SOCIETY OF ACTUARIES

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A Look at Ourselves

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Other than financial and "social" projections, how are we actuaries who are in the life insurance industry doing as business executives projecting current trends into the future? All of us have been subjected to endless discussion in the trade press, business newspapers and magazines, television, and certainly in our own companies about what appear to be obvious and clear trends toward diversification in the financial service industry.

I need not cite examples of "everyone getting into everyone else's business," because we are up to our necks in such illustrations and they increase in number every day. Now what do you think the official position of the industry is on diversification? Is it "Let us recognize the existing situation, project it into the future, and work so that the life insurance industry will have equal access to all segments of the financial markets"? Or is it, "We will fight to the last policyholder to keep everyone else out of our business"? Do we really want the playing field to be level? Do we actually believe that competition is a good thing?

Finally, we might look at the current trends of regulation in the life insurance industry. I expect that all actuaries, whether in industry, consulting firms, government or academia, can agree that there has been increasing involvement of the Federal Government over the past 25 years in the regulation of life insurance. The Securities and Exchange Commission, the Federal Trade Commission, the Federal Reserve Board, the Treasury Department, the Internal Revenue Service, and Senate and House Committees are all arms of the Federal Government reaching out eagerly to embrace what they view as an "unregulated industry." It would surprise me if any projection of the future is a scenario with less Federal involvement than at present.

Perhaps some of you who are concerned with such matters as approval of policy forms, and attempts at diversification, may have also noted the increasing activity of the state regulators. I leave it to you to judge whether this has resulted in more uniformity of regulation or deepening chaos. Where do you think the future lies in this area, including that of mandated benefits?

If these trends are accurate might we not project a future where the industry is increasingly regulated by the Federal Government? Is it possible that it could be a positive thing to have a federal agency to turn to for help and protection as the banks do to the Federal Reserve Board or the securities industry does to the Securities and Exchange Commission? Is it in our own best interest to shape the future rather than to be shaped by it?

Perhaps in making our projections from now on, we might try asking ourselves some of these questions. After all, we need all the help we can get in this uncertain world.

Editor's Note: E. James Morton is President of John Hancock. □

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An Agent's Perspective

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plaining this disparity to my agent, as the agent always feels that our actuaries and those of our reinsurers are being overly conservative in their guidelines for their underwriters.

I fully recognize the fact that the many decisions that are made in the daily life of the actuary involve probability as well as the effect on company expenses. Perhaps more weight should be given, however, to the problems of the real world that we field people face as part of our everyday existence. All too often, decisions are made without regard for the many difficult and untenable problems they create for the field. We want our actuaries to know that we stand ready to serve as their partners to help our companies and our industry survive and grow in these turbulent times in which we live and work. United, we can all rise to unprecedented levels of growth and success!

Editor's Note: Leonard Frieden has been a General Agent for 20 years. □

REINSURANCE ADMINISTRATION IN THE SPOTLIGHT

By Mark R. White

Reinsurance has always been one of the more glamorous fields of the insurance business, but not all aspects of it have received equal attention. Reinsurance grabs headlines when there is a natural disaster or an insurance company insolvency, or when the IRS gets miffed, which is most of the time lately.

Perhaps the least noticed aspect of reinsurance over the years has been administration. Except for a small group of people in the reinsurance companies who developed the reinsurers' administrative systems, few people in the industry cared to know much about the subject. And why should they have cared? Generally things worked well enough without their constant attention.

Historically, of course, the reinsurers were responsible for the administration under most treaties. Negotiations focused on other factors such as price. Ceding companies, except for the relative few who had their own administration systems, took for granted that portion of a reinsurer's service.

In the last decade, however, several major changes have had an impact on the reinsurance marketplace. The entrance of many new reinsurers, particularly from Europe, was accompanied by a steady decrease in the price of reinsurance, not to mention a steady increase in the number of reinsurance doodads given away at actuarial meetings. In order to attract market share, reinsurers were often willing to consider additional price discounts for direct writers who self-administered.

At the same time, products such as Universal Life and Variable Life were being developed which in many cases necessitated self-administration because the reinsurers had not yet developed administration systems that could adequately handle the products' complex requirements.

Due to the proliferation of low reinsurance premium rates, reinsurers also found it more difficult to cope with the substantial increase in the volume of low cost term business reinsured. This led to dissatisfaction on the part of some ceding companies and a conse-

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Reinsurance Administration

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quent interest in self-administration. Of course, the reinsurers were receptive because of their problems in dealing with the backlog.

Almost overnight, self-administration grew to be a common mechanism for handling reinsurance.

Now the pendulum is swinging back. Self-administration has become the object of a great deal of attention from reinsurers and ceding companies alike. While many of the arrangements are working out quite well, there are also cases where they aren't.

Some of the consequences of unsuccessful self-administration arrangements are:

- Reinsurers have not received adequate reporting to enable them to complete their annual statements or management reports.

- The auditors and senior management of reinsurers have been placing increasing pressure on the accounting/administrative areas of the reinsurer to obtain more and better information. This pressure is then relayed back to the ceding company.

- Ceding companies have found it difficult to obtain sufficient internal EDP resources to upgrade self-administration systems when they are found to be deficient. Many of the desired changes in the systems were not known to be the ceding company's responsibility when the systems were first put in place.

- A rapidly increasing number of audits are being performed on ceding companies. In some cases, substantial numbers of processing errors are being found. In particular, many reinsurers are finding that they have not been receiving premiums or cession information for some of the risks that should have been reinsured with them. Without audits, the first time these errors might come to light is with the death claim years later.

- Discounts for self-administration are no longer common. The current feeling of many reinsurers is that they do not show a net savings due to the existence of a self-administration system.

In this environment, it is not surprising that reinsurers and ceding companies alike are paying a great deal more attention to their self-administration systems than they did in the past. Even reasonably successful self-administration arrangements are being affected by this changed environment.

The actions that the reinsurance industry is taking in response to this new state of affairs are just beginning. These actions can be loosely grouped into the following categories:

1. Upgrading Existing Self-Administration Systems

Reinsurers are beginning to identify which of their clients have inadequate self-administration systems. Once identified, they are working with those whose systems need to be improved. In general, reinsurers would rather try to work something out with the ceding company (assuming administration is the only problem) than pull out of the program entirely. Experience on a block that is running off is expected to be worse than that of a block where the ceding company is still actively involved.

2. Encouraging Caution in Setting up New Systems

Reinsurers are no longer willing to let "just about anyone" set up a self-administered system. Similarly, ceding companies are more aware of the pitfalls of self-administration than they have been in the past. Together, these factors have led to a more realistic assessment of whether a self-administration system is appropriate for a given reinsurance arrangement.

3. Education

One of the most important goals of the Administration Committee of the Reinsurance Section is education. With that in mind, the Committee is in the final stages of producing the "Guidelines for the Reporting of Self-Administered Reinsurance." The exposure draft of this document was well received and a final version is expected to be available for distribution before the end of 1985. The Guidelines discuss issues that should be considered by every ceding company and reinsurer in setting up a self-administered arrangement.

4. Auditing

Reinsurers are auditing their clients in ever increasing numbers. This is likely to continue for some time until reinsurers feel that they have brought their business under better control. After that, activity will probably slack off somewhat, but never to the pre-1985 level. Although many ceding companies are not concerned about the possibility of an audit, it is likely that a great many of them will have to endure at least one over the next few years.

5. Research into Electronic Data Transfer

There is significant interest in improving the ability of ceding companies and reinsurers to communicate easily. The most intriguing prospect is for the use of electronic data transfer. Work is being performed by a number of companies in this area.

There is indeed a great deal going on. Those working in the reinsurance area over the next few years are likely to find the stresses and strains at least as great as they have ever been.

But after all is said and done, in a few years most self-administration arrangements will probably be working fairly well, and the now exciting subject of reinsurance administration will once more slip out of the limelight. In fact, if you were to ask most of the people currently involved in reinsurance administration, they would all probably be quite pleased for that spotlight to start fading away right now.

Editor's Note: Mark R. White is an actuary with The Wyatt Company and is the Chairman of the Reinsurance Section Administration Committee.

CORRECTION

The book review of *Pension Mathematics for Actuaries*, published in last month's issue, was incorrectly attributed to Deborah Poppel. The review was done by Geoffrey Crofts.

We hope that the difference in credibility of these two reviewers did not affect your decision as to whether or not to read the book.

The Actuary
Is Always Interested
In Receiving
Letters to the Editor