

Funded reinsurance

Greg Solomon and Martina Moosmann discuss an innovative bank 'warehousing' approach to financial reinsurance.

What are your current responsibilities and what have you done previously?

Greg Solomon (GS): I am responsible for reinsurance financing in Asia region. I qualified as an actuary in South Africa, and have since worked in Tel Aviv and in London (where I've been for eight years). Previous roles were pricing actuary, marketing actuary, and valuation actuary.

Martina Moosmann (MM): I am responsible for the 'Warehouse' (see below), both in terms of originating and structuring deals, as well as arranging the funding. Prior to this role I concentrated on corporate finance as well as business analysis (Swiss Re) and corporate development (food industry).

Do you have an example of a real banking/actuarial problem that you have been involved in solving recently?

GS: When insurers write new business, there is an initial capital demand (commission, initial expenses, setting up reserves, etc) which gets repaid out of future margins. Insurers are not always able to take full credit in their regulatory statements for these margins at policy inception, and thus their regulatory accounts will show new business strain. Reinsurance financing allows the company to exchange a portion of these inadmissible future margins for an admissible reinsurance asset – thereby covering much of their new business strain. This reduces the capital demands of writing new business, thus boosting the insurer's return on capital.

MM: One way a reinsurer can provide such an asset is to pay cash to the insurer upfront. The sourcing of the cash needs to be cost-efficient, and flexible enough to cope with the uncertainty in the future cashflows. From a funding perspective, not only is it critical to assess the certainty of ultimate repayment (which is high in such transactions) but also its timing (which for this type of transaction is the real challenge). Further, the structuring and bifurcation of the cashflows to define the priority of payments

(between prefunding and insurance) are critical elements. Treasury's role is to ensure the client gets the cash on terms which meet the financial requirements of all parties concerned.

Securitisation is one way of doing this, ie sourcing the funding directly from the capital markets. However, the transaction size needs to be considerable (hundreds of millions of pounds, typically) to justify the cost and effort of setting up such a deal. We have established the Warehouse to act as accumulation and interim funding vehicle for a series of smaller transactions which ultimately could be taken to the capital markets as a diversified portfolio. Funding is sourced by the Warehouse as and when required by these smaller transactions, whether life, P&C, or corporate.

The first benefit is that this allows smaller financing arrangements to be entered into, which otherwise would not be possible. The second benefit is that, at any time, we can potentially securitise (ie sell) certain portfolios from Warehouse. The size and diversification of the Warehouse make it of interest to the capital markets – something which would not previously have been the case.

How did you solve the problem?

GS: On the actuarial side, the focus was on understanding the cashflows of our client, and particularly how they behaved under stressed situations. We were focused on setting up a reinsurance structure which helped them cover their new business strain, at a cost which had a positive impact on their return on capital calculations.

MM: The treasury perspective was that cash had to be provided over a period of time, on agreed terms, allowing for a transaction size which was not as large as might be expected on a typical life office financing transaction.

On the one hand, our financing contracts are very flexible because they are usually cashless, and on the other hand, treasury was used to a more certain cashflow stream for obtaining repayments. Again, our challenge was to understand each other's requirements (essential vs nice-to-have) and find a solution that works for both.

Who else was involved in solving the problem and how did you work together?

Initially, to put such a life structure in place, we of course had a demanding approvals process, which involved lawyers, accountants, actuaries, treasury, credit risk management, and others. Since each group had a specific role in this task, the need to find a common language was less of an issue than it had been

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when initially getting the actuaries and the treasurers talking with each other. Having set up the framework, subsequent deals are of course easier to put through the Warehouse.

What lessons have you learned in setting up the Warehouse?

The main lesson was that whatever your area of expertise, you have a 'usual' set of problems that you see, solutions that you implement, and tools that you use. Yet what is obvious for one group may not be obvious for another, so when you put different groups together, each focused on finding a solution, some very innovative ideas are possible.

More generally, do you see actuaries in banking as a natural fit?

Absolutely. There is of course a 'phasing in' period (as we experienced), while both sides get a feel for the others' presuppositions, perspectives, and even language. (It took longer to negotiate the internal funding agreement between the Warehouse and the respective business unit than to agree the reinsurance treaty with the client!) However, since both fields are focused on solving financial problems, there is certainly value in working together, especially once we started understanding each other.

How can I find out more?

This article is one of a series promoted by the actuarial profession's Action Group for Banking (AGB) and explores situations where the actuarial and banking worlds overlap to the benefit of both sectors. The articles serve the following broad purposes:

- **Push:** to demonstrate where actuarial skills and thinking have been applied in a banking or financial context to add real commercial value.
- **Pull:** to highlight tools and skills available in banking and finance that may be of use to traditional life and pensions actuaries.

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