

Cede It Right the First Time

10 Practices of Effective Ceded Reinsurance Claims and Accounting Teams



Illustration / Rafael Edwards

“We apply reinsurance recoveries to the oldest balance due regardless of which claim the reinsurer is actually paying.”

“What do you mean we paid 40% more than our contractual limit and the reinsurer is refusing to reimburse us?”

These are just two examples of issues that can generate significant obstacles in effectively managing an insurance company's ceded reinsurance asset. The complex contractual structures of reinsurance programs and individual reinsurance agreements; cumbersome ceded reinsurance processes and systems; and evolving reinsurance accounting rules create challenges for those responsible for determining, reporting, and collecting reinsurance cessions. It can be difficult to determine how to manage reinsurance obligations efficiently and effectively within available resources while also trying to meet operational goals in a constantly changing external environment. Meeting these challenges requires the successful incorporation of human and technical resources, as

well as, the appropriate implementation of processes and controls. In order to optimize the effectiveness of ceded reinsurance programs and the associated accounting, ceded reinsurance teams should strive to implement the following practices.

1. Establish a clear culture of learning and adapting

Critical to an organization's profitability is the ability of management and lower level employees to learn from past behavior and integrate learning into the company's daily culture. Adapting to change and incorporating knowledge from past successes and mistakes will help an organization identify future opportunities and potential risks.

The goal of the ceded reinsurance team is to identify and secure the reinsurance asset. In order to achieve this goal, each individual team member must understand the role in the overall process. For example, employees who develop a quarterly bordereaux not only view themselves as processors of information, but as individuals who carry out critical functions necessary for the company to seek and record the proper reinsurance

assets. These employees also understand the a) necessity of securing the reinsurance asset, b) contractual relationships, and c) other team members' roles. This enables them to identify red flags that may require further investigation. Having a good grasp of the overall process and their role in the process helps employees gain an understanding of how reinsurance impacts surplus and liquidity and, more importantly, the organization as a whole. If individuals at all levels focus on finding solutions to business challenges, then an organization is much more likely to prosper.

2. Understand placement profiles and identify reinsurance relationships

A successful ceded reinsurance team understands the company's reinsurance programs and the goals for current reinsurance placements. Effective ceded reinsurance leaders promote an understanding of reinsurance programs at all staff levels. This helps staff to identify claims that fall outside of the developed processes and controls and uncover opportunities for missed cessions. Teams that thoroughly document ceded

reinsurance placements on an individual program basis within a sound and tested system, will have quick and accurate retrieval of placement information.

Effective ceded reinsurance teams encourage staff managing individual programs to have a working knowledge of the coverage the reinsurance contracts offer, as well as, the nature and structure of the specific reinsurance program.

Companies often fail to identify cessions because of siloed approaches to managing various types of protection (facultative, treaty, excess of loss, or quota share).

For example, when a claim exhausts facultative protection and the company fails to identify additional coverage that may be available under a reinsurance treaty. Another commonly missed cession occurs in the context of non-concurrent coverage, due to placement issues or exiting initiatives, including covered periods, layers of protection and treatment of expenses. Individuals responsible for billing initiatives in successful ceded reinsurance teams understand these issues and, as a result, can avoid inappropriate billings and overstatement of reinsurance assets on the balance sheet.

3. Master technology and data

While many insurance organizations have data quality issues resulting from operating multiple claims and reinsurance systems, a well-managed ceded reinsurance team is knowledgeable about the basic operations of all available systems and sources of data. To understand which systems feed or impact the data (e.g., application of deductibles or loss sensitive premiums), as well as, what causes differences in timing. This knowledge can enable the ceded reinsurance team to consistently pull and organize data, create net and gross calculations, and incorporate predictive analytics when identifying red flags in certain books of business or types of claims. The individuals inputting data into the systems will have a thorough understanding of the data (definition and need for the various fields of information, the purpose and goal of the system, and

databases fed by their inputs) and will be able to consult internal and external subject matter specialists to address data and/or coverage interpretation issues in a timely manner.

To optimize resolution initiatives, it takes a proactive approach to litigation and arbitration management, and communicates outcomes to internal stakeholders.

4. Manage the reinsurance program with an understanding of the financial statement impact

A financially healthy insurance company has financial statements with transparent reinsurance footnotes, fully collateralized Letters of Credit (LOC) that are replenished on a timely basis, and no Schedule F penalties. Such an organizations' reinsurance staff understand the impact of Schedule F, why there is a penalty, and how the penalty is calculated. The company identifies poorly performing reinsurers (those with balances due over 90 days) and pursues outstanding balances beginning 60 days from the date of invoice. On a quarterly basis, the ceded reinsurance team reviews Schedule F balances and the associated penalties, establishes targeted collection goals, and addresses variances of planned to actual recoveries. In addition, at least twice yearly, the team verifies collateral and seeks replenishments one quarter in advance. The team also vets financial statement footnotes on reinsurance topics with other company stakeholders involved in financial reporting such as the Chief Financial Officer.

5. Conduct regular, ground up account and broker reconciliations

An effective ceded reinsurance team is confident in the accuracy of its brokers and vendors' data and logic used in calculating cessions and applying payments. This team has an established process to reconcile data periodically

through an independent — “ground up” approach rather than just a “roll forward” methodology — and regular reviews of retained losses against reinsurance placements to identify missed cessions. In addition, it resolves differences promptly and appropriately documents the resolution.

6. Maintain an enhanced process for evaluating credit risk

To determine the creditworthiness of prospective and current reinsurers, an effective ceded reinsurance team reviews information available from a variety of sources such as reports from multiple rating agencies, recent reinsurer financial statements, and other available industry resources. They evaluate and test their evaluation methodology regularly, and upon identification of an at-risk reinsurer, review management strategy, including potential exiting transactions, credit risk adjustment, and the associated balance sheet impact.

7. Appropriately manage disputes and record risks

In order to facilitate the analysis of possible outcomes and recording of disputed risk reserves (i.e., “allowances”), effective ceded reinsurance teams can identify disputed ceded reinsurance matters and quickly evaluate and discuss the relevant coverage issues and exposures with both internal and external stakeholders. Such a team maintains supporting documentation detailing the basis of the disputed risk value and tracks revisions and the associated drivers. The team also reviews documentation to identify opportunities for improvement with respect to existing and future cessions. To optimize resolution initiatives, it takes a proactive approach to litigation and arbitration management, and communicates outcomes to internal stakeholders.

8. Continually advance processes and controls

Effective ceding reinsurance teams develop manuals that cover the processes related to their reinsurance programs, including accounting for cessions,

10 Practices... (continued)

effectuating and crediting invoices, limit impairment, collateral requirements, preparing financial statements / reports, and entering / interpreting data. In addition, these manuals document current processes and controls clearly in a user-friendly fashion and provide updates in real time. The companies also test controls and review for consistency with leading industry practices. Moreover, they train appropriate staff in both processes and the controls and encourage individuals at all levels of the organization to identify opportunities to enhance operations and improve efficiencies.

9. Clearly document accounting records and collection initiatives

An effective ceded reinsurance claims and accounting team documents reinsurance collection activities, including contract interpretation, cession calculation, notice, billing, loss reporting, and reinsurance audits, in an accurate, timely, concise, factual and retrievable manner. Such a group communicates expedi-

tiously, both internally and externally, and quickly escalates issues and shares resolution-oriented plans.

10. Team, cross train and plan for succession

Successful ceded reinsurance teams work consistently with other departments within the organization to manage current issues and plan effectively for the future. Incorporating a multidisciplinary approach, whether formal or informal, provides an effective means of addressing a variety of issues, including direct and reinsurance contract wording, potential loss development on existing claims, calculation of ceded IBNR, and financial reporting. Cross training should coincide with teaming opportunities to promote individual career development, expand bench strength and ultimately maximize resource capabilities. Going hand-in-hand with cross training, succession planning not only is important to plan for advancement, but also prepares the team through mentoring programs and

forecasting exercises for anticipated and unanticipated events that may require a change in leadership and staffing.

A ceded reinsurance team who effectively implements these ten practices likely will optimize its ability to identify all applicable cessions and timely secure its reinsurance asset; appropriately address issues as they arise; efficiently and effectively manage its data; ensure accurate, timely and transparent financial reporting; and effectuate mutually beneficial dealings with stakeholders. ●



Barbara K. Murray is a Director in the PwC Actuarial & Insurance Management Solutions. barbara.k.murray@us.pwc.com

The firm worth listening to is the firm that listens to you.™

Talk to Foley. We're listening.™

©2013 Foley & Lardner LLP • Attorney Advertisement • Prior results do not guarantee a similar outcome
321 N. Clark Street, Suite 2800, Chicago, IL 60610 • 312.322.4500 • 13.0674

Our clients say it's critical to understand the implications insurance and reinsurance matters can have on their business. At Foley, we listen carefully so that we understand their business concerns and objectives underlying each dispute then formulate a strategy to help resolve them — from labor and employment and D&O liability to securities fraud and product liability.

Tell us how Foley can add value to your business. Contact Partners Chip Davenport in our Madison office at gdavenport@foley.com or Neal Moglin in our Chicago office at nmoglin@foley.com.

Foley is a proud sponsor of AIRROC.

Foley.com

FOLEY
FOLEY & LARDNER LLP

BOSTON • BRUSSELS • CHICAGO • DETROIT • JACKSONVILLE
LOS ANGELES • MADISON • MIAMI • MILWAUKEE • NEW YORK • ORLANDO
SACRAMENTO • SAN DIEGO • SAN DIEGO/DEL MAR • SAN FRANCISCO • SHANGHAI
SILICON VALLEY • TALLAHASSEE • TAMPA • TOKYO • WASHINGTON, D.C.