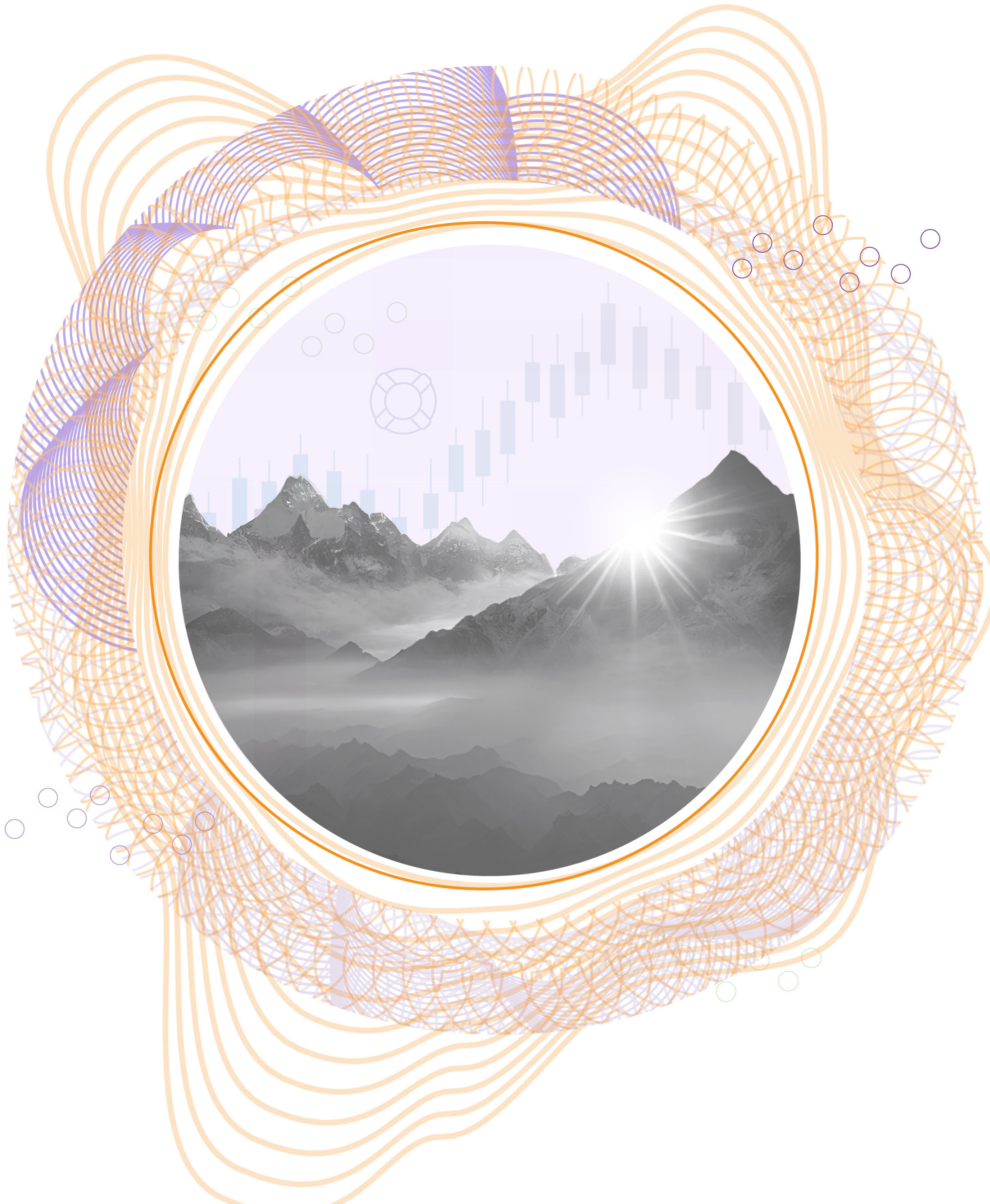


Reimagining reinsurance strategies in a changing landscape

Contents

Introduction

Reinsurance has a long history of being used by insurance carriers as a mechanism to achieve business goals. While insurance has long been the “safety net” for many in society, ensuring individuals are financially supported on their worst days; reinsurance is the safety net for insurance carriers themselves. Primary objectives of reinsurance, whether internal or external, include:

- Obtaining external expertise regarding pricing, product design, and underwriting.
- Managing risk exposure.
- Changing the risk profile of a company to allow it to strategically exit or reduce exposure to a certain product.
- Ensuring efficient use of capital and/or reducing strain of capital-intensive products.
- Modifying the balance sheet to improve profitability.

While these basic tenets and strategies remain, a combination of market forces and regulatory changes has resulted in some companies reevaluating their existing reinsurance strategy or maturing their capabilities. These factors have created both opportunities and challenges for insurers and reinsurers, who need to adapt to the changing landscape and improve their reinsurance strategy. Companies who fail to monitor the reinsurance landscape and its implications may be at a strategic disadvantage relative to competitors.

The changing reinsurance landscape

While reinsurance remains a vital mechanism for insurers to transfer risks, improve capital, and enhance profitability, the traditional reinsurance model is being challenged by several factors:

- **The influx of private equity (PE) capital in the reinsurance space.** This trend is especially evident in the life and annuity sector. The PE firms bring not only significant available capital, but also asset management expertise that allows for engineering of new reinsurance transactions. This creates new competitors and increases price pressure. PE firms typically have a long-term investment horizon and can therefore absorb short-term volatility. PE firms also bring process and product innovation and are more inclined to invest in innovative or alternative solutions. Companies looking to enter the market or pivot strategy have found the presence of private equity firms to be an added layer of competition in an already crowded market.
- **The rise of alternative reinsurance jurisdictions.** These deals, which involve jurisdictions such as Bermuda and the Cayman Islands, may offer tax efficiencies and more efficient risk and capital management for US insurers, but also entail higher complexity and compliance risks. Alternative vehicles, such as sidecar arrangements, have become increasingly popular because they provide an effective mechanism to raise capital. Currently, Bermuda is recognized by the National Association of Insurance Commissioners (NAIC) as a Reciprocal Jurisdiction, and Cayman is increasing its alignment with US insurance regulations.[1] Executing a reinsurance transaction in an alternate jurisdiction involves elements of regulatory, tax, operational, and technology expertise. Underestimating the impacts in each of these areas poses substantial risk to the direct writer.
- **Macroeconomic forces.** The recent rising interest rate environment has driven record annuity sales across the industry. These products carry significant capital requirements that have driven many carriers to seek relief in the form of reinsurance. Additional volatility in US interest rates or equity markets will likely place a further emphasis on capital management and the need to explore reinsurance options.
- **Rating agency and regulator evaluation of reinsurance strategies.** Recent activity has demonstrated rating agencies' increased attention to reinsurance. Bermuda's regulatory capital changes[2] and the NAIC's recent exposure letter regarding potential stand-alone asset adequacy testing[3] for business reinsured offshore are some examples of increasing regulatory requirements for reinsurance activity.
- **The changes in accounting standards, such as US GAAP Long-Duration Targeted Improvements (LDTI) and IFRS 17.** Optimizing the balance sheet and earnings are a common focus of any reinsurance strategy, but companies also need to adapt to the transformational changes in accounting frameworks over the past few years. The recognition and measurement of reinsurance contracts is different, and many companies have or are currently undergoing significant system and process enhancements in response to these regulatory changes. The goal of these refinements is to produce results that enable insurance companies to better tell stakeholders the story of how reinsurance affects financial results across accounting standards. This is important for companies operating under multiple reporting standards with different accounting approaches (i.e., earnings emerging differently under US GAAP and IFRS 17). Even under the same accounting basis, earnings may vary between direct and ceded results due to potentially different definitions of cohorts, discount rates, and measurement models, which may not be intuitive relative to the intended reinsurance economics.
- **The changes in tax regulations, such as BEAT and GILTI.** The base erosion and anti-abuse tax (BEAT) and global intangible low-taxed income (GILTI) regimes impose additional tax burdens and reporting obligations on cross-border reinsurance transactions and affect the after-tax profitability of reinsurance. As reinsurance structures become more complex, missteps can have significant financial consequences from a tax perspective.

These factors pose significant challenges and opportunities for insurers and reinsurers, requiring them to rethink their reinsurance strategy and operations in light of the new market and regulatory realities.

The need to recalibrate reinsurance

The factors noted previously require a "call to action" for insurers. The lens to look at capital efficiency, balance sheet optimization, and risk management due to reinsurance has changed. In order to fully unlock the value of reinsurance, companies should take a broader, enterprisewide view as to how reinsurance fits in with broader company strategy and risk appetite.

Specifically, insurers and reinsurers alike can ask several key questions, including:

- **Do we have the right partners?**

  The influx of PE capital has driven a broad assessment of reinsurance partners and counterparties. This population now includes traditional reinsurers, private equity firms, and special purpose vehicles, which all differ in their financial strength, risk appetite, pricing, and service quality. A broader pool of partners opens new reinsurance structures, all of which need to take into account the impact on accounting, capital, tax, and liquidity. Companies should have a full appreciation of these emerging players along with the rules and regulations that govern them across geographies.

- **Do we have the right strategy? Have we considered possible alternatives, and do we need to shift our strategy?**

  Recent trends have forced companies to assess reinsurance objectives and business goals. Growth, profitability, risk diversification, capital optimization, and tax efficiency should all be evaluated as potential objectives of reinsurance, whether previously considered or not. It is the appropriate time for companies to consider whether existing arrangements meet stated objectives or a strategy shift is required. Evaluating these options requires a comprehensive look at alternatives from a cost, benefit, and risk perspective. Additionally, companies should consider the optimization of reinsurance structure and terms, such as ceding commission, reserve credit, profit sharing, and recapture, to ensure the arrangement meets business goals.

- **Do we have the capabilities to implement the strategy?**

  Operational and capability gaps, as well as capacity strains, are all hurdles to reinsurance execution. The shift of focus to offshore reinsurance transactions has highlighted the need for operational excellence, including the management of reinsurance execution and administration. Data quality concerns, system integration, contract drafting, reporting, and auditing need to be executed to achieve a smooth and compliant reinsurance process. Furthermore, many insurers have determined to modernize enterprise projection and forecasting capabilities to assess the earnings and capital impacts of potential transactions in a timely and accurate manner under a range of potential scenarios.

  Many leading insurers are also evaluating their current-state operating model to ensure their teams have the capacity and the right skill sets to execute on strategic reinsurance plays. The integration of emerging technology can further enhance existing capabilities, but should also be considered within the bounds of the skills and future development of the existing team. Companies should look to future-proof their team to the greatest possible extent, planning for the skills needed to execute well into the future.

- **How do we monitor the efficacy?**

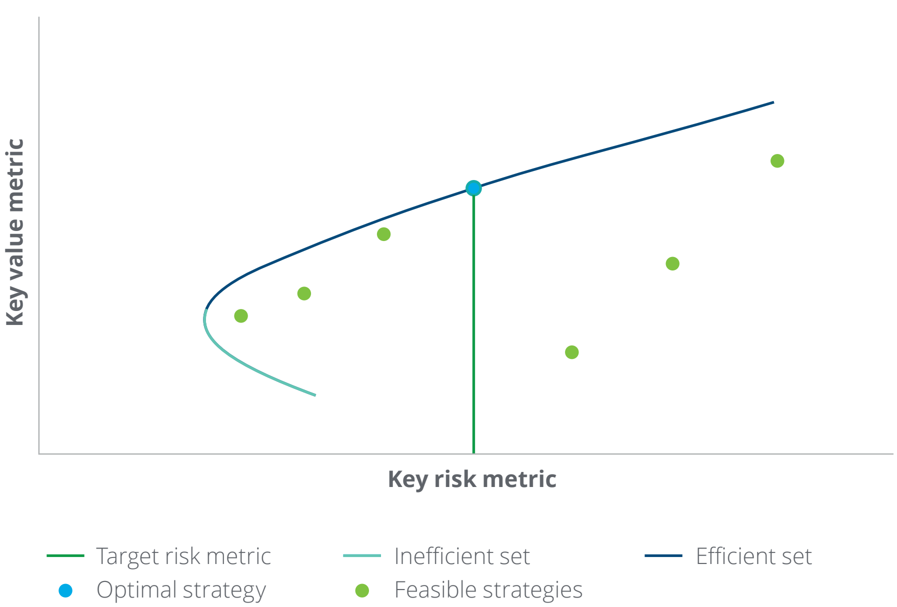
  The changing landscape of reinsurance and the need for recalibration also extend to how insurers monitor performance and execution across their strategic goals. A robust data collection and storage approach is essential to monitoring the efficacy of a reinsurance deal. A solid data foundation empowers companies to establish real-time dashboards with operational, financial, and risk-focused metrics that balance operational strain with insight to be able to change, refine, or pivot their reinsurance strategies. While not necessarily driving reinsurance initiatives, changes in accounting standards should be included in such dashboards and metrics to gain a complete picture of financial performance across the applicable accounting bases.

The Deloitte difference

Deloitte has been carefully monitoring emerging reinsurance trends and is actively assisting companies through the changing reinsurance landscape. Through its presence in the United States and multiple popular reinsurance hubs such as Bermuda and Cayman Islands, Deloitte helps insurance and reinsurance clients navigate the complex and evolving reinsurance market and regulatory environment. Deloitte has a multidisciplinary model and strong capabilities to offer services in the following areas throughout the reinsurance life cycle:

- **Strategic advisory services:** Deloitte helps companies evaluate potential reinsurance strategies from an enterprise perspective. We help companies assess the potential value created by reinsurance strategies, evaluate potential deals in light of existing risk appetites, and navigate the tax and regulatory hurdles that reinsurance deals often face. We monitor potential deals along an "efficient frontier" (see figure 1) that considers value delivered against capital deployed. The depth and breadth of Deloitte's experience helps clients achieve strategic evaluations that are broad and executed in a collaborative fashion.
- **Accounting and valuation:** Deloitte helps clients navigate the people, process, and technology change to enable capabilities to understand and implement the new accounting standards, such as LDTI and IFRS 17, with a focus on assessing the impact of new regulations on their reinsurance contracts and financial statements. We regularly assist chief financial officers, chief accounting officers, and chief actuaries to provide better transparency into insurers' profitability and capital positions.
- **Actuarial analysis:** Deloitte brings deep actuarial experience to help clients perform actuarial analysis, construct pro forma models to evaluate financial statement impacts, assess capital implications, and determine feasibility of proposed reinsurance transactions across accounting bases. This analysis can help inform go/no-go criteria for deal execution and evaluate alternative reinsurance structures.

Figure 1. Efficent frontier analysis

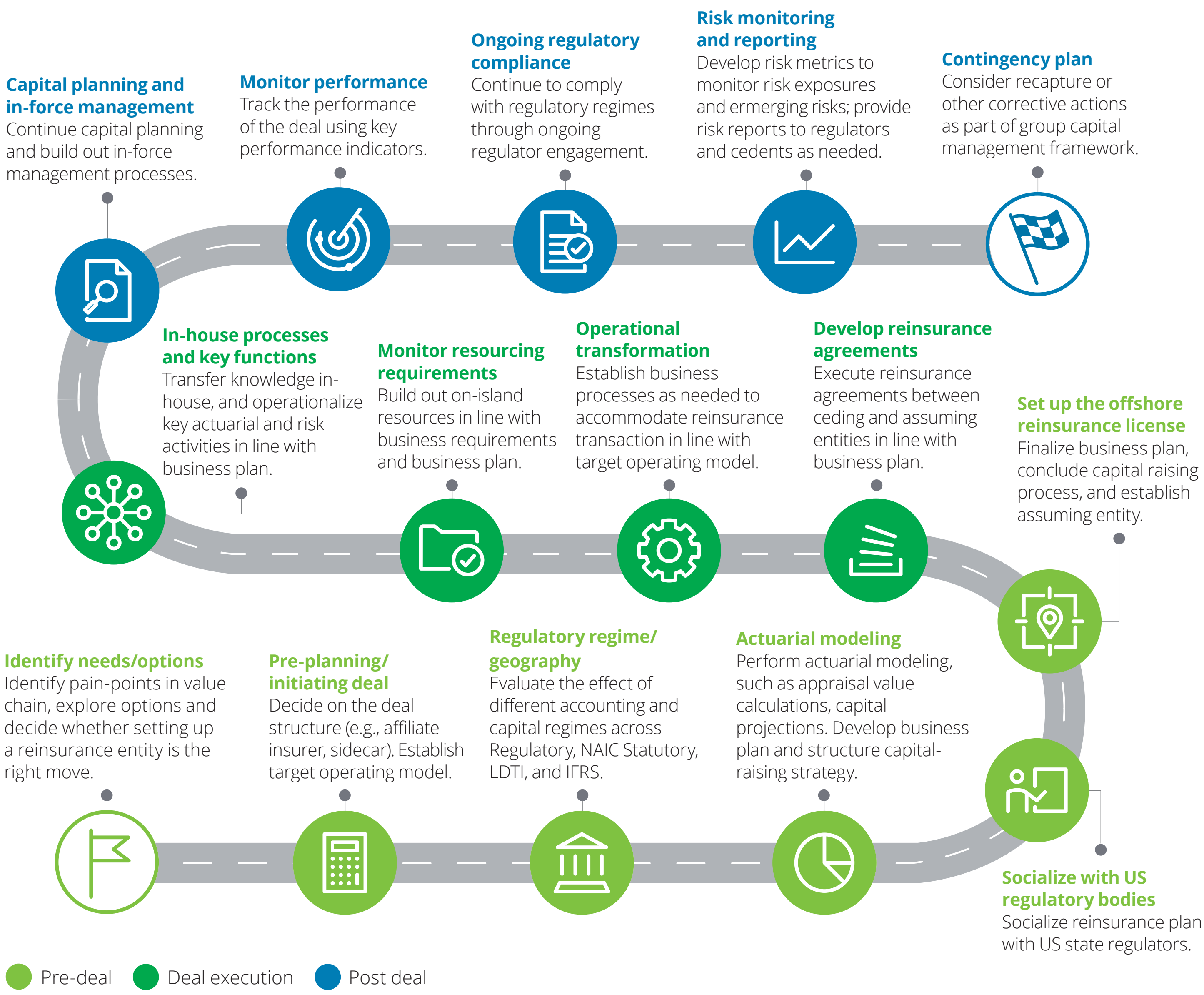


- **Financial performance and risk metrics:** The variety of reinsurance strategies deployed within the industry should be monitored carefully to ensure the intended strategy is meeting operational, financial, and strategic goals. Due to our experience with reinsurance arrangements, Deloitte can help clients analyze and improve their financial performance and risk metrics, such as return on equity, earnings volatility, solvency ratio, etc. Establishing a well-defined dashboard with meaningful, actionable metrics that are easy to refresh is a differentiator in monitoring and pivoting reinsurance strategies as needed.
- **Deal optimization:** Reinsurance deals face a number of key strategy decisions that are difficult to quantify. Deloitte has deep reinsurance modeling experience that can help clients develop and quantify customized key risk and value metrics. This endeavor offers a powerful reward: Clients can enhance their reinsurance strategy using efficient frontier analysis.

  For a given set of target key value metrics, clients can leverage Deloitte's reinsurance optimization toolkit to pick the strategy that provides maximum value while aligning with the company's desired risk profile.
- **Reinsurance system and data advisory services:** Systems and data remain foundational to the success of any insurance initiative, especially in the reinsurance world, where data delays, quality issues, and system integrations are frequent challenges for companies. Deloitte can help clients design and implement reinsurance systems and data solutions that address data governance, quality, and integration hurdles to support their reinsurance operations and reporting and facilitate future growth and expansion in this space.
- **Post-deal operating model and processes:** Expanding reinsurance footprints have highlighted the need for the right skill sets across actuarial, finance, asset liability management, operations, and the capacity to be able to deliver on the strategic vision. This means having the "right people in the right chairs." Deloitte can help clients design and execute their post-deal operating model and processes—instituting the proper governance, controls, and reporting—to achieve a smooth and efficient reinsurance operation.
- **Tax implications:** Deloitte's tax capabilities can help clients navigate the tax implications of their reinsurance arrangements, such as transfer pricing, withholding tax, consolidated return considerations, permanent establishment, etc., and advise on the tax impacts of reinsurance structures.
- **Emerging technology:** Emerging technology continues to be a hot topic for insurers, and the reinsurance space is no different. Deloitte can help clients leverage emerging technology, such as artificial intelligence, to enhance their reinsurance capabilities and create competitive advantages across operational and strategic aspects of the reinsurance considerations.

By leveraging Deloitte's capabilities and value proposition, insurance and reinsurance clients can achieve their strategic objectives and unlock the full value of reinsurance in a changing world.

Figure 2. Illustrative roadmap to set up an offshore reinsurance entity using Deloitte's services



Endnotes

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2. Bermuda Monetary Authority (BMA), *The Bermuda Capital and Solvency Return: 2024 Instruction Handbook for Insurance Groups*, 2024.
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