Canada Life™ Reinsurance

Reinsurance as a Source of Capital for Group Products

Michael Mulcahy

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Reserve Financing

Securitization

AG XLVIII

XXX

AXXX

VM-20

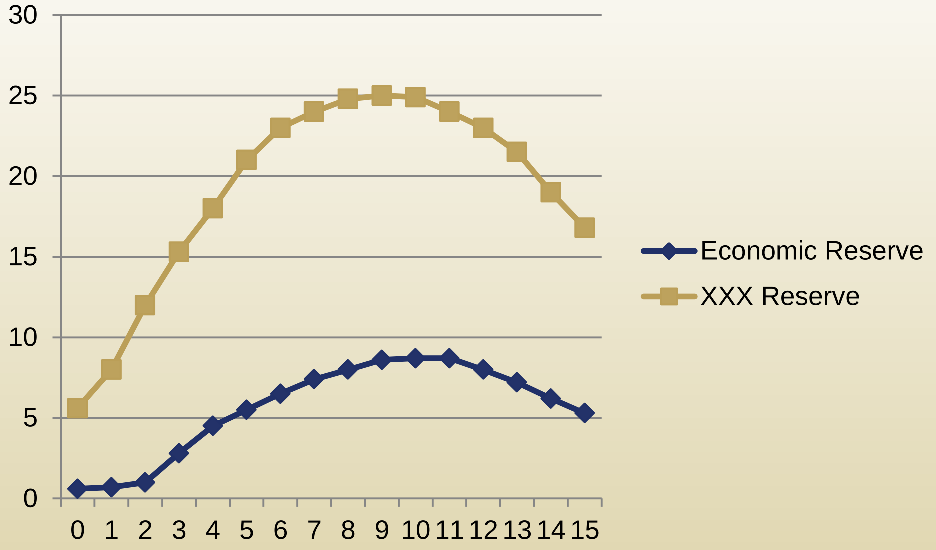
Captives

PBR

NOTE EXCHANGE

Primary Securities

Term Life Reserve Redundancy



Group Products RBC

Reserves for group insurance products are "economic" based

- Group Life/Group Health/LTD
- IBNR reserve based on experience triangles

RBC requirements for group insurance products are not

- Formula based
- No adjustments for experience

Capital

The four main components of RBC include:

- C1: Asset Default Risk
- C2: Insurance Risk
- C3: Interest Rate Risk
- C4: Business Risk

Main source of RBC for most group products is C2

RBC Factors

Product	C2 RBC Factors
Health Products	% of Net Premium (>$25M)
Comprehensive Medical	9.0%
Stop Loss	25.0%
Group Life	Factor applied to NAR (>$25B)
Group Life	0.08%
LTD	
DLR	7.7%
Premium	4.6% (>$50M)

Arguments that RBC for Group Products is Redundant

- Not related to experience
- Short duration product
- Ability to reprice frequently

RBC Relief Reinsurance for Group Products

- If RBC for group products is redundant, why isn't RBC relief reinsurance a hot topic for insurers?

  A. No racy name like "XXX Relief"
  B. RBC relief transactions aren't happening on group products
  C. RBC transactions on group products are straightforward and non-controversial
  D. B. and C. but not A.
  E. A. and C. but not B.

RBC Reinsurance Transactions are Happening

- At least 7 of top 10 writers of group life have reinsurance programs in place that are capital motivated
- Aetna "Vitality Re" – have announced 7 transactions securitizing capital on health business
- LTD reserve buyouts have often been capital motivated

Motivation for Capital Relief transactions

- Improve Capital Efficiency (cost of capital)
- Pricing Competitiveness
- Maintain RBC Ratio for Regulators/Analysts/Rating Agencies
- Raise Capital for M&A activity
- Support Strain from Rapid Growth
- Reduce Liquidity Risk

How Does Capital Relief Reinsurance Work?

- Transfer driver of RBC to Reinsurer
  - Group Life – NAAR
  - Group Health – Premiums/Claims
  - LTD – Premium/DLR

Form can be YRT or Coinsurance (usually Modco)

Common Features

- Loss Carryforward
  - Ceding Company pays back only if they terminate
  - Otherwise paid back from future profits
- Experience Refund
  - Reinsurer charges a “risk charge”
  - All other profits returned to Ceding Company
  - Reinsurer can eliminate ER after set time
- Termination Rights for Cedant
- Bulk Reporting with minimal Reinsurer oversight

Life RBC Reinsurance Structure

Group Life Capital YRT Structure

- Quarterly (or monthly) renewable term structure, with quarterly accounting.
- Premiums are set at or near the gross premiums of the ceding company.
- No expense allowance is typically paid.
- Premiums are paid in arrears, therefore minimal reserve transfer.
- Usually claims are net of existing reinsurance

Group Life Capital YRT Structure

Loss Carryforward and Experience Refund

- All profits net of a risk fee are returned to the ceding company through an experience refund.
- Losses to the reinsurer are carried forward and repaid out of future profits, if they emerge.
- Ceding company can terminate on short notice (must repay loss carry-forward if they terminate).

Group Life Capital YRT Structure

Common Risk Reducing Features

- Reinsurer may have a right to increase premiums.
- Reinsurer may have right to increase the risk charge after some period.
- Reinsurer may be able to remove experience refund at a future date.
- May include limits to catastrophe claims.

Group Life RBC Reinsurance Example

Group Life RBC Reinsurance Example

- Happy Insurance Company writes only group life
  - $100B of Net Amount at Risk
  - Average premiums are $2.5/1000 of NAAR
  - Average claims are $1.75/1000 of NAAR
  - Total expenses are 20% of premium

NAAR	100,000,000,000
Premium	250,000,000
Claims	175,000,000
Expenses	50,000,000
Profit	25,000,000
CAL RBC	84,300,000
ROC (@200% CAL)	14.8%

- Assumptions: Taxes ignored, static state – no reserve impact, RBC for other than C2 ignored

Group Life RBC Reinsurance Example

- Happy Insurance Company reinsures 50% of business under a YRT arrangement:
  - Reinsurance rate is $2.4/1000
  - Risk Charge = $.01/1000 of NAAR

	Gross	Ceded	Net
NAAR	100,000,000,000	50,000,000,000	50,000,000,000
Premium	250,000,000	120,000,000	130,000,000
Claims	175,000,000	87,500,000	87,500,000
Expenses	50,000,000	-	50,000,000
Risk Charge	-	500,000	500,000
ER	-	32,000,000	32,000,000
Profit	25,000,000	500,000	24,500,000
CAL RBC	84,300,000	42,150,000	42,150,000
ROC (@200% CAL)	14.8%		29.1%

  - Cost of relief (@200% CAL) = $500K/$84.3M = 0.59%

Impacts to Cost/Benefit of RBC Reinsurance

- Covariance Adjustment - Companies with large amounts of C1/C3 relative to C2 may not get much benefit from reducing C2
- Target Level of CAL RBC will alter ROC benefit of the RBC relief
- Reinsurer's willingness to cover business and the level of Risk Charge will be affected by:
  - Loss ratio
  - Volatility of the business
  - Catastrophic exposure – considering any existing reinsurance
  - Ceding Company Financials and position in the market

Group Life RBC Reinsurance
Risk Transfer

Risk Transfer for YRT Reinsurance

- Statutory risk transfer is governed by the Credit for Reinsurance Model Regulation, as codified in A-791 of SSAP 61
- Law sets out 11 primary provisions which a contract must follow for a ceding company to “take credit” for reinsurance.
- YRT Reinsurance is exempt from 4 of those provisions:
  - Covering renewal expense allowances
  - Including reinsurance payments other than from profits on the reinsured business
  - A list of significant risks that must be transferred
  - Transfer or segregate assets if investment risk is significant

Risk Transfer for YRT Reinsurance

Significant Risk Transfer Provisions that must be met by YRT:

- Ceding company can't be deprived of assets or surplus at reinsurer's option
- Ceding co. can't be required to reimburse the reinsurer for losses. Loss carry forwards and payment of them for voluntary cancelation by the ceding company is specifically allowed.
- No pre-specified or triggered termination or recapture allowed.
- At least Quarterly settlements of amounts due
- No representations or warranties made by the ceding company not related to the business reinsured, or about the future performance of the business reinsured
- The expected potential liability of the company on the reinsured business must be altered by the reinsurance

Recap

- Reinsurance for capital management purposes is a powerful tool. It:
  - Boosts a products return
  - Increases the Cedant's RBC ratio
  - Meets credit for reinsurance requirements

- Most importantly, it:
  - Reduces the Cedant's required capital while still allowing the Cedant to
    1) retain all of the profits on the business, in excess of the Risk Charge, and
    2) Retain all of the assets backing the reinsured business