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**Financial Impact of Using Reinsurance for Healthcare Business**

David Heeney

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**Financial Impact of Using Reinsurance for Healthcare Business**

- What does “financial success” mean?
- School report
- Special features of healthcare business
- How can reinsurance help?
- Making reinsurance work for you
- Conclusions
- Discussion

  
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**What does “financial success” mean?**

- **Outcomes:**
  - Attractive, sustainable return on capital
  - Attractive, sustainable top-line growth
- **Ingredients:**
  - Efficient use of capital
  - Intelligent, continuously refined pricing
  - Effective risk selection and assessment
  - Productive distribution; effective coverage of target market
  - Appropriate product design
  - Fair but active claims management

  
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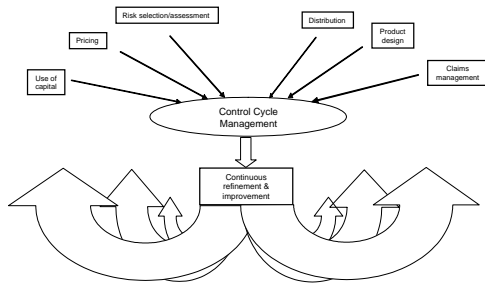
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## What does “financial success” mean?



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## School Report: “Could do better!”

- UK IP market has persistently under-performed in terms of sales and return on capital
- UK: 12 million people in “advice gap” (Resolution Foundation)
- Massive gaps in UK protection cover remain: as an industry we are failing to match real insurance needs with effectively-distributed, attractive products
- UK CI market has been heavily criticised for inappropriate product design and unfair claims management
- US DI market generated losses of over USD 3bn during mid 1980s – mid 1990s
- Recent US legal actions have successfully challenged disability claims practices leading to massive costs for leading providers and further reputational damage for the industry

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## Special features of healthcare business

- “Real” risk factors are complex and difficult to assess
- Results can be very volatile
- Worsening experience can be difficult to spot and correct quickly
- Financial performance varies widely between providers

### CONCLUSIONS:

- Healthcare business requires intensive, ongoing risk management
- Costs and resources may be disproportionate to business volumes

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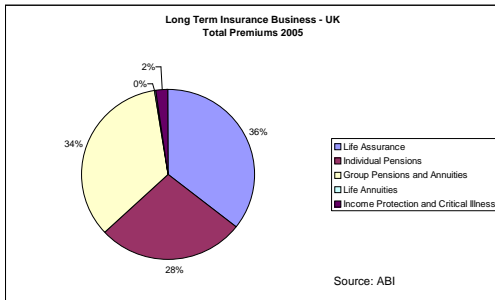
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## Healthcare: small proportion of total



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## How can reinsurance help?

### Tangible financial benefits:

- **Capital efficiency**
  - Lower regulatory capital requirements enabling benefits of reinsurers' diversification to be shared with clients;
  - Tax efficiency (particularly where offshore solutions are available).
- **Financing support**
  - Various structures are available to ease the impact of new business strain and to improve return on capital;
  - Similar techniques can be used to accelerate the emergence of embedded value and/or release excess capital on in force blocks;
  - Design of optimal reinsurance structures depends heavily on individual office circumstances and product characteristics
- **Competitive pricing**
  - Reinsurers specialise in the assessment and management of insurance risk;
  - This enables more precise pricing with lower margins for uncertainty;
  - These benefits are shared with clients through competitive reinsurance terms.

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## How can reinsurance help?

- **Direct impact on profitability:**
  - 10-20% increase in Value of New Business (typical)
  - Accelerated CI generates particular capital efficiency benefit
- **Reinsurance structures can be tailored to meet specific client needs to maximize financial benefits, for example:**

Structure	Potential Suitability	Influencing Factors
Risk Premium	<ul style="list-style-type: none"> <li>▪ short duration covers</li> <li>▪ unit-linked riders</li> <li>▪ yearly reviewable products</li> <li>▪ decreasing term</li> </ul>	<ul style="list-style-type: none"> <li>▪ lapse risk</li> <li>▪ cost of capital</li> </ul>
Net Level (no financing)	<ul style="list-style-type: none"> <li>▪ long term covers</li> <li>▪ level, guaranteed premiums</li> </ul>	<ul style="list-style-type: none"> <li>▪ portfolio mix</li> <li>▪ reserve margins</li> <li>▪ cost of capital</li> </ul>
Net Level (with rebate)	<ul style="list-style-type: none"> <li>▪ high NB strain</li> <li>▪ rapid NB growth</li> </ul>	<ul style="list-style-type: none"> <li>▪ risk discount rate</li> <li>▪ lapse risk profile</li> </ul>

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## How can reinsurance help?

### More subtle advantages:

- **Lower volatility through increased diversification:**
  - Reduced impact of "bad apples" in portfolios;
  - Shared access to wider emerging experience;
  - Bigger picture perspective enables faster movement round control cycle.
- **Cost-effective access to shared risk management services**
  - Reinsurers have higher incentives to commit dedicated specialist resources;
  - Effective means for insurers overcome "critical mass" conflicts;
  - Similar arguments to outsourcing key services.
- **Convergence of capital management and risk management:**
  - Regulatory capital requirements will increasingly be based on economic capital assessment methods;
  - New regulatory standards (Solvency II, ICAs, etc.) will focus on company-specific capital assessment;
  - **Result:** good risk management = lower capital requirements

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## Making reinsurance work for you

- **Sharing information at outset**
  - Product specification, distribution, commission structure
  - Expected business mix
  - Experience data
  - Underwriting and claims philosophy and processes
- **Tender process**
  - 1<sup>st</sup> round: cast net widely
  - Eliminate outliers
  - Work with 1-2 competitive reinsurers to find optimum structure
  - Examine sensitivities carefully
  - 2<sup>nd</sup> round of quotes on a **consistent reinsurance structure**
  - Consider wider factors:
    - Risk concentrations
    - Ongoing technical support
    - Risk management philosophy
    - Value of partnership approach

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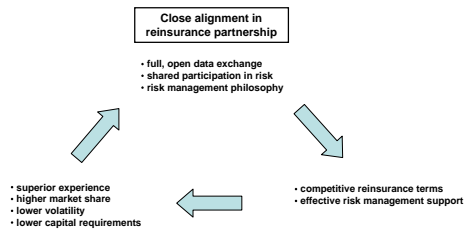
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## Making reinsurance work for you

Financial alignment → virtuous circle



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## Conclusions

- Financial success in healthcare business requires greater investment than other lines in continuous control cycle management;
- Reinsurers have higher proportions of health business exposure than most direct writers => greater incentive to invest in risk management;
- Insurers can benefit from reinsurers' economies of scale;
- Reinsurance has always offered capital efficient solutions and this will continue;
- Effective risk management will improve capital efficiency under emerging regulatory regimes.

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## Discussion

- Are reinsurers doing enough to support profitable market growth?
- Have reinsurers become too risk averse?
- Are we achieving optimal alignment of interests?
- Have reinsurance relationships become weaker in recent years?
- Does regulatory arbitrage have a future?
- Has product development moved quickly enough?
  - Are today's products meeting customer needs effectively?
  - Guaranteed vs reviewable rates?
  - Particular challenges arising from TCF?
  - Why does IP continue to sell so poorly?
- Should reinsurers be more (or less?) active in product development?

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