**REPORTING ISSUES**

**FACE INCREASES AND DECREASES**

# **Introduction**

Face increases and decreases are an everyday aspect of reinsurance administration. However they are an aspect that has some complexity to it and requires thoughtful consideration as to how they will be administered by the direct writer/ceding company.

## **Purpose of the document**

• Present definitions of Face Increases and Decreases

* Present Discussion of Administrative Considerations
* Present some Best Practices Administration
* Provide example scenarios

## **Definition of a Face Increase or Face Decrease**

1. Face increases can be either contractual or various forms of non-contractual.

a. Contractual face increases are a feature built into a policy that allows the policyholder to increase the face amount of their policy by scheduled amounts at scheduled intervals. Normally there is a cap as to the ultimate face amount the policy can be increased to.

b. Non-contractual face increases fall into three basic categories:

i. Policyholder request: These are not scheduled but are done at the request of the policyholder and often require new underwriting since the policyholder’s circumstances could have changed since the original policy issue date

ii. IRS Corridor Regulations: IRS regulations require a policies face amount/death benefit to exceed its cash value by an amount calculated by an IRS formula in order to maintain its status as an insurance product and not an investment product. Since this can be a complex issue we will not address it in this document. See US Code section 7702 for further details.

iii. Account Value Increases: On certain products if a policy account value grows to exceed the original face amount then the face amount will automatically increase to equal the account value. Check your company’s products to see if they fall into this category. We will not address this type of increase in this document.

## **Best Practices**

1. Face increases and decreases are normally manually administered within an admin system such as TAI due to each situation being somewhat unique and potentially complex. As a result diligent peer to peer reviews as well as a manager review of each face increase or decrease transaction is appropriate to prevent future issues, especially at claim time.
2. Communication of face increases or decreases between ceding companies and reinsurers is normally done through the monthly billing record data files sent from ceding company to reinsurer. There are notifications on those files that indicate whether the policy has had a face increase, decrease or some other change.
3. Ceding companies should document what their policies and practices are with respect to face increases and decreases so that they can be shared with reinsurers if or when questions or issues arise. This can help facilitate smoother audits and better overall communication between the parties.

## **Face Increase and Decrease Scenarios**

* **Contractual Face Increase with Existing Reinsurance on an Excess Basis:** In this scenario the ceding company has a $5M retention limit, the original policy has a $7M face amount, and the face increase is for $2M.



* **Contractual Face Increase without Existing Reinsurance on an Excess Basis:** In this scenario the ceding company has a $5M retention limit, the original policy has a $4M face amount, and the face increase is for $2M. The reinsurance pool is the current pool open for new business.



* **Non-Contractual Underwritten Face Increase with Existing Reinsurance on an Excess Basis:** In this scenario the ceding company has a $5M retention limit, the original policy has a $7M face amount, and the face increase of $2M is newly underwritten. Pool A-D is the original pool and Pool W-Z is the original pool with a separate coverage set up at the current age and duration 1.



* **Contractual Face Increase with Existing Reinsurance on a Quota Share Basis:** In this scenario the ceding company has a 10% Quota Share up to $2M retention limit, the original policy has a $7M face amount, and the face increase is for $2M.



* **Non-Contractual Underwritten Face Increase with Existing Reinsurance on a Quota Share Basis:** In this scenario the ceding company has a 10% Quota Share up to $2M retention limit, the original policy has a $7M face amount, and the face increase of $2M is newly underwritten. Pool A-D is the original pool and Pool W-Z is the original pool with a separate coverage set up at the current age and duration 1.



* **Non-Contractual Face Decrease with Existing Reinsurance on an Excess Basis:** In this scenario the ceding company has a $5M retention limit, the original policy has a $7M face amount, and the face decrease is $1M.



* **Non-Contractual Face Decrease with Existing Reinsurance on an Excess Basis:** In this scenario the ceding company has a $5M retention limit, the original policy has a $7M face amount, and the face decrease is $3M.



* **Non-Contractual Face Decrease with Existing Reinsurance on a Quota Share Basis:** In this scenario the ceding company has a 10% Quota Share up to $2M retention limit, the original policy has a $7M face amount, and there is a face decrease of $2M.



## **Conclusion**

The discussion and examples above are presented to provide guidance and examples for discussion. They are not designed to cover all possible scenarios. It is always important to review the ceding company’s retention rules as well as the treaties involved in any face increase or decrease scenario if there is any doubt about how it should be administered.

It is also important for ceding companies and reinsurers to communicate when there are unique or special situations which can arise from time to time to help avoid conflicts or uncertainty.