SYNOPSIS OF THE REINSURER'S POINT OF VIEW

by Reto W. Arpagaus

1. The Ultimate Risk?

a. The risk of losing the executive job

At the beginning of 1983, there were more than 150 companies reinsuring U.S. business. Less than half of these reinsurers were in business 10 years before. In the last 18 months, in the United States alone, 1 out of 4 reinsurance operations closed shop. In their large majority, these reinsurers did not become insolvent, but just stopped writing business. What happened to the executives? The trend toward early retirement and outright dismissals has not been noticed in reinsurance alone, it affected the whole industry, insurance, brokerage, financial services.

b. The trend to prosecute

Ambassador Insurance Company and its accounting firm, Coopers & Lybrand, are being sued by the Vermont Insurance Department for over $50 million for fraud and negligence in making financial statements during proceedings which led to Ambassador being declared insolvent. (Best's Insurance Management Reports, May 27, 1985.)

Richard Beckett Underwriting Agency Syndicates. "Long term fraud" has been alleged. It was reported that the Syndicates were under-reserved by about 36 million pounds, and went over their underwriting limits. (Best's Insurance Management Reports, June 24, 1985.)

The trend to sue and prosecute is obvious. It proved almost impossible to regulate against fraud. Indications are, however, that existing laws will be enforced, and the high publicity given to these cases will make it clear to marginal operators that the ultimate risk is more than just losing a business.

2. How secure is your insurer? What risk managers can do.

a. White lists and black books

These lists are confidential and not necessarily helpful for the insurance buyer. White lists tend to state the obvious, and black lists tend to carry names of companies you wouldn't want to do business with anyway.

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b. Best's Key Rating Guide

It is interesting to note that in its 1985 issue a substantial number of down-gradings were effected. We noticed a significant reduction in A+ ratings and a substantial increase in the percentage of companies which were assigned the Omitted Rating. The ratings reflect the current status of profitability, leverage, and liquidity of the industry as reflected by their evaluation of the adequacy of loss reserves, the market value assets, reinsurance exposures, and pyramiding. (Best's Insurance Management Reports, July 1, 1985.)

c. The use of a service specializing in insurance company ratings outside of the United States

International Insurance Financial Service
750 Summer Street
Stamford, CT 06901

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Tel.: (203) 324-5683
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Affiliated with Conning & Company since 1983.

Insurance Solvency International Ltd.
Eldon House, 2 Eldon Street
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Tel.: (01) 377 8929
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A member of the Fox-Pitt, Kelton Group.

d. Insurance Regulatory Information System (IRIS)

The Insurance Regulatory Information System (IRIS) was developed by a Committee of State Insurance Regulators. It is primarily intended to assist State Insurance Departments in executing their statutory mandates to oversee the financial condition of insurance companies operating in their respective states. The System is described in a brochure issued in January of each year. There is a Property and Casualty Edition (yellow), and a Life and Health Edition (blue). It can be ordered from:

National Association of Insurance Commissioners
1125 Grand Avenue
Kansas City, Missouri 64106

IRIS does not provide a panacea. It provides ratios which give a strong indication on the overall standing of a company, the profitability, the liquidity, and the reserves.

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An excellent source of reference for U.S. Companies is Best's Trend Report, Property-Casualty Insurance Companies. It combines Best's Ratings and the IRIS Financial Ratios for a five-year record. The brochure may be ordered from:

A.M. Best Company
Oldwick, New Jersey 08858
Tel.: (201) 439-2200
Telex: 837744

e. You get what you pay for

What is true for consumer goods also holds for services, and of course, is even more true for insurance which is nothing but a promise in exchange for cash. Insurance companies should be selected for cover by using criteria similar to the ones used by investors before they buy stock. If you would not invest in your insurance company, this is a clear indication that you do not truly consider your insurance to be an asset, and this is really what insurance is: money in the bank.

f. Is a new captive boom under way?

If the insurance industry finds itself unable to continuously sell a quality product at the appropriate price, it does not make sense that anybody should compromise and spend good money on a bad product or little money on a promise that eventually will not be honored. As a buyer, you may be better off running the risk yourself, along with all the other commercial risks you have, or fund it in your own captive.

The most serious capacity crunch will be faced in business liability insurance. In the United States this crunch is particularly hard felt in the line of directors and officers liability. Marsh & McLennan is in the process of organizing a facility which looks like an industry captive: American Casualty Excess Insurance Company.

3. What reinsurers do.

a. The retreat from reinsurance is under way

The cash flow reinsurers are leaving the field. They are being driven off by the growing gap between premium income and losses. This must be considered good news.

Lately, cash flow to reinsurers who are still in business has improved dramatically, and combined ratios are coming down to more acceptable levels. Reinsurers love it, risk managers will pay for it. Security will be less of a problem.

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b. Reinsurers taken for a ride

Whenever ceding companies get really into trouble, it is because they find themselves under-reserved. If reinsurers do not catch this long before a company goes into receivership, reinsurers are in for a rough ride. It is the liabilities, and more particularly, insufficient loss reserves which bring an insurance company down. In such situations the temptation is great to reach into the reinsurer's legendary deep pockets. It is not at all unusual that a relaxed attitude towards administration and reserving at the ceding company's end has to be paid for by its reinsurers, and this does not seem right.

c. The use of the inspection clause

Reinsurers have the right to inspect the books of a ceding company any time during normal office hours. Thorough reviews today are very common, particularly in the United States. The purpose is to check for adherence to treaty terms, check that procedures are known and followed by client company personnel, check out any feelings reinsurers have that some money may be owing to them in terms of renewal premiums, charge-backs, and replacements. Audits may be indicated based on a sudden rise in cancellations, rapid growth of new business in connection with new products, a lack of timeliness in reporting, parts of reports missing, change of major reinsurers, delayed claims reporting, unusual run-off patterns, etc. More recently, reinsurers also review processing and information systems, particularly with ceding companies that show slow or nonexistent cash flow to the reinsurer.

Client reviews have become an integral part of the reinsurance business. These audits are labor-intensive, but must remain confidential. Insurance buyers do not need to know the details of such reinsurance audits. What counts, is the fact that such audits are actually performed, and indications are that leading reinsurers do it, and fringe markets continue to write risks unknowingly. The question risk managers must ask is, who stands behind their insurers, because the insurance promise may be as good as its reinsurance.

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