The future of financial reinsurance

Agenda

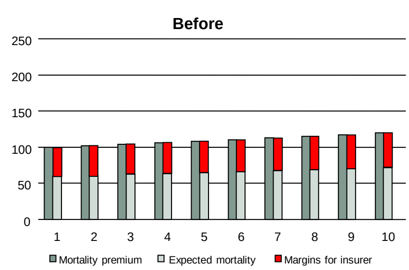
- What is financial reinsurance?
- Advantages / disadvantages
- Structuring
- Regional examples
- Going forward…Solvency II
- Contract terms

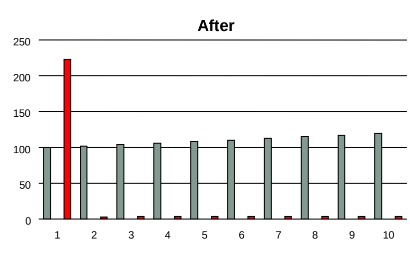
What is financial reinsurance?

Reinsurance with additional financial motivation beyond risk transfer

- Statutory capital
  - New business strain
  - Balance sheet management
- Liquidity
  - Off-balance sheet financing
  - Funding new business marketing expenses/commissions
  - Liquify intangible assets for dividends
- Accounting P/L
  - Deferred acquisition costs/DAC
  - New business statutory capital strain (improve IRR metrics)
  - 'Sell' intangible assets for accounting profit

Financial reinsurance schematic





- 'Before' shows expected natural unwind of realised margins for insurer
- 'After' shows effective acceleration of future margins at inception
- Financing provider retains subsequent unwind of realised margins
- Arrangement may run until expiry of underlying business or earlier recapture of financing amount, depending on level of risk transfer

Advantages / disadvantages of financial reinsurance

Advantages

- Cost efficient tier 1 capital (vs. sub-debt, equity)
  - Repayment contingent on future profits emerging
- Private and flexible

Disadvantages

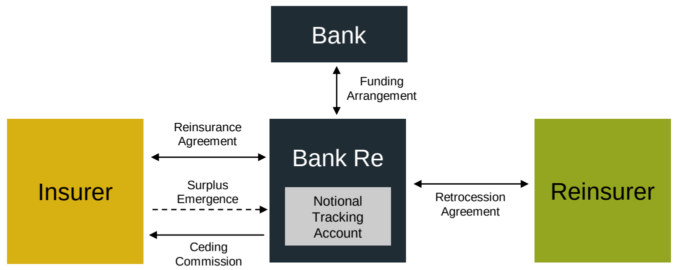
- Incurred costs
- Regulatory approval (and possibly risk reinsurer)
- Encumbrance of portfolio
- Initial and on-going administration

Financial reinsurance structures (1)

- Subject business
  - New business vs. inforce portfolio
- Level of risk transfer
  - Remote risk (pure financing) vs. full risk reinsurance
  - Deficit account vs. coinsurance
- Funded or unfunded
  - 'Cash' vs. 'cashless' financing
- Contract form
  - Reinsurance vs. contingent loan
- Financing provider
  - Single reinsurer or bank vs. multi-party arrangement

Financial reinsurance structures (2)

Multi-party arrangement



- Allocation of risks
  - Bank: primary credit risk, repayment timing risk (within limits)
  - Reinsurer: stress liquidity and ultimate loss linked to insurance risks (e.g. mortality, lapse)

Regional examples of financial reinsurance

Japan

- Cashless new business financing of acquisition expenses

UK

- Insurance groups directive (IGD) capital enhancement

US

- Regulatory reserve financing e.g. A/XXX collateral requirements

Spain

- Bancassurance VIF monetisation

Financial reinsurance in Spain

Case study[1]

Santander signs a reinsurance agreement with Abbey Life Assurance Ltd, a unit of Deutsche Bank AG, for its life risk insurance portfolio in Spain and Portugal

Madrid, July 19, 2012 – Grupo Santander has reached an agreement with Abbey Life Assurance Ltd, subsidiary of Deutsche Bank AG, under which Abbey Life Assurance Ltd will reinsure 100% of the individual life risk portfolio of the insurance companies of Banco Santander in Spain and Portugal.

This reinsurance transaction is unique in the Spanish and Portuguese insurance markets and will enable Santander to monetize its life risk insurance portfolio, generating an extraordinary result of EUR 337 million after tax.

The policies ceded to Abbey Life Assurance Ltd consist of the portfolio as of June 30, 2012. This reinsurance agreement does not involve any changes for Santander customers as services will continue to be provided by Santander's insurance companies.

Grupo Santander will use the pre-tax extraordinary capital gain of EUR 490 million to partially cover provisions which will be charged to the period ended June 30, in line with the royal decrees of February and May regarding provisioning of real estate assets in Spain.

[1] www.santander.com

Financial reinsurance going forward… (1)

Near term

- Financial reinsurance is counter-cyclical
  - Eurozone crisis
  - Solvency II implementation date slipping back
  - Still strong interest in Solvency I driven transactions

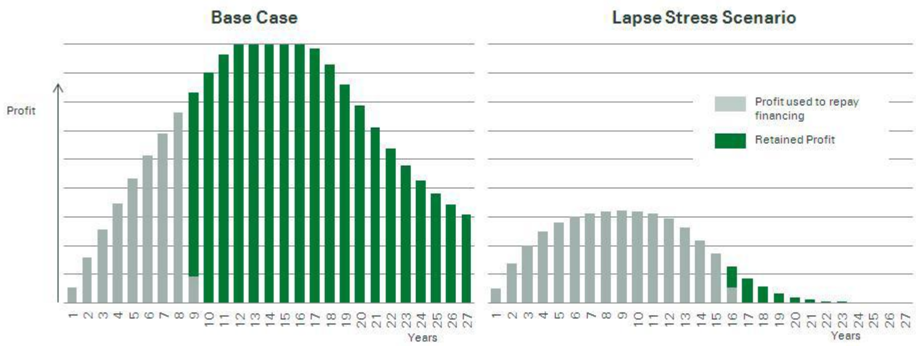
Post Solvency II

- Remote risk pure financing deals less relevant
  - Negative liabilities recognised as Tier 1 capital (maybe…)
  - No SCR/economic capital relief
  - Financing costs will be capitalised
- VIF monetisation in general may still be useful
  - Non-recourse funding for reinvestment or dividends
  - Full risk transfer will provide SCR/economic capital relief

Financial reinsurance going forward… (2)

Post Solvency II (cont.)

- Solvency I type arbitrages may still exist
  - Non-recognition of negative liabilities past 'contract boundaries'
  - e.g. future premiums paid into unit-linked investment accounts



Financial reinsurance contract terms

Alignment of interests

- Quota share percentage

Termination rights

- e.g. UK FSA prescribed terms
  - Non-payment
  - Misrepresentation
  - Unauthorised transfer of business
  - Fraud

On-going obligations

- Reasonable behaviour... protect reinsurer financial interest
  - Not churning policies and encouraging lapses
  - Not entering into damaging transactions

Questions or comments?

Expressions of individual views by members of The Actuarial Profession and its staff are encouraged.

The views expressed in this presentation are those of the presenter.