

Finance, Management & Operations

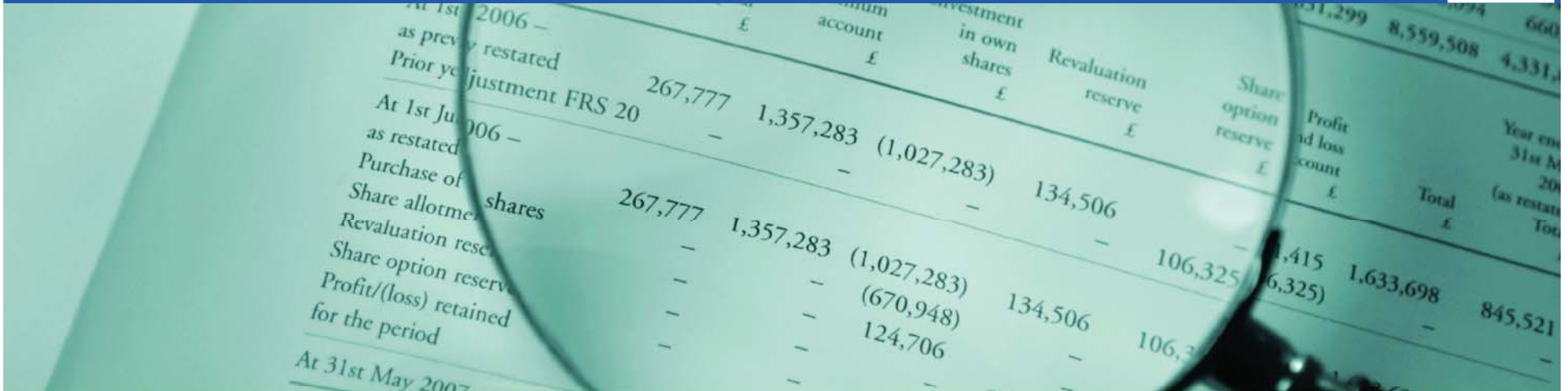
R&R: Risk and Reinsurance

Peter Blume, Managing Director – Life, Accident & Health
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Bruce Stahl, Vice-President & Actuary
RGA Reinsurance Company





	£	£	£	£	£	£	£
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Prior year adjustment FRS 20	267,777	1,357,283	(1,027,283)				
At 1st July 2006 – as restated							
Purchase of shares	267,777	1,357,283	(1,027,283)		134,506		
Share allotment							
Revaluation reserve						106,325	
Share option reserve							
Profit/(loss) retained for the period					134,506		
At 31st May 2007						106,325	

R&R: Risk and Reinsurance

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Vice-President & Actuary

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ERM: risks insurance companies seek to manage

- Market Risk
 - Currency
 - Equity
 - Interest
 - Inflation
- Credit Risk
 - Credit migration
 - Insurance Counterparty
- Insurance Risk
 - Mortality Catastrophe
 - Mortality Mis-estimation
 - Mortality Volatility
 - Morbidity Mis-estimation
 - Morbidity Volatility
 - Policyholder Behavior
 - Fund allocation
 - Lapse sensitivity
 - Lapse supported
 - Withdraws
 - Longevity Mis-estimation
 - Longevity Volatility

ERM: risks insurance companies seek to manage

- Operations Risk
 - Process
 - Administration
 - Claims
 - Disruption
 - Financial reporting
 - Information security
 - Investment operations
 - Pricing process
 - Retrocession
 - Underwriting
 - Legal/compliance
 - Regulatory change
 - Sovereign
- Financial
 - Collateral
 - Expenses
 - Financing
 - Liquidity
 - Tax
 - Valuation
- Intangibles
 - Human capital
 - Ratings
 - Reputation
 - Strategy

Addressing policyholder behavior risk



- Although LTCl policyholders rarely lapse and do not accumulate cash value, benefit options still determine policyholder behavior.
- Examples:
 - Cash benefits vs. Expense Reimbursement
 - Assisted Living Facilities vs. Nursing Homes
 - Waiver of premium
 - High Lifetime Maximums

Addressing policyholder behavior risk (cont'd)



- Insurers may try to address policyholder behavior with high lifetime maximums using Excess reinsurance.
 - Reinsurer receives set premium rates to cover benefits after x months or y dollars on each claimant.
 - Exaggerated adverse or favorable experience for reinsurer (high deductible).
 - Insurer's exposure to high lifetime maximums is not eliminated, only capped.

Addressed specific risks:

- **Individual excess (specific stop loss):**
 - Reinsurer receives set premium rates to cover benefits after x months or y dollars on each claimant.
 - Some morbidity risk (claim tail) and some interest rate risk.
 - Reinsurer's concern: own interests are not aligned with insurer's interests.
 - Insurer's concern: timing of premium increases.



- **Yearly Renewable Term (YRT):**
 - Annual premium rates move with expected morbidity.
 - Morbidity volatility (expect periodic fluctuations).
 - Morbidity mis-estimation (unexpected differences in actual vs. expected morbidity).
 - Reinsurer's concern: market attitude toward increases to YRT premium rates.
 - Insurer's concerns: no room for gains from favorable experience; no investment yield and inflation offsets.



- **Coinsurance (Quota share)**
 - Proportionate premiums, benefits & perhaps expenses.
 - Share all insurance risks.
 - Both parties share of Market, Credit Migration, and some, if not all, Operations risks (including financing of first year strain).
 - Reinsurer may have limits on underwriting & claim admin risks.
 - Reinsurer may have less control over pricing.
 - Counter-party risks may be very long term.
 - Reinsurer's concern: Lack of control over distribution of benefit options and demographics of LTCI buyers.
 - Insurer's concern: Giving up some percentage of profits.

LTCl Reinsurance Today

“I know I’m different, but from now on I’m going to try and be the same.”

-Judy Maxwell (played by Barbra Streisand) in the 1972 comedy, What’s Up, Doc.

Alignment of Interests

“The same as what?”

“The same as people who aren’t different.”



Coinsurance (Quota share)

- Reinsurer tries to align interests with insurance company:
 - Same expenses.
 - Contractual agreement on the toleration for adverse experience.
 - Agreement on underwriting and claims administration.
- Unaligned interests:
 - Reinsurer not responsible for materially adverse deviations from underwriting and claims procedures (if discovered); perhaps smaller process risk.



Coinsurance (Quota share), continued

- Insurer retains rate increase filing control if experience is not worse than agreed upon tolerance.
- Insurer generally has greater control.
- Accounting differences may be difficult to align (such as GAAP DAC):
 - Insurer can only amortize expenses associated with accepted policies.
 - Reinsurer's expenses are associated only with accepted policies, though first year expenses are designed to include underwriting of declined applications.



Counter-party risks

- Insurer's counter-party risk (primarily financial):
 - Modified coinsurance ("Mod-co"):
 - Assets are not transferred to reinsurer, though reinsurer receives proportionate credit for the investment yield.
 - Volatility in earnings due to differing accounting rules.
 - Reinsurer places assets in trust.



Counter-party risks, continued

- Reinsurer's counter-party risks (primarily financial and reputational):
 - In early years, the DAC is higher than the reserves.
 - Insurer's reporting.
 - If insurer were to enter rehab or liquidation, adverse policyholder behavior may increase.
 - Example: lapses of healthier policyholders and earlier claims
 - Becoming publicly associated with unpopular insurer actions or insurer liquidation.

Necessary provisions for reinsurer to assume the risk:

1. Ability to take Corrective Action
 - Experience Adjustment if severe adverse experience
 - Allowance reduction or file for premium rate increase
 - Insurer maintains the choice
 - No guarantee of premium rate increase approval
 - Not looking for correction of past, but trying to address the future

Necessary provisions for reinsurer to assume the risk, continued

2. Maintenance of administrative standards
 - Ability to audit:
 - Underwriting
 - Claims processes and decisions
 - Insurer and/or its Administrator needs “skin in the game”

Necessary provisions for reinsurer to assume the risk, continued

3. Generally no extra-contractual obligations.
 - Audits help to observe standards, but processing is the insurer's responsibility.
 - Reinsurer is not normally staffed to perform the work or advise on normal decisions.

Addressing First Year Capital Strain

- Substantial capital needed to issue new business:
 - Often underwriting, commission, and policy issue expenses exceed 100% of first year premium.
 - Also capital needed to support the business.
- Insurer may not want to limit sales despite having limited capital.
 - Coinsurance with x% quota share.
 - Reinsurance allowances align with the insurer's expenses.



Addressing Pricing & Operational Risk

- Reinsurer serves as second opinion for pricing, underwriting, and benefit administration.
 - Reinsurer “has skin in the game”.
 - Reinsurer can provide input regarding the risks associated with certain policy provisions and practices.
- The reinsurer will likely expect a portion of the risk (coinsurance).



Addressing ERM Constraints

- Insurer wants to issue product as part of its overall portfolio
 - Despite reaching corporate risk appetite limits, or
 - Product diversification concerns
- Reinsurance can help protect insurer from acquiring risks that exceed ERM limits
 - Coinsurance again, with quota share depending upon the volume of business projected to be written
 - Possibly alter the quota share as volume of production shifts

Addressing Interest Rate and Credit Risk

- Pricing assumptions in 2014
 - Strong emphasis on current low interest rate environment.
 - Some emphasis on use of conservative assets.
- Would pricing change if “economic reserves” replaced GAAP reserves?
 - Low interest and relatively high inflation assumed in reserves, in part to protect against the lock-in principle.
 - Could reinsurance help alleviate this concern and render prices more affordable?
 - Coinsurance could help if reinsurer charges smaller premium rate for its portion.
 - Coinsurance on the inflation riders alone.

Reinsurance of “Combo Products”

Ronald Reagan’s 1984 debate response when questioned about his old age, “I will not make age an issue in this campaign. I am not going to exploit, for political purposes, my opponent's youth and inexperience.”

Combination Products and Inexperience?

Are insurers of combination products learning from their older brother, stand-alone LTCI?

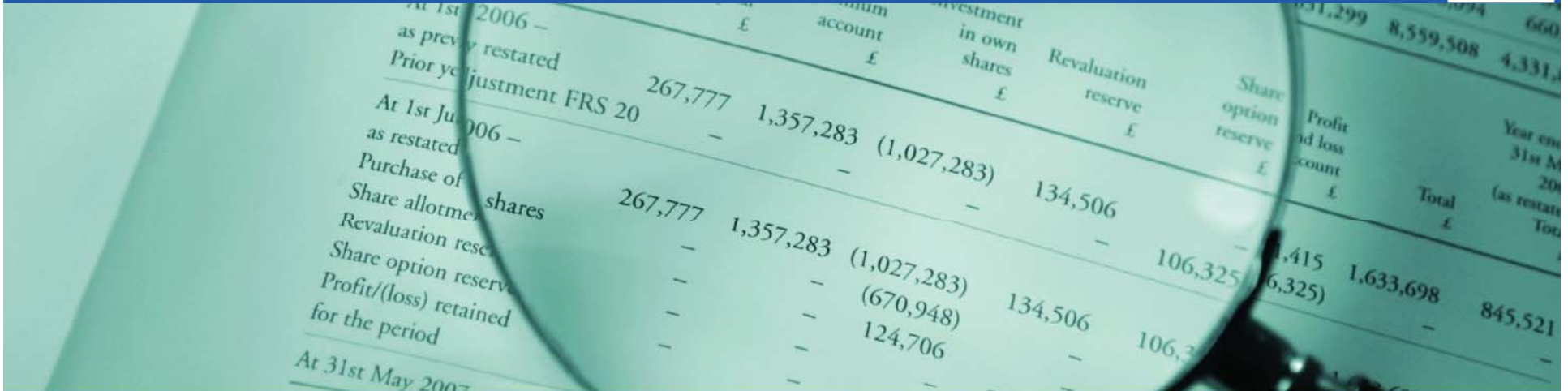
Are Reinsurer and Direct Writer Assumptions Aligned?

- Combination Life Insurance Policies
 - Reinsurer's perspective on acceleration rider likely depends on:
 - When the benefit is calculated (at claim or at pricing) or
 - Whether it is measured from the cash value or amount at risk
 - Reinsurer's perspective on the extended benefit riders:
 - Is there opportunity for corrective action?
 - Will claimants view this component like they did a high stand-alone LTM?
 - What will happen when interest rates rise?



Are Reinsurer and Direct Writer Assumptions Aligned?

- Chronic Illness Riders
 - Will policyholders treat cash nature of this rider differently than an acceleration rider that reimburses actual expenses?
 - Will a rising interest rate environment induce anti-selection?



	£	£	£	£	£	£	£
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Prior year adjustment FRS 20	–	–	–	–	–	–	–
At 1st July 2006 – as restated	267,777	1,357,283	(1,027,283)	134,506	–	–	–
Purchase of shares	–	–	–	–	–	–	–
Share allotment	–	–	–	–	–	–	–
Revaluation reserve	–	–	(670,948)	–	–	–	–
Share option reserve	–	–	–	134,506	–	–	–
Profit/(loss) retained for the period	–	–	124,706	–	–	–	–
At 31st May 2007	–	–	–	–	–	–	–

R&R: Risk and Reinsurance

Peter Blume

Managing Director – Life, Accident & Health

Guy Carpenter & Company

What Motivates Insurer (ceding company) to Reinsure LTC Risk Today?



New business

- Capital management
- Risk management
- External validation
- Additional services
 - Underwriting and actuarial support
 - Administrative services
 - Product development
 - Marketing support

Proactive Strategy Solution

Inforce business

- Underperforming interest rate, lapse, or claims assumptions
- Non-core
- Exited line of business
- Administrative burden
- Regulatory considerations

Defensive or Opportunistic Strategy Solution

- Market demographics indicate growing need for LTC Insurance
- Underwriting tools are becoming more sophisticated
 - Some require Blood Tests and Lab Tests
- Ceding companies increasing efforts to manage counterparty risk, so new capacity needed
 - Reinsurance market controlled by one or two players, so room for additional sources of capacity



- Good reinsurance market dynamics
 - Reinsurers may learn from past
 - Follow the fortunes / ability to secure rate increases
 - Willingness by ceding companies to educate reinsurance market
 - New markets focusing on long-tail business where losses are predictable
 - Market interest in asset intensive products
 - Significant ceding company interest in offloading non-core blocks

- Instability among direct writers
- Decrease in overall product sales
- Poor market perception (e.g. headline risk)
- Legacy issues
 - Impacting a number of direct writers
 - Large underperforming inforce blocks
- Very limited reinsurance capacity available
- Significant product tail of 40+ years
- Traditional life reinsurers have LTC legacy issues
- Steep learning curve for P&C reinsurers considering long-tail exposures



- Custom approaches for new business and inforce blocks
 - Solutions may come from different sources
 - Some new business interest given recent de-risking and increased pricing
- New business reinsurance
 - Stand alone LTC
 - Combo products (Life/LTC, Annuity/LTC)
- Leverage past learnings and key product and underwriting enhancements

Developing LTC Reinsurance Relationships, continued



- Insurer (ceding company) needs to be transparent in cultivating new relationships
- Develop a shared expectation and attempt to align interests
- Devote time and effort to educate reinsurers
- Shorter and longer term solutions exist

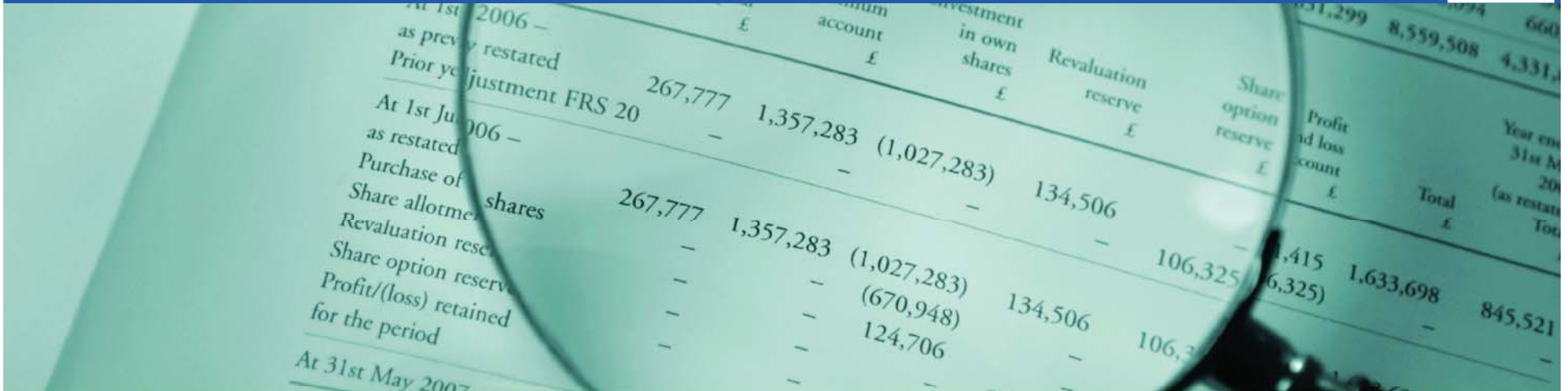
- Develop a focused reinsurance marketing strategy
 - Make time to meet with reinsurers and develop relationships
 - Reinforce compelling aspects of the LTC market
 - Be prepared to share data and modeling assumptions
 - Education will expedite reinsurers' learning curve
 - Develop internal metrics to measure reinsurer benefits
 - Develop “how LTC works and how you earn your money” exhibit

Long term reinsurance relationships require transparency, good communication & commitment to mutually profitable partnership.

Key Elements of Successful Reinsurance Partnership



- Proactively address key negotiation issues
 - Duration of contract
 - Funding requirements
 - Reinsurance structure
 - Modeling assumptions and overview
 - Rate increase protocol
 - Investment guidelines and philosophy
 - Added timing and responsibility
- What is the definition of success?
 - Reinsurance partnership, two-way communication, willingness to support product line growth and development



	£	£	£	£	£	£	£
At 1st July 2006 – as previously restated	267,777	1,357,283	(1,027,283)	134,506	106,325	1,415	1,633,698
Prior year adjustment FRS 20	-	-	-	-	-	(6,325)	-
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R&R: Risk and Reinsurance

Chris Sinito

Senior Director

Bankers Life & Casualty Company

- Impact on Operations depends on type of reinsurance, treaty contract and service agreement.
 - Generally:
 - One company has operational ownership and other has some level of oversight
 - Company with operational ownership can be:
 - The reinsurer
 - The ceding company
- Note: A third-party administrator (TPA) can have operational *responsibility* but *ownership* of the performance of the operations still resides with the company who hired the TPA.

The relationship between the company with operational ownership & the company with oversight is key!

- Operational adjustments – *If you didn't have these before, you need to have them now!*
 - Operational best practices and discipline in management of processes, people and technology:
 - Well-documented standards, practices, processes and procedures
 - Well-defined organizational structure, roles and responsibilities, and training program
 - Data structure and integrity
 - Quality Audit on claims
 - Vendor Management of TPAs
 - Transparency into operational performance
 - Constant drive for feedback and improvements

- Operational adjustments (cont'd)
 - Well-defined communication structure between reinsurer and ceding company
 - Example: A matrix-based communication structure that has a single-point-of-contact at the treaty level, and point-of-contact for each operational area with a counterpart on oversight:
 - Onboard new contacts to the relationship, the treaty and the expectations
 - Recurring communication – establish frequency and agenda
 - Focus on building relationships
 - Use best practices of Contract and Vendor Management

- Possible key areas of operational focus depending on treaty and service agreement:
 - Reporting – Identify key performance metrics required for communication and oversight, and frequency of reporting
 - Data integrity affects accounting – accounting of funds back and forth needs to be accurate & complete
 - Litigation strategy and process
 - Possibility of resource augmentation (e.g., TPA)

- Key benefit of reinsurance to an operational group – *industry insight and expertise*:
 - Reinsurers provide good source of industry information and best practices
 - Key operational trends across industry
 - Operational structure / ideas
 - Annual audits for underwriting and claims
 - The value of reinsurance audits:
 - Additional visibility into operational performance to supplement internal feedback loop
 - Periodic holistic audits of end-to-end processes
 - Best practices across the industry to leverage

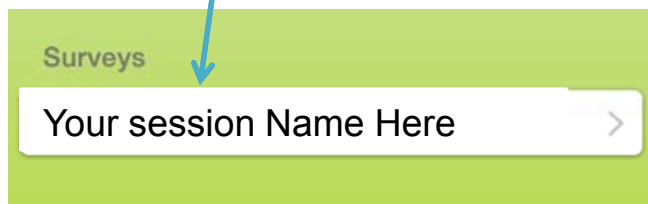
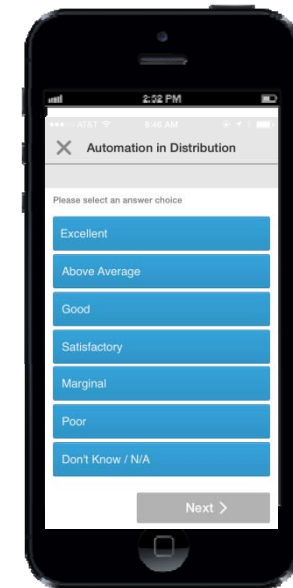
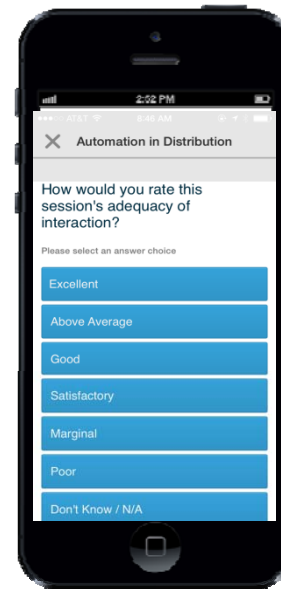
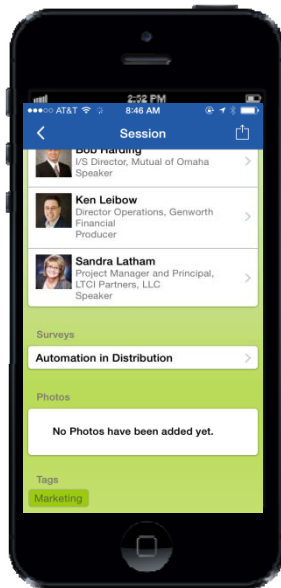
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