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Today's reinsurance CFO: Dynamic challenges in a dynamic market

The primary mandate of a life reinsurance company's CFO is to ensure that the company is positioned to succeed under as broad an array of economic and business environments as possible.

Carrying out that mandate, however, is considerably different from the prior role, even as evaluated a decade ago. The conventional wisdom about the life insurance industry – that it typically does well when the economy suffers – is no longer accurate. As the fluctuations in the world's economies, more and more, directly affect the performance of life insurance companies – our clients – the range of outcomes for which a life reinsurance CFO must plan has had to broaden significantly.

Regulatory overhauls

On the positive side, reinsurance CFOs have had time to review and determine how to cope with the implementation of two major regulatory overhauls: the International Financial Reporting Standards (IFRS), which have to date been implemented in several countries around the world, and Solvency II, the expanded solvency requirements for insurance companies operating in the European Union that are due to be effective January 2013. In the US, CFOs are increasing their preparations for potential IFRS adoption and related convergence with US Generally Accepted Accounting Principles.

On the negative side, these regulatory overhauls have been a moving target in terms of ultimate outcomes. There is still a lack of clarity regarding the exact nature of the final changes to financial reporting standards, level of enactment, timing of required adoption, etc. Likewise, it is not completely clear whether solvency standards will continue to develop and when certain standards will be adopted by the regulatory regimes in particular countries.

Increased complexity of life RI transaction

The business of life reinsurance would appear to be simple – the provision of financial and risk mitigation solutions to clients typically desiring one or more of several outcomes, including: transfer of insurance risk, capital relief, or mitigative relief across a range of needs that could include currency exchange risk, liquidity risk, risk of changing interest rates, and other economic risks.

However, it is the structuring of solutions to meet a number of the desired effects that can radically increase the complexity of a life reinsurance transaction. The solution must be of a nature that can be appropriately managed by the reinsurer, and it must fit into a particular regulatory framework for reporting by both the cedant and the life reinsurer.

Changing views by regulators

A primary challenge in effective risk transfer is determining, with some degree of reliability, how each such transfer might be viewed, long-term, by regulators.

In a world where regulators are increasingly likely to change their respective views on risk transfer techniques over time, this can be a daunting task. Changing views on the efficacy of risk transfer may be due to a change in the perception on the part of a regulator of a particular economic risk. Or, it may relate to real or perceived abuse of a risk transfer technique associated with one or more financial failures, or which perhaps is highlighted relative to a particularly visible solvency problem.

Because the ceding company and the life reinsurer seek to execute transactions which, from a regulatory standpoint, achieve a permanent transfer of risk, both must make assumptions about how regulators will treat the transaction over its life. Thus, changing views by regulators are necessarily one of the risks of executing long-term reinsurance solutions.

Hope different reporting regimes will cease

From the standpoint of the broader financial reporting landscape, if IFRS is implemented on a worldwide basis, it is hoped the various issues posed by so many different financial reporting regimes can be mitigated. The current matrix of financial reporting in a number of regulatory environments can require reinsurers to produce several significantly different reporting variations for the same reinsurance transaction.

More widespread acceptance of a particular basis of reporting would almost certainly be less onerous for reinsurers. On the other hand, the complex set of revised calculations for solvency might themselves wind up being more onerous than expected, and could change the relative values of certain reinsurance structures or transactions.

Impact from new regulations still unknown

Regulations will, of course, certainly have an impact on how specific transaction structures are reported, and how capital or reserve relief can be attributed to various transaction structures. What is not fully known is how any new regulations or financial reporting regimes will, directly or indirectly, affect life reinsurance's utility and viability as an industry.

Ultimately, any such changes could result in life reinsurers with global operations no longer being able to benefit from moving risk from one statutory environment to another. It could also reduce the demand for certain types of transactions – those which could be influenced by ongoing questions about financial reporting under evolving financial reporting regimes.

Satisfying investors

Another evolving challenge is determining just how much detail in financial reports to investors is appropriate. Over the past decade and a half, investors have sought increased financial disclosure and transparency from companies with registered securities. This is appropriate, as investors need robust financial information about companies in which they take a financial interest in order to understand and monitor their investment risks.

However, a reinsurer's highly complex, multi-part risk transfer and pricing decisions are based on a myriad of inputs and assumptions. CFOs must constantly weigh decisions about how much detail will satisfy an investor's needs without creating an overload of data and detail, which may actually make the investor's review process even more difficult.

Wide array of skills needed

The life reinsurance industry is also increasing its focus on the capital markets aspects of its reinsurance solutions, due to a broadening array of risks being assumed and a widening range of savings-oriented products being reinsured.

Reinsurance CFOs need to ensure a wide array of financial management skills are in place at their companies – not just skills in selecting and managing actuarially determined risks. They will also have to be sure that they can build and then refine a practical, functional financial structure that will enable the delivery of products and risk mitigation strategies clients require.

Stable hand on tiller

These decisions cannot wait for the dust to settle from the coming regulatory and reporting changes. CFOs must wisely advise the management teams of their respective reinsurance companies how best to assume and manage risk. They must do this while, at the same time, determining in which direction reporting and regulatory standards might change and evolve, and the twists and turns those changes could impose upon them.

CFOs must also keep a stable hand on the tiller to ensure their company's internal financial systems can provide, on an ongoing basis, the necessary management and reporting information in order to keep their company on sound financial footing.