

RETENTION MANAGEMENT

By

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Managing retention on a life has been the bane of life underwriters, claims personnel, and reinsurers for as long as I have been in the business. Back in the 70's when I entered the industry, performing retention checks was a highly manual process. Many companies and reinsurers had manual alpha indexing systems with hard copy cards listing pertinent insured and related coverage information. At that time I worked for an insurer that was also a professional reinsurer so we had assumed, ceded, and retroceded business and all of the insured's information such as name, date of birth and policy details was managed by a bin and card system.

Cards were manually updated as new business was written. Unfortunately terminations and policy conversions were not always recorded, or if they were, not necessarily on a timely basis. Oftentimes we had duplicate cards on the same life due to a transposition in the date of birth information, a variation in name spelling, or the use of nicknames, pseudo names (famous people) and "a.k.a"s. (also known as). In most instances, thankfully, gender was entered correctly

The real issue is that personal insured information is coded on a new business or policy administration system when the application is received by any number of data entry staff who may not use a consistent format or achieve the same degree of accuracy. Many more applications are received than policies issued and paid which can make this task tedious and repetitive. Moreover, there are no industry defined standards for entering name information. In some systems the name is in one field, in others the first, middle and last are coded in separate fields. Prefixes and suffixes such as Dr. or Esq. are added on some policies and omitted on others in various formats. The danger is not being able to recognize that coverage is in place on the same life, and not two separate insureds. For instance, Margaret Smith and Peggy Smith may be seen as two distinct individuals, and if she then marries and assumes her husband's last name chances of any additional policies issued being linked to either one of the two life IDs already on file would be miraculous.

In those days most clients managed retention on a per policy basis rather than on a per life basis. While retentions were smaller, so were the average policy sizes. Large risks were the exception and not the norm and it was usually not as difficult to monitor those larger risks to ensure they did not exceed binding or jumbo limits. Also, there was less reinsurance because companies ceded on an excess of retention basis to one reinsurer. Most used alpha splits on last name if there were two or more automatic reinsurers covering a block of business or product type.

Then, along came self administration. Reinsurers no longer received paper cessions requiring manual keying of insured and reinsurance information. They had to rely on

clients to control the automatic limits. Oftentimes errors were detected at claim time. With self administration came automation and the ability to cede a risk to two or more reinsurers with the goal of spreading the risk and increasing capacity limits. This shift forced an increase in focus on retention management and highlighted the potential for uncovering over retention situations.

Companies began purchasing and implementing automated alpha indexing systems that were client based and had phonetic search capabilities, thereby being able to improve the odds of linking policies that they could not do previously. The undertaking was huge however, and therefore results were not as impactful as anticipated given the volume of data and number of incidences of inconsistency. Companies have spent millions on the issue with improved results, but today's solutions are far from perfect. While many of the newer systems are client based, the reality is that some insureds still have multiple client identifiers. Clients with more than one policy administration system may have unique client identifiers assigned by each system.

First dollar quota share mitigated the over retention problem somewhat for ceding companies, but potentially increased exposure for reinsurers depending on the amount of risk they were receiving from various ceding companies and their own capacity. In addition, with the increase in large face amount competitive term, UL, VUL, and Joint Survivorship plans being issued, retention on a life rather than on a policy basis is essential.

Ceding companies also introduced more complex retention schedules. Retention was not only graded by age, mortality rating and flat extras, but also often varied by product type like permanent vs. term, or single vs. joint type plans. With the introduction of first dollar reinsurance, especially on retained blocks of business, companies could potentially have both excess and first dollar reinsurance on the same policy and calculate the net amount at risk on each cession differently.

Reinsurance administrators and the systems they utilize must assist in the process of controlling retention on a life. Many companies have a new business system, a separate underwriting system, multiple policy administration systems, and a standalone reinsurance system that may or may not receive extracts or feeds from some or all of its partner systems. Managing and controlling all of the data is no easy task and requires strong analytical skills backed by dedicated systems support. In most instances the various systems do not communicate with one another so bringing the data together can be a tremendous effort. Some companies have adapted databases and implemented data warehouses that are fed by multiple administration systems to help consolidate the data into more usable formats.

If reinsurance administration is to play a major role in controlling retention on a life, it is essential to have all in force policies, reinsured or not, on the reinsurance system data base. Once all in force policies are inventoried how are policies on the same life linked? Does the company maintain a separate client file that covers all policy information or does each policy administration system have its own set of files with or without client

identification capabilities? In this case there is no easy way to link policies on the same insured across different administration systems.

Creating a unique client identifier is essential. Social security or social insurance numbers are usually not viable because they are not available for all insureds and due to privacy considerations should probably not be used. Also, the data provided may be on the owner/payor rather than the insured. For business purposes a company's tax ID number may be used rather than the social security or social insurance number of the insured resulting in false determinations.

Most systems randomly assign a number based on the insured's last name, first name, optional middle name or initial, date of birth and gender. Phonetic searches along with nickname logic have been introduced but data entry errors and transpositions still require human intervention. For most companies, aggregating all of an insured's policies is an ongoing challenge. Multi-line companies use the information not only for retention management, but also for marketing and cross-selling purposes.

Even if the client information is deemed reasonably accurate, as new policies and coverages are added, ongoing analysis continues to be required to determine whether this coverage fits an existing profile, or a new client record needs to be added.

Reinsurance on a life is further complicated by line of business or product type. For example, individual vs. group or pension business, joint vs. single life business, term vs. permanent business, life vs. critical illness, plus disability income and long term care coverages. Are these retentions independent and if not what is the hierarchy for filling retention limits?

Joint coverages provide some unique challenges. Today, in most instances, information is available for both insureds assuming it is a joint life policy. Some companies insure three or more lives on a coverage (multi life policies), but it is the exception and requires unique processing not within the scope of this document. How retention is calculated often depends on the product. Joint First to Die policies may determine retention based on the insured with the least amount of insurance while Joint Survivorship may be based on the insured with the highest amount of prior coverage or visa versa depending on the companies' assumptions. Survivorship may base the retention on the insurable life if one life is uninsurable. For these reasons some companies maintain a higher retention limit on joint life policies as opposed to single life coverages.

In addition some survivorship plans attach Estate Protection Riders that are reinsured, but expire after a few years. Retention computations need to be adjusted once coverage expires.

If multiple statutory companies are involved, does each company maintain its own retention and is there an overall corporate retention? How is it applied and managed?

Determining the available retention at new business time is dependent on the treaties under which the business is placed. What is the retention amount? What has been previously retained? Does it meet automatic acceptance limits and not exceed the jumbo limit? In other words is this plan reinsured on an excess retention basis or a first dollar quota share basis? If automatic reinsurance requirements are not met, it then needs to be sent to one or more reinsurers seeking an offer on a facultative basis.

As policies terminate, increase, decrease or convert, the administration becomes a little more complicated. Let's consider each of these issues separately.

When policies terminate, retention is reduced unless the risk was fully reinsured. The amount retained on the terminated coverage should be used to reduce existing reinsurance unless it is facultative or first dollar quota share. If some or all of the prior reinsured policies are first dollar quota share, you may not be able to fill your excess capacity because the retained and ceded percentages do not change. Surrenders and expiries may allow you to re-allocate sooner if the termination reason was appropriately assigned. Again this is a simpler process if all reinsurance is excess of retention-not as easy with some of the risks being first dollar quota share. If your reinsurance system only contains reinsured policies, you may not know when a non reinsured policy terminates and that retention can be filled. You are lacking the necessary information to make the determination.

Policy increases that are treated as new coverages or segments can usually be processed as new business if underwritten and/or first year commissions are paid. Face increases on existing policies may require additional processing. Here I am referring to increasing benefit plans (not death benefit changes) on UL and VUL policies that determine reinsured net amount at risk. Companies need to establish rules on these with their reinsurers, and then work with their vendor or in house IT Department to make sure the reinsurance system handles the increase appropriately. With increasing benefit plans, reinsurers need to know the potential maximum increase in risk (ultimate amount) so they do not exceed their own retention or if they do, have the appropriate retrocession coverage in place and be able to report on it. Again if there is a potential for exceeding jumbo limits and these cases need to be identified at issue and not at claim time.

Policy decreases can be handled either as proportional or by maintaining a level retention depending on what is negotiated and subsequently outlined in the treaty. A potential issue here is the exercise of accelerated benefits for serious illnesses. This is not a common occurrence, but one that can occur and many policy administration systems do not differentiate between the processing of accelerated benefits versus a normal face decrease. The payment of a benefit should not affect the retention amount. Also, as stated earlier, first dollar and excess reinsurance will show different results-the former being proportional and the latter may result in the reinsurer absorbing the full decrease, especially if UL or VUL, depending upon the treaty parameters.

Policy conversions are problematic in general, but timing differences between the old and new policies adds complexity. Does the old policy terminate as a conversion termination,

or another type of termination that is not associated with the conversion, or is it a partial conversion? When the new policy is added, is the original policy and face amount unchanged and later terminated? If that is the case, ultimately you can be under retained when the original policy is reduced or terminated.

All of these situations require a high level of accuracy when it comes to establishing good client records and highlight the need to have procedures in place to monitor the changes as they occur. Maintaining the appropriate retention on a life requires continuous data analysis.

One of the major issues we encounter with clients is under retention situations that are discovered at claim time. When requesting payment for an automatic claim, reinsurers may ask how much is currently retained on the life. If full retention has not been maintained, the claim amount may be adjusted downward in which case the reinsurer would refund premiums on the excess amount of coverage ceded. This type of occurrence is often as a result of non reinsured coverages terminating without notification being provided to the reinsurance department, or face decreases occurring on coverages that may or may not be reinsured. How many other in force policies are in this under retained category? Your company may be over paying reinsurance premiums on coverage that is not needed.

Most retention checking is done when new coverages are added by the underwriting and reinsurance departments. Fewer companies adjust retention upon coverage termination. I recommend that if a policy terminates due to a lapse, not to adjust retention immediately, wait at least one quarter as it may reinstate and reinsurance will have to be reallocated. Do adjust immediately though for other types of terminations such as surrenders, expiries, etc.

Retention checking should also be done for face increases and decreases. Face increases that are underwritten and processed as a separate phase or coverage are the most easily identifiable. Increasing Benefit Plans that have an initial face amount and an Ultimate Face Amount that can grow to three or four times the initial face amount depending on interest rates or the stock market are more difficult to manage. Companies can often provide a projected face amount that can be used to inform the reinsurer of the potential ultimate ceded amount. Here I am not referring to the level or increasing death benefit on a UL or VUL policy, but a truly increasing benefit plan where the reinsurers risk may be a multiple of the risk amount originally ceded. Face decreases may be level or proportional for retention purposes depending on how the treaty is written and administered.

It is recommended that companies run over retention checks periodically based on current retention. Find those situations where there is over retention and reinsure the excess risk immediately. If it is an impaired life or one that exceeds the binding or jumbo limits, facultative underwriting and approval will be required. This is why it is imperative to uncover these situations as soon as possible after issue, or your company may be stuck with a risk it does not wish to retain.

Determining over or under retention situations based on policy issue date is much more difficult. Initially all of your company's retention tables will have to be loaded into a system by effective date. Then programs will have to be run to identify cases that can potentially be under or over retained based on what your policy in force looks like at the time of the run. Reinsurance will then have to be added or reduced as of those dates.

If reinsurance is to be added, are there existing cessions in force or do new ones have to be added? If new ones are being added, does the business meet the criteria for automatic reinsurance and is the treaty still active? If it is not active, the reinsurer may not accept new business and you will have to shop for coverage with one of your current automatic reinsurers to find one that is willing to assume the risk under acceptable terms. Should the risk be identified as needing facultative coverage, there may not be any willing takers, especially if the coverage has been in force for some time. Reducing reinsurance and filling retention is much easier, but again, if your company has a mix of excess retention and first dollar reinsurance, it may require special analysis.

Over and under retention checks require extensive analysis and consistent procedures to resolve past problem situations. Involve your reinsurers; let them know what you are doing, the timeline you've established for completing and reporting on the results of your review and how you plan to correct inconsistencies. What you do especially retroactively will have an impact on their business and potentially what they may need to retrocede or recapture from their reinsurers.

As companies diversify their product offerings, they may opt to keep separate retentions on different products or lines of business. With the consolidation in the industry, there may be multiple statutory companies involved each with their own retention schemes, further topped by a corporate retention that can be filled by various entities.

Over retention situations can also occur as a result of a new acquisition. It often takes time to amalgamate a new block with an existing block and thus determine the amount of new reinsurance coverage that needs to be secured. The company must then find a willing partner interested in assuming the in force block as at a given date.

Until recently I have not seen much recapture activity on eligible business. I think there are several reasons behind this:

Firstly, first dollar reinsurance companies are more focused on handling the increased volume of reinsurance and less concerned about business that is processing successfully.

Secondly, applying the rules for recaptures can vary by reinsurer and attempting to manage them requires much manual painstaking analysis.

Despite these inconveniences, the business that is still in force is probably profitable to the company and if they have increased their retention limit substantially, it may be in

their best interests to initiate a recapture program. This is another reason why it is so important to have control of your retention on a per life basis.

In this document, I have considered retention based on ceded face amount. A few companies have tried to maximize their retention amounts by basing retention on risk and adjusting that amount monthly or annually. This is much more difficult to do especially when processing retroactive adjustments. Managing a consistent retained amount is difficult, and dealing with an ever changing retained amount is tricky in terms of its complexity as well as reliance on systems support.

In conclusion, keeping the correct retention on a per life basis seems like a straight forward concept. Most companies do not change their published retention tables all that often. However, linking policies for an insured over a period of time without a client identifier or where there can be variations in name is no easy task. Today there are technologies to assist in the process and many companies have invested heavily in more sophisticated systems to facilitate this process.

Achieving effective retention management assures companies the protection they need on the risks they hold, but also helps them to minimize the amount of reinsurance coverage by maintaining the appropriate retention on a life. This truly is a risk management function that should receive the human resources and system support needed to keep it in sync with the data on a company's various administration systems. Maintaining full retention on all lives may not always be possible, because mistakes do occur, but with vigilance and proper monitoring tools, a high level of accuracy can be achieved, thus reducing exposure and minimizing the incidence of surprises at claim time.