

Property Liability Reinsurance Auditing

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Agenda

- Both Buyer and Seller perspectives
- What is “Reinsurance auditing”?
- Why Audit?
- Some reinsurance basics
- Suggested risk continuum
- Types of Audits
- Desk Audits
- Field Audits
- Wrap-up



Both Buyer and Seller perspectives

- Buy side: Almost every company is a buyer
- Sell side: Very few are active sellers but many are involved through:
 - Legacy runoff involvement
 - Voluntary pools
 - Block of business acquisition
 - Fronting
 - Alternative risk – captive arrangements

What is “Reinsurance auditing” ?

Any process or technique which can be used to assess:

1. *whether the operational performance and financial accounting by either party to a reinsurance contract is in compliance with the express and implied terms of the contract as well as the applicable accounting guidance*

Plus: on sell side only:

2. *whether the Disclosures made by the buyer prior to acceptance or renewal by the seller were accurate and complete*



Why Audit (Buyer side)?

- Reinsurance is usually not a core business activity but consider....
 - Size
 - Complexity
 - Non-routine
- Therefore – will (or should) receive internal control and external audit attention
- May result in **economic benefits**



Why Audit (Seller side)?

- For Sellers actively involved – reinsurance is the core business activity
- For other Sellers – consider factors noted above
- For both consider:
 - Reliability, Adequacy, Timeliness of information
 - Performance of counterparty (Buyer)
 - Possible involvement of Third Parties
 - Special emphasis on initial disclosure by Buyer
- May result in **economic benefits**

Some reinsurance basics

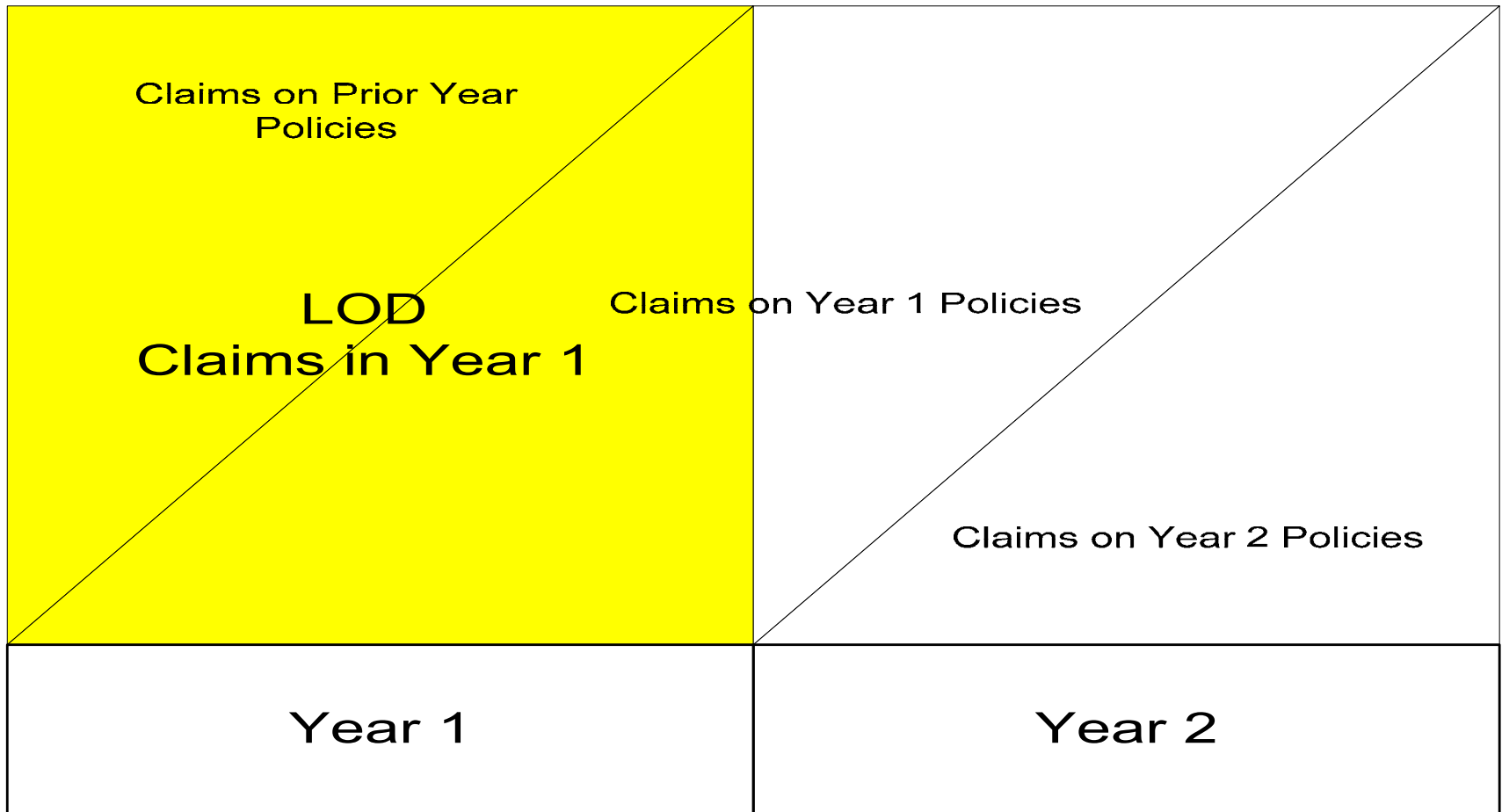
- Treaty (defined block) or Facultative (one policy)
- Proportional
 - Quota Share
 - Surplus Share*
- Excess of Loss
 - Per Risk
 - Per Occurrence*
 - Aggregate *
- Inuring concept (priority)

* *Treaty only*



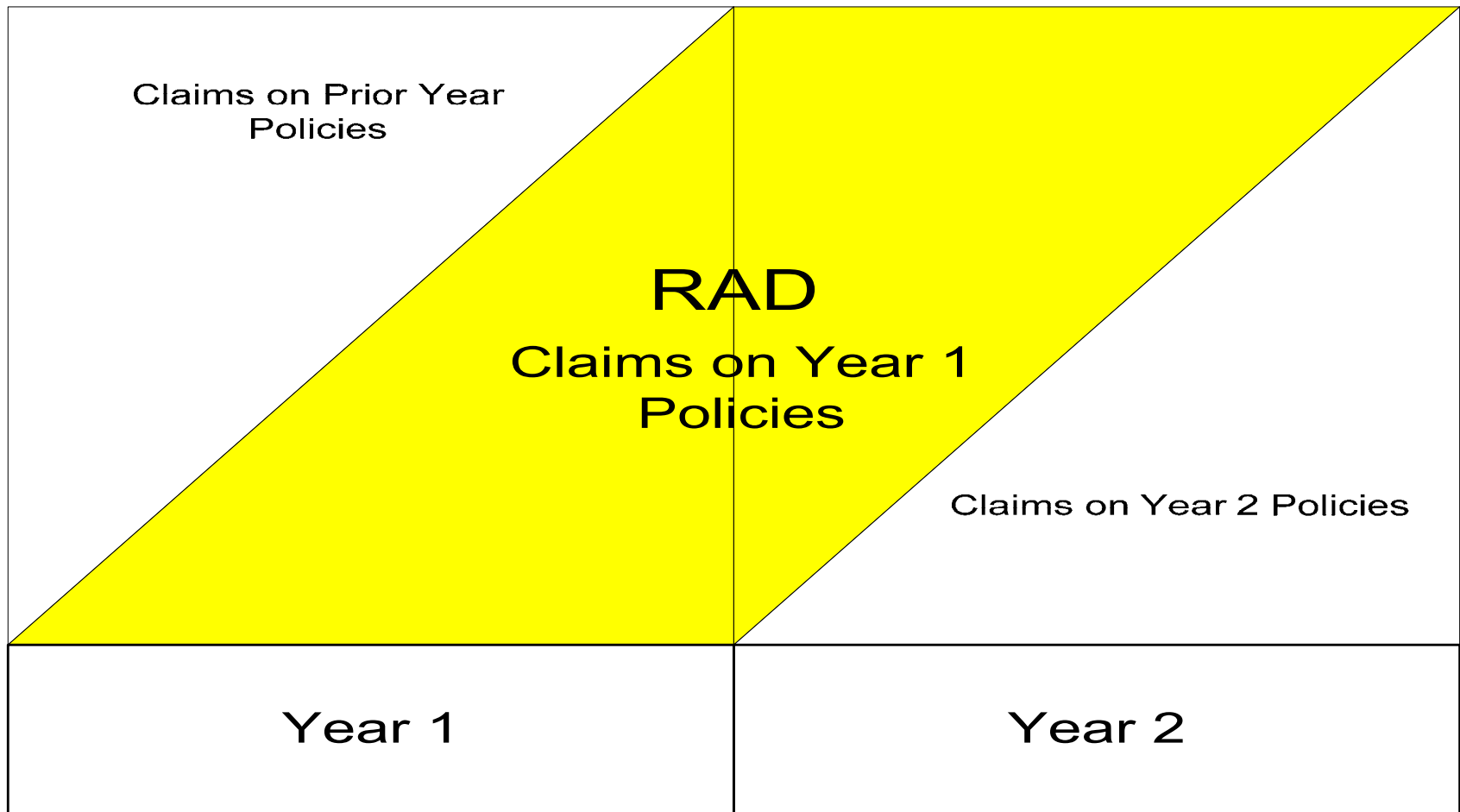
Some reinsurance basics

Losses occurring coverage (LOD)



Some reinsurance basics

Risk attaching coverage (RAD)



A suggested risk continuum

Shorter tail

Longer tail

Proportional Treaty

Excess Aggregate Treaty

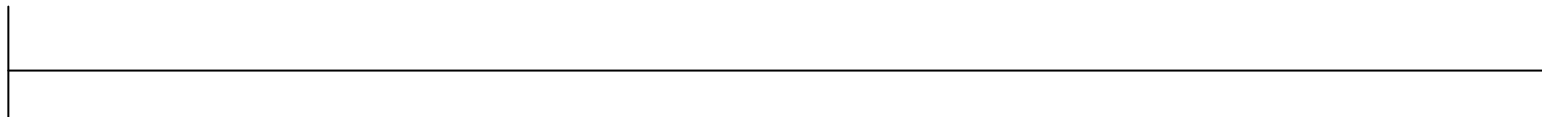
Excess per risk Treaty

Proportional Facultative

Excess per occurrence Treaty

Excess Facultative

Retrocession Treaty



Less Risk

More Risk

Types of audits

- Internal or desk audits
 - Not including “Security Committee” activity
 - Not including “Risk Transfer” evaluation activity
- Field audits
 - Due diligence
 - Quantum, performance & disclosures

Desk audit (Buyer side)

- Planning considerations
 - Selection of contracts should use risk ranking
 - Audit “around” the current process
 - Staffing
 - Independence
 - Knowledge of reinsurance contracts, reinsurance accounting, and direct information processing systems (premiums and claims)

Desk audit (both Buyer & Seller)

General Objectives

- Validate reinsurance premiums written, earned, and payable and associated expense reimbursements (if any)
 - Buyer (minimize cost) Seller (maximize revenue)
- Validate reinsurance losses paid and incurred
 - Buyer (maximize recovery) Seller (minimize cost)



Desk audit (Buyer side)

Steps

- Need to select “cutoff” date
- Obtain contract parameters from direct reading of applicable contract documents
- Use these parameters to obtain direct premium and claims data
- Re-calculate through the “cutoff” date
- Compare re-calculated premiums and losses to premiums and losses produced by current process
- Consider other reinsurance inuring



Desk audit (Seller side)

- Similar to Buyer side – but limited information
- “Reverse Schedule F” analysis tool



Field audit Due diligence

- Can be conducted either before a reinsurance contract is accepted (“Pre-quote”) or while it is active
- Requires more extensive planning and coordination
- (hard) Cost vs. (soft) benefit
- Increased use = fewer disputes



Field audit Due diligence

- Audit planning
 - Audit request letter
- On-site audit activities
 - Disclosure, underwriting, pricing, claims focus
 - Operational review orientation
 - Wrap up meeting
- Resolution and Reporting

Field audit

Quantum, performance, & disclosures

- Dispute may exist
- May be contentious
- Legal advice should be obtained
- Specialized skill sets may be needed
 - Underwriting, claims, actuarial



Field audit

Quantum, performance, & disclosures

- Audit planning
 - Audit Request Letter
 - The “Inspection” or “Access to Records” clause
 - Recommend obtaining underlying policy, premium, and claims data for analysis prior to fieldwork (and to make selections for audit)



Field audit

Quantum, performance, & disclosures

- On-site activities
 - Evaluate disclosures for accuracy and completeness
 - Quantum & performance audit
 - Premiums
 - Claims



Field audit

Quantum, performance, & disclosures

- Objectives for policy/premiums:
 - Have been properly underwritten and priced within any relevant guidelines
 - Make up the subject premium base of the reinsurance contract(s)
 - Is the basis of the reinsurance premium taking into account terms (rates, etc), any inuring reinsurance, and proper deductions (if any)



Field audit

Quantum, performance, & disclosures

- Objectives for claims:
 - Are covered within the underlying policy which is included in the subject premium (see above)
 - Are covered within the reinsurance terms in the amounts claimed (limits, shares, retentions have been applied in keeping with implied or explicit parameters, no exclusions apply, and inuring reinsurance has been properly calculated)



Field audit

Quantum, performance, & disclosures

- The “Query” Letter(s)
- The “Coverage” Letter(s)
- The Field Audit Report
- Proceedings may follow
 - Mediation
 - Arbitration
 - Litigation



Wrap up

- Increase awareness generally
- Buyer side: encourage use of Audits
- Seller side: provide some insights



Questions



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