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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 2023, 87 percent of life insurers with life premiums ceded at least some of those premiums as reinsurance. Among insurers with accident and health premiums, 81 percent ceded accident and health premiums as reinsurance. Fifty-two percent of insurers doing annuity business in 2023 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 \$445 billion total reinsurance premiums paid by U.S. life insurers in 2023, 44 percent was paid to reinsurers domiciled in the U.S. and 56 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
	2022	2023	2022/2023
PREMIUMS PAID ON CEDED BUSINESS			
Life insurance			
Individual	\$88,854	\$144,604	62.7
Affiliates	38,221	54,305	42.1
Non-Affiliates	50,633	90,300	78.3
Group	28,354	28,343	0.0
Affiliates	15,382	14,058	-8.6
Non-Affiliates	12,972	14,285	10.1
Credit	263	NA	NA
Total	117,471	172,947	47.2
Annuity considerations¹			
Individual	153,040	152,160	-0.6
Affiliates	60,966	90,382	48.2
Non-Affiliates	92,074	61,778	-32.9
Group	45,230	60,442	33.6
Affiliates	33,889	43,948	29.7
Non-Affiliates	11,342	16,494	45.4
Total	198,271	212,602	7.2
Accident and health insurance			
Individual and Group			
Affiliates	34,690	31,766	-8.4
Non-Affiliates	23,101	27,370	18.5
Credit	227	NA	NA
Total	58,018	59,136	1.9
Aggregate total	373,759	444,685	19.0

Table 6.1, continued

Reinsurance Assumed and Ceded - Premiums, continued			
	Millions		Average annual percentage change
	2022	2023	2022/2023
PREMIUMS FROM ASSUMED BUSINESS			
Life insurance			
Individual	\$58,515	\$65,518	12.0
Affiliates	20,319	12,968	-36.2
Non-Affiliates	38,195	52,551	37.6
Group	14,412	14,337	-0.5
Affiliates	2,574	2,652	3.0
Non-Affiliates	11,838	11,685	-1.3
Credit	112	NA	NA
Total	73,038	79,856	9.3
Annuity considerations¹			
Individual	32,258	45,749	41.8
Affiliates	4,619	13,606	194.6
Non-Affiliates	27,639	32,143	16.3
Group	52,232	25,953	-50.3
Affiliates	23,796	8,855	-62.8
Non-Affiliates	28,436	17,098	-39.9
Total	84,490	71,702	-15.1
Accident and health insurance			
Individual and Group			
Affiliates	13,213	10,910	-17.4
Non-Affiliates	21,038	22,126	5.2
Credit	110	NA	NA
Total	34,360	33,036	-3.9
Aggregate total	191,888	184,594	-3.8

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.

NA: Not available.

Table 6.2

Life Reinsurance Assumed (face amount)					
	Millions			Average annual percentage change	
	2013	2022	2023	2013/2023	2022/2023
Face amount (millions)					
Individual	\$1,302,429	\$1,379,057	\$1,452,760	1.1	5.3
Group	259,925	349,418	285,660	0.9	-18.2
Credit	7,836	8,060	7,247	-0.8	-10.1
Total	1,570,190	1,736,535	1,745,667	1.1	0.5
Policies (units)					
Individual	14,074,438	11,445,265	15,041,552	0.7	31.4
Group	14,232,385	17,709,125	2,657,503	-15.4	-85.0
Credit	390,211	398,580	957,317	9.4	140.2
Total	28,697,034	29,552,970	18,656,372	-4.2	-36.9

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