Financial Reinsurance
Proven concepts in a changing world

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What is Financial Reinsurance?

- PCC
- Spread Loss
- Deficit Account
- Deposit Accounting
- Illiquidity Premium
- Cashless Financing
- Recapture Provision
- Lapse Claw-Back
- ModCo
- VIF Monetization
- Variable Quota
- Adverse Development Cover
- Virtual Capital
- Securitization
- COLLATERAL
- Surplus Relief
- Nil Premium Period
- Finite Re
- CoModCo
- Loss Portfolio Transfer
- Regulation XXX
Let’s start with a Quiz

Which of the following structures would you count as FinRe?

New written level premium term life business ceded as 50% quota share on original terms with

a) an initial cash commission of USD 1 M  
   OR

b) 20% first year premium discount  
   OR

c) 1 year Nil Premium period  
   OR

d) 100% profit commission after 5% expenses
Hint: It’s (probably) Financial Reinsurance, if

- The **B/S impact** of the transaction dominates the negotiations (and more MBA’s, CFA’s and lawyers than actuaries are involved)

- The (biometric) **risk transfer test** is barely (if at all) passed

- The **cash flow** in the first years is positive for the cedant

- The reinsurer can set up a **DAC** item under US GAAP

- The **rating** of the cedant counts (not the other way round)

You will (probably) know when you see it
**Financing vs. Solvency Support**

**Financing**

**Objective:** Increase in assets by bringing forward future profits

Works if there are differences in
- Refinancing conditions
- Accounting standards
- Regulation

**Solvency Support**

**Objective:** Reduction of required capital or reserves

Works if there are differences in
- Cost of Capital
- Diversification benefits
- Regulation
- Best Estimates

Source: PartnerRe
Another – rather simplistic - way of looking at it

<table>
<thead>
<tr>
<th>Cash</th>
<th>Non-Cash</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financing the new business strain</td>
<td>Supporting capital intensive new business</td>
</tr>
<tr>
<td>Monetizing of Value of in-force</td>
<td>Optimizing the cedant’s solvency position</td>
</tr>
</tbody>
</table>

New Business  In-Force Business

Source: PartnerRe
# Reinsurance vs. other Capital Management Solutions

<table>
<thead>
<tr>
<th></th>
<th>Reinsurance</th>
<th>Equity</th>
<th>Sub Debt</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cost</strong></td>
<td>Depends</td>
<td>Expensive</td>
<td>Depends</td>
</tr>
<tr>
<td><strong>Flexibility</strong></td>
<td>High</td>
<td>Low</td>
<td>Low</td>
</tr>
<tr>
<td><strong>Liquidity</strong></td>
<td>Depends</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Capacity</strong></td>
<td>Limited</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td><strong>SII Recognition</strong></td>
<td>Usually Tier 1</td>
<td>Tier 1</td>
<td>Usually below Tier 1</td>
</tr>
<tr>
<td><strong>Tax Deductible</strong></td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Risk Transfer</strong></td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td><strong>Service</strong></td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

No ‘one size fits all’ solution

Source: PartnerRe
A typical European Example: Deficit Account

Source: PartnerRe
Typical items to consider in underwriting and pricing DA deal:

- Stability of projected cash flows
- Proportion of future profits financed
- Fixed vs. floating interest on DA
- Amortization pattern/period
- Value of the risk run-off
- (Biometric) Risk transfer
- Policyholder behavior patterns
- Counterparty credit risk
- Regulatory aspects
- Reputational risk

Actuarial Pricing vs. ‘Market’ Price
What is going on around the globe?

- **US:** Regulation (A)XXX solutions
- **UK:** Nil premium periods for TCI business
- **Iberia:** VIF monetization for bancassurance business
- **EU:** Preparing for Solvency II
- **Germany:** Financing reserves for interest rate guarantees
- **China:** Short-term bridging non-cash financing
Key Points

- It’s not always obvious where to draw the line between traditional and financial reinsurance.

- The underlying concepts are – despite all the lingo – actually relatively simple.

- Financing can and need to be adapted to the concrete circumstances, which can vary significantly.
Questions or comments?

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