



# Professionalism, Standards of Practice, and Reinsurance

Craig Hanford, FSA, MAAA  
Actuaries' Club of the Southwest  
June 29<sup>th</sup>, 2012




## Agenda


- > Client relationships
- > The RFP process
- > Treaty negotiation
- > Risk transfer
- > Valuation of ceded business

2



## Client relationships


- > Basics of a great relationship
- > The client visit
- > Corporate policy on gifts

## Client relationships: Basics of a great relationship

- Reinsurer's team
- Client's team
  - Main reinsurance contact
  - Key reinsurance decision maker(s) or committee
  - Other functional areas (uw, claims, administration, etc)
    - Trend toward more risk management involvement
- Usual points of contact
  - Phone calls, emails, and client visits
- Both parties want a healthy, productive relationship
  - Measuring criteria

4



## Client relationships: The client visit

- Typical structure and purpose
- Observed practices for...
  - Food
  - Gifts
- Location
  - Client's office
  - Reinsurer's office
  - Offsite (i.e. industry meetings, golf course, ball game)

5



## Client relationships: Corporate policy on gifts

- Usually established for client and reinsurer
  - Rules around what is and isn't acceptable
    - Consistent with customary business practices
    - Not excessive in value
    - Cannot be construed as bribe
    - Complies with laws and regulations
  - Doesn't give appearance of impropriety
  - Doesn't compromise ability to make objective / fair decisions

6

Swiss Re  
iii

## The RFP process

- > Delivery / receipt of RFP material
- > Information sharing
- > Developing a proposal
- > Competitive feedback
- > Different perspectives
- > Reinsurer-provided solutions



7

Swiss Re  
iii

## The RFP process: Delivery / receipt of RFP material

- Generally, an e-mail from main reinsurance contact
- Confidentiality / non-disclosure agreements?
- Exchanging seriatim data
  - Proper protocol for transfer and protection
  - Internal and external guidelines / laws
- Reinsurer reliance on information provided
  - Accuracy
    - Good faith best estimates
  - Completeness
    - Precept #8

8

Swiss Re  
iii

## The RFP process: Information sharing

- Obtain comprehensive information
  - Common for back-and-forth between client / reinsurer
  - 6 or 7 reinsurers quoting = a full time job to coordinate!
- Share information equally
  - The goal is to have a level playing field among all reinsurers
    - Are there examples of when this doesn't happen?
- Competitive advantages do arise from time to time; not necessarily inappropriate

9

Swiss Re  
iii

## The RFP process: Developing a proposal

- Reinsurer pricing and analysis
  - Develop key assumptions
    - Mortality
    - Lapse
  - Build a model to project cash flows
  - Solve for rates
- Prepare a written proposal
  - Accurately describes key terms and conditions of the quote
  - Not classified as an Actuarial Communication

10

Swiss Re  
iii

## The RFP process: Competitive feedback

- How much is too much?
- The goal is to obtain the most competitive rates
  - But need rates to be sustainable
  - Want to maintain relationships to access services / capacity
- Can clearly be influenced by relationships and history...
- ...but ultimately comes down to personal preference

11

Swiss Re  
iii

## The RFP process: Different perspectives

Too much information!

↔

All's fair in love & war!

- Fairness to reinsurer giving the better quote
- Reinsurers' quotes are confidential
- Multiple rounds draw out the quoting process (more work)
- Price isn't everything (partnership is important)

- Looking for the best deal for own company
  - More competitive products
  - Better profitability
- Can help reinsurers find errors or conservatism in their pricing
  - More common than you might think

12

## The RFP process: Reinsurer-provided (less traditional) solutions

- Differences from normal RFP process
  - Reinsurers do much client-specific research to identify need/solution
  - Exclusivity can be more common
- Is it okay to involve other reinsurers?
  - Non-disclosure / confidentiality agreements may prohibit
  - Exclusivity may be required for highly unique solutions
  - If more traditional, may depend on size of proposed deal
    - i.e. inforce coinsurance deal: big vs. small
- Product development & actuarial services

13

## Treaty negotiation

- The basics
- Difficult terms



14

## Treaty negotiation: The basics

- RFP → Quote → Win → Treaty
- Who writes the treaty?
  - Reinsurer-prepared vs. client-prepared
  - Regardless, 1<sup>st</sup> go-around is most difficult
- Abiding by terms of reinsurer's proposal
  - Normal proposal is non-binding, but states material terms
  - Ceding company should include its critical provisions in original RFP
  - Timely execution (within 90 days)
- Built to last
  - Via business guidelines and other mechanisms

15

## Treaty negotiation: Difficult terms

- The proposal can't do it all
- Treaties tend to reflect industry standards
  - Material variations lead to polarization
- Several key terms that often come up
  - Ratings triggers, recapture, rate guarantees, claims and E&O
- Last resort leverage techniques:
  - Client redistributes pool share
  - Reinsurer comes off the risk
- Ultimately, want to reach a compromise!

16

## Risk transfer

- The over-arching goal
- Further analysis



17

## Risk transfer: The over-arching goal

- What is it?
  - Statutory
  - GAAP
  - Achieving reinsurance accounting treatment!
- L&H Reinsurance Agreements Model Regulation
  - "Risk Transfer Reg"
- Most forms of reinsurance should satisfy risk transfer
  - Or disclose otherwise

18

### Risk transfer: Further analysis



- Exploring transferred risks
  - Coinsurance
  - YRT
  - New business vs. inforce
- Accounting treatment
  - Reinsurance accounting
  - Deposit accounting
  - SSAP 61 and Appendix A-791

### Valuation of ceded business



- > The reserving process
- > Taking reserve credit



### Valuation of ceded business: The reserving process



- Reinsurance administration is a big component
  - Controls quality of data
- Reinsurer builds valuation model
  - Mostly parallel processes and methods to direct side
  - Admin data flows through
  - Stat / GAAP / economic reserves are aggregated and booked
- Validation checks in place
  - SOX/MARSOX controls, internal controls, state exams, etc.
- Schedule S – Reinsurance Assumed

### Valuation of ceded business: Taking reserve credit



- Reinsurance credit allows clients to partially offset reserves
  - YRT = unearned statutory net valuation premium relief ("1/2 Cx")
  - Coinsurance = full statutory relief
- Client responsible for calculating "reserve credit"
  - Need to satisfy Risk Transfer Reg requirements
  - Need to satisfy Credit for Reinsurance Model Reg requirements
- Schedule S – Reinsurance Ceded
- Schedule S inconsistencies...why do they happen?
  - Modeling, timing, and reserving methodology differences

Thank you




### Legal notice


©2012 Swiss Re. All rights reserved. You are not permitted to create any modifications or derivatives of this presentation or to use it for commercial or other public purposes without the prior written permission of Swiss Re.

Although all the information used was taken from reliable sources, Swiss Re does not accept any responsibility for the accuracy or comprehensiveness of the details given. All liability for the accuracy and completeness thereof or for any damage resulting from the use of the information contained in this presentation is expressly excluded. Under no circumstances shall Swiss Re or its Group companies be liable for any financial and/or consequential loss relating to this presentation.

## Professionalism, Actuarial Standards of Practice and Reinsurance...



**Clark Himmelberger**  
Consulting Actuary, Milliman, Inc.



1

## Actuarial Standards of Practice and Professionalism Relating to Reinsurance

Documents Related to Reinsurance	Reference Name
SOA Code of Professional Conduct	Precepts 1, 3, 6, 7, 8, 9, 10
Actuarial Communications	ASOP # 41
Data Quality	ASOP # 23
Appraisals	ASOP #19
<i>Financial Statement Treatment</i>	ASOP #11
<i>Illustration Actuary</i>	ASOP #24
<i>Deficiency Reserves</i>	ASOP #40

2 June 7, 2012

## Reinsurance Transactions Impact ALL Operating Functions

- Sales
- Marketing
- Underwriting
- Information Technology
- Legal
- Accounting
- Administration
- Claims



3 June 7, 2012

## Reinsurance Professionalism Topic List

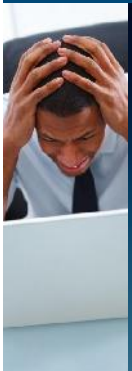
Documents Related to Reinsurance	Reference Name
<b>SOA Code of Professional Conduct</b>	<b>Precepts 1, 3, 6, 7, 8, 9, 10</b>
Actuarial Communications	ASOP # 41
Data Quality	ASOP # 23
Appraisals	ASOP #19

4 June 7, 2012

## SOA Code of Professional Conduct: Reinsurance-Relevant Precept Requirements

- #1: Honesty, Integrity, Competence
- #3: Satisfy the Actuarial Standards of Practice
- #6: Identify sources of all direct/indirect material compensation
- #7: No actual or potential conflicts of interest
- #8: Take reasonable steps to avoid misleading third parties
- #9: Keep confidentiality
- #10: Courtesy and professional respect

5 June 7, 2012



**The precepts apply even if the person you're negotiating with makes you want to tear your hair out.**

6 June 7, 2012

## Reinsurance Professionalism Topic List

Documents Related to Reinsurance	Reference Name
SOA Code of Professional Conduct	Precepts 1, 3, 6, 7, 8, 9, 10
Actuarial Communications	ASOP #41
Data Quality	ASOP # 23
Appraisals	ASOP #19

7 June 7, 2012

## ASOP #41: Actuarial Communications

### Guiding Principles to Actuarial Communications

- Applies to cumulative communications (thank goodness)
- Can be oral, written, or electronic
- You have responsibility for documentation
- You have responsibility for managing potential use by others

8 June 7, 2012

## ASOP #41: Actuarial Communications

### What's required in an actuarial communications

- Identify principal(s) and scope of work
- Form and content should be clear and appropriate and be provided within reasonable time-frame
- Identify the responsible actuary
- Identify any non-apparent relationships
- State reliances on others and the extent
- State whether you are acting as an advocate
- State any prescribed assumptions from principal(s)
- Disclose any laws/regulations impacting your results

9 June 7, 2012

## ASOP #41: Actuarial Communications

### Get in early

*It's important for the actuary to get involved in the reinsurance quote process early to ensure documentation is inclusive of all required information...*



10 June 7, 2012

## Reinsurance Professionalism Topic List

Documents Related to Reinsurance	Reference Name
SOA Code of Professional Conduct	Precepts 1, 3, 6, 7, 8, 9, 10
Actuarial Communications	ASOP #41
Data Quality	ASOP #23
Appraisals	ASOP #19

11 June 7, 2012

## ASOP #23: Data Quality

### Requirements

- Disclose known material data limitations and its implications
- Consider intended use of the analysis to determine the data needed
- Must review data for reasonableness and accuracy
- Reasonable effort to determine definition of each data element
- Identify questionable data values
- Request/review prior data and test current data for reasonableness
- If data may cause uncertain or biased results, must disclose
- If data is inadequate, must obtain different data or decline to provide
- Document data evaluation process, data defects, and modifications

12 June 7, 2012

## ASOP #23: Data Quality

### Required Disclosures

- Source(s) of data
- Did you review the data?
- Reliance statements (otherwise you're responsible for data glitches!)
- Adjustments or assumptions applied to data
- Limitations on actuarial work due to uncertain quality
- Unresolved data concerns with potential material affect on results
- Existence of uncertain or biased results
- Any conflicts arising from complying with laws/regs

13 June 7, 2012

## ASOP #23: Data Quality

### Protections in the ASOP

- Completely accurate, appropriate, and comprehensive data is not assumed to be available
- You are allowed to rely on others for accuracy of data
- Acknowledgment that you may not catch defects
- Not responsible for catching falsified, intentionally misleading data
- Not required to develop additional data to replace questionable data
- Not required to audit data
- You can use timing, cost, relative benefit, and feasibility of getting new data as reasons for going with imperfect data as-is

14 June 7, 2012

## ASOP #23 Data Quality

*Take the time to understand your data...*

*You have to know what kind of limitations you're dealing with and accurately assess and disclose the good and the bad about your data.*



15 June 7, 2012

## Reinsurance Topic List

Documents Related to Reinsurance	Reference Name
SOA Code of Professional Conduct	Precepts 1, 3, 6, 7, 8, 9, 10
Actuarial Communications	ASOP #41
Data Quality	ASOP #21
Appraisals	ASOP #19

16 June 7, 2012

## ASOP #19: Appraisals

Appraisal	"An assessment of the value of an insurance business including, but not limited to, an actuarial appraisal."
Actuarial Appraisal	"An appraisal of an insurance business presenting a set of actuarial appraisal values...but may be single unique value..."
Actuarial Appraisal Value	"The present value, calculated as of the appraisal date, of projected distributable earnings of an insurance business where the distributable earnings are based on a set of assumptions."
Insurance Business	"...an insurance company or health maintenance organization; a collection of policies or contracts in-force that cover insurance risk; and a distribution system that sells such policies..."

17 June 7, 2012

## ASOP #19: Appraisals

### Processes and Requirements

- Consider history and known environmental changes when setting assumptions and take reasonable steps to make the assumptions internally consistent
- Consider circumstances, needs, and strategies of intended audience when preparing appraisal analyses
- Perform validation tests to determine how good the model is and perform sensitivity testing of key assumptions
- Document such that another actuary can evaluate reasonableness

18 June 7, 2012

## ASOP #19: Appraisals



*Reinsuring blocks of business...*

*Projections of income statements from inforce blocks of business subject to a potential reinsurance transaction could be construed as an appraisal.*

19 June 7, 2012

## One Last Topic: Reinsurance Arbitration

*Where Actuarial Standards of Practice Matter Most...*



20 June 7, 2012

## What Causes Arbitrations?

- Bad results are almost always the precursor to a formal reinsurance disagreement.
- Bad results are rarely if ever anticipated by either side in a reinsurance transaction. Always ask yourself what's the worst that can happen and prepare your documentation to defend those results.



21 June 7, 2012

## Munich U.S. Life Reinsurance Survey in 1989

*Reinsurers with at least 1% market share, plus Optimum Re*

- American United Life
- Business Men's
- CIGNA
- Cologne Life Re
- "CNA"
- Crown Life
- Employers Re
- Frankona
- General American Life
- Hamburg International
- Life Reassurance Corp
- Lincoln National
- Mercantile & General
- Munich
- North American Life & Casualty
- North American Re
- Optimum Re\* (0.1% share)
- Phoenix Mutual
- Security Life of Denver
- Transamerica

22 June 7, 2012

## Munich U.S. Life Reinsurance Survey in 2009

*Reinsurers with at least 1% market share*

Canada Life	Optimum Re
General Re Life	RGA
Generali	SCOR
Hannover	Swiss Re
Munich	Wilton Re

23 June 7, 2012

## Professionalism, Actuarial Standards of Practice and Reinsurance...



Clark Himmelberger  
Consulting Actuary, Milliman, Inc.

Milliman

24