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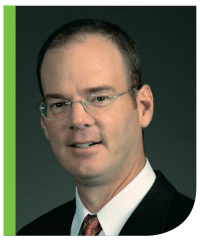


By Scott Boug, FSA, MAAA, CFA
Senior Vice President, Global Deputy Head Financial Solutions — sboug@scor.com

Building Permanent Structures to Address XXX Reserves

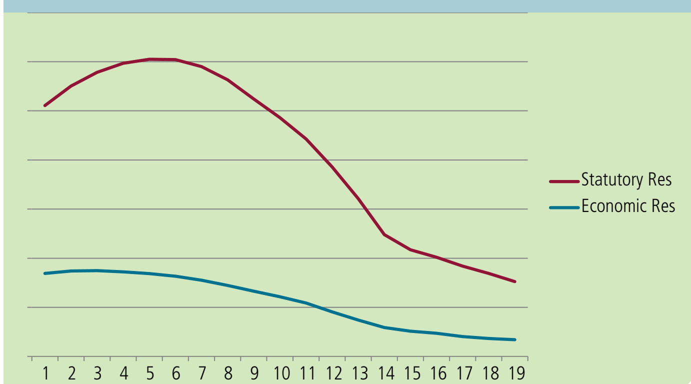
It has been a decade since the height of the term wars, when many life companies were selling policies at lower and lower rates and coinsuring the risk with reinsurers. Carriers then came to believe that they were leaving short-term profits on the table. They began to retain higher levels of risk in anticipation of financing future peak reserve strain through securitization.

The market collapse in 2008 derailed these plans. Today a number of companies are seeing their books of term business reach peak reserve strain. To compound the challenge, the timing of the peak coincides with the maturity of many "longer-term" (i.e., 5-7 year) letters of credit and other financing solutions that life insurers considered stopgaps on the way to securitization.

Today several companies are reassessing their options for financing redundant XXX reserves. The least attractive option is retaining the business unfinanced on the balance sheet. This causes a triple blow against a company's statutory capital:

- Peak redundant reserves consume capital at an increasing pace
- Allocating that capital to address reserve strain is not an efficient way to deploy capital
- Unless a carrier stopped writing new level-premium term life 7-8 years ago, they are reaching a near constant level of capital allocation

Figure 1 – Estimated XXX Reserve Requirement by Duration (Illustrative)



Industry sources estimate term life redundant reserves have grown from virtually zero to $70 billion in 2012 as a result of Regulation XXX.

Figure 2 outlines the steps in the process for structuring capital financing relief. A number of carriers were in the midst of structuring their own deals when the market crisis hit. Most financing activity came to a sudden halt at this point, demonstrating the extent to which these deals were exposed to execution risk – the risk that unforeseen events, internal or external, can jeopardize the entire venture.

The Term Concern

Companies that sell both permanent and term life products get considerably higher returns from their permanent business. Yet, even with tighter margins, most carriers are committed to offering term life because the product provides important consumer protection and is a necessary product to round out a producer's portfolio.

SCOR Global Life Americas

Charlotte
101 South Tryon Street
Suite 3200
Charlotte, NC 28280

Kansas City
11625 Rosewood Street
Suite 300
Leawood, KS 66211

Minneapolis
45 South Seventh Street
Suite 1850
Minneapolis, MN 55402

www.scor.com/SGLA

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Figure 2 - Process for Structuring Capital Relief Financing

In many cases these processes occur simultaneously, and any challenge posed at any step threatens the entire process. Execution risk can be high. Our team can enter the process at any step above to assist in the facilitation of a permanent financing solution.

Given the cost of financing peak redundant reserves, companies that are not "term shops" may view their mature term portfolios as more of a burden than an asset. The good news today is that as reserve requirements peak, financing options also appear to be opening again.

Reserve Financing Options

Straight insurance-linked securities designed for reserve financing are still limited; the investment community remains a little gun-shy following the housing bubble, and monolines, key players in past reserve securitization deals, have been sidelined entirely. Reinsurers, by contrast, have been increasingly willing to help fill the demand for financing services.

By the mid-2000s, many life reinsurers had in place capital efficient structures to help companies manage redundant XXX reserves. These structures continue to enable reinsurers to offer competitive rates to life insurers who, in turn, can pass the savings onto consumers. At the core of many of these structures is coinsurance – a reinsurance tool that has proven its worth in building highly effective capital management solutions.

SCOR Global Life has developed a global Financial Solutions discipline to assist clients with reserve and capital financing. The key to our approach is flexibility – in identifying products that can benefit from financing, structures to use, structure ownership and client company strategy.

Our team leverages SCOR's global expertise to help companies assess the best approach to their short- and long-term needs.

- We can enter into a coinsurance agreement (with recapture) to provide immediate reserve and surplus relief
- During the coinsured period clients can assess and elect the best structure for longer-term needs and count on us for support in executing these plans
- We work in tandem with clients to determine our role in managing strain and underlying risk through capital efficient structures
- We look beyond peak reserve financing to help clients optimize their portfolio's entire performance
- In most cases our execution and financing costs are more competitive than other market options

Our approach addresses immediate needs for reserve and surplus financing, which gives clients more time to investigate other long-term or permanent options. As a reinsurer, we can assist in the development of these permanent solutions in ways that help clients deploy capital more effectively.

Figure 3 provides a snapshot of the relative strengths and weaknesses of different financing alternatives. SCOR can assist in structuring any of the alternatives listed in the illustration. An ideal approach to surplus management combines a short-term coinsurance solution with a future transfer of business to a permanent structure.

Conclusion

While most life insurers can manage peak XXX reserve redundancy with existing internal capital, such an approach is far from efficient. SCOR is helping clients find an effective solution and is serving as a key partner through the entire process.

If you would like to explore your company's options, please contact your account executive. If you would like to speak more about specific deals you and your company may be considering, please feel free to contact me directly. ∞

Figure 3 – Comparison of Financing Structures/Strategies

	Cost	Execution Time	Regulatory Approval	Complexity	Leverage Impact	Flexibility
SCOR Solution	+	0	0	0	+	+
Coinsurance	–	+	+	+	+	+
LOC	0	–	+	0	0	0
Conditional LOC	0	–	+	0	+	0
Funded Solution	–	–	+	0	–	–

Alternative structures above are rated, "+" as better, "–" worse and "0" as neutral. All financing options carry some challenge relative to others, and none is perfect. However, our flexible approach and willingness to enter short-term structures until permanent solutions can be implemented makes our services stand out.