Swiss Re

Insurer`s Capital Management using Reinsurance: The Experience of European Insurers responding to solvency II

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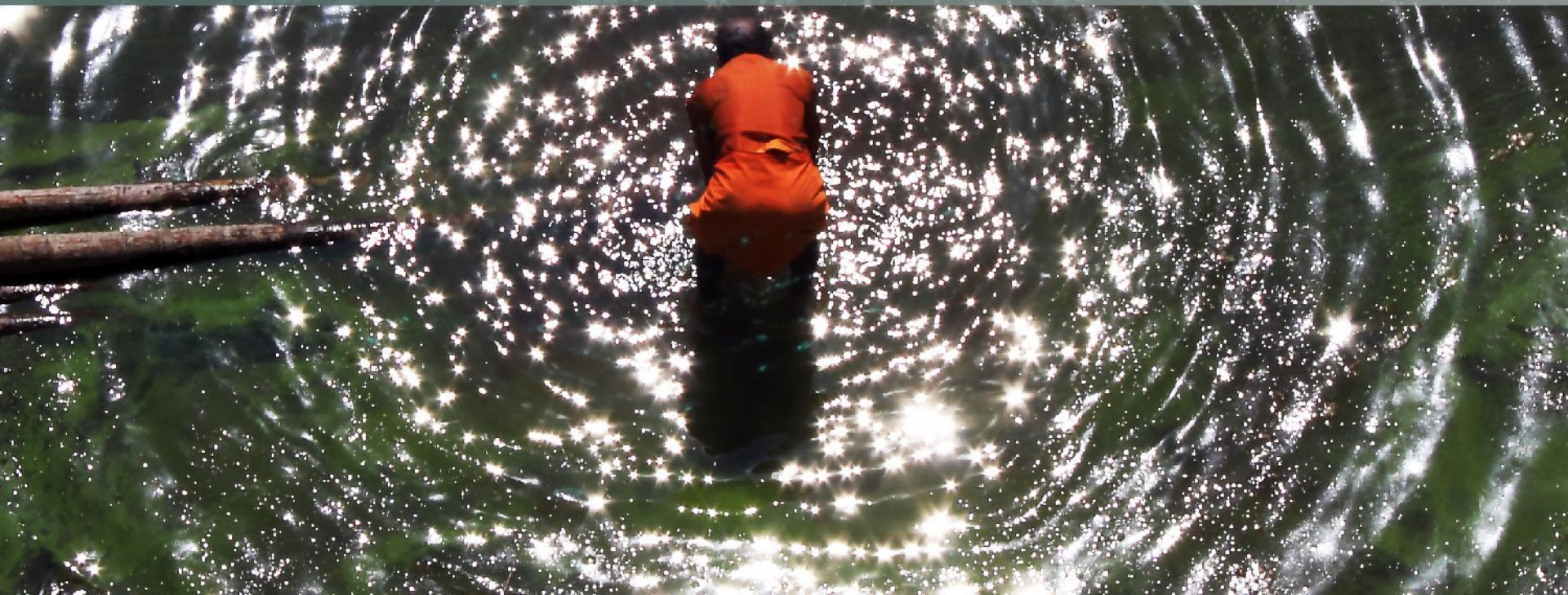


Agenda

1. Solvency II Background and Drivers
2. Expanding View of Reinsurance
3. Reinsurance Case Studies
4. Regulatory Process and Conclusion

Solvency II Background

- Insurance regulation governing the European Union
- European Council launched the process in 2001, effective from 2016

OBJECTIVES

- Increase the understanding of the risks
- Improve the risk management framework and risk mitigation

FEATURES OF FRAMEWORK

- Creating an Economic Balance Sheet
- Required Capital is risk based and calibrated to 1-in-200 years event
- Explicit allowance for diversification benefits

New regulation is principles based

Key Drivers of the Solvency II regime

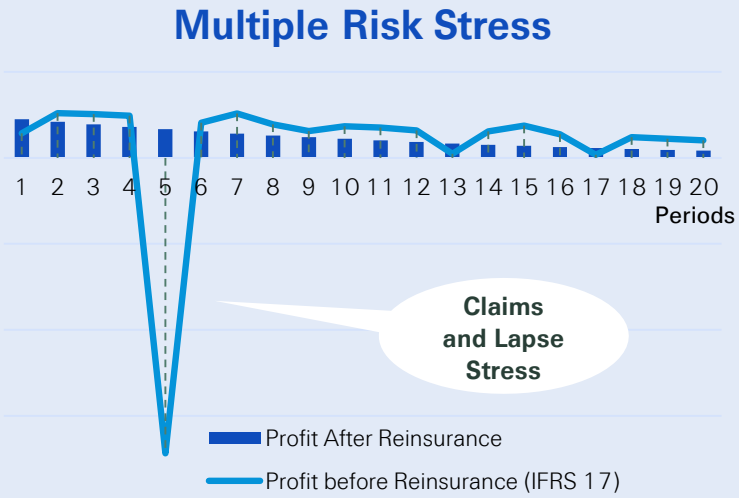
Market Value of Assets	Exposed to full market volatility
Discount Rates are risk free rates	Resultant negative spread on guaranteed investment products required long transitional measures
Negative Reserves count towards Equity	Protection and unit linked products can increase solvency
Required Capital calculations are scenario based	Diversification recognised as a key feature

Increasing volatility → **Increased use of Risk Mitigation Tools**

Increasing Volatility requires more complex risk management tools

Traditional approach to L&H reinsurance covers single risks

Under risk based scenarios the interaction between multiple risks drives losses and volatility

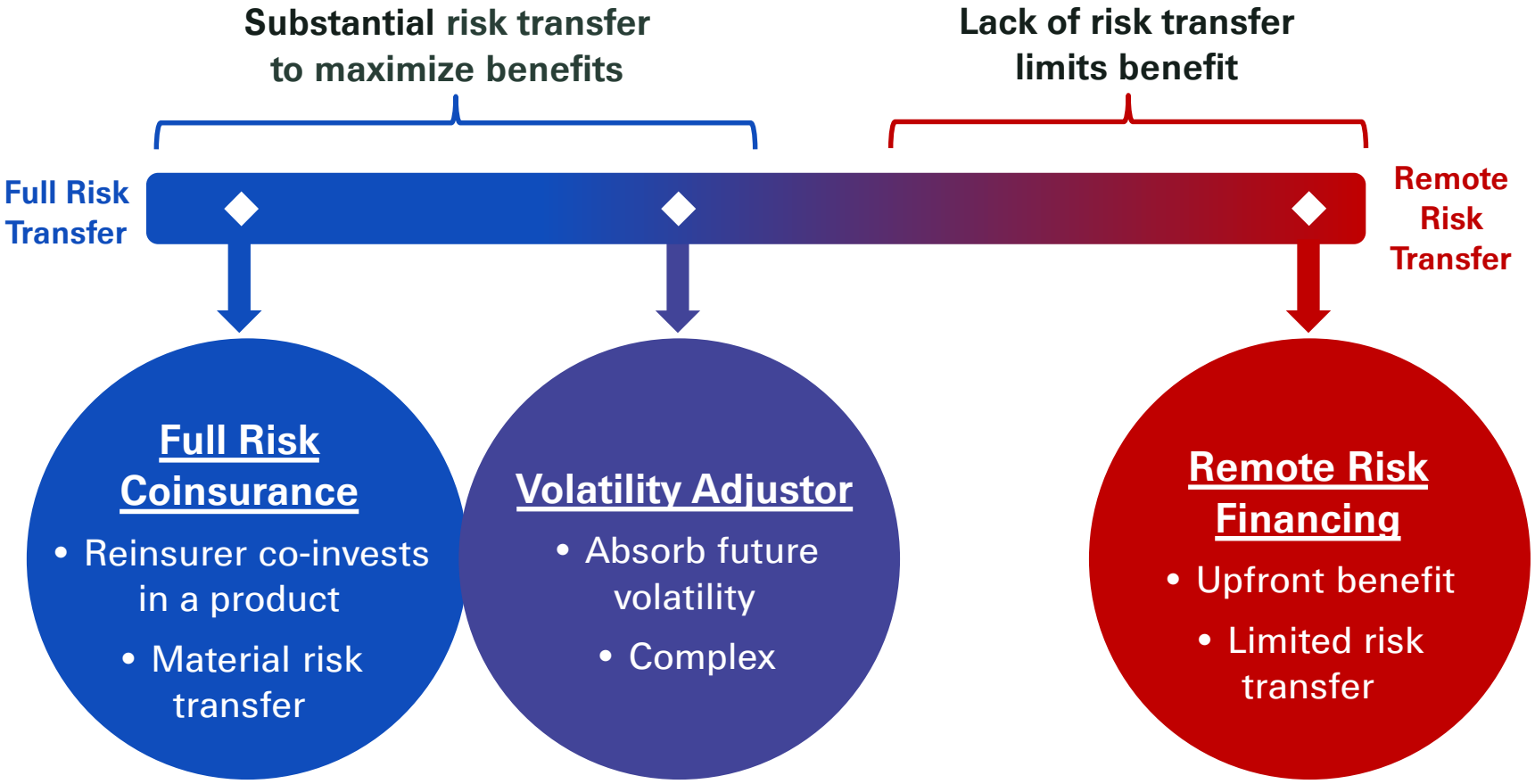


Tools are available to manage this volatility

2. Expanding view of Reinsurance

Reinsurance focused on substantial risk transfer maximises benefits

The table below shows the range of reinsurance solutions available



*Focus is on **ensuring sufficient risk transfer***

Reinsurance as a Capital management tool under Solvency II

Reinsurance activities can be grouped into **3 categories**

1 Portfolio Transfers

- Monetise negative reserves in order to drive strategic change
- Reduce exposure to long term risks, e.g. interest rates, trend risks

2 Reduce concentration risk

Solutions can either improve diversification or remove volatility, e.g.

- Longevity swaps or Mass lapse solutions
- Embedded Interest Rate Risks

3 Access to capital

- Strengthen access to capital under stressed conditions in order to enhance risk framework;
- Employ Contingent Solutions

Increased access to reinsurance supports increased capacity to increase primary risk taking and allows for innovative products to policyholders

3. Reinsurance Case Studies

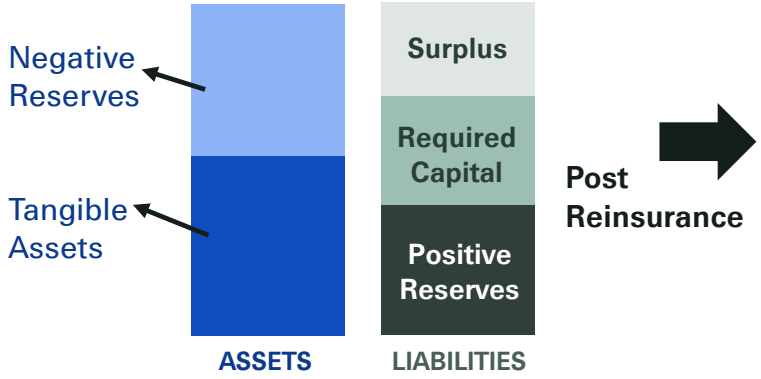
Case Studies: Portfolio Transfers – *Monetise negative reserves*

MOTIVATION

Motivation for the transaction was two-fold:

- **Strengthen** its **capital position** under Solvency II and
- Provide **cash** to fund future **growth**

*Analysts at JP Morgan noted that this tailored transaction provides **capital** that is immediately **fungible***

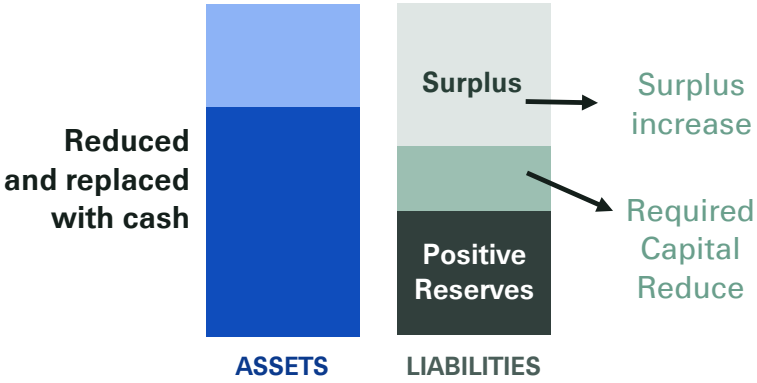


OUTCOMES

Swiss Re entered into **coinsurance arrangement** with a joint venture of a client in Spain*

In exchange for Swiss Re making a **day 1 cash payment** of €684m, Swiss Re will accept all future risks relating to the underlying portfolio

The Client will continue to service the costumers and **do not change** their **commitment** to the policyholders



*https://www.reinsurancene.ws/swiss-re-reinsures-life-portfolio-bansabadell-vida/

Case Studies: Portfolio Transfers – *Remove long term risks*

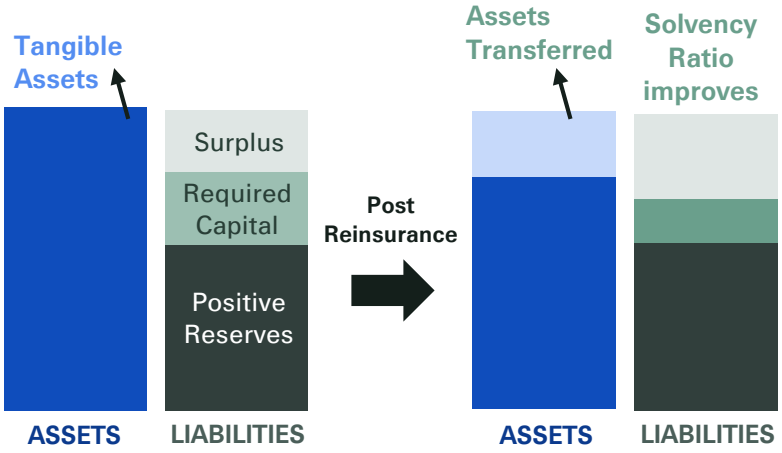
MOTIVATION

The company objective was to **reduce exposure** to core **legacy risks** and focus on newer protection business.

The legacy risks, driving the volatility was

- Older age mortality trend
- **Interest rate guarantees**

Any transaction should **increase** the **solvency ratio** of the firm



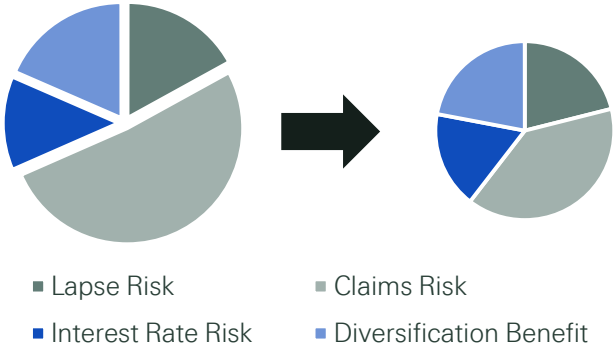
OUTCOMES

- Enter into a coinsurance arrangement that covers whole of life mortality business
- On day 1 the insurer **transferred reserves**
- The **reinsurer pays all** future mortality and surrender **claims**

The insurer frees up capital to redeploy, but

- Can be complex to manage; and
- Client swapping diversified assets with single counterparty risk

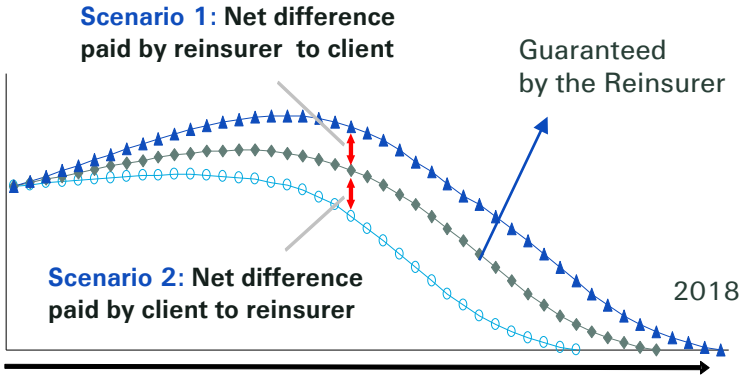
Required capital reduces; Risk profile becomes more balanced



Case Studies – *Reduce Concentration Risk*

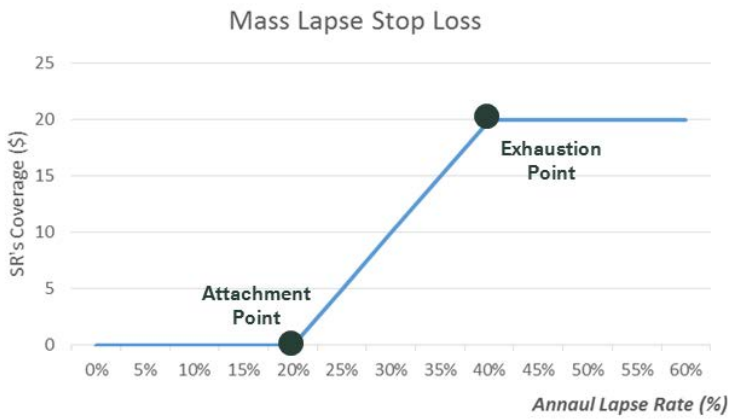
LONGEVITY REDUCTIONS

- Longevity risk is a core risk pool within the UK,
- **Changes** in longevity **trend** also materially **impacts** underlying **interest rate risk**
- Hedging longevity risk, creates cashflow certainty in order to better manage the long term interest rate risk as well as reduce longevity risk capital
- Swiss Re is a key player in this market via the use of longevity swap transactions



MASS LAPSE SOLUTIONS

- **Mass lapse** can be a **key driver** of insurance risk **capital**
- Solutions to reduce lapse capital can also improve diversification benefits
- Reinsurance guarantees a portion of the "negative reserves"



4. Regulatory Process and Conclusion

Process to Review Reinsurance Transactions

New transactions are reviewed as part of a 2 step process – **Substantial & Compliance**

1 Substantial Review

Motivation of Insurer

Risk Transfer to Reinsurer

Managing Operational Complexity

? Typical Questions

- Does the reinsurance improve solvency margin?
- Has the insurer allowed for counterparty risk, e.g. what happens if reinsurer is downgraded or defaults?
- Are there loss scenarios where the insurer is worse off?
- Under what scenarios does the reinsurer lose money? Is this sufficient?
- Does reinsurance impact fungibility of capital?

- What is the administrative process the insurer sets up to manage the data?
- Can the insurer's actuarial model reflect the benefits?

Conclusion

- **Solvency 2 aims to improve the risk framework,** including allowance for increased risk mitigation tools to offset volatility

- **Reinsurance is used as:**
  - A key component of risk mitigation
  - A capital management tool to strengthen the solvency position

- **Stabilising Solvency Margins creates capacity to increase primary risk taking**

- **Regulatory approval focuses on:**
  - Motivation
  - Risk transfer; and
  - Ensuring the insurer understands the impact of reinsurance

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