RGA

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Looking Back: What Does 2019 Tell Us to Expect in 2020?

It has been suggested that managing a reinsurance company is like a road trip where the CEO is behind the wheel, the head of sales has her foot on the accelerator, the lawyers and risk management team are scrambling for the brake, and the chief actuary is looking through the rearview mirror to tell everyone where they are going. In the spirit of this analogy, I'll describe some of the transactions and trends that we saw emerge last year and, reaching back to my own inner actuary, offer some predictions for the coming year.

David Addison
SVP, Business Development

RGA's Global Financial Solutions (GFS) division had an energetic and productive 2019, participating in a number of refinancing opportunities in structured reinsurance. As existing facilities move into their free or reduced cost recapture period, lower market prices for excess of loss and credit-linked note structures have been driving increased interest in refinancing. We expect to see continued activity for these pre-principle-based reserves (PBR) facilities in both the XXX and the AXXX space. There has also been a fair amount of activity related to regulatory capital. Some older group transactions have been subject to regulatory scrutiny, and we expect there will be greater clarification of the associated regulations for these transactions in the coming months. This will be a positive development as it removes market uncertainty and, in certain situations, may require current solutions to be restructured. The post-PBR structured reinsurance marketplace has experienced some activity, but this has been far more sporadic to date. We have also been working with our Canadian clients to explore opportunities to leverage our balance sheet to support their efforts under the emerging Life Insurance Capital Adequacy Test regime.

In the U.S., the greatest level of activity in longevity occurred in the pension risk transfer marketplace. The insurance community continues to support buyouts of pension liabilities, from the smallest schemes featuring a few plan participants to multibillion-dollar liability schemes. Following RGA's first-to-the-U.S.-market longevity-only reinsurance transaction, we have seen more reinsurance activity, including coinsurance solutions covering both the longevity and the asset risk. We think the U.S. longevity market is a great opportunity to bring value to our clients, which is why we are pleased to announce that our colleague from RGA's London office, David Lipovics, Vice President, U.S. Pension Risk Solutions, has relocated to St. Louis to lead these efforts. Later in this newsletter, Lipovics provides insights from his time in the successful U.K. longevity space, and how the U.S. longevity market may follow suit.

Asset intensive reinsurance was another area of vigorous activity, and RGA was the winning bidder on a number of U.S. in-force blocks in 2019. Additionally, we assisted clients evaluating potential acquisitions by both seeking to assume insurance-related risks that did not fit in the client's risk profile, and by providing financing support.

In the coming year we anticipate two trends to continue: low interest rates, which seem unlikely to rise in an election year, and the trend of sellers pairing traditionally hard-to-transact insurance blocks with more attractive insurance products in an effort to incentivize acquirers towards blocks that in the past have been more difficult to divest. In GFS, with an understanding of these trends, we do our best to innovate by partnering with our clients to develop tailored solutions. When our capabilities are combined with RGA's other areas of expertise, GFS may produce a suite of tools and methods to solve our clients' – and potentially industry – problems. In the following pages, we take a look at how we collaborated with RGAX to develop a new solution for the fixed indexed annuity market. And last, but by no means least, I want to share the news that Larry Carson has succeeded John Laughlin as Executive Vice President, GFS. Larry, who has been with RGA for 21 years, most recently led the pricing and risk management areas within GFS. John Laughlin will stay on in a senior advisor role at RGA. It is our hope and expectation that you will get a chance to catch up with Larry in person sometime this year. ■

PRT Market Update: A Glimpse Across the Atlantic

It's official – 2019 was a record breaking year for pension risk transfer (PRT) activity on the other side of the Atlantic. Propelled by healthy scheme funding levels, sharp insurance pricing, and a general willingness to transact, the U.K. PRT market has been growing in recent years, and breached the $50 billion mark in terms of annual de-risking activity just before Christmas. Many U.K. commentators wonder if this is the new norm and, if so, how sustainable it is. The relevant question stateside, however, is whether European trends are a preview for the U.S. PRT market and, if so, what the concerns for U.S. PRT providers might be.

David Lipovics
Vice President,
U.S. Pension Risk Solutions

Available capital is one obvious concern. PRT liabilities are long-term and capital-intensive; once transferred to an insurance balance sheet they attract a total asset requirement that is typically higher than the PRT premium the pension scheme pays to offload its liabilities. This results in a sizable initial capital strain. In Europe, this is exacerbated by the Solvency II reserving and capital requirements, which aim to assign an 'economic value' to carrying long-term risks such as longevity. Consequently, timely access to additional capital, essential for keeping up with the pace of new business opportunities, is an ongoing difficulty for PRT writers in private ownership. Similarly, listed companies have to contend with analysts' questions on the sustainability and stability of dividend levels as the strain of new business eats into retained earnings and ongoing cash generation.

> Two features of the U.K. market stand out as catalysts to the widespread use of reinsurance: price certainty and insurers' valuation framework.

Besides external pressures, internal risk management considerations also come into play. With high volumes and an increasing number of jumbo cases, U.K. PRT players frequently bump into appetite constraints. This, to a large extent, is driven by longevity exposure rather than the asset risk side. Just like their U.S. counterparts, most U.K. PRT insurers define their value proposition around asset origination and management, or administration scale and capabilities. Longevity risk, on the other hand, is more difficult to predict and diversify than asset performance. It also has the potential to slowly and irreversibly erode future earnings and, with medical advances and lifestyle changes affecting the pensioner population, to transform the balance sheet. This is particularly true of younger lives in their pre-retirement period, which are increasingly becoming a feature of new PRT opportunities.

Looking beyond financials, new business volumes also continue to put pressure on pricing technology and human resources. The derivation of demographic assumptions

that underpin a PRT transaction is an exercise requiring deep expertise and professional judgment. Additionally, there is a constant race to factor in the latest technology (such as predictive mortality models) and most recent information (such as annual population mortality data) to avoid the 'winner's curse' as a result of information asymmetries.

Despite these challenges, it's a mistake to suggest that U.K. insurers are struggling. They continue to adapt with the help of a continuously evolving risk and capital management toolbox. In recent years, longevity reinsurance has grown to be the pre-eminent item in this toolbox and with that, a core part of the U.K. PRT ecosystem. For example, more than 80% of longevity risk inherent in new PRT business has been passed on to reinsurers at the same time as (or shortly after) the front-end PRT transaction. Given this impact on insurers' overall capital and risk levels, as well as access to the latest pricing technology, the role of reinsurance in last year's $50 billion of PRT business cannot be overstated.

While the use of longevity reinsurance is not new, the reasons for it have become considerably more varied and forward-looking. For instance, longevity reinsurance is now routinely used as a 'winning lever', built into the front-end PRT offering of the insurance company, allowing the insurer to compete for bigger or more complex cases. At the other end of the spectrum, open-ended or 'flow' longevity reinsurance solutions cater to the small end of PRT case sizes, providing automatic reinsurance pricing and coverage with minimal operational friction.

RGA executed its first longevity-only reinsurance transaction in 2008 in the United Kingdom. Since then our Global Financial Solutions team has completed more than 50 longevity risk transactions in the U.K., the Netherlands, Canada, France, and Spain. Additionally, by drawing on the extensive knowledge gained from these markets, RGA was able to support the U.S. PRT market by executing the first longevity-only transaction in the U.S. in 2018. Innovative and highly tailored, a number of these arrangements were first of their kinds, supporting our clients with longevity-only, asset-intensive longevity, as well as tail risk solutions. Additionally, RGA has several open-ended "small pension plan" longevity risk transactions with participants in the U.K. PRT space.

In the meantime, with a less active reinsurance market, U.S. PRT stands in stark contrast to the U.K. Two features of the U.K. market stand out as catalysts to the widespread use of reinsurance: price certainty and insurers' valuation framework. First, robust and good quality data sets (for both the U.K. national population and at the individual pension scheme level) have allowed transacting parties to have confidence in the pricing of longevity risk and in evaluating transactions. Second, Europe's focus on defining principle-based capital models highlights what the true cost of longevity risk could be, and the value of offloading it.

While the two markets may never be the same, we believe the economic and business rationales for reinsurance should, by and large, remain valid on both sides of the Atlantic. With anticipated developments in the NAIC's Risk Based Capital charges for longevity risk, as well as the evolution of PRT data sets and pricing models, the time might come for U.S. PRT players to look for new tricks from the Old Continent. ■

RGAX Is Innovating with a Keen Focus on Building a Healthy Life Insurance Ecosystem

There's tremendous energy and interest around innovation in the insurance space today. Year after year, traditional innovators, forward-thinking carriers and new entrants from the venture capital and entrepreneurial sectors seek to close the "protection gap" consumers face in the current market. While these leaders' ideas may be industry-changing, the barriers to entry can seemingly slow progress to a halt. The insurance industry is heavily regulated and complex, with significant "table stakes," including capital requirements, financial ratings, consumer awareness and trust; not to mention the sheer amount of raw data required to manage risk. Perhaps, given these requirements, potential innovators could use the help of an unexpected barrier-buster: a reinsurer.

Through its normal course of business, a reinsurer maintains a real-time perspective on nearly all aspects of the insurance environment. They continuously add these learnings to a store of knowledge gained over decades of supporting carriers of various sizes. RGA's internal subject matter experts and scaled data practice allows us to work with our clients to identify compelling new business models and reach new customers – all while maintaining a proven track-record for robust data security and client confidentiality. Combine these resources with our global reach and you have a best-in-class "insights-engine" which helps make sense of the gaps and opportunities in the life, health, and annuities markets.

In 2015, RGA launched RGAX to act on those gaps and opportunities. With RGAX we are committed to remaining a stalwart ally of our client base and a steward of the industry. We believe that through partnership, established players in the life insurance industry can ride the wave of disruption. Our team digs deeper to better understand the core causes and ultimate effects of the most pressing challenges carriers are facing as well as a capacity to take advantage of the most promising innovation opportunities.

We are in a position to see where a carrier's innovation efforts could be combined with those of an outside entrepreneur for an improved customer experience or maybe faster speed-to-market, resulting in an idea that can be scaled for greater impact. These ▶

perspectives, along with the accumulated experience of the Global Financial Solutions (GFS) division and a focus on measurable market validation, offer a more holistic and informed approach to innovation. By connecting and assisting key players along the entire value chain, from consumers to regulators, and from carriers to entrepreneurs, our end-to-end innovation strategy allows each party to do what they do best and collaborate for the rest.

A recent example of this collaborative approach has evolved through a joint effort between RGAX and RGA's GFS team which seeks to transform the Fixed Annuity market (see sidebar). Employing collective industry expertise and a vision for a differentiated way of building annuities, Project LifeVest was born. The team has been creating a solution, utilizing significant research horsepower and unique approaches to consumer-centric design, which could be leveraged in the industry to offer greater access and transparency to an important and growing group of customers that are hungry for novel approaches to retirement and protection products.

This is an example of how RGA and RGAX combine internal expertise with a broad portfolio of modular solutions and services to develop new business concepts across the entire value chain. In order to continue to drive value for our customers, RGA not only regularly acquires risk business, but we also maintain a strong network of partners by evaluating promising entities that may be acquired or supported through incubation within RGAX. Our interest is as a strategic investor, looking beyond returns and traditional business, to find opportunities where we can plug into the value-chain, or to be a trusted partner and entry point to help other entities do the same.

Ultimately, whether it be through experimentation or investment, we're looking for opportunities to leverage our full suite of services to help our carrier clients achieve greater customer engagement, convert this engagement into sustainable business returns, and reduce the costs and time involved in bringing new concepts successfully to scale.

RGAX at Work: Project LifeVest Case Study

Fixed Index Annuities (FIA's) are a growing segment of the annuity market, combining principal protection, guaranteed returns, and optional guaranteed lifetime income. They appeal to retirees and near-retirees looking to allocate a portion of their retirement portfolios for diversification and income. Research has indicated that high commissions, excessive complexity and a lack of transparency traditionally associated with these products is preventing FIA's from reaching their full market potential.

RGA's annuity experts had the idea to create a simplified next-generation, direct-to-consumer FIA platform and product without high commission fees which would target a currently underserved market. They then looked to collaborate with RGAX to help create the go-to-market strategy and business case. Now, after successfully validating early versions of the value proposition, the team is in the process of onboarding interested carrier partners who want to leverage this platform to reach new consumers and develop new products.

All throughout the development process, the team benefited from the rigor and discipline of the RGAX innovation process to validate the concept and test the distribution potential. This lean-startup approach included in-depth interviews with internal subject matter experts in regulatory compliance, product creation and digital distribution; as well as real-world feedback via Facebook/Instagram marketing campaigns and consumer interviews. All of this data-gathering confirmed there was an unmet need for this type of solution within our target market centered on low fees, transparency, and convenience.

The FIA products and distribution platform currently being prototyped through Project LifeVest are preparing to launch into the market and we are actively seeking additional carrier partners who are interested in selling through this new and innovative channel. The hope is that Project LifeVest will eventually become a new platform of multiple offerings and an advice engine with planning tools and educational resources. ■

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