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REINSURANCE

A. What are the limits of company retention for ordinary insurance? What actuarial considerations are involved in determining such limits?
B. What interest is there in loss ratio or catastrophe reinsurance? What are the problems likely to be encountered in such forms of reinsurance?

Stating his feeling that the purpose of reinsurance is to enlarge the freedom of action allowed in individual companies, MR. CHARLES H. CONNOLLY questioned whether the three forms of reinsurance (automatic, facultative, and catastrophic) give companies the freedom of action they seek.

Furthermore, Mr. Connolly stated that complete freedom implied that a company could assume any risk without financial danger and with continuing confidence in its underwriting. Although the conflict between financial stability and faith in underwriting is partially resolved by adoption of a schedule of limits of retention, he questioned the common practice of holding down retention limits for underwriting reasons.

Mr. Connolly suggested that an adequate catastrophe program, coupled with a facultative-automatic agreement under which the issue (but not the table rating) is bound, might be a better solution to the need for reinsurance. The catastrophe coverage, which would serve to maintain company solvency and stability, would minimize the necessity for automatic reinsurance agreements. Reinsurance issued under a facultative agreement, with the reinsurer automatically accepting the issue but not necessarily the rating, should cost approximately the same in the aggregate and still provide a facultative agreement's primary service—underwriting reassurance. In addition Mr. Connolly advanced the thought that if the above were combined with a method of moving gradually from the underwriting limit of retention to the financial limit of retention, through reinsurance of half the excess over the underwriting limit rather than the entire excess, the reinsurance cost would then be more in line with the service that is being sought.

MR. HERBERT A. WINTERS told of the plan the Great Southern Life has initiated in the field of retention limits.

At the onset of the plan his company had over $900 million of insurance in force, a strong capital and surplus position of about $30 million and a competent underwriting force. Under these conditions the first step was to establish a retention of $350,000. Realizing the possibility of significant claim fluctuation, $500,000 of surplus was next established as a special mortality fluctuation reserve with the idea that it would be added to or drawn from, depending on the experience of any calendar year. At the end of each year the ratio of the company's actual-to-expected mortality for the past five years would be determined, the average found, and that figure applied to the life insurance tabular cost to obtain an "expected" claim figure. If there were greater than 3% variation from the "expected" for the year, a contribution to or withdrawal from the fluctuation reserve would be made accordingly.

Double indemnity, with a retention established at $100,000, was handled similarly. An additional $100,000 special mortality fluctuation reserve was established for double indemnity. Realizing, however, that double indemnity fluctuations would be wider, no contribution to or withdrawal from the reserve would be made unless the actual double indemnity claims varied more than 25% from the "expected."

In actual 1959 operations no contributions or withdrawals were required on either line. The experiment continues to work to the satisfaction of the Great Southern Life.

MR. WILLIAM A. DREW discussed the problem of excess loss reinsurance, pointing out the reasons why the Lincoln National to date has declined to assume and retain this sort of coverage. He stated the two general reasons for advocating excess loss reinsurance: (1) to solve completely the financial requirement of the alleviation of radical changes in surplus due to unfavorable mortality results, and (2) to do so in a more direct and economical manner.

Mr. Drew proposed that an unlimited excess loss plan, which he considered as a plan in which for an annual consideration all losses in excess of a certain amount are paid by the reinsurer, no other qualifications being made, be compared with current methods. The test is to be the extent to which each meets reinsurance requirements, from the standpoint of both the reinsurer and the reinsured.

Six motives for reinsurance were set out:

1. alleviation of radical changes in surplus due to unfavorable mortality results;
2. relief, through coinsurance, from heavy surplus drains due to large amounts of new business;
3. use of the reinsurer as an independent underwriting check;
4. use of the reinsurer's help on questionable claims;
5. drawing upon the reinsurer's experience for guidance on various home office practices, such as application, issue, policy forms, accounting and reserve methods, investments and agency and personnel problems; and
6. meeting certain nonrecurring problems such as excess group amounts and special plans of contingent insurances.

Mr. Drew had found that today's methods of reinsurance solve most of the problems of both the reinsurer and its clients—the high administrative costs of individual handling, however, remaining as the weak point.

He pointed out that from the reinsured's viewpoint unlimited excess loss reinsurance would provide peace of mind in having a pre-set maximum loss point, and would operate in an administratively economical way. On the other hand, excess loss reinsurance:

1. could *not* provide surplus relief for new business purposes;
2. would *not* provide underwriting checks;
3. could *not* provide special services except to the extent that loadings are added;
4. would require giving information to the reinsurer regarding its spread of risks which might not be readily available;
5. would place the reinsured in the position of having no ceiling on his total reinsurance costs if experience proved poor, since excess loss coverage cannot practically be guaranteed for more than a year or two at a time;
6. would place the reinsured in an awkward position in case of cancellation by the reinsurer on short notice, thus compelling the ceding company to look for another reinsurer who might grant reinsurance only on the usual individual basis.

From the reinsurer's viewpoint an unlimited excess loss plan:

1. would eliminate checks on the ceding company's underwriting;
2. would eliminate checks on the ceding company's claim practices;
3. would do away with fixed premium scales and put each company on an individual basis in which gross premiums would be determined by the ceding company's spread of risks, reinsurance benefit provided, loadings for outside services provided, and contingencies;
4. would eliminate statistical records from which valuable underwriting information is obtained;
5. would place the reinsurer on the risk for a large potential loss for a relatively small premium;
6. would pose certain problems in the relationship of necessary reserves and the federal income tax law;
7. would expose the reinsurer to loss from a large *number* of claims, considering the possibilities of war and epidemic;
8. would make experience refunds impracticable, especially during the early years;
9. would make pricing of the coverage, though possible with more refined mathematical theory, dependent upon difficult-to-obtain information;
10. would make it impossible to guarantee the pricing mechanism, because of the very nature of the coverage.

To partially overcome a reinsurer's objections to an unlimited excess loss plan, Mr. Drew stated, restrictions proposed generally take the form of: (1) including in the plan limited amounts only on each life, perhaps grading down with increase in substandard rating, and (2) a coinsurance feature in which the reinsured pays a certain small percentage of all claims in excess of the reimbursement point. Each of these limitations, Mr. Drew felt, destroyed in part the advantages of the excess loss method and neither of them completely solved the reinsurer's problem of placing practical restraints on uncontrollable losses. The proposed restrictions raise for the ceding company the problem of comparing competitive quotations.

It is not clear that total reinsurance costs under an excess loss plan would be less than those at present. Necessary loadings for special services, and for the lack of information on specific underwriting and claim practices, would increase the cost. Deterioration of the self-interest of the ceding company could increase basic loss costs.

Mr. Drew concluded by reaffirming his feeling that, on balance, the interests of both reinsured and reinsurer are generally best served by one of the plans now in general use.