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A Practical Guide to Obtaining Reinsurance

by Tamora A. Kappeller

Smaller insurance companies are increasingly concerned with finding viable reinsurance solutions for their business needs. This article will explore changes in the reinsurance industry, which contributes to this trend, and discuss things smaller companies might consider to improve their ability to form a mutually satisfying relationship with their reinsurer.

Reinsurers, like their direct company counterparts, must answer to their owners regarding profitability and performance, and owners are increasingly asking for a higher return on their investment. Most reinsurers are owned by European parent companies that demand profitability on an embedded value basis. Pricing must cover capital costs, in addition to mortality and expenses, and continuously add value to the growing block of business. Due to the long guarantees inherent in prevailing products, high capital levels are necessary to support them. Reinsurers must use a combination of surplus, letters of credit and other mechanisms to fund the reserves required to support product guarantees. The cost of these devices are accounted for in reinsurance pricing models, and thus are ultimately paid by ceding companies.

In order to ensure smooth earnings and reduce wide variation in claim ratios each year, a reinsurer must spread its risk among a large number of cases. Profitability is measured overall as well as by ceding company account. Each ceding company must submit enough business to cover the expenses involved in managing the reinsurance account. Therefore, many reinsurers set parameters for minimum reinsurance volume necessary to make the account viable. The management of smaller insurance companies often insists on purchasing reinsurance on an excess of retention basis rather than first-dollar quota share. Without a good spread of risk on every piece of business, a reinsurer does not have a large incentive to provide its reinsurance services. This is especially true if a ceding company requires a high level of facultative underwriting support or requires other reinsurance services disproportionate to the level of business to cede.

Oftentimes, smaller companies choose to cede their business on an excess of retention basis because they do not have a reinsurance administration system in place to effectively manage reinsurance accounting. In order to obtain and maintain quality reinsurance, it is well worth the investment in a good reinsurance administration tool. Many reinsurers choose not to do business with companies that are unable to administer their business electronically.

An important consideration in forming a reinsurance relationship is the level of partnership formed between the ceding company and reinsurer. A reinsurer prefers partners willing to share information regarding mortality results, underwriting procedures and who values a win-win relationship. Transparency in the relationship ensures proper pricing and results consistent with expectations.

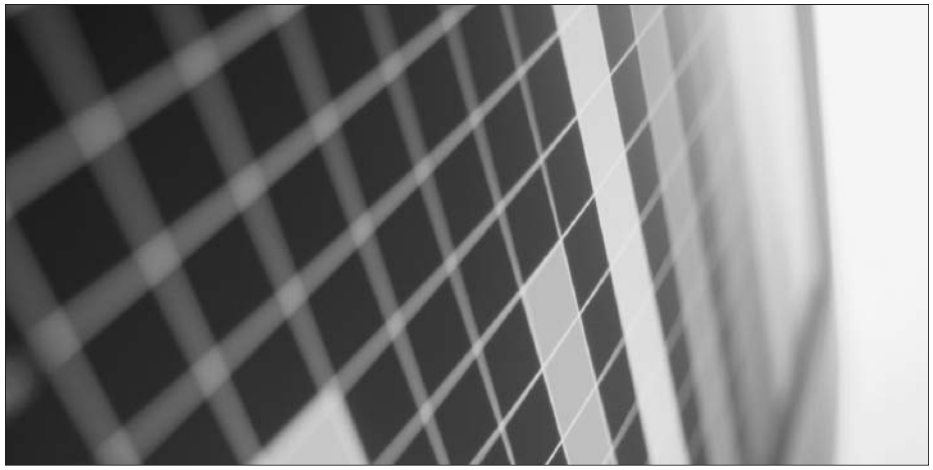
When evaluating a request for reinsurance, underwriting is a key consideration. A priority for an underwriting assessment is the quality and consistency of underwriting decisions. It is important that ceding companies adhere to their underwriting manual and limit exceptions. If exceptions are made, they should be consistent and defendable. It is important that ceding companies allow their reinsurers to perform underwriting audits to verify that underwriting practices match expectations. Another important underwriting consideration is the reputation and strength of the ceding company's underwriting talent and whether a company has regular access to a medical director. Facultative volume also affects pricing of reinsurance when it demands a large amount of resources. Strong placement ratios become important to ensuring the success of a reinsurance relationship.

When submitting a request for reinsurance, it is helpful to provide several pieces of information to the reinsurer. The following is a list of items to help reinsurers when preparing a reinsurance proposal:

- Type of reinsurance arrangement (Auto/FAC, First-Dollar/Quota Share, Coins/YRT)
- Rate basis (COI rates, mortality table, underlying retail rates, etc.)
- Product specifications
- Underwriting Information:
    - Risk class definitions
    - Medical exam requirements
    - Height/weight requirements
    - Retention schedule
    - Jumbo limit and definition
    - Binding limits
    - Special programs (e.g. table shaving)
    - Facultative support requirements
    - Application
- Premiums (current and guaranteed)
- Age basis (ANB or ALB)
- Average policy size assumptions

New Preneed Valuation Mortality Table

by Mark C. Rowley and Kent L. Scheiwe



The development of a preneed insurance valuation table is currently under way. Fifteen companies that sell preneed insurance have committed to share their mortality experience with the Society of Actuaries to produce the mortality table. A Project Oversight Group (POG) consisting of actuaries representing the industry was selected to assist the Society of Actuaries in developing the table. The NAIC was notified of the table development so they can begin the process of creating a regulation for approval by the states adopting the table as the "preneed mortality table."

The need for a preneed mortality table came about because reserves produced by the 2001 CSO table are seen as inadequate for preneed insurance. Because of the unique mortality experience for preneed insurance, discussions are under way to create a distinct preneed valuation mortality table. Once the 26th state approves this table for preneed reserves, insurance companies will be able to use this table for tax reserves.

Any questions concerning the table can be addressed to Mark Rowley of Van Elsen Consulting or Kent Scheiwe of Milliman. ●

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- Total volume sold and expected to be sold
- Distribution assumptions — volume sold by plan, sex, risk class, age
- Mortality experience
- Lapse assumptions and/or experience (especially for unique/different product types)
- Policy form
- Types of riders reinsured, rider premium rates including supplemental benefit riders, rider policy forms
- How product is sold (i.e., what distribution channel is—- direct market, brokers, career agents...)

Smaller insurance companies need realistic expectations for reinsurance coverage. If reinsurance is necessary to maintain overall financial stability, ceding companies should offer enough volume to provide an acceptable spread of risk to the reinsurer or be willing to pay a little more to cover the additional variability and cost. Smaller companies should also realize that reinsurers are more likely to value the relationship when resources are not tapped disproportionately to business ceded. Smaller companies still have reinsurance options, but they may have to make some changes in business practices to maximize their utilization. ●

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