Reserving for Individual Reinsurance Contracts: An Accounting Perspective

The Reinsurer Shall “Share The Luck of the Cedent”
**Functions/Purposes of Reinsurance**
- Stabilization
- Risk Capacity
- Surplus Relief
- Catastrophe Protection
- Business Expansion

**Types of Reinsurance**
- Pro Rata
  - Quota Share: Sharing of the premium and loss: a fixed percentage of premium and loss on each ceded risk
  - Surplus Share: Selection of retention ("line") by the ceding company on specific risks; they cede a portion or a multiple of that "line" on each risk subject to a maximum cession (per SSAP # 62 paragraph 45)
Types of Reinsurance

- Excess of Loss
  - Per Risk: Ceding an amount of loss in excess of a specified amount/retention;
  - Aggregate Excess: Cedent is reinsured for an amount exceeding (for a specific period) a set dollar amount or a percentage of stated subject premiums (subject to a limit);
  - Catastrophe Excess of Loss: Protection from an accumulation of losses from a catastrophic event/events.

Forms of Reinsurance

- Treaty: Classes of risks that the reinsurer underwrites in advance and these risks of the ceding company are automatically reinsured.
- Facultative: Individual risk that reinsurer has the power to accept or reject.

Accounting Elements: SSAP # 62

- "The" SSAP for Property and Casualty Reinsurance Accounting.
- Discusses types and forms of reinsurance and the accounting for ceded and assumed reinsurance.
- Discusses required terms for Contracts.
- Discusses specific terms i.e. loss limiting factors, commissions, etc.
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• Basic Accounting Elements:
  - Assumed
  - Ceded
  - Net

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Reviewing the Reporting Clause in the Contracts:
• Gross and Ceded premiums
• Commissions
• Gross and Ceded Loss and LAE Paid
• Gross and Ceded Outstanding Loss and LAE Reserves

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• Accounting Elements: SSAP # 62
  - "The agreement (emphasis added) must provide for reports of premiums and losses, and payment of losses, no less frequently than on a quarterly basis...The report of premiums and losses shall set forth the ceding entity's total loss and loss expense reserves on the policy obligations subject to the (emphasis added) agreement, so that the respective obligations of the ceding entity and reinsurer will be recorded and reported on a basis consistent with this statement..." (from SSAP # 62 paragraph #8)
  - Note the emphasis is on accounting/reserving for an individual agreement and its specific features
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Accounting Elements: SSAP # 62

- Commutation of reinsurance agreement or part of one “results in complete and final settlement and discharge of all, or the commuted portion thereof present and future obligations between the parties arising out of the reinsurance agreement.” (per SSAP #62 paragraph #60)
- Ceding company “gets rid” of reinsurance recoverable recorded against the loss reserve and records the cash received as a negative paid loss. (Per SSAP #62 Paragraph #61)

Net gain/loss to be reported in underwriting income in the statement of income.

Reinsurer “eliminates loss reserve carried at ultimate cost for cash payout calculated at present value”, per SSAP #62 paragraph #62

Commutations: Many are done per individual contract (SSAP #62 paragraph #60). Others done by combining some or all contracts to a reinsurer.

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Accounting Elements in Schedule F:

- Schedule F-Parts 1 and 3
  - Purpose
    1. Provides data for assumed and ceded reinsurance.
    2. Documents reinsurers and balances—items in dispute.
    3. Shows the aging of amounts due/recoverable for each reinsurer.
    4. Provides a method to calculate the Provision for reinsurance for both authorized and unauthorized reinsurers.
- Recoverables and Ceded balances payable
- Provision for Reinsurance.
Reserving for Individual Reinsurance Contracts: An Accounting Perspective

- **Annual Statement Pages**
  - Annual Statement Underwriting and Investment Exhibits and Schedule F: No breakdown by treaty or facultative
  - Examples

- **“Pros” and “Cons” for Reserving for Individual Reinsurance Contracts and Facultative Certificates: “Pros”**
  - Good control over contract results
  - Good information for renewals
  - Good information for management analysis

- **Some “Cons”:**
  - Not a net picture of the entire program
  - While one treaty may show positive results, another related contract may not
Reinsurers and Additional Case Reserves: “ACR’s”

- Reinsurers not the first to know about a claim
- Time lags in reporting eg: a quarter in arrears — may not provide an accurate picture
- Reinsurers may have more difficulty in reserving
- Systems of cedents vary, and capturing true premium and loss data by line may be difficult
- How does a ceding company allocate/code the premium/loss to the correct line — Need to ascertain the process
- Setting an ACR

Cedents, Reinsurers and Retrocessions

- Keeping track of individual treaty reporting and net #’s on all reinsurance items
- Good to know internally for performance measures on business
- Ascertain terms for renewals

- Need to ascertain how retrocessions will affect your net
- Cedents, and Retrocedants’ Need to keep track of Uncollectible Reinsurance and solvency/insolvency of reinsurers, retrocessionaires
Reserving for Individual Reinsurance Contracts: An Accounting Perspective

- Reinsurance Programs
  - Looking at the sum of parts (treaties and facultative certificates) and the whole (the net reserve)

Reserving for Reinsurance programs:
- Looking at entire program rather than individual reinsurance contract: EG: Property per risk treaty, aggregate excess, and Catastrophe treaty together to ascertain the true net reserve
- Eg: Property Program:
  - Q3
  - Property XOL, Per risk Excess, Aggregate Excess
  - Three Layer Catastrophe Cover
  - (with Occurrence Limit)
  - Reserving for the net
  - However, still track/account for the reserves for each contract

Areas of concern:
- Accounting is concerned with accurately reporting the numbers for the individual contracts and the total reserves for the assuming and/or ceding company
- Time lags in reporting for reinsurers
- Bulk Reserving and Ascertaining the IBNR:
- Reviewing for a commutation by the actuary
- ACR’s used by the reinsurer
- Loss limiting features
- Law-included / not included and Aggregates
- Retrocessions
- Schedule F Reporting: Combined contract totals for reinsurers
Reserving for Individual Reinsurance Contracts: An Accounting and Actuarial Perspective-Summary

- Specific Identification of “true” reserves for each contract
- Ascertaining the Case and IBNR reserves
- Effects of Insolvencies
- Commutations
- Discussion of reserving methodologies to follow

Questions

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