

The financial magazine for the global insurance market

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# Reactions

June 2002



## New market, fresh blood

Why these CEOs are  
out of a job

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The life markets

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AGENCIES TO  
DO BETTER**

## LIFE REINSURANCE

The amount of risk that life insurers are ceding to reinsurers increased steadily during the 1990s. This means more business for reinsurers as they play an increasingly important role in the way the life insurance industry manages its risk. By Alan Gersten

# Less competition, more business

### US life reinsurance marketplace

Life reinsurance in force (\$m)

	Total US and Canada		
	1999	2000	Change
<b>Ordinary life</b>			
Recurring	2,796,834	3,492,982	24.9%
Portfolio	325,956	381,736	17.1%
Retrocession	258,043	263,898	2.3%
<b>Total ordinary</b>	<b>3,380,833</b>	<b>4,138,616</b>	<b>22.4%</b>
<b>Total group</b>	<b>137,658</b>	<b>139,296</b>	<b>1.2%</b>
<b>Total life</b>	<b>3,518,491</b>	<b>4,277,912</b>	<b>21.6%</b>

Source: Swiss Re

## Top 10 life reinsurers

Ranked by life and health net premium written in 2000 (\$m)

Rank	Group	Life/health net premium written
1	Swiss Re	5,169
2	Munich Re	4,011
3	General Cologne Re	2,263
4	Employers Re	1,637
5	Hannover Re	1,499
6	RGA	1,404
7	Transamerica Life Re	1,178
8	London Reinsurance Group	1,163
9	ING	966
10	Gerling Global Re*	890

\* Estimated, as Gerling only provides a life/non-life split for its gross premiums written

Source: Standard & Poor's

In 1993, the percentage of business ceded by life insurers into the reinsurance market was just 15%. By 2000 this figure had increased to 64%. An increasing number of life insurers believe their strength lies in marketing and asset gathering. They are becoming less willing to retain large amounts of risk.

This is good news for life reinsurers. While the primary life companies are facing many pressures and struggling to find new ways to grow, it is a different story for life reinsurers. A lot more business is coming their way.

Jim Senn, president of individual life and health business at ING Re, says that the US, because of its relatively high standard of living, is the largest life insurance market in the world. Such a large market needs a lot of life reinsurance. "There are a lot of wealthy people in the United States who need significant amounts of life insurance and can afford to purchase it," Senn says. "That's a strong reason for life insurers to partner with reinsurers."

This makes the life reinsurers powerful players in the life insurance industry. "Reinsurers have as much life insurance in force as the large primary companies like MetLife and Prudential," says Michael Colannino, vice-president of life solutions at Transamerica Re.

Their power has been increased further since a number of primary life insurers floated on the stock markets. It is now important that these listed life companies produce stable and consistent returns for their shareholders and manage their quarterly earnings. "They want to take out the fluctuation," says Terry Dickinson, vice-president of group life reinsurance at ING Re's

group life, accident and health operation. He says this creates more business for reinsurers, like ING Re, which deal with the primary life carriers in the US and Canada.

But not all recent market developments have been positive for life reinsurers. Consolidation between primary companies could reduce the amount of risk ceded to them. "You have the same number of reinsurers chasing fewer prospects," Dickinson says.

Consolidation is also an issue for life reinsurers, although Dickinson says he does not expect any of the large life reinsurers to

## Profile – Scottish Annuity &amp; Life Holdings

## A new type of cook

Scottish Annuity & Life Holdings was created to capitalise on a perceived gap in the life reinsurance market. Wyn Jenkins talks to the group's president Scott Willkomm about how he sees the life reinsurance market changing and why he believes working in the reinsurance industry is like being a chef.

In November 1998, Scottish Annuity & Life Holdings, a life reinsurance company based on the Cayman Islands at that time, completed its initial public offering (IPO), raising more than \$250m. There was nothing remarkable about the deal itself except that the company had only been formed six months earlier. Investors had no track record to go on. They were instead taking a gamble on the experience of the management team to make the start-up work.

Just over three years on Scottish has just completed its second stock offering, raising another \$120m. Some 5m shares were offered and 40m orders came in. The deal was seven times oversubscribed. Meanwhile, its total revenues for 2001 were \$119.5m. The company has completed two acquisitions since 1998, has redomiciled on Bermuda and is now looking to establish a global presence.

The driving force behind Scottish is Michael French, an ex-banker who founded Maverick Capital on the Cayman Islands in 1993. Maverick went

on to become one of the largest hedge funds in the world.

In May 1998 he formed Scottish. After its IPO, lead managed by Prudential Securities, he teamed up with one of the bankers who executed the deal, Scott Willkomm. Willkomm is now the company's president and was, until recently, its chief financial officer. Elizabeth Murphy has now taken that role. She was formerly the treasurer of Bermudian insurer Ace.

## Filling the gap

French and Willkomm noticed in the late 1990s that there was a gap in the life reinsurance market. The sector had undergone heavy consolidation and a handful of players were beginning to dominate the market. But French and Willkomm believed there was room for smaller players to grab market share. They also recognised that a company domiciled in an offshore jurisdiction could have big advantages over larger onshore players.



Scott Willkomm

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"We saw an opportunity to create a offshore life reinsurer," says Willkomm. "There had been a lot of acquisition activity in the US and that meant a concentration of capacity. Ceding companies were looking for new outlets. We also saw that we could capitalise on the efficient nature of operating in places such as the Cayman Islands and Bermuda."



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**John Tiller, president of the global life and health division at Employers Re, the reinsurance arm of GE Capital**

merge now. He points out that the market is quite concentrated. The five biggest US reinsurers now cover 70% of the market.

But Senn at ING Re says that some of the smaller players might still become targets because they will find it difficult to compete with the larger entities. “You need a certain critical mass,” he says. Others agree: “A lot of smaller and medium-sized reinsurers may not be around much longer,” says John Tiller, president of the global life and health division at Employers Re, the reinsurance arm of GE Capital. “It takes capital when you’re playing with the big boys.”

#### Technological revolution

But Tiller says some of the biggest developments will be in life reinsurers’ computer systems. “Years ago when I got into the

business, spending money on systems never seemed to get any benefits,” says Tiller. “But in the past few years I’ve seen the benefits. Globalisation is more than representing a lot of countries. It’s also about [implementing] common processes.”

He continues: “If you have a core, a common platform, you can go anywhere. Your geography becomes fungible.” He points out that technology allows life reinsurers to enter new markets more quickly than they could before. Complex analysis, such as assessing the effect a new drug will have, can be done far faster by life reinsurers if they have common systems that can be used anywhere in the world.

Such systems give life reinsurers far more advanced ways of analysing certain risks. One of these is mortality risk. Reinsurers

French and Willkomm were not the only ones to take advantage of this perceived opportunity. Bermudian reinsurer Annuity & Life Re was set up before Scottish. But not all companies got their operations off the ground. “There were a number of other companies looking to get organised like us which were not successful,” says Willkomm.

Scottish’s success depended on its IPO. Attempting to float only six months after the company’s creation is reminiscent of the way many internet start-ups funded themselves – raising cash on the back of the hype surrounding the world-wide web. But this was a strange approach for a reinsurance company.

“We were a direct-to-public company,” says Willkomm. “It is unusual. I call it public venture capital.” He points out that Annuity & Life Re had a similar start in life, although it was sponsored by heavyweight insurance players Marsh and Prudential.

But it appears that French’s instinct for a business opportunity was correct. Scottish cannot compete with the size and balance sheet power of its bigger rivals. But it has low costs and it started with a clean slate. It now specialises in selling life reinsurance and variable insurance policies to wealthy

#### The history of Scottish Annuity & Life

##### 1998

**May** – Scottish Annuity & Life Holdings is incorporated as an exempted company with limited liability under the laws of the Cayman Islands

**November** – Completes a \$250m initial public offering

##### 1999

**September** – Acquires Harbourton Reassurance, which is renamed Scottish Re

##### 2001

**April** – Relocates its corporate and international reinsurance operations to Bermuda.

**August** – Acquires World-Wide Reassurance in the UK, a subsidiary of Pacific Life. Pacific becomes Scottish’s largest shareholder

##### 2002

**April** – Completes its second offering of stock raising \$120m

individuals. It picks up business where other companies do not.

Scottish has made a couple of strategic acquisitions that have broadened the scope of business it can write. In September 1999 it bought Harbourton Reinsurance, which it renamed Scottish Re. This allowed the company to write business in the US.



**Michael French**

In August 2001 it bought World-Wide Reassurance, a UK operation that was a subsidiary of Pacific Life Insurance Company. The acquisition gave Scottish an immediate presence in the UK and parts of Europe and Asia. As part of the deal Pacific Life became the largest shareholder in Scottish with a 16% stake.

Scottish is now looking to set up more operations in other parts of the world. It has opened offices in Dublin and Luxembourg and is looking at Latin America and parts of Asia. But Willkomm says he is cautious of doing too much too soon.

“M&A was not an express part of the strategy,” he says. “Our strategy is to grow one piece at a time. But we are open minded about opportunities that do come ▶

## ◀ “Reinsurers have access to a lot more data. We develop a lot of expertise on mortality. That’s our core risk.”

Jim Senn, president of individual life and health business at ING Re



often take a more aggressive underwriting approach on this compared with primary life companies. But this can also benefit life insurers. “This allowed primary life insurers to achieve a more stable and lower mortality cost,” says Senn.

But last year, for the first time in 10 years, the volume of recurring reinsurance in the US dropped by about five percentage points. Senn says his firm is trying to evaluate why this is.

He thinks one reason could be the way mortality risk has been priced. During the past 10 years, reinsurers were more “aggressive on mortality risk,” and thought people would live longer, he says. Reinsurers guessed right. Americans lived longer, and the reinsurers benefited by receiving premiums for a longer period of time.

But the primary carriers could now be reassessing the situation. Senn believes they may be starting to buy less reinsurance as they become more comfortable with this type of risk. He adds, however, that preliminary indications also appear to show that life insurance sales overall may have decreased in 2001 compared with 2000. This may also account for the drop in cession.

But Senn doubts the cession level will fall below 50%. He

believes the primary carriers are interested in marketing their product and developing new products. Reinsurers, however, specialise in mortality risk. “Reinsurers have access to a lot more data. We develop a lot of expertise on mortality,” Senn says. “That’s our core risk.”

### A capital question

Capital is a big problem for life insurers. They must hold large statutory reserves against the risks they write. But passing risk on can help them free up this capital. “The capital requirements, especially for the type of returns you get, are out of line,” says Tiller at Employers Re. “These guidelines create extremely redundant reserves, and the insurance industry tries to pass that onto the reinsurer.”

He adds that some life companies cede 90% of their in-force

## Profile – Scottish Annuity & Life Holdings (continued)

along. We feel it is important to have a global platform and we want to put our footprint in places such as the US and Bermuda.”

Willkomm admits Scottish has turned down several other potential acquisitions. “We are very picky,” he says. “We don’t want to deviate from our strategy, which is very focused.”

### Smaller is not always better

But despite the advantages of a clean balance sheet and low operating costs there are also disadvantages to being a small life reinsurer. One of these is its rating. Scottish is rated A- by AM Best and Standard & Poor’s, A by Fitch and A3 by Moody’s. But since September 11 Willkomm says these ratings are sometimes not high enough to get some new business.

“Since September 11 a lot of companies are being very thoughtful about how they evaluate their counterparties,” he says. “We have just raised another \$120m, which should help strengthen our balance sheet. We are an improving credit and we hope to improve our ratings this year.”

He says that getting four ratings was also a deliberate ploy to put clients’ minds at rest about the company’s security. “Different clients like different rating agencies and this creates a lot of

### Scottish Annuity & Life Holdings share price



Source: Thomson Financial Datastream

transparency,” he says. “It was a lot of work and the caring and feeding of rating agencies is a big job. But we felt that it was important as a newer company to present credibility to our customers.”

Willkomm believes the biggest challenge for Scottish now is to maintain high underwriting standards and not write business for the sake of scale. In 2001 he says Scottish missed the targets it had set for the volume of business it was going to write. But he viewed the reason

for this as positive. “We didn’t want to reduce our return criteria to pick up the added volume,” he says.

In March last year Scottish set up a financial solutions group which writes financial reinsurance business. It is part of Scottish’s strategy to provide solutions to clients beyond just traditional reinsurance. It is also fits in with the way Willkomm sees this market developing.

He believes that life insurers are increasingly becoming marketing



**“Reinsurers have as much life insurance in force as the large primary companies like MetLife and Prudential”**

Michael Colannino, vice-president of life solutions at Transamerica Re.

cover and new business to reinsurers. “Reinsurers are massive wholesalers for the mortality risk,” Tiller says.

But two years ago, the US tightened these laws even further. It adopted a regulation that the industry calls Triple X. It requires large reserves for mortality coverage whether that risk is held by an insurer or a reinsurer. It is very conservative and insurers and reinsurers say the laws are too conservative. “These are massive amounts of capital,” Tiller says.

In response, some reinsurers have started using offshore letters of credit. Thus, “you have 20 to 30 years of liability backed by letters of credit that are one to five years long,” Tiller says. “We do not believe this is appropriate on the massive scale in which it is being applied,” he adds.

Life reinsurers have also been hit by losses in their asset portfolios because of volatility in the capital markets. Many have more than 50% of their assets in equities and real estate. “They have potential liquidity problems, and regulators are looking at that,” Tiller says. “Go anywhere in the world and you have capital problems and capital constraint problems.”

In the aftermath of September 11, a big issue for life reinsurers is the potential for a high concentration of risk in one place. They must find out, for example, what their exposure is to a single employer or building.

“Group life insurers and reinsurers are increasingly focused on identifying where their concentrations are,” says Dickinson. “We’re not driving this. We help our clients through the thought process.” ●

## Profile – Scottish Annuity & Life Holdings (continued)

companies and asset gatherers. The insurance risks are being passed onto reinsurance companies. The most successful life insurance companies, he believes, will be those that can most efficiently transfer their risks.

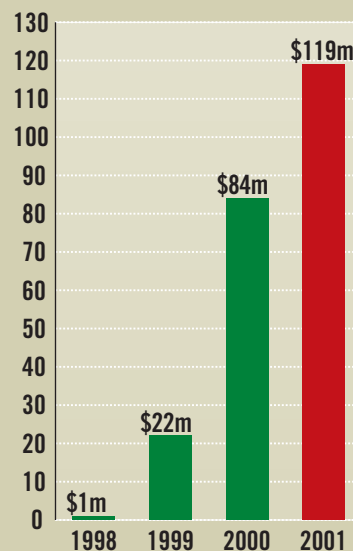
“Life insurers are not really in the risk-taking business anymore,” says Willkomm. “But the way they offset their risk will become critical. It will allow them to reduce their cost of capital and increase their return on equity. Reinsurers are experts on risk management and they will step into this role.”

He also believes companies will use many other techniques apart from traditional reinsurance to transfer this risk. He cites financial reinsurance as one increasingly popular method and he also believes the capital markets will play a bigger role through techniques such as securitisation.

“Our vision is that reinsurers will end up acting as the conduit to the capital markets for direct companies,” he says. “So many capital market concepts fit well with the life insurance industry. The insurance industry is probably several decades behind the banking industry but it is evolving pretty quickly.”

This is another area where he believes Scottish has an advantage. Both he and French have a background in banking. He believes this will stand the company in

**Total revenue**  
\$m

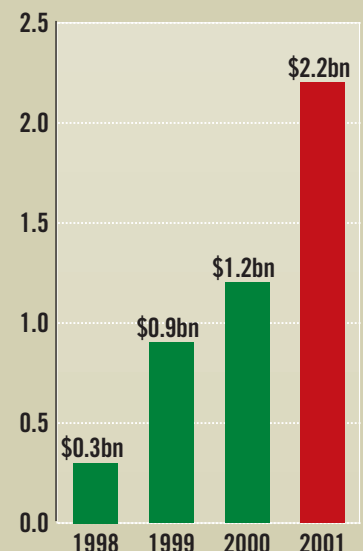


Source: Scottish Annuity's 2001 annual report

good stead as the market develops. And, although he admits getting frustrated sometimes with the pace of the insurance industry, he also recognises it has certain advantages.

“Working in the capital markets is like being a doctor. You have to distance yourself from the patient or else you go mad,” says Willkomm. “Working in the

**Total assets**  
\$bn



Source: Scottish Annuity's 2001 annual report

insurance industry is more like being a chef. There is a certain scientific approach but there is also some art and flair as well.”

In the future the role of small life reinsurers like Scottish may become more defined as the nature of life reinsurance changes. There may also be room for more chefs in the kitchen.