2023 CARe Reinsurance Seminar
C-22: Structured Risk: *How Many Levers Can We Pull*

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Structured Quota Share

Managing Capitalization

Quota Share Reinsurance as Capital Management Tool

Finance growth

- Generate **capital relief**, improve capitalization scores (i.e., BCAR)
- Competitive pricing, when compared to other forms of capital, plus the flexibility of reinsurance
- Reduces premium required capital

Available reinsurance options run the continuum of cost/benefit

- **Traditional /** Unlimited
  - Costly under favorable scenarios
- **Structured /** Limited
  - Cost effective

Available reinsurance capacity from highly rated reinsurers mitigates execution risk

- Well-understood contract and terms
- Deep structured reinsurance market

Capital issues faced by Insurance Companies

- Statutory accounting and regulatory capital models have conservative biases
  - Accelerate capital requirements
  - Accelerate expense and defer income recognition
- Significant upfront capital contributions required
  - Depresses ROE's during the start-up phase
- **A Quota Share will lower otherwise required capital by sharing economics with reinsurer**

Capital Benefit of Structured QS Reinsurance

- Quota Share reinsurance acts as a from of capital
  - Reduces and/or delays capital contributions otherwise required
  - Reduces premium capital charges in AM Best BCAR capital model
- Structured Quota Shares are most often compared to debt financing whereas Traditional Quota Shares are more comparable to equity
  - Structured – fixed cost in upside scenarios, limit on downside protection
  - Traditional – proportional sharing of economics both upside and downside

- Cost of “capital” is the reinsurer’s margin relative to capital benefit in AM Best’s BCAR

$$\text{Ceded cost of capital} = \frac{Impact\ on\ Net\ Income\ (ceded\ margin)}{Implied\ Capital\ Benefit\ based\ on\ BCAR\ improvement}$$

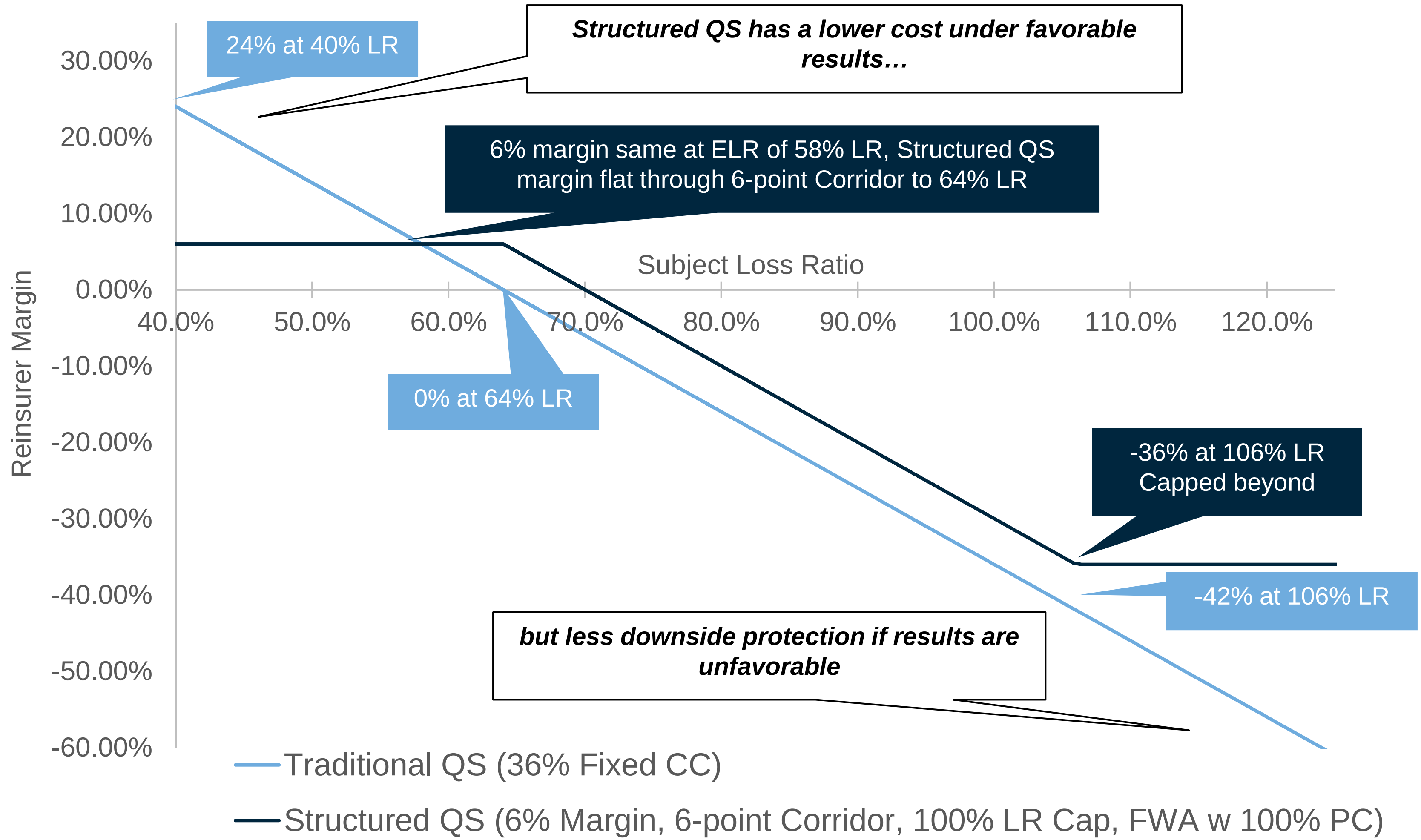
Structured quota share vs. debt financing

Structured QS

Structured QS Typical Coverage Terms

- Common contract features used to lower cost and limit risk include:
  - Experience Accounts – returns excess profit to cedant
    - Similar to 100% profit commission at ELR or better
  - Sliding scale ceding commission or loss corridors – losses in a specified range are retained by cedant
    - 60% - 70% corridor used in the example on the next slide
    - Limits reinsurers downside to balance upside retained by cedant
  - Loss ratio caps – losses in excess of the cap are retained by the cedant e.g., the reinsurer will not be responsible for losses in excess of a specified amount
    - 100% LR used in the example on the next slide
- Structured Quota Shares are subject to the same accounting and risk transfer rules as Traditional Quota Shares and all other reinsurance contracts:
  - Any limitations on recoveries (loss ratio or occurrence) must be reflected
  - Any experience related features must be currently accrued (profit commissions, loss corridors)
- Structured deals exceed accounting risk transfer guidelines and fully qualify for reinsurance accounting and capital relief

Margin Comparison: Structured vs. Traditional QS



Multi-Year Excess of Loss

Managing XOL Retentions

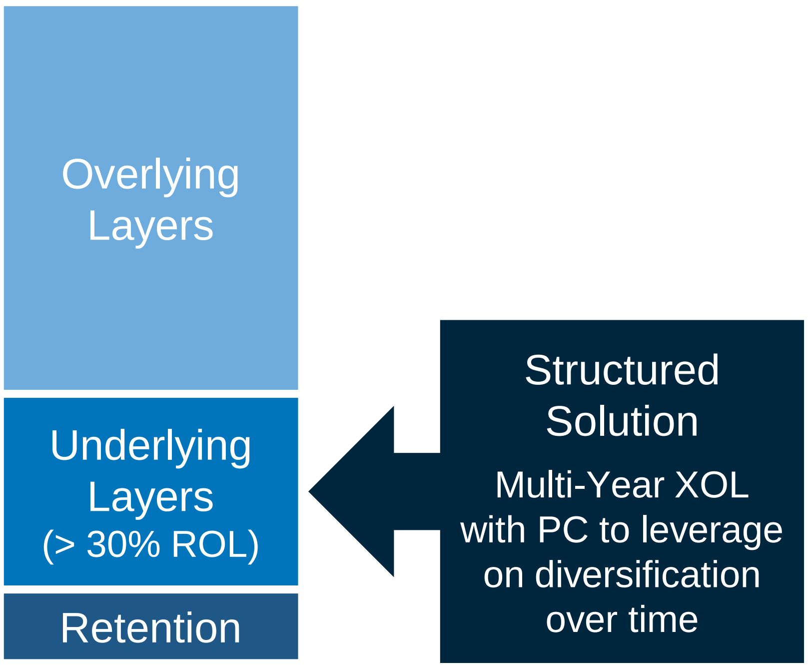
Structured Multi-Year XOL with Profit Commission

Improving Cost Benefit on High Activity Working Layers

- **Best for High ROL layers with poor cost-benefit relationship**
- **Takes advantage of diversification over time – most effective in high loss activity areas**
- **Reinsurers often have dedicated teams for this product**
- **Typically written with single or limited reinsurer**
- **Can help bridge view of loss cost between cedent and reinsurer**

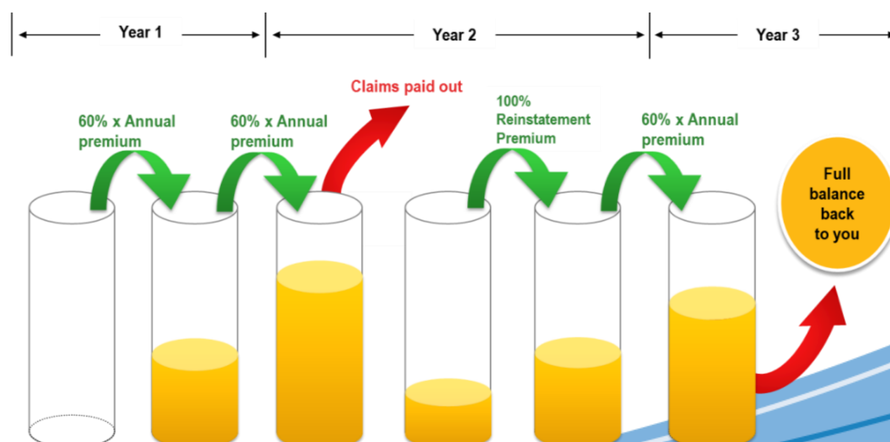
Multi-Year Excess of Loss

Potential Solution to Increasing CAT XOL Costs



How it works:

- 2-to-3-year period
- Upfront Premium same or marginally higher than Traditional
- Cumulative notional Experience Account
- Margin 30-50% / PC 50-70%
- Annual Limits matching Traditional with additional Term Limits share across years
- Early cancellation option if profitable



Multi-Year Excess of Loss

Potential Solution to Increasing CAT XOL Costs

Bottom Layers – Commensurate Protection for Cost?

- High ROL layers = poor cost-benefit
- Large component of loss activity self-funded via high upfront and reinstatement premium
- Time diversification lowers volatility charge, diversification most effective on high loss activity areas

Identical to Traditional

- **Same annual coverage**
- Similar or marginally higher upfront ROL

Cash flow Benefit

- Upfront payment of **only RI margin** instead of full Deposit Premium

Efficient Solution

- Product with high Profit Commission on good experience
- Budget stability and security over time with strategic capacity provider
- Not exposed to market volatility or post-loss adjustment

Significant Profit Commission

- Potentially substantial cost savings with **PC up to 70%+**

Guaranteed Pricing & Capacity

- Regardless of loss experience
- **No post-loss adjustment**

Attractive cost-benefit with profit commission on good experience, guaranteed terms and capacity on poor experience, all while providing identical annual coverage as Traditional.

Motivations & Adaptations

An approach not a product

"Vanilla" MY – Pure Efficiency	***Risk-Reward Tradeoff***
Leveraging on time diversification for better cedant economics without compromising on reinsurer's. In turn can achieve similar premium with significant PC. ▪ The time element reduces volatility which in turn reduces margin requirement. ▪ Significant PC possible given modelled loss activity compounded by tightened distribution over time. Reinsurers, however, are unlikely to openly acknowledge above – expect default position to include loading on upfront premium in their favour.	The flexible augmentation of risk-reward profile – to sit in between traditional and self-retention – should in itself be a valuable, differentiating option. ▪ Works well when there is discrepancy between client and reinsurer view of expected loss – leveraging the gap. ▪ Also when the client is already in some mindset for higher risk retention – voluntarily or otherwise. Above aspects compound in a hardening market whereby clients have increasingly limited options outside of straightforward risk-adjusted loadings.

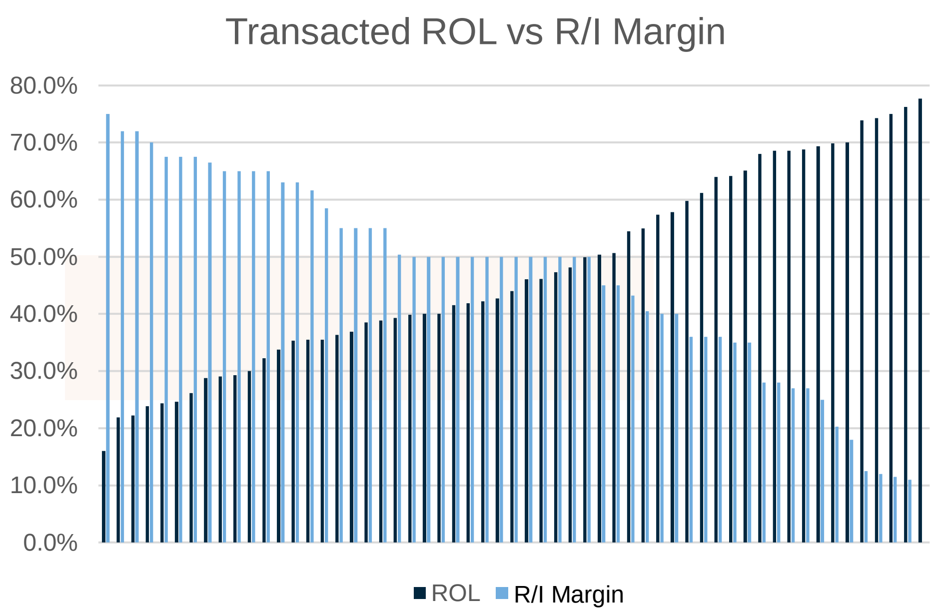
Transaction Statistics

Highly varied in application

(Paid) ROL
Average ~50%
Majority 30-70%

Profit Commission
Average ~50%
Majority 30-70%
R/I Margin = 1 - PC

Duration
Vast majority 3 years
Up to 5 years



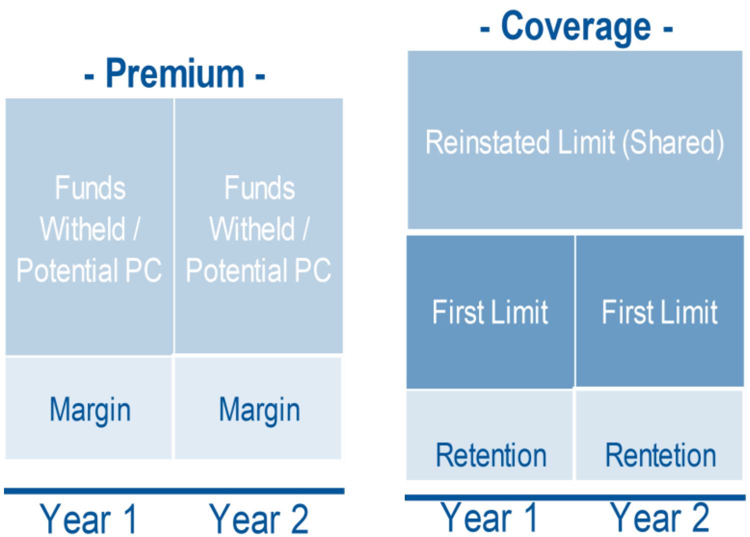
Customization of Premium, Limits & Margin subject to goals and constraints

“Cat 32” Illustration

2-Year CAT XOL with 3 Limits over Term

Illustrative Terms

- 2-year period
- Upfront Premium same or marginally higher than Traditional
- Margin 30-50% / Profit Commission 50-70%
- Annual Limits matching Traditional at 2 occurrence limits, Term Limits set at 3 occurrence limits



Covered Business	
Subject Policies	TBD
Geographic Scope	TBD
Subject Premium	TBD
Broker	Gallagher Re
Structured Terms	
Product	Multi-Year Excess of Loss
Reinsurer	TBD
Effective Term	2 annual periods
Premium	TBD per Annual Period
Reinstatement Premium	TBD
Margin, Funds Transferred	A percentage of the Premium, Settled on a Funds Transferred basis
Funds Withheld Account	Premium less Margin, to be retained by Company on a cumulative Funds Withheld basis
Interest Credit	X%, applied to Funds Withheld Account each year until Commutation
Coverage	
Attachment Point	TBD, each Occurrence
Occurrence Limit	TBD
Aggregate Limit	3 Occurrence Limit per Term
Annual Limit	2 Occurrence Limit per Annual Period

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