Scor deal breathes new life into the sector

By creating the second largest life reinsurer in the US SCOR's recent acquisition of Transamerica Re's mortality business from AEGON has once again highlighted the attractions of life business to reinsurers who are trying to build multi-line platforms

The SCOR deal will see AEGON transfer $1.8bn of liabilities and corresponding assets in cash and securities to the French reinsurer. Transamerica Re's gross written premiums amounted to $2.2bn last year, making it the third largest life reinsurer in the US and the 7th largest in the world.

The deal is the latest in a round of consolidation in the North American life reinsurance market, as companies try to position themselves for a rebound after the financial crisis. Last October, Warren Buffett's Berkshire Hathaway agreed to buy Canadian insurer Sun Life Financial's reinsurance business.

"If you look at the opportunities for reinsurers to grow their businesses then non-life is growing more slowly than in the past, so Life is the place to be," says Marc Beckers, Head of Aon Benfield Analytics for Europe, Middle East and Africa.

The transaction excludes certain lines of Transamerica Re's business including structured solutions and fixed and variable annuities, which SCOR says are not in line with its "strategic orientations".

"The acquisition of Transamerica Re's mortality portfolio will mark a new milestone in the history of SCOR. This transaction relates only to biometric risks, and is fully consistent with SCOR's strategy and risk appetite," commented Denis Kessler, Chairman & CEO of SCOR, about the deal.

The acquisition of Transamerica will boost SCOR's market share in the United States, where it currently earns less than 30% of its global life reinsurance premiums.

"The SCOR/Transamerica Re transaction continues a trend of consolidation in the life reinsurance market from a US perspective that has been driven by one or two things. The US market is considerably smaller than it was 10 years ago. A decade ago there were 10 major players, now that number is down to four or five," comments Chris Shanahan, Executive Vice President, Mortality Risk Hannover Life Re of America.

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"If you look at some of the significant players from a decade ago, companies like Lincoln Life and ING Life, a lot of these companies were not first and foremost reinsurers. Transamerica was the last of these companies and it's offloading by AEGON has completed the evolution to a separation of direct writers versus professional reinsurers," Shanahan adds.

The acquisition gives SCOR access to an experienced management team, a strong franchise, a proven infrastructure and an underwriting system.

Shanahan says: "For those of us in the space today you have top be mindful of your infrastructure. Hannover Life Re was a niche player until 2005 when it acquired the ING life business from Scottish Re, which was in financial trouble. This enabled us to step in and take over an existing infrastructure."

However, what affect the deal has on the overall US Life reinsurance market remains to be seen, says Shanahan.

"It will depend on whether SCOR's risk management and pricing models has an affect on the Transamerica business model. Transamerica is a little unique in the skew of its business was largely co-insurance," he continues.

The size of the US life reinsurance market is around $500bn when measured by 'New Face Amount', down from roundly $1trn a decade ago. In premium terms Life business is estimated at $40bn per annum in globally.

The US accounts for around half the global market and key players include Reinsurance Group of America (RGA), Swiss Re America, Munich American, Hannover Life Re of America and Generali USA.

Traditional Life reinsurance classes of business include Accident, Critical Illness and Dread Disease, Short-Term and Long-

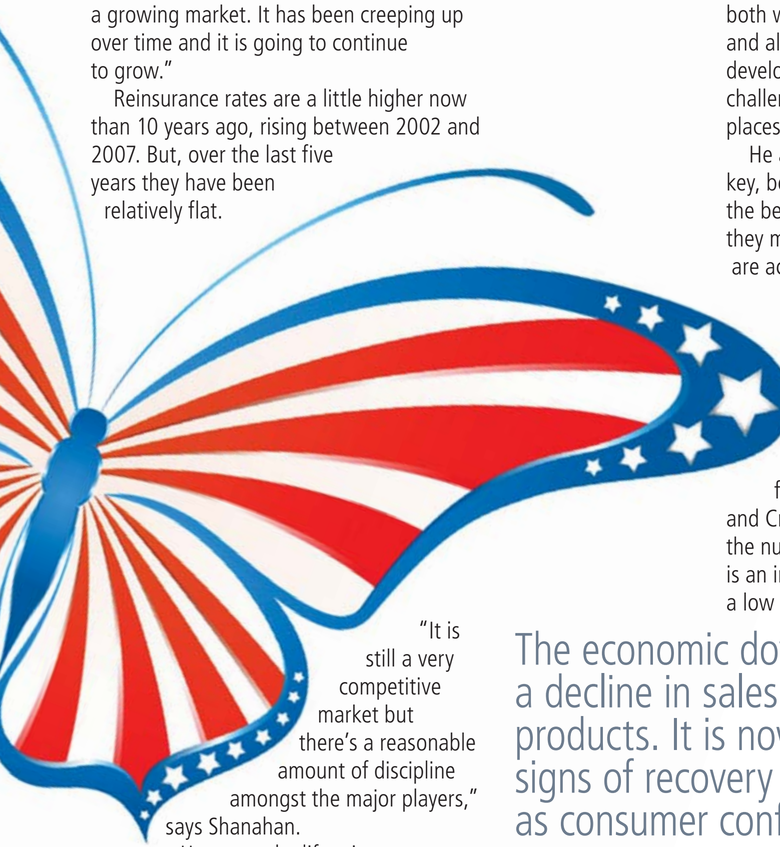
Term Disability, Longevity, Long Term Care, Mortality, Preferred Lives.

Mortality Risk Transfer, which is generally sold on a Yearly Renewable Term basis, is the largest line of business.

Reinsurers are now increasing their focus on non-traditional products, which have a greater element of financial services business. These services leave most risk with the insurer and concentrate on reserve and financial relief to the client.

Beckers says: “Life is a long-term business, you expect people to live over the 30 years of the contract, so most of the total capital is in future profits. It is a growing market. It has been creeping up over time and it is going to continue to grow.”

Reinsurance rates are a little higher now than 10 years ago, rising between 2002 and 2007. But, over the last five years they have been relatively flat.



“It is still a very competitive market but there’s a reasonable amount of discipline amongst the major players,” says Shanahan.

However, the life reinsurance market has been battling plummeting cession rates. The percentage of business being ceded increased from 1997 to 2002. But, after peaking at 61% in 2002 for US life reinsurers, cession rates have declined steadily.

Since then, life reinsurers increased rates while direct rates have been flat at best. As a result, cession rates plummeted, and the amount of ordinary life reinsurance assumed dropped severely

“Part of what has happened is in the last few years the direct market has been down.

From the early 00s the cession rate dropped significantly. The cession rate is down from 60% to 30% as insurers opted to retain rather than reinsure. Over most of the decade the direct market has been flat, but the cession rate has halved,” says Shanahan.

According to Beckers upcoming changes to the regulatory landscape could see this trend reversed.

“Longevity Risk and Lapse Risk take a lot of capital under Solvency II. For insurers going into the Life space there’s more risk and more awareness of the risk so transferring the risk is becoming a big attraction,” he says.

Dealing with regulatory regimes that differ by territory and are constantly evolving is one of the big challenges faced by Life reinsurers at the moment.

“We are facing a lot of regulatory change both with the introduction of Solvency II and also in the US. We are seeing positive developments in some states but the challenge is that states are in different places,” says Shanahan.

He adds: “The question of equivalence is key, both the US and Europe think they have the better regulatory system. In the end, they may have to accept that both are acceptable.”

On the underwriting side Life reinsurers face a major challenge from the increase in life expectancies worldwide and the consequent future longevity scenarios.

It is clear, however, that demand for long-term care coverage, disability and Critical Illness is going to increase as the number of older people is growing. This is an important issue for reinsurance as it is a low frequency and high severity problem.

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> Chris Shanahan

“Longevity risk is becoming too big a risk for the life reinsurance industry to cover, so it has to think about how much risk it can take on,” says Beckers.

In response to this demand a consortium of (re)insurers, banks and pension experts was set up last year to launch a campaign to build a liquid trading market to transfer longevity and mortality-related risks to the capital markets.

The Life and Longevity Markets Association (LLMA) includes Munich Re, AXA, Deutsche Bank, JPMorgan Chase, Morgan Stanley, Prudential, RBS, Swiss Re and UBS.

The LLMA was set up last year to construct capital market instruments to slice longevity risk into tradable portions – similar to the way hurricanes and earthquakes, are protected against by shifting the risk to investors via catastrophe bonds.

Costas Yiasoumi, Chair of the LLMA’s Accessibility Committee, and Head of Longevity Solutions at Swiss Re, says the insurance industry’s capacity to write longevity risk is limited and the “establishment of a capital market investor base will contribute towards the long term availability of longevity solutions”.

“To achieve this goal, buyers and sellers in mortality index transactions need comfort that there are recognised pricing standards, actuarial data and indices that both sides can use as the basis for a transaction,” adds Yiasoumi.

However, Beckers says: “The trouble with transferring to the capital markets is that investors want a five to seven year return period but Life business takes 30 years to mature. You need to break it down into chunks, but nobody has done that successfully yet.”

Another challenge is the wider economic climate that has seen countries around the globe struggling to recover from recession.

“The economic downturn has seen a decline in sales of many financial products. It is now showing some signs of recovery but it is still down as consumer confidence is lacking and people don’t feel they have money to spare,” says Shanahan.

There have been some unfortunate social consequences to the bursting of the property bubble with an uptick in suicides and accidental deaths following it and causing a corresponding uptick in claims.

Although there is no definitive link underwriters say that a look through claims files will show some familiar stories that include such details as falling property prices, redundancies, over-extended mortgage borrowing and life insurance policies that cover the losses for remaining family members.

Another fear is a likely increase in disability claims, as according to a report written by SCOR: “Increasing unemployment and bankruptcies as well as deteriorating consumer confidence have been found by many empirical studies as appropriate determinants for rising disability claims and vice versa.”

On the financial side deficit and other budget issues in the US are also causing the industry some concerns.

“Uncertainty on the tax side is also an issue. It’s well known that the potential exists for sweeping changes to the US tax system – which could have meaningful implications for life products and annuities,” says Shanahan. **re**