



Reinsurance : Tool for Capital Management

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Meeting the Challenges of Change

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Tool: Meaning

- <http://www.urbandictionary.com/define.php?term=tool>

A person, typically male, who says or does things that cause you to give them a 'what-are-you-even-doing-here' look...

...The tool is always making comments that are out-of-place, out-of-line or just plain stupid.



Capital

ASSETS

LIABILITIES

Free Assets

Regulatory Capital

- Technical Reserves and provision of other liabilities
- Stat. basis - BE + PADs

Capital

ASSETS

Free Assets

PCR
MCR

LIABILITIES

Free Assets

Rating /
Internal
Capital

LIABILITIES

Capital

ASSETS

Free Assets

PCR
MCR

LIABILITIES

Free Assets

Rating /
Internal
Capital

LIABILITIES

Capital

ASSETS

Free Assets

Tied Capital

LIABILITIES



Need to Manage Capital

- Improve Solvency Position
- Increase Return on Total Capital
- Finance profitable growth
 - ❖ New business
 - ❖ Acquisition
 - ❖ Any other capital investment



Improve Solvency Position

ASSETS

Free Assets

Tied Capital

LIABILITIES

Free Assets

Tied Capital

LIABILITIES

Improve Solvency Position

ASSETS

Free Assets

Tied Capital

LIABILITIES

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Tied Capital

LIABILITIES

Increase Return on Total Capital

ASSETS

Free Assets

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Increase Return on Total Capital

ASSETS

Free Assets

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LIABILITIES

Quick summary...

- Need for capital can be varied
 - To demonstrate financial strength
 - ❖ Internal, Regulatory, Rating
 - To finance profitable growth opportunities
- Approach to meeting these needs are also varied
 - Increase assets without increasing liabilities
 - Decrease Liabilities
 - Increase assets and decrease Liabilities
- To note: with regard to the most efficient capital resourcing solution
 - What works in one market may not work in another market
 - What works for one company may not work for another company in the same market

Sources of capital

- As the needs are, the sources are also varied...
 - Equity
 - Subordinated Debt
 - Traditional Reinsurance
 - Reinsurance Financing
 - Securitisation



Which one to choose...

Preference of a particular source of capital would depend on

➤ **Its ability to meet the need for capital**

❖ For example, admissibility as regulatory / rating capital

➤ **Flexibility**

❖ Quantum of capital, term of capital, servicing costs, repayment schedule, ability to postpone or cease servicing, rights on liquidation / insolvency

➤ **Impact on existing shareholders**

❖ Dilution of equity, ability to raise further capital, impact on profit emergence

➤ **Ease of raising capital**

❖ Time taken from proposal to realisation of capital, regulatory filings, etc.

➤ **Cost of capital**

❖ Servicing costs in comparison with other sources of capital, costs being fixed or variable over the future periods

Equity

ASSETS

LIABILITIES

Free Assets

- Restrictions on equity participation
- High cost of issue
- High return expectations
- Raising equity is cumbersome, long drawn and has to be timed perfectly

Debt

ASSETS

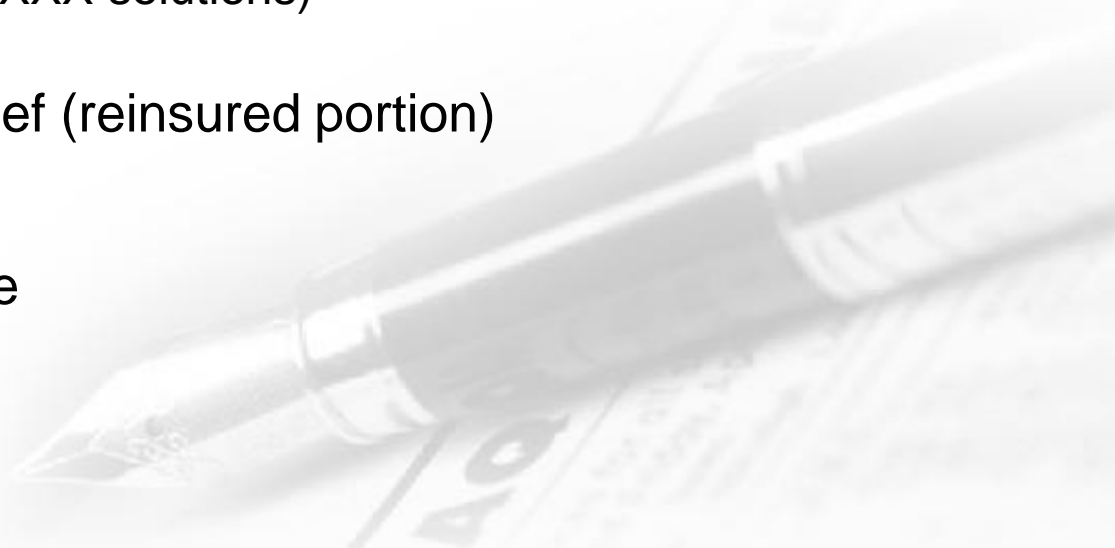
LIABILITIES

Free Assets

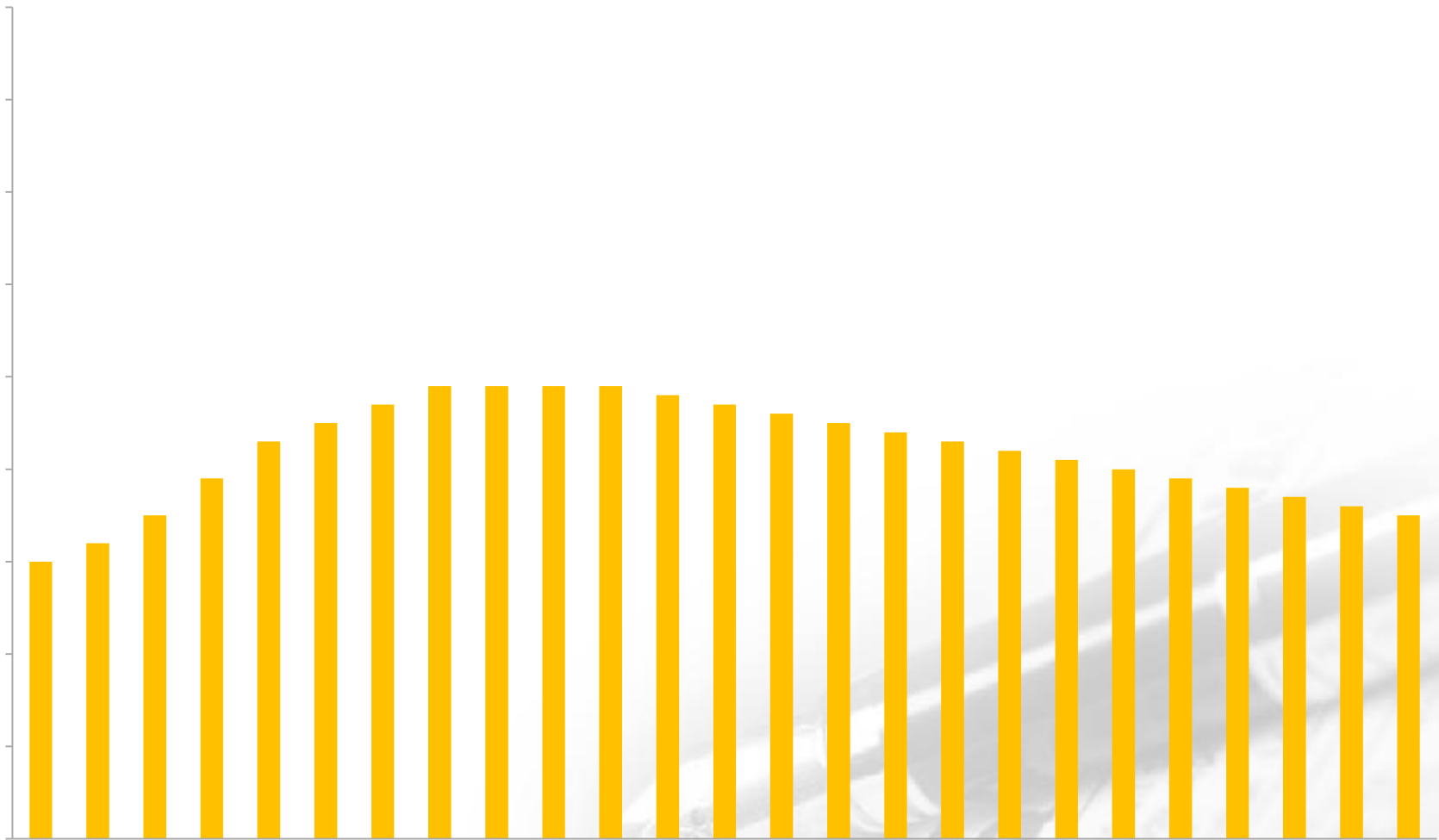
Free Assets

- No impact on B/S
- Cash-flow solution
- Interest on debt impacts P&L
- Gearing effect
- Availability depends on markets – might be difficult to source

How can reinsurance help

1. Selection discounts in excess of the selection effect
 - Reduction in reinsurance premium vis-à-vis the transferred risk can be source of capital
 2. Guaranteeing reinsurance rates for biometric risks
 - In regimes where valuation tables are prescribed and when the guaranteed reinsurance rates are less than the prescribed
 - Provide reserve relief (XXX solutions)
 3. Reserve and Capital relief (reinsured portion)
 4. Quota share reinsurance
 5. Deficit Financing
- 

Let us assume a profitable portfolio...

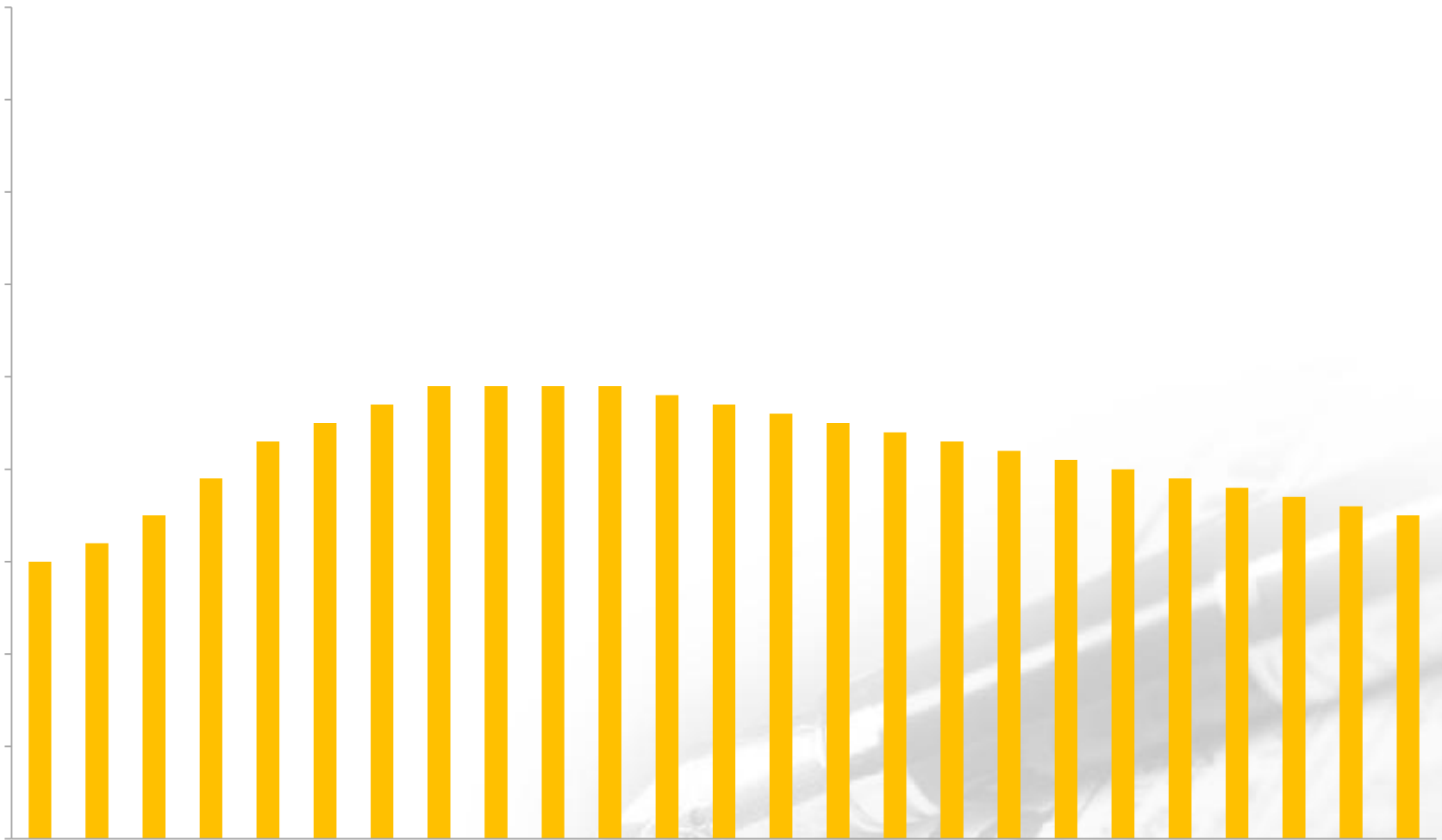


Quota Share

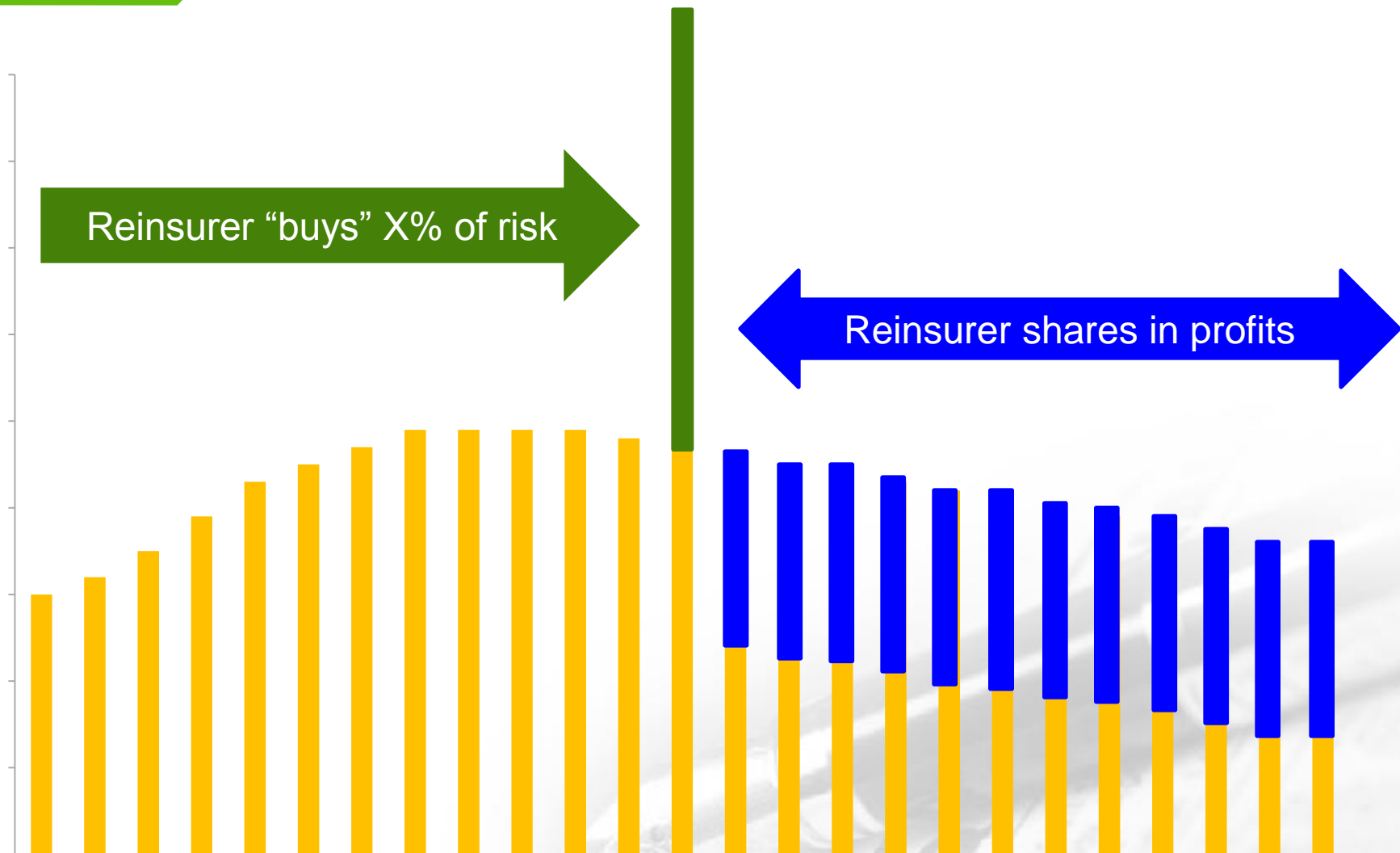
- The reinsurer buys a share of this profitable block of business and thereafter shares proportionately in all premium receipts and benefit payments
- The reinsurer pays a portion of the value embedded in this business to the insurer (i.e. capitalises future profits)
- The insurer transfers the appropriate share of the reserves to the reinsurer



The profitable portfolio



Monetising ViF – Quota Share



Quota Share – Impact on B/S

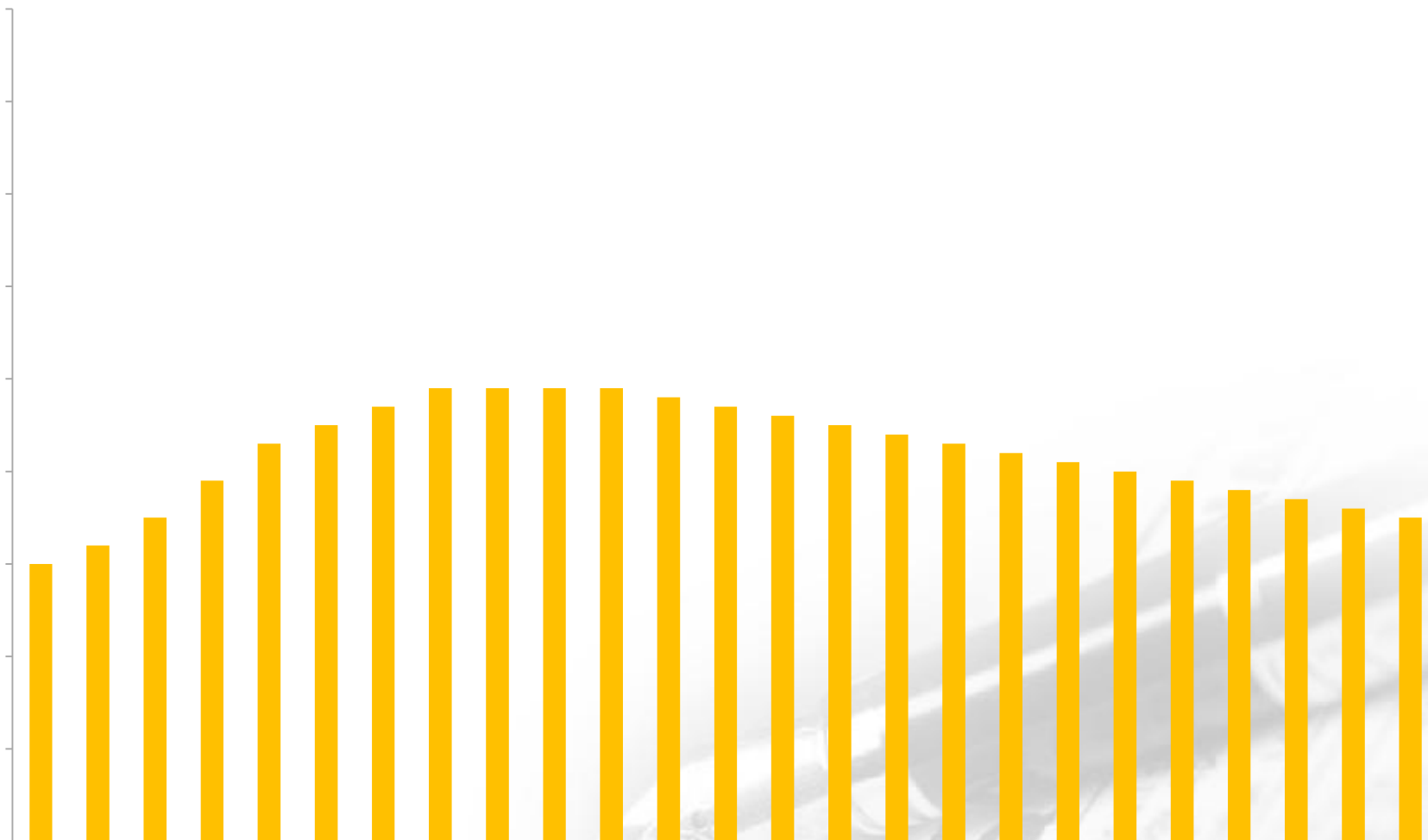


Deficit Financing

- The reinsurer lends money to the insurer, using future expected profits from the in-force block as collateral
- The amount lent is a portion of the value embedded in the business
- Until the debt is repaid, the insurer services the “deficit account” using the surplus emerging under the in-force block



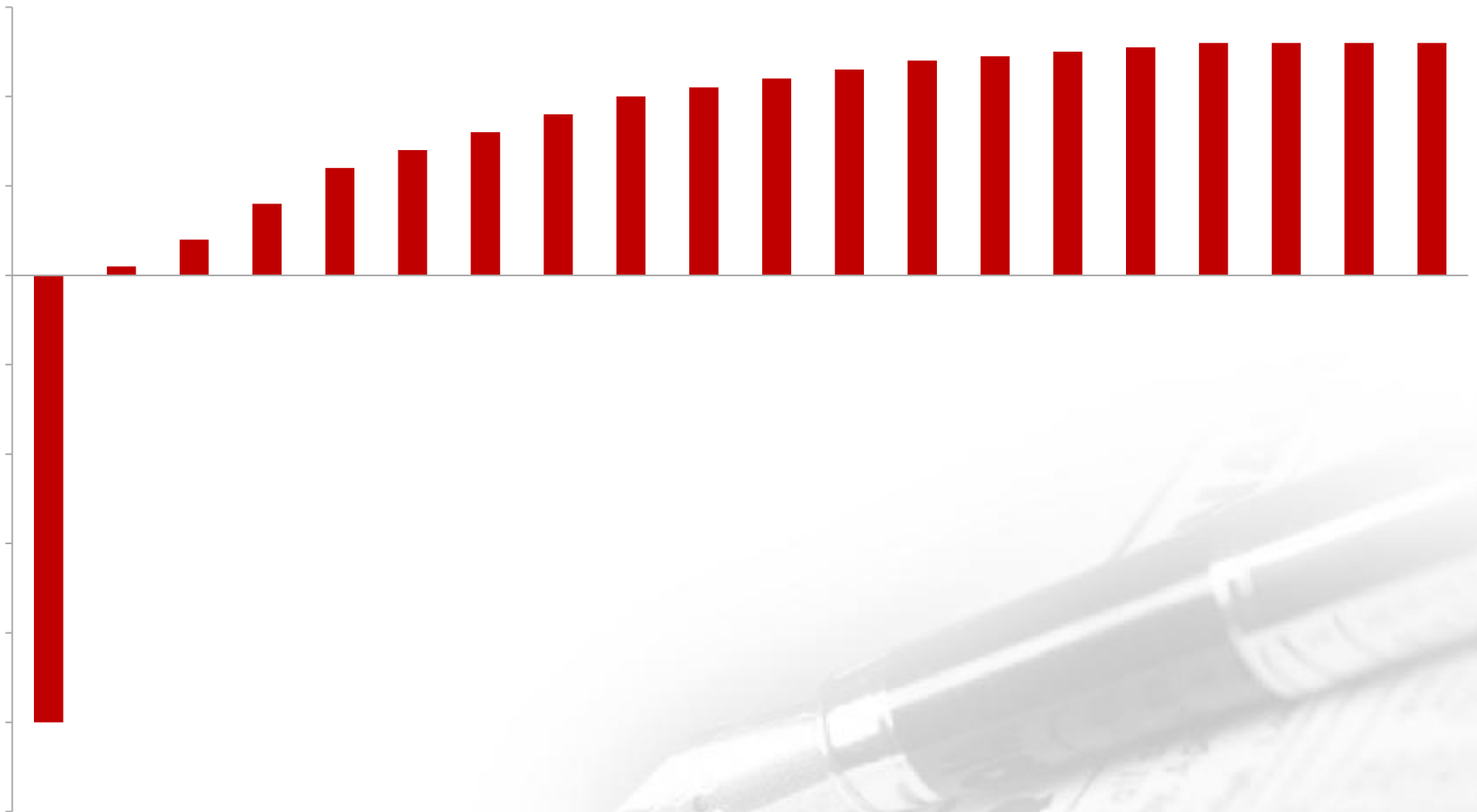
The profitable portfolio...



Deficit financing – Impact on B/S



NB Strain can also be financed...



How do regulators view such arrangements...

“Finite Reinsurances are legitimate; however it is essential that they are accounted for appropriately under generally accepted accounting principles (GAAP).”



INTERNATIONAL
II

**GUIDANCE PAPER ON
RISK TRANSFER, DISCLOSURE AND ANALYSIS
OF FINITE REINSURANCE**



**INSURANCE CORE PRINCIPLES,
STANDARDS, GUIDANCE AND ASSESSMENT
METHODOLOGY**

For an arrangement to be a legitimate reinsurance contract, it seeks
Adequate risk transfer, Adherence to local GAAP, Adequate disclosures

erved. Brief excerpts

Summary

- Insurance is a capital intensive industry with
 - Varied capital needs and
 - Various capital resources
- Reinsurance is a source of capital and has its own advantages
 - Legitimate
 - Flexible - bespoke terms agreed between knowledgeable parties
 - Can be cost effective and
 - Can be placed in reasonably short period time.



Earlier Presentations

Event	Year	Title	Author
3 rd GCA	2001	Reinsurance	David Muiry
5 th GCA	2003	FIN RE – Why do Companies need it and what are the Regulatory Concerns?	Madhu Sridharan
6 th GCA	2004	Capital and Risk Management of Life offices	David Howell
6 th GCA	2004	Capital Consumption: An alternative methodology to pricing reinsurance	Donald Mango
7 th GCA	2005	Life Reinsurance Effects	Marc Bastien, Madhu Sridharan
9 th GCA	2007	Development in sources of capital for UK Insurers	Matthew Hunt
12 th GCA	2010	Introduction to Financial Reinsurance	Dieter Kroll
CILA		Several presentations on financial reinsurance	

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14th GCA	2012	Reinsurance: Tool for Capital Management	Madhu Sridharan

Next Steps

- Suggest IAI sets up a project team to produce a discussion document covering
 - Reinsurance structures that are appropriate for the Indian market
 - Risk transfer principles, Accounting principles and Disclosure Requirements





THANK YOU!

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