

# Offshore Reinsurance

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# Intro

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- Offshore Market Background
- Ceding Company Considerations in Reinsuring Offshore

# Market Background: Answering W's

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- What is "offshore"?
- Where are offshore reinsurers located?
- When did offshore begin? Evolution of biz models; How make money? what is reinsured?
- Who is in the market?
- Why reinsure offshore?
- Future outlook: fad or trend?

# Offshore Defined

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1. Transaction currency differs from transaction jurisdiction
2. Transaction parties located in different jurisdictions

# Where Offshore Domiciles are Located



# Evolution of Offshore Market

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## Offshore market is not a new market

- Pre-WW II, first “exempted” company
- 1948 - AIG sets up admin office in Bermuda
- 1963 – “captive insurance” philosophy invented
- 1970s+ - several P&C covers developed

# Evolution of Offshore Life Reinsurance

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- 1980's Subsidiaries of US/Cdn parents
  - Financial/Finite Reinsurance
  - Some transactions with onshore co, retro-ed to offshore sub
  
- 1998-2000 Start-Ups as direct competitors onshore
  - Life – 1998
  - Annuity – 1998/9
  - Group Disability – 1999
  - GMDB – 2000
  
- 2000-2001 Start-Ups sponsored by hedge funds
  - Similar in risks/products
  - Different in investment of capital account funds

# Money-making Models

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- Risk taking (capital intensive; offshore focus)
  - Insurance
  - Investment
- Fee income
  - managing assets
  - administration
- Distribution allowances



# Products Reinsured

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In force and/or new business:

- Life mortality
- Deferred Annuities
  - Fixed
  - Variable – benefit guarantees
- Payout Annuities
- Disability claims

... generally, liabilities of longer duration

# Reasons for Offshore

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- Regulatory System and Capital Efficiencies
- Tax Efficiencies
- Investment Flexibility

# Regulatory System & Capital Efficiencies

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- Outside the Scrutiny of “Onshore” Regulatory Bodies
  - Not completely unregulated – just less regulated
  - Allows more flexibility with regard to capital structure, investment style, taxes, etc.
- Reserving
  - Generally Appointed Actuary opines on sufficiency of liabilities established
    - vs prescribed/inflexible reserving requirements
  - Opinion can be based on variety of accounting and risk Standards, such as U.S. GAAP, Canadian GAAP, U.K., etc.
- Risk Based Capital
  - Allows reinsurer to establish and follow economic realistic standards, rather than conservative solvency standards set by “onshore” regulations

# Tax Efficiencies

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- Recently become an important consideration for establishment of offshore companies
- Typically, the offshore company's home jurisdiction collects little corporate income tax
- In regard to a U.S. client doing business with an offshore reinsurer, that reinsurer could be:
  - U.S. Taxpayer
  - non-U.S. Taxpayer
  - non-U.S. Taxpayer in a "Treaty" Country
- Reinsurer's tax status has different implications from U.S. client's perspective

# Tax Efficiencies

Effect of Various Items for U.S. Clients When Ceding to...			
	U.S. Taxpayer	Non-U.S. TaxPayer	Non-U.S. Taxpayer but "Treaty"
Reserve Credits	Yes, if Properly Secured	Yes, if Properly Secured	Yes, if Properly Secured
Excise Tax	No	Yes	No
DAC Tax "Credits"	Yes	Maybe	Maybe

# Investment Flexibility

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- “Onshore” Companies have Regulatory Restrictions on Investments
- Also, Most Often, Rating Agency Scrutiny
- If a Company is Public
  - Stock Analyst Oversight
  - Potential Swings in Earnings/Capital
- Operating Offshore, in general, Gives Flexibility
  - But Even an Offshore Company may have Similar Limitations, such as
    - Rating Agency, or
    - Stock Analyst Oversight, or
    - Earnings/Capital Swings

# Example of Offshore Leverage

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Ceding Company Before Reinsurance:

Assets	Liabilities
5,000 Invested Assets	5,000 Liabilities
	0 Surplus

# Example of Offshore Leverage

After reinsurance:

Ceding Company After Reinsurance		Reinsurer After Reinsurance	
Assets	Liabilities	Assets	Liabilities
1,200	0 Reserves	3,800	3,800 Reserves
	1,200 Surplus		0 Surplus *

\* Letters of credit provided for 1,200



# Product Examples – Ceding Co Benefits

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- **Deferred Fixed Annuities**
  - Pricing benefit with offshore reinsurance can be:
    - Retained by ceding co. to enhance net income
    - Passed on to policyholder via higher crediting rate
    - Some combination of above two
  
- **Disability Claims Reserve – Older Claims**
  - Substantial case management has occurred, may remain with ceding company
  - Risk Based Capital
    - C-2 component of 5% -- widely held view is this is onerous since claim volatility reduced after substantial case management
    - C-3 may be substantial, regardless of volatility associated with case management

# Considerations in Reinsuring Offshore

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- Tax reporting
  - When excise tax applicable, ensure treaty is clear on who will make the payments

# Considerations in Reinsuring Offshore

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- Credit for business reinsured
  - current and future (counter-party)

NAIC addresses via:

- Credit for Reinsurance Model Laws and Regulations
  - “how to” not “don’t do”
  - no attempt to regulate offshore companies
  - focus on security
- Model Reg.on Life & Health Reinsurance
  - No distinction between domestic and offshore reinsurance

# Considerations in Reinsuring Offshore

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- Security Mechanisms
  - Letters of Credit
  - Assets held in Reinsurance Credit Trust
  - Funds withheld

# Considerations in Reinsuring Offshore

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- Asset transfer
- Risk-based capital
- Due Diligence
- Offshore Regulators
  - Accounting (no Stat)
  - Reserving (not specified)
  - RBC (smaller)
  - Start up capital (minimal)
  - Flexible, facilitators of business, review business plans, and conduct on-site visits

# Future of Offshore Reinsurance

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- Here to stay: credit for unauthorized reinsurance has been increasing
- Trends
  - Financial reinsurance
  - Risk-Based Capital reinsurance
  - Guideline XXX
  - Investment gains
  - Credit Enhancement

# Advantages

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- Finance difference between regulatory and economic capital
- Avoids timing risks of capital markets
- Minimal lead time
- Flexible duration and structure

# Disadvantages

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- Viewed as “Unauthorized” reinsurance by U.S. regulators
- More difficult counterparty risk assessment
- Regulator and rating agency views
- Federal Excise Tax



