

Reinsurance Treaty Construction Considerations

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Introduction

My background w/treaty negotiations

- Marketing Actuary for Swiss Re for 8+ years
 - responsible for executing and maintaining treaties/amendments
- Multi-disciplined effort
 - Contracts
 - Legal
 - Underwriting
 - Claims
 - Administration
 - Valuation
 - Inforce management
 - Finance

Disclaimer

- This Panel Discussion is being conducted for educational purposes.
- The comments or views expressed by the Speaker are not being made on behalf of their employer, or in their capacity as an employee of said employer.

Reinsurance Section Council sponsored project

- Separate research team of volunteers working w/SOA staff
- Generate pipeline of projects
- Once projects & funding are approved, POG is formed
- Advantages to working on POG
 - opportunity to oversee project
 - work w/others including peers and hired consultants
 - rewarding to see projects move quickly
 - projects generally relate to work
 - provides opportunities to speak at industry meetings!

Overview of 2013 Life Reinsurance Treaty Construction Project

Project Background

- Strong interest from council to pursue
- Formed POG of 6 members, Chairman Greg Brandner
- Worked closely w/SOA on project design and RFP
- Anti-trust issues had to be worked through
- Actuarial Compass LLC selected as consultant
- Solicited volunteers from reinsurance community to serve as participants
 - many more than the 14 that we could accept
 - good representation by function (actuarial, legal, administrative, etc)
 - good mix of companies (small/large, direct/reinsurers/retrocessionaires)

Project Goals

- Increase awareness of the importance of many treaty terms/provisions
- Identify common treaty structures, practices, solutions
- Illustrate the evolution of treaty terms over time
- Share ceding companies' and reinsurers' viewpoints and objectives
- Ultimately, reduce time to treaty execution and number of disputes leading to arbitration and/or other legal action

Project Methodology

- Questionnaires
- Phone interviews
- Participant research assignments
- Culminated in an in-person round-table discussion
 - format to share and listen to each others' opinion
 - free from pressure and judgement
 - no goal to compromise, negotiate or reach a conclusion
 - dialog captured using a documentary approach

Key Concepts

- Recapture
- Rate Guarantees
- Liability
- Administration
- Errors & Omissions

Changing landscape has led to re-evaluating some common terms.....

- Financial crisis, ratings downgrades
- Increased focus on ERM
- Failure of several life reinsurers
- Period of increased underwriting exceptions
- STOLI – live rescissions, void policy for fraud
- Greater use of third parties for securitizations, retrocessions
- Nature of Reinsurer/ Reinsured relationship has changed
- Impact of mergers & acquisitions within the industry

Strive to obtain the right balance

- Treaties are long term contracts that reflect current business practice
- Predicting future circumstances has been a challenge
- Need to weigh the pros and cons of using precise language vs more flexible guidelines
- Challenge when dealing w/multiple parties for both cedents and reinsurers

Recapture

- Typically allowed under certain conditions (passage of time, retention limit increases, reinsurer raises rates, insolvency)
- Viewed as a one-sided option similar to the rate guarantee
- Reinsurers wary of “cherry-picking” whereby cedent recaptures only the profitable business
- Retrocessions complicate situation further
- Past language written for XS agreements – did not anticipate the rise of FDQS agreements
- Change in control provision – two-sided provision could benefit either party unduly
- Push back from reinsurers to use ratings downgrade as possible trigger (creates liquidity risk).
- Preference for RBC triggers as it is more within reinsurers control

Rate Guarantees

- Treaty language pertaining to rate guarantees has not been standardized across the industry, and Reinsurers and their Cedents may disagree as to what extent, if any, the treaty language permits the Reinsurer to unilaterally raise rates.

Liability

- Disputes around facultative business – communicating acceptances prior to time of claim
- “Follow the fortunes” of the cedent IF all requirements are met
- Non-disclosure/misrepresentation are common dispute issues
- Companies not administering reductions, terminations and changes correctly either due to system limitations or operational deficiencies
- Handling of conversions and replacements

Underwriting

- Jumbo limit breaches – no centralized monitoring facility
- Automatic binding limit errors (expressed for pool or for single reinsurer, does it include cedant's retention?)
- Complexity added when retrocessionaires are involved

Administration

- Does cedent have the capability to administer the policies according to treaty language?
- Late reporting leading to millions of dollars of premium adjustments, reinsurers exceeding their retention limits
- Should there be a limit as to how far back corrections can cover (e.g. 3- 5 years)?
- Are reinsurance audits a safe harbour?

Errors & Omissions

- Difference between an error and a known deficient practice
- Historically, the E&O provision was short and open
- Therefore, Cedents generally interpret as broad and all-inclusive
- Reinsurers have been attempting to narrow to administrative errors
- Sunset provision limiting how many years a party to the agreement can go back and restate
- Operational risk is not what reinsurer is looking to assume

Personal Observations

To ensure timely execution

- Highlight any terms that may be contentious sooner rather than later (i.e. at time of RFP if possible)
- Allow for costing of terms that may come with a price tag up front (e.g. early recapture, finite reinsurance premium payment period, conversions, etc.)
- Know what the deal-breakers are
- Involve other functional areas as needed (e.g. reporting capabilities, admin capabilities, etc.)
- “Keep the ball rolling” – too easy to put the agreement aside and forget about it
- Bring functional experts from both sides together as needed as they “speak the same language”/share common bonds
- Be open to compromise – “aim for mutual satisfaction, not victory”

Other resources

Other resources

- American Council of Life Insurers (ACLI). 2008. *Life Reinsurance Treaty Sourcebook*. 2nd edition
- Actuarial Standards Board. 2011. “financial Statement Treatment of Reinsurance Transactions Involving Life or Health Insurance.” *Actuarial Standard of Practice No. 11*. Revised edition.
- Society of Actuaries. 1994. *Guidance and Commentary of Life Reinsurance Treaties*.
- <https://soa.org/reinsurance/>
 - current and prior issue of *Actuarial News*
 - section sponsored research



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