

http://www.nationalunderwriter.com/archives/Lh_archive/2005/L01-31/L4newcapital.asp

New Capital Fueling Life Reinsurance Market

By Jim Connolly

The life reinsurance industry is at an "inflection point" that will become still more evident in 2005, according to Paul Rutledge, president of Transamerica Reinsurance, Charlotte, N.C.

That inflection point, he continues, is evident in the growing coordination of the reinsurance and capital markets.

Part of the reason, he explains, is that it takes more capital and infrastructure to start up as well as more expertise. Even a few years ago, it would take \$100 million to \$200 million to start up a reinsurance operation, but today it takes more, Rutledge says. "Today, there are a more complex set of solutions that are being delivered."

Interviews with several industry executives affirm that demand for reinsurance relief from direct writers of life insurance is prompting new capital investment even as the list of longtime players consolidates.

Two announcements underscore the interest in this market. On Jan. 3, Scottish Re Group, Hamilton, Bermuda, announced that a private equity firm, The Cypress Group, New York, had made a \$180 million investment in the reinsurer. The announcement reflects both the new infusion of capital, as well as the consolidation in the market, since the company said the money was raised to support the U.S. individual life reinsurance business acquired from ING Groep, N.V., Amsterdam, on Dec. 31, 2004. For its investment, Cypress Group received a 9.9% stake in Scottish Re's ordinary common stock.

The need for capital also was underscored by a new report from UBS analyst Andrew Kligerman who notes, among other points, that the mortality experience on life reinsurance held by Scottish Re can deteriorate as business ages and that UBS believes reserves on Triple-X business could increase substantially in the future (see related story for more details).

The Scottish Re deal followed a year-end entry by a new player in the reinsurance market. Wilton Re Holdings Limited, Hamilton, Bermuda, raised more than \$600 million in capital to provide a new source of life reinsurance capacity to life insurers through its Wilton Re U.S. Holdings unit. Sponsoring investors include Trident III, L.P., a private equity fund managed by MMC Capital Inc., and Chris Stroup, chairman of Wilton Re Holdings Limited. John Tiller, also a longtime reinsurance veteran, will act as CEO of Wilton Re U.S. Holdings.

The new operation first was conceived during the summer of 2004, fund raising was completed in mid-December 2004 and the company was up and running on Jan. 1, says Stroup. The company will concentrate on two areas: traditional mortality business and run-off solutions.

Consolidation in the life reinsurance marketplace has created a demand for additional reinsurance, he adds. The reinsurance capacity that Wilton Re offers provides ceding direct writers with monetizing for statutory accounting purposes, the present value of future profits as well as freeing up the capital and administrative capabilities needed to support those contracts, Stroup says.

Wilton Re will not be active in other areas such as reinsuring catastrophe insurance, variable annuity guaranteed minimum death benefits and income benefits, and long term care and health insurance because there is not a reasonable risk-adjusted return, he continues. Ultimately, he says the company will look like Life Re Corp., the company of which he was executive vice

president and CFO before it was purchased by Swiss Re.

Stroup says he believes that within 36 months, reinsuring traditional life and fixed annuity business will bring Wilton Re to its targeted scale.

Although other techniques such as hedging and securitizations are being explored by direct writers as options to create more capacity, Stroup maintains "reinsurance is too effective a capital and risk management tool to be eliminated."

Hedging may help alleviate risks associated with guarantees in variable products, but it is not a perfect science, says Stroup, adding there can be significant accounting ramifications associated with detailed GAAP accounting rules.

Securitizations can be effective if the direct writer is a very large institution, he says. Even for companies that use securitizations to ensure greater control over the ultimate collateral, there is still a large need for reinsurance, Stroup continues. For both options, there is "a certain size and sophistication" that is needed.

There is a need to bring together insurance risk and capital markets, and securitizations are one viable way to accomplish this, says Michael Pado, senior vice president with Transamerica Reinsurance, Charlotte, N.C., and a former president and CEO of Convergence Re, LLC.

Prior to joining Transamerica, Pado had attempted to focus on securitizations through Convergence, the company he founded. There was interest among capital providers and derivative dealers, but there also was difficulty in attaining critical mass that resulted in the end of that venture in April 2004, he explains. Even so, Pado maintains it could still be a viable idea because of the growing need to manage risk.

In certain higher-end markets, there will be more securitizations, according to Joe Sikora, senior vice president and chief actuary with Hannover Life Re in Orlando, Fla. On the low end, there is an approximate \$150 million minimum needed just to have an investment banker talk to a direct writer, he continues.

The reduced availability of more traditional reinsurance will result in direct writers having to reconsider how they operate, he says. There might be a need to reprice products or settle for short-term lower returns on capital, he continues. More traditional reinsurance will be harder to come by because reinsurers themselves face more hurdles, including the availability of letters of credit, he adds.

The market is moving in a direction that will include more banking and offshore reinsurance facilities, says Curt Hagelman, a senior vice president and chief marketing officer with Hannover Life Re.

Jeff Burt, vice president-marketing with Hannover Life Re, says a reinsurer can help direct writers determine what business to retain and what to pass on, as well as help them have a more realistic idea of the availability of reinsurance.

Sikora thinks that one of the ways reinsurers will work with the capital markets is to consolidate business of different carriers and "present a cohesive package that is easy for the capital markets to understand."

Transamerica Re's Rutledge says the capital markets will continue to play a role in helping direct writers reduce risk. "Securitizations are here to stay. Whether there are other more efficient ways to do it over time remains to be seen since this is all new."

These alternatives will supplement available reinsurance from reinsurers who face increased

retrocession costs, the cost of reinsuring reinsurance, as well as the increased costs of letters of credit, which make it possible for reinsurers to assume additional risk.

Rutledge says a balance needs to be found between the demand for products with an equity component and managing extremes in the equity markets.

There is a real need to design products that properly hedge risks such as fluctuations in the stock market that would affect guarantees in products, he adds.

These products have unknowns such as how well hedges for these guarantees will perform as well as how the policyholder will perform. It is uncertain whether the policyholder will annuitize, surrender or put more money in a contract, Rutledge adds.

But both consumer demand and regulatory requirements or potential changes will continue to create a need for reinsurance, he says.

Currently, there are requirements for the Valuation of Life Insurance Policies model regulation, known as Guideline Triple-X, and potential regulatory requirements associated with a C-3, Phase II project for risk-based capital and reserving of variable products with guarantees. Conceivably, work on Guideline 38 or A-Triple-X, a follow-up to Triple-X, also could be put in place, although the outcome is uncertain.

Bob Brown of CIGNA, who is currently working on the American Academy of Actuary's C-3, Phase II capital project, says the impact on direct writers that would affect their need for reinsurance and the impact on reinsurers themselves will depend on the amount and manner of hedging that companies have put in place for variable annuities with guarantees.

The amount of capital that could be required also would be determined to a degree by the product mix held by the company, he adds.

Jim Connolly
Senior Editor
National Underwriter Life & Health
Phone--201-526-1236; Fax--201-526-1260

Subscribe to our new Retirement Income Planning e-newsletter.
http://www.nationalunderwriter.com/rip_register/default.asp