Risk Transfer

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Evaluation of Risk Transfer in Structured Contracts

- Structured Contracts insulate reinsurers from a portion of loss
- Insurers obtain balance sheet relief by accounting for contract as reinsurance
- Risk Transfer Testing and deposit accounting requirements provide integrity in financial reporting when there is no true risk transferred
- Due to changes in reinsurance market, evaluating these types of contracts is not straightforward

Anastasios Serafim

- Experience with Risk Transfer Analysis
- Experience with Structured Policies
- Experience with International Treatment

A Few Examples

1990's structure example – multiyear with funds on deposit

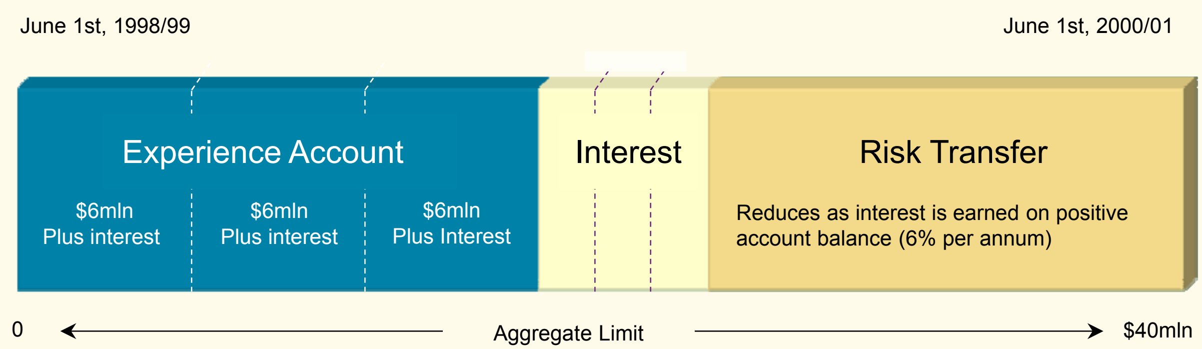
- Clearer attachment and expected cost

2000's Structure Example – Graduated Reinsurance

- More "skin" in the game

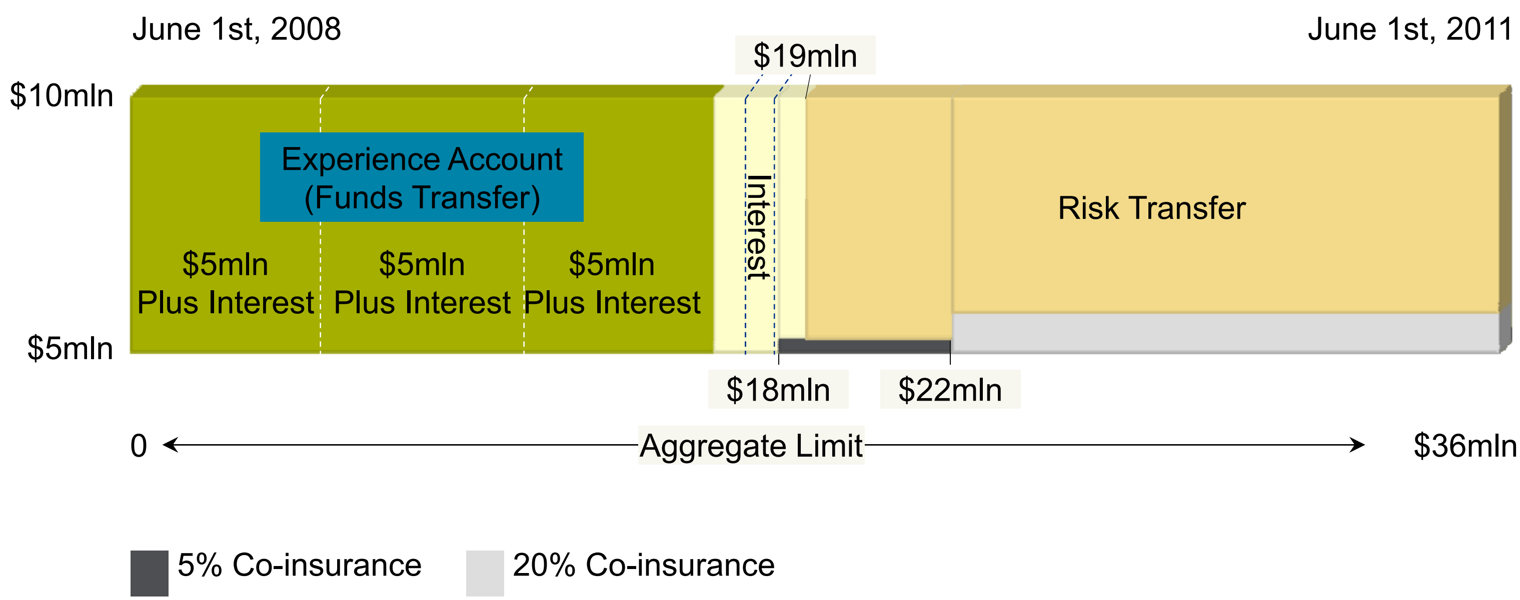
Multi-year Structured Example

- 3 Year Contract with Experience Account
- Premium $8 million per Annum
- Contractually Specified Interest Rate of 6% per Annum



Multi-year Structured with Graduated Co-insurance Example

- 3 Year Contract with Experience Account
- Premium $7 million per Annum
- Interest accrued based on prescribed yield until Experience Account Cap of $4 million is reached.
- Reinsurance program offers $33 million in net limits less co-insurance.

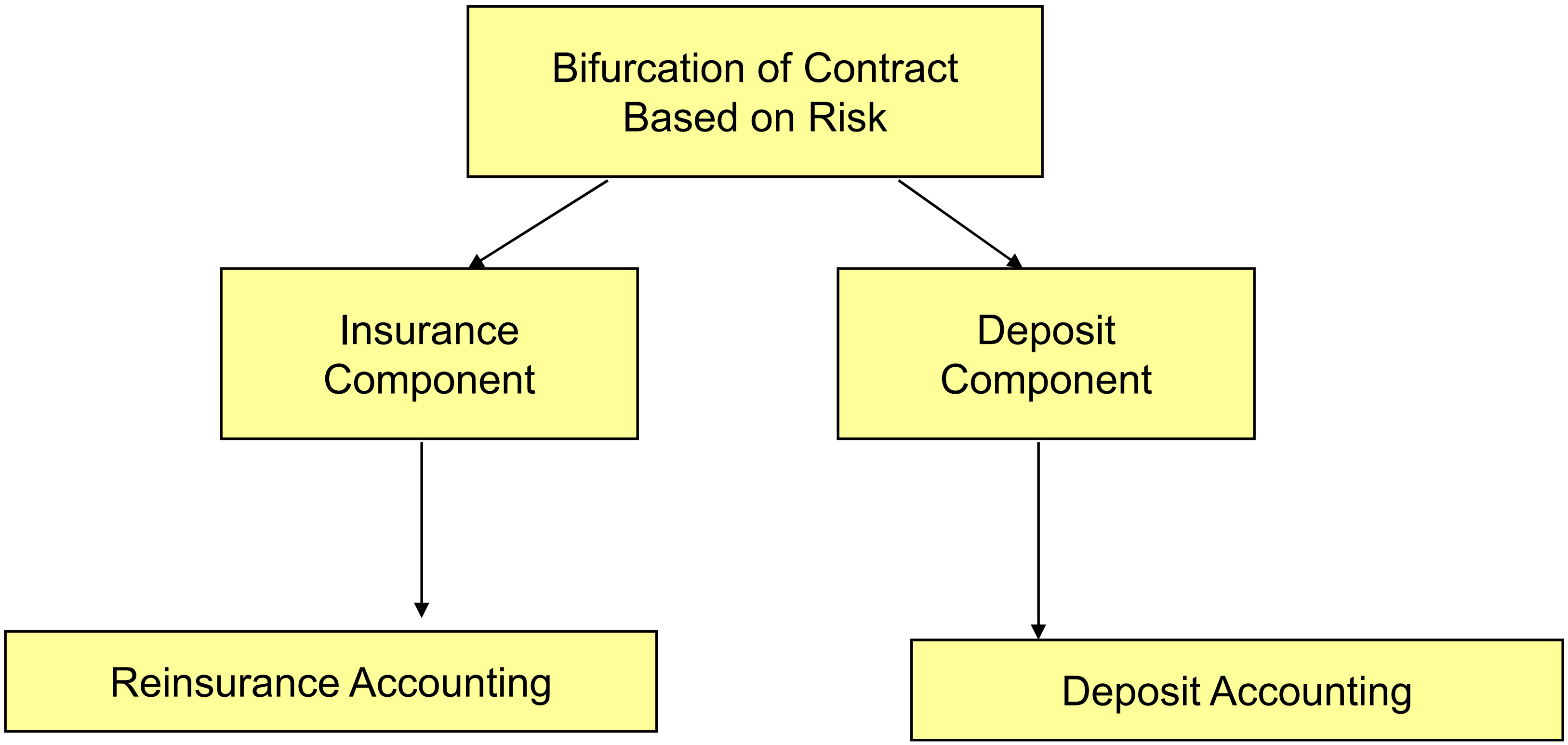


Client Feedback

- Initially – Served Need
  - Loss sensitive nature big plus
- Balance Between Complexity and Responsiveness
- Clients have need for simplicity and therefore have utilized this space less.

IFRS vs. GAAP

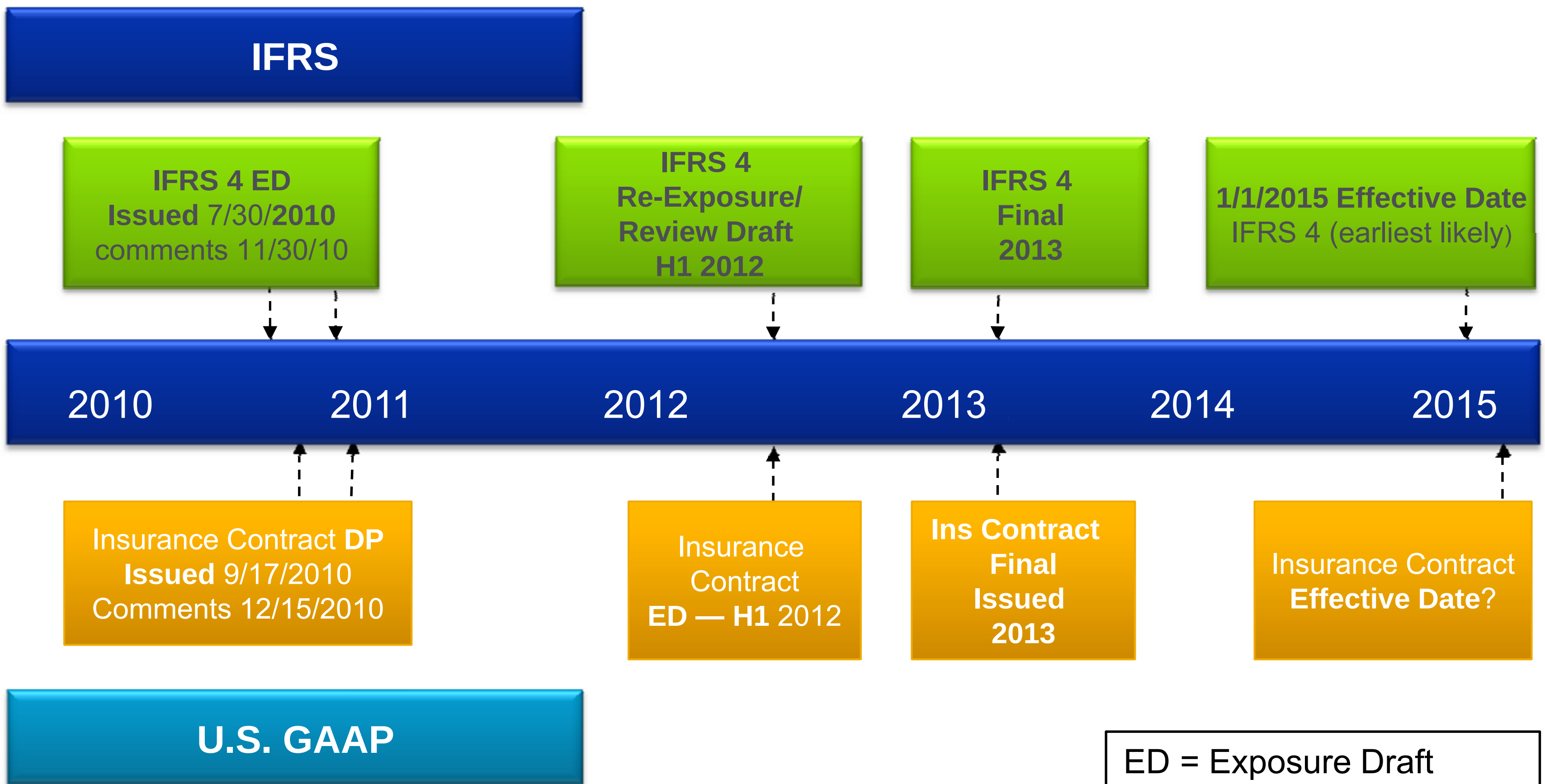
Bifurcation of structured insurance contract under IFRS 4



IFRS vs. GAAP

- Bifurcation issue FAS 113 vs IFRS 4
- IFRS 4 – Insurance Contracts finalized March 2004, Effective January 2005
- IFRS 4 - Second Phase ED 2010, Proposed Effective January 2015
- On May 26, 2006, FASB issued an Invitation to Comment, Bifurcation of Insurance and Reinsurance Contracts for Financial Reporting.
- On June 11, 2008, as part of FASB's review of its technical plan and its process to update the Memorandum of Understanding with the IASB, the insurance risk transfer project was removed from its agenda.
- FASB discussions ongoing with IASB on planned convergence Proposed Effective January 2015

IASB / FASB Expected Time Line



ED = Exposure Draft
DP = Discussion Paper

The Building Block Approaches

FASB

Composite margin

Discounted expected cash flows

Unbundled elements

IASB

Residual margin

Risk adjustment

Discounted expected cash flows

Unbundled elements

- Consistent under both proposals
- Unbundled elements include **deposits**

Insurance Contracts
From IASB ED and FASB DP

Unbundling

- Also subject to continued deliberations; and
- Goal is generally to unbundle certain investment accounts, embedded derivatives and goods and/or services not closely related to the insurance agreement.

Insurance Contracts
From IASB ED and FASB DP

Discounted Expected Cash Flows

- **Discount rate**
  - Capture characteristics of liability (i.e., risk-free rate)
  - Liquidity adjustment
  - No own-credit standing adjustment
- **Expected cash flows**
  - Measurement objective is the mean of distribution
  - Re-measured each period
  - Reflect entity perspective
  - Within the contract's boundary

Insurance Contracts
From IASB ED and FASB DP

Composite Margin (FASB) vs. Residual Margin and Risk Adjustment (IASB)

- **Composite Margin -** An amount to eliminate any gain at initial contract recognition that includes an implicit risk adjustment margin and residual margin (recognized in earnings over the coverage and claims handling periods; not re-measured; interest not accreted).

- **Residual Margin -** An amount to eliminate any gain at initial contract recognition (recognized in earnings over the coverage period; not re-measured; accretes interest at the discount rate).

- **Risk Adjustment Margin -** An explicit assessment of the maximum amount that the insurer rationally would pay to be relieved of the risk that the ultimate fulfillment cash flows exceed those expected (re-measured each reporting period with changes recognized in earnings).

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