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# REINSURANCE STRUCTURES

## Basic types

### → Coinsurance (Original Terms)

- Reinsurer participates proportionally in premiums, claims, reserves and the accumulation of reserve-backing funds

### → Coinsurance funds withheld

- Like coinsurance, but the funds backing the reinsured reserves are deposited back with the Cedant

### → Modified coinsurance (ModCo)

- Like Coinsurance, but both reinsured reserves and respective funds are deposited back with the Cedant

### → Yearly Renewable Term (YRT)

### → Hybrid forms (e.g. Co-ModCo) and non-proportional solutions

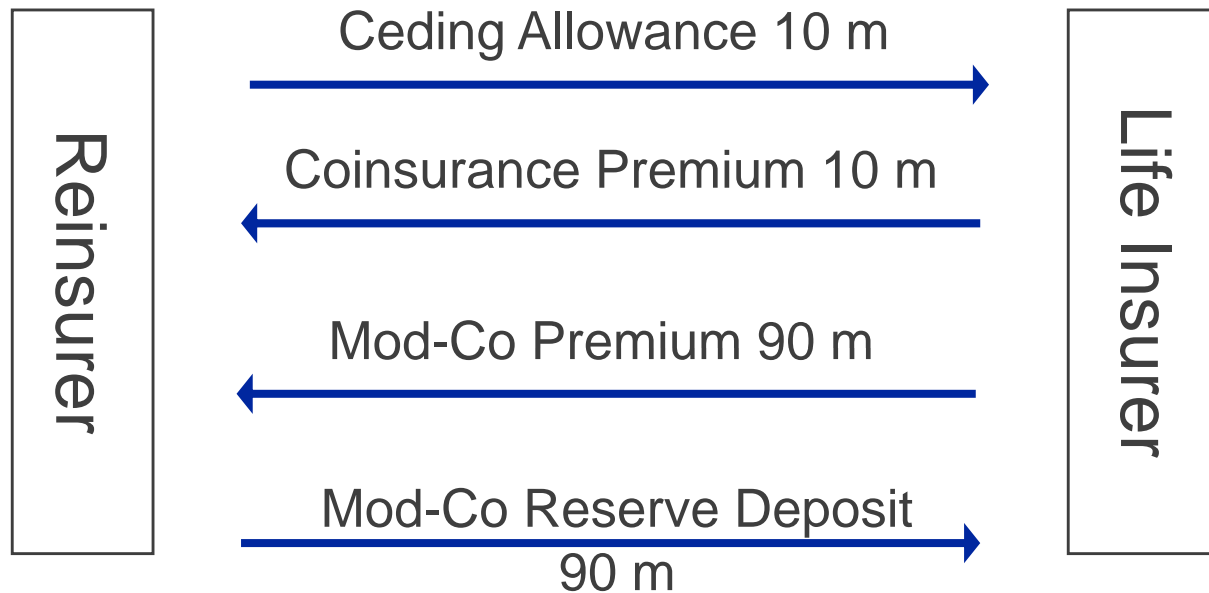
**Most of the reinsurance types are implemented on a quota share basis**

# REINSURANCE STRUCTURES

## Example: Co-ModCo Non-Cash Financing

→ At inception, the Reinsurer assumes on q/s basis a closed block of business with underlying statutory reserves of 100 m

- 10% of the business on Coinsurance basis
- 90% of the business on Modified Coinsurance basis
- A Ceding Allowance of 10 m is paid at inception



**Zero Cashflow**

## REINSURANCE STRUCTURES

### Example: Co-ModCo Non-Cash Financing

#### Result:

- The life insurer's assets remain unchanged
- But its liabilities have fallen by 10 m

#### What happens next?

- Each year, a (high) portion of the reinsured statutory profit is refunded as a ModCo-Adjustment and added to the deposited ModCo-Reserve
- Over time the Co-ModCo treaty converts into a pure ModCo treaty
- Eventually the deposited reserve represents 100% of the reinsured statutory reserve
- **(if the underlying business performs favourably enough!)**



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## THE REGULATOR'S PERSPECTIVE

- Ensure the protection of policyholders
- Strengthen the financial security of the insurance industry
- Encourage good management of insurance companies
- Limit tax avoidance
- Promote certain trade policies
- Support innovation and development in the insurance industry

**Financial Reinsurance is a very globalised and international business. Financial centres usually have "favourable" regulatory and tax regimes.**

## **POSSIBLE REGULATORY REGIMES**

### Extreme restrictions on Financial Reinsurance

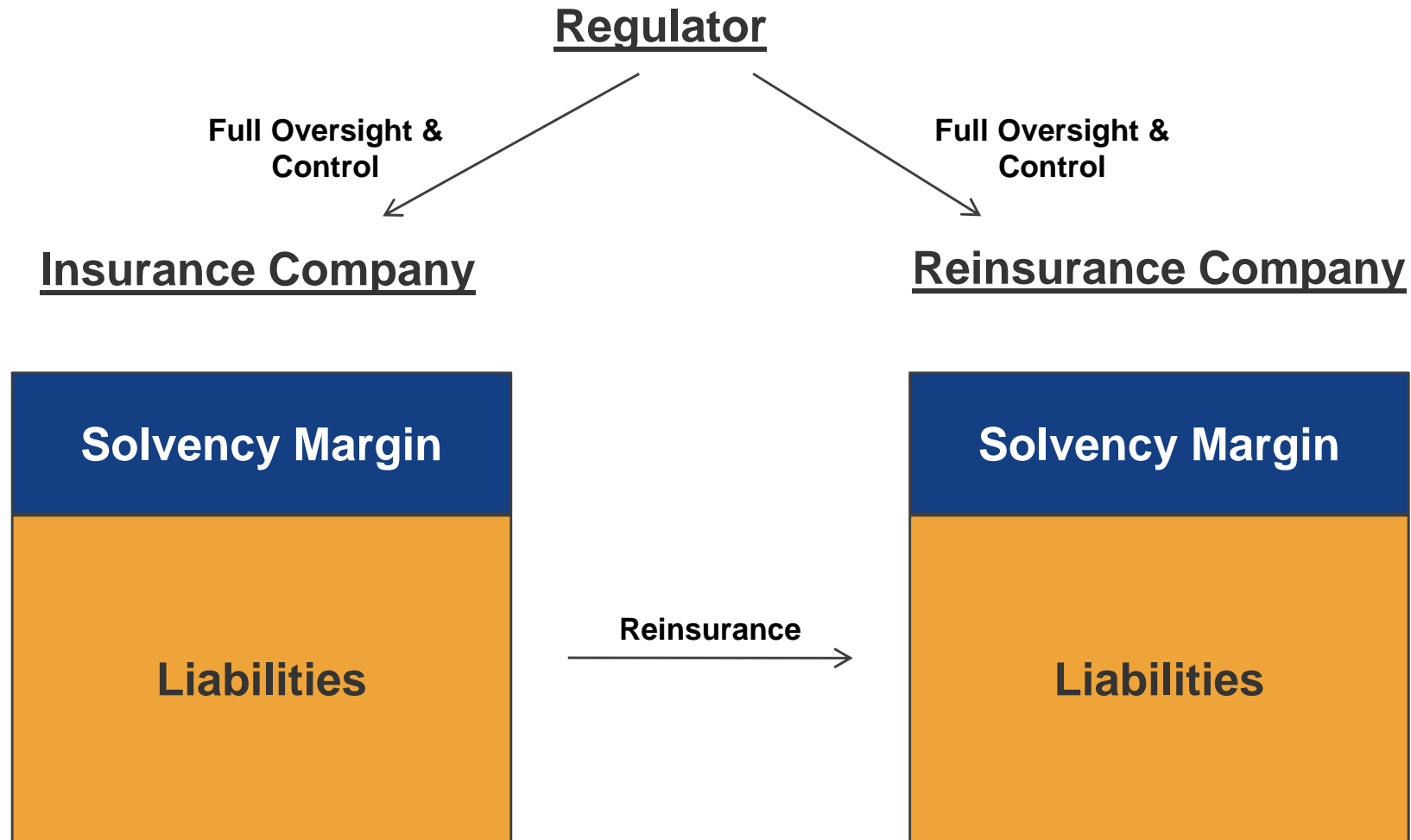
- **Allow only domestic companies to provide reinsurance**
- **Subject reinsurance companies to the same regulations as insurers**

#### **Consequences of Regulatory Regime:**

- **No reduction in total statutory liabilities due to reinsurance**
- **No reduction in total statutory solvency margin requirement**
- **Tax advantages of reinsurance are limited**
- **Scope for capital optimization in the insurance industry is restricted**

# POSSIBLE REGULATORY REGIMES

Extreme restrictions on Financial Reinsurance



## **POSSIBLE REGULATORY REGIMES**

### Few restrictions on Financial Reinsurance

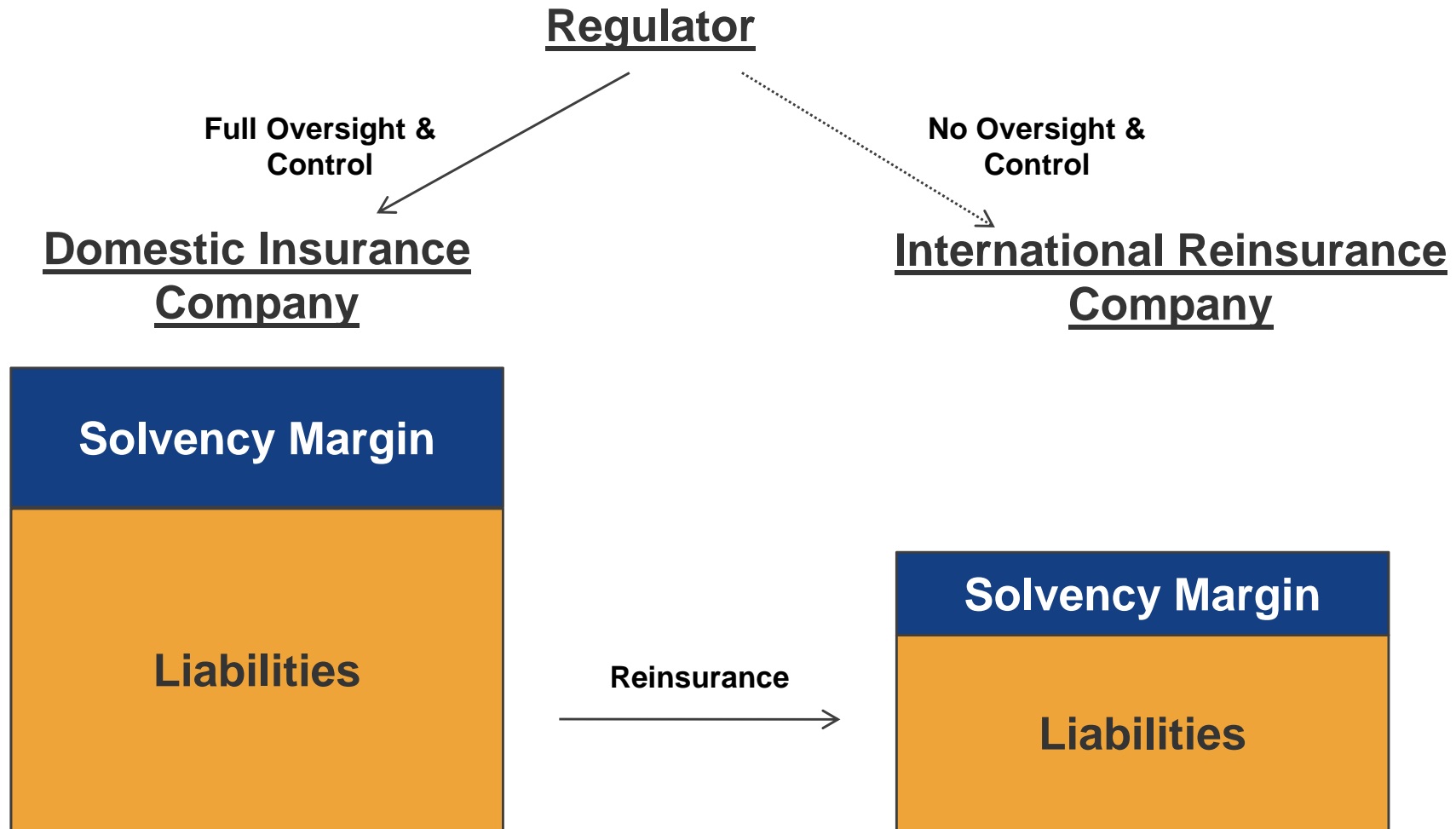
- **Allow domestic and international companies to provide reinsurance**
- **Subject international reinsurance companies to no regulation**

#### **Consequences of Regulatory Regime:**

- **Total statutory liabilities are reduced by reinsurance**
- **Total statutory solvency margin requirement is reduced**
- **May be major tax advantages to international reinsurance**
- **Reinsurance will encourage capital optimization in the insurance industry**
- **Considerable uncertainty as to security of reinsurance arrangements**

# POSSIBLE REGULATORY REGIMES

Few restrictions on Financial Reinsurance



## **POSSIBLE REGULATORY REGIMES**

### Reasonable restrictions on Financial Reinsurance

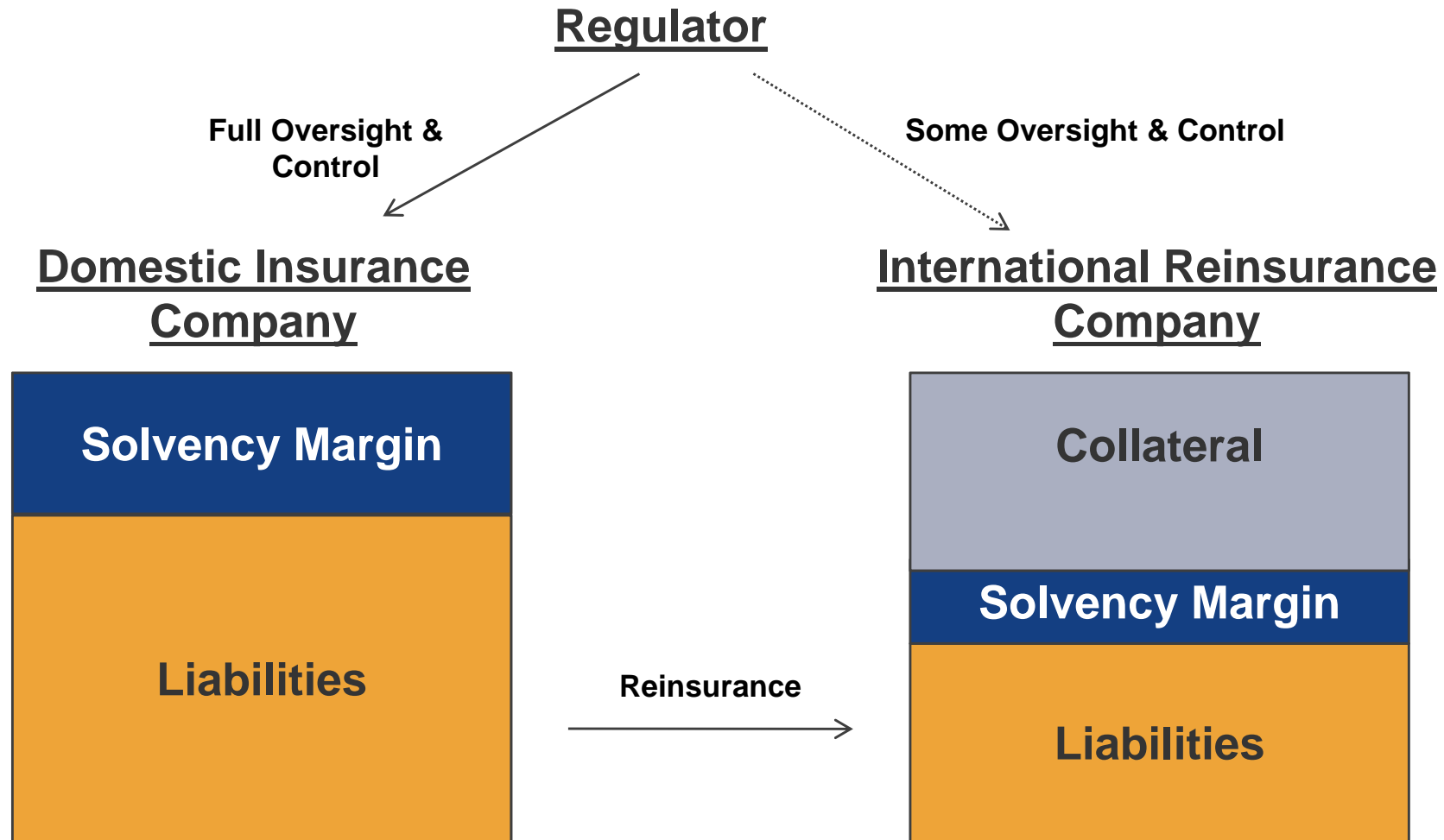
- **Allow domestic and international companies to provide reinsurance**
- **Subject reinsurance companies to a reasonable amount of regulation**
- **International reinsurers must be authorised, approved and provide financial guarantees**

#### **Consequences of Regulatory Regime:**

- **Amount of capital backing insurance liabilities is unchanged**
- **The form of the capital backing insurance liabilities is changed**
- **May be tax advantages, some scope for capital optimisation**
- **More certainty as to security of reinsurance arrangements**

# POSSIBLE REGULATORY REGIMES

Reasonable restrictions on Financial Reinsurance





## THE REGULATOR'S PERSPECTIVE

### Important issues

- **"Definition" of reinsurance and risk transfer requirements**
- **Acceptable forms of reinsurance**
- **Approved reinsurance companies**
- **Rules for non-approved companies**
- **Contract wording requirements**
- **Capital and solvency requirements**
- **Collateral requirements for reinsurers**
- **Tax rules, accounting rules**
- **Extent and frequency of oversight**

## **REGULATION AND ACCOUNTING**

### Some Developments and Outlook

- **Solvency II Regulatory Regime in Europe (Implementation in 2012?)**
- **International Financial Accounting Standards (IFRS)**
- **New Collateral Rules in the United States**
- **Possible Federal Regulation in the United States**
- **Impact of the Financial Crisis and Credit Crunch**

# REGULATION AND ACCOUNTING

## Developments and Outlook

### Scenario I

- IFRS adopted worldwide
- Solvency II adopted worldwide
- Restrictions on tax havens



- No regulatory capital arbitrage
- No tax arbitrage



Limited demand for  
Financial Reinsurance

### Scenario II

- Different accounting standards
- Solvency II not widely adopted
- Continued existence of tax havens



Ongoing demand for  
Financial Reinsurance



High importance of  
reinsurance regulation



somewhat  
different

**Thank you for your attention!**