REINSURANCE AS A CAPITAL MANAGEMENT TOOL
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Peter K. Sohl, ASA, MAAA

Contents

Types of reinsurance contracts
Reinsurance agreements have varying structures and applications

1 Facultative

- Covers a single specified risk or contract
- Additional coverages must be negotiated on a case-by-case basis

2 Quota share (proportional)

- Cedes risk across a company or LOB
- Reduces risk and capital requirements in proportion to the business ceded

3 Non-proportional

- Coverage begins once losses exceed a specified amount
- Helps mitigate tail risk and smooth company balance sheet and P&L

4 Excess-of-loss

- Type of non-proportional coverage typically applied to catastrophic events
- Applies to single-loss amounts (i.e. per risk, per event)

5 Stop loss

- Caps aggregate losses for which the ceding company is responsible
- Applies to aggregate losses in a period net of other reinsurance coverages

6 Retrospective

- Covers claims that have already occurred, but whose ultimate cost is unknown
- Reduces exposure to adverse claim development

Introduction to capital management
What is it, and what do organizations stand to gain from it?

What is capital management?

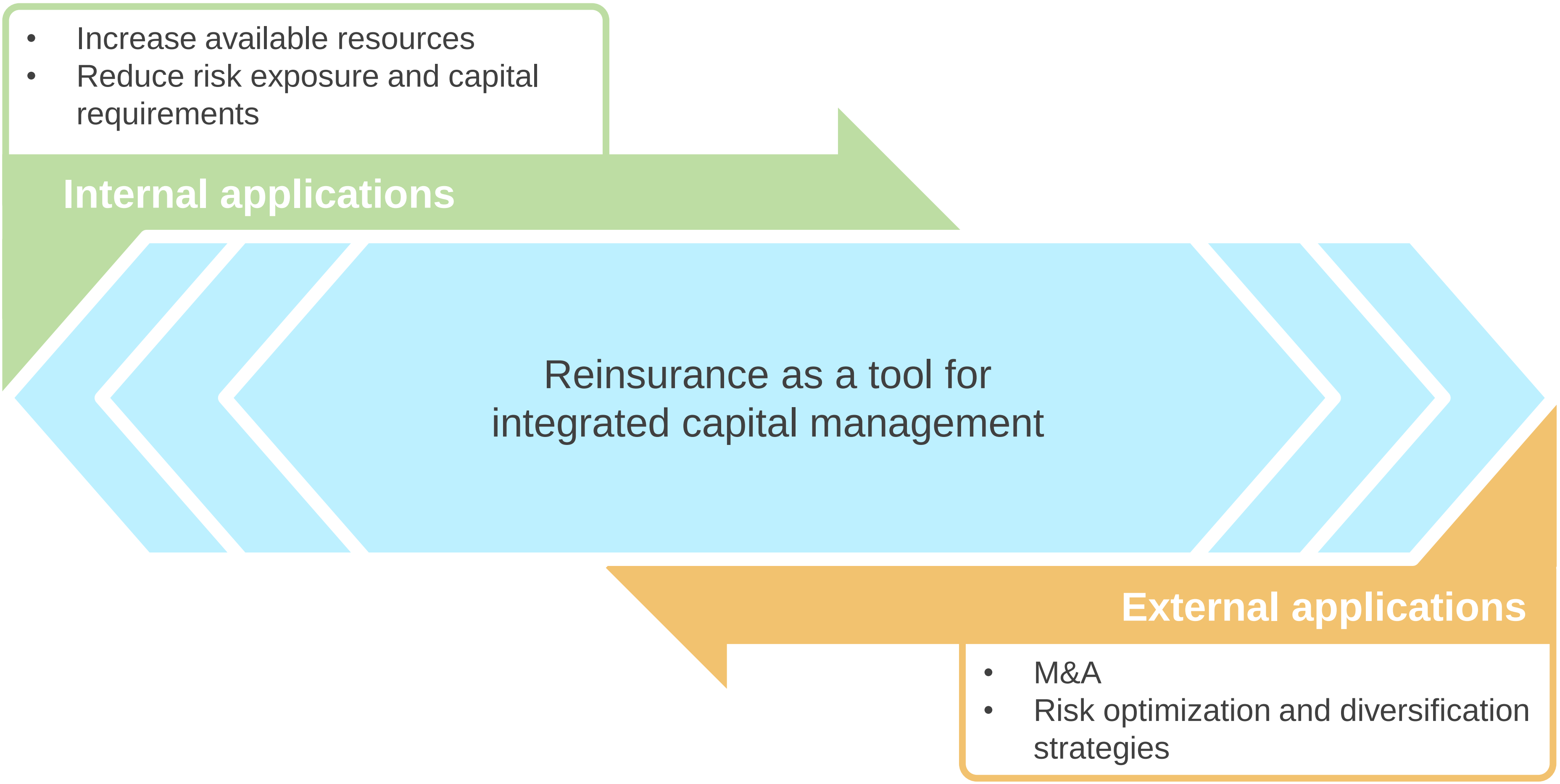
- A broad financial strategy meant to optimize the efficient use of an organization's cash flows
  - Where are funds being spent?
  - Why are we spending funds?
    - Growth? Regulatory requirements? etc.
  - Are capital expenditures yielding optimal returns?
- An essential consideration for financial institutions doing business in today's regulatory environment

Why should we care about it?

- Ensuring adequate liquidity and the ability to fund liabilities
- Optimizing the organization's return on investment
  - Can capital be reallocated to more profitable lines of business?
- Avoiding costly and unnecessary regulatory oversight
- Maximizes shareholder value

Effective and deeply integrated capital management practices are necessary for an organization to thrive in today's business environment

Applying reinsurance as a capital management tool



Reinsurance can be utilized to capture both internal and external efficiencies

Strategic and tactical considerations

Organizations must weigh several long- and short-term perspectives when considering a reinsurance agreement

STRATEGIC CONSIDERATIONS

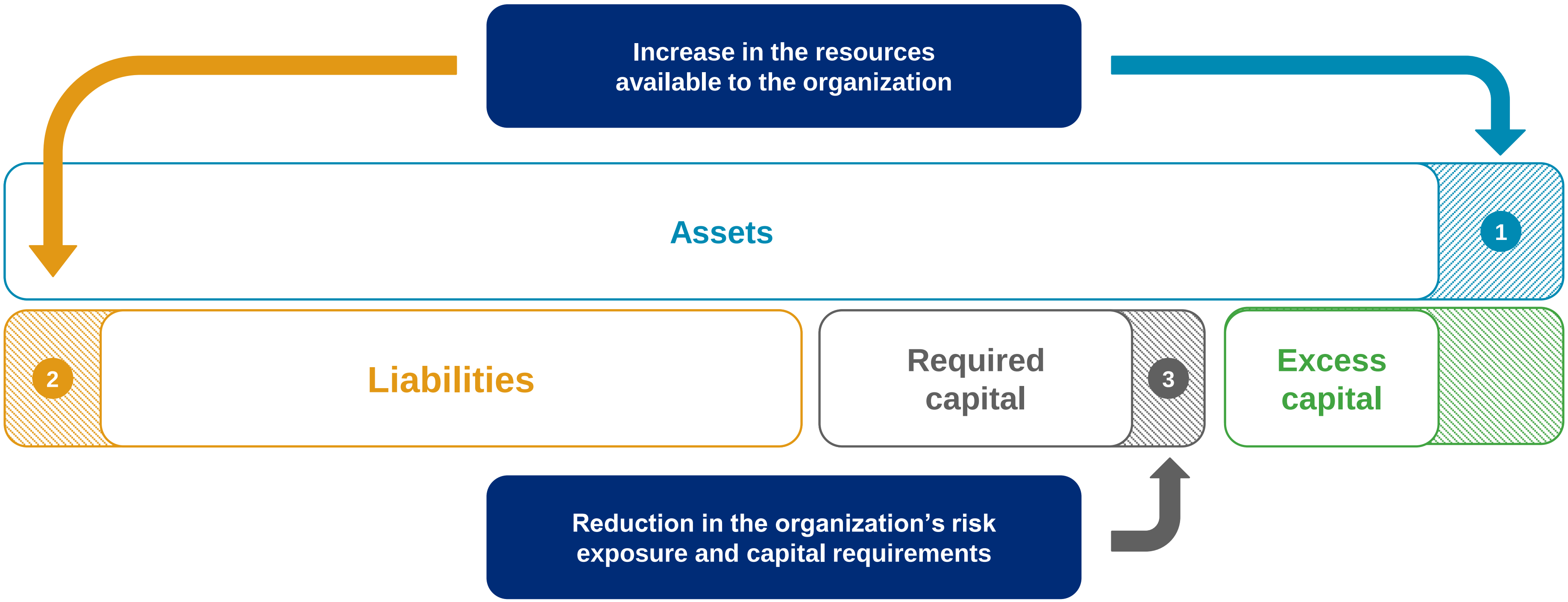
- Core vs. non-core risk exposure
- Entering new markets vs. exiting antiquated ones
- Exposure to extreme tail events and their costs
- Earnings vs. stability

TACTICAL CONSIDERATIONS

- Improving financial metrics
- Liquidity and/or regulatory capital positions
- Investment opportunities

How reinsurance impacts an organization’s financials (1/2)

Reinsurance can help strengthen an organization’s solvency ratio and serve as an overall hedge against adverse movements



1
- Enhance the organization’s capital & liquidity positions
- Transform inadmissible/intangible assets into admissible/tangible assets

2
- Remove redundancies and conservatism from reserving requirements
- Improve profitability measures

3
- Reduce capital requirements
- Capture risk diversification benefits

How reinsurance impacts an organization's financials (2/2)

A case study: Organizations stand to benefit in several ways when partnering with the right reinsurer

1

Mitigate risk exposure

- Company cedes risk to reinsurer in exchange for a nominal risk charge
- Certain risks which are highly costly to the company may not be costly to the reinsurer

2

Limit impact on earnings

- Depending on the risks ceded, the cost and subsequent impact on earnings are minimal
- By releasing risk to the reinsurer, the company limits impact to earnings while reducing capital requirements

3

Improve financial measures

- Reduction in required capital leads to a corresponding increase in return on equity
- Improved liquidity due to reduced regulatory capital requirements

4

Redeploy capital efficiently

- Capital released from the reinsured business can be redeployed elsewhere in the company
- Company can invest in profitable new ventures or growth business, buy back stock, etc.

External applications of reinsurance
M&A transactions are often structured like reinsurance deals

Deals may be structured as a…

LEGAL ENTITY SALE	VS	COINSURANCE
1 Seller exiting the industry		1 Seller needs to retain the legal entity
2 Seller doesn't retain servicing		2 Seller prefers to keep staff, operations, and administration
3 Simpler than novation		3 Tax or capital efficiency
4 Avoid counterparty risk		4 Ability to split sale to more than one party
5 Accepting all risks		5 Avoid the headlines

Different approaches to transactions structured as reinsurance

COINSURANCE

- Preferred GAAP accounting treatment
- Need for investment restrictions and trusts are less common
- Less complicated
- Potential tax advantages for the reinsurer
- Smaller statutory balance sheet and lower leverage ratio post-transaction for ceding company

VS

MODIFIED COINSURANCE

- Required for separate account business
- Security for the ceding company of withholding the assets
- Smaller net settlement cash flows
- Slightly more capital efficient
- No reserve credits required
- Recapture and experience refunds are common

The approach chosen is highly dependent on the needs of each counterparty

Questions

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