Interview with Peter Schaefer, CEO of Hannover Life Reassurance Company of America

by Reinsurance News

Mr. Schaefer, thank you for taking time out of your busy schedule to speak with us. Could you begin by telling us about your background and your role at Hannover Life Reassurance Company of America?

I grew up in the suburbs of Buffalo, N.Y. (which means I'm still a long-suffering Buffalo Bills and Buffalo Sabres fan). I graduated from the University of Pennsylvania in 1982 with a B.S. in Economics majoring in actuarial science and insurance. After graduation, I worked in the pension consulting field for two years. Given the impact of the changes occurring related to defined-benefit plans, I decided to refocus my career toward life insurance and joined The Penn Mutual Life Insurance Company. After 15 great years, I had the opportunity to join Hannover Life Reassurance Company of America (HLR America) as chief actuary and moved with my wife and two children to Orlando. Two years later, HLR America's president and CEO retired, and I was selected to replace him.

We understand that you are a fellow of the Society of Actuaries. Could you tell us about your career path? What are some of the highlights of your career that you remember most? Are there any individuals who inspired you or were a figure in your career growth?

Like most actuaries, I was always good in math. When I was a junior in high school, my calculus teacher gave me a pamphlet describing careers in mathematics. That's where I first learned what an actuary was and the career sounded interesting. I looked for a college that offered an actuarial science program, and that's one of the reasons I ended up at Wharton.

Throughout my career, I've had opportunities to work on interesting and diverse projects. Penn Mutual's actuarial development program emphasized not only passing exams, but also developing the skills necessary to become an industry leader. When I started there, one of our leading agencies operated out of the home office building. This gave me the chance to learn about the sales process for our industry's products and to understand the impact this industry has on our customers. I'm very proud to be a part of an industry that pays out nearly the same level of benefits to the American people as Social Security.

At Hannover Re, we're one of the largest, most successful reinsurers in the world. We have more than 5,000 insurance clients in about 150 countries. A highlight for me is the opportunity to work closely with my Hannover Re colleagues around the world to take advantage of our global expertise to bring creative and innovative solutions to our customers.

What would you describe to be the biggest challenges for actuaries to transition from traditional actuarial roles to management? How were you able to make this transition?

I think actuarial training provides a tremendous foundation for moving into a leadership role in the insurance industry. It's understandable that because of the necessary time commitment for most actuarial students, passing exams is often the singular focus. Even so, for those who want a role beyond technical actuarial work (and technical actuarial work can make for a great career), it's never too early to begin to focus on developing the skills needed to reach the desired level. Often this "soft" skill development revolves around communication and influence. As my career developed, I've had the opportunity to work with great leaders, both on company projects and industry projects. Without exception, I've found these people willing to answer any questions I had and to give me constructive feedback on what I could have done better. It has been, and continues to be, of great value to my career.

Hannover Re's U.S. life reinsurance business has grown considerably in the last few years, notably with the purchase of ING and Scottish Re's life reinsurance portfolio. How has this changed your company, and how have these changes affected you?

First, the acquisition more than doubled the size of the organization—both in terms of premium and people. Second, we added locations in Denver, Colo. and Charlotte, N.C. Third, and most importantly, we added the talent, expertise and infrastructure to become a major player in the mortality risk reinsurance market.
At the time of the acquisition, we changed from a

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Peter R. Schaefer, FSA, MAAA, is president and CEO of Hannover Life Reassurance Company of America in Orlando, Fla. Peter can be reached at pschaefer@hlramerica.com.

functional organization structure to a business unit structure. We have three business units:

1. Financial Solutions is our most diverse business unit, covering all forms of transactions that help our customers finance their reserves and capital.
2. Mortality Solutions addresses the traditional life mortality risk reinsurance market.
3. Senior Markets focuses on the reinsurance of products sold in the rapidly growing senior citizen markets, primarily Medicare-related products.

From a personal standpoint, the change in the positioning of Hannover Re in the United States has led me to become much more active in industry affairs. I currently serve on the board of directors of the American Council of Life Insurers (ACLI) as well as co-chairing its Executive Task Force on Global Solvency. I can't overstate the value that I've gotten from working closely with other CEOs around the life insurance industry, our state insurance commissioners and the great team at ACLI.

Could you talk about the challenges you have faced from the integration of these recent acquisitions? What were your success criteria?

As this was both a strategic and transformational acquisition, the integration was extremely important. We looked at this integration in two pieces.

The piece people most often focus on is the system and technology integration. Although HLR America had been a small player in the mortality risk reinsurance market, we did have thousands of treaties that we were administering on a legacy system. The infrastructure that we acquired included a robust, state-of-the-art administrative platform, and it was an obvious decision that we would retire the legacy system. The team who joined us had the experience of two conversions to the acquired system and that made the transition quite smooth. The best decision we made was to rely upon their experience and expertise. We had a very granular project plan and, thanks to the team's dedication and hard work, completed the conversion on time and under budget.

In the long run, the most important part of the integration was to create "One Hannover." That is, while we have multiple locations, we can't think of ourselves and our customers can't think of us as multiple companies. We made a conscious effort to avoid falling into the "we/they" trap by location—actually raised some money for charity with a fine system. From the customer perspective, the acquisition significantly enhanced our value proposition. We took advantage of the time we had between deal announcement and deal close to develop a very detailed plan to communicate our vision to our customers so that immediately after close, we could be meeting with clients to discuss their needs and how HLR America could help them be more successful.

Do you foresee your company continuing to grow through acquisitions, organic production, or a balance of the two?

For the reasons discussed earlier, our transaction with Scottish Re was strategic and materially changed Hannover Re's position in the U.S. life reinsurance mar-

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ket. Going forward, we'll continue to review potential acquisitions of reinsurance portfolios as they become available, but I would doubt there would be another strategic acquisition. We will certainly focus on the organic growth, which in our Financial Solutions business unit includes the reinsurance of in-force portfolios to monetize their embedded value.

Where do automated underwriting systems such as Merica-US fit in your U.S. marketing strategy?

Automated underwriting systems such as Merica-US fit into our U.S. marketing strategy in a way that complements Hannover Re's overall value proposition. Over the past few years there has been an increased focus on simplified, or alternative, underwriting methods to penetrate the middle market. Our strategy has been to provide leading-edge mortality solutions to our clients that currently participate, or are considering participating, in this market space. Merica-US gives us a unique opportunity to work with clients and develop solutions and processes to address the middle market. Based on our experience with Merica-US, we are in a position to assist our clients in the development of a simplified or alternative process regardless of whether or not Merica-US is the ultimate solution chosen to automate the process. Our experience with Merica allows us to understand the many different facets of a simplified or alternative approach—i.e., application questions and development, claims philosophy, etc.—and the ultimate associated mortality.

Do you believe that automated underwriting systems will replace traditional underwriting in the future, or will there still be a need to have a large staff of underwriters?

Automated underwriting is being used and will continue to grow in all life underwriting processes, not just the middle market or simplified issue markets. My opinion is if you do not automate, your expenses will fail to be competitive. The majority of cases in the future will go through some form of automated underwriting process to determine which cases can be issued automatically and which need to be referred on to underwriting for further review. This will cut down on the number of cases going all the way to underwriting and allow the company to reduce expenses or focus their underwriting resources on what matters the most—the larger cases and the older issue ages. The most valuable tool in underwriting remains the doctors' reports for impaired or high amount cases. Automating the review of the attending physician's statement (APS) is still a difficult process, but even this is being improved with newer technology.

Will underwriters go away? No. Large face amounts and the highly impaired or difficult cases will be referred to an underwriter. We will just focus the professional underwriters on the abnormal or difficult cases, and they will not do routine "clean" cases. We might need fewer underwriters, but the underwriters we have will be required to be more educated and higher trained. As a reinsurer, we will only be able to automate so much as the cases we review are usually impaired or difficult cases, but we are looking at ways to screen cases to better utilize the underwriters' time. This dynamic will create a new challenge for the industry: How do we train new underwriters if we automate the underwriting of the less difficult cases?

How does Hannover Re view the longevity reinsurance market and its potential as an avenue for growth in the United States?

Hannover Re pioneered the enhanced annuity in the U.K. nearly 20 years ago. We continue to work to develop this concept in the United States. We do recognize the phenomenal growth of the individual longevity market in the U.K. has been driven by the tax structure, which incentivizes annuitization at retirement.

Longevity hedges for defined-benefit pension plans have also grown rapidly in the U.K., and Hannover Re has been an active participant. I do expect this market will grow in the United States with a lag period relative to the U.K., as I think our pension plans may first need to rationalize the investment earnings assumptions in their valuation.

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How is the current low interest rate environment affecting Hannover Re's products and pricing, especially with respect to longevity reinsurance?

The Federal Reserve, through its quantitative easing programs, has driven interest rates to the lowest levels in the history of our country. Fed leaders acknowledge that this is a tax on savers, but believe this to be necessary to stimulate economic growth. As the life insurance industry is both a long-term savings and protection industry, this obviously puts pressure on our products and pricing.

The current low interest rate environment ramps up the pressure on all companies to become more efficient. While dealing with these issues ourselves, it does provide the opportunity for reinsurers to provide solutions that can make our customers more successful. Often the most important efficiencies can be gained through finding more effective ways to finance capital and reserves and, thus, reduce the level of investment earnings needed to achieve the company hurdle rate.

Also, from an underwriting perspective, we've already discussed the benefits of automation. Beyond automation, another opportunity is to modify the underwriting protocol. Because of the breadth and depth of experience reinsurers can access, it is often possible to reduce the cost of underwriting requirements and improve the expected mortality. That's a great win-win result.

What other headwinds in the U.S. life reinsurance market are you experiencing, and how are you adapting?
There are three issues I'd like to address here. First is the flat to declining trend in life insurance sales. This has been a key contributor to the decline in the cession rate to below 30 percent. The good news for Hannover is that we staffed our team in 2009 for a 25 percent cession rate, but everyone, including the American people, will be better off if life insurance sales begin to grow. The second issue relates to the changes in our health care system. It's about three years since "Obamacare" was signed into law, and a significant percentage of the rules are yet to be determined. The changes here will have a cascading effect on the entire health insurance industry. As a health reinsurer, we are following events closely and have various plans at the ready depending on the developments. Finally are the tax, regulatory and accounting changes on the horizon. I've heard this described as "10-dimensional chess" and think that is an apt characterization. This is certainly taking up an ever-growing amount of resources, and with the uncertainty around the implementation dates, the planning is certainly challenging.

Recently, the Obama administration has suggested that U.S. insurance premiums ceded to foreign entities should not be fully deductible under U.S. tax laws. How would a change in U.S. tax policy that eliminated the benefit of ceding premium to low-tax jurisdictions affect the reinsurance market overall and Hannover Re in particular?

This proposal has been discussed for a number of years and has generally focused on property/casualty business. I think there is a very small chance that it will ever be enacted. In any case, there are a couple of fundamental flaws with the proposal as it seems to be based on the incorrect notion that the sole purpose for ceding premium to foreign entities is to find a jurisdiction with a lower tax rate (of course, today, the United States has the highest corporate tax rate in the industrialized world). First, of the 10 largest reinsurers in the world, only two are headquartered in the United States. I recently attended a panel discussion with a number of state insurance commissioners from coastal states with significant windstorm risk. As they discussed the difficulty in assuring their residents and businesses had adequate access to windstorm insurance, they all agreed that the capital provided by foreign reinsurers was irreplaceable. Second, insurance works best and is most cost-effective when the ultimate risk taker is able to diversify its book of business across uncorrelated risks. This reduces the capital required to support the business and leads to lower prices for consumers.

What are your priorities now? What are your plans for the future?

When I took over as CEO, we had 26 critical success factors. Not a single person in the company could name half of them. We brought our management team together and came up with a list of five essential success factors we needed to focus on to be successful.

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They still drive our plans today. First, being a part of the Hannover Re family brings more than tremendous financial strength; it gives us the opportunity to bring to our customers in the United States solutions that have been tested around the world. It also gives Hannover Re's customers around the world the benefit from our experiences here in the United States. Second, we have to market our solutions to our customers. Wolf Becke, who retired at the end of 2011 after heading the worldwide life business of Hannover Re for over 20 years, had a saying: "Our customer is our employer." We have to live that every day. Third, our analysis of opportunities has to be excellent. Sometimes the greatest value we can provide to clients is to help them to avoid a bad transaction. Fourth, we have to stay on top of our business. With one of the largest mortality databases in the world, I think it's clear how this can benefit our customers and Hannover Re. Also, for our Medicare business, rates are updated annually. We participate actively in this process. Finally—the piece that brings it all together—we must recruit and retain great employees, and we can only do this by making Hannover Re a great place to work. ■