

THE CIRCLE OF LIFE

With life expectancy on the rise, new markets opening up and continued globalisation and consolidation, **Pat Malloy** looks at the changing face of life reinsurance.

HOW CAN SOMETHING BE expanding and contracting at the same time? This seemingly paradoxical situation can be applied to the life reinsurance industry, which is currently experiencing the effects of globalisation and consolidation. The consensus seems to be that the US primary life market is mature and that for most insurers, significant organic growth is unlikely. Everyone targets the high-net-worth market. The middle market is ignored because it is difficult for producers to be profitable there and to date, the internet has experienced the “failed promise” of instant issue that everyone had hoped for (although it does now appear that progress is being made in this area). The great hope for real growth in the future seems to hang on the ability of companies to tap into the global marketplace, and this applies to reinsurers as well as ceding companies.

Of the top 50 reinsurance groups in the global market, 19 companies assume life reinsurance. The two largest and most dominant writers, Swiss Re and Munich Re, wrote almost 46% of total life net written premiums in 2005, with 24% and 21.9% market shares respectively. With Swiss Re's recent acquisition of GE Insurance Solutions this wedge of the market should increase further in 2006.

GLOBALISATION AND CONSOLIDATION

The recent acquisition of Revios Reinsurance AG by French reinsurer Scor Group will make the new entity, Scor Global Life, the fourth largest life reinsurer in the world. Scor will consolidate its leading position in France, whilst gaining market share in Spain and Germany. In the US and Canada, Scor Global Life will increase its market share to 5%. Further expansion into Latin America, Asia, the former Soviet Union and even the Middle East, spurred by very low penetration rates, is also likely. Clearly, the dual forces of globalisation and consolidation are at work here.

Market speculation about the future of Scottish Re, with a number of major rivals rumoured to be contemplating an acquisition, would further consolidate the life reinsurance market. One impact of this trend is that the sector's remaining players have more leverage and this has resulted in higher rates, tougher treaty terms, less flexibility and overall less interest in exploring new ways to do business. Higher reinsurance costs have led to increased retention and reinsurance on an excess of retention rather than first dollar quota share basis and consequently less ceded volume.

The Munich American Reinsurance Survey, prepared at the request of the Society of Actuaries

Reinsurance Section, demonstrates that ordinary reinsurance assumed volume for the year 2005 alone decreased by 51.3%. This situation will only be exacerbated by further consolidation. As the pool of credible reinsurers shrinks, ceding companies are finding it increasingly difficult to find four or five quality treaty partners with whom to cede risks. Reinsurance intermediaries have an opportunity to prove their added value by developing markets for clients which may not have been previously considered or where relationships did not already exist. After determining the client's goals and objectives, an intermediary will recommend the programme structure, develop the request for proposal response and negotiate the most favourable terms while accessing the best reinsurance security.

RECENT NEW ENTRANTS

New entrants such as XL Re Life America, Wilton Re and ACE Tempest Life Re have added capacity to the market, albeit not always with the same level of services as their more established counterparts. XL and ACE seemed to stumble with their initial US launch, but have now acquired broadly licensed shell companies (each acquired shells previously owned by Hartford) and now seem ready and able to do business.

As witnessed with Scottish Re, the fall from grace can be very quick indeed, and none of these new companies have longevity in the US market as a selling point. Additional new entrants are possible, but it is no easy task raising the necessary capital and recruiting quality management with the mix of skills necessary to woo Wall Street. Furthermore, with the mindset of having to show positive results next quarter as opposed to looking at the long-term picture, shareholders put pressure on management to show growth quickly and this is not always possible. This scenario further fuels the consolidation engine for reinsurers and ceding companies and has perhaps encouraged some acquiring companies to make aggressive offers for blocks or companies that were not always prudent.

In addition to the challenge of where to find growth is the question of how to fund it in a cost-effective way. Securitisation has certainly evolved quickly and although some believe that principles-based reserving

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Life | The world's top eight life reinsurers – Net premiums written

Reinsurer	2005 Life NPW	Life NPW as % of total NPW
Swiss Re	\$8bn	37%
Munich Re	\$7.2bn	29%
Reinsurance Group of America	\$3.9bn	100%
Hannover Re	\$2.7bn	32%
Berkshire Hathaway	\$2.3bn	22%
XL	\$2.2bn	44%
GE Insurance Solutions	\$2.2bn	45%
Scottish Re	\$1.9bn	100%

Source: Author's own

will lessen the need for securitisation, there are others that question what benefit, if any, will spring from this initiative as the drive for principles-based reserving moves forward. But it seems likely that in the short term, as 2006 has already demonstrated, there will be increased use of securitisation to address Regulation Triple X and AXXX issues by both ceding companies and reinsurers alike.

Reinsurers are not the only ones seeking growth outside North America. Primary companies are in the mix as well with much press comment extolling the virtues of an educated consumer base in Russia, for

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example, or the rise of China as an economic powerhouse with the concomitant potential to market insurance and retirement type products to a population exceeding 1.3 billion. Neither should India be forgotten, the world's second most populous country, which is expected to surpass China in population by 2040.

The opportunities presented by these markets will have to be balanced with the unique challenges they may present. These challenges may be of a regulatory nature, such as the restrictions on foreign ownership of life insurance companies in countries such as China and India, or of a cultural nature. The question remains as to whether Western-style life insurance is permissible under the tenets of Islam.

TECHNOLOGY

The internet may not yet have fulfilled its potential as a low-cost channel, but it appears that industry changing technology is at the life reinsurer's doorstep. Straight through processing (STP) has been utilised by the banking industry for many years to control costs, increase efficiency and reduce risk. True STP eliminates manual intervention by highly secure data transmission from initiation to confirmation. Realtime STP, developed by Realtime Solutions in Chicago, is one of several similar industry offerings that enables policies to

be issued in real time – dramatically reducing the sales cycle from weeks to minutes, underwriting costs by 50% or more and decreasing “not taken” polices dramatically. These systems can also be employed to introduce new products, penetrate new markets or implement new distribution channels in record time.

Applicant data is verified as it is being taken using the Medical Information Bureau, prescription drug profiles, motor vehicle records and credit reports that reduce the need for attending physician's statement requests and/or paramedics for collecting health histories and fluids. Another key component of the STP technology is the use of electronic signatures to provide applicant authorisations in real time. Bottom line, placed and paid ratios increase and costs are significantly reduced with STP, which is particularly important for the smaller face policies that meet the needs of middle market consumers. STP, it is claimed, is already having a significant impact on the marketplace and holds great promise for the future. Reinsurers must recognise the competitive advantage of these new technologies and support the ceding companies in their efforts to penetrate the middle market in a more profitable manner.

Without doubt, globalisation is heavily dependent on technology to achieve the economies needed to make it work. Insurance carriers and reinsurers have not been traditional players in the world of change and innovation. Adopting technology to enable the work to get done in the best, cheapest and fastest way is anti-intuitive to most North American insurance cultures. But without it a successful globalisation strategy is nothing but a melding of big cumbersome bureaucracies lumped together, with the end result being that you are just getting bigger. According to Mike McCarthy, executive vice president of LIDP Consulting, “To gain the economies, the cultures of almost all North American carriers will have to change. The changes will have to acknowledge wholesale adoption of enabling technologies – technologies that really do shift the paradigm and make carriers and the stuff they sell better, cheaper and faster.”

That globalisation and consolidation will continue is almost certain, as is the occasional formation of a new life reinsurer – either on or offshore – as capacity diminishes and life reinsurance rates harden, likely attracting new capital. The capital markets will continue to provide innovative products and, depending on the extent to which they are utilised by the life industry, could have a significant effect on the volume of new ceded life reinsurance.

Globalisation and consolidation are certainly related. Whether talking about ceding companies or reinsurers having the wherewithal to “get the job done” on a global scale, companies will need the size and related economies achieved through technology to do it profitably.

Pat Malloy is executive vice president at Gallagher Re. Other contributors are Craig Wolff, Peter Heinrichs, George Whipple and Ed Rankin.