



SOCIETY OF ACTUARIES

Article from:

Reinsurance News

February 2008 – Issue 62

BUSINESS DECISIONS—REINSURER VERSUS DIRECT COMPANY PERSPECTIVES

by Gordon Gibbins



In May of 2006 the Life Insurance Mortality and Underwriting Survey Committee of the SOA surveyed both reinsurers and direct companies about their practices with respect to making business decisions in the underwriting process. The results of the separate surveys were published by the SOA (Reinsurer survey-January 07 and Direct Company survey-March 07) and are available on the SOA Web site. Further a presentation on some aspects of the results was done as part of session 61 at the 2007 annual SOA meeting. For the most part this presentation analyzed the results differently than how they were presented in the published reports, using practical examples of business decisions to provide focus for the presentation.

The purpose of this article is to highlight the comparison of the results of the two surveys as outlined in detail in Appendix 2 of the Direct Company Survey. Familiarity with the surveys and their definitions is assumed. Please refer to the SOA Web site if you are not familiar with these reports before proceeding.

The major difference between Definition 1 and Definition 2 is that Definition 2 provides for some underwriting judgment.

The main points of interest are listed below:

Definition

Direct writer respondents were more likely to choose the more restrictive definition (Definition 1) than reinsurers (59 percent versus 43 percent for preferred risk underwriting and 33 percent versus 0 percent for substandard classification). The comparison may be even more pronounced for preferred risk classification as 33 percent of the direct writers do not use “stretch” criteria and hence some may have chosen Definition 2 but are underwriting similarly to direct companies with “stretch” criteria who chose Definition 1.

Business Decisions on Preferred

Fifty-nine percent of direct companies indicated that they allow business decisions on preferred whereas only 45 percent of reinsurers allow it (See the reports for additional detail).

Business Decisions on Standard/Substandard

Sixty-three percent of direct companies allow business decision on standard/substandard classification whereas 73 percent of reinsurers do.

Tracking Business Decisions

For direct companies that allow business decisions, 36 percent track on preferred classification and 25 percent on substandard classification. However 50 percent of reinsurers said they require periodic documentation from clients.

Prevalence of Business Decisions

When asked what their percentage of cases involved business decisions, over 50 percent of direct writers reported less than 1 percent, 83 percent less than 3 percent and none reported more than 5 percent. The reinsurers’ perspective (based on recent audits) was somewhat different with 45 percent indicating less than 3 percent and 91 percent less than 5 percent.

Handling of Business Decisions in Treaties

Fifty-seven percent of reinsurers indicated they insist on the treatment of business decisions be documented in their treaties. However, only 16 percent of direct writers indicated it was included with another 23 percent saying they were in negotiation with their reinsurers.

Reinsurer Adverse Actions from Business Decisions
Thirty percent of direct writers reported adverse actions on business decision cases by reinsurers which seems high compared to the incidence inferred from the Reinsurer survey.

The most common adverse action stated by direct companies was “to give a warning that a future claim may not be paid” whereas that stated by reinsurers was “decline to pay a claim or reduce the amount paid.” This reason was only third most common (29 percent) in the direct survey.

Automatic Binding of Business Decisions

One-third of reinsurers indicated they allow direct companies to bind them automatically on business decision cases whereas two-thirds require the ceding company to pay the real rate or discuss the case in advance. For direct companies, only 24 percent indicated they usually pay the true rate. In addition, nearly 33 percent indicated they always discuss the case in advance, but 11 percent indicated they never

discuss the case in advance. Further, of the direct respondents that did not consult with the reinsurer, 44 percent indicated they usually cede automatically to the pool without paying the true assessed rate.

Note: Given so few (four of 12) reinsurers allow themselves to be bound automatically on business decision cases, but a greater percentage (11 of 45) of direct companies indicated they usually cede automatically to their pools without discussing the case beforehand or paying the true assessed rate, one has to wonder if there is not a disconnect in the understanding of the parties.

In reviewing all of the above analysis, one must of course remember that the information only represents the answers of a limited number of ceding companies and most reinsurers in May of 2006. The answers today could be different. Nevertheless, both sides to a reinsurance treaty should clearly understand the other’s perspective. ✱



Gordon Gibbins, FSA, FCIA is Senior Vice President, Development with Optimum Re, located in Milford, Ontario. He can be reached at gord.gibbins@optimumre.com.