RECORD OF SOCIETY OF ACTUARIES
1984 VOL. 10 NO. 1

THE PROBLEMS WITH BULK REINSURANCE

Moderator: DONALD C. KIEFER. Panelists: CHARLES R. BRITTON, EDWARD B. MARTIN, WILLIAM E. SIMMS, DOUGLAS A. SZPER. Recorder: IRA SLOTNICK*

- Certification of information on reports by an actuary.
- Reinsurance audits of bulk accounts.
- Format of information on bulk reports.
- Software for handling reinsurance of universal life.
- Special problems of ceding facultative reinsurance under bulk agreements.

MR. DONALD C. KIEFER: The Committee on Reinsurance Administration of the Reinsurance Section of the Society of Actuaries has scheduled this session to be held in both the Atlanta and Salt Lake City twin meetings. The objective of the session is to identify the various problems occurring in the industry with respect to this relatively new but very popular method of reinsurance administration. Following identification of those problems the committee can then begin to address and resolve some of the issues.

My name is Don Kiefer and I am Senior Manager and Associate Actuary of the Individual Operations area of the Life Reinsurance Division of the CNA Insurance Companies. In that capacity I am responsible for the reinsurance administration of accounts which report to us on a bulk basis. This afternoon we are fortunate to have panelists who are particularly well qualified to address the issues. The first two panelists represent the viewpoint of the ceding company and the final two represent the viewpoint of the reinsurer.

Our first speaker will be Charles Britton, Second Vice President for the North American Company for Life and Health Insurance in Chicago. Although currently responsible for product development and pricing, earlier Charlie designed and implemented the system North American continues to use to supply information to its bulk reinsurers. Prior to joining North American, Charlie was responsible for financial reporting and administration of bulk accounts for a large reinsurer.

*MR. SIMMS, not a member of the Society, is Vice President, Reinsurance Administration for Transamerica Occidental Life Insurance Company, Los Angeles, California.

Our second speaker will be Doug Szper, Financial Actuary for the Capitol Bankers Life Insurance Company in Milwaukee. In that capacity one of Doug's major responsibilities is the accuracy of information Capitol Bankers supplies to its reinsurers on a bulk basis. During development of Capitol Bankers' bulk system, Doug was in charge of their data processing department.

Our third speaker this afternoon will be William Simms, Vice President in charge of Reinsurance for Transamerica Occidental Life Insurance Company in Los Angeles. Bill is responsible for assisting clients in the development of administrative procedures and reports to provide Occidental with the necessary and complete information it needs to satisfy its requirements.

Our final speaker this afternoon will be Ed Martin, Second Vice President and Director of the Reinsurance Service Department for Lincoln National Life Insurance Company in Fort Wayne. Although Ed's reponsibilities are primarily in pricing, he spends a significant amount of his effort working closely with clients and Lincoln's Home Office Administrative Staff to create a smooth flow of adequate information from the client to Lincoln National.

Each of our panelists will make a fifteen minute presentation and accept questions for roughly ten minutes thereafter. Following all four presentations we will have some time remaining for questions and comments prior to the end of the session.

Once again, the topic of discussion is The Problems with Bulk Reinsurance. The theory of bulk is sound--a more efficient, and more effective administrative system than that offered by the redundant nature of individual cession administration. These efficiencies theoretically result in cost savings for both companies which will vary depending on the type of bulk reinsurance used. That is, the cost savings will vary depending on whether the bulk reinsurance is of the blind variety whereby the insured is not identified, as in bulk ADB insurance, or bulk reinsurance of the bordereau variety, whereby individual identification is made en masse via computer listing or tape transmission periodically to the reinsurer. Such cost savings can translate into increased margins available for the reinsurer or for the ceding company by a reduction in the price paid for the reinsurance. But the concept is not without practical problems that can be very significant for both the ceding company and for the reinsurer. They are these problems that our panelists have been asked to address this afternoon. Our panelists will address items that appear in the outline and may also draw upon items of their own experience that do not appear in the outline.

At this point I would like to turn the program over to our initial speaker, Charlie Britton from the North American Company for Life and Health Insurance.

MR. CHARLES R. BRITTON: I would like to start with a clarification. By bulk reinsurance I will be referring primarily to individual handling and reporting of reinsured cases by the ceding company. I am not addressing the true bulk or block reinsurance that is typically seen with bulk ADB, surplus relief or other special quota share type arrangements. Perhaps a more appropriate term would be self-administered reinsurance which I have tried to use in preparing these remarks. Others use the term "bordereau" for this type business. First, I will discuss the considerations which a ceding company should review in evaluating whether or not to switch to self-administration and then I will speak about some specific potential problems which can arise in both the automatic and facultative reinsurance on a self-administered basis. I wish to stress the phrase "potential problems." None of the problems that I will be outlining exist in all or perhaps even a majority of existing reinsurance arrangements, and none of those that do exist cannot be overcome by cooperation between ceding company and reinsurer.

Also, at times during my discussion, I will be referring to a survey which we conducted recently of twelve major reinsurers concerning their experience and practices in the area of self-administered reinsurance. All the twelve companies that I contacted responded. They represent a total of about five thousand bulk reinsurance treaties in force as of year-end 1983. That accounts for fifty-seven billion dollars of new business and about ninety-four billion dollars of inforce face amount. This was about fifty-nine percent of the new business by face amount, and forty-nine percent of the inforce for all of those reinsurers combined. While I do not have figures on the total reinsurance inforce in all companies, I am sure that the companies we surveyed represent a large portion of the reinsurance business transacted in the United States and Canada between unaffiliated companies.

Considerations in Choosing Self-Administration

While a ceding company may realize a number of secondary benefits from self-administration, such as enhanced control over the flow of information, the primary reason for choosing this form of reinsurance is to reduce costs. Cost reductions can arise in two areas. First, and most obvious, is an increase in the reinsurance allowances reflecting cost savings that the reinsurer expects to realize, and second, a savings in the ceding company's administration expenses. It is not always clear, however, that real savings can be realized from the two sources. I recommend that any company considering self-administration should attempt to quantify the cost and the benefits related to both of these items before making the decision to switch to self-administered reinsurance.

The benefit of the additional reinsurance allowances can be quantified if the company asks the reinsurers to quote "both ways", that is, with and without self-administration. Then a projection of new business expected applied to the difference in the quotes yields the expected savings. Quantifying the costs and benefits associated with the administrative functions is not as simple. A number of decisions have to be made, such as which department will handle the administration, what type of system support will be provided, etc.

Since administration of ceded reinsurance is specialized, it may have to be handled by a separate, fairly highly compensated department. At my company, for example, the self-administered reinsurance is handled by clerks at the high end of the clerical pay scales and under the supervision of an actuary. When the cost of that type of administration is added to start-up costs for the computer support, it is not at all clear that a cost reduction results. When this is the case, the aforementioned expected benefits from the additional allowances granted by reinsurers become more crucial in the analysis.

One item that can easily be overlooked in this analysis is the cost of valuation. If the reinsurance ceded must be revalued for GAAP purposes, then some type of system for doing this valuation must be established by the ceding company anyway, regardless of the reinsurance administration method selected. In this case the additional cost of expanding from a self-valuation system to a full self-administration system may be minimal. So the true cost reduction associated with self-administration may be greater than it might otherwise seem if the question of valuation is ignored. In any event, since the start-up costs for setting up a self-administration system will be relatively fixed, it is clear that switching to self-administered reinsurance is cost effective for the ceding company only if the expected volume is large. In fact, while bulk treaties accounted for about half the reinsurance volume in the survey we took, they accounted for only about ten percent of the number of treaties in force. That means the average volume per self-administered treaty is about nine times the average volume for traditionally administered treaties.

Potential Problems with Automatic Self-Administered Reinsurance

Various problems can arise with self-administered reinsurance because the objectives of the ceding company and the objectives of the reinsurer, while often coinciding, are not entirely identical. The ceding company objectives include: (1) making sure that sufficient information about each reinsured life is sent to the reinsurer so that the coverage is clearly effected; (2) making sure that appropriate reserve credits are obtained; (3) keeping the workflow at a manageable level; and (4) within these constraints, keeping administrative costs to a minimum. Clearly then, it is in the ceding company's financial interest to provide the reinsurer with only the information upon which the reinsurer insists and according to its (the ceding company's) timetable. The reinsurer objectives would include: (1) making sure that it receives premiums for all the cases that are ceded; (2) receiving notifications and premiums on a timely basis; (3) maintaining a good relationship with client companies; and (4) within those prior constraints, minimizing its own administrative cost.

Clearly it is in the reinsurer's interest to receive complete, prompt and accurate reporting of data in the standardized format. Because of these potentially conflicting objectives the ceding companies and the reinsurers face a number of challenges, which I would like to discuss specifically.

First, there is the need to make sure that omissions are kept to a minimum. If the reinsurance processing at the ceding company is not fully integrated with the mainframe underwriting and issue system, there is great potential for omission.

At my company, for example, we unfortunately have to rely on a stand-alone system for reinsurance processing, which involves a manual interface with our issue system. To minimize omissions, we have had to resort to extensive manual checking procedures. This is very time-consuming and expensive but preferable to the alternative course which would be to rely on the errors and omissions clauses in our treaty at claim time.

Second, there is the potential for discrepancy in the records of the two companies due to timing differences. Often these differences may be acceptable to the independent auditor, but they can pose a problem on a state examination. From the ceding company's perspective, this discrepancy is actually easier to reconcile with self-administered reinsurance than with traditional reinsurance, because it does not depend on the reinsurers' processing turnaround. I suspect, however, that the timing differences on self-administered reinsurance are somewhat of a problem for the reinsurers. In the survey we took, nearly all of the reinsurers indicated that they attempt to accrue for items that are outstanding or late and a number indicated that the lateness of reporting by some ceding companies was a real problem for them at statement time.

A third potential problem would be the format and the content of the report sent by the ceding company. All of the reinsurers that we surveyed said that they have a suggested format and/or content that they ask their clients to provide. But they are successful in obtaining the data that they want only fifty to seventy-five percent of the time on the average.

Half the companies in the survey indicated that the lack of common format is a major problem. In my experience, I found that the requirements of the various reinsurers vary considerably. For this reason the ceding company needs to have a system flexible enough to accommodate the reasonable requests of its various reinsurers.

When I worked in financial reporting for a reinsurer, my most difficult task was to revalue the bulk assumed business for GAAP purposes. Apparently, this is also a problem for most of the reinsurers which do report on a GAAP basis. Many of the companies in the survey do not even attempt to perform such revaluations, but simply use a statutory reserve, with perhaps calculation of deferred acquisition cost on some type of a worksheet basis.

A fourth area to be addressed by the ceding company is its own audit concerns. If, as in the case of my company, the reinsurance processing is handled outside the main processing areas on a stand-alone system which is not under the control of the data processing department, there is potential for criticism by either internal or external auditors. Ceding companies involved in self-administered reinsurance must give some thought to their own internal controls.

A final item I will cover in this area is the unfortunate fact that some ceding companies do less than an adequate job in handling self-administered reinsurance. In my company, the actuaries involved with reinsurance have expended considerable effort in educating our new business, underwriting, and policyowner service people about the effects of their respective areas and the transactions that they do, on our reinsurance. However, we still uncover errors and omissions on a daily basis. Reinsurance is simply not one of their priorities.

Since the reinsurers should have much greater expertise in reinsurance administration than the ceding companies, it is somewhat surprising that few of the reinsurers surveyed conduct periodic audits on the premises of the ceding companies. Several indicated that they have plans to begin doing so in the near future. I note from experience working for both a reinsurer and a ceding company that such audits can uncover significant problems. I think the reinsurers need to overcome their fears that audits conducted in a responsible manner will somehow damage the business relationships they have with their clients. It is in the interest of both parties to conduct periodic audits.

Potential Problems with Facultative Treaties

This is more of a problem for the reinsurers than it is for the ceding companies. When a reinsurer makes a quote on a facultative case, it reserves its facilities on that life until the case is placed. Typically, if the reinsurer does not receive a formal cession within a few months, it follows up with an inquiry to the ceding company to find out if the case was placed. With a self-administered treaty the formal cession is replaced with an entry on a computer listing. The reinsurer must review the bulk listings, search for facultative cases, and match them to their own underwriting records. This can be a time-consuming task and, I might add, if they cannot find the case on their computer listing and send out an inquiry to the ceding company, the ceding company may not know what to do with it if it goes to the wrong department. For the ceding company, the underwriting and administrative areas need to be coordinated, especially if it is the underwriting department which initiates the cession on facultative cases.

Another problem that can arise for the reinsurer with bulk facultative reinsurance, is possible over-retention. If large amounts are being ceded on a bulk basis, the reinsurer needs to keep track of the individual insureds in order to determine those cases which need to be retroceded. This tends to defeat the purpose of bulk, when one of the major purposes of bulk reinsurance is savings in expenses on the part of both sides. All the reinsurers in our survey indicated that they do keep track of individual insureds for retrocession purposes. About half the companies indicated that tracking placement of facultative cases is a major problem for them.

There are a number of things that could be done to manage this problem of handling retrocessions. My company, for example, cedes each case to a pool of reinsurers with each reinsurer taking a fixed percentage of every case. In this way we are able to negotiate a fairly high binding limit and the reinsurers can accept multi-million dollar cases without having to retrocede anything. Of course this type of arrangement involves some extra administrative complications especially in the treaty area. But, we have found that the reinsurers prefer this type of agreement to a traditional alphabetic split for a couple of reasons. First, their risk is spread over more lives and second, their retrocession costs are minimized.

An additional procedure is to prepare formal cessions for all cases exceeding the reinsurer's combined retention. In other words, very large cases would be excluded from the bulk administration. This probably means a little extra trouble for the ceding company, but a big reduction in confusion for both sides.

Finally, I am told that a company which is concerned that a case in excess of its retention might slip through, can purchase a special non-proportional type of reinsurance to cover inadvertent over-retentions.

MR. BRIAN R. LAU: One thing that we have been considering is using an increased retention with a stop-loss. Do any of you have any comments about that?

MR. BRITTON: Clearly it would save some of your administration expenses. Although if you are doing it on a self-administered basis, there are certain fixed costs associated with setting up such a system. It might be that you can get enough extra allowances from the reinsurers on the bulk administration relative to traditional administration so that you can cover those fixed expenses easily.

MR. WILLIAM K. TYLER: A couple of clients have talked to us about stop-loss programs where they could increase their retention and reduce the number of cases they are ceding. In many cases, the expression of interest did not continue further because it is still pretty much the case that a stop-loss program tends to be viewed as a short term program, and that is often not enough assurance to the ceding company that they are going to have effective reinsurance for a long term.

MR. MICHAEL P. HEALY: I know that the Reinsurance Section is talking about standardized reinsurance treaties. I would like to encourage standardized bordereau reporting. We have the same problem to which Mr. Britton alluded concerning bordereau treaties with several reinsuring companies where they are requesting different formats. It would be reasonable to have a standardized format.

MR. KIEFER: That is one of the ultimate goals of the Committee on Reinsurance Administration of the Reinsurance Section.

MR. JAMES W. PILGRIM: In my experience we have asked the ceding companies what they produce as a matter of course for their own records for new business. We then try to utilize that kind of information. Companies will send us diskettes with their new business that qualifies for reinsurance, so there is no paper that gets passed at all. Our only problem is the format of the data on the diskette so that we can make sure it can be handled. My experience is that we have always tried to tailor reports to the ceding company as opposed to the ceding company being forced to tailor it to five or six different reinsurers.

MR. BRITTON: It seems to me that the ceding company should keep the retention amount in their individual records, because the amount ceded cannot be based on the direct face amount and general company retention alone. This is due to the fact that the underwriter might have decided to keep less than the full retention, or, there may have been a prior issue on the life and therefore the entire case might be ceded.

MR. PILGRIM: That is the way we do it in our operations. I have observed that the only time the total coverage on a single life is pulled together is in the underwriting process when each company searches its index. That is the time when all of the records are brought together and at which point one is able to elicit the information necessary for reinsurance.

MR. KIEFER: Charlie, you spoke about considerations in developing a bulk reinsurance system. With the great advent of interest-sensitive type products, are there any additional considerations for bulk reinsurance on those types of products?

MR. BRITTON: For universal life, ideally one would want to have the reinsurance administration system tied into the main processing system. If not, there is almost no way to keep track of monthly changes and amounts at risk. Since we do not have our system tied together, we managed to get the reinsurers to agree to some approximation methods. Basically, we keep the net amount at risk at the beginning of the year in force for the entire policy year, which means we are always a bit over-retained or under-retained but not by a significant amount.

Another question, not specifically a bulk consideration, concerns ceding the decreasing net amount at risk, level face amount version of universal life. Who absorbs the decrease in the amount at risk? Does the reinsurer absorb the entire decrease or is it shared between the ceding company and the reinsurer?

MR. KIEFER: Very good point. You must, of course, maintain consistency among your reinsurers if you have it split on a quota share basis.

I want to get back to a point that you made about auditing by the reinsurance companies. Now that North American does a great amount of bulk reinsurance, have any of the reinsurance companies with which you have dealt visted your home office and audited your system? Have they looked at it carefully to make sure that it maintains integrity?

MR. BRITTON: We have not had any scheduled audits but we have had one or two unscheduled audits. In other words, at times when the reinsurers noticed some things appearing on their listings that were unusual, they came and audited. We were allowing many term-to-term conversions when we had reductions in premium rates and our administrative people were processing it as new business and collecting first year allowances all over again. Reinsurers happened to notice that they had certain policy numbers dropping off one listing and showing up on another. They came in and did an audit and found that we owed them a considerable sum of money. This is an example of the types of things that can be uncovered on an audit. It was just a matter of people at our company not really understanding the consequences of their actions, namely the issue, underwriting and the actuarial departments. The reinsurers, with their expertise, probably should be there on a regular basis reviewing what ceding companies are doing.

MR. KIEFER: I think you will find that more frequently will be the case in the coming years.

MR. DOUGLAS A. SZPER: At Capitol Bankers we currently have a wide variety of reinsurance treaties involving a range of administrative requirements, from individual cession business to bulk ADB. Specifically, I would like to discuss the problems and the opportunities that I see in shifting the responsibility for the reporting and tracking of the business from the reinsurer to the ceding company.

As Don mentioned, I was head of data processing when I started at Capitol Bankers about two years ago. One of my big challenges was to take the commitments that we had made via the reinsurance agreements, and try to translate that into the actual reporting that was needed to fulfill our obligations.

Some of the reasons for bulk reinsurance have been mentioned. One, expense reduction, I think is important. As Charlie said, it is not necessarily going to reduce the ceding company's expenses but in fact may increase the ceding company's expenses trying to fulfill a commitment to produce reports by tracking business through automated systems. However, there is, at least in this concept, the opportunity for the ceding company to manage its own expenses, try to control the expenses, and have the opportunity to produce savings through its own efforts while not being committed to whatever the reinsurers dictate as to expenses.

Another reason for bulk reinsurance is that the ceding company is the one that has the information on their computer system, and they therefore have the opportunity to control the integrity of the data, from the data entry process through the data processing functions that are involved. This can lead to more accurate and complete reporting. The ceding company has this data on computerized files and therefore can manipulate it to produce certain kinds of information such as experience studies or distributions of inforce business which might not be otherwise available to the reinsurers if they were taking individual cessions.

Another reason for bulk reinsurance is product needs. The elimination of fixed benefit and cash value schedules from current-assumption type products has lead to a need for the ceding company, which has the data on its own system, to produce the information on the amounts of risk and the premiums associated with those risk amounts for the treaty to be effective.

One of the problems that has been mentioned in prior sessions is that of certification reports by an actuary. There are two basic ways to produce a bulk report. One is to integrate it with your entire administration system. The other is to let the actuaries collect their own data on a micro or on their own separate system and manually make sure everything is in agreement.

There are advantages and disadvantages to each. When the actuary is called upon by the reinsurer to certify the reserves, if he has the information on the mainframe system and has access to his valuation data base, he should be able to produce the kind of valuation that the reinsurer needs simply by some minor modification to his current processes.

If, on the other hand, he is relying on a stand-alone system he might have to go out of his way to be able to do the valuation. Either way it seems that the actuary needs to get more involved in the entire data processing function in order to ensure the proper reporting of liabilities. The key problem in the valuation process is actually having the appropriate correct data on the record to be able to produce the split by reinsurer or by amount within a given policy. The existence of multiple reinsurers for a single policy does cause problems in that process. This is primarily related to the fact that additional data on the record is needed which might not be there in a traditional administration system. This is the area where we had to expend most of our efforts in developing bulk reinsurance reports. We have continually expanded them and redefined the data base that underlies our administration to enable us to produce the reports from that data base.

By being in control of the data processing function, I felt confident that when the system was working properly, the data was on the system, and the processes had been checked, I could certify to the accuracy of the reserves that were being reported.

Again, concerning the statutory certification for reserves, there is often a disclaimer that the actuary relied on the administrative department, data processing department or some other source for the creation of the listings on which the valuation is based. This might not be appropriate for the actuary certifying the bulk reserves especially if that actuary is controlling the data base for the reinsurance. The direct control of the data base does give the actuary a higher comfort level in the reserves that are being produced, so the disclaimer might not be necessary.

I believe that integration, by incorporating the data base of the reinsurance information into the overall data and moving the responsibility for the reporting and processing to the data processing department, is essential in order for a company to control its expenses, to ensure the total integration of corporate data bases and to develop or enhance existing management information reports.

On the subject of reinsurance audits, I would like to talk about the several different levels of audits that should be considered in any bulk reporting system. One's own internal audit department should be making sure that the procedures used, data defined and the processes being applied to that data, are appropriate. That should just be part of a normal company's internal audit process.

Audits by the certifying actuary may be necessary in order for that person to feel comfortable with the reserve amounts which are being certified. It is especially important at the inception of any new treaty or at the time a new set of procedures is introduced. This will avoid starting off in the wrong direction and ending up with bad information.

There may be other special problems that occur if the actuarial department is actually doing the processing of the information and producing the reports. This is a matter with which the auditors may have concern. Questions have been raised about the control of information by the actuarial department as opposed to a separate administrative area.

Audits by the ceding company's independent auditors are part of the overall audit process. Again the issue of a stand-alone system and its own separate data base may raise special questions that must be dealt with and may require additional audit resources during the normal audit process. This should be taken into account when one considers the possibility or the value of switching to a bulk reporting system.

Audits by the reinsurers are probably the most sensitive area. One must look at the commitment that is being made prior to the agreement. It is imperative that the reinsurer and the ceding company reach an understanding as to what is really expected of the ceding company in terms of the reports they are going to produce and in terms of the procedures that they expect to follow. It might be appropriate for the reinsurer to discuss with the ceding company's own independent auditor what comfort level they have with the company's ability to produce the kinds of results that are being planned for in any new treaty.

On an ongoing basis, both parties have a responsibility to plan carefully for various kinds of audits. If regular audits are scheduled, both as to administrative procedures and report data content, and these are carefully planned, the stigma of having the reinsurer investigate because of suspicions concerning the bulk operations, can be avoided.

We found that over time many problems have been uncovered by the reinsurers in reviewing the reports. They have enabled us to uncover procedural problems in our own company, not just with respect to the reinsurance treaty itself but in fact the whole process of putting new business in force.

I feel that ongoing, well planned, face-to-face review sessions, at least on an annual basis, are important to make sure that both parties understand their prior commitments and what is occurring in each company so that they can avoid potential problems.

It is also a key responsibility that both parties understand that they do not want to create any unnecessary expense in this process. There should not be any burdens imposed later that were not anticipated initially. This may make the decision to bulk administer incorrect because of the failure to be able to control expenses.

As far as the format of reports, we basically chose our own format, and as the reinsurers began to look at what they were receiving, they realized that there may have been a piece of data that was missing or additional information that would be useful to them. Basically, if the correct and necessary information is in the system, changing a report is technically the easiest thing to do from a data processing point of view. It is still more efficient to include all the information even if some reinsurers do not care to use some of it.

One of the problems with the constraints on fixing formats, enhancing them, or adding information is always that every project which is submitted to data processing must be prioritized and someone must make a decision as to whether and when it is to be done. That is one of the challenges that I face, because while we would like to be able to meet the reinsurers' needs and satisfy them as much as possible, we cannot commit infinite resources to the bulk reinsurance process.

There are special problems in facultative cessions which relate to the formats of the reports. We are using the same data base for our internal valuations as we are using to report the bulk reinsurance information. Every policy that is ceded to reinsurer A will appear on that listing. This was causing a problem because both facultative and automatic cessions were included on the same reports. We think we have solved that problem by simply putting in an indicator showing the type of reinsurance cession. Again, if the appropriate data is captured on the record as to the type of cession, then it is a relatively simple problem to either eliminate those policies that should not be reported, such as facultative cessions, or to simply re-sort the listing so that they all appear at the bottom of the listing.

The use of internally developed software to do one's administration is an advantage because any modifications that are requested along the way can be handled by the ceding company's personnel who are knowledgeable about the system.

One of the biggest problems that we have had has been data errors, either through data entry or procedures that were not well defined in our underwriting and issue department where policies appear on a report that do not belong there. In one case where we had an alphabetic split between two reinsurers, the policy issue people could not remember where the split was, whether it was A-J or A-K, so we had many policies that were ceded incorrectly and had to manually correct them.

Another problem is that there is a substantial investment involved in developing any system for bulk reinsurance. If shortly after one enters into a treaty the reinsurer decides that it does not want to continue on this basis, it can be very expensive and can cause a loss to the ceding company. It is the responsibility of both parties to any treaty to act with prudence and to maintain an open dialogue so that there is an understanding between the companies as to what potential problems exist in the agreement.

Our biggest problem at Capitol Bankers with bulk reinsurance is that we do not do enough of it. The process of defining what it was that was needed on the reports, and the company procedures that were required to insure the integrity of our data base, was very effective in pointing out other potential problems in areas other than the bulk reinsurance, either on individual cession business or administration in general. In going through that process we uncovered several problem areas that we were able to resolve. We had to define the specific functional requirements and transactions that were needed to process policies and put them in force. We had to completely define the data that we needed to capture so that these transactions could be done effectively. Finally, we had to define the reporting requirements for the report and the report formats. In doing that in a structured manner, we did uncover problems that we were able to resolve before they became too large. We also were able to move the responsibility for reinsurance cessions from the issue department to the administrative area so that the underwriters and people involved in policy issue were able to concentrate on their jobs and the administrators take care of the reinsurance.

The need to produce bulk reinsurance reports has put an added strain on our administrative areas, due primarily to the data processing requirements. Areas where there were not many transactions, such as policy changes or lapses, reinstatements and so forth have not been automated to the point where they appear automatically as a transaction on our reports. Recently we improved our processing so that lapses and terminations are now being tracked in a separate data base and can be reported. Reinstatements are still done manually. Basically we have to look at the volume of the information that needs to be produced and make a decision as to what point we need to automate that function.

On our individual cession business we have a lack of information which the bulk reporting process has enabled us to develop for our bulk business. One of our big challenges in the future is to build those same capabilities to produce information on the amounts ceded and the inforce by various reinsurers for all our business.

I believe there are opportunities in the future for bulk reinsurance. As we develop the technology for direct transfer of information either over phone lines, from one computer to another, or via magnetic tapes, it may enable both the reinsurer and the ceding company to have complete information on the business inforce at any given time which would eliminate the distinction between bulk reporting and individual cession business. That should be the ultimate goal of all our reinsurance ceding.

MR. KIEFER: Earlier you talked about valuation basis on the reinsurance block of your business. Do you have any comments about problems that might arise between reinsurers and ceding companies that do not use the same valuation basis?

MR. SZPER: Yes, we had to deal with that problem recently. One of the reinsurers asked us to report our business on a 80 CSO basis. Because we had a fairly well defined system which was integrated with our main valuation systems, we easily switched over and produced the valuation on the 80 CSO basis. We had a little trouble because we used 4-1/2% instead of 6% as they requested but that was fixed with another ten minutes worth of work. When it comes to GAAP valuations we have not attempted to do anything because most of our business is on an annual renewable term basis and we use statutory reserves.

MR. KIEFER: How significant might your problems be for blocks of business which you share among two different reinsurers with varying reinsurance terms, say, varying expense allowances, varying automatic binding authority or things of that sort?

MR. SZPER: We have had some problems in those areas because where there was a split, the split was not being handled properly and it was only through reviewing the reports manually that we were able to correct some of the problems. Another area would be where the allowances vary, and this could either be with two reinsurers or two treaties with one reinsurer. Examples are, facultative versus automatic, or the same policy being ceded in part to various reinsurers. The problems arise in two areas. One is in the data itself. Most systems that I have seen are not capable of handling information for multiple reinsurers on a single policy. We have had to develop the ability to create a hierarchy of data within a given policy, indicate our retention, and then each of the reinsurers' amounts. The second problem relates to a split on one policy when there is a change in the amount at risk. The question arises whether the increase or decrease occurs on a pro rata basis. If there is a primary or secondary relationship, it is first taken away from the secondary reinsurer and then the primary. These areas need to be identified early, before entering into this type of agreement to avoid inconsistent terms between the two reinsurers. Data can then be properly defined along with the transactions needed to keep it current.

MR. BRITTON: The situation of having different reinsurance expense allowances and binding limits presents a problem. We have attempted to use one set of reinsurance allowances on treaties that are split between a number of reinsurers, and also have common binding limits for each company. But even if all this is agreed to, it is not at all easy to get the various reinsurers to agree on treaty wording. The first time we tried to set up an arrangement of this sort we had three reinsurers and we said that we would write the treaty. It took over a year to get the three reinsurers to agree on common language for the treaties. Needless to say, the next time we negotiated such an arrangement with five companies, I asked them to send in their own standard treaties which we signed and sent back which made it a lot easier, but then there is the problem that we have five different treaties with different wording.

Another interesting difficulty that can arise when a number of reinsurers is involved is to get the administrative and underwriting people of the reinsurers to all agree on how the treaty is supposed to work. We negotiated some special underwriting in excess of our automatic binding. There is one layer where one company can bind the other companies in the pool up to another limit so that we do not have to send out multiple sets of facultative papers. We thought we had understood the terms of the treaty and that the actuaries of the other companies understood them. As we proceeded we found that the underwriters of the reinsurers did not understand what they were supposed to be doing, in that they were underwriting for other companies. If we sent them a case, they were not sure how much they were supposed to be underwriting and for what purpose. This caused considerable problems.

MR. HERMAN H. SCHMIT: I have a question for Doug with respect to audits. If you do business with six different reinsurers and each of those reinsurers prudently audits you at least once a year, you are faced with six audits. How would you feel about audits conducted jointly by more than one reinsurer or alternatively to have reinsurer A ask you for the audit report of the audit recently conducted by reinsurer B?

MR. SZPER: Generally, we are trying to keep our audit informal, more of a review of treaty terms, and a review of procedures to make sure we are on track, so that both the ceding company and the reinsurer are in agreement as to what the goals are and if, in fact, we are accomplishing them. If we had six bulk reinsurance agreements in effect, it would definitely be preferable to work out some arrangement by which we could go through a formal audit once and have everyone agree to that as being sufficient.

MR. DAVID HOLLAND: I would like to mention that the American Institute of Certified Public Accountants is coming up with a statement of position on auditing reinsurance. So, whether we start this or not, the procedure is going to be in place and we will have to be more actively involved in auditing reinsurance.

MR. WILLIAM E. SIMMS: Back in 1979 at Transamerica Reinsurance, twenty percent of our new business issued was on a bulk basis. That increased to forty-one percent in 1981, to fifty-four percent in 1982 and seventy-one percent in 1983. So you can see we have some concerns about the amount of business we accept on the bulk basis and that is only what we call individual life or conventional bulk reinsurance. It does not include the business that we accept in some of our financial reinsurance deals or portfolio reinsurance. We have other problems in that area. In measurements of inforce, fifty-four percent of our business in 1983 was on a bulk basis and that had grown from thirty-two percent in 1980. This growth in our inforce and new business caused many questions to be raised with regard to the quality of business we had on the bulk basis by our actuaries, auditors, both internal and external, and the senior management team. These questions involved whether or not the assumptions of the original pricing were actually being experienced in the business that we had accepted, and whether or not the client had been processing the business the way we expected it to be processed. That is, was accounting accurate? Were claims being handled properly, and were we getting the kind of experience that we expected to get when the business was originally put together?

In the Spring of 1982, we launched a formal audit program of the major bulk accounts within Transamerica Reinsurance. By major accounts we meant new business of one-hundred million dollars or more, and now that number is down to fifty million dollars. We have audited seventy-three accounts on an annual basis since 1982. We have internal auditors who perform the financial part of that audit. They are not members of the reinsurance operation at Occidental. They are CPAs in the internal auditing area. We have reinsurance underwriters within the reinsurance line who perform the underwriting portion of that audit. Our intent is to audit not only the numbers that we get, but also the underwriting that is done on the cases because we do not get a chance to see much of the underwriting that is handled on the bulk basis.

During this process we determined that it has cost us, in travel and salaries, entertainment and other expenses, about two-hundred seventy-five thousand dollars to perform these audits. One audit alone turned up four-hundred twenty thousand dollars of premium due Occidental that had not shown up on some of the bulk reports. So just one of the audits by itself paid for the associated expenses.

In other situations we found that the ceding company actually had money due them that they had not found in their preparation of the bulk reports and, we of course, had to reimburse money to them, so it was to their advantage, obviously, that we had performed the audit. Again, the audit program has been very successful for us. We used the internal auditors because, firstly, we did not have any CPAs in reinsurance that we thought could provide the auditing expertise that was needed for it, and secondly, it relieved the pressure on the reinsurance area as they looked at our reinsurance inforce records. They noticed that a large portion of our inforce business and therefore a large portion of our profitability, was tied up in information on which we had only summary data. They asked what we were going to do to solve that problem. They asked how we were going to obtain the information which would tell us that these records comply with the assumptions in original pricing and with the original contract. Therefore, we invited them to perform the audit. That has given them a great education in reinsurance and it has allowed us to at least focus their attention on areas of reinsurance in which we want them to get involved. It has also kept them away from areas in which we do not think they need to get involved.

One of the major fears that we had in entering the audit process obviously was the hindering of client relationships. The history of reinsurance obviously is that there is a gentlemen's agreement associated with reinsurance and since we were in effect saying that we were going to check their handling of our account, we were concerned that there would be some animosity raised. We could find something really wrong and have to critcize it and thereby put in some corrective action. But we explained to our clients the reasons we had to do it from our perspective, that is, the impact it had on our earnings, and also explained to them that it was also for their benefit. There was a lot of information that was tied up in records that they were not accustomed to producing and also some records which were for our benefit more than they were for their benefit. Out of this could come some corrective action in regard to premiums or claims or cases to be reinsured that could save some problems down the road.

We had no problems with our auditing with the exception of underwriting, which is an interesting problem. Once an underwriter is told that his underwriting is acceptable and his reinsurance is accepted on an automatic basis, it is very difficult to go back and do an audit, to sit down with him and say that a case should have been somewhere in the range of two tables or a case should have been a decline. Underwriting seems to be very subjective and because of that we do not get a very clean audit where it can be said that the underwriting is acceptable. It has been very difficult to get the kind of audit results that we get on the financial side.

As we performed the audits we found that there was a tremendously wide variance in the report formats that I had created as head of administration. This was embarrassing because as I went to explain to the auditors why one report was different, I had to explain why I had better judgment two years ago than I had yesterday and vice versa. We also found that we seldom took into consideration the needs of the actuary or controller in putting together our administrative reports. We always settled the administrative needs since I was the one doing the creating, but we seldom identified the other needs. As a result of all these experiences, we have put together a manual of report formats for bulk accounts which is educational for our field force. It is also something we leave with a client and ask him to take all the information he has available and fit it into a form that is required by us. Our goal is to get the ceding company to fit into a series of reports that we have developed all the data that we need, taking into consideration all the people that have to be involved in bulk reporting.

To enhance this process, we have recently launched a program where we will offer a client a Personal Computer (PC) and assist him to program that PC to do as much of the reinsurance accounting for bulk reporting as possible. We have also in some cases, assisted in doing the programming on the client's own mainframe computer. We have paid for some of that programming to help get the data that our actuaries need for valuation and profit planning.

The key here is to again address the needs that we have in reinsurance but at the same time make it as easy as possible for the client to produce bulk information and not increase his expenses.

We have also put the process of bulk report formats into the hands of our field force where we start the development of bulk reports in the sales negotiation process. It had previously been left up to me, after the sale was consummated, to go out and put together a bulk format, but now we have our salesmen do the negotiations. This tends to relieve some of the difficulty in the process.

The other problem that comes with bulk reporting involves facultative reinsurance. The main problem from the reinsurance perspective is that there happens to be a file for underwriting on the shelf some place that was used to produce an underwriting quote. In that file rests the underwriting action, the rating given the client, and the amount of reinsurance to be accepted. In our case that underwriting file happens to be in a regional office and we request that all bulk reports showing new business or change activity come to the Home Office. So the first problem is how to get those two pieces of information together, that is, the bulk report and the underwriting file. We have asked our clients first of all to identify cases which were handled on a facultative basis on that bulk listing. If they can at least do that for us we will send that bulk listing to our regional office and have the cases identified, and then compare the underwriting rating and size of the risk involved. Where that is impossible, we place faith in our clients to (a) make sure that we are getting the facultative application, size and mortality rating that we had offered and (b) that the case is coming to us on a properly selected basis, that is, we are not getting it when somebody else has turned it down. One protection we have is that we have placed a life on our underwriting actions, and that case must be paid within sixty days or our action is no longer valid. That tends to tighten up some of our exposure.

The only other problem that we have with regard to bulk accounting comes in our controller's area. It relates to the profit planning process of Occidental and it involves the experience on a given account from an actuarial point of view. In most of the cases for large bulk accounts, we have asked our clients to provide us with individual data on some automated basis, either a computerized tape or on a diskette, as Jim Pilgrim mentioned earlier. Because so much of our business is on the bulk basis, we cannot do experience studies or profit planning very well, so we have begun to ask clients to produce some form of computer output that allows our actuaries to do the profit planning they need to do. We have offered, and in most cases do, pay for that data or at least reduce the cost of reinsurance to allow the client to give us that information. We feel that that expense is well worth the data we are getting because it is very important to us.

The final thing that I want to talk about involves universal life and then I will give a summary for bulk accounting from Occidental's point of view. We have tried to administer some universal life contracts on an individual cession basis. We have gone to the point of taking net amounts of risk and holding them level for a year. We have changed them monthly. We have done many types of things with them on an individual cession basis. We have lost two new business managers because of it. I have also lost other employees because of it, so we are encouraging bulk handling of universal life business in two ways. One, we have again put IBM PCs in our clients' offices, and they have programmed them to do reinsurance, or we have set up programs for our clients to do reinsurance on the IBM PC. The clients enjoy the fact that they have the PC. They use it for other reasons, which is at their discretion, but at least it gives us the benefit of having our reinsurance done accurately and timely on a bulk basis.

We have also, in some cases, offered to administer the client's universal life product and do both their direct administration and their reinsurance administration. This gives us some control of the bulk data that we have and gives us the individual information we needed for profit planning. We have also entered into a joint venture with a software house and have them administering the universal life products. At the same time they provide us with reinsurance output which gives us a chance to get the data we need and solve the client's administrative problems. All of these tend to move us away from the paper shuffling that reinsurance has always been and to an environment where we can handle these very flexible products and still stay competitive in reinsurance.

Our opinion at Transamerica Reinsurance is that there is no way to escape bulk reinsurance. All the optimistic, and more than optimistic assumptions have already been taken with regard to mortality and persistency in our pricing. We need now to find ways to reduce the expense element in our pricing. We have these problems with the new interest-sensitive products as well, for they also change the amounts at risk on a monthly basis or annual basis, which complicates administration.

Finally, we feel that reinsurance has got to be one of the last bastions of administration where policy information is duplicated over and over again from one reinsurer to another. There must be a better way to get the information from the client to the reinsurer and still give the reinsurer enough individual data to handle profit planning and valuation. So we believe that some form of automated bulk accounting is absolutely necessary and we are moving toward all forms of computer to computer communication to address this issue.

In summary we think bulk is here to stay. I do not believe the answers that we have now are the ultimate answers for bulk reinsurance but I think that we are on the road toward solving the problems. The key to any form of bulk reinsurance is standardization and I hope the Reinsurance Section of the Society does address this issue because there is need to present at least some standard procedures from a company management point of view. I agree that one ought to also take into consideration the capability of the reinsurance client and that the reinsurer extend himself to use what the client can produce. I think, as Herm pointed out, the audit process will become very commonplace in this business. There will also need to be some collective effort by reinsurers in the auditing. If fifteen reinsurers come in to audit I think the auditing process is going to become a bit distasteful to our clients. So team audits by reinsurers are indicated. Using a reinsurer's audit report will be another way to solve it. But some way to get reinsurers to use their data on a collective basis will be the answer to that.

As the reinsurer does the auditing and finds that it solves both his problem and the problem of the ceding company, that is, gives the latter information about his administration and ways to improve his processing of reinsurance, and gives the reinsurer more accurate information with regard to the premiums and amounts at risk on lives associated with the reinsurance, auditing will be a welcome part of the reinsurance relationship because it is really done in the interest of both parties. It is not a witch hunt and I think it is the best thing that can be done to bring some credibility to bulk reporting.

MR. KIEFER: Bill, does Transamerica attempt to index all cessions on a bulk basis?

MR. SIMMS: No, we set limits. With such a large amount of our business on a bulk basis we have decided that any policy reinsured with us, with an amount reinsured greater than a quarter of a million dollars, will be indexed within our own company and an attempt made to determine the amount that has to be retroceded. We do not always get enough individual data to even do an index. Some companies send only summary information. But where we can, we will try to get enough information to do retroceding and if we find that more information is necessary, we will go back to the client to get all the details for an individual cession.

MR. KIEFER: So essentially you are willing to assume a liability greater than your retention on reinsurance assumed for a face amount of at least two hundred fifty thousand dollars. You could have two hundred fifty thousand from several different sources. Have you purchased any sort of other reinsurance coverage to cover that contingency?

MR. SIMMS: No, we received approval from the Board of Directors that for bulk reinsurance, we could be over-retained by as much as one million dollars.

MR. KIEFER: What about a client where you had indicated, during the sales process, your needs as a bulk reinsurer, and they have not yet developed such a system but promise delivery within several months? Do you then quote your allowances based on bulk reinsurance?

MR. SIMMS: The answer to that, basically, is yes. If a client says that they are going to build the bulk system, want to develop one, or will let us help develop one, we will quote with the expense assumption that goes with bulk reporting. But the key to that rests with the relationship. We have had that happen and two years later they backed away from their commitment, but still wanted to keep those bulk allowances. That made it very difficult for us to back up. But when the relationship is sound, yes, we do quote on that basis and help them develop that bulk report.

MR. KIEFER: I was interested in your comments that you actually send programmers to the company to help them program.

MR. SIMMS: Yes, we have some systems people in reinsurance who obviously know the business of reinsurance and other systems with whom we are working to do our affiliate bulk reinsurance arrangements. Transamerica has many affiliate companies where all intercompany reinsurance is done on the bulk basis, so we stay current in coming up with new systems and it is those people who go out and help our client companies' programs.

IRA SLOTNICK: I am curious as to Occidental's giving away so much money in terms of PCs, programmers and other types of aid. It seems to me that the whole idea of bulk reinsurance is to save the costs, both for the ceding company and the assuming company, but I do not see that with your program. For the ceding company, referring to Charlie's earlier statements, when it has to develop a system, either one that coordinates with the direct system or one built within the direct one, the expense seems to be very large. So where is the savings in bulk reinsurance?

MR. SIMMS: First of all, we do not give the PCs away. We take them back when an account changes. Also, the vendor price is not really that much, about three thousand dollars. In some bulk accounts there is enough business that it would normally take ten clerks to handle, so the savings is still there. You do not have to hire those ten clerks and the three thousand dollar expense is a one time expense. To buy a diskette these days is extremely inexpensive. In fact I have a supply at home for my own computer that I loan to a few clients and they go back and forth, so that expense is really low. The beauty of the IBM PC, is that it allows the reinsurer to control the kind of report that he wants to have. It is also a great sales incentive when talking to the actuaries. If offered a program along with a PC for bulk reinsurance, a client is more likely to say he can live with the program than if he is not given the PC. So with that expense comes a good investment for controlling the kind of bulk information that is received.

MR. BRITTON: From the ceding company point of view I think you are right in that the start up costs could be substantial and whether there is subsequent savings in self-administration is not at all clear. That is why it is important to try to get the reinsurers to quote on both bases to see how much the ceding company is really going to save in allowances if bulk administered. The ceding company can control the flow of information. They have all the information there. They do not have to rely on the reinsurer's processing delays, if any. There are some intangibles also for the ceding company. Everybody talks about getting extra allowances from the reinsurers for bulk administration, but that should be checked out to be sure.

MR. MICHAEL R. WINN: Forgetting about the extra computer people that you send to client companies, and about the cost of the PCs, have you noticed internally any reductions of staff in your administrative area? Have you ceased to add people, given the great surge that you had in new business production in this line?

MR: SIMMS: Yes, our staff is down. Administration alone is down about forty percent from 1980 as opposed to being up, in projections for staff to work on individual business. So we have realized some substantial savings in the number of people. The problem though, is that the individual who handles bulk reinsurance now has to be more experienced and more capable, as mentioned before, so we have incurred some additional expense with the kind of people we have managing the bulk accounts. However, this is not nearly the expense we would have had in benefits and salaries with staff increases if we would have stayed on an individual basis.

MR. EDWARD B. MARTIN: Unlike my Transamerica counterpart on this panel, I do not have a background in the management of reinsurance administration. In my role at Lincoln National, I am in charge of our pricing activity for individual life reinsurance and I am also our product manager for our reinsurance ordinary line of business.

In my pricing role I have had the opportunity to be involved in the up front process of negotiation of reinsurance arrangements, including the administrative method.

And in my product manager role I have become acutely aware of the interaction between reinsurance administration and the needs of the reinsurance division with respect to financial reporting and accurate earnings analysis. Hopefully, together with Bill's administrative experience, by the time we are done today, we will have been able to provide you with a fairly complete view of simplified reinsurance administration from the reinsurer's perspective. You will certainly find that the tenor of my remarks will reflect that end of the business with which I am most familiar.

To start off, I think it is necessary to make a couple observations with respect the title of our session, The Problems with Bulk Reinsurance.

The first one is something that Charlie also mentioned. In the world of reinsurance administration, one can find administrative approaches ranging from the traditional individual policy cession method, where all the record keeping, billing, etc., is usually done by the reinsurer, all the way to methods where no individual policy detail is exchanged. It is this latter end of the spectrum that I am used to referring to as bulk reinsurance. It is the type commonly used with ADB products. In between bulk and individual cession you can probably find an endless variety of approaches differing in the amount of information which is exchanged. The most common of these can be grouped under the general heading of bordereau which at Lincoln is commonly referred to as SPREAD, an acronym for Special Reinsurance Administration. Under bordereau or SPREAD administration, individual policy detail is provided via the form of a monthly or quarterly computerized policy listing. I suspect that this form of reinsurance administration, the bordereau form, is what most of us are thinking about when using the term bulk reinsurance, and that is the sense in which I am going to be using it today.

My second observation with respect to the title, The Problems with Bulk Reinsurance, sets the theme of my remarks. There has been a growing tendency within the reinsurance industry to view bulk or bordereau or self-administration as a problem, as something which we would all be better off without. Why does this attitude exist? There is definitely a place for administrative methods other than individual policy cession. My feeling is that we have come to view alternative methods as a problem because one, we have over-sold them, and two, we have under-communicated in the process of setting up bulk arrangements. This has been a somewhat natural result of our marketplace over the last several years. Our push for market share of sales volume has caused us to grasp at any opportunity to lower the cost. If the ceding company can do some of the administration, we can lower the cost. We can be more competitive and we can sell more reinsurance. Often this has been done without the reinsurer explaining to the ceding company in the initial stages exactly what obligation they are assuming and without the reinsurer adequately evaluating whether the ceding company can provide what is expected. Also, it has been done even without really thinking through whether or not the particular business in question is ideally suited to a bordereau or self-administered type of approach.

Client driven administration may be a problem today, but my theory is that it is a problem because it has often been used where it should not have been. Even where it is appropriate, the client and the reinsurer have entered into arrangements too quickly without reaching a meeting of the minds on the needs, the capabilities, and the time frames of both parties involved. It is important to understand that we are not necessarily eliminating responsibility or expense by using self-administered reinsurance methods.

While there may be economies to be gained, we are more accurately shifting responsibility and expense from the reinsurer to the ceding company, ostensibly for the good of both parties.

What does it mean to take on this responsibility? Because this question has not typically been addressed on a timely basis, we have come to view bordereau reinsurance administration as a problem. We have not necessarily simplified administration, but we have transferred much of the burden to the ceding company. From a reinsurer's point of view we need to have certain information to manage our companies adequately and responsibly. There are other items of information which we would like to have but may not be absolutely necessary. In many cases our needs are not any different from those of our clients. For example, we need to put together our statutory statements within the same time frame and the same format as our ceding companies. To fulfill our responsbilities we need to be comfortable that the ceding company is meeting its responsibilities as far as the administration is concerned. This will mean, as it has already been referred to by each of our speakers today, increased audits on the part of the reinsurer. The reinsurer has lost some degree of control over its financial and policy data.

The certification of liabilities is a key issue. Our actuaries, as reinsurers, need to certify the adequacy of our liabilities. This can be a problem when the data that we have received is sometimes confusing or incomplete. In an attempt to get at this certification question, at Lincoln National, for year-end 1983, our Chief Financial Officer sent a letter for the first time to the actuary of each SPREAD client requesting certain summary information and a sign off by that actuary as to the accuracy of the data that we had been receiving during the year. We do need to develop, in our operation, a satisfactory comfort level as to the adequacy of our reserving so we think that doing something of this sort is important and will be continuing to do so in the future.

We want and need to be able to certify that our statutory statement is as credible as our clients' who are certifying that theirs is. I have mentioned that self-administration is a problem when it is used in the wrong situation. At Lincoln we have attempted to define a set of criteria to be used in qualifying clients for the use of our SPREAD or bordereau administrative approach. I am certain that many, if not most, reinsurers have made similar attempts at defining such criteria.

I would like this afternoon to go through this list with you using it as a vehicle to identify what Lincoln views as many of the potential problems and potential opportunities for self-administered reinsurance. Obviously some of these criteria will be more important than others but all serve to define, in our view, the ideal situation for the adoption of self-administered reinsurance procedures.

The first item is automated capability. We feel that the client should have the automated capability to produce listings and billings providing our mandatory data items. The automated capability is an important point. If a client produces such listings manually, the potential benefit of reducing administrative expense most likely will not be realized. Information on manually produced listings will be subject to a high probability of error and as the block of business grows, this will become more of a problem. The timeliness and accuracy of information are also likely to suffer.

The second point on the list is credible internal operating procedures. This is an obvious statement. The client's internal operating procedures need to be highly credible. As I have already mentioned, the incidence of audits by the reinsurer will necessarily increase as a result of self-administered systems. Reinsurers no longer have the same degree of control over information as they have with individual cession systems, and increased audits are necessary to ensure the appropriate degree of confidence in the information that we are receiving. Client audits are often time-consuming and expensive and can lead to negative sales systems if they are not approached properly. It is important as a reinsurer to be comfortable with a client's internal procedures before entering into a self-administered reinsurance arrangement. The greater the degree of comfort that can be developed beforehand, the greater likelihood that audit activity can be kept to the necessary minimum.

The third point refers to large number of cessions, small average cession size. This again is probably an obvious point. With a small number of cessions there is probably very little to be gained in entering into a self-administrative approach. Likewise, we generally feel the smaller the average cession size, the more likely a self-administered approach makes sense. From a reinsurer's point of view, business with larger average cession size will entail greater retrocession needs which in turn will involve additional data requirements. The ideal situation for self-administration is with accounts of relatively small cession size and large number of cessions.

Point number four concerns universal life and adjustable life. Products such as these are generally considered to be well suited to self-administered approaches. The variable and monthly nature of these products makes individual cession handling expensive and time-consuming. Also, most clients developing these types of plans have had to implement new data processing systems for administering this business. The opportunity exists to develop a reinsurance administrative system at the same time the direct system is being developed and this can be a big advantage in structuring to transfer the appropriate amount of data. The number of cessions still needs to be at some minimum level to have self-administration make sense. We have used the rule of thumb of two hundred cessions per year as being the number that would make sense for self-administration. Obviously, with very small numbers of cession, the self-administration would not make sense.

Point number five is that the arrangement should generally be nonrefunding. If the client is using an experience refunding product its system will need to be designed to track a refunding limit per life. The system will also need to be able to separate refunding premiums and claims from nonrefunding premiums and claims and other experience items. These capabilities create programming complications and excess expense for the client. From the reinsurer's point of view, these additional complications create the additional hazard of errors in information and therefore greater auditing needs.

Item six is that the business should be primarily automatic when the self-administered reinsurance approach is used. Facultative reinsurance, which has been alluded to, does create some of its own problems. On cases submitted facultatively, an individual pending record is established by the reinsurer. Once a case is placed, or withdrawn, the reinsurer needs to remove this case from its pending file, and retrocession reserve facilities may be involved. This creates the requirement on the part of the ceding company to be able to identify those cases that were facultative so that the reinsurer can update its pending file.

An additional item, relative to the facultative business, relates to the need or desire of the reinsurer to study its experience, particularly its mortality and lapse experience. Under today's bordereau type of reporting methods, reinsurers do not have the ability to study the mortality or lapse experience on this business. Many people would identify this desire as something that is nice to have but not mandatory and therefore does not preclude the use of a bordereau type of reporting. While this may well be true the fact does remain that reinsurers are in the unique position, particularly with respect to the facultative business, to assemble fairly large blocks of data on impaired risks. The ultimate study of this type of experience can benefit not only the reinsurer, but also the insurance industry in general, and our approach to underwriting an impaired risk in the future. We generally consider it to be a negative in the adoption of a self-administered system, if there is likely to be a large amount of facultative business involved.

Item seven refers to bonuses and charge-backs. As with refunds, these items add additional complications into the design of the client's system, and, from the reinsurer's point of view, present additional chances for error in information and difficulties in verifying data sent. The calculation of production bonuses usually requires that qualifying and partially qualifying volumes be identified separately. The use of bonuses and allowances in excess of one hundred percent typically entails chargebacks which requires that the client's system be able to track persistency of the business.

The final item, number eight, relates to underwriting. Business involving special underwriting programs generally will not be considered for self-administration. This would entail such things as guaranteed issue and underwriting of an experimental nature. Often, special retention practices may be involved with respect to this business both on the part of the ceding company and the reinsurer. The experimental nature of this business is such that the reinsurer will want and need to examine its experience separately. Such monitoring is important for an ongoing ability to offer these types of products and price them adequately. The ceding of such business on a simplified basis will increase the need for audits. As we discussed, these are expensive, time consuming, and, if not handled properly, could have a negative impact on the reinsurance relationship.

This list gives an outline of the parameters that Lincoln National feels are important in determining whether or not a particular reinsurance arrangement is well suited to self-administered systems. If these criteria are generally met, SPREAD administration may be appropriate. But even in this event, communication is key. Communication has to take place between the reinsurer and the ceding company, particularly between the reinsurer's administrative staffs and their counterparts in the ceding company. This communication must take place early in the process, well before arrangements are put into place, and needs to continue as the administration gets started.

Additionally, and this point is often overlooked, the administrative approach must be reevaluated at the time of any change in the reinsurance arrangement, whether this be in plan rates, reinsurance features, etc. Even small changes can create serious administrative difficulties. It probably can be said that the future flexibility in one's reinsurance program is made more costly by the adoption of a self-administered method.

As an industry, we need to move away from selecting an administrative system solely as a reason for lowering price and concentrate on selecting that option which most nearly meets the needs of both parties involved. If we can accomplish that perhaps the next session of this type can be titled "The Benefit of Bulk Reinsurance Reporting."

MR. PILGRIM: Ed, I was interested in your comment about receiving certifications from the actuary. That has always been one of my concerns. We tried to modify the statement that we made by saying we relied on the listings of the clients in their bulk reports. Interestingly enough, the state insurance departments must have categorized these things, because they would say that the prescribed opinion was not stated. We wrote letters to the effect that we had many bulk arrangements, and we did rely on our clients. The departments still were not accepting. I would be interested in comments from, perhaps, other reinsurers who may have modified their certifications by the actuaries.

The second question I have concerns frequency of reporting. We find that quarterly is about the minimum frequency with which we can live, with the exception of bulk ADB, which has been on an annual basis. Perhaps some others can live with annual reporting, I do not know.

The third question I have relates to the policy exhibit in the annual statement. Many of the bulk reports that we receive do not pay adequate attention to the policy exhibit. Now, if everybody starts selling universal life type products, the policy exhibit will not exist in the same format as it does today. But, we always have a problem completing the policy exhibit with the bulk information we get and it becomes more a work of art than of science.

MR. MARTIN: Regarding the latter of your statements, with respect to policy exhibits, I do not know that our experience has been that much different than yours with respect to the information that we are getting. Often times there is little consistency with respect to the premium data on the policy. Often we have questions of reserve data and that has been a real problem.

With the letter that we sent out at year-end, we also sent to the actuary three blank summary forms. One asked for year-end reserve information, one for year-end policy exhibit information, and the third being a summary of premium and commission.

You might be interested, in that we sent out one hundred forty-two requests in early December and asked for a response by January 14. The end of January is when we needed the data for our statutory purposes. We did receive reponses from fifty-eight companies, as of January 21, on a reasonably timely basis. We had only received nine by January 14. We did get a good number in the next week. But obviously there are quite a few companies from whom we did not hear. We intend to continue with this approach. I am not sure, at this point, what kind of follow-up we are going to be taking over the next few months, but hopefully by next year-end we will have refined the procedure so that we can develop an even better feel for bulk numbers.

I am not sure to what extent we may or may not have modified our actuarial certification because of SPREAD. Bill Tyler might be able to comment on that.

MR. TYLER: The letter we sent to clients this year was really intended to see what kind of reponse we would get. I think that the fifty-eight companies who responded represented a higher percentage of response than we expected. Our intent is to follow-up on some basis through the year and continue to ask for that summary sign-off in future years and try to strengthen the timeliness of the responses.

As far as our own actuarial certification is concerned, specifically the state of Indiana in our case, we do not make any specific disclaimer with regard to client-generated information on self-administered accounts. We do have some normal disclaimers about relying on information accumulated by the administrative area and so forth. Obviously for self-administered business we are depending on the information we are getting from the clients and the audit we are able to do in Fort Wayne on those reports. But, because we have not specifically put in a condition or constraint on our ability to look carefully at bulk administered business, we have not received any inquiries from the state insurance department in that regard. We are not really depending upon the sign-offs from the actuaries of our client companies, certainly for 1983, to give us the assurances that we need to make representations to the insurance departments that our statutory statement is solid.

It is our intention to ask for a more formal sign-off from our clients in the future. We think it is a reasonable request and most of the clients with whom we talked, agree. I suspect the reason we have not received a one hundred percent response this year, is because we did not give them sufficient notice and in many cases our self-administered accounts are not in the best of shape for many of the reasons that were discussed here this afternoon. It is going to take some time before clients are in a position to look at that summary information and agree that this is appropriate information upon which we can rely.

The other thing on which I would like to comment is with respect to frequency of reporting. Over the years, we have had self-administered programs where the client reported to us on a monthly, quarterly, annual, and sometimes less periodic basis. None of the arrangements provided for more than annual reports, but some have turned out that way. In some respects, we would agree that annual reporting is too long. Quarterly reporting is probably alright. Monthly reporting is probably better, just because one has a more frequent opportunity to clarify the information, at least at a summary level, and see how things are developing.

But even beyond that, one of the big problems we have had is trying to put our annual statement together and anticipate what the due and unpaid items outstanding are, either because they had not yet been received from the client, or not booked when the statement had been received by our office.

From that standpoint there would be some value to administrative approaches where, whether the frequency of reporting was monthly or quarterly, the client was, in effect, providing some sort of crude "mini" annual statement for the self-administered business. This would allow the reinsurer to simply book the information on that statement into the annual report and not have to make judgments or guesses as to how much new business was still outstanding. The reinsurer would basically be able to book the business as the reports came in and know that it had an internally consistent incurred type of financial information that it was recording in the annual statement.

I think this is a practice that is much more prevalent in the property and casualty side of the business and probably one that could be used on our side of the business.

One significant change that would have to be made though, is to get away from the situation where currently clients submit, on a monthly basis, annual premiums for all policies that passed their anniversary in that month. One either has to change to a method where each month the client pays the monthly premium for all policies in force, or somehow provide something like an unearned premium, or a reserve increase, that is associated with the unearned portion of the premiums that they are paying in that monthly report.

I think changes of that sort take time to determine exactly how it would work out with the client to make sure that their reporting is internally consistent within their company, as well as the reinsurance information provided, so that it can be relied on.

MR. SCHMIT: I have a brief comment on Jim's question about the policy exhibit and related questions with the annual statement. Last week a client called us to ask how we solved the lapse problem. Apparently, in our 1983 statement, a three percent lapse rate is shown. I said he can be sure that our lapse rate is not three percent. When I checked with our actuary he said that he could reasonably defend line one and line twenty-two of the policy exhibit, and that everything in between was fairly creative. I did not have the nerve to ask him about page six of the annual statement. It seems to me that in the days before the bulk era we patterned our administration very much along the direct side. We were cession-oriented the way the direct company is policy-oriented and so we filled out the policy exhibits like that. I have serious questions about the value of the policy exhibit, even for the direct writing company, and I think for most reinsurers it is next to meaningless. Perhaps we ought to get permission from the Commissioners to put a big "not applicable, reinsurance only", statement on page fifteen.

RESULTS OF SURVEY ON BULK REINSURANCE

The following twelve reinsurers participated in the survey:

American United Life Insurance Company
Business Men's Assurance Company of America
CIGNA Re
CNA Insurance
General Reassurance Corporation
The Lincoln National Life Insurance Company
The Mercantile & General Reinsurance Company
Munich American Reassurance Company
NRG America Life Reinsurance Corporation
North American Reassurance Company
Phoenix Mutual Life Ins. Company
Transamerica Occidental Life Insurance Company

The volume of bulk reinsurance represented by the companies surveyed was as follows:

Company	Treaties In Force	New Treaties	New Business*	In Force*
A	80 (-)	20 (-)	680 (11)	1,715 (11)
B	191 (-)	40 (-)	13,721 (-)	24,106 (-)
C	44 (4)	27 (54)	895 (25)	1,741 (16)
D	- (-)	- (-)	7,400 (53)	13,850 (54)
E	27 (10)	6 (12)	- (-)	- (-)
F	156 (23)	42 (58)	2,600 (56)	4,400 (44)
G	62 (13)	7 (64)	6,349 (90)	8,104 (77)
H	34 (-)	11 (-)	512 (16)	1,200 (12)
I	220 (-)	- (-)	17,619 (75)	26,235 (64)
J	70 (12)	10 (12)	4,813 (55)	8,271 (49)
K	65 (6)	16 (21)	1,389 (36)	2,006 (20)
L	- (-)	- (-)	15,100 (67)	26,400 (66)

* Face amounts in millions.
( ) Represents bulk as percentage of total reinsurance.
– Represents not answered, or not available.

Q Do you require actuarial certification of bulk reports?

A Two companies replied that they do. One company pointed out that the AICPA is currently looking into this.

Q On what percentage of bulk accounts are the reports reviewed by the ceding company actuary before they are sent to you?

A All companies replied that they did not know. Many guessed that the percentage was small (less than 10%).

Q When you are audited, do bulk assumed treaties cause a major audit problem?

A Four companies answered yes. One additional company indicated that this was a problem on internal audits, but not on external.

Q Do you have a set schedule for periodically auditing client companies? What is the average time between audits?

A Four companies replied yes, while five others are planning to implement such schedule soon. The most typical schedule is once a year for major accounts, every two or three years for others.

Q How would you rate the average accuracy and timeliness of record keeping by client companies?

A

Excellent	0
Acceptable	6
Poor	3
None of the above	3

Q What percentage of your clients provide all the information which you request in approximately the format you request?

A

0 - 25%	3
26% - 50%	3
51% - 75%	1
76% -100%	5

Q Is the lack of a common format a major problem in putting together financial statements?

A Seven companies answered yes. Timeliness of reporting was also cited as a problem.

Q If there is a reporting lag on bulk ceded treaties, do you accrue all financial statement items in an effort to make up for the delay?

A Eleven companies answered yes. Several stated that they attempt to obtain the information by phone from their largest accounts.

Q For what percentage of bulk treaties do you use these methods for GAAP valuation?

A See table at end of this survey.

Q Do you keep track of individual reinsureds for retrocession purposes?

A All twelve companies answered yes. A number stated that they routinely check only cases over a certain size, however.

Q Would you say that tracking the placement of facultative cases is a major problem?

A Six companies replied yes. The most frequent problem identified was the time lag between acceptance of the offer and bulk reporting of the case.

Q Do your practices for handling death claim reimbursements on a bulk treaty differ from such practices under an individual cession treaty?

A Seven companies reported that they allow netting of claims from premiums. Nearly all of these indicated that this is the exception rather than the rule and only applies to a few small accounts. One company was forced to discontinue the practice at the insistence of its internal auditors.

	COMPANY											
	A	B	C	D	E	F	G	H	I	J	K	L
No GAAP Revaluation			100		25	100	54		14	100	100	100
Use Ceding Company Valuation		100										
Factor Method Using Individual Records				80			24					
Factor Method Using Grouped Records							22	100				
Others	100			20	75				86			