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Considerations in Administering First-Dollar Reinsurance

by Johanna B. Becker

First-dollar quota share reinsurance has taken over the reinsurance marketplace with a vengeance. It started with new business on term products, expanded to new business for other life products, and has even moved into reinsurance of in force for some companies. "Overnight" a ceding company may find that almost every policy it issues is reinsured and possibly a chunk of its in force as well. This can have a tremendous impact on the administrative procedures that the ceding company has in place that were set up to handle smaller volumes of reinsurance, based on more traditional reinsurance needs. In addition, the administrative burden is further compounded by the fact that the ceding company most likely has multiple reinsurers sharing the risk.

The purpose of this article is to discuss some concerns my company has had and to raise awareness of issues you may wish to consider for your reinsurance arrangements. My comments on our solutions are general, because one solution may not fit all situations and each ceding company must work out solutions with its reinsurers.

Recently my company identified three areas affected by the impact of first-dollar reinsurance: audits, claims, and underwriting. In order to address our concerns, we invited representatives of nine reinsurers that participate in our first-dollar pools to a meeting at our home office. To keep the size of the meeting manageable, we suggested that each reinsurer send only two representatives. Given the topics we wished to discuss, we suggested that these representatives be the sales representative and an underwriter. Because our goal was to reach agreement on procedures, we requested that the representatives have the authority to speak for their companies, so that we could reach consensus at the meeting.

Prior to the meeting, we sent out specific proposals for audits and claims procedures as well as information on certain underwriting issues. This allowed the reinsurer representatives to discuss our

ideas with appropriate personnel in their companies and come prepared.

Audits

In the last few years we had begun to experience an increasing number of administrative and underwriting audits. These audits were requested by reinsurers as part of their due diligence requirements to audit large accounts periodically, not because of any particular problems they perceived with our business. As we did more first-dollar reinsurance with multiple reinsurers sharing in pools, we began to realize that we could be inundated with audit requests. We therefore proposed to

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our pool reinsurers that (1) a schedule whereby reinsurers would take turns doing audits each year be established and (2) results be shared with other pool members. In addition, given the number of reinsurers, we proposed that two reinsurers in the same pool audit each year and that they work as a team rather than doing separate audits. In our proposal we paired the reinsurers and even went so far as to identify the week each year that the audit would be held (taking into account vacation season, annual sales contests, annual financial reporting, and so on).

Prior to making the team-audit proposal, we spoke to reinsurers that had participated in a team audit to determine how successful such an approach would be. The feedback we received was favorable. The one cautionary note was that the team must determine in advance the focus of the audit. In our meeting, the reinsurers agreed to the team approach. It was further agreed that the team, prior to the audit, would provide the other pool

members with details of the scope of their audit and these members could have any specific concerns added to the audit. Within 60 days of the audit's completion, it was agreed that the audit team would provide our company with its findings so that a management response, if needed, could be prepared and incorporated. The final document would be distributed to us as well as all pool members within 90 days of the audit.

It was agreed that the details of the standard "inspection of records" article in our treaties would not be modified; thus reinsurers would still have the right to inspect off-cycle if a situation arose that required immediate attention. Given the annual nature of team audits, it is unlikely that an off-cycle audit would be necessary.

Last, we recognize that these team audits will not cover all our reinsurance arrangements. We suggested that an auditing reinsurer with whom we have other treaties may wish to stay on and audit its other business. We also have some reinsurers that are not members of our pools and we recognize we will have to deal separately with them. But we do believe that the majority of the focus will be on the pools, and by addressing the pools we have covered our most likely audits.

Claims

Our administration of reinsured claims has involved advance notification to the reinsurer(s), possible consultation on specific claims (depending upon the treaty terms), request for payment accompanied by copies of the death certificate, and proof of payment. We realized that we could not continue to perform these functions with existing staff if in the future a large percentage of claims potentially had some reinsurance and we had to deal with each reinsurer. Further, while a significant portion of a

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pool claim may be reinsured, a reinsurer's share could be small, thus making it inefficient for a reinsurer's staff to spend much time processing a claim at their end. For example, if a reinsurer's share of a claim is 10% and the claim is for \$50,000, the share is only \$5,000.

As a result of our meeting, we were able to streamline our procedures for notification, consultation, and payment. This streamlining included factors such as size of claim, contestable versus incontestable, the role of consultation, claims in litigation, and information provided with request for payment. Because the administrative audit each year will include claims review, this will serve as a control to ensure that these streamlined procedures are working properly.

Underwriting

Conditions for acceptance of automatic reinsurance are set out in treaties. These conditions may require adherence to specific underwriting requirements or refer to the normal underwriting rules of the ceding company. These rules may be reviewed by reinsurers as part of the quote process. As a result, the ceding company may not be able to change or deviate from what has been

agreed to without the agreement of its reinsurers.

For our company this had never been a major concern because so much of its business was within its retention limit and not subject to reinsurance. But first-dollar reinsurance is another story. For example, how would first-dollar affect our ability to deviate from our underwriting guidelines, make exceptions in competitive situations, allow less than full underwriting for special marketing programs, and so on? Many of these were issues that could not be put into proposals prior to the meeting, therefore it was important to have underwriter representatives of our pool members at the meeting. As a result of our discussion, we reached agreement on the degree of flexibility our underwriters would have in various situations and established rules for situations requiring reinsurer agreement using a rotating-lead-reinsurer approach.

Similar to the approach used in the claims situation, it was believed that the annual team underwriting audit would serve as a control and check on our underwriting and the flexibility agreed to.

Meeting Summary and Future Plans

After the meeting we prepared a summary of the agreements, which was

signed and sent to the participants for their signatures. This summary served to document the understandings and the signatures confirmed the accuracy.

A future meeting is planned to touch base with our reinsurers, to review agreements reached at this meeting, to determine how successful they are and whether modifications are in order, as well as to discuss any new issues that have arisen. This meeting will be scheduled when we have had both an underwriting and administration audit.

A Final Thought

Reinsurance has been called a partnership, and this is especially exemplified in first-dollar reinsurance where every policy sold and every decision made has reinsurance implications. The goal of ceding companies should be to address workflow and communication issues and ensure the success of the relationship.

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Reinsurance Section Survey Results

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- Correlated with this, more than half of the responding nonmembers said that they chose not to be members of the Section because reinsurance issues are not relevant to their roles. Another quarter said that they delegated reinsurance issues to someone else.
- Only 13% of responding members had participated at a SOA meeting as a speaker, moderator, or workshop leader for a session sponsored by the Reinsurance Section.
- Both members and nonmembers gave strong support to the traditional panel and workshop meeting formats; however, both groups also indicated a strong interest in longer, in-depth teaching sessions.
- While more than 85% of responding members said that the Section was meeting their expectations, 15% said it was not. The primary areas of concern are that the Section focuses too much on life reinsurance and too much on reinsurance from the assuming company perspective.
- There was also broad support among both members and nonmembers for expanding the use of surveys to gather and disseminate data on reinsurance practices. The most interest was indicated in the areas of pricing assumptions/approaches and treaty provisions/interpretation.
- Finally, 33 individuals, including three nonmembers, took advantage of the survey to express their interest in volunteering to work with the Section in a variety of capacities from speaker to author to candidate for the Section Council.

The Reinsurance Section Council would like to express its sincere appreciation to all those who took the time to participate in this survey, with special thanks to those who indicated an interest in volunteering. The results of the survey are already being used to help shape Council decisions and doubtless will continue to prove valuable for the foreseeable future.

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