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GUIDELINES FOR REPORTING OF SELF-ADMINISTERED REINSURANCE

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- o "Guidelines for the Reporting of Self-Administered Reinsurance" exposure draft which covers:
  - Administrative reporting
  - Statutory and generally accepted accounting principles (GAAP) statement reporting
  - Actuarial certification of reports
  - Reporting required for mortality and statistical studies

- o What are the proposed guidelines?
- o Why are they necessary?
- o How will ceding companies be affected?
- o What is the impact of recent auditing and U.S. Tax law developments?

MR. MARK R. WHITE: The exposure draft on "Guidelines for the Reporting of Self-Administered Reinsurance" was developed by the Reinsurance Administration Committee of the Reinsurance Section throughout this past year. To broaden the diversity of the group contributing to the guidelines, each draft was circulated for comments to about twenty companies other than those represented on the committee. A particular emphasis was placed on obtaining the input of ceding companies. After going through several drafts, which incorporated most of the comments received, this exposure draft was prepared for circulation to the entire Reinsurance Section.

The primary purpose of the guidelines is educational. It can be used by ceding companies and reinsurers in negotiating treaties, deciding whether to move to a self-administered arrangement, or implementing a self-administration system. The guidelines will assist ceding companies in understanding the needs of reinsurers in various areas of reporting.

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Reinsurers often know what they need from ceding companies that self-administer, but they haven't always done a good job of making these needs known to the ceding companies. There are several sections in the guidelines which can serve as useful checklists to ceding companies and vendors of reinsurance systems. These checklists do not represent items that must be included in self-administration systems but items that might be considered.

A secondary purpose of the guideline is to encourage discussion on the topic of self-administration. These guidelines are intended to be impartial -- developed to be neither pro-reinsurer nor pro-ceding company.

The major thrust of the exposure draft is that ceding companies and reinsurers should think about what self-administration entails ahead of time and negotiate on it just as they negotiate on price.

The "Thoughts on Systems Development" section contains a list of questions and issues that should be considered when evaluating self-administration systems. There are many options available. The ceding company should be in a position to make these decisions before it implements a self-administration system. Reinsurers should advise their clients on the trade-offs of various options.

The section on "Transmission of Information" covers matters such as the mode of transfer, timing, and format of reports, and how much detailed information is needed. Particularly with electronic transfers, it is even more clear that there is no single right method. There has been some interest among reinsurers and ceding companies in coming up with a standardized format and core set of data to facilitate electronic transfers.

The "Guidelines for Administration Reporting" section consists mainly of lists of details that are frequently reported in self-administration situations.

The "Guidelines for Statement Reporting" section consists of a list of required statutory information. The ceding company is responsible for providing the reinsurer with accurate and timely statutory information or else sufficient backup detail from which the reinsurer can calculate it. If the ceding company calculates tax reserves on a different basis than statutory reserves, those would normally be made available to the reinsurer as well. Beyond that, however, items that the ceding company would not normally calculate, such as GAAP reserves on the reinsurer's reserve basis, would create a lot of extra work for the ceding company. So those items should be negotiated. An additional topic of this section is the actuarial certification. A ceding company actuary signing such a certification for a reinsurer would be providing the reinsurer with a statement of the reasonableness of various statutory numbers. This would allow the reinsurer to satisfy its own auditors about the validity of numbers being reported to it by self-administering ceding companies. It is important that the ceding company and the reinsurer jointly negotiate any such certification.

GUIDELINES FOR REPORTING OF SELF-ADMINISTERED REINSURANCE

The section on "Guidelines for Statistical Reporting" deals with two situations: the first where an individual reinsurer is monitoring an individual ceding company, and the second where the ceding company data is to be included in a larger multicompany study sponsored by a group such as the Reinsurance Section. The information to be provided as listed in this section is completely negotiable.

The concept of the guidelines has generally been well received thus far. There has been some legitimate concern that they should not be presented as requirements. This could create real restraint-of-trade problems.

The most controversial parts of the guidelines are apparently those concerning the actuarial certification and statistical reporting. Some people have had problems with the certification because they object to the implied existence of standards of performance. They also suggest that it is not within the scope of the Reinsurance Section to produce an actuarial certification. The best response to these criticisms is to note that the certification is not required and that it is really only a method of formalizing and consolidating information which must be transmitted anyway. The reinsurers would be looking for some assurance that the ceding company actuary has used his or her normal professional standards in calculating the transmitted information.

Statistical reporting is controversial because many self-administered agreements make no provision for it. From the reinsurers' point of view, this is probably the greatest weakness of self-administration. However, from the ceding company point of view, unanticipated statistical reporting is an extra expense burden, particularly if some of the information, such as impairment, is not on the ceding company's system. Depending on the relationship between ceding company and reinsurer, the ceding company may not have seen the results of any statistical studies in the past and may wonder why the reinsurer is so interested in statistical studies now that the ceding company is supposed to be doing the work.

We at John Hancock had three reasons for considering self-administration. First, historically we had always had a major role in our own reinsurance administration. Second, reinsurance costs are theoretically lower for ceding companies that do their own work. (Of course, this can be offset by the increased expenses of the ceding company. This is a less important reason for us.) Third, we have control over the processing and are more comfortable with that because our information is more likely to be accurate and up-to-date than the reinsurer's.

John Hancock recently has undergone a great deal of reinsurance systems development. With hindsight, I would say we spent a lot of time reinventing the wheel. We could have used these guidelines to cut weeks off of our developmental time -- not because they provide answers, but because they provide questions. We agonized over decisions that others could have advised us on, but we were reluctant to put too much faith in our reinsurers due to their vested interest. We ended up developing our own approach based more on what we wanted than on any understanding of what the reinsurers' needs were. As a result of not having the guidelines, we ran into some problems that could have been avoided, missed some details, and, worse still, missed some shortcuts.

In making the decision to self-administer, I agree with the guidelines that both the reinsurer and ceding company should carefully explore the pros and cons before signing any agreements. The administrative people should be involved up front. A primary task of any negotiation should be determining who has responsibility for the various areas discussed in the guidelines; that way a ceding company won't be surprised.

When negotiating a treaty, the ceding company has a right to get some pricing information from the reinsurer. At the very least, the reinsurer should be in a position to give some assistance in determining reinsurance price reductions. The reinsurer's expertise might help the ceding company estimate what the additional expense burden will be for self-administration.

MR. NOORUDDIN S. KARSAN: Administration has come to the forefront over the last couple of years. There are two reasons for this. One is the advent of self-administration or bordereau, and the second is that executives or the senior management of insurance companies pay more attention to expenses now. Administration in many organizations constitutes up to 40-50 percent of the expense dollar.

Self-administration, per se, has been in existence a long time. At my company we have an arrangement that dates back into the mid 1960s. It's a closed block of business where the reporting is only done on inforce lives with annual accounting, but nevertheless, it's self-administration.

The driving force for the current form of self-administration or bordereau has been the universal life product. Reinsurance companies, when designing their systems back in the 1970s, had not envisioned a product that changed its amount at risk on a monthly basis with unpredictable increases and decreases. Hence, the systems had no facility to manage such amount at risk changes.

When the universal life product hit the market, reinsurers were at the tail end of the administration, while pressure forced the direct companies to get an administration system in place.

A lot of the packages that were available in the marketplace had "reinsurance administration" as an inexpensive by-product, that is, it constituted a small percentage of the cost of the administration package. When self-administration was beginning to be an important subject, the question of cost arose, and direct writers would ask, "Since we're doing the administration, do we get a price break?" The reinsurers who were falling all over themselves to get the business would say, "Of course you do." Therefore the ceding company's attitude was that with the cheap package, it got better terms. That is probably the primary reason for the popularity of self-administration.

Reinsurers have five general needs for insurance reporting: for the general ledger, i.e., premiums, commissions, and other accounting type information; for the movement and exhibit reports (new business, lapses, inforce statistics etc.; for individual policy administration, i.e., when you spot check a listing, when you're setting up your own retrocession requirements, or setting up your own alpha index; for the regulatory and financial statement areas; and for internal management reports or experience studies.

To what extent does a reinsurer need information in order to meet these requirements? The guidelines provide an excellent focal point for discussion. They obviously don't need to be identical for every single arrangement, since every single reinsurance agreement is individually tailored, but they provide a scope or framework which you can build upon.

Self-administration is a two-way street. The reinsurer gives up control while the direct writer gets a price break and takes on additional responsibilities for the timeliness and accuracy of the business. This exchange of information is imperative. When I first looked at the actuarial certification I wondered how anyone could ever provide that kind of information. In the past, we reinsurers were asking only for five or six basic pieces of information. Soon enough, down came the corporate actuary who demanded additional information.

Ceding companies can have problems building up a system in order to meet all the reinsurer's requirements for self-administration. The expenses can be high, so that the original break in reinsurance price may be illusory. Though the cost may seem to be high, you are being partially subsidized with better reinsurance terms. It may not be a large portion of the ceding company's total reinsurance cost.

Given that the reinsurer has given up some of the control, what are the consequences of poor or inadequate reporting? The reinsurer can solve the problem of inadequate control through the audit process.

Our company decided to do audits towards the end of last year, and to a certain extent, these audits were instigated by our external auditors. All of our audits have boiled down to one simple objective: to insure that the premium payments we get from the ceding company are rightfully ours and that we get no more and no less. When I discuss audits with people, the first thing that they ask is whether we found any dirt when we were there. What do they mean by dirt? Did we find lost premiums? Yes we did. Did we find entire plans that we "forgot" to reinsure? Yes we did. Did we find replacements, conversions, and decreases other than lapses being treated as lapses, and being reinsured with another reinsurer or retained? Yes we did. So the audits helped us substantially in terms of controlling our business. This in turn pleased our external auditors.

There was a short interesting article from the April 1985 issue of the Actuarial Digest by John Tiller. He addresses five points relating to whether or not one should consider self-administration. First, will the volume generated justify a special procedure? He suggests an absolute minimum of ten lives per month with an increasing volume. I suggest closer to one hundred. If you're only looking at ten lives, your administration costs will not be made up; you will not get a good cost benefit ratio. Second, can facultative cessions be dealt with on an individual cession basis? Third, is a long-range commitment of appropriate computer systems viable, or will future additions and changes strain the system? Fourth, if volume is small or marginal, will reasonable projections of net amounts at risk be acceptable to both parties? Fifth, will the reinsurer extract all necessary data for individual cessions from the reinsurer statement?

Given that self-administration is so new, and we are going through an evolutionary process, should we consider self-administration a stop gap measure? Will electronic transfer take over four or five years from now? From a reinsurer's standpoint right now, in order to satisfy our external auditors and the state examiners, we have to get a certain amount of information. The guidelines provide an excellent background for that.

When one considers going into self-administration, one should seriously project what his future administration problems are going to be. Traditionally, this has had low priority; give it high priority.

MR. CARL B. WRIGHT: I will cover three main points:

1. Reasons for embarking upon self-administration.
2. Systems development considerations.
3. Reporting obligations of the ceding company.

Union Central Life has always thought of itself as self-administering its reinsurance business. However, until about two years ago, the only real self-administration activity that we performed was preparing the billing. The business was virtually all individual cession yearly renewable term (YRT) or coinsurance. We relied upon the reinsurer to provide us with the necessary record cards based on the information we provided to them before billing began. However, today we are self-administering a significant part of our reinsurance and will continue to do so.

Why self-administration? There are three primary reasons: phenomenal growth in the number of policies that require reinsurance; the introduction of universal life; and flowing out of the first two reasons, a need for data to measure financial impact of reinsurance.

Growth has arisen from several sources. In 1980, Union Central began a significant expansion of its agency force, which is continuing. We generate a volume of direct business that is five times more by number of policies and ten times more by amount than it was five years ago, with consequent growth in the number of policies requiring reinsurance. During that time, Union Central has not increased its life retention limit. In 1981, we entered into client-company relationships for sale of our individual disability income product. In February 1983, we began selling an annual renewable term (ART) product that is reinsured on a quota-share basis, rather than an individual retention basis. In April

1983, we introduced universal life, which in less than three years has gone from zero sales to 90 percent of our individual life business. In 1982, the year prior to the introduction of the universal life product, our annualized premium was just under 8 million dollars. This year, our annualized premium for universal life alone will be 40-50 million dollars. Any interest-sensitive life product where the risk amount changes monthly does not lend itself readily to administration by the reinsurer. Therefore, the responsibility for that administration must fall upon the writing company. Finally, in 1984 we entered into the first of an anticipated significant number of client-company relationships for sale of our universal life product.

With all these factors combined, three numbers illustrate the rapid growth that we anticipate in our self-administered reinsurance business. At the end of 1980, we had about 2,000 policies reinsured. By the end of 1990, we project that we will be reinsuring over 110,000 policies. In our self-administration, we find ourselves in the role of ceding company, assuming company, and retrocessioner.

Union Central first requested development of a reinsurance system in 1972. However, no action started until 1984. That twelve years passed with little or nothing transpiring is justified on the basis that the volume simply didn't exist to warrant any kind of resource allocation for developing an automated system. During 1984, we began in earnest to develop detailed specification for a reinsurance system covering all of the types of reinsurance that we wanted the system to handle. Regardless of timing, we decided the best way to get to the end result was the piecemeal approach. If you try to do all your reinsurance at one time, you may never get a system installed. We looked at all the major blocks of reinsurance and associated administrative needs.

The most urgent block to deal with is universal life, due to both the nature of the product and the fact that with our client company business, the number of policies will increase from 3,000 at the end of 1985 to 45,000 by the end of 1990. The next block we plan to install is our individual disability income, because it is all individual cession business. Volume will increase from 3,500 at the end of 1985 to 15,000 at the end of 1990. For the client companies, these numbers include only the retroceded business. Assuming the business from them is handled as a separate company on our direct system. Next we will install our quota-shared ART business which we currently handle using a utility program run against the direct master file. Finally, we will look at our traditional excess risk YRT and coinsurance. We may decide to never do anything with it because of the expected small numbers.

In the fall of 1984 the reinsurance project system was put on hold because our systems provider, Electronic Data Systems (EDS), was developing a new administrative processing system for direct business. We needed to determine whether or not the reinsurance system that we were specifying would be consistent with the new administrative system or whether we would find ourselves with an expensive throw-away system. We finally determined earlier this year that the approach we were following was not consistent with the new administrative system, so major system development was stopped.

We are concentrating now on developing a separate reinsurance data base. We will be able to maintain the data base and have the needed mainframe controls for a reinsurance system. However, most of the processing, billing, and reporting will have to be handled with utility programs and personal computers. We will start installing the new system in 1986. The reinsurance module will be the last piece installed. Although our system's vendor expects an installation date of 1988, I expect 1990.

In the interim, we have looked at other approaches to fill the gap, such as using personal computers. Personal computers are not a long-range solution. They can only handle small volumes of data. Self-administration is not advisable for such small volumes of data. We also tested dBASE III for interim handling of our health reinsurance and found it lacking. Even the data record could not be converted to our mainframe system down the road. Problems with the data base systems include record size limitations, difficulty in managing and controlling the file, and performing all the required calculations. Either it is not feasible, or so time consuming that it's ineffective. From a control aspect, it represents the ultimate in manual systems.

We develop much of the necessary information by running utility programs against our master file. This is how we are handling both our quota-share ART and universal life. For universal life, until such time as we actually have the capability of doing monthly calculations, we are reinsuring the universal life on an annual premium basis, using the risk amount on the policy anniversary. We simply ignore the monthly changes in risk amount, unless caused by a policy change or large premium payment. Should there be a death claim, the amount for which we will receive reimbursement is whatever we have bought, which may be more or less than we would have reinsured on a 100 percent accurate basis.

When a company decides to self-administer, it assumes certain reporting obligations. The question is how to report to a large number of reinsurers with potentially different requirements. The approach that makes the most sense is to develop a generalized reporting format that will incorporate the requirements of all your reinsurers to the extent that is feasible to develop the data. This could mean some companies will receive data that they did not ask for, but this is easier than tailoring reports to each company's needs.

A second important area of self-administration is to provide reinsurers the data they need to properly complete their annual statements. We must recognize the requirements or obligations being imposed upon the reinsurers by external auditors and state insurance departments. A major issue is the timeliness of data. They have the same timing requirements for data as we do, both in terms of being able to complete the annual statement and file it accurately and on time, as well as for reporting to their own management.

Reserves are a special subset of reporting of annual statement data. It's necessary to provide the statutory reserves that the reinsurers need. Additionally, for coinsurance, we will need to provide tax reserves under the new act. The reinsurers will not have the necessary information to develop reserves themselves. It will be necessary to continue to provide 1959 Act 818(c) reserve data to enable them to continue to perform the appropriate calculation limits for their policyholder and shareholder surplus accounts. Although most companies' limits will be on a premium basis, we have to allow for the possibility that at any time they could find themselves on the reserve basis. We need to provide the reinsurer a data base that will enable it to develop the GAAP reserves that it needs for GAAP financial reporting.

With the advent of self-administration, ceding companies will be subject to audits by the reinsurer, so that reinsurers can comply with the requirements of insurance departments and internal and external auditors. We need to include this in our costs of self-administration and provide for it in our systems. This will become a part of the reinsurance agreement and must be negotiated.

I object to an actuarial certification that goes beyond that presently required for the annual statement. I will provide the rest of the numbers needed in any accompanying letter assuming they haven't been provided throughout the year. Such a broadened certification should not be implemented until thoroughly exposed and commented upon, particularly by the regulators. I recognize the need for the data, but at the present time, as a valuation actuary, I would be unwilling to certify anything more than what I am currently required to certify for the annual statement. I would await developments of the concept of valuation before expanding the actuarial certification expected of the ceding company to a reinsurer.

MR. JAMES F. HARRINGTON: We can all agree that reinsurance is a significant part of an insurance company's operations. Insurance company managers should be concerned about reinsurance and the stability of reinsurers since reinsurance does not discharge the primary liability of the ceding company to its insureds. The ceding company has a contingent liability for the total amount of reinsured losses and must pay 100 percent of a claim if the reinsurer defaults. Obviously, the ceding company must know and have confidence in the assuming company and its financial ability to pay claims presented for payments. Likewise, the reinsurer must have confidence in the validity of information submitted to it by the ceding company.

Over the years, there has been a significant amount of publicity about reinsurance and the failures of insurance companies, many of them due to inappropriate or fraudulent reinsurance transactions. Many of these problems have been associated with the property and casualty business; however, life insurance companies have not been exempt.

The Securities and Exchange Commission (SEC) has been concerned about reinsurance for some years and has concluded that there was not enough guidance available for auditing reinsurance. The SEC went to the American Institute of Certified Public Accountants (AICPA) with its concerns and the AICPA, in turn, formed the Reinsurance Auditing and Accounting Task Force.

In 1982, the AICPA issued a Statement of Position (SOP), for Auditing Property and Liability Reinsurance and, in November 1984, issued a Statement of Position, Auditing Life Reinsurance. The same task force is also developing recommendations for accounting guidelines for reinsurance transactions. Additionally, New York state issued its Regulation 98 which, in effect, required property and liability (P&L) companies to comply with the SOP. I anticipate similar requirements for life reinsurance. The annual statement now includes Schedule S-Listing of Reinsurers, which shows the reserve credit taken by ceding companies and the reserves set up by reinsurers. Furthermore, the SEC is requiring more information about reinsurance.

The SOP does not establish any drastically new requirements. All it does is codify an appropriate system of internal control over reinsurance transactions. The following is an overview of the proposed SOP Auditing Life Reinsurance.

Ceded Life Reinsurance

Statement of Auditing Standards No. 1, Section 320.31, issued by the AICPA states: "The establishment and maintenance of a system of internal control is an important responsibility of management." In light of that, the ceding company should have appropriate control procedures to evaluate the financial responsibility and stability of the assuming company. The proposed SOP outlines what those control procedures may include:

a. Obtaining assuming companies' most recent financial statements and, if those statements were audited, the independent auditor's reports.

b. Obtaining copies of recent financial reports of assuming companies filed with the Securities and Exchange Commission (if applicable).

c. Obtaining assuming companies' statutory financial statements, including the actuary's opinions filed with regulatory authorities.

d. Obtaining and reviewing information on assuming companies from available sources, such as:

    o A.M. Best reports and ratings.
    o Dun & Bradstreet reports.
    o Insurance department examination reports.
    o Letters relating to the adequacy of internal accounting controls filed with regulatory authorities.

e. Inquiring about assuming companies' retrocessional practices.

f. Inquiring about the general business reputation of assuming companies and the backgrounds of owners and management.

g. Ascertaining whether assuming companies are authorized to transact reinsurance within the ceding company's state of domicile or whether letters of credit or other means of security are provided if the assuming company is not so licensed.

h. Requesting and evaluating collateral from assuming companies on certain reinsurance contracts.

Also, the ceding company has a responsibility to have a sound system of internal control over its own financial data to insure the veracity of the information that is passed on to the reinsurer.

Assuming Companies

Under the provisions of the proposed statement of position, an assuming company should establish appropriate control procedures for assessing the accuracy and reliability of data received from ceding companies. Such procedures should include:

a. Maintaining information relating to the business reasons for entering into reinsurance contracts and anticipated results of the contracts. Such a file might include:

   - o Actuarial studies of business assumed.
   - o Projected profitability.
   - o An indication of the frequency and content of reports from the ceding company.
   - o Prior business experience with the ceding company.
   - o The assuming company's experience on similar risks.
   - o Information regarding pricing and ceding commissions.

b. Monitoring the actual results reported by ceding companies and investigating the reasons for and the effects of significant deviations from anticipated results.

c. Visiting ceding companies and reviewing and evaluating underwriting, claims processing, and reserving procedures.

d. Obtaining a special report from ceding companies by their independent accountants regarding the internal accounting controls relating to ceded reinsurance (see Statement of Financial Accounting Standards (SFAS) No. 30, Reporting on Internal Accounting Control, paragraphs 60-61).

e. Obtaining ceding companies' most recent financial statements and, if those financial statements were audited, the independent auditors' reports.

f. Inquiring about the general business reputation of ceding companies and the backgrounds of owners and management.

g. Obtaining and reviewing ceding companies' statutory financial statements, including the actuaries' opinions filed with regulatory authorities.

h. Obtaining and reviewing available sources of information on ceding companies, such as:

- o A.M. Best's reports and ratings.
- o Dun & Bradstreet reports.
- o Insurance department examination reports.
- o Letters relating to the adequacy of internal accounting controls filed with regulatory authorities.

An assuming company's independent auditor will study, evaluate, and test the assuming company's procedures for assessing the accuracy and reliability of data received from ceding companies in connection with his examination of financial statements. If the assuming company does not maintain adequate control procedures to assure reliable and accurate data from ceding companies, the independent auditor would be required to extend his audit procedures in order to obtain such assurance, including but not limited to the previously mentioned procedures. The auditors' inability to perform the necessary procedures whether as a result of restrictions imposed by the client, by the inability to obtain sufficient competent evidence, or by inadequacy in the accounting records constitutes a scope of limitations which may require the auditor to qualify or disclaim an opinion.

Independent Auditor

To determine whether transactions are appropriately accounted for, the independent auditor of the ceding or the assuming company should perform procedures for selected transactions and related balances which include the following:

a. Reviewing the reinsurance contract and related correspondence to:

- o Obtain an understanding of the business objective of the reinsurance contract.
- o Determine whether the contract should be accounted for according to the provisions of SFAS No. 60, paragraph 40, which states that despite its form, if a reinsurance contract does not provide for indemnification of the insured against loss or liability, the premium to be retained shall be accounted for as a deposit.

b. Testing selected transactions to supporting documents, obtaining written confirmation of selected balances or contract terms, and testing related receivables and payables.

Despite the fact that many companies may feel that these procedures are onerous, reinsurance transactions are significant and complex enough to warrant such controls, and the proposal outlines a generally sound system of internal control which companies should have been using even without the SOP.

With respect to the exposure draft of "Guidelines for the Reporting of Self-Administered Reinsurance," one extremely important point must be kept in perspective: The validity and integrity of financial information is the responsibility of management.

The Foreign Corrupt Practices Act, which was enacted by Congress in 1977 requires that companies (1) keep books and records that, in reasonable detail, accurately and fairly reflect their transactions, and (2) maintain appropriate systems of internal accounting control. Accordingly, when entering into a reinsurance arrangement, whether it is self-administered or cessional, management must be sure that controls are in place to insure that transactions are valid, that assets and liabilities are appropriately recorded, and that assets are recoverable.

MR. WRIGHT: In regard to the AICPA Statement of Position on Auditing Life Reinsurance from a mutual company perspective, there could be a tendency for mutual companies to ignore this, because they are not subject to the stock company GAAP audit guide. However, mutuals do so at their own peril and risk. Several states now require the filing of a certification by a certified public accountant (CPA) for the statutory statement. In the CPA's audit of the reinsurance aspects of that statement, he will be guided by this Statement of Position. This statement also calls attention to the need to review the Statement of Position for Auditing Property and Liability Reinsurance, which includes within its purview, accident and health insurance.

If you have not seen a copy of the Life Statement of Position, obtain one and read it. In the process you will discover that it reflects nothing more than good common sense. Pay attention especially to paragraph 14 under "Internal Controls of the Ceding Company" which states, "The ceding company should have those internal accounting procedures that it considers necessary to evaluate the financial responsibility and stability of the assuming company, whether the assuming company is domiciled in the United States or in a foreign country." That places a significant responsibility on ceding companies that they may not have concerned themselves with in the past. How many of us, as ceding companies, have really evaluated the financial responsibility and stability of the company to which we are ceding our business?

MR. HARRINGTON: In regard to the SOP being an addendum or an attachment to the Stock Audit Life Guide, it is also a compilation of standard auditing procedures. These are auditing procedures, that if we are asked to issue an opinion in accordance with generally accepted auditing standards, we have to follow. So from a mutual company standpoint, even though mutual companies' GAAP or accounting principles are not as strictly defined, we would be required to follow the SOP when auditing a mutual insurance company, as well as a stock life insurance company.

MR. MICHAEL R. WINN: The date on the exposure draft is March 11, 1985, and you are asking for comments by the end of July. I'm curious about the nature of the comments you've received so far. Also, does a vendor in the software market have a self-administration package you could purchase?

MR. WHITE: Most of the comments on the exposure draft have been favorable. We have not received that many comments because the draft was circulated to the membership of the Reinsurance Section, not to the membership of the Society -- about eight hundred people. Most of the points that people are raising are for fine tuning and there has been little objection to the idea of the guidelines or to specific portions of the guidelines.

MR. WRIGHT: We haven't evaluated any outside self-administration software systems. I've referred the advertisements for them to our data processing people because we will have to work through them in any event. Even if we buy an outside system, they're going to have to install it. Presumably the new system that we're developing is more data base oriented. We'll have to wait and see how the data base is going to be structured before we start looking at systems. It's now deferred until 1990. Maybe there will be more viable systems by then.

MR. WHITE: The question of going to an outside vendor versus going to an electronic data processing (EDP) department within your company is a choice that many larger companies have to face when they do their systems. We were fortunate at the Hancock in that we were able to establish a rotation of a programmer out of our EDP department who worked exclusively for the reinsurance people. That person was responsible then for developing, from scratch, our self-administration system. It took about six months for the programmer to get started up. But once she had invested the necessary start up time, she became highly productive, because she was working exclusively on our reinsurance system. That would have been completely impossible working either through our normal EDP department with its long, involved feasibility process, or going to an outside vendor. You might want to consider whether you can work something out like that with your own EDP department.

MR. JAMES L. SWEENEY: The "Guidelines for Statistical Reporting" say that providing certain statistical information is negotiable. However, the AICPA Statement of Position says that the reinsurer should monitor the actual results and investigate any significant deviations. Do the AICPA guidelines then make the statistical requirements a little less negotiable?

MR. HARRINGTON: It really depends upon what the reinsurer needs to evaluate in that business. Whether everything that's in the guidelines is necessary, I'm not sure, but it's a matter of negotiation between the reinsurer and the ceding company, and what the reinsurer needs to monitor in that business.

MR. WHITE: To the extent that an auditor will be focusing on certain clients of the reinsurer -- perhaps their larger clients or more questionable clients -- the reinsurer might have more exacting demands from certain clients. So which information you got from particular clients would be somewhat negotiable.

The new U.S. tax law allows small companies to use their statement reserves rather than the new prescribed tax reserves for tax purposes.

This election doesn't apply to large companies, including many of the reinsurance companies. If the reinsurer who has to report tax reserves is dealing with ceding companies who have elected not to report tax reserves, who would be responsible for developing the separate tax reserves?

MR. WRIGHT: You are going to have to negotiate that one. It's possible that the reinsurers, under those circumstances, if it is an insignificant part of their business, might be allowed to use the nonrevalued reserves for their tax return. The argument is if it is essentially an insignificant item, it is not the absolute level of the reserves that matter anyway, it is the change in the reserves that is important. I'm not even sure what recommendations are being made in that area by the American Council of Life Insurance (ACLI) Task Force. The Congress certainly didn't think about it when it passed the tax law; the only thing it thought about was Section 845(b), to get rid of surplus relief agreements. My next best suggestion is for the larger companies to go out and buy up all the small companies.

MR. WHITE: The situation might be fairly common where a ceding company, which has a certain set of reinsurance rates, would introduce a universal life product and ask the reinsurer for new rates. Because the company was self-administering, it would expect to see a reduction in the rates. However, the new rates might not reflect any reduction. Do you have any comments on this situation?

MR. KARSAN: The expense savings associated or reflected in the pricing by the reinsurance actuary does exist, from the standpoint that at our company, when we test our market against what our competitors are quoting, we find that the quotes are more competitive if they are on a self-administered basis. No reinsurer knows exactly what the expense savings are. If anything, more reinsurers seem to be leaning toward the fact that there aren't much expense savings associated with self-administration. To give a rough, ballpark figure, I would say about 2 percent of premium would be a nice round figure for expense savings associated with self-administration.

MR. WRIGHT: From the viewpoint of a ceding company, I'm not getting into self-administration because I expect to save any money. I might get a 2 percent discount on my rates, but I'm going to spend a lot more than that on my system.