Asset Intensive Reinsurance Ceded Offshore from U.S. Life Insurers (with focus on Bermuda)

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Motivations for Offshore Reinsurance

- Reserving, Hedging, Capital, and Accounting Efficiencies
- Investment Flexibility
- Localized Expertise and Innovation
- Tax Efficiency
- Strong regulatory framework (Bermuda)

Existing Actuarial Guidance

- Under current statutory rules, the cedant's Appointed Actuary must perform asset adequacy testing (AAT) for all direct business (including reinsured)
- There is no prescribed methodology, but ASOP No. 22 provides the following examples of AAT approaches:
  - Cash flow testing
  - Gross premium reserve test
  - Demonstration of conservatism
  - Demonstration of immaterial variation
  - Risk theory techniques
  - Loss ratio methods
- ASOP No. 11 states that the actuary should take into account counterparty risks that impact the asset adequacy analysis report

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AAT Approaches

Approach	Considerations
Perform cash flow testing	• Whether cedant's analysis can reliably extend to reinsured business • Whether data is available • Potential to leverage existing cash flow projections used for other purposes (e.g. enterprise risk management (ERM) • Still important to consider counterparty risk (and required by ASOP No. 11)
Leverage reinsurer SBA	• May include sufficient information to assess asset adequacy under moderately adverse conditions • Some adjustments may be necessary to meet the purpose of the analysis • ASOP No. 22 requires consideration of any cash flow differences • Still important to consider counterparty risk
Assess counterparty risk	• Important regardless of the AAT method • Reinsurance receivable is the asset being tested for adequacy • Consider reinsurer credit rating, default and recovery probabilities, and specifics of the reinsurance program

Additional Counterparty Risk Considerations

- Significant guidance in ASOP No. 11 and ASOP No. 7
- Additional information in the Credit for Reinsurance Practice Note
- Treaty provisions can be used to reduce counterparty risks
  - Collateral requirements
  - Investment guidelines
  - Recapture provisions
- Regulatory notice requirements for concentration risks

Collateral Provisions

- Collateral is used to secure the obligations of the reinsurer
- Most common forms of collateral are:
  - Funds withheld
  - Collateral trust
  - Letter of credit
- Historically, unauthorized reinsurers required to hold collateral, but this has changed for certified and reciprocal jurisdiction reinsurers
- Collateral may bring its own risks:
  - Insufficient level of collateral
  - Illiquid collateral unavailable when needed
  - Under funding by the counterparty

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Aggregation

- Under AAT, the Appointed Actuary may aggregate blocks together.
- Per ASOP No. 22, “When performing this aggregation, the actuary should not use assets or cash flows from one block of business to discharge the reserves and other liabilities of another block of business if those assets or cash flows cannot be used for that purpose.”
- Depending on the reinsurance structure, assets from a reinsurance treaty may not be available for use for another block of business, and therefore aggregation would not be allowed.
- Bermuda also does not allow aggregation unless the insurer demonstrates that the assets can be used across those lines of business (in both normal and adverse scenarios).

Recapture/Termination

Most agreements allow cedant to recapture, and ASOP No. 11 identifies the following risks that should be reflected in the actuary's financial report:

- Impact of potential termination, including post-termination obligations
- How the following factors affect risk of termination
  - Agreement terms and conditions
  - Regulatory and financial reporting regime
  - Known business practices of counterparties
  - Current and potential internal and external environments
- Actuary should consider performing scenario testing to quantify the impact of a potential termination event

Retrocession

- Common in the reinsurance industry
- Bermuda Monitory Authority (BMA) monitors this and may correspond with home regulator
- Treaty terms may require disclosure, but unusual
- Management of the risk by the cedant includes:
  - ➢ Insolvency considerations
  - ➢ Disclosure requirements
  - ➢ Relationship management
  - ➢ Risk diversification

Questions?

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