



SOCIETY OF ACTUARIES

Article from:

Reinsurance News

January 2011 – Issue 69

Jumbo Limits: Compensating For Terrible Administration

This article is solely the opinion of its author. It does not express the official policy of the Society of Actuaries; nor does it necessarily reflect the opinions of the Society's individual officers, members or staff.

By Ross A. Morton



With 40 years of insurance industry experience, Ross Morton has evolved into a recognized mentor, advisor and reassurer. From 1994 to 2009 Ross has been used on various assignments around the world by RGA, and recently joined the Advisory Board for Logiq3. Ross can be found online at www.rossmorton.com

A long time ago, likely before most of this article's readers were born, and for those that were they were still thinking mathematics was a lucrative career choice, reinsurance played a trivial role in the life insurance industry. In Canada 0.04 percent (rounded up, of course) of all life risk was reinsured in 1969. There was a slightly higher percentage in the United States, but my notes and memory failed to enlighten me as I wrote this article. Believe it or not, for you youngsters reinsurance was a follower and minor player in the realm of life insurance risk taking. The icons of the era were insurance company leaders not reinsurance personnel. Reinsurance personnel deferred to the wise counsel of insurance leaders who were at the leading edge of pricing and risk selection. Content to beg or cajole a mere pittance of the premium pot the reinsurers fought each other for the privilege of table scraps.

Administration of risk was lax and tardy but with most cedants keeping their full retention and reluctant to write policies larger than their retention, the penalty for such lackadaisical administration was trivial and easily manageable by both insurer and reinsurer. It helped that the largest of reinsurers was such that they routinely forgave blunders in insurance company administration as a sign of friendship and hoped for rewards of even more poorly administered business. The smaller companies, fearing the wrath of their reinsurers where their role was integral to their success, tended to administer risk expediently and pay promptly. The fear of not having notified the reinsurer of a big risk (i.e., more than twice their own retention) before the early and unfortunate claim arrived was paramount to their psyche. When a treaty, as casual as it was written in the "good old days," called for notification and payment within 30, 60 or ("Do you really need this long?") 90 days, the practice was to do as the treaty was written (sort of like the Ten Commandments).

Tardiness was so rare that I once had an accountant who would call companies five days past the premium and administration due date and inquire as to where the

money was and the administrative paper work for both new and renewal business. It was an extremely rare company that Lou had to call more than once in a year! Reinsurance was indeed trivial in the scheme of things within an insurer and often the staffs so employed were both part-time reinsurance administrators and, in some instances, far from the sharpest pencils in the company. Both insurer and reinsurer took the notification, administration and premium due dates seriously, but again that was before easy credit that is so fashionable amongst the young (or was until the meltdown of late).

As smaller insurers grew into large producers of risk through the advent of "brokers," and as large companies became addicted to low reinsurance pricing, the amount of reinsurance ceded escalated probably 2,000 fold in Canada and 1,450 fold in the United States by the end of the century. There remained a serious lack of attention being spent on reinsurance administration by either insurer or reinsurer. The insurer was faced with a myriad of complex issues from government reporting standards and how to manipulate numbers to the bottleneck that was the new business area. Reinsurance administration was rarely one of the top five priorities and had little chance of being considered as important to overall success within an insurer's executive's mind. The reinsurer was faced with the need for ever and often insatiable thirst for new business (risk yes, premiums maybe) and was woefully neglect on enforcing administrative time lines with customers and potential customers. Reinsurers were by their collective mindsets a group encouraging indirectly poor administration—if one does not ask for payment or "supportive paper work," after a while one does not get it.

In my personal opinion, based on recollection and too-often frustration, the world of reinsurance administration deteriorated yearly from 1970 onwards and it took sheer catastrophe before a cacophony of voices raised up in horror at the absolutely poor risk management in both the cedant and the reinsurer. Everyone expected the proverbial s___ to hit the fan, but everyone crossed their fingers and leaned on their optimism that carried

“IN AN AGE WHERE EVERYTHING SEEMS TO HAVE HAPPENED YESTERDAY, WAITING THREE YEARS FOR RISK INFORMATION AND PREMIUMS SEEMS LIKE A HALLUCINOGENIC DREAM. ALTHOUGH WE ASK, ‘HOW COULD IT BE TRUE,’ WE KNOW IT WAS TRUE.”

over from their much praised pricing success. When the eventual eruption of issues came, there was more of the bad stuff below the surface that caused great embarrassment. The lucky ones were those new to reinsurance as they could point the finger at a generation that “blew it.”

Whether one says it was the large claims that showed one’s risk was greater than known as multiple policies from various cedants were in force but not “administered yet,” or lapsed policies that were lazily reinstated, or underwriters who disregarded the follow-up necessary to make sure policies that were “intended” (I hate that word) to be lapsed were indeed lapsed, or it was true that only one of the five policies applied for in five different companies was to be accepted, and the list goes on, it does not matter as in reality it was the perfect storm (an overused phrase) of eruptions within the casual risk management that was practiced throughout the insurer-reinsurer realm. There are legends and urban legends of up to three years between a risk being assumed and contract issued by an insurer and the reinsurer knowing it was on risk. In an age where everything seems to have happened yesterday, waiting three years for risk information and premiums seems like a hallucinogenic dream. Although we ask, “how could it be true,” we know it was true.

Solutions were many and they ranged from better administration systems to real risk management practices. But one of the quickest solutions was to try to insulate oneself if you were a reinsurer from the administrative bottlenecks and poor risk management in the insurer who was always tardy in appreciating the importance of reinsurance administration even when 75 percent of the risk was passed off to one or more reinsurers! The hallowed jumbo limit was a quick and clean protective barrier to poor administration in the cedants.

Our industry defines the jumbo limit as, “A limit placed on the amount of coverage that may be in force and applied for on an individual life for automatic reinsurance purposes. If such insurance exceeds the limit, the risk must be submitted for facultative review.” (Taken from the Glossary of Reinsurance Terms compiled by the American Council of Life Insurers Reinsurance Committee).



CONTINUED ON PAGE 16



If an insurer wrote the jumbo treaty clause with feeling, it would probably read as follows: An overly restrictive limitation on the ceding company's previously agreed-to authority to cede specific cases on an automatic basis because the reinsurer does not trust the cedant or the insurers in general to administer reinsurance in a timely and detailed way. If the amount of insurance currently being applied for with the ceding company, which may be well within the cedant's binding authority, and all other companies, together with the amount of insurance in force with all companies, which is rarely accurate or even known, exceeds the jumbo limit specified in the automatic treaty, the case may not be ceded automatically. Generally, as my reinsurer you insist that whether explicitly stated in the treaty or not, amounts of in force insurance to be replaced are included in the jumbo limit determination.

If a reinsurer wrote the jumbo treaty clause with feeling, it would probably read as follows: A much needed limitation on the ceding company's authority to cede specific cases on an automatic basis because we can neither trust the cedant to pass on material risk information in a timely fashion or perform proper due diligence on the ultimate amount of insurance to be in force at any point in time. If the amount of insurance currently being applied for with the ceding company, which may be some very large sum that clouds the judgement of the cedant's underwriters and marketers, and all other companies, together with the amount of insurance in force regardless of "intentions" which are often fleet-

ing, with all companies, exceeds the jumbo limit specified in the automatic treaty, the case must be ceded facultatively where our underwriters can properly underwrite the risk both financially and medically ensuring proper diligence is applied. Generally, whether explicitly stated in the treaty or not, and we know from experience blunders are made often, amounts of in-force insurance to be replaced are included in the jumbo limit determination specifically because you insurers can never guarantee the replacement and are loath to follow up after issue.

Reinsurers give two reasons for forcing jumbo limits on the industry: first they recognize that their own finite automatic capacity on a particular life may already be totally absorbed by other clients on a life with a lot of in-force insurance; second, they have learned from experience that the fine art of large case underwriting is best left to those underwriters employed by reinsurers since they know best (just like in the sitcom *Father Knows Best*). Having self-professed prowess in the large case market, reinsurers want to control the underwriting evaluation of these cases. In several publications it is boldly stated, or subtly implied, that the ceding company's underwriters overlook jumbo limits enough to scare the bejesus out of true risk managers.

A rather large eastern-U.S. life insurer has the following table published online to encourage business:

Automatic Binding—Best Class through Table 4

Issue Ages	Automatic Binding Limits	Jumbo Limits
0-65	\$50,000,000	\$60,000,000
66-75	\$40,000,000	\$48,000,000
76-85	\$15,625,000	\$18,750,000

It is great to see that a reinsurer (or reinsurers) trusts this rather large company with above average industry reputation for risk selection to the level of \$50 million per life. The reinsurer(s) then takes it all away, and say your underwriting falls apart if there is already a policy in force for \$20 million issued say 10 years ago. The reinsurer steps in and has its finest underwriters of a certain vintage start all over again and makes their own decision as to the financial and medical well being of the proposed insured. The reality is that in most cases

the jumbo limit is there to compensate for poor administration and risk management.

If our industry had great, sorry make that average administration, the need for a jumbo limit of such a low amount as \$50, \$60 or \$70 million would not be needed. If, at the time of application, all automatic reinsurers were given notice of the potential risk and had a window of say 48 hours to respond with retention conflicts, why would we need such low jumbo limits? If we had better risk management and work flow software we could almost eliminate the jumbo from a consequential level. Yes, there may be instances because of “not takers” and such that a reinsurer is left with no risk, but even that could be eliminated if we trained underwriters to both underwrite better and manage risk better.

Sloppy and much tolerated error-prone risk administration got our industry into this mess. Improved administration and risk management will truly get us out of the mess. Jumbo limits at the current levels are merely a Band-Aid on a gaping wound of a haemophiliac-like industry that lags in administrative excellence. ■



LIFE & ANNUITY
2011 SYMPOSIUM
 SEEK KNOWLEDGE. GAIN SOLUTIONS.

SHERATON NEW ORLEANS
 NEW ORLEANS, LA
 MAY 16-17, 2011

The SOA Life Spring Meeting and Product Development Symposium are now one ... the 2011 Life & Annuity Symposium.

Don't miss this opportunity to expand your life and product development expertise—hear from industry leaders, get insight on hot topics and learn what you need to know to grow your career and company.

Here's what attendees of the 2010 premier Life & Annuity Symposium had to say:

- "A lot of opportunity was packed into a two-day meeting."
- "I really liked the mini-seminar about product development that was embedded in the overall symposium."
- "Informative and useful."

Sign up today at www.SOA.org/LAS

