



Going It Alone

In an age when most life reinsurance is sold by multiline companies, and the number of pure life reinsurers serving the U.S. market has shrunk, the few remaining players are going strong and a new player has joined them.

by Ron Panko

THE RIGHT TIME: Don Araldi, chief sales and marketing officer for Wilton Re, said the declining number of life reinsurers and possibilities for placing risk created a good opportunity for “an experienced management team to raise an appropriate amount of capital and try to solve that problem.”

Pure life reinsurers are a rare breed, RGA Reinsurance Co. and Scottish Re (U.S.) Inc. were joined in September 2004 by Wilton Reassurance Co. as the only companies to sell the product line exclusively. Most life reinsurance in the United States is sold by large, multiline companies, with Swiss Re holding the largest market share by far, but RGA Re and Scottish Re rank second and third, according to the Munich Re/Society of Actuaries Life Reinsurance Rankings.

The pure life reinsurers like their positions today despite significant changes the past few years in the life reinsurance market and a difficult year for many in 2005. Several life reinsurers have sold their businesses, concentrating 75% of market share among the top five reinsurers, according to an A.M. Best Co. report in November of 2005. The consolidation has made it harder for direct writers to diversify their reinsurance risks. And while A.M. Best has reported that it expects more new life reinsurers this year and next, competition for capital has risen

as property/casualty reinsurers recapitalize following last year’s devastating hurricanes.

Adding to industry change was the fact cession rates fell last year as reinsurers tried to raise prices. Finally, life reinsurers and direct writers are trying to rebuild relationships that deteriorated in recent years.

Wilton Re, formed in 2004 and named after the Connecticut town in which its U.S. operations are headquartered, is taking advantage of the industry trends, said Don Araldi, chief sales and marketing officer. Many direct writers had agreements in past years with seven or eight reinsurers, “which gave them good comfort and a nice risk profile for the pool,” he said. For some direct writers, that number has dropped to three or four, and when Scottish Re bought ING Re’s individual business, direct writers began to think their risk profiles were unacceptable, Araldi said. “That’s when it seemed like an ideal time for an experienced management team to raise an

Key Points

- Wilton Re, a pure life reinsurance start-up in 2004, is using unusual strategies to build its book of business.
- Cession rates are dropping from the highs of 2004 and earlier.
- Life reinsurers and direct writers are struggling to re-establish strained relationships.

appropriate amount of capital and offer to solve that problem,” he said.

Scottish Re (U.S.) Inc., headquartered in Charlotte, N.C., is part of a group with operating companies in the United Kingdom, Ireland, Cayman Islands and Bermuda. Its primary business is to underwrite life and annuity risks. Formed in 1998, it currently reinsures about 14 million lives and \$1 trillion of face amount in North America and is one of the three largest life reinsurers in the U.S. market with 15% of market share.

RGA Reinsurance Co., Chesterfield, Mo., ranked second as of June among North American life reinsurers, according to an A.M. Best report on the company.

At year end 2005, RGA insured \$1.2 trillion in face amount, which equates to about a 15% share of the U.S. market.

Wilton Re: Starting from Scratch

As a newcomer to the market-place, Wilton Re has adopted some unusual strategies. One is that Chris Stroup, president and chief executive officer, hired Araldi to head up sales and marketing rather than someone with a traditional actuarial or accounting background. Araldi brought 24 years of sales and marketing experience with some of the largest software companies in the world.

The strategies also include a capitalization structure that Araldi said is unique to the insurance world. The company acquired \$628 million in three-year irrevocable calls from the private equity investors that make up its investment group. As it writes business, incurs expenses and forecast opportunities, it draws down capital against that fund-raising effort. "So we don't have \$628 million invested somewhere at 3% burning a hole in our pockets," Araldi said. "Investors aren't standing over our shoulders wondering why we're not closing more business faster. The money is still in their hands. That has been a great thing for our investors and our board. It takes pressure off the organization and allows us to maintain our pricing discipline."

Wilton Re also benefits from a clean balance sheet. "We don't have legacy issues that have an effect on how we evaluate risk and price business today," Araldi said. "It is a common belief...that a number of reinsurers who have priced too aggressively have been attempting to raise rates over the last year or two in an effort to raise their returns to offset losses from poorly priced business. Of course, that doesn't make direct writers happy. We don't suffer from any of that. We have the opportunity to either execute well or create our own legacy issues."

Every new piece of business in fact, grows the company's portfolio. Araldi said many competitors struggled last year to keep recurring business as cession rates industry wide plunged to 48% in April 2005 from 59% in 2004. "Most large players in the reinsurance industry took a beating last year," said Araldi. He predicted that the cession rate would drop again in 2006, probably to 40%. "So, while they are struggling to keep their

boat afloat, we're still building our boat," he said.

A variety of issues is causing cession rates to drop. Many direct writers changed from a coinsurance basis to a yearly renewable term basis, which Araldi estimated cuts premiums to the reinsurers by about half. Some moved from quota share to reinsurance in excess of \$1 million per policy. For example, Wilton had priced a particular block of term-life business for which it estimated its share to be worth about \$1.5 million as a coinsurance product, Araldi said. But the direct writer switched to YRT, dropping premiums to \$750,000. Finally, the direct writer added a change in its retention so as to cede amounts only over \$1 million per policy. In the end, the business was worth only \$35,000 to \$40,000 in premiums to Wilton Re.

Finally, Wilton Re employs a very unusual strategy in which it offers full transparency to clients on how it has priced a book of business or a pool and what assumptions have been used to model the business. Even expected internal rates of return are disclosed so that the customer has comfort with the Wilton Re pricing process. While ratings organizations will not give their highest ratings to start-up companies, Araldi said this practice has not hurt Wilton Re. "We have been able to overcome hesitation by some direct writers who otherwise would require a higher rating, by explaining our capitalization, offering a competitive price, and demonstrating our transparency process." "Under this disclosure process Wilton shares all data with the client as long as the client provides all information that Wilton requests.

Araldi also said that Wilton may benefit from relations that soured last year, when some of the large reinsurers were raising rates, rewriting treaties and structuring more strict language into their treaties. "A lot of direct writers were displeased with the way in which it was done," he said. "That actually drove a number of people to call us before we called on them, so it was a great opportunity for us."

To diversify its business, Wilton has developed Run Off Solutions as its other major business. In effect, the company buys closed blocks of business and administers them until they no longer exist. "Many direct writers have old closed blocks of business that are currently being administered on old

legacy technology," said Araldi. "These blocks can represent a substantial amount of trapped capital for the direct writers and continuing to maintain the legacy platforms can be very costly. We can take the burden of those closed blocks off their hands and deliver the value of the trapped capital today."

Wilton has partnered with a number of tech companies to migrate Run Off business off of old legacy systems and onto a new system that can manage the business at a much lower cost per policy, Araldi said. The company intends to maintain a balance between the growing balance sheet that comes from a portfolio of traditional treaties and the declining balance sheet that comes from the Run Off business.



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—Greg Woodring,
RGA Re

RGA Re: Fully Focused

In 2005, a year in which many life reinsurers struggled to keep up premiums from business written; RGA Re actually more than doubled its U.S. market share to 21%, the highest in the industry, and slightly increased its in-force business. Greg Woodring, president and chief executive officer said 65% of RGA business is out of the United States, 8% out of Canada, and the rest outside of North America. The company opened an office in China, and it raised \$400 million in capital in the form of junior subordinated debentures to support continued growth.

Woodring said that if there is an advantage to being a pure life reinsurer, it is that management is able to focus on the business. RGA is a subsidiary of MetLife Inc., which has helped in its ratings, but Woodring said they remain separate companies with no sharing of resources or "any real" information.

Reinsurers and direct writers have had many intense discussions to work out problems, but when they can't, they go to arbitration. There have been more arbitrations recently than ever before; Woodring said, typically, disputes revolve around systematic breakdowns of the underwriting process.

While reinsurers have much at stake, direct writers also want to know in the future that reinsurers will stand behind

their business, said Woodring. Some direct writers are actually pleased that reinsurers had “cracked down” on their competitors because those companies had hurt their businesses, too, he said. “So it’s just getting back to what makes the whole business work well, and that’s understanding on both sides and integrity on both sides,” said Woodring. He said new contracts are becoming more specific and detailed.

RGA Re specializes in a number of services, but Woodring said the most important is facultative reinsurance. He believes the company is the largest facultative writer in the United States, with about 100,000 cases a year averaging more than \$1 million each. On a worldwide basis, it currently writes about 250,000 cases a year.

An A.M. Best Co. report on the company states, however, that despite strong operating fundamentals and profitable operations, A.M. Best’s outlook is negative due primarily to concerns about weakened operating performance. “In recent reporting periods, the company experienced increases in death claims in both the U.S. and the U.K., pressuring overall results in 2005,” the report said.



“Securitization is clearly an emerging area of technology for financing the life reinsurance business.”

—Scott E. Willkomm,
Scottish Re

Scottish Re: Acquisitions Key

Two recent acquisitions have propelled Scottish Re into the third-largest U.S. life reinsurer. In December 2003, the company bought 95% of the capital stock of ERC Life, then a subsidiary of General Electric’s Employers Reinsurance Corp., for \$151 million. In late 2004, it acquired the individual life reinsurance business of ING Re, which more than doubled its reinsurance portfolio.

Scott E. Willkomm, president and chief executive officer, agreed that a pure life reinsurer is a rare breed and noted there many more in the past. “The scale of your balance sheet that drives ratings and financial flexibility is probably more efficiently achieved being part of a much larger... financial-services enterprise,” he said. “That’s one of the reasons there are so few of us.”

But specializing in life reinsurance is an advantage because life liabilities are much longer in duration than those of nonlife reinsurers, and the focus and

discipline about capital allocation is a lot more precise than one might find in composite companies that move capital back and forth between the life and nonlife sides of the house, he said.

A disadvantage to being a pure life reinsurer is the “profit signature” is a lot more predictable. “In nonlife, you could have today a 35% return on equity, but it could all be wiped away in the next quarter or next year,” he said. “If you get it wrong in the life reinsurance business, it’s the difference between say 13% to 14% ROE and 10%. It’s not lights out.”

That may sound like an advantage, but Willkomm said shareholders and investors like the chance of achieving “robust ROEs,” even though the stocks of life reinsurance companies have outperformed nonlife companies over the past 15 years by two to one.

The two recent major acquisitions were of great benefit to Scottish Re because in life reinsurance, the profitability of a firm is dependent on the efficiencies provided by a large scale of operations, Willkomm said. That scale has allowed the company to develop capabilities it probably couldn’t have afforded as a smaller company. One such capability, he said, is its mortality and morbidity research center, manned by about a dozen professionals who constantly analyze experience.

ING Re actually paid Scottish \$600 million to take its business, which reinsured wealth-accumulation products. (Wilton Re also bid on that block.) The payment was necessary because “of our view of their reserves and our view of the profitability of the book of business,” said Willkomm. But Willkomm would not say ING Re mad mistakes. “Our view of the profitability was that we didn’t have some of the internal financial efficiencies that ING may have been able to achieve throughout their enterprise,” he said.

Scottish Re’s mortality business is primarily term life and is called Traditional Solutions. Its other main business segment, Financial Solutions, is principally for the reinsurance of fixed annuities and similar types of products, which carry risks that tend to be shorter in duration. “It allows us to diversify our risks,” said Willkomm of the Financial Solutions segment. “These risks are somewhat inversely correlated, and the business creates some incremental capital efficiency on a [regulatory] basis, and they have different profit signatures.” The National Association of Insurance

Commissioners’ Risk-Based Capital model gives a reinsurer credit for diversification of risk, he added.

Learn More

RGA Reinsurance Co.
A.M. Best Company # 09080
Distribution: Direct negotiation

Scottish Re (U.S.) Inc.
A.M. Best Company # 08785
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Scottish Re is also the leading securitizer of life insurance risks through its Capital Markets team, Willkomm said. Securitizations help optimize the balance sheets of both Scottish Re and its customers, he said. “Securitization is clearly an emerging area of technology for financing the life reinsurance business,” said Willkomm. “That will significantly change how the whole life insurance industry finances itself. We’ve tried to be on the leading edge of that trend, and we’re only at the tip of the iceberg.”