Strategic Reinsurance Options

What we’ll be covering today

- Potential impact of Reinsurance Disruption
- Tactics for mitigating
- Embedding into Strategic Planning
- Understanding there are alternative reinsurance strategies

How Pools Use Reinsurance

Purpose

Enables Pool to provide meaningful coverage while protecting surplus
How Pools Use Reinsurance

**Example**

Pool provides $5 million of coverage

| Self-Insured Retention $500,000 per loss | $5,000,000 |
| Reinsurance $4,500,000 excess of $500,000 per loss | $0 |

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**Reinsurance Disruption**

A "hard market"

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**Reinsurance Disruption**

What It Could Mean

- Reinsurance coverage costs more
- Lower reinsurance limits
- Reinsurance sub-limits
- Reinsurance exclusions
- No reinsurance
Reinsurance Disruption
Impact on Pools

1. Reinsurance coverage costs more
   > Higher cost of coverage for members
2. Lower reinsurance limits
   > Pool retains more risk
3. Reinsurance sub-limits
   > Pool surplus exposed to greater risk
4. Reinsurance exclusions
   > Pool provides less coverage
5. No reinsurance
   > Pool retains more risk
   > Pool surplus exposed to greater risk
   > Pool provides less coverage

Reinsurance Disruption
Potential Causes

- Market-wide
  - Macro-economic event or series of catastrophes
- Public entity sector
  - Change in appetite
- Specific risk types
  - Concerns over risks that have become subject to large claims payments
- Your pool
  - Adverse loss experience

Reinsurance Disruption
How Likely?

- Chicken Little?
- Was 1980s hard market a one-off?
- Listen to your advisors
- Look for leading indicators
- What's the word on the street?
1. Ignore

2. Mitigate

- Know how to mitigate
  - With specificity
- Plan for change
  - Waiting until it becomes a necessity will narrow your options
- Embed into Strategic Planning
  - This topic should be a part of governance

- Enhance your existing reinsurance relationships
- Improve your story / differentiate your pool
Mitigation
Plan for Change

1. Have a vision of what your future state might need to look like, for example:
   • Additional reinsurers
   • Retain more risk
   • Alternative Reinsurance

2. Understand the lead time to move to that future state

3. Shorten the lead time

Plan for Change
Lead Time

Recognize the lead time needed to change your structure

<table>
<thead>
<tr>
<th>Possible Changes</th>
<th>Lead Time Required For</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Additional reinsurers</td>
<td>Obtaining proposals</td>
</tr>
<tr>
<td>2. Retaining more risk</td>
<td>Financial / actuarial analysis</td>
</tr>
<tr>
<td>3. Alternative Reinsurance</td>
<td>Due diligence / education</td>
</tr>
</tbody>
</table>

**Lead Time**
Possibly two years, depending on scope of changes.

Plan for Change
Shorten the Lead Time

• Structure your current reinsurance for flexibility
• Quantify how much risk you can retain
• Become familiar now with options that might need to be implemented at short-notice
Shorten the Lead Time
Structure for Flexibility

More than one reinsurer - Quota Share

- Reinsurer A: 40% (e.g.)
- Reinsurer B: 30%
- Reinsurer C: 30%

Self-Insured Retention $500,000 per loss

Pool coverage of $5 million

A framework that accommodates future changes

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Shorten the Lead Time
Know How Much Risk You Can Retain

Evaluate your capacity for a higher SIR

- How much would your surplus support?
- What is your risk appetite?

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Shorten the Lead Time
Be Informed on Alternative Reinsurance

Be sufficiently familiar with the options

- Reinsurer A
- Reinsurer B
- Alternative Reinsurance

Alternative Reinsurance requires education and due diligence
Reinsurance Disruption
Mitigation

- Know how to mitigate ✓
  - With specificity
- Plan for change ✓
  - Waiting until it happens will narrow your options
- Embed into Strategic Planning
  - This should be a part of governance

Recap

Mitigation
Embed into Strategic Planning

Include in SWOT Analysis

| Strengths | Weaknesses | Opportunities | Threats |

Example: Dependency on the reinsurance market exposes our Pool to volatility

Mitigation
Embed into Strategic Planning

Include in Scenario Analysis

EXAMPLE
A rise in interest rates leads investors to shift their funds away from the (re)insurance markets in search of higher yields. Reinsurance market capacity shrinks. Reinsurers realign their risk appetites. They reduce their capacity and increase pricing in specific sectors, including the public entity sector.
Alternative Reinsurance

Other terminology:

• Alternative Risk Transfer
• Alternative Risk Finance
• Structured Reinsurance

Comprises:

Anything that doesn’t look like traditional reinsurance
Three categories:

- Non-traditional products that are in common use
- Non-traditional products that are complex
- Concepts that clever people talk about

Alternative Reinsurance

In common use:
- Captives
- Reinsurance pooling
- Loss Portfolio Transfers

Complex:
- Multi-year / Multi-line
- Weather derivatives
- Catastrophe bonds

Alternative Reinsurance

Some Perspective

[Diagram showing a spectrum from common to uncommon with categories like Captives, Reinsurance, Pooling, Loss Portfolio Transfers, and Cat Bonds.]
Alternative Reinsurance

Some Perspective

Captive Insurer:
An insurance company owned by a public entity pool that provides coverage to the pool and its members

- Does not transfer risk outside of the “family”
- Is a means of retaining risk more cost-efficiently
- Is a regulated entity

Alternative Reinsurance
Example

Captive Insurer

Pool Members

Coverage

Ownership

Reinsurance
Alternative Reinsurance

Reinsurance Pool:
A reinsurer owned by several public entity pools that provides coverage to those pools ("pool of pools")
- GEM, CRL, NLC Mutual, Transit Re
  - Provides risk transfer to its members
  - An alternative to traditional reinsurers
  - Generally used complementary to traditional reinsurers

Alternative Reinsurance

Reinsurance Pool
- Risk shared with peers
- Group purchase of external reinsurance

Alternative Reinsurance Example – Captive / Reinsurance Pool

Mitigating Reinsurance Disruption
Loss Portfolio Transfer:
The transfer by a pool of some or all of its existing liabilities to an insurer

- Uncertain liabilities are exchanged for a fixed payment
- Might provide surplus relief to the pool

Alternative Reinsurance Example

Loss Portfolio Transfer:

Catastrophe Bond:
A structure for transferring catastrophe risk to the capital markets

- Generally applies to hurricane or earthquake risk
- Where the traditional market doesn't have enough capacity
- Complex and expensive to arrange
- Buyers of this product are mostly traditional insurance and reinsurance companies
Alternative Reinsurance
Catastrophe Bond

Buyer of Catastrophe Coverage

Special Purpose Insurer

Sponsored or named by participating pools

Takeaways

A framework for asking the key questions:
• Could Reinsurance Disruption impact our Pool?
• What would be the worst case?
• How can we mitigate?
• What alternatives should we consider?