Reinsurance as a Capital Financing Tool

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Agenda

- Introductions
- How reinsurance is used for capital financing
- Why reinsurance is used for capital financing
- Where reinsurance is used for capital financing

Introductions

Dave Rowbottom, FSA

Founder of Reinsurance Actuarial Solutions, brokerage firm specializing in capital motivated reinsurance for health plans

Frank Melaccio, CPA, CFA, FRM

Vice President & Treasurer for Horizon BCBS, and adjunct professor of finance at Hofstra University in New York.

Poll

What experience do you have with structured capital motivated reinsurance?

1. Never considered or explored the idea
2. Explored the idea but expect not to pursue any implementation
3. Have implemented or expect to pursue an implementation in the future

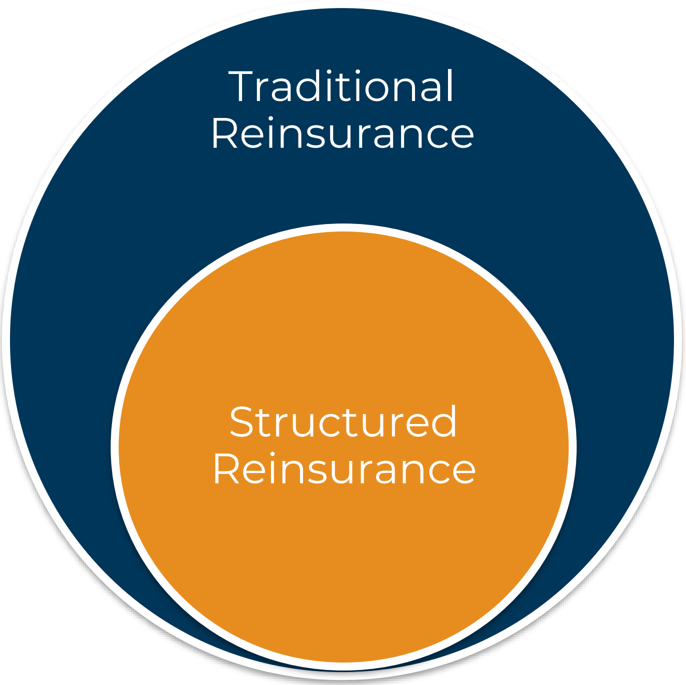
How reinsurance is used for capital financing

What is reinsurance?

"Reinsurance is an essential tool insurance companies use to **manage risks and the amount of capital they must hold to support those risks**." – NAIC Center for Insurance Policy and Research

- Coinsurance (e.g., "quota share", "proportional", "first-dollar") cedes a percentage of premium and claims.
- Risk-based capital (RBC) requirements (that are a function of premium and claims) are transferred to the reinsurer.

What is structured reinsurance?

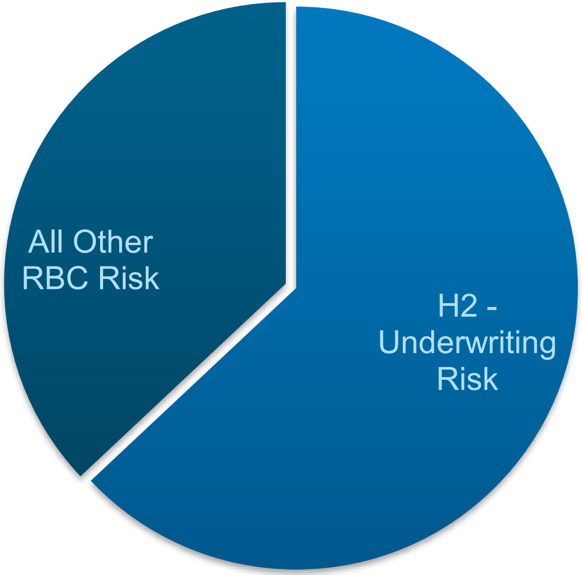


- Structured reinsurance is a subset of traditional reinsurance, using the same mechanics and following the same rules and regulations.
- It is designed to transfer statutory risk while using structural features that align the reinsurer and ceding company with the statutory goal at an efficient cost.
- For health, structured reinsurance is typically a capital financing transaction.

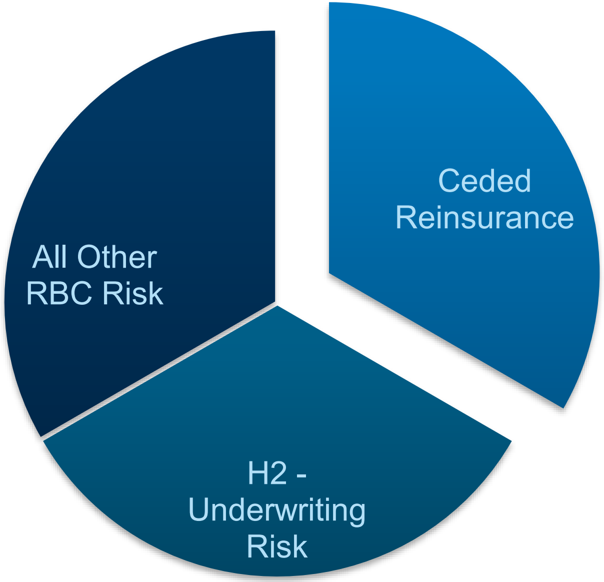
Uses of capital for an insurance company

- ✓ Excess capital – available to return to shareholders (or social mission initiatives) after all other capital considerations are met.
- ✓ Growth capital – available to support ongoing business growth (organic growth, M&A, investing in the business, etc.)
- ✓ Risk capital – available to absorb financial risk and volatility.
- ✓ Internal target providing margin above external stakeholder requirements (i.e. 500% ACL).
- ✓ Market level of capital – minimum to satisfy rating agency (AM Best, S&P, Moody's, etc.) and association level requirements (BCBSA, i.e. 375% ACL)
- ✓ Regulatory capital – Authorized Control Level (ACL) Risk Based Capital (RBC).
- ✓ Company Action Level (CAL) = 200% ACL

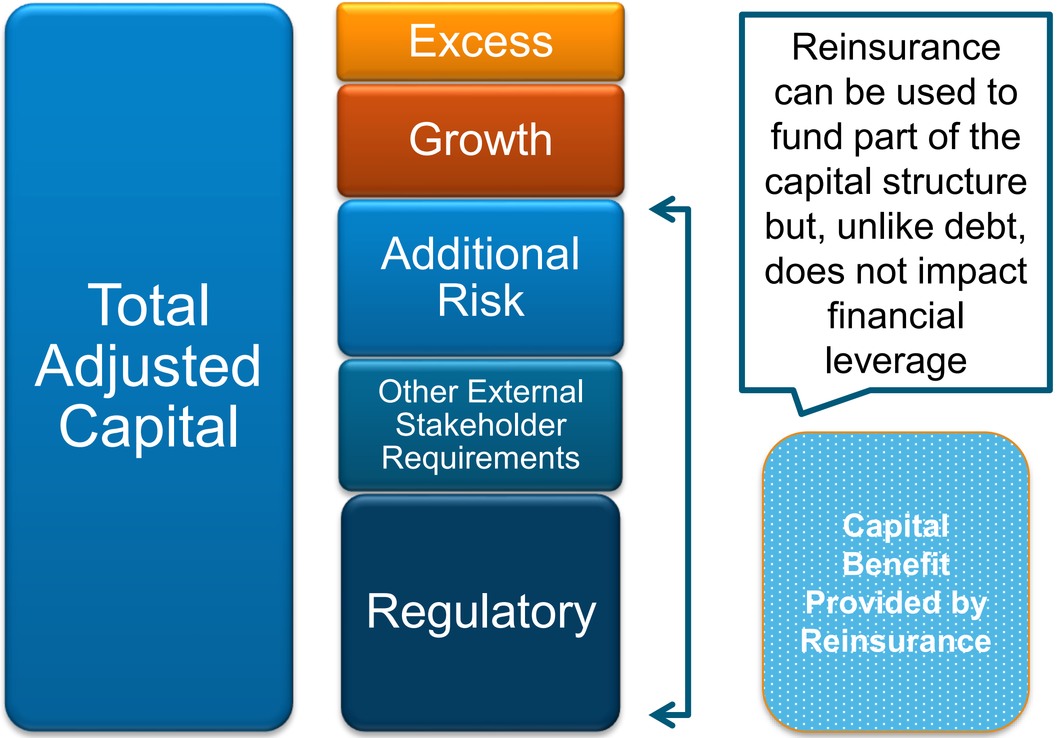
Regulatory capital – RBC



- Majority of RBC for health plans is Underwriting Risk, a function of premium and claims.
- Coinsurance cedes a % of premium and claims, transferring that RBC to the reinsurer.



Reinsurance used to fund part of the capital stack

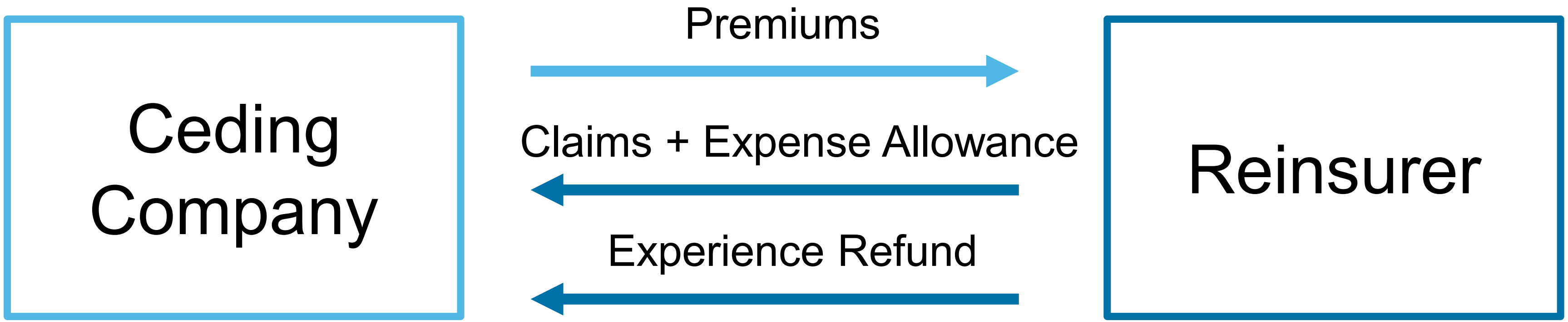


Reinsurance can be used to fund part of the capital structure but, unlike debt, does not impact financial leverage

Reinsurance replaces a portion of the capital stack that would have otherwise been allocated to risk capital, regulatory and other external stakeholder requirements.

The ceding company still has the same total adjusted capital (less a reinsurance risk fee – equivalent to a capital financing charge), this can allow the ceding company to allocate a greater portion of their capital towards higher return ventures with growth or excess capital.

Reinsurance structure



- Funds withheld coinsurance ceding a % of premium, claims, and resulting RBC.
- All reinsurance profits net of reinsurer risk charge are paid back to the ceding company through experience refunds.

Experience refund and loss carryforward

- Experience refund allows the ceding company to retain profit on the business (less a risk charge for the reinsurer).

- Loss carryforward allows the reinsurer to recover potential losses through future profit on the reinsured business.

Example RBC ACL benefit

Quota Share	50%
Ceded Premium	1,000,000
Ceded Claims	880,000
Expense Allowance	70,000
Risk Charge	4,500
Experience Refund	45,500
Estimated ACL RBC Benefit	40,000
ACL Benefit @ Target 500% ACL	200,000
Cost of Capital	2.3%

- Coinsurance ceding premium, claims, and providing expense allowance for statutory risk transfer.
- Experience refund returns profits net of risk charge.
- Capital benefit provided by reinsurance funding part of the capital structure at an efficient cost.

Why reinsurance is used for capital financing

Benefits of Structured Reinsurance

- Improve risk adjusted returns, capital efficiency and capital ratios.
- Alternative capital financing; no offsetting debt liability or equity dilution.
- Competitive cost of capital to finance growth or capital projects.
- Flexible to adjust terms with mutual agreement; easy to execute an amendment to adjust quota share.

Commentary from AM Best

Health Reinsurance Report - August 31, 2023

"More companies are using reinsurance to enhance financial flexibility. Reinsurance allows health insurers to free up capital and use it to cover operational needs, expand vertical integration capabilities, maintain debt service, and return to shareholders."

"Structured reinsurance offers an opportunity for capital relief and greater financial flexibility. It can be used to fund part of the capital structure but, unlike debt, does not impact financial leverage."

"Primary carriers can use structured reinsurance to write more premium or free up capital for other purposes – M&A, investing in the business, returning to shareholders. Structured reinsurance can also allow the primary carrier to meet risk-based capital requirements without turning to more expensive sources such as borrowing."

Source: © A.M. Best Company, Inc.

Assessing Capital Solutions as a Blues Plan

Surplus Note

- **Generally, most expensive option**
- **Less flexibility**
- **Requires regulator approval**

Traditional Reinsurance

- **Can be expensive depending on experience**
- **Takes profit from performing business lines**
- **May create budgetary pressures**

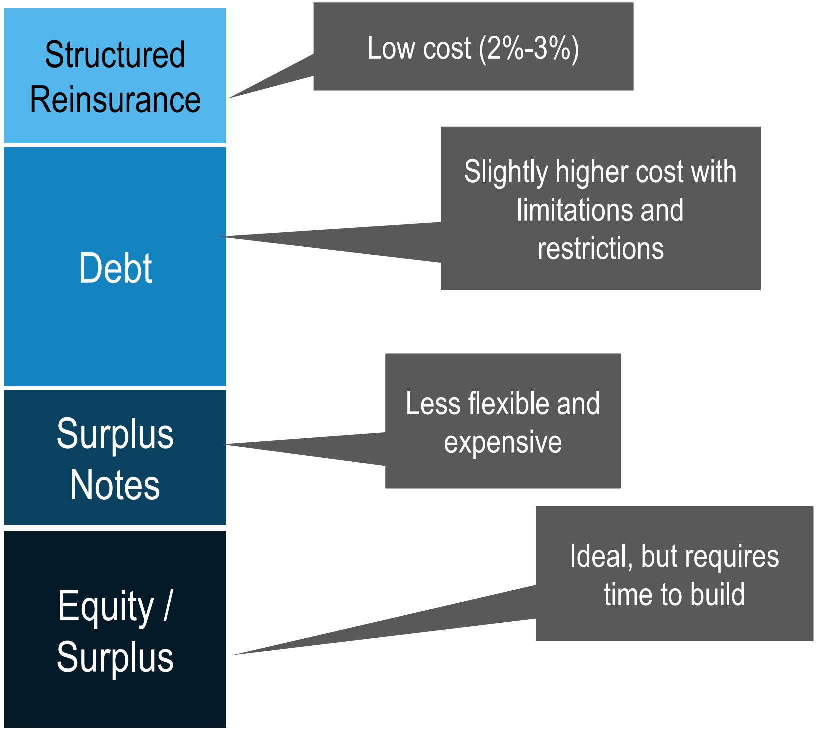
Structured Reinsurance

- **Least expensive option**
- **Allows for return of profits to the plan**
- **Provides flexibility to increase or decrease on need**

Treasurer's Perspective on Why Structured Reinsurance

- **Flexible capital solution** easy to increase or decrease the RBC relief based on need
- **Does not 'eat up' profit margins** from higher performing business lines and less impactful to bottom line
- **Easy to implement** and does not require significant time to go to market and excess filing requirements with regulators

Thoughts On Structured Reinsurance as Capital Financing



- Capital can become trapped in a regulated subsidiary because of a minimum RBC requirement
- Achieve the desired RBC ratio through quota share allowing excess surplus to move to the parent company
- When compared to issuing debt at a parent company level, quota share can prove to be a more economical solution

Where reinsurance is used for capital financing

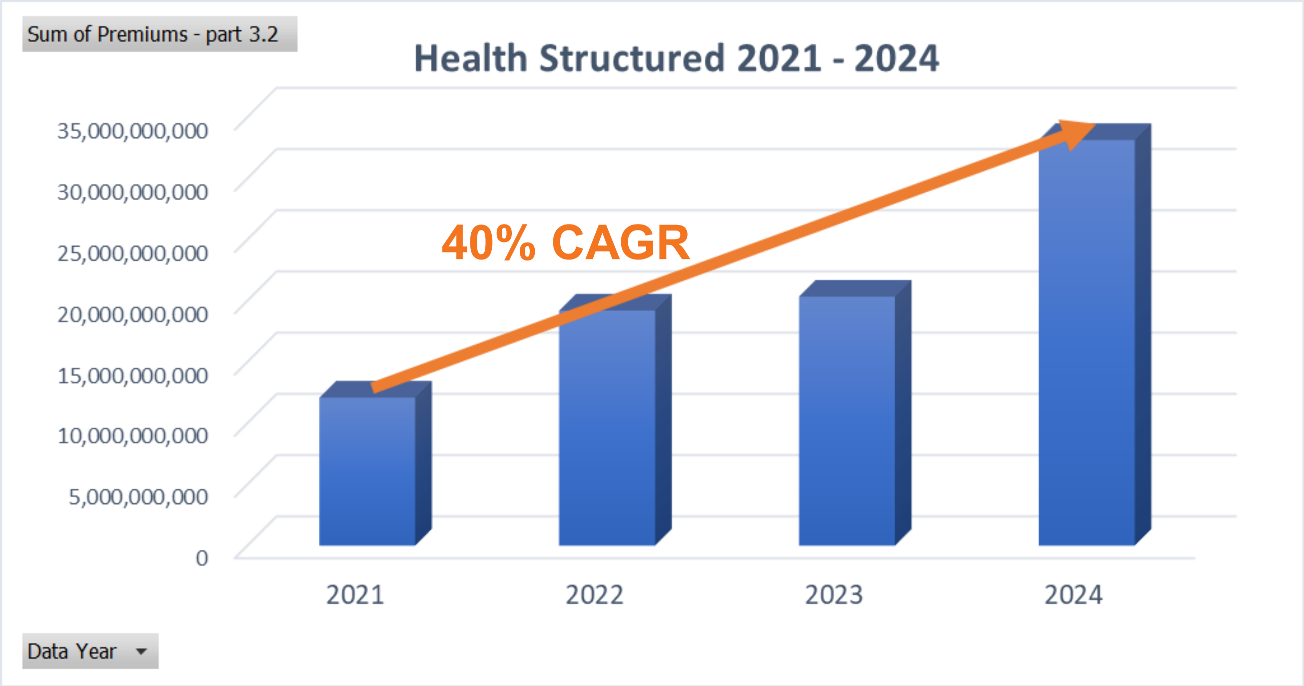
Schedule S

- Schedule S is filed as part of the annual statement by life, accident, and health insurers
- It includes information on reinsurance transactions:
  - Effective date
  - Type of reinsurance
  - Type of business ceded/assumed
  - Premium ceded/assumed

Prevalence in the industry (12/31/24)

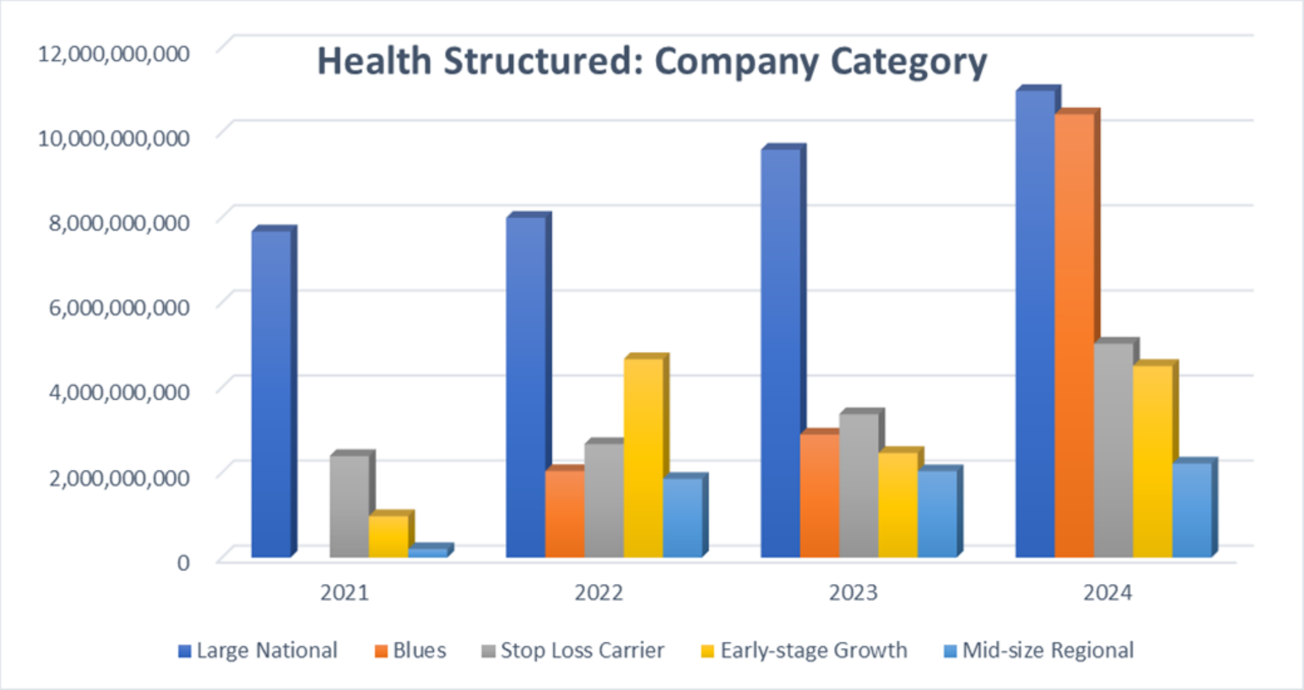
30	Active health structured reinsurance transactions
15	Active transactions on comprehensive major medical
9 / 9	Active transactions on Employer Stop Loss / Medicare Advantage
18	Domiciliary jurisdictions
$33B+	Annual reinsurance premium on active transactions

Growth in health structured 2021-2024



- Significant growth from 2021-2024, that growth has continued to accelerate in 2025

Use by company category

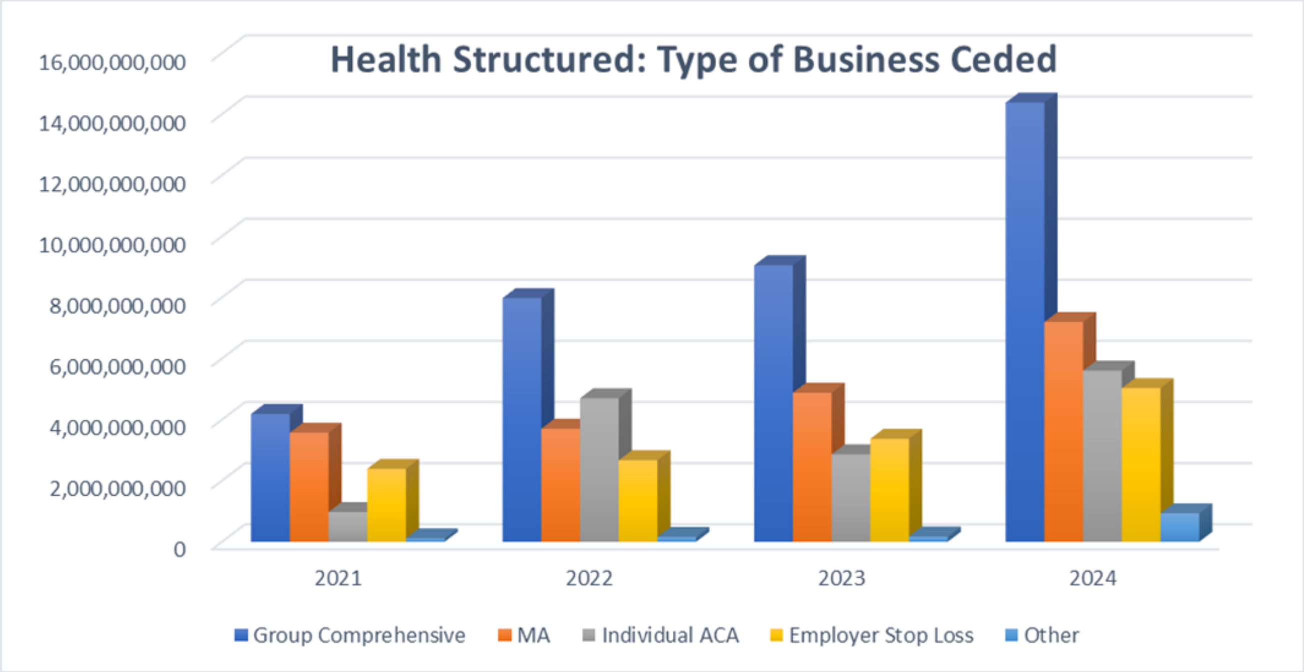


- Blues plans (Horizon, Highmark, BCBS MI) established programs in the last few years.
- 2 other Blues in 2025.

Use by company category

- Large national carriers and Blues with holding company structures use this reinsurance as part of their long-term capital management strategy as an efficient funding source for the parent company.
- Early-stage companies use this reinsurance as a cost-effective way to support capital strain from growth while allowing them to expand operational scale.
- This reinsurance is particularly efficient for Employer Stop Loss (ESL) carriers, where the RBC factor for ESL is more than 2.5 times that of commercial medical.

Use by type of business ceded



- Mainly concentrated in Group Commercial, MA, Individual ACA, and Employer Stop Loss.

Use by type of business ceded

- Group Commercial has continued to be the most common product since it is typically a large block of stable and profitable business, that can be easily underwritten by the reinsurer.

- Medicare Advantage and Individual ACA business have also been popular products because of the growth in those markets; ceding companies have aligned this reinsurance to support capital strain from that growth.

- Employer Stop Loss is the most capital efficient product to use with this reinsurance because of its high RBC factor.

- Other products (Medicaid, Medicare Supplement, Standalone Part D, Student Medical, Disability, Dental, Vision) are less commonly used, but can be considered in the right situation, or included with other products for diversification benefits.

Looking forward

- Structured reinsurance has proven to be a cost-effective funding source of capital for the parent company with notable advantages over other capital financing options.
- The use of this reinsurance is only expected to grow with health plans seeking greater capital management efficiency in a challenging environment with higher medical costs and profit margin compression.
- For those that have not implemented this reinsurance, there is an untapped opportunity to improve risk adjusted returns, capital efficiency and capital ratios.

Questions?

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Thank You!

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