

CONTINUATIONS

Introduction

Processing continuation reinsurance is one of the more complex transactions in reinsurance administration. In its simplest term, it means continuing reinsurance with the original reinsurer or reinsurers even if the policy or coverage changes. The most frequent occurrence is policy conversions which will be the major focus of this document, but other types of continuations will be mentioned.

Most life insurance policies contain a contractual provision granting the insured the right to convert to another plan of insurance for a specific period of time as long as the policy is continually in force. When an insured exercises his right to convert from one policy to another he/she usually does not have to provide evidence of insurability unless applying for additional coverage. Typically, insureds convert from a term policy to a more permanent form of insurance. Oftentimes the term coverage expires after 5, 10, 20 years or longer, and if the insured has a need for continuing protection this provision provides for that need. Some policies even provide term to term conversions.

Reinsurance continuations can also be as a result of a policy replacement or reissue or exchange. Policy replacements or reissues usually occur a short time after the original policy is issued and no new underwriting is performed. Exchange programs are typically special programs that allow an insured to exchange current coverage with a new plan offering more favorable benefits. Exchanges can be internal or external, but as such should be provided for in the reinsurance agreements. In most cases these are treated as continuations. Thus, all reinsured conversions are continuations, but not all continuations are conversions, they can be reissues, replacements, re-entries or exchanges.

It should be noted that policies can change several times, but if there is reinsurance on the initial policy the reinsurance usually stays with the original reinsurers if it meets the criteria of continuation as described below.

Definition of Continuation

A continuation is defined as a new policy replacing an existing policy where the new policy lacks at least one of the following characteristics: new business underwriting, full first year commissions, new suicide period or new contestable period. **Life, Health & Annuity Reinsurance** Third Edition, John F. Tiller, Jr., FSA, Denise Fagerberg Tiller, FSA, 2005, ACTEX Publications.

At a recent ACLI Meeting, a Treaty Boilerplate Definition was provided. In force life insurance coverages whose provisions have been significantly modified without evidence of insurability are classified as continuations. Those modifications may include internal replacements, policy exchanges, term conversions, re-entries and contractually permitted increases. Reinsurance on these policies stays with the original reinsurer unless otherwise agreed.

With the broadness of these definitions it is imperative that the treaty documents clearly define the conditions for continuations, and the premiums to be paid. Administrators must not only be informed about these provisions, but also have the 'tools' to identify and process them correctly.

What are the Conditions for a Continuation?

The original policy or portion of it is terminated and a new policy is issued. In addition one or more of the following conditions are met: There is no new underwriting for the continued portion of the new policy, only if the insured requests an increase in coverage is there underwriting for the increase. Also, the unexpired portion of the original policy's suicide and contestable period applies if applicable. The agent is not entitled to a full first year commission on the converted portion of the policy.

Continuation Terms

Most Reinsurance Agreements stipulate that if a reinsured policy converts to another plan the reinsurance stays with the original reinsurers and on the same terms including risk classification, mortality rating, and any unexpired flat extras. Depending on the Agreement Provision the reinsurance for the new policy is calculated at original age, point in scale premiums or current age rates. If the original policy was coinsured, the new policy is typically reinsured on a set of pre-defined rates often referred to a Yearly Renewable Rates (YRT). Even if the original policy was reinsured on a YRT basis the converted policy can be on a different rate schedule.

The original reinsurer or reinsurers may not be participating on the new policy form. In this case the original treaties should address the rates to be used for policies that meet the criteria for reinsurance continuations.

If the reinsurer and cedent agree there can be alternate terms. The reinsurer may allow the ceding company to recapture policies that convert under specific terms. If the existing reinsurer and the reinsurer of the new plan agree, assuming they are different, the ceding company can cede the business to the new reinsurer. These accommodations need to be addressed in the treaty agreements or amendments and communicated to all pertinent parties.

Challenges

There are many challenges facing today's administrator trying to accurately process reinsured continuations. Much of the reinsurance that has been ceded in the last ten to fifteen years has been ceded on a quota-share basis to two or more reinsurers. Initially reinsurance was done on an excess basis, but much of today's reinsurance, especially term business, is quota-share on a first dollar basis which means that a portion of all new policies have reinsurance. Thus, when policies convert or change it involves multiple reinsurers and cessions with terms amongst those reinsurers that are not always consistent.

Below are some of the more common conversion issues:

When policies terminate the termination reason is not always accurate. Some policy administration systems permit a generic termination code so it is not easily discernable if it is due to an expiry, replacement or some other type including conversion.

Insurance companies often have multiple policy administration systems based on product or product type. For example; traditional products may be one system, UL and VUL on another, joint products on another, and COLI/BOLI plans administered by a TPA.

The new policy that is being issued may or may not be on the same policy administration system as the original policy. If the new policy does not have a unique issue type identifying it as a conversion, replacement or reissue, and is issued without rate restrictions as new business, it will go through normal new business processing, and be reinsured as automatic new business if it meets the conditions for automatic reinsurance or may even be retained if within retention. If the original policy and the new policy reside on different policy administration systems chances are there are no links between these systems. These policies are only possibly linked through proper coding or the alpha system or an audit of the business looking for possible continuation situations.

The majority of policy conversions are one to one conversions. That is one term policy converting to a new policy with a like face amount. If there is an increase in face amount it is underwritten and is accompanied by a new suicide and contestability clause for the increase in face. Most continuations use a single rate table, but not always, especially if the policy can convert to a number of different plans that can utilize different rate tables.

There can also be partial conversions. That is, only a portion of the original policy is converted at any given time. Thus, the original policy stays in force but the face amount decreases by the amount that is converted, and the new policy is issued in the amount of the decrease. Again identifying the new issue as a partial continuation of the original coverage is difficult especially if the policies are on different policy administration systems. Converting a portion of a policy can occur multiple times as the insured's income increases and is able to afford the increase in premium for more permanent coverage. If multiple partial conversions occur, the reinsurance durations on original age conversions will vary or the current age depending on the reinsurance provision in the treaty.

If multiple policies convert into one new policy then multiple reinsurance records will be needed even if they are all to the same reinsurer. Likely the issue dates of the old policies will vary and possibly the risk class and mortality rating based on the insured's physical condition, policy provisions on the new plan, and the underwriting criteria used at the time of issue. Usually the Reissue and Conversion and the Underwriting Departments are aware of these multiple policy continuations and it is imperative to have procedures in place to inform the Reinsurance Department if there is reinsurance on any of the policies.

Some companies allow two single life policies on different but related insureds to convert to one new joint life coverage. For this to occur the policies usually have to have similar face amounts and have been issued within a reasonable time period of each other. Such conversions are not commonplace, and require the agreement of the reinsurer so there should be special provisions in the Reinsurance Agreement between the ceding and reinsuring companies to handle the processing for these cases.

If your company allows off anniversary conversions the reinsurance agreements should stipulate if the conversion processing is based on the nearest age anniversary or on the last age anniversary.

A recent “wrinkle” in the continuation process has been caused by the merger and acquisition activity taking place in the industry. Companies are now allowing insureds from one company to obtain policies from the new acquiring company thus we now have cross company conversions or replacements. The new company may or may not have a relationship or a reinsurance agreement with the reinsurers on the original business. In order to process continuations if cross company conversions or replacements are to be permitted involves a negotiation with the original reinsurers and establishing the appropriate treaty agreements.

What the original arrangement provided for may not be known, since often the staff does not come with the business, but even if it is known may not apply since the parties to the agreement are different. This is a complex issue and may involve several departments including actuarial, underwriting and administration to have the proper procedures in place to assure reinsurance coverage.

There has even been consolidation among the major reinsurers so there may not be a clear definition of original terms on old policies. This is especially true if an insured changes his or her policy several times.

There are those companies that have unique conversion provisions that do not follow industry standards. It is fine to negotiate such terms if the reinsurers are in agreement with them. Too often though, those terms are negotiated based on the financial impact to the ceding company, but without proper consideration for the administration or validation of the process. If the administration is too cumbersome and is not automated, the results will be inaccurate reporting and potentially the reinsurer denying liability for the risk.

Recently at least one reinsurer has been focusing on possible anti-selection factors in the conversion process. The longer an insured waits to exercise his/her right the more likely they are to exercise it if there has been a deterioration in health risk or they may not qualify for new coverage. The proposal is to have several rate scales with increasing premiums the later from issue one decides to convert their policy. While this is a recent proposal being considered there is no automated processing in place to support it. Both the reinsurer and the ceding company have to be sure there is a clear understanding of the terms and the procedures that will be implemented to assure compliance. There are ways to facilitate automation of this type of processing with the appropriate lead time and proper direction.

Exchanges and policy replacements are also considered along with conversions, but how they are defined and processed can vary amongst companies. Exchanges can be internal or external. Internal exchanges allow an insured to exchange his/her existing policy for a more up to date policy possibly with increased benefits at a reduced cost. If a ceding company initiates such a program they should obtain the approval of their reinsurers and specify the terms for reinsurance. Exchanges may be treated similarly to continuations at original age point in scale or current age rates.

External exchanges were prevalent several years ago. Such programs allowed an insured's policy that was issued by another recognized company to be exchanged for a new policy with the same face amount in a new company without evidence of insurability. There may have

been a brief questionnaire regarding changes in health, but otherwise no real underwriting and no new suicide and contestable periods. Other restrictions may have been that the original policy had to be fully underwritten and issued within a specified time to be eligible for the exchange program. Exchanges require special provisions in the Reinsurance Agreement to be included, but were often treated as continuations but may have had a unique rate schedule to provide for some additional anti-selection.

Replacements or rewrites often occur shortly after a policy is issued. If so, the original policy usually terminates and a new policy is issued. Such cases may not require additional underwriting unless the risk is altered and/or the plan or benefits change. Later year replacements may or may not be handled like continuations, but the terms of the replacement cession have to be defined among the trading partners.

Policies with a re-entry provision are not very prevalent today, but there are policies in force with this feature at some companies. It basically allows the insured after a stipulated time period, typically one to five years, to start a new select period if his/her health has not changed. If approved the insured gets a new lower rate premium and a modified first year allowance may be provided by the reinsurer. Depending on the issuing company a new policy number may be assigned or the existing number is used under the new favorable terms. Unless otherwise agreed, the reinsurance stays with the original reinsurer no matter how many times the insured is allowed to re-enter. If your company issues this type of policy check for treaty provisions in the applicable reinsurance agreements, and find out how re-entries are recognized when the option is exercised.

If all of this seems complicated, well it is. Most reinsurance systems, especially the homegrown systems, do not adequately support these various scenarios. Also, many administrators are not adequately informed of the variations that can occur and too frequently they do not receive the needed information to process the continuations according to the applicable reinsurance treaties. The result is many continuations get processed as new business and unless the insured dies during the contestable period the improper administration may never be detected unless uncovered in an audit.

Processing continuations as new business causes a loss of premium to the original reinsurers. This loss for the reinsurer is exacerbated if the original policy was reinsured and the new policy is within current retention and is not reinsured. It is no wonder reinsurers deny claims for policies they learn are continuations after the fact, when the cessions were processed as new business with first year rates and allowances.

Consequences

If the continuation administration is not done correctly according to treaty terms your Company may not have coverage when it is needed most at claims time. Moreover, the reinsurers may lose confidence in your ability to self administer your reinsurance business and not offer favorable terms on future new business. If a company has too many reporting inadequacies reinsurers may decline to do business with that company if they do not have appropriate checks and balances and a viable reinsurance administration system.

Now that I have told you all the issues, problems and pitfalls let us focus on the solutions.

Solutions

Conversions and other policy changes resulting in reinsurance continuations processing issues have been prevalent forever. True there are new complexities being introduced, but over the years continuations have been the focus of many discussions, training sessions, and articles in various trade journals. I believe with proper understanding, good administrative procedures in place and the support of technology reinsurance continuations can be administered correctly.

To begin, negotiate continuation terms at the time the reinsurance agreement is written not when policies start converting and administrators are scrambling for processing procedures. Next, educate all possible parties involved in the process and make them aware of the contractual obligations for handling policy continuations. This includes the New Business and Issue Department, Underwriting, Reissue and Conversion, and of course Reinsurance personnel. The responsible people in those departments not only need to identify continuation situations, but also need to communicate the information to others that may have a function to perform.

For example; an insured may wish to convert a one million dollar term policy to a permanent plan. The term coverage may not be terminated until after the new plan has been issued and delivered to the insured. If that original policy is not terminated, the company will be on the risk for two million dollars instead of the one million that was originally underwritten. If this occurs, chances are ceded reinsurance is not correct especially if the new converted policy is treated as new business for reinsurance purposes. Should that insured die shortly after the new policy is issued, the reinsurer is not contractually obligated to pay the claim on that policy.

Make sure whatever portion of a policy that is converted to a new policy that the original policy is decreased or terminated if a full policy conversion.

Review the continuation provisions in all your reinsurance treaty agreements and make sure you understand them and have procedures in place to support them. If you use quota-share pools try to negotiate consistent terms amongst your reinsurers. Reinsurers will work with you, as long as the terms are equitable, because they want these situations to be handled accurately. As previously mentioned, if your company allows exchanges or replacement of reinsured coverages make sure the terms for handling these situations are specified in the reinsurance treaty agreement and administrative procedures are in place.

Recapture old reinsurance business as it becomes eligible if you meet the terms of recapture. This may limit your reinsurance continuation exposure.

In summary, **document** all the reinsurance procedures that need to be followed. As new terms are negotiated document them and make sure all affected parties are aware of the updated procedures. That includes those previously mentioned Departments: Actuarial, New Business and Issue, Underwriting, Reissue and Conversion, Reinsurance and even Claims. Sometimes other departments are not aware of the impact of not communicating information that is needed by another department.

Perform self audits to check procedures. Check recent terminations against new business issues on the same life to identify possible continuations that may have been missed. Work with your Information and Technology staff to see what support they can provide. If you have a vendor reinsurance package make them aware of your issues and look for support. If you

have multiple policy administration systems, there are often data warehouses or data bases containing key policy information that can be queried to identify possible risks. The tools are there we all just need to utilize them. Finally, work with professional organizations within the industry be it Actuarial, Administration, Financial, or Underwriting to heighten the understanding, provide training and improve the flow of data so processes like reinsurance continuations can be processed fairly and equitably.

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