



Some Things Never Change

by R. Michael Cass, J.D., CPCU



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At the close of the recent CPCU Society Annual Meeting and Seminars held in Nashville, Tennessee, my three-year term as chairman of the Reinsurance Section Committee came to an end. It has been a privilege representing all Reinsurance Section members as your chairman, and I want to thank my fellow section committee members for all of their assistance these past three years.

New Committee Responsibilities

The incoming chairman for the Reinsurance Section will be **Richard T. Blaum, CPCU**, supervising claims consultant for Swiss Reinsurance Group in Armonk, New York. Rick has served on the Reinsurance Section Committee for several years and has made significant contributions to our annual reinsurance symposium held each year in the spring. Congratulations to Rick; I know he will provide excellent leadership for the Reinsurance Section.

We also have a new *Reinsurance Section Encounter (RISE)* newsletter editor, **Richard G. Waterman, CPCU, ARe**. Richard has been a member of the Reinsurance Section since its beginning, and a member of the Reinsurance Section Committee since 1996. He follows in the footsteps of Professor Bruce Evans, CPCU, who was the *RISE* newsletter editor from the formation of the Reinsurance Section in 1982 until 2005. I know that Richard will continue the tradition of bringing current and interesting articles about our industry to the Reinsurance Section members.

As we all know, communication over the Internet is becoming more common and more important. Each CPCU Society

Section has the ability to communicate with its members through the CPCU Society's web site. **Thomas M. Pavelko, J.D., CPCU**, will be the Reinsurance Section's new webmaster. Sincere thanks to Tom for assuming this role, as he also currently serves as president of the Society's Chicago-Northwest Suburban Chapter.

Recent Accomplishments

Over the past three years the Reinsurance Section has focused attention on various themes in its efforts to provide timely topics for its programs. Three years ago, the attention was focused on a review of reinsurance basic concepts and how important they are to an understanding of the principles of reinsurance. Our 2004 symposium was entitled "Back to Basics." As John Wooden, legendary UCLA basketball coach once said, "Before you learn the 'tricks of the trade' you better understand the trade."

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In 2005, the Reinsurance Section Committee directed its educational programs to the events that were bringing reinsurance to the attention of the public. "Reinsurance Ripped from the Headlines" was the Reinsurance Section symposium title that year. Severe and frequent windstorm catastrophes causing disruptions in the insurance and reinsurance marketplace, finite reinsurance, and terrorism insurance availability made reinsurance a front-page topic not only in trade publications but newspapers across the country.

This past year, the overall theme of the Reinsurance Committee's educational programs was managing reinsurance. Whether catastrophic events, cycles, or simply unknown risk, the programs and publications of the committee focused on how such risks can be better understood and managed. In 2005 and 2006, the committee also offered workshops in Chicago on current topics of interest. A similar event is tentatively planned for 2007.

Final Thoughts

One thing is certain as Rick Blaum and the other members of the Reinsurance Section Committee begin planning for this coming year and beyond—the quality of programs and publications will remain at a consistently high level. For the 2006–2007 year, the Reinsurance Section Committee is planning events that will continue to provide cutting-edge programs with topics to keep section members up to date with the reinsurance marketplace.

My heartfelt thank you to the CPCU Society and its members for the opportunity to be a part of the Reinsurance Section's focus on education and ethics. I again extend to all section members the open invitation to be a part of the planning and presentation of our Reinsurance Section programs. Your ideas and contributions are always welcome as the section continues its efforts to keep you at the forefront in your profession. ■

Upcoming Reinsurance Section Events

Mark your calendar to join us at an upcoming seminar or symposium sponsored by the Reinsurance Section. Attendance will give you an opportunity to meet members of the Reinsurance Section Committee as well as an opportunity to network with other reinsurance industry professionals.

Reinsurance Education and Communication Hotline (REACH) Workshop
February 1, 2007
(half-day seminar)
Chicago, Illinois

Reinsurance Section Symposium
March 15–16, 2007
Philadelphia, Pennsylvania

CPCU Society Annual Meeting and Seminars
September 8–11, 2007
Honolulu, Hawaii

Look for more information in upcoming issues of *RISE* and on our web site at www.cpcusociety.org.

Editor's Column

by Richard G. Waterman, CPCU, ARE



■ **Richard G. Waterman, CPCU, ARE**, is president of Northwest Reinsurance, Inc., a Minnesota-based management consulting firm specializing in the fields of insurance, reinsurance, and alternative dispute resolution. Waterman is the former president and chief executive officer of American Equity Insurance Company and GRE-RE of America Corp. In addition to working with both ceding and assuming companies involving treaty and facultative contract formation, structure analysis, risk exposure, and claim settlement issues in his consulting practice, Waterman has served as an arbitrator or umpire on more than 110 panels to resolve industry disputes as well as serving as a neutral mediator, facilitator, and fact finder assisting parties to work out differences in a confidential setting. Waterman has been a member of the CPCU Society since 1978 and has served on the Reinsurance Section Committee for nearly eight years.

In 1969, President Richard Nixon questioned "How will we house the next hundred million Americans? How will we educate and employ such a large number of people? How will we provide adequate health care when our population reaches 300 million?"

We have indeed witnessed tremendous adaptation and change over the past 37 years. And notwithstanding how our society has become more technologically sophisticated, we all may question

whether solutions to solve problems in the past will be adequate in the future. I have a personal sense of vulnerability in serving as the interim editor of *RISE* in the mold that **Bruce Evans, CPCU**, capably forged as the editor of *RISE* from its inception, nearly 20 years ago. Bruce continues to pursue his professional activities at the University of Dallas Graduate School. We will miss Bruce's vision, leadership, and contributions to the Reinsurance Section Committee and especially his *RISE* editorship. We are dedicated to continuing the traditions and commitment to excellence that he worked so hard to maintain.

Another change for 2007 is our new section chairman. Outgoing chairman, **R. Michael Cass, J.D., CPCU**, who has served as the Reinsurance Section Chairman for the past three years, has handed the chairman baton to **Richard T. Blaum, CPCU**. In the previous article, Mike has written his final Chairman's Column that only begins to highlight his many accomplishments. During his tenure, Mike has devoted an enormous amount of time and energy to the CPCU Society and the Reinsurance Section Committee to carry out his responsibilities. We are deeply grateful for Mike's leadership and countless contributions as chairman of the Reinsurance Section Committee. Our new chairman, **Richard T. Blaum, CPCU**, is not a stranger to the Reinsurance Section Committee. We have worked with Rick on numerous projects and Reinsurance Section-sponsored seminars since he joined the committee several years ago. In the next issue of *RISE*, Rick will present his goals and aspirations for the Reinsurance Section during his term.

To keep up with changing conditions in our professional work environment, continuing education opportunities are especially important. In another article in this issue, Mike interviewed **Connor M. Harrison, CPCU, AU, AIAF, ARP, ARE**, a program director for the Associate in Reinsurance program, to learn more

about a new online ARE continuing education program that will provide CPCUs with points toward satisfaction of CPD requirements. Also in this edition, **Kelli M. Kukulka, CPCU, ARE, AFIS**, a member of the Reinsurance Section Committee, wrote an article about the Circle of Excellence award earned by the Reinsurance Section this year. Every member of the Reinsurance Section can contribute toward our goal of earning gold again this year so please contact her when you write an article or organize a seminar so Kelli can record your accomplishment.

And finally, this edition includes two articles related to audits conducted by reinsurers pursuant to the terms of the Access to Records clause made part of most reinsurance agreements. From a pragmatic perspective, **Bina Daga**, an insurance and reinsurance consultant, describes the fundamentals of the reinsurance auditing process while **Andrew S. Boris**, a reinsurance attorney and a regular contributor to *RISE*, articulates how the reinsurance audit process has changed over time and how the records inspection audit may become contentious.

The population of the United States is expected to eclipse 400 million in a quick 37 years. Where will all the additional people live? Will we have enough food to feed everyone? Will we be driving gasoline engine automobiles or some new-fangled fuel cell contraption? How will the reinsurance industry adapt and change? Will there be adequate capacity for natural catastrophes? How will you adapt to the changes that are coming? In future issues of *RISE*, we expect to present insightful articles related to catastrophe bonds, sidcar capacity, a federal charter for reinsurance companies, and other paradigm-busting changes that will affect the reinsurance industry. Also, we would appreciate hearing from you about cutting-edge subjects you would like to see discussed in an upcoming *RISE* edition. ■

ARe Program Update and New Continuing Education Opportunity

R. Michael Cass, J.D., CPCU, recently spoke with Connor M. Harrison, CPCU, AU, AIAF, ARP, ARe, an assistant vice president of the American Institute for CPCU and the Insurance Institute of America. Harrison is the program director for the Associate in Reinsurance program. Cass asked Harrison for an update on the ARe program.



Cass: *The Institutes made significant changes to the ARe curriculum effective January 2005. How has that affected the program?*

Harrison: Because we went from a four-part program

to a five-part program, the Institutes had a surge of ARe students completing in 2004. These changes created a renewed awareness of the ARe program particularly among CPCUs who need only take ARe 144 and ARe 145 to earn the ARe designation.

Cass: *What changes were made in 2006 to the ARe-specific courses?*

Harrison: The current ARe program has an online readings course: ARe 145—Readings in Reinsurance Issues and Developments. We have refreshed these readings to ensure that they continue to be timely and relevant. Additionally, the Institutes released a second printing of the ARe 144 text: Reinsurance Principles and Practices.

The ARe 143 course guide reading on TRIA has been updated to reflect TRIA's extension.

Cass: *How about changes to the ARe elective options?*

Harrison: ARe requires students to choose one elective from among CPCU 540, ARM 56, and AIAF 111. As far as those electives go, we've also made some changes students should know about.

The CPCU 540 course has been revised entirely. The Institutes' current text (Business and Financial Analysis for Risk Management and Insurance Professionals) will be replaced with Finance for Risk Management and Insurance Professionals. The new text

is available now for exams administered beginning in January 2007.

Finance for Risk Management and Insurance Professionals, First Edition

This new text contains insurance-specific examples to illustrate the financial concepts covered and presents topics in an insurance context. Topics covered in the text include general corporate finance topics such as financial statements, working capital management, time value of money concepts, among others. In addition, the text covers topics such as the insurer operating environment, insurer investment strategies, and insurer capital needs and sources.

The ARM 56 course has been extensively revised as well. This new fourth edition really is a refinement of what had been in the third edition. The Institutes kept much of the existing structure of the text, but some of the content was consolidated. Consequently, the text went from 16 chapters to 13 chapters. The new text is available now for exams administered beginning in January 2007.

Risk Financing, Fourth Edition

This newly revised text contains chapters describing the various means through which organizations can finance risk. Topics covered in the text include insurance as a risk-financing technique; loss forecasting; self-insurance plans; retrospective rating plans; reinsurance and its importance to a risk-financing program; captive insurance plans; finite and integrated risk-financing plans; capital markets; noninsurance contractual transfers of risk; purchasing insurance and other risk-financing services; and allocating risk management costs.

AIAF 111 was revised, but not significantly. The new AIAF 111 course guide now assigns an insurance taxation

chapter that was previously unassigned. The new course guide is available now for exams first administered beginning in January 2007.

Cass: *What changes are planned for 2007?*

Harrison: Based in part on the success of ARe 145, the Institutes have developed the Institutes' Online Professional Development Series (PDS) courses that will launch in 2007 with reinsurance and risk management components. The Institute Online PDS courses are voluntary continuing professional education courses aimed toward today's relevant issues.

The ARe-PDS course consists of online readings with accompanying exams. Most exams will have 15 questions that can potentially earn points toward the 150 points required to complete the course. Course completers will receive a certificate of completion. The cost of ARe-PDS is \$309, which grants access to the online readings for a year. This course should be available December 15, 2006. A demo of the course is available through the Institutes' web site or directly with this link: <http://blackboard.aicpcu.org/>. The username is "demo" and the password is "demo."

ARe-Professional Development Series

ARe-PDS is a voluntary continuing professional development course that focuses on a limited number of specific reinsurance-related issues, such as emerging sources of liability (specific pharmaceuticals, lead paint, etc.), catastrophe exposures (hurricane, earthquake, etc.) and market trends (Bermuda, reinsurance pricing, etc.). ARe-PDS is not a required component of the ARe program nor is it required to maintain the ARe designation. ARe-

PDS is not limited to ARe students or ARe graduates. Access to ARe-PDS is provided for 12 months regardless of the date the course is completed.

This course is similar in structure to ARe 145 in that all of the course materials and examinations are presented online. However, it differs in that several readings on a particular topic are presented, and students are required to read all of those articles. The exam on a topic will cover several readings.

Cass: *What led to the creation of this course?*

Harrison: ARe 145 students have regularly asked to remain enrolled in the course long after they have satisfied the course requirements. Oftentimes we would also hear from students requesting more courses like ARe 145. Rather than depend on this anecdotal information,

the Institutes surveyed ARe 145 course completers.

Cass: *What were the results of that survey?*

Harrison: Of those surveyed, 87 percent of ARe 145 students said that they would take a continuing education course covering reinsurance similar in format to ARe 145. It's also worth noting 99 percent of ARe 145 students were satisfied with the ARe 145 course (of which 70 percent were very satisfied).

Cass: *Will CPCUs be able to use ARe-PDS toward CPD?*

Harrison: Yes. Completion of ARe-PDS would provide CPCUs with 15 points toward satisfaction of the CPD requirements.

Cass: *How can the Reinsurance Section interact with the Institutes on this new course?*

Harrison: ARe-PDS explores topics of interest to reinsurance professionals. Anyone who has suggestions for new topics or for new readings on previously identified topics is welcome to contact the Institutes. ■

Reinsurance Section Awarded Gold Circle of Excellence Recognition

by Kelli M. Kukulka, CPCU, ARe, AFIS



■ **Kelli M. Kukulka, CPCU, ARe, AFIS**, is a vice president for the Agriculture Department of Munich Reinsurance America, Inc. in Chicago. She works with agricultural clients on a national basis and is responsible for treaty marketing, underwriting, and individual risk facultative for agriculture specialty risks. Kukulka has served on the Reinsurance Section Committee since 2003, and she is a past president of the CPCU Society's Chicago Chapter.

The CPCU Society Section Circle of Excellence Recognition is awarded in levels of gold, silver, and bronze, based upon a point system. Points are awarded based upon activities conducted by the sections. The activities are grouped in accordance with the annual strategic goals of the Society, and an additional category called Stewardship.

So you might be asking yourself, what's in it for me? Why should I care? The Reinsurance Section is largely dependent upon the quantity and quality of the actions of our membership to earn a Circle of Excellence award. So you could say that this award is "all about you."

Activities eligible for consideration should meet the general criteria of adding value to section membership, bringing value to CPCU Society membership at large, and promoting visibility of the



CPCU Society. Activities of all section members, not just section committee members, are eligible for consideration.

For example, during the last 12 months have you:

- conducted, organized, or participated in any industry seminars, symposia, workshops, etc.

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The Audit Tension—The Reinsurer's Request for Information

by Andrew S. Boris

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On paper, it appears like a simple enough request from a reinsurer—"We would like to conduct an audit in connection with the billings received . . ." Depending on your background, this request may be perceived in two ways: (1) the reinsurer has identified some inconsistencies or questions and, pursuant to the terms of the reinsurance contract, wants to conduct a short and pointed investigation; or (2) the reinsurer is looking to either extend the time to issue its payment for a valid claim, or the reinsurer is developing arguments it can use to dispute the claim in future arbitration or litigation.

Typically, reinsurance contracts contain a clause that gives the reinsurer the right to access records or conduct an audit. While the language of the clause varies in different contracts, reinsurers may be offered the opportunity to review premium information, loss records, as well as the policies and claims ceded to the reinsurance contract. In application, the reinsurer may be looking for an opportunity to examine underwriting information and philosophy, claims information and the cedent's "track record," accounting records, and the company's overall approach to its business operations as they may relate to the reinsurance program. While all forms of audits or inspections can strain

relationships, the claims-related audit can quite often lead to disagreements between the parties.

Since the concept that an audit involves some form of "second-guessing" or a feeling that the cedent is being "watched for errors" creates pressure in a reinsurance relationship, the result can be a significant amount of disharmony. One of the most problematic situations occurs when the reinsurer's request for an audit is denied because the reinsurer is not current in its payments for outstanding billings. The reinsurer, believing that it has a contractual right to an inspection, wants its questions answered before it authorizes payment. In turn, the reinsurer may often contend that the cedent is in breach of contract for not allowing the audit. There is wide-ranging legal support protecting the reinsurer's right to audit in this context. See e.g., *Manhattan Life Ins. Co. v Prussian Life Ins. Co.*, 296 F.3d 39 (2d Cir. 1924); *Michigan Mutual Ins. Co. v Uniguard Security Ins. Co.*, 44 F.3d 826 (9th Cir. 1995). The response by the cedent is highly predictable—the reinsurer is the party in breach of contract for not paying

the outstanding billings. Again, there is legal support for a cedent's position. See e.g., *American Home Assurance Co. v Instituto Nacional de Reaseguros*, 1991 WL 4461 (S.D.N.Y. 1991) (addressing a party's rights to inquire into support for billings forwarded to a reinsurer). In the end, this disagreement often does not lead to a dispositive result on the actual billings themselves (i.e. one party wins), but rather simply hastens the parties' move to arbitration. While some arbitration panels may be called upon to determine if one of the parties was in material breach of the contract, it appears to be more common for the panel to grant the reinsurer an opportunity to conduct an audit (i.e. discovery) as part of the arbitration process. However, the arbitration panel may require the reinsurer to post some form of security because of the parties' past inability to reach a compromise concerning the outstanding billings and the audit request (the reinsurer's financial condition would also be a consideration in these cases).

Other disputes often arise with respect to the types or categories of documents that a reinsurer is entitled to review



during the audit. As an initial matter, the cedent should pay particular attention to the language of the audit or inspection clause to evaluate what documents it should make available. Of course, the cedent would need to make all relevant, responsive documents available in connection to any discovery served as part of an arbitration process. However, with respect to an audit request and the contract only allows a reinsurer access to loss information, for instance, the amount of materials provided to the reinsurer would be more limited than in a situation where the access to records clause might provide for a broader inspection.

■ . . . *the position taken by many is that each reinsurer acts independently of other reinsurers and is not correspondingly entitled to information about other reinsurers.*

Another area of potential dispute is whether a reinsurer is entitled to see communications between the cedent and reinsurers other than the reinsurer conducting the audit. In general, the position taken by many is that each reinsurer acts independently of other reinsurers and is not correspondingly entitled to information about other reinsurers. In turn, cedents will often refuse to make documents from other reinsurers available during an audit. Arbitration panels are asked to balance, among other considerations, the relevance and the confidential nature of the documents in determining whether to order their production. As an aside, cedents can aid the logistics of a potential audit by filing correspondence with their reinsurers in separate files, apart from the actual claims file.

Finally, the cedent will almost certainly conduct a preliminary document review to determine whether any materials should be withheld or redacted based on attorney-client privilege or the work-product doctrine. The problem that often develops as part of this review process is that the reinsurer requests the ability to review documents about underlying claims from a cedent or its insured (and its attorneys). Often, cedents maintain that such documents are shielded from production via the attorney-client privilege and work-product doctrine. Reinsurers often contend that the stated privileges are inapplicable based on one or several potentially applicable exclusions such as: (1) there being a significant substantial need for the documents and an inability to gain access to the information through other means; (2) the existence of a common interest between the reinsurer and cedent; (3) the existence of a fiduciary relationship between the parties; (4) the question of whether the cedent has placed the contents of the documents at issue by pursuing an arbitration; or (5) the question of whether fraud was involved in the handling of the subject claim. The full discussion addressing these concepts is quite developed and beyond the scope of this article, but arbitration panels are called upon to address these issues regularly.

As with many reinsurance-related practices or procedures, the audit has changed a great deal over time. As less deference is given to the concept that a cedent will undertake all appropriate steps to maintain utmost good faith with its reinsurers, a greater emphasis is placed on the need to conduct extensive audits. For many, the reality of treating reinsurance contracts as commercial business relationships means potentially more intrusion and disruption as audits or inspection of records requests become more involved and potentially contentious. ■

The Reinsurance Underwriting Audit: An Essential Process

by Bina Dagar

■ **Bina Dagar** is president of Ameya Consulting, LLC. She serves as a consultant to the insurance and reinsurance industry in the areas of underwriting, claims, and marketing in matters such as coverage disputes, contract wording interpretations, underwriting functions and procedures, underwriting and claims auditing, management/operational issues, reinsurance runoffs, ceded reinsurance, retrocessions, and industry best practices.

In today's highly complex world of reinsurance underwriting, the industry is showing a renewed emphasis on reinsurance underwriting audits, thus giving reinsurers an additional tool in their analytical tool kit with which to gain a better understanding of their books of business. The treaty agreement between the two parties provides the reinsurer the prerogative to review the cedant's files and records. Obtaining information specific to a class of business provides reinsurers an edge in a market where risks are becoming increasingly complex, and losses are eroding the bottom line with increasing frequency and severity. This is not to say that verifying incurred loss information and assessing incurred but not reported losses (IBNRs) is the overarching purpose of an audit. Rather, the underwriting audit enables the reinsurer to familiarize himself or herself with the cedant's book of business, quality of risks underwritten, underwriting guidelines, and underwriting and claims practices, procedures, and philosophies. In spite of its prevalence in our current environment, an audit continues to be a source of anxiety to the cedant. But, when viewed as an opportunity for both parties to exchange valuable information and to solidify business partnerships, it becomes an asset to both cedant and reinsurer. So what does the reinsurer do to make the audit pill more palatable both to himself or herself as the reinsurer and to the

cedant? Out of respect for the value of the process done right and the cedant's time and effort expended in hosting the visit, the reinsurer considers his or her purpose, organizes a specific agenda, and communicates, communicates communities . . . the same to the ceding company. The reinsurer maintains a sensible level of communication with the cedant in the pre- and post-audit process as much as during the audit.

Why Conduct a Reinsurance Underwriting Audit?

Function

There are many reasons to conduct an underwriting audit; some of these are:

- compliance of cedant's underwriting practices with reinsurance contract terms as well as with representations and warranties contained in the reinsurance offer
- complexity of the class of business or of the portfolio of exposures
- exposure to catastrophic accumulations
- significant¹ premium income
- deterioration of loss experience
- nature, frequency, and/or severity of the claims
- concerns regarding cedant's management, staff, and/or financial stability
- cedant's expansion into a new territory, jurisdiction, or line of business that presents special challenges to the cedant
- cedant's delegation of authority to a third party, a managing general agent (MGA), to ensure MGA's compliance with contract terms

Form

Once the reinsurer determines an audit is required, he or she identifies the type of audit most suitable to the account:

- pre-quote audit, where the reinsurer reviews the cedant's files as part of the analysis of the book of business being reinsured and in preparation for taking a lead or substantial line on a new or existing treaty
- existing client audit, where an annual or biannual audit is a routine practice to gather portfolio information such as primary rates, terms, and conditions; management issues; individual loss updates; results and company information; and to promote mutually beneficial relationships
- initial new client, where a new reinsurer supplements the underwriting information on file with specific data on pricing procedures or rating guidelines; claims-handling procedures; and getting to know the new client, etc.
- transactional audit, where the reinsurer traces the business activity as reflected in the policy and claims files through the cedant's accounting/financial records and its flow into the reinsurance accounts. The reinsurer conducts a review of the cedant's premium and loss data and correlates these figures with his or her own information; this review includes checking cedant's line setting methods to ensure that premium and loss cessions made to the treaty are allocated to the relevant treaty/accident year
- follow-up audit, where the reinsurer conducts a review to ensure that crucial recommendations have been implemented or to review the addition of a new class of business to an existing portfolio

Pre-Audit Preparation Information Gathering:

Once the type of audit is established, an important initial step is to ensure that the reinsurance file is current and up to date on all the necessary information such as:

- underwriting information
- updated list of individual losses for the period(s) in question
- résumés of key personnel
- treaty terms and conditions, as known
- pricing procedures or rating guidelines
- claims-handling procedures
- sufficient and credible loss experience
- financial information, as needed, including Annual Statement and Report, audited loss reserves, etc.

Forms and Communications

In order to conduct an organized audit, the reinsurer collects his or her thoughts by assembling people, questions, and forms that will aid in gathering the necessary information on site. This step includes:

1. Identify the need for a concurrent claims audit and/or assistance from other departments (e.g., the treaty underwriter may seek assistance from a facultative underwriter, as he or she is “closer to the ground” in terms of currency of rates and trends and can offer insights into the direct business being reviewed; from internal actuaries for rate-making reviews; or from the Accounting Department for financial statement review). Should either or all be necessary, the reinsurance treaty underwriter schedules an internal pre-audit meeting to establish goals and objectives of the audit based on the type of treaty and class of business; and to discuss existing knowledge of the client company, results and Best’s information.



2. Assemble questionnaire guidelines and prepare areas of discussion with the client such as underwriting management; underwriting; loss control; claims management; file check; etc. (This questionnaire may be amended over time with experience gained from doing audits.)
3. Design an underwriting audit form specific to the line and class of business of the reinsured’s portfolio being audited.

Thereafter, the reinsurer identifies information required at the audit site along with a carefully determined number of files. He or she contacts either the cedant or the broker, if one is involved, at least 30 to 60 days prior to the desired dates (the audit is generally three to five days in duration) and conveys the request for the following list of items:

- active files, with renewal data, if applicable
- non-renewals
- quotes not bound

- declinations
- organizational charts
- departmental workflow charts
- underwriting guidelines

The number of files in each of the above categories will vary with each audit, based on class of business, type of program, etc. If the reinsurer has a bordereau of risks, he or she can instead compile and send in advance a list of the specific risks to review at the audit so that the files may be gathered prior to the reinsurer’s arrival and are awaiting review. Alternatively, the reinsurer may wish to randomly select files for review when on site (this is typically done when the account experience compels a closer look).

In this communiqué, the reinsurer sets an agenda of things he or she wishes to accomplish during the visit including the client’s company management and underwriting management information to be obtained during a formal or an informal roundtable conference on the

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The Reinsurance Underwriting Audit: An Essential Process

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first day of the audit; and the reinsurer's preferred manner of file selection for review (methods as discussed above).

Underwriting Audit Procedures

Management Discussions

An audit is not merely a physical inspection of files. An essential component of this process is the meeting between the reinsurer and the ceding company's management and staff. It works best to start with a roundtable meeting with the principals to present goals and objectives of the audit, and to receive the general manager's presentation to include current market conditions, trends in underwriting, a broad overview of client's business plan, new products, operational concerns, etc. The reinsurer broaches any delicate issues openly at this juncture. He or she discusses matters relating to the cedant's standing in the market, competition, management, underwriting, and claims issues in detail. He or she attempts to identify the cedant's degree of knowledge, control, and professionalism through questions on policy and procedure.

Where necessary, management and staff interviews highlight how well management philosophies are followed as well as provide insight into the knowledge of the underwriting staff.

Loss control personnel can play a key role in mitigating losses through safety programs, engineering, and loss control services. The reinsurer gathers information on this important function to gauge how well this department interrelates with the ceding company's underwriting process. In the underwriting audit, information on claims management proves to be helpful in assessing a company's ability to effectively handle this task in protecting reinsurers' position under a treaty. This is especially critical for low-layer, working casualty and, when necessary, may be handled by a claims professional.

Discussions of this nature give life to the process, aid in deeper understanding, and foster good relations valuable to the two parties. It is one of the main functions of an audit.

At the conclusion of the meeting(s) with management and staff, the reinsurer will have gained knowledge of the organization, overall underwriting, accounting and claims operations, underwriting philosophy, and workflow procedures to reach a perspective that prepares him or her for the file check.

■ ***Loss control personnel can play a key role in mitigating losses through safety programs, engineering, and loss control services.***

File Review

The file review can be as organized and consistent as the reinsurer's preparation for it prior to the audit. The process includes:

A full understanding of the treaty terms, conditions, and exclusions as well as any representations made by the company such as specific cases of adherence to underwriting guidelines, pricing methodology, discounting practices, minimum premiums, exclusions, warranties, etc. Methodical completion of the Underwriting Audit Form, created for the purpose of identifying targeted areas of concern or interest for each risk/file reviewed, will obtain a uniform sampling of information. Details of such consistent records help to underscore the criteria for conducting the audit:

1. They reveal a trend, or highlight mix and quality of business, quality, and depth of underwriting analysis such as use of inspection reports, applications, worksheets, D&B reports etc.

2. They identify areas to assess such as adherence to underwriting guidelines, authorities, and clearance levels, use of endorsements and specific policy provisions.
3. They provide tools to analyze the selection and pricing of business; and the use of valid rating techniques.
4. They reveal the condition of the file documentation such as explanation of hazard analysis; and file arrangement, completeness, neatness, and continuity.

At the end of each day or at some point during the day, the reinsurer reviews any questions on specific files with the client's office staff to solicit clarifications or comments.

Post-Audit Procedures

Summation of Findings

On the last day of the audit, an essential step for the reinsurer is to share his or her audit findings with the cedant and broker (if one is involved). At this "wrap-up" session, the reinsurer provides feedback to the cedant and offers constructive suggestions. It is important to note that the reinsurer is in a delicate position and should maintain professionalism by diplomatically communicating observations and recommendations. These suggestions may encompass areas of deficiency and offer ways of improving performance. If the cedant had expressed concerns regarding particular issues at the outset, this is the time for the reinsurer to address them.

Every comment/critique should be accompanied by examples of specific references from the risk files reviewed. This micro-level analysis should lead to a macro-level observation of industry best practices aimed at improving the cedant's practices, to focus on enhancing the cedant's business approach, and to achieve profitability. This closing meeting also affords the cedant an opportunity to respond to the reinsurer's observations.

Conclusion

The visit is followed by a written report to be completed within a reasonable time after completion of the audit. The report may be organized as follows:

- executive summary
- analysis of the business reviewed
- comments regarding risk-by-risk review notes compiled at the audit, or, alternatively, the discussions on each file with audit questions raised during the visit and its outcome or resolution at the wrap-up
- observations and recommendations; summary of the wrap-up session covering all the pertinent recommendations discussed with management as well as the cedant's responses to them
- conclusion to tie the report together for a final decision, be it participation or renewal

A thank-you letter to the cedant confirming the wrap-up discussions and reiterating, in writing, the recommendations discussed at the "wrap-up" session concludes the process. Some cedants are now insisting on audit reports as a condition to allow reinsurers the audit privilege. In either case, if the recommendations offer substantive amendments for implementation in the short term, the reinsurer should follow up with the cedant within a reasonable agreed-upon time frame. Otherwise, the suggestions form the basis of the next scheduled audit.

Last Thoughts

When done right—with the necessary preparations, with efficiency and with appropriate communications—an audit is beneficial to both the reinsurer and the reinsured. It protects the reinsurer from "surprise" coverages and losses, and the reinsured from "naïve" reinsurers, who lack an understanding of the book of business they are reinsuring. Most audits are routine and aid in developing and maintaining good relations between the two partners. In spite of their routine

nature, audits are worth the effort taken, just as much as the difficult reviews are; for without this constructive tool, a reinsurer may end up with a cover he or she did not bargain for. For the cedant's part, the payback for having a well-informed reinsurer is security (the "sleep-at-night" factor) obtained in knowing that the reinsurer is competent. ■

Endnote

1. "Significant" may imply income on a contract that represents more than a set percent of the entire portfolio; or income on a contract that exceeds a set dollar amount; or reinsurer's income on a contract that exceeds a set percent of the treaty premium.

Note: An adapted version of this article originally appeared in *Business Insurance's Industry Focus* supplement.

Reinsurance Section Awarded Gold Circle of Excellence Recognition

Continued from page 5

- written articles about our industry for newsletters, magazines, web sites, or other publications
- participated in other insurance, risk management, or legal community activities

Circle of Excellence Gold

Did you know the Reinsurance Section earned the gold level award in 2006? I believe we achieved gold because we have some of the best people in the business. Those people are setting the benchmarks for our industry. I had the privilege of collecting the details from our section members and section committee for the 2006 Circle of Excellence Recognition Program submission. We received messages from more than 35 section members detailing more than 54 activities they performed during the year. Each and every one brought value not only to the CPCU Society membership, but to their profession, their companies, and their communities.

I was amazed by the commitment to the industry and the creativity of the activities. Some members conducted symposia and workshops. Some published articles. Many members were speakers and teachers at many different levels. The lives touched by these individuals ranged from children aged 9 to 15 learning about insurance basics, to clergy members, to legislative representatives, to insurance

underwriters and executives in Beijing. Others simply helped answer questions while staffing the Sections Booth at the CPCU Society's Annual Meeting and Seminars. Each member added value in his or her own unique way.

So now I'm asking you, what have you done for 2006? What will you do in 2007? How will you make a difference? Only you can make a lasting mark on the lives of others. I'll be looking forward to hearing from you next spring as we prepare for our next Circle of Excellence submission. ■

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