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## MEETING OF THE REINSURANCE SECTION

*Moderator: IRWIN T. VANDERHOOF. Panelists: DAVID M. HOLLAND, ALICE KROLL, HERMAN H. SCHMIT, LAWRENCE SILKES, COURTLAND C. SMITH, WILLIAM K. TYLER, MELVILLE J. YOUNG*

1. Role and purpose of the Reinsurance Section.
2. The reinsurance treaty - problems and pitfalls.
3. Panel discussion: In choosing a reinsurer, what do I want and in choosing a client, what do I want?

MR. IRWIN T. VANDERHOOF: This is an open forum and it is crucial to this program that the people in the audience actively participate. This will probably end up being the annual meeting of the Reinsurance Section. There has been one Council meeting. A newsletter was prepared and went out describing the decisions made by the Council. However, to a very large extent, those decisions are not final but are dependent upon your attitudes, opinions and participation. One thing you must expect is that you are going to have to work. We have identified areas which might be the nuclei for five committees. The Council does not plan to be the total membership of these committees. It is possible for people on the Council to pick others they know and thereby form the committees, but that is far less satisfactory than having people volunteer.

The basic pattern of the committees was described in the newsletter. To review, the five committees are:

1. Uniform Treaty Provisions. The Section could make recommendations on the wording of general reinsurance treaty provisions; e.g., conditional receipt; risk designation; punitive damages; interest on late claim payments; and insolvency offset.
2. Education. The Section could contribute reinsurance material for the Society of Actuaries exam syllabus and provide continuing education for Section members in the field of reinsurance.
3. Statistical Research. Potential areas for study include large claims, excess major medical, large case persistency and retention limits.
4. Reinsurance Administration. Topics that could be studied include computer data exchange and hidden costs of reinsurance.
5. Reinsurance Coverage and Areas of Special Interest. Areas falling in this category include substandard shopping programs, replacements, and tax aspects of reinsurance.

These are proposed committees. After today's session they will be proposed to the appropriate Society Vice President as committees of this Section.

We need comments from the members of the Section, either on these proposed committees or on other areas which you feel would be of interest and of value to the Section and to the Society. May we have some comments on this?

MS. JOHANNA B. BECKER: One of the proposed committees deals with education and interrelation with the exams. I am Part 9I Vice-Chairman and reinsurance is on that exam. How is the Reinsurance Section supposed to relate to the reinsurance task force which is making recommendations for exam material?

MR. MELVILLE J. YOUNG: I am the chairman of that task force. What we are hoping to do is complete our first stage work sometime early in 1983 on suggestions to the E and E Committee. I will then turn over the chairmanship of the Task force to the new chairman of the Education Committee of this Section.

Also there is a sixth committee Irwin didn't mention. It is the Program Committee of which I will be Chairman. We are also seeking volunteers for many of the other chairmanships.

MR. MICHAEL R. WINN: Irwin, many of the reinsurers here, and perhaps some of the direct writers, also operate in Canada or Latin America and South America. Would you want to include in the list of various topics that you mentioned some reference to non-U.S. operations? I can't elaborate all of the differences, particularly in the Latin American and South American markets, but there are differences that may be meaningful.

MR. TREVOR C. HOWES: Along the same lines, I wonder if the Committee on reinsurance coverage and special topics was intended to focus on special interests of group reinsurance or A & S reinsurance as opposed to life reinsurance which perhaps is of primary interest.

MR. VANDERHOOF: That category- reinsurance coverage and special topics- was an open category. The question of group and accident and sickness did not come up in the discussions as a particular area of reinsurance. It should have.

Some other comments? Does anyone have any feeling about whether these categorizations, as they have been supplemented by the last few comments, conform to the interests of the members of this Section? Are there some of these that aren't necessary? For example, is there any danger or disadvantage in having uniform treaty provisions?

DR. GOTTFRIED O. BERGER\*: Uniform treaty provisions should be done, but I am surprised that the Society of Actuaries initiates this. I question the competence of this group to do that. It is such an important issue

\* Dr. Berger, not a member of the Society, is President of Cologne Life Reinsurance Company.

that it should be done in cooperation with the reinsurance industry and particularly the legal part of the reinsurance industry. We might waste time if one interested group starts to do this without any coordination.

MR. VANDERHOOF: The need for legal cooperation or legal advice is important in any treaty work, but right now there is no coordinated effort among the reinsurers to have their lawyers do this work. And the danger from the point of view of the client in not doing this might be substantial. It's not clear to anybody that clients actually have the coverage they think they have. There are too many possibilities for clients to think they have coverage and not actually have it. The split of the reinsurance between two companies may allow one big claim to fall through the cracks. It would be very nice if the reinsurance industry would like to volunteer three or four lawyers to work on this, but saving that, we probably should try and go ahead.

MR. PETER PATTERSON: In Canada we have an organization called the Canadian Reinsurance Conference. This same suggestion was put to the Canadian Reinsurance Conference that there should be a set of uniform provisions that act as an industry standard. If you didn't have these provisions in your treaty, then they (the uniform provisions) would be a fall back provision to solve disputes. Interestingly enough, the reaction of the people at that Conference was: are we competent and is this the right body to do it? Surely it should be done by the Institute of Actuaries, but this is a ball which one could pass from one group to another very easily. In Canada, the actuaries did put together the 1965 reinsurance provisions so that the question by the Conference was a natural one. The Conference did decide that, notwithstanding they hadn't done anything like that before, they would tackle the problem. A Conference committee was formed in Canada and it is trying to put together a set of standard provisions.

I have a great fear of lawyers. I deal with claims in my company and I see those costs escalating. I would hate to turn something over to them (the lawyers) to start the work. Maybe give them the end result and ask them to pick some holes in it. But I do agree that the lawyers would have to be involved at the final stage.

MR. DAVID M. HOLLAND: Irwin, one comment is that this is not meant to be a Committee just of reinsurers. We want direct company participants too, because they have to live with the treaties. We need input as to what their concerns and interests are. Therefore, this isn't meant to be a "reinsurers only" project. But this does seem to be the only group available to work on this type of project. It really should help both the direct companies as well as the reinsurers.

MR. DENIS W. LORING: I don't know what the proportion of direct writing companies to reinsurers is in this room. I have a hunch there are many reinsurers here. The Section might try to find a way to reach out to the direct writing companies and make an affirmative action effort to bring them into the activities here because the temptation is gradually to become purely a reinsurers' section as opposed to a reinsurance section.

MR. VANDERHOOF: In the original membership the statistics were that about half of the membership of the Section was connected with reinsurance as a client and the other half, reinsurance as a seller. Can I ask how many people in this audience are connected with reinsurance as a seller, as a producer of reinsurance? How about the other way? In this audience, it is weighted a little more heavily toward the reinsurers.

MR. YOUNG: Irwin, are you going to have some facility for people to volunteer for one of these committees?

MR. VANDERHOOF: Yes, it would be great if you approached me later and volunteered for one of those committees. You can also volunteer your help to anyone on the Council. We need and want membership on the committees. We are particularly looking for membership from other than professional reinsurers. From the distribution of people in the audience the primary group here are the professional reinsurers and that's not what anyone wants as the ultimate staffing of the committees.

MR. EDWARD B. MARTIN: The first three committees you mentioned seemed to have a very specific purpose or charge. That's less clear to me with respect to the latter two. Did the Council have anything particularly in mind that those committees were to pursue?

MR. HOLLAND: One of the topics under reinsurance administration is computer data exchange. Part of the uniform treaty provisions is to find ways to make both of our jobs easier. We don't like the situation where you, the direct company, send us something. We punch it into the computer. We make a mistake. We send it to you. You find the mistake and you correct it. In the meantime, we have billed you incorrectly. You send us something else. There is a lot of paper that goes back and forth in the reinsurance industry, and a lot of duplication. In today's environment, we are all very cost conscious. Anything that we can do to improve the administrative relationship we have would be welcome. It seems also that there are opportunities for us to get involved in trying to set up some standards for computer data exchange. This would simplify the work load of the direct company side as well as the reinsurer if we can have some way to approach that problem. It is something that won't be realized for some time, but it is something that would help in the cost and expense quite a bit.

MR. YOUNG: I input something to that Committee that was my concern as a reinsurer. A very large percentage of the business that we receive today is reported on a bulk basis. Because of this, we have no access to the statistics that we normally use to do our pricing, GAAP accounting, etc. This data could be sent to the reinsurers. We hope to develop a standardized approach to this in order to receive the data we need.

MR. VANDERHOOF: Those answers are both addressed to reinsurance administration. Reinsurance coverage and areas of special interest were not as well defined as a topic as was administration. Coverage and areas of special interest dropped out as a catchall category. It clearly would

cover tax aspects of reinsurance and shopping programs. How to properly conduct a shopping program and what you should expect to get from it should be of interest to client companies.

MR. YOUNG: I don't want to let Mike Winn's statement drop because it was intriguing. We should consider further the foreign market and see if there isn't some reason for us to have a special committee in that area. Any members interested in this area, please express that interest after this session concludes.

MR. HOWES: A question on the Program Committee. Is the charge of that Committee to form topics and agendas for sessions such as this and are we only assuming a meeting once a year at the annual SOA meeting and no content at regional SOA meetings?

MR. YOUNG: Yes, we are charged with developing programs of interest to the Section. We have some thoughts and we hope that we can develop some good programs. Some we envision will be in conjunction with Society meetings and the Society as a whole.

MR. VANDERHOOF: We have had some discussion about the possibility of having a meeting on special topics either within a Society meeting or as an extension or a preface to such a meeting, or one entirely independent for a day or two. There are arguments against having entirely separate meetings in that transportation, time and costs are involved. We have to have an annual business meeting aside from special topic meetings. There should be at least once a year an opportunity for the Section to get together and express opinions and ask questions. We have not made any decision about requesting time at other Society meetings. The final decision has not been made about setting up separate meetings, although there is a strong feeling that we should have one in the spring on special topics.

MR. LORING: The Section was approached by Steve Frankel, who is chairman of the Society Program Committee. He asked if we were going to have a Program Committee that would act as consultant, advisor, etc., to the Society Program Committee for all topics relating to reinsurance that might appear within the Society programs.

MR. ROBIN B. LECKIE: I entered part of the Health Section's Program Committee meeting. Paul Barnhart conducted a survey of his members as to how they would like to organize their meeting. The first choice was to have a meeting either before or after SOA meetings; the second choice was to have one or more sections within a Society meeting; the third choice was a separate meeting altogether, although they saw the same problems with this as previously discussed.

MR. DAVID M. WELSH: Do you plan on sending anything out to people along the lines that you have laid out here this morning? Some of us have come here and feel a little bit surprised at the plans that existed. We simply haven't had time to react to them and don't know how we would prefer to participate in the proposed committees.

MS. SUE COLLINS: After the Council meeting in June, we sent out a newsletter that outlined these five committees and mentioned the Program Committee. This came out with the September copy of The Actuary.

MR. COURTLAND C. SMITH: We are going to challenge you in this part of the program. We will challenge you to think about problems that are now appearing in the industry because we are in a time of change and in a time of economic contraction. These problems relate to the way our agreements should be structured. We had a good deal of stability in the industry until the early 70's and now we are seeing intense competition. Shopping has become a way of life not only in the underwriting area, but also in the area of coinsurance pricing, rates, etc. We see situations where the traditional automatic arrangements of one company with one reinsurer have changed to one ceding company with many reinsurers.

One question we have to consider is, who are the parties to these treaties? It is important to keep in mind that reinsurance agreements are not between an ordinary consumer and a businessman; they are between two businessmen. Although our treaties are not treated as contracts in the usual sense, businessmen are presumed in law to be able to protect their own interests.

Who writes treaties? Typically it is the reinsurers who write the treaties. Treaties have been written in terms of a fairly stable historical situation which is now changing. The section of the Illinois Insurance Department Handbook on life company statutory accounting practices has an interesting quote which I will repeat at this time. "Common sense and a healthy skepticism should prevail when considering the matter of reinsurance treaties. It has been said that reinsurance contracts result from agreements between gentlemen. It is necessary that each party, therefore, be certain that the other is a gentleman."

MR. HOLLAND: In my comments this morning, I have been asked to talk about a gentlemen's agreement and of course everyone knows what a gentlemen's agreement is. It's "of course, I'll marry you." First, I will give you the environment surrounding reinsurance and the changes that have taken place since its early history.

The first recorded reinsurance treaty goes back to 1370. It was a marine insurance treaty, as much of our business originated in the marine area. The treaty dealt with the transportation of goods from Genoa to a place in Belgium called Sloos. They had to go through the Mediterranean around the English Channel and down the canals by Brugge and into Sloos. There was an original company involved. They had pressure to place the case from a high powered agent, one of their big hitters. They had no problem in keeping the risk through the Mediterranean from Genoa to Cadiz, but from there into Belgium, they had a real problem. Hence, they reinsured it. That was the first reinsurance treaty. We don't know what the results were, whether the reinsurer made or lost money. But, there are a couple of things about this treaty that are of interest. One is that it wasn't a capacity treaty. The direct company

was willing to retain the full amount of the risk during the safe part of the journey. The reinsurance was only needed during the high risk portion of the journey.

Reinsurance evolved and had a very interesting history; so interesting that by 1746, England outlawed reinsurance. That was the England Marine Insurance Act of 1746 which lasted until 1864. The reasons they outlawed reinsurance are not exactly clear, but they thought there was speculation for the gambling purposes involved in reinsurance rather than a true transfer of risk. Nevertheless, reinsurance was transacted. I have a quote that I would like to share with you from a textbook written in England in the early 1800's which explains the rationale as to why reinsurance was really needed. "But if an underwriter repents of what he has done, if he be afraid to encounter the risk which he has engaged to run, or find that he has incautiously bound himself to a greater amount than he may be able to discharge, he may shift it or a part of it from himself to other insurers by causing a reinsurance to be made upon the same risk upon the best terms he can and the new insurer will be responsible to him in case of loss." Thus ends the law on the subject of the maritime states of Europe.

There was much to be desired in the origins of life insurance in England too. Apparently there were times when the ceding company would not tell the reinsurer what his retention was. There was also the problem that the ceding company would keep a zero retention. Another problem in early reinsurance was that the policy would often be lapsed but the reinsurance would be continued in force as a speculative matter. As a result of this, there were some reinsurance regulations developed in Scotland in 1849 and in England in 1900. The English Act still governs facultative reinsurance.

As you can see, most of the early risks were facultative risks. Early business was transacted on a risk-by-risk basis, but things evolved and became much better as they developed into an atmosphere of partnership, an atmosphere of cooperation between the direct company and the ceding company. They began to have concepts like utmost good faith and many of our treaties are based on that particular concept, as well as the concept that the reinsurer follows the fortunes of the ceding company. Following the fortunes right now seems to be a one-way street. We will follow the losses but not necessarily the profitability.

Much of what is happening today resulted from the utmost good faith, to follow the fortune, the cooperation, the true gentlemen's agreement, but the way things are developing in the 1980's, the way mores have changed, the way people have developed, we see certain trends. One is the lack of commitment. This is evidenced in divorce rates by the fact that people do not believe as much in marriage today. We see palimony suits; we see a lot of things where people don't have an idea of commitment. We see a company agent's lack of commitment today, where again we get into the law of large numbers - that is, if the volume is sufficient, we will suspend all logic. There is also a corollary that greed varies directly with the amount of volume.

In terms of the company-agent relationship, it is, "of course, I will marry you" as well in that type of a situation. "I know this case has been moved every year for the last ten years, but I have control over it now, and I am sure that I can...." Or you see a particular general agent who has been with three different companies and each time he moves companies he replaces the business. You say, "of course, we can have him under control and we'll produce the business now." Reinsurance is also concerned with this problem, lack of commitment. This is unfortunate, because it really goes back to the fact that there are special risks that you are reinsuring as opposed to retaining.

I would like to mention some reinsurance uses or abuses in today's market that may or may not be healthy for either the ceding companies or the reinsurers in the long run. One area is the area of reentry underwriting. Originally when we started having select and ultimate products with reentry underwriting, we were obtaining the full medical evidence at the expense of the insured. That lasted about a day. It got to the point where the company absorbed the cost of the evidence; then people started saying "look how much money we can save in underwriting costs if we just get paramedicals, and then if we just get inspection reports, and then only a statement of good health, and finally if the check clears the bank, he must be in good health."

One case comes to mind in particular. We were not a front line reinsurer, but were a second line retrocessionaire. We took a piece of a \$12,000,000 risk just for capacity and didn't know that it was a reentry product. At the end of the first year, because it was annual reentry, the direct reinsurer sought assistance in revising the rates. We wouldn't have taken it had we known it was an annual reentry situation. After a good deal of negotiation we asked to see the papers on this \$12,000,000 risk to see if we could work something out. We got two pieces of paper on this risk: one was a statement of good health from the insured; and the other was an APS about eight months old, on which the doctor had stated that he had seen the guy eight months ago and he looked like he was in good health. Now those are not very good underwriting standards for a \$12,000,000 risk. At least, it doesn't seem consistent with the way various things have been priced. Again this gets into the question where we have an agreement in the beginning which was priced on very select assumptions; and the question is, as time goes by, will we continue to "live like this"?

We see questions of zero retention one reinsurer at a time. A company needs some surplus relief. They decide to reinsure 30% of their retention. They get surplus relief. They liked it so well, they reinsure another 30%; they liked it so well, they reinsure another 40%; and therefore, they have a zero retention. The first reinsurer may not know that this company has the binding authority of a million dollars on a zero retention. This gets back to what was occurring in England in the early days. This is not a healthy situation, and reinsurers as well as direct companies need to be concerned about such situations. I mentioned the law of large numbers - there is a law of large number, singular, situation. This is that a \$10,000,000 claim is a pretty big claim, and if you charge \$1 per thousand, which is what some of the

competitive rates are, you have to have a \$10,000,000,000 portfolio just to cover one \$10,000,000 claim. There is something there to be said about the true risk element as well as the cost of handling such large claims.

Another thing we have seen is that a company will ask us for aggregate YRT premiums for an automatic quote. Later they ask to see our smoker/non-smoker premiums. Then they award the reinsurance to another company and say they would like a facultative shopping arrangement with us. We say okay. They don't like our smoker/non-smoker premiums and want to use the aggregate premiums because, after all, they are equivalent. It sounds very logical, but whenever we get involved in more discussions, we find out that the way the direct company awards ties is on a cost comparison grid. The results of using an aggregate premium for the facultative reinsurer and the smoker/non-smoker premium for the automatic means that all of the non-smokers go to the automatic on a non-smoker premium and all of the smokers go to the facultative reinsurer on an aggregate premium. Hence, there are areas of antiselection, either witting or unwitting, but again, it gets back to the concept of what is a gentlemen's agreement.

I hope that everyone feels that reinsurance provides significant services. We have had a good history of cooperation. Reinsurance principles should be adhered to by the reinsurers and the ceding companies should expect us to be reasonable in what we do. We should not have the attitude of current society of the lack of commitment, but should see that commitment and reinsurance is a two-way street.

MR. PATTERSON: I am going to tell you two stories this morning and leave you to draw your own conclusions. Once upon a time, there was a young man that decided to take his girlfriend for a joy ride on his motorcycle. He thought they were having a great time until she tapped him on his shoulder and indicated to him that he should pull over to the side of the road. She then explained to him that while she was enjoying the ride, she was freezing to death - it was cold back there with all that wind. He thought for a second and found a great solution - he took off his leather jacket and told her to put it on backwards. He then zipped it up the back. Back on the bike they got and off they went. It worked fine and I would like to tell you that everything was okay from then on, but unfortunately, just down the road, they encountered a truck that swerved toward them. The motorcycle went careening into the ditch, throwing both parties to the ground. The young man eventually came to his senses and realized that there was a large burly police officer leaning over him asking him how he was. He said, "I guess I am all right, but my girlfriend, how is she?" "Oh", said the police officer, "she seemed all right at first, but since I turned her head around the right way, she has just laid there and not said a word".

Well that is pretty awful but I want to ask you a question. Was the police officer well intentioned; was he a gentleman; and did he do what he thought was right? Secondly, did everything turn out all right in the end?

The second story I want to tell concerns a life insurance company called Trusting Life. Trusting Life has two reinsurers - one automatic reinsurer and one facultative reinsurer. The agreements it has with both the facultative and the automatic are standard agreements with standard provisions allowing Trusting Life to reinsure business automatically with the automatic up to a certain point. If a case is sent out facultatively, then the case is sent to the automatic as well. If a case is sent out facultatively it cannot then be sent to the automatic under the automatic provisions. The facultative company has a provision that says it goes on risk when it is notified in writing that its offer has been accepted.

Trusting Life had an agent in California who had a million dollar case. The agent took money for the full million, even though the conditional receipt was limited to \$100,000. The policy was received by Trusting Life and Trusting Life knew that it was not a decline. It was simply a substandard case and probably not heavily substandard. The case was sent to the two reinsurers and Trusting Life did not return the premiums. The day after the case was sent out, the automatic reinsurer sent back an answer of Table 4 subject to an X-ray. The next day Trusting Life received word that the applicant died. The day after that, the facultative reinsurer responded with a Table 2 firm quotation.

What we have here is a million dollar claim. Trusting Life then looked to see who should pay this million dollar claim. The automatic reinsurer's position is absolutely clear. The case was shopped; there was an auction; the case could not be sent automatically after that; and, therefore, the case does not come under the automatic agreement. Also, the automatic's offer was conditional and obviously an X-ray could not be obtained; hence, the offer was non-existent. The final point was that their offer was Table 4 and, if the case was going to be placed, since there was a Table 2 offer on the table, it wasn't ever going to be placed with the automatic; therefore, there was no liability. The facultative reinsurer merely pointed out that when a case is sent out facultatively, the ceding company is not making an offer which the reinsurer can accept, because otherwise a contract would exist as soon as one of the reinsurers accepted it. It's being sent out as an invitation for the facultative reinsurer to make an offer, which the insured or the applicant can accept; then the contract is made. In this case, the offer from the facultative reinsurer came back at Table 2, but by that time the insured had died, and clearly could not accept the offer; therefore there was clearly never any contract and obviously no liability to the facultative reinsurer. Trusting Life couldn't quite believe that they were responsible for the million dollar claim. Their retention was \$100,000; there was no way that they had a million dollar claim, was there?

Now I am sure that each of you has worked out who is responsible. I ask you to think of yourself as being the president of the organization you think is responsible for the million dollar claim. As president ask yourself how you are going to phrase your explanation to your shareholders about why you think, despite what's on the table, that your organization should be paying that million dollars.

Now let's examine the claims provision. Assume for a moment that the facultative reinsurer agrees to pick up the entire claim. The Trusting Life then obtains its normal claims evidence - a claimant's statement, an attending physician's statement, and because the claim is accidental and for a million dollars, they obtain an Equifax report. The Equifax report costs \$300 or \$400. The ceding company then sends the bill to the reinsurer to pay for the cost of that investigation. The reinsurer says that the treaty states that normal claim expenses are covered by the ceding company. Trusting Life says "that is ridiculous because we have no liability here - the whole million dollars is yours. We are doing this for your sake, and certainly there is no way we should be paying for a claim expense of \$500." That is peanuts compared to the million dollars, so gentlemen ought to be able to resolve that easily. It will probably mean that the reinsurer will pay. Unfortunately in this particular case, there was a small misrepresentation and the reinsurer says that this misrepresentation would have meant at least four tables. The reinsurer would have quoted Table 6 and that's material, and therefore they think this claim should be denied. The Trusting Life says "it's small potatoes, once you have quoted Table 2, Table 2-Table 6, it's already substandard. This misrepresentation can't mean that much. This is the sort of claim that we pay. If it was our claim, we would pay it. Now I am sorry it isn't. We are not really sorry it isn't, but we could demonstrate our good faith if we had a share of it, but we don't. The widow is pretty important in our town. Her husband was an important man, and this is one of our best agents and the reputation of our company is that we pay our claims." The reinsurer then has the million dollars on the table and looks at his claims provision which says that he can recommend but not make the decision. Think who decides to pay the million dollars and who has no risk involved in making that decision?

One other last point in the provision is extracontractual damages or punitive damages and probably it's not in the provision. Why isn't it in the provision? "Gosh, if we mention that at the time we are setting up the treaty, their reaction might be that reinsurers should pay punitive damages and that might start a whole series of questions which might lead to a different reinsurer having this business - a reinsurer that didn't raise this issue. So gosh, the chances are that there won't be any claims; and if there are any claims, the chances are there won't be any contested claims; and if there are any contested claims, the chances are there won't be any punitive damages; so we will leave that alone for a little while and worry about that some time later. Besides probably all the other provisions imply that there is no coverage for punitive damages." Now we have got this claim and we finally persuaded the ceding company to deny it. The ceding company says "okay we will deny the claim but one point before we send out our letter of denial: that is, you are agreeing with us then, if there are punitive damages or extracontractual damages, those will be the responsibility of the reinsurer." "Well," said the reinsurer, "we would like to say yes, because we don't want to discourage you from denying the claim which we have just persuaded you to do, but three things need mentioning. First of all, we don't know that the courts are going to allow reinsurance on punitive damages anyway. Secondly, we can't just give you carte blanche

because there is no telling what one of your people might do down the road. One of them might say something to the widow that offends her or might write the wrong kind of letter or might say something in court which gives rise to the punitive damages and we can't be responsible for the actions of your staff. The most important reason, though, why we can't promise you that we will cover you for punitive damages is that that might be revealed in court. It might be that when you are on the witness stand, and frankly this is very likely, the lawyer for the other side will ask you about your reinsurance arrangement. They will ask you if the reinsurer is picking up any part of the punitive damages. If you say yes, then the court, which might have said 'well to punish this company we will make the damages 1% of their assets,' might easily say 'well there are two people to punish here, we had better reach through the ceding company and add the assets of the reinsurer to the ceding company's assets and punish both of them in that form.' The ceding company says 'you are telling me that if there are extracontractual damages on top of this, that you won't pick them up, that they are going to be left with me.' The reinsurer says, 'that's the way it is.' The Trusting Life says "I have got to rethink whether I am going to deny this million dollar claim." I leave it to you to decide whether these problems, assuming both sides are gentlemen, are still easily resolved and if they are more easily resolved right now or more easily resolved when you have a million dollar claim on the table.

MR. SMITH: What do you think is wrong with the reinsurance business right now, with your reinsurance agreements and what would you do about it if you had the power to do something?

MR. TIMOTHY FITCH: One of the problems with the agreements is all these gray areas that are undefined at claim time.

MR. ROBERT W. MAULL: In the time I have been involved in reinsurance, we are moving a little bit away from both parties being gentlemen. It is more of the hard bitten bottom line, what can I get out of this arrangement.

MR. HOLLAND: Let me mention another claim case. It's a situation where a ceding company sent out a case they underwrote and thought was a decline. They sent it to their automatic and the automatic came back with a decline. They sent it out facultatively. All the facultative reinsurers said it was a decline. The ceding company stamped the case declined and threw it in the "to be issued" stack and as a result the case was issued. Everybody clearly said it was declined; it was an administrative mistake. Is that covered by errors and omissions or not? That is not the kind of error that was contemplated, but again what happens when we're talking about a million dollar application.

There are a number of gray areas. Reinsurers very much dislike getting notice of facultative acceptance five years later along with the actual claim papers. This develops into a real problem in trying to decide who really quoted on the case. A company needs very clear, well defined rules as to who is at risk and how they are going to award ties for facultative cases.

MR. LORING: When I was doing ceding company business, a case came in and was sent to several reinsurers under a shopping program. Four reinsurers were notified that they did not get the case. One reinsurer got the case, but was not notified due to a clerical mistake. The case was issued and retained instead of issued and reinsured because there was a check mark in the wrong box. Four years pass; the insured dies; the records are resurrected; and the mistake is identified. A notice was sent to the reinsurer that there was a clerical error four years ago and, in fact, they had been on the risk all of the time. We apologized and sent four years of premiums and asked that they pay the \$200,000 claim. The reinsurer paid the claim, but requested that they come and do an audit to see if there were any more of these errors.

MR. SMITH: The point is a good one. That particular claim is only one of many cases which may have ended, not necessary in death, but in surrender or just remained in force and not been formally reinsured through mistake.

MR. HERMAN H. SCHMIT: There was a real claim that a number of the reinsurers in this room will remember. The president of that particular Trusting Life called in every reinsurer with whom he had ever done business or ever would do business and locked them in a room. Before the afternoon was over, he had agreements that each one of them would take 5 or 10 or 15% of that claim and he took his retention. That's the way these cases get settled.

MR. SMITH: Actually this reaches into the heart of what reinsurance is. Reinsurance involves atomization of risks. The only thing is that everything works much more simply and efficiently if we atomize the risk at issue or at least have an idea of how it is going to be atomized before issue rather than at claim time.

MR. LAWRENCE LUBIN: I appreciate the need and welcome the need for better treaties, but are treaties really the answer? What is missing is not only legal input but the underwriting input and guidelines that might be communicated among ceding companies and reinsurers that outline how specific cases will be handled. We have plenty of treaties and they are not the answer. We need other guidelines as well.

MR. WELSH: It is fine to talk about commitment between ceding and assuming companies, but in this situation the commitment of management of both companies toward their stockholders and, if they are mutual companies, policyholders also is necessary. The loss is going to fall onto somebody. One gentleman mentioned that the Trusting Life may end up in receivership. If it doesn't end up in receivership, it may be a situation where it is a mutual company and there is a reduction forced on the dividends of all the other policyholders. Should there be less commitment on the part of management of Trusting Life to its other policyholders than the degree of commitment it has to its assuming reinsurers? I am not sure. These are problems that have plagued mankind as long as there has been civilization.

MR. GARRY M. ECKARD: In the current situation are companies going to court against each other?

MR. PATTERSON: We haven't ever gotten to court or even to arbitration, but arbitration may be more common now. Times have changed. Before there was only one reinsurer involved in most companies' business. Now shopping programs have overtaken us. No commitment should be expected from one's facultative reinsurers since they just get business on an auction basis when they make the right mistake.

MR. JOSEPH F. KOLODNEY\*: I want to respond to what Tim Fitch said. There are gray areas in claim settlements and always will be. This is one of the reasons provisions of the reinsurance agreements should be standardized. However, the industry itself will remain as a gentlemen's agreement. These cases that Peter mentioned emphasize the fact that when claim time comes, the quality of the relationship between the ceding company and the reinsurer should be of such magnitude that these problems will be amicably resolved and an adversary position not be created. The relationships between ceding companies and reinsurers have deteriorated in the last five years to where we sense certain adversary relationships between ourselves and clients that historically were dealt with on a gentlemen's agreement basis. We should look back to where the spirit of the business was about ten years ago and resurrect that attitude because litigation is far more profligate.

MR. YOUNG: There is much that ceding company and reinsurer should be saying to each other as the business relationship develops but many things that need saying don't get said. As reinsurers, we don't always know what we need to do to serve our client's interests and many client companies do not focus on the needs of the reinsurer. Four people, two people from each side of the fence, will now discuss what they look for in a reinsurance arrangement.

MS. ALICE K. KROLL: First, I will give some background information on Farm Bureau. At Farm Bureau we sell traditional life products through career agents. In the past we did not sell many policies over our retention of \$150,000. We sold mostly at the younger ages and almost all the business was standard. Hence, when I started there three years ago, reinsurance was insignificant. Since that time, however, it has become very significant and that's due to the changes in our marketplace. We have an increased need for substandard capability. We have a competitive ART product on which we lowered our retention. We have been emphasizing sales at both older ages and for larger amounts. Concurrent with this, many new reinsurers entered the market and we felt increased pressure from those competing for a share of our business.

For these reasons, it became necessary to rethink how we evaluated a reinsurer. I have divided our evaluation process into three categories. The first is underwriting. Competitive quotes and time service are the main criteria. We also look at less important items: we like to be comfortable with the underwriters in order to get assistance on cases that may not be reinsured and does the reinsurer offer underwriting training schools, etc.

\* Mr. Kolodney, not a Member of the Society, is Vice President, International and Selected Accounts, of General Reassurance Corporation.

The second area is actuarial. Reinsurance is now an explicit factor in our pricing. This started with our smoker/non-smoker products when we had to establish that at the older ages where our retention is very low that the slope of the reinsurance rates was compatible with our discount structure. The second point is competitiveness of the rates. As margins have become smaller, the cost of the reinsurance has become more crucial, to the point where we now desire a profit from reinsurance on some of our products. There are other aspects which I have put under actuarial which are not easily quantified. These are situations where we have a particular problem and want our reinsurers to show us solutions for that problem. Problem areas would include tax planning, surplus relief or special arrangements for a particular kind of product.

The last area is administration. It is pretty easy to get good rates and good quotes from almost any reinsurer, but it is very difficult to get an efficient administrative system. The primary ingredient is quick turnaround time for processing cessions. Unless we have 2-3 weeks turnaround time, we run into problems with processing changes against pending files, lost paperwork and a nightmare at statement time in calculating unpaid premiums. We also look for forms that are easy to use, clear and consistent procedures and good communication with the reinsurer's staff. Unfortunately, evaluation of a reinsurer's administrative system can only be done after the reinsurance is actually in place.

Finally, we feel that reinsurance is a good faith agreement. The elements of trust, confidence and confidentiality are prerequisites. A company has to meet these tests before we can even apply the other criteria.

MR. SCHMIT: I was asked to say a few words about what makes an ideal reinsurance client. We used to say, somewhat facetiously, that the perfect client is dumb and rich. Dumb enough to assume that a reinsurer's every pronouncement was a gem of wisdom - and rich enough to pay us promptly and well, usually in the form of fat YRT premiums. Much has happened since then. There may still be a few dumb clients and there may be rich clients. But the groups are now mutually exclusive.

All reinsurers mourn the fact that things aren't what they used to be: that reinsurance used to be a gentleman's agreement; that a man's word (or handshake) was his bond; that cancellation of treaties was nonexistent; that the arbitration provision was included only because a treaty was required to contain such a provision, not because people actually envisioned invoking the provision. The idea that business was done in a more genteel way in days gone by is probably a little exaggerated. There is a story about an english vicar who had a sick cow and had her treated by the local veterinarian. The cow recovered. The veterinarian sent the vicar a bill for services. The vicar accidentally misplaces the bill and doesn't find it until 4 months later. He sets out for town to pay the veterinarian and asks, "Dr. Miller, you treated my cow more than four months ago, sent me a bill, but never called on me for settlement of my account. Why?" "Vicar", said the doctor, "I make it a point never to ask a gentleman for money." "But what if your client doesn't pay? If you don't ask him for the money, how will you

get paid?" "I never ask a gentleman for money. If my client doesn't pay for six months, I conclude he is not a gentleman and then I ask him for the money." Nevertheless, I believe we have seen a change in recent years in how reinsurance is placed.

There are two types of relationships between ceder and reinsurer: The first one is where a ceding company cedes its business simply to the highest bidder without any concern for other considerations. The relationship is strictly one of buyer and seller. The relationship is shallow and the reinsurer feels no obligation to be particularly accommodating when a special problem arises or a business decision needs to be made. If the reinsurer offers terms that show that the reinsurer is much more optimistic as to actuarial assumptions, the ceder will often lower his retention limit. He'll argue that, based on his actuarial assumptions, he'll make more money on ceded business than on retained business. Such a situation does not a happy marriage make. If the ceder is right, the reinsurer will ultimately discover his folly and cancel the treaty. If the reinsurer is right the ceder will end up unhappy because he has sold his birthright - and become merely a general agent for the reinsurer. The relationship is unsatisfactory because it pits the interests of reinsurer against those of the ceder. Their interests ought to be parallel.

A much more satisfactory client-reinsurer relationship is one where a ceder does business with a reinsurer it respects and trusts - on a basis that both parties agree is reasonable; it is a relationship where a ceder wants the reinsurer to make money because a profitable reinsurer is a helpful reinsurer. It should be a relationship that is valued by the ceder on the grounds that the reinsurer makes an important contribution to the success of the ceding company - whether this contribution is in the form of help in development of new products, surplus relief, useful advice based on the reinsurer's wide access to the marketplace - or any other way.

It's been said that one of the effects of TEFRA is that reinsurers are going to have to learn again to make an honest living. It is very clear that with the enactment of TEFRA there will be a lot fewer opportunities for reinsurers to earn income from treaties entered into for financial planning reasons. Some of the existing treaties may be expected to have a shorter lifespan as their tax advantages for 1982 and later have diminished or vanished. This will mean a greater dependence by the reinsurers on the profitability of conventional excess of retention limit reinsurance. Most reinsurers will agree that the earnings on this business have been seriously eroded. If TEFRA has had one salutary effect on reinsurers it has been the fact that face volume has finally been debunked as a meaningful measure of a reinsurer's growth and performance or market share.

In the future business will be placed in a different fashion. Rather than submitting a new product to a large number of reinsurers for competitive coinsurance quotations (and possibly awarding the account to the highest bidder), there will be more collaboration between a ceder and one or two of his trusted reinsurers. They will jointly agree to a reasonable reinsurance agreement and then possibly open it up for other

reinsurers to participate in the account in order to enlarge the scope of the treaty.

There have been too many short lived treaties. In our own small and young company, we have cancelled at least four automatic accounts in the last year. Other reinsurers have had similar experiences. Cancellation of a treaty - after only a short duration - leaves a bad taste in the mouth of both parties.

All this sounds like old fashioned preaching - all this talk about follow the fortunes - about partnerships and long term relationships. I am convinced, however, that reinsurers are in for a continued deterioration of their earnings and that it will be this red bottom line that will make more and more reinsurers withdraw from this auction atmosphere that has prevailed in the reinsurance market for too long.

MR. LAWRENCE SILKES: Reinsurance is a mechanism for shifting risks and/or cost from one time period or from one company to another. The purpose of the shift, at least for National Benefit, has been to help its marketing, its underwriting and its financial situation. National Benefit has chosen reinsurance over its lifetime since 1963 for many reasons based upon the problems it had at the time. Initially, in 1963 National Benefit was a new company and needed help and assistance in forms. Later the company sought help from reinsurers in substandard underwriting. Then National Benefit became a mass marketer and needed large amounts of cash. It went to the reinsurers and reinsurance pools were formed to assist with that. Now, National Benefit is entering a new phase. We are a competitive general agency company where reinsurance is an essential element in the profit. Because of the volume of business that National Benefit is writing, we need assistance in surplus. These are the items we have desired in a reinsurer. We are growing so rapidly and losing such large amounts that we now will be asking reinsurers to assist us in our tax planning.

We look for a long-term relationship. Price is also very important because National Benefit is competing with other companies of similar prices. Because reinsurance is such an important element and because price is essential, long-term relationships are essential.

MR. WILLIAM K. TYLER: Based on the earlier discussion, it seems that the criteria for defining an ideal client from a reinsurer's perspective are fairly simple. First, the client should accept no cash with applications. Second, the client should not engage in any shopping activity. Third, the ceding company should employ no clerks or other persons capable of creating clerical errors. Finally, and most importantly, the ceding company should reinsure business on which no claims will occur. Such a client would not "turn our head" and therefore be ideal as a perspective client.

Virtually every insurance company in the country requires reinsurance in one form or another on an ongoing basis. Each company, therefore, represents a potential client. As a professional reinsurance company, Lincoln National serves the reinsurance needs of our clients and prospective clients. We are interested in expanding our client base

because that makes us more effective. At the same time, we are responsible to our management and stockholders for earning an acceptable rate of return on capital invested in the reinsurance operations.

The following criteria, while not all inclusive, might define an ideal client when we consider a new business relationship or an expansion of a relationship with an existing client.

1. A company with a well-thought-out marketing plan. Without such a plan, the client will not be successful nor will we as their reinsurer. With such a plan, the company has a much better chance for success and for identifying the fact that the marketing plan is not being achieved, and therefore, in modifying and controlling the plan where necessary.
2. A company with a capable management staff. Even with a good marketing plan, the need for a capable management staff to effectively execute the plan is essential. In addition, the capable staff is valuable to the reinsurer in discussing mutual concerns of the reinsurance program. Further, we, as reinsurers, can learn from good managers much more than we can from those less capable.
3. A company with an interest in a long-term business relationship. Despite the enthusiasm over quarterly results, the life insurance business is still a long-term business. It is important to both the reinsurer and the client company that there be long-term continuity in the reinsurance program. This is essential, both to insure modification of the reinsurance program as necessary, and to support an ongoing service commitment that generally runs from the reinsurer to the ceding company.
4. A company with effective control of its business. This includes many facets, including a competent underwriting staff which can appraise risks consistent with the pricing parameters. In addition, a company that has the ability to write business which will persist, again within pricing bounds. Finally, the company must be able to effectively administer the business that is being reinsured, especially in those instances where the ceding company is responsible on a self-administration basis for providing profit and loss and policy exhibit information to the reinsurer.

Not all of the companies we deal with are ideal clients. But many are, and most would like to be. That fact is the key ingredient which makes the reinsurance business a continuing pleasure.

MR. YOUNG: We have heard much about short term interests. From both the reinsurer's standpoint and the ceding company's standpoint, those individuals that show the short term interests are generally not going to be around long. The reinsurers will stop providing capacity to the ceding companies that have the short term outlook and likewise the reinsurers that have the short term outlook will cease to exist.