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REINSURANCE

Reinsurance is a risk management tool used by insurers to spread risk and manage capital. The insurer transfers some or all of an insurance risk to another insurer. The insurer transferring the risk is called the "ceding insurer". The insurer accepting the risk is called the "assuming insurer" or "reinsurer". For life insurers, the risk transferred may be mortality, longevity or morbidity risk, surrender or expense risk, investment risk, or a combination of these risks.

Reinsurance has made possible the protection of a wider array of individuals and groups than would otherwise be feasible. An insurer who is approached by an applicant who presents an unusual risk—or who needs an amount of life insurance policy that is larger than the insurer's retention limit (the amount of risk an insurer has determined it can judiciously retain)—may still be able to offer the policy to the consumer if part of the risk is transferred to a reinsurer. A ceding insurer also uses reinsurance to limit its risk on a group of policies to avoid fluctuations in claim levels or to lower the risk of claims involving multiple deaths from single events.

Virtually all life insurers buy reinsurance to improve their risk profile. In 2020, 88 percent of life insurers with life premiums ceded at least some of those premiums as reinsurance. Among insurers with accident and health premiums, 82 percent ceded accident and health premiums as reinsurance. Fifty-two percent of insurers doing annuity business in 2020 ceded annuity considerations, excluding deposit-type funds. The Society of Actuaries annually publishes more detailed data on the life reinsurance marketplace in the *Reinsurance News*.

ALLOCATING RISK

In order for families to have peace of mind and for economies to thrive, there must be a mechanism to deal with large financial risk. Life insurers provide that financial security. Reinsurance spreads the risk of loss between two insurance companies. The risk can be spread even further if the ceding insurer uses more than one reinsurer, or the reinsurer in turn transfers some of that risk to another reinsurer, or retrocessionaire.

In the most basic reinsurance arrangement, a single insurer issuing policies to the public cedes business to a single reinsurer, usually an independent firm operating in the open marketplace. Insurers sometimes cede business to affiliates to aggregate similar risks in one entity for efficient risk management. Insurance groups also use captive reinsurers to reinsure risks exclusively from affiliated companies to access capital markets.

When reinsurance exists, the ceding insurer transferring the risk retains its financial relationship with, and legal obligation to pay claims to, the policyholder. The policyholder will not even be aware that part of the risk in their policy is covered by a reinsurer. The reinsurer indemnifies, or reimburses, the ceding insurer for losses incurred on the reinsured policies.

Reinsurance is now a global business. Of the $296 billion total reinsurance premiums paid by U.S. life insurers in 2020, 55 percent was paid to reinsurers domiciled in the U.S. and 45 percent to reinsurers domiciled in other countries.

REINSURANCE RELATIONSHIP

Underwriting Strength

A closely related motivation for reinsurance is obtaining the reinsurer's underwriting assistance and proficiency. Reinsurers review and maintain policy and claim records on a large volume of risks from many ceding companies whose policyholders are diverse and geographically distributed. The risk pool from which they develop and provide underwriting knowledge is larger and wider than is normally available to a single primary insurer.

Underwriting is further strengthened when risk is spread to more than one reinsurer or retrocessionaire, because of the exposure to an even broader range of policies and claims. Confidence that underwriters are competently and professionally meeting its underwriting needs allows a ceding insurer to concentrate on other activities to expand its business.

Product Flexibility

Another reason to reinsure is the opportunity it gives a ceding insurer to exit from some product lines and enter others. If an insurer has issued policies in a particular product line that it wishes to discontinue, the insurer can reinsure most or all of the risk on those policies.

Conversely, if an insurer wants to enter a particular product line, reinsurers can help with product development and assume some of the product's risk. Later, as the primary insurer gains more confidence in its ability to underwrite and develop the product, the insurer might retain more of the risk on new business and recapture provisions in the reinsurance treaty might allow it to take back some of the risk the reinsurer assumed.

Capital Management

Reinsurance also helps a ceding insurer manage its capital efficiently. This is especially helpful to a life insurer issuing new policies because initial costs (expenses plus reserves) are often higher than premiums received. Sharing those initial costs and risks with a reinsurer helps the ceding insurer manage its cash flows.

TYPES OF REINSURANCE

Various reinsurance plans are available based on ceding companies' needs and their reasons for reinsuring. Plans can be broadly classified as either proportional reinsurance, specifying in advance the amounts or percentages of risk for which the reinsurer is liable, or nonproportional, specifying instead the loss limits, time limits, or conditions beyond which a reinsurer will reimburse some or all of the ceding insurer's benefit payments.

Proportional Reinsurance

Specified amounts or percentages are shared between ceding companies and reinsurers in proportional reinsurance. Excess of retention allocates risk by amount. The ceding insurer establishes a dollar amount beyond which it is unwilling to retain risk, and the reinsurer assumes risk over this amount, up to the reinsurer's retention limit. In contrast, quota share allocates by percentage, where the ceding insurer and reinsurer establish the percentage of risk for which each will retain or assume responsibility.

Proportional plans commonly used in life insurance include:

Yearly renewable term (YRT) In this type, mortality risk is the only risk transferred to the reinsurer. The reinsurance premium varies each year with the age of the insured. YRT reinsurance allows a ceding insurer to transfer mortality risk, but it leaves the insurer responsible for establishing reserves for the remainder of the policy benefits. Despite its name, YRT is not yearly renewable. The reinsurer may not terminate coverage until the original insurance policy terminates.

Coinsurance The ceding insurer transfers a proportionate share of all the policy risks and cash flows. The reinsurer receives its share of premiums, pays its share of benefits, sets up its share of reserves, and pays an allowance to the ceding insurer to cover its share of the costs of administering the policy.

Modified coinsurance The reinsurer transfers its share of reserves back to the ceding insurer while the risk remains with the reinsurer. The ceding insurer, however, must pay interest to replace what the reinsurer would have earned had it retained its share of the reserve. This arrangement allows the ceding insurer to reduce potential credit risk and to retain control over investments. The latter is particularly important where the insurer is using a unique investment strategy.

Nonproportional Reinsurance

Nonproportional plans can be used for all types of insurance. Common uses include:

Stop loss The reinsurer remits some or all of a ceding insurer's aggregate claims above a predetermined dollar amount (the attachment point), or above a percentage of premiums during a specified period.

Excess of time Most often used for disability or long-term care reinsurance, this type of plan specifies the time after which a reinsurer pays some or all of the claims.

Catastrophe The reinsurer covers claims that exceed a specified amount or number of insureds due to a single event resulting in more than one loss, as in an accident, or natural disaster.

Table 6.1

Reinsurance Assumed and Ceded - Premiums

	Millions		Average annual percentage change
	2019	2020	2019/2020
PREMIUMS PAID ON CEDED BUSINESS			
Life insurance			
Individual	$98,436	$86,996	-11.6
Affiliates	47,257	42,560	-9.9
Non-Affiliates	51,179	44,436	-13.2
Group	20,228	24,022	18.8
Affiliates	7,879	13,621	72.9
Non-Affiliates	12,349	10,400	-15.8
Credit	290	262	-9.5
Total	118,954	111,280	-6.5
Annuity considerations[1]			
Individual	53,833	88,311	64.0
Affiliates	37,521	33,174	-11.6
Non-Affiliates	16,311	55,137	238.0
Group	11,214	36,735	227.6
Affiliates	7,600	9,718	27.9
Non-Affiliates	3,614	27,018	647.5
Total	65,047	125,046	92.2
Accident and health insurance			
Individual	15,882	26,058	64.1
Affiliates	9,530	10,473	9.9
Non-Affiliates	6,352	15,584	145.3
Group	34,748	33,240	-4.3
Affiliates	19,669	16,836	-14.4
Non-Affiliates	15,078	16,404	8.8
Credit	276	212	-23.3
Total	50,907	59,510	16.9
Aggregate total	234,908	295,835	25.9

Table 6.1, continued

Reinsurance Assumed and Ceded - Premiums, continued

	Millions		Average annual percentage change
	2019	2020	2019/2020
PREMIUMS FROM ASSUMED BUSINESS			
Life insurance			
Individual	$70,239	$54,871	-21.9
Affiliates	14,439	15,685	8.6
Non-Affiliates	55,800	39,187	-29.8
Group	10,237	11,526	12.6
Affiliates	2,218	2,250	1.4
Non-Affiliates	8,020	9,277	15.7
Credit	135	118	-12.4
Total	80,612	66,516	-17.5
Annuity considerations[1]			
Individual	32,699	24,651	-24.6
Affiliates	15,196	13,127	-13.6
Non-Affiliates	17,503	11,524	-34.2
Group	6,279	24,827	295.4
Affiliates	-24	74	NC
Non-Affiliates	6,303	24,753	292.7
Total	38,979	49,478	26.9
Accident and health insurance			
Individual	12,106	17,060	40.9
Affiliates	5,925	8,163	37.8
Non-Affiliates	6,181	8,897	43.9
Group	20,299	18,175	-10.5
Affiliates	5,401	3,968	-26.5
Non-Affiliates	14,898	14,207	-4.6
Credit	114	101	-11.5
Total	32,519	35,336	8.7
Aggregate total	152,109	151,330	-0.5

Source: ACLI tabulations of National Association of Insurance Commissioners (NAIC) data, used by permission.
Notes: NAIC does not endorse any analysis or conclusions based on use of its data. Data represent U.S. life insurers and fraternal benefit societies.
[1] Excludes deposit-type funds as income due to codification, making data incomparable with previous years.
NC: Not computed.

Table 6.2

Life Reinsurance Assumed (face amount)

	Millions			Average annual percentage change	
	2010	2019	2020	2010/2020	2019/2020
Face amount (millions)					
Individual	$1,198,790	$877,890	$1,038,971	-1.4	18.3
Group	728,785	102,051	982,668	3.0	862.9
Credit	2,118	10,848	15,527	22.0	43.1
Total	1,929,692	990,789	2,037,165	0.5	105.6
Policies (units)					
Individual	12,386,140	11,117,495	10,594,781	-1.6	-4.7
Group	5,486,048	4,127,804	11,385,581	7.6	175.8
Credit	473,546	510,220	1,385,343	11.3	171.5
Total	18,345,734	15,755,519	23,365,705	2.4	48.3

Source: ACLI tabulations of National Association of Insurance Commissioners (NAIC) data, used by permission.

Notes: NAIC does not endorse any analysis or conclusions based on use of its data. Data represent U.S. life insurers and fraternal benefit societies.