CLAIM ASPECTS OF REINSURANCE

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Someone once said, "If you can't annoy somebody, there's little point in writing."

I have no intention of annoying anybody, but I do appreciate the opportunity afforded me to write about claims and reinsurance. My comments will be from a reinsurance perspective, although I will attempt to present an overview of claims in general.

First, a brief background of claims. This may be helpful, if only to dispel the impression in some quarters that the claim function entails nothing more than routinely writing checks to claimants. Claims have an immediate and quantifiable impact upon the financial results of any company. The quality of the claim function determines whether the impact is a positive or negative one. Claims, whether direct claims or reinsured claims, are the last link in the insurance "chain." In a broad sense, until a claim is presented, everyone is working with "play money." The marketing types compete for market share, while the underwriters and medical people look for reasons to issue the latest multi-million dollar application.

Once the claim is received, we return to the real world and real money. The million dollar application that was such a source of pride a few short months ago has now become something more than an abstract exercise in debits and credits. It has become something more than an impressive number on a new business production report. It has become something more than an abstract exercise in debits and credits. It has become a claim.

A beneficiary now expects to be paid, and the regulatory authorities have mandated strict guidelines as to how a claim is to be handled.

Charles A. Will often said that underwriting is an art, not a science. If that is true, then I would suggest that claims is more of a science than an art. Claims are paid, or not paid, on the basis of provable facts, not feel or intuition. With the very real threat of extra-contractual damages, good faith claim handling is a requirement, not a choice or an option.

I believe that the AIDS epidemic gave, and continues to give, underwriters an appreciation of the pressures that outside special interest groups can exert on established day-to-day procedures. For a time, underwriting came under strict scrutiny from various pressure groups, quite apart from the allocation of debits and credits as called for by the underwriting manual. Underwriters were told that they could not use certain types of information in risk assessment, in spite of genuine concerns regarding adverse mortality.

While the attention given to AIDS and underwriting has subsided somewhat, external pressures are an ever-present reality to the claim function. Keeping in mind the expectations of a beneficiary and the mandates of the various states, direct (client) claim handling is further complicated, or should be, by the existence of reinsurance. I say "should be" since, despite treaty obligations, many clients are not even aware of the existence of reinsurance and, in some very few instances, do not even care.

Reinsurance agreements generally require that the client (direct writer) allow some sort of review by the reinsurer before liability is admitted. What is meant by "liability admitted?" My understanding is that a client has a good faith obligation to allow the reinsurer to review all documents before the claim is paid, or a decision is made to pay. To allow the reinsurer to review the claim file, offer an opinion and, ideally, reach a consensus with the client as to the handling and disposition of the claim. I believe this is particularly applicable to facultative cases, especially those fully reinsured. Unfortunately, there are clients who believe that the obligation to notify the reinsurer of an admitted claim liability is satisfied when a copy of their claim check is mailed to the reinsurer, along with a request for the reinsurer's share of said claim. For the moment, let us assume that everyone agrees with my understanding of notification. By referring the file to a reinsurer, resolution of the claim is further delayed. This results in added pressure from a beneficiary expecting payment or, if a complaint is filed with an Insurance Department, pointed inquiries from the Department and possible penalties. Since the reinsurance agreement is between the client and the reinsurer, the reinsurer does not receive the telephone calls or letters from the Department. Because of the contractual relationship between the parties, extra-contractual damages are also, arguably, not a concern of the reinsurer. A cynic might suggest that the reinsurer has no down-side in this claim relationship, other than an obligation to pay claims.

Although the reinsurer experiences no direct pressure from claimants, agents or Insurance Departments, and, again arguably, is not exposed to the risk of extra-contractual damages, there is a reinsurer down-side to this relationship. Automatic agreements often allow binding multiples of up to ten times a client retention, occasionally more, while in facultative arrangements, the reinsurer might have eighty to one hundred percent of a risk. Therein lies the problem: The client administers the claim and the reinsurer holds the risk. Intelligent cooperation is necessary to ensure that each claim is handled to the mutual satisfaction of both parties. At the outset, I stated that claims is the last link in the insurance chain. That is not quite true, at least on the direct side. Reinsurance administration is the last link in the insurance chain on the direct side. Obviously, that is where the reinsurance is administered, if the reinsured application ever reaches that area. After underwriting, it seems that all knowledge of reinsurance disappears, except for the person responsible for the reinsurance administration.
In my experience, client reinsurance administration is operated as a unit totally detached from the regular operations of the client company. This is understandable since reinsurance is an add on, not truly a part of the routine insurance process; it is an exception. However, the handling of reinsurance in this area is usually a clerical function with a primary responsibility of processing the reinsurance billing. It is rare that there is any real, substantive knowledge of reinsurance. A working knowledge of reinsurance usually ends with the actuary and underwriter. The lack of attention to reinsurance is understandable, since reinsurance usually accounts for a small percentage of a company's income. However, reinsurance accounts for 100 percent of a reinsurer's business, and the accurate and timely processing of the business becomes a very real concern. I have had claims reported ten years after the claim was paid because reinsurance was only found on an audit.

The above is an extreme and, fortunately, quite rare, but it does happen. In my opinion, as expense margins narrow further and reinsurance agreements are more tightly, even legally, worded, instances such as the example risk exclusion from the Oversights provision of the reinsurance agreement.

Most of the problems encountered with reinsured claims tend to fall into a few recurring "categories." Note that while the client and reinsurer intend to pay all valid claims, friction develops through a failure to recognize that common objective and to effectively communicate the respective means of reaching that objective. Following is a brief categorization of certain practices I have experienced:

a. Lack of knowledge of reinsurance: Usually occurs in a very large company where knowledge of reinsurance itself is limited to a specialized administrative function. The claims area has no idea what reinsurance is or what to do. In this instance, we quite often learn of the death of a reinsured through the billing statement adjustment made by the client. However, we must then remind the client that they are due reinsurance reimbursement and a formal claim notification is necessary.

b. Knowledge of reinsurance present, but lack of understanding of what it is: Client realizes there is reinsurance, but feels that it exists as only another area from which to request reimbursement. This example is somewhat like (a) above, except that they are aware they are due reinsurance reimbursement, but believe that a check is sent out automatically, without any sort of formal claim documentation.

c. Knowledge of reinsurance and an awareness that reinsurance functions much like a direct company, but understanding is in terms of their own insurance environment: This client realizes that the reinsurer underwrites and pays claims as they do, but operates in the belief that the reinsurer underwrites using the same standards, offers at the same rate, rejects the same risks. Cannot understand why a reinsurer would want to deny a claim, when the claim was originally rejected by the client. They reason that the risk was so uninsurable, according to their standards, that there could be no basis upon which to argue material misrepresentation.

d. Client is very knowledgeable about reinsurance, but wants to pay regardless of the opinion of the reinsurer: This client does not care what the reinsurer might want to advise on a particular claim. This client feels it has no risk, and, therefore, will not devote its expense or risk exposure, i.e., extra-contractual damages, by contesting a reinsured claim. These companies are usually strong advocates of the reinsurance partnership theory when dealing with a reinsurer regarding rates, allowances, oversights, etc. This is an interesting scenario. Most reinsurance agreements contain a provision that provides that if a reinsurer disagrees with a client decision to pay a claim, then that reinsurer may discharge its liability in full by paying the reinsured portion to the client. Is it possible that the reverse could be true? If a client refuses, in bad faith, to deny a claim the reinsurer believes should be denied, could the reinsurer refuse to pay its proportionate share?

e. Client recognizes reinsurance, but wants to turn everything over to the reinsurer: This client reinsured most, if not all of the risk, and tells the reinsurer to do whatever they want with the claim including conducting the investigation and dealing with the beneficiary. Completely ignores the fact that the insurance contract is between them and the beneficiary, and any Insurance Department would object to any attempt on their part to abdicate claim authority to a third party. The relationship here becomes almost adversarial between client and reinsurer. The underlying rationale here is similar to (d) in that the client wishes to avoid any additional expense investigating a claim and also wants to avoid any exposure to extra-contractual damages on a claim on which they retained nothing.

f. Client recognizes that there is reinsurance and feels that it is obligated to do whatever the reinsurer suggests: Probably the easiest client to deal with in that they are acting in good faith. All works smoothly once they understand that it is their policy and they have final claim authority. The reinsurer works with the client to resolve the claim and works toward a consensus claim decision.

g. Client has experienced and knowledgeable claim personnel, but resists any reinsurer involvement: This client does not want to be put in a position where their professional judgment could possibly be questioned by a third party. There is a tendency to rationalize their resistance to any reinsurer involvement by insisting that their personnel are knowledgeable and experienced enough to handle any claim, even if the claim is one hundred percent reinsured. They tend to ignore the very real possibility that their shop might at some time lack the depth of knowledge and experience. This really boils down to a question of egos, to the extent that personalities become the issue rather than an equitable resolution of the claim.

h. Miscellaneous: These clients are too big to readily change. They are cooperative, but have procedures and practices that do not make sense, or run counter to industry practice and can only be changed over time. As an example, these clients continue to treat smoking misrepresentations as a misstatement of age and adjust the face amount accordingly. Others do not deny claims because of material misrepresentation, but treat the misrepresentation as a misstatement of age and adjust the face amount. Some complicate the situation even further by handling non-reinsurance claims as described, but, on the reinsurer's suggestion, denying like claims that were reinsured, thereby creating a troublesome difference in claim results. Unfair claim practice?
Conclusion
The above examples are intended to illustrate some common problems encountered while handling reinsured claims and are by no means indicative of reinsurance in general or claims in particular. As with anything, it is the exceptions that stand out and are remembered, rather than the routine situations.

The reality is that reinsurance is, and will continue to be, the orphan as far as client priorities are concerned. The client can never be expected to attach the same importance to reinsurance and, therefore, reinsured claims, as a reinsurer does. It is the responsibility of the reinsurer to ensure that their own interests are protected, since they are the part most affected. It is not unreasonable that a reinsurer should expect the same consideration be given to a reinsured claim as that given to one which is not reinsured.

A successful reinsurance relationship is predicated upon the understanding that both parties operate in good faith. If each party extends the consideration to the other party that they expect in return, then there should be a satisfactory relationship.

It has always been my experience that reasonable people can agree on a mutually reasonable result, as long as both act in good faith, notwithstanding George Bernard Shaw's contention that "The Golden Rule is that there is no Golden Rule."

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