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Inforce Management Inforce Block Transactions Are a Powerful Tool

Executive Summary

The concept of inforce management has taken on increased importance due to low interest rates and an increasing number of level-premium term life insurance policies reaching their post-level periods. As George explains, inforce management can take many forms, though perhaps the most discussed option is using inforce block transactions to transfer the risks to other companies.

George examines some of the trends in inforce management and what factors might contribute to a company preferring one option over another.

Managing inforce business has become a growing priority for life insurers. In the following article, I take a look at forces driving inforce performance, different actions companies are taking (with a focus on inforce block transfers) and the chances that these actions will become a permanent feature of their risk management agenda.

While many factors influence the performance of inforce business, two forces driving inforce management strategies are the recession and prolonged low interest-rate environment and blocks of term policies reaching their post level period.

The Economy

Until the mid-2000s many companies managed existing blocks of business in relatively quiet back-office departments. But the effect of the recession and prolonged low interest rate environment on inforce performance brought inforce management into the spotlight. Product features that originally were designed to be modest became rich benefits.

Unlike new business that is priced based on today's mortality, lapse and interest rates assumptions, inforce business has these assumptions already factored in. While improvements in some pricing factors (e.g., actual mortality experience, mortality improvement) can alleviate pressures in other areas, it cannot offset the decline in expected investment returns.

Post-Level Term

Focus on inforce management increased as the first wave of XXX level-premium term policies began to reach their post-level term (PLT). The combination of high lapses and correspondingly deteriorating residual mortality spurred carriers to investigate ways to maintain profitability during the PLT. Companies consequently have been testing PLT pricing structures that could enhance persistency of better risks in the early post-level durations.

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Inforce Management

Inforce Block Transactions Are a Powerful Tool (cont.)

Inforce Transactions

Companies typically have options available to manage inforce business. For example, mutual companies encourage as many policyowners as possible to exercise the conversion provisions, rolling policyowners into permanent products. Larger life insurers may determine that the embedded value is worth retaining the business and manage any mortality strain in-house, even though this may tie up capital for some time.

Inforce transactions can provide many advantages as part of an inforce management strategy. We address these as adverse, neutral and opportunistic below.

Adverse Outcomes. In some cases, today's realities simply cannot support the original pricing assumptions used in pricing the product. In this worst case, the block may become a long-term drain on earnings and capital. A number of companies have adopted de-risking strategies, offloading unprofitable business to reinsurers or other companies that may have the scale to more effectively manage the block. Our experience has shown that investors and regulators value predictability in mortality experience and in earnings: divestitures of loss-making business (with a recorded one-time charge against earnings) commonly are viewed as positive.

Neutral Outcomes. Instances may arise where the estimated effect to a business portfolio falls within the margin of error. In such a case entering an inforce transaction is not necessarily a priority, but the cost of internal management – on resources and capital

– may be questionable. Financial tools such as hedge programs can help life insurers manage the downside risk while protecting any earnings potential.

Opportunistic Circumstances. A number of life insurers may find themselves in a position where actively managing inforce business can add to earnings. In such a situation, entering an inforce transaction makes sense if the resulting benefits outweigh what the company can achieve on its own. The most compelling benefit for such companies is in accelerating cash flow, either through an immediate realization of the future profit stream, a release of reserves and capital, or both. This can be especially beneficial if a company is considering expanding a (profitable) product line or when the business in question has become secondary to the company's objectives.

Who Is Involved?

Since 2012, inforce block transactions have been almost evenly split between transactions involving affiliated captive reinsurers and deals utilizing professional reinsurers. Each approach has advantages.

Affiliate Captives. Using affiliate captives has allowed carriers to cede the reserve and capital strain to an arms-length, but affiliated, company, usually in a favorable reserve or tax jurisdiction. The ceding parent receives the reserve credit and uses funds raised by bonds issued by the captive to finance the reserve strain. However, captive use has come under increased regulatory scrutiny, culminating with the adoption of Actuarial Guideline 48 and pending updates to the NAIC Credit for Reinsurance Model Law and Regulation. Lastly, and depending on how the transaction may be structured, the risk usually will ultimately remain with the parent.

Professional Reinsurers. Reinsurers offer the expertise to evaluate the performance of blocks of business perhaps better than any other financial institution. By ceding an inforce block to a (non-affiliated) reinsurer, the life insurer can relinquish all reserve, capital

Figure 1 – Inforce Reinsurance Activity, 2011-2014

	2011	2012	2013	2014
# Transactions	22	29	21	19
Total Volume	\$314.5bn	\$553.8bn	\$257.1bn	\$321.6bn
Average Volume	\$14.3bn	\$19.1bn	\$12.2bn	\$16.9bn
Largest Deal	\$100.3bn	\$127.3bn	\$96.6bn	\$101.0bn

Deal activity, both by number of transactions and business volume, peaked in 2012, though two transactions accounted for more than \$250bn of volume. Note: Includes both affiliate and non-affiliate activity. (Source: Statutory reporting.)

and mortality issues to the assuming company. It is then up to the reinsurer to determine how best to manage the block. For these reasons, regulators are more open to such transactions. However, carriers usually cede 100% of the block to a single reinsurer, which may raise concentration-of-risk concerns.

A Third Way, with a Third Party. To address some of the drawbacks of the above approaches, we are seeing a trend where commercial banks are getting involved in the transaction. In these scenarios, the carrier brings the block of business to the table, the reinsurer uses its valuation expertise to estimate embedded value and to assume the pure risk, and the bank acts as the financing agent for the capital and reserve strain associated with the block. The primary advantage is that each party brings their core asset to the transaction. A challenge involves acquiring all parties' buy-in, which increases ultimate execution risk.

A Trusted Partner in Business Optimization

The key to inforce management remains making the inforce block perform as efficiently as possible. SCOR has worked with client companies in evaluating different approaches to maximize the earnings potential locked in inforce blocks. We have engaged in a variety of transactions focused on providing the best return for carriers with the least volatility.

If you would like to learn more about what SCOR can do to help your company optimize your business portfolio, please contact your account executive or me. ∞