Optimizing the benefits of reinsurance

Reinsurance accounting and reporting requirements may be difficult to manage, so it is not unprecedented that errors and omissions occur in the administration of the reinsurance agreement.

Errors and omissions that remain undiscovered for a period of time (i.e. spanning more than one calendar year) can have a destabilizing effect on the ceding company’s net underwriting results. For example:

- An unidentified claim recovery has a negative impact on a ceding company’s net results until the error is discovered.
- Underreported reinsurance premiums provide a false indication of better than expected net results in the year(s) when the errors occur.
- When underreported premiums are discovered in a subsequent year the necessary corrections can cause a company’s net results to decline.

Since errors and omissions can undermine the stabilizing effect of reinsurance, effective internal controls are necessary to prevent and/or detect errors.

Of the many ways Munich Re brings value to our clients, stabilizing a ceding company’s results is among the most important. We engage in transactional reviews with key clients to help minimize operational risk that manifests itself in the form of errors and omissions in the administration of ceded reinsurance and ensure that a client’s risk portfolio is protected as intended.

Control environment

Operational risk can arise from many causes. Whatever the cause, it is critical that a cedant has the necessary processes or measures in place to address transactional issues before they negatively impact the company’s financial standing.

The best way to ensure that controls are functioning effectively is to test them frequently and thoroughly. Efficient testing requires the use of analytical review procedures applied to the entire data set underlying the reinsurance reports. The data set must include the direct and ceded premium and loss transactions for all business that is the subject of the treaty, and it must include data related to any inuring reinsurance agreements. This process allows us to identify any omissions from the ceded transaction details that underlie the reinsurance reports.
**Procedural analysis**

The design, implementation and testing of controls requires a deep understanding of reinsurance. Munich Re’s professional Account Services team, each member having over 15 years of transactional review experience, follows a systematic approach to evaluating the relevant transactions.

A summary of procedures required for a thorough transactional review includes:
- Review the terms and conditions of the subject reinsurance contracts.
- Obtain the direct and ceded data pertaining to the contracts.
- Reconcile the ceded data to the summary reinsurance reports previously issued by the ceding company.
- Employ computer assisted analytical procedures to reconcile the ceded transactional data to the direct transactional data to:
  • Identify any omissions from the ceded data.
  • Identify any inconsistencies between the ceded premium and loss transactions.
- Conduct an in-depth analysis of any anomalies – this analysis may require a review of documents contained in policy files and claim files.

Upon completion of the review, we will prepare a report that summarizes the findings and provides recommendations for corrective actions, which may include changes in processes or systems to prevent or detect errors and omissions.

**Transaction reviews provide assurance**

A transactional review can provide validation of the accuracy of reinsurance reports and the adequacy of reinsurance accounting controls. A transactional review can also assist by identifying errors and control weaknesses that need to be addressed.