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Reserving for Individual Reinsurance Contracts: An Accounting Perspective

- Functions/Purposes of Reinsurance
 - Stabilization
 - Risk Capacity
 - Surplus Relief
 - Catastrophe Protection
 - Business Expansion

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Reserving for Individual Reinsurance Contracts: An Accounting Perspective

- 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 #5)

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Reserving for Individual Reinsurance Contracts: An Accounting Perspective

- **Types of Reinsurance**
- **Excess of Loss**
(per SSAP # 62 paragraph #5)
 - ❑ **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

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- **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

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Reserving for Individual Reinsurance Contracts: An Accounting Perspective

- **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)

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Reserving for Individual Reinsurance Contracts: An Accounting Perspective

- Accounting Elements: SSAP # 62
 - ❑ 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

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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

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Reserving for Individual Reinsurance Contracts: An Accounting Perspective

- “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

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- Some “Cons”:
 - Not a net picture of the *entire* program
 - While one treaty may show positive results another related contract may not

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Reserving for Individual Reinsurance Contracts: An Accounting Perspective

- 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

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Reserving for Individual Reinsurance Contracts: An Accounting Perspective

- 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

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Reserving for Individual Reinsurance Contracts: An Accounting Perspective

- Cedents, Reinsurers and Retrocessions
 - 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

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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)

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Reserving for Individual Reinsurance Contracts: An Accounting Perspective

- 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**:
 - ❑ QS
 - ❑ Property XOL, Per risk Excess, Aggregate Excess
 - ❑ Three Layer Catastrophe Cover:
 - ❑ (w/wo Occurrence Limit)
 - ❑ Reserving for the net
 - ❑ However, still track/account for the reserves for **each contract**

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Reserving for Individual Reinsurance Contracts: An Accounting Perspective: Summary


- 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 Ascertain the IBNR:
- Reviewing for a commutation by the actuary
- ACR's used by the reinsurer
- Loss limiting features
- Lae-included /not included and Aggregates
- Retrocessions
- Schedule F Reporting: Combined contract totals for reinsurers

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Reserving for Individual Reinsurance Contracts: An Accounting and Actuarial Perspective-Summary

- Specific Identification of "true" reserves for each contract
- Ascertain the Case and IBNR reserves
- Effects of Insolvencies
- Commutations
- Discussion of reserving methodologies to follow.....



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Questions

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