Financial Reinsurance

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Agenda

- What is financial reinsurance?
- Uses and benefits of financial reinsurance
- Commonly used reinsurance structures
- Regulatory and accounting frameworks

What is Financial Reinsurance?

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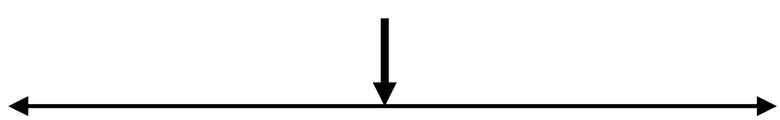
- Every reinsurance transaction, regardless of whether it is YRT, Coinsurance, Modified Coinsurance or a combination of the above, will impact both the ceding company and the reinsurer financially.
- The primary objective of fin re is the achievement of a specific business goal.

Typical Business Goals

- Improve the level and timing of earnings
- Improve the stability of earnings
- Improve the level of IRR, ROE, etc.
- Assist in financing acquisitions or joint ventures
- Efficient tax management
- Efficient allocation of income or capital between entities

Reinsurance can help with all of the above

Financial Reinsurance: Mitigating Risk on a Continuum



Financing	Risk Reinsurance
(Lower economic risk, debt-like cost)	(Higher economic risk, equity-like cost)
"Financial Reinsurance"	"Asset-Intensive Reinsurance"

Defining Financial Reinsurance

- Financial Reinsurance is specifically designed to help an insurer manage its capital and statutory earnings by passing risk and the associated capital strain to the reinsurer.
- Financial reinsurance is not a loan. The reinsurer can recover its capital only from the future profits of the reinsured block.

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Uses and Benefits of Financial Reinsurance

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Uses and Benefits of Financial Reinsurance

- Accelerate statutory earnings to shareholders.
- Reimburse ceding company’s acquisition costs, thereby reducing capital strain.
- Reduce required RBC and / or increase ceding company capital.
- Support the growth of new business.
- Higher ROEs, through capital leverage.
- Attract capital / financing without compromising ownership.
- Develop expertise in new product areas.

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Alternatives to Financial Reinsurance

- Equity
- Subordinated Debt
- Contingent Debt
- Surplus Notes
- Hybrid Securities
- Securitization

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Advantages of Financial Reinsurance

- The Reinsurer is on risk.
- Capital leverage is more effective than other forms of financing as reinsurance can both:
  - Reduce required reserves and/or RBC.
  - Provide capital through a ceding allowance.
- Rapid implementation, Confidentiality and Simplicity.
- Competitive Pricing / Low Transaction Costs.
- Access to Reinsurer's expertise.
- Flexibility of size, structure, and / or duration.

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Commonly Used Reinsurance Structures

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Forms of Reinsurance

- YRT
- Coinsurance
- Coinsurance/Funds Withheld
- Modified Coinsurance
- Co/Modco, Co/CFW and Co/Modco/CFW also possible
  – The % split between Coinsurance and Modco/CFW can change over time
  – Can be designed so that cash flows between ceding company and reinsurer are minimized

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Examples of Financial Reinsurance

- Relief of redundant statutory reserves
  – XXX / AXXX
  – Deficiency / tax overhang reserves
- Acquisition cost financing
  – Either cash or non-cash
- Risk-based capital relief

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How Is This Done?

- Use economic expectations rather than statutory valuation to:
  - Replace conservatism in actuarial valuation with competitive reinsurance rates.
  - Stabilize future earnings by reducing risk.

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Regulation, Accounting and Tax

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Financial Reinsurance Regulation

- NAIC Model Regulations passed in 1985 and 1992, following NY and CA.
  - Regulations say both what must and what can't be done.
  - Control is denial of ceding company reserve credit.
- Regulations were in response to perceived abuses.
- All significant risks must be transferred for ceding company to receive reserve credit.
- "Significant" risks are identified by product.

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Statutory / Tax Accounting

- "All or nothing" statutory reserve credit
- Controlled by risk transfer regulation
- More detail in Appendix A-791

- Section 845 prohibits transactions with "significant tax avoidance effect."
- The Model Regulation sets the standard
- Recognized by courts in Trans-City decision

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GAAP Accounting

- Limited discussion in FAS 60.
- FAS 113 addresses in more detail.
  - Treat as reinsurance if:
    - Reinsurer assumes significant risk, and
    - Reasonable possibility of significant loss, or
    - All of insurance risk transferred
- Deposit accounting used for transactions not deemed to be reinsurance.

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Questions?

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