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Effectuating a commutation – Behind the scenes

*Casualty loss reserve seminar
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With you today....

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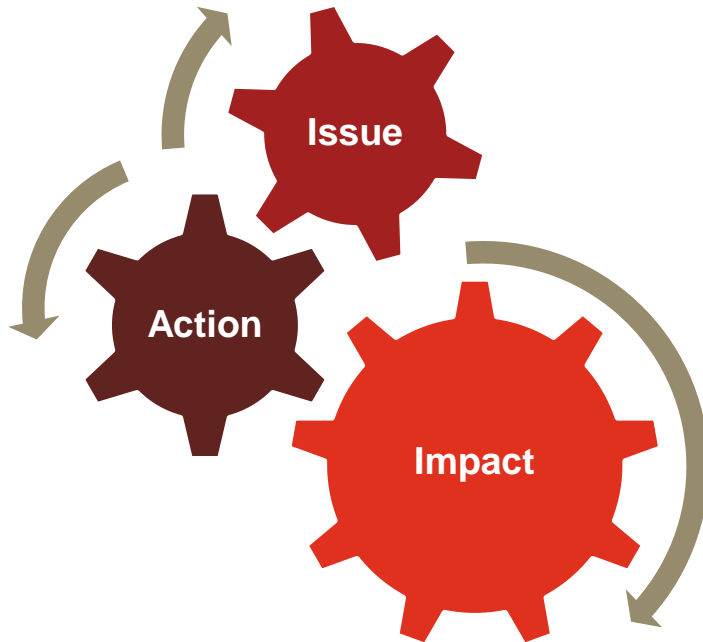
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What is a commutation?

A Commutation is a termination of a reinsurance obligation of an agreement between a reinsurer and the reinsured.

Steps to effectuating a commutation



- Identify targets
- Assess viability, motivators of parties
- Information gathering
- Assessment/Establishing value
- First meeting
- Party to party reconciliation
- Follow up meetings
- Final agreement
- Post commutation activities

“Effectuating a Commutation – Behind the Scenes”

There will be two acts with no intermission, audience participation is encouraged.

Each act will be performed in two scenes:

- Cedent internal meeting
- Assumed Reinsurer internal meeting

Act 1 – Preparing for the initial meeting and developing an offer

Act 2 – Addressing opponent concerns and revising offers

“Effectuating a Commutation – Behind the Scenes” – The parties

Leverage Ins. Co. – The Cedent

Surplus: \$40M

Liquidity: \$128M

Liabilities: \$1.6B

Schedule F balances due: \$900M

Schedule F over 90 day balances
due: \$645M

Renew Re – The Assuming Reinsurer

Surplus: \$120M

Liquidity: \$200M

Liabilities: \$150M

Schedule F balances due: 0

Schedule F over 90 days balances due: 0

“Effectuating a Commutation – Behind the Scenes” – The exposure

Leverage – Direct Policies:

Booked exposure: \$68.3M

- Primary Casualty (GL, AL & WC)
- Casualty Limits \$3M AL; \$5M GL each occurrence
- WC Limits Statutory
- 1/1/1980 – 12/31/1994
- Underwritten by: MGA’s
- Key states: CA, NY, and MA
- The net retained for 20 Asbestos claims was transferred via an LPT to Reinsure It Company (“RICO”) who leverages a Third Party Administrator, We Manage Asbestos Claims (“WEMAC”)

Ceded OSLR and IBNR					Paid loss due	
	LOB/Open claim count	WC total	GL total	AL total	Grand total	Paid loss due total
Construction/842		15.30	7.50	7.50	30.30	12.00
1980-89 25% QS		4.60	3.05	3.05	10.70	3.00
1990-94 40% QS		5.60	2.55	3.55	11.70	6.00
1990 - 94 \$3M x \$2M XOL		5.10	1.90	0.90	7.90	3.00
Manufacturing/100		3.10	0.90	0.50	4.50	3.00
1980-89 25% QS		1.30	0.30	0.20	1.80	1.00
1990-94 40% QS		1.30	0.50	0.30	2.10	2.00
1990 - 94 \$3M x \$2M XOL		0.50	0.10	0.00	0.60	0.00
Transportation/652		10.50	1.50	1.50	13.50	5.00
1980-89 25% QS		2.60	0.75	0.50	3.85	1.00
1990-94 40% QS		3.60	0.75	1.00	5.35	3.00
1990 - 94 \$3M x \$2M XOL		4.30	0.00	0.00	4.30	1.00
Total/1594		28.90	9.90	9.50	48.30	20.00
1980-89 25% QS		8.50	4.10	3.75	16.35	5.00
1990-94 40% QS		10.50	3.80	4.85	19.15	11.00
1990 - 94 \$3M x \$2M XOL		9.90	2.00	0.90	12.80	4.00

“Effectuating a Commutation – Behind the Scenes” – The exposure (continued)

Renew – Reinsurance

Agreements:

Booked exposure: \$46.1M

A) Quota Share on 1st \$2M Primary Casualty (GL, AL & WC) each occurrence

- 25% 1/1/1980-12/31/1989
- 40% 1/1/1990-12/31/1994
- Billed on a bordereaux basis

• Losses over \$250K require individual reporting

B) XS GL, AL & WC 3M xs 2M each occurrence

- 1/1/90-12/31/1994
- WC Losses over \$1M reported individually

Assumed OSLR <i>LOB/Open claim count</i>	<i>WC total</i>	<i>GL total</i>	<i>AL total</i>	<i>Grand total</i>	Paid loss due
					<i>Paid loss due total</i>
Construction/842	7.80	2.50	2.00	12.30	12.00
1980-89 25% QS	2.10	1.05	0.55	3.70	3.00
1990-94 40% QS	3.10	0.55	1.05	4.70	6.00
1990 - 94 \$3M x \$2M XOL	2.60	0.90	0.40	3.90	3.00
Manufacturing/100	2.60	0.40	0.00	3.00	3.00
1980-89 25% QS	1.10	0.10	0.00	1.20	1.00
1990-94 40% QS	1.10	0.30	0.00	1.40	2.00
1990 - 94 \$3M x \$2M XOL	0.40	0.00	0.00	0.40	0.00
Transportation/652	8.80	0.50	1.50	10.80	5.00
1980-89 25% QS	2.10	0.25	0.50	2.85	1.00
1990-94 40% QS	3.10	0.25	1.00	4.35	3.00
1990 - 94 \$3M x \$2M XOL	3.60	0.00	0.00	3.60	1.00
Total/1594	19.20	3.40	3.50	26.10	20.00
1980-89 25% QS	5.30	1.40	1.05	7.75	5.00
1990-94 40% QS	7.30	1.10	2.05	10.45	11.00
1990 - 94 \$3M x \$2M XOL	6.60	0.90	0.40	7.90	4.00

1994 Excess of Loss paid to date is \$6M, resulting in reinstatement premium

“Effectuating a Commutation – Behind the Scenes” – Key reinsurance contract terms

- “Follow the Settlements” provision
- Expenses are in addition & Reinsurer has the right to associate in the defense at their expense
- Loss occurring on risks that attach
- “Honorable Engagement” and “Errors and Omissions” clauses
- Reinstatement Provision allows for two reinstatements at 100% additional premium, with no additional reinstatements allowed
- Sunset Provision, effective 12/31/2004
- Mandatory Commutation Clause 12/31/2009, as mutually agreed by the Parties
- Ceding company Asbestos liabilities for 1985 & prior were transferred to RICO. The 20 open Asbestos claims are managed by RICO’s Third Party Administrator WEMAC

Act 1 preparing for the initial meeting and developing the offer

Scene 1 the ceding company – Reinsurance
Committee quarterly meeting

ACT 1 – The ceded company booked values

Ceded OSLR and IBNR

LOB/Open claim count	WC loss	WC exp	WC IBNR	WC total	GL loss	GL exp	GL IBNR	GL total	AL loss	AL exp	AL IBNR	AL total	Total loss	Total exp	Total IBNR	Grand total	Paid loss due total
Construction/842	7.50	0.30	7.50	15.30	2.00	0.50	5.00	7.50	1.90	0.10	5.50	7.50	11.40	0.90	18.00	30.30	12.00
1980-89 25% QS	2.00	0.10	2.50	4.60	1.00	0.05	2.00	3.05	0.50	0.05	2.50	3.05	3.50	0.20	7.00	10.70	3.00
1990-94 40% QS	3.00	0.10	2.50	5.60	0.50	0.05	2.00	2.55	1.00	0.05	2.50	3.55	4.50	0.20	7.00	11.70	6.00
1990 - 94 \$3M x \$2M XOL	2.50	0.10	2.50	5.10	0.50	0.40	1.00	1.90	0.40	0.00	0.50	0.90	3.40	0.50	4.00	7.90	3.00
Manufacturing/100	2.40	0.20	0.50	3.10	0.40	0.00	0.50	0.90	0.00	0.00	0.50	0.50	2.80	0.20	1.50	4.50	3.00
1980-89 25% QS	1.00	0.10	0.20	1.30	0.10	0.00	0.20	0.30	0.00	0.00	0.20	0.20	1.10	0.10	0.60	1.80	1.00
1990-94 40% QS	1.00	0.10	0.20	1.30	0.30	0.00	0.20	0.50	0.00	0.00	0.30	0.30	1.30	0.10	0.70	2.10	2.00
1990 - 94 \$3M x \$2M XOL	0.40	0.00	0.10	0.50	0.00	0.00	0.10	0.10	0.00	0.00	0.00	0.00	0.40	0.00	0.20	0.60	0.00
Transportation/652	8.50	0.30	1.70	10.50	0.50	0.00	1.00	1.50	1.50	0.00	0.00	1.50	10.50	0.30	2.70	13.50	5.00
1980-89 25% QS	2.00	0.10	0.50	2.60	0.25	0.00	0.50	0.75	0.50	0.00	0.00	0.50	2.75	0.10	1.00	3.85	1.00
1990-94 40% QS	3.00	0.10	0.50	3.60	0.25	0.00	0.50	0.75	1.00	0.00	0.00	1.00	4.25	0.10	1.00	5.35	3.00
1990 - 94 \$3M x \$2M XOL	3.50	0.10	0.70	4.30	0.00	0.00		0.00	0.00	0.00	0.00	0.00	3.50	0.10	0.70	4.30	1.00
Total/1594	18.40	0.80	9.70	28.90	2.90	0.50	6.50	9.90	3.40	0.10	6.00	9.50	24.70	1.40	22.20	48.30	20.00
1980-89 25% QS	5.00	0.30	3.20	8.50	1.35	0.05	2.70	4.10	1.00	0.05	2.70	3.75	7.35	0.40	8.60	16.35	5.00
1990-94 40% QS	7.00	0.30	3.20	10.50	1.05	0.05	2.70	3.80	2.00	0.05	2.80	4.85	10.05	0.40	8.70	19.15	11.00
1990 - 94 \$3M x \$2M XOL	6.40	0.20	3.30	9.90	0.50	0.40	1.10	2.00	0.40	0.00	0.50	0.90	7.30	0.60	4.90	12.80	4.00

ACT 1 – Preparing for the initial meeting and developing the offer – The ceding company recap...

Motivators

- Solvency and need for liquidity
- Investment portfolio not performing well
- Potential disputes regarding Asbestos claims
- Loss ratios are on the rise, already over 110%, risk of adverse development
- Reinsurer credit worthiness is viewed as good, yet payments have not been forthcoming, Schedule F Penalties are on the rise

Issues

- Reinsurer has asked for audit, but payments not current, Follow the Settlements language dictates that payments should be forthcoming and the agreement is subject to an “Honorable Engagement”
- New actuary to address prior approach to ceded IBNR, appears to have been a butter knife approach
- RICO may have to be part discussions as their TPA, WEMAC, manages the asbestos claims which may be potentially under reserved
- Potential under reserving for WC
- Need to value WC has medical inflation and present value discount

Next steps to prepare

- Assess IBNR/IBNE, consider scenario testing

Goals for meeting

- Agree scope, timeline, and to get information from RICO
- Explain approach to IBNR
- Explain risks and needs for premium on top of IBNR (IBNE)
- No audit until they have made a good faith payment, refer to “Follow the Settlements” and “Honorable Engagement Clause”
- Reconcile reported OSLR and Paid Loss due immediately

Goals for transaction

- Surplus and liquidity positive, no write offs
- Interest for unpaid balances due (to be possibly offset by PVD)

Value	Issue
\$48.3M	OSLR + IBNR as booked
\$7.2M	Addition to IBNR for WC/asbestos reserves plus a 6% WC medical inflation
\$20M	Paid Loss Due
\$2M	Interest on Paid Loss Due
\$0	Present Value Discount
\$77.5M	Transaction target

Act 1 preparing for the initial meeting and developing the offer

Scene 2 the assuming reinsurer – CFO
quarterly meeting

ACT 1 – The assumed company booked values (IBNR held in bulk)

Ceded OSLR and IBNR																	Paid loss due
LOB/Open claim count	WC loss	WC exp	WC IBNR	WC total	GL loss	GL exp	GL IBNR	GL total	AL loss	AL exp	AL IBNR	AL total	Total loss	Total exp	Total IBNR	Grand total	Paid Loss due total
Construction/842	7.50	0.30	0.00	7.80	2.00	0.50	TBD	2.50	1.90	0.10	TBD	2.00	11.40	0.90	0.00	12.30	12.00
1980-89 25% QS	2.00	0.10		2.10	1.00	0.05		1.05	0.50	0.05		0.55	3.50	0.20		3.70	3.00
1990-94 40% QS	3.00	0.10		3.10	0.50	0.05		0.55	1.00	0.05		1.05	4.50	0.20		4.70	6.00
1990 - 94 \$3M x \$2M XOL	2.50	0.10		2.60	0.50	0.40		0.90	0.40	0.00		0.40	3.40	0.50		3.90	3.00
Manufacturing/100	2.40	0.20	0.00	2.60	0.40	0.00	TBD	0.40	0.00	0.00	0.00	0.00	2.80	0.20	0.00	3.00	3.00
1980-89 25% QS	1.00	0.10		1.10	0.10	0.00		0.10	0.00	0.00		0.00	1.10	0.10		1.20	1.00
1990-94 40% QS	1.00	0.10		1.10	0.30	0.00		0.30	0.00	0.00		0.00	1.30	0.10		1.40	2.00
1990 - 94 \$3M x \$2M XOL	0.40	0.00		0.40	0.00	0.00		0.00	0.00	0.00		0.00	0.40	0.00		0.40	0.00
Transportation/652	8.50	0.30	0.00	8.80	0.50	0.00	TBD	0.50	1.50	0.00	0.00	1.50	10.50	0.30	0.00	10.80	5.00
1980-89 25% QS	2.00	0.10		2.10	0.25	0.00		0.25	0.50	0.00		0.50	2.75	0.10		2.85	1.00
1990-94 40% QS	3.00	0.10		3.10	0.25	0.00		0.25	1.00	0.00		1.00	4.25	0.10		4.35	3.00
1990 - 94 \$3M x \$2M XOL	3.50	0.10		3.60	0.00	0.00		0.00	0.00	0.00		0.00	3.50	0.10		3.60	1.00
Total/1594	18.40	0.80	0.00	19.20	2.90	0.50	TBD	3.40	3.40	0.10	0.00	3.50	24.70	1.40	0.00	26.10	20.00
1980-89 25% QS	5.00	0.30		5.30	1.35	0.05		1.40	1.00	0.05		1.05	7.35	0.40		7.75	5.00
1990-94 40% QS	7.00	0.30		7.30	1.05	0.05		1.10	2.00	0.05		2.05	10.05	0.40		10.45	11.00
1990 - 94 \$3M x \$2M XOL	6.40	0.20		6.60	0.50	0.40		0.90	0.40	0.00		0.40	7.30	0.60		7.90	4.00

1994 Excess of Loss paid to date is \$6M, resulting in reinstatement premium

ACT 1 – Preparing for the initial meeting and developing the offer – The assuming reinsurers recap

Motivators

- Cedent's' need for cash may motivate them to take a “good” deal
- Potential disputes regarding asbestos claims
- Loss ratios are on the rise, already over 110%
- Costly to process
- Is there an on-going Client Relationship
- Uncertainty of opioids on WC

Issues

- Cedent refuses to allow for an audit unless balances are paid, there are concerns over the Cedent's' ability to reimburse any sums found not to be covered
- Missed mandatory commutation date of 12/31/09 for XS agreement
- Claims subject to a Sunset clause in the XS agreement expiring in 1994 are erroneously being reported
- Little information is available about the asbestos premises claims (managed by RICO's TPA WEMAC)
- Will RICO be a 3rd party to commutation discussions or only Ceding Co.
- Reinstatement premium has not been paid, value \$1M
- IBNR is established on a bulk bases for all assumed business
- Potential under reserving for WC and asbestos
- The value of the present value discount should be significant
- Does any assumed business impact any Retrocession contract

Next steps to prepare

- Review current reserves, scope for audit and reconciliation of data
- Review any current and prior disputes (and resolution)

Goals for meeting

- Explain concerns over issues tied to the LPT to RICO, asbestos reserves, Sunset clause, late notice, and withholding of reinstatement premium
- No payments will be issued until audit is completed and data reconciled
- Schedule an audit
- Agree scope and data as of date for claims subject to mandatory commutation should be the date defined in the agreement
- Agree claims subject to Sunset clause are removed from the cessions

Goals for transaction

- No additional reserves will need to be posted, Reserve takedown
- No interest for unpaid balances due plus a Significant Present Value Discount

Value	Issue
26.1M	Current OSLR
TBD	IBNR (determine appropriate allocation of bulk to these contracts & audit)
\$20M	Paid Loss Past Due
TBD	Reduction for Sunset Clause and other issues
TBD	Present Value Discount
\$46.1M	Current balances

Question 1

Should the assuming reinsurer be forced to remit some level of payment before it is allowed to audit the ceding company?

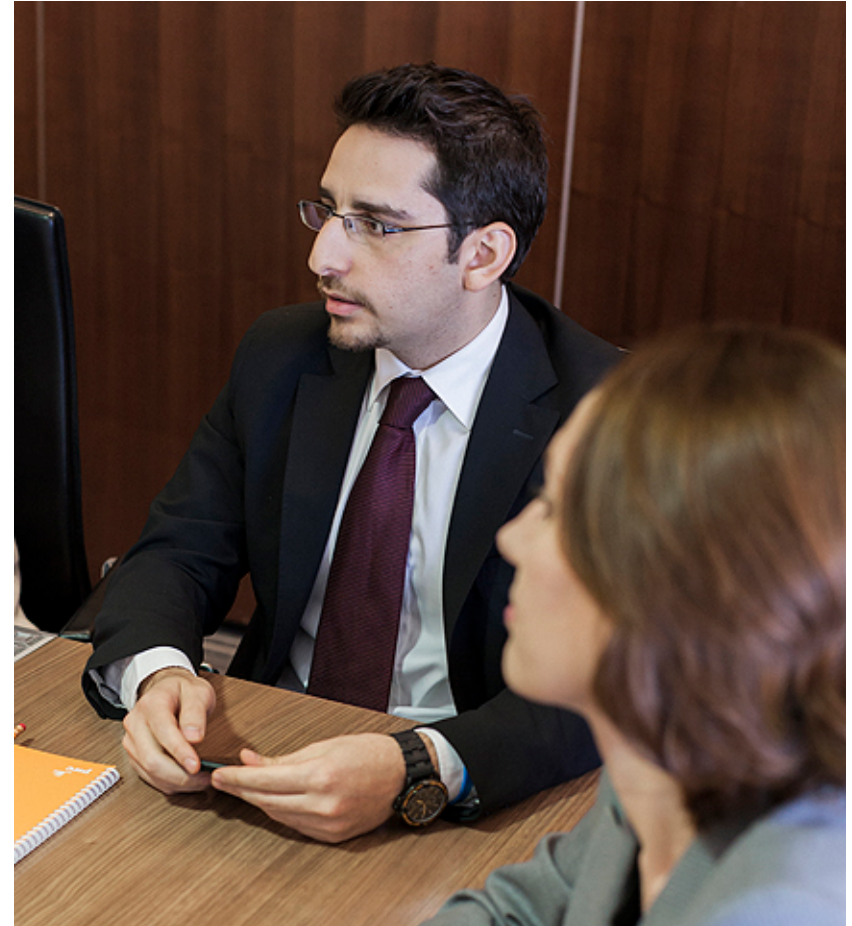
1. Yes
2. No



Question 2

Should the IBNR for the deal be solely determined by the Ceding Company as they are most familiar with the book of business and have real time data?

1. Yes
2. No



Question 3

Should IBNE be a unique line item in the explanation of any commutation offer?

1. Yes
2. No



Act 2 preparing for the second meeting and offer revision

Scene 1 the ceding company –
The Reinsurance Committee

ACT 1 – Issues recap

- Cedent in need of liquidity and surplus gains
- Reinstatement premium was not paid by the Cedent
- Assumed payments are being withheld and the Cedent is incurring penalties (Follow the Settlements)
- Assuming Reinsurer will not agree to reconcile the data until after the audit has taken place
- Missed mandatory commutation date
- Sunset clause in XS agreement was not adhered to (last claim to be reported 12/31/2004)
- Allocation issue in Construction asbestos book
- Potential under reserving on the WC and asbestos claims
- Disagreement on application of Present Value Discount
- Actuary carries IBNR for assumed business on a bulk basis
- Ceded IBNR was approached on a “butter knife” basis
- Cedent target \$77.5M, Assuming Reinsurer target \$46.1M
- RICO may want to be part of the discussions

ACT 2 – Preparing for the initial meeting and developing the offer – The ceding company recap...

Initial Goals for transaction

Value	Issue
\$48.3M	OSLR + IBNR as booked
\$7.2M	Addition to IBNR for WC/asbestos reserve issues plus a 6% WC medical inflation
\$20M	Paid Loss Due
\$2M	Interest on Paid Loss Due
\$0	Present Value Discount
\$77.5M	Transaction Target

Issues

- Missed mandatory commutation date, data should be current as IBNR would have accounted for unknown at the time, number would be the same
- Sunset clause in XS agreement was adhered to, annual bordereau's sent to the reinsurer, Follow the Settlements applies, this is an Honorable Engagement (potential revision to IBNR/Significant reduction in cession if IBNR is high)
- Follow the Settlements language requires payment of non-disputed items immediately
- Honorable Engagement Clause can potentially broaden "Bad Faith" Damages against the assuming reinsurer, risking an increase in exposure to them
- Reinsurer wants 2% medical inflation (NCII data) and a 10% PV Discount, viewed as high
- Reinstatement premium was not paid, hold for offset
- Risk of increase reserving on the WC and asbestos claims IBNR
- Does not want to get involved in a dispute over RICO's poor reserving or other claim disputes

Next steps to prepare

- Revise Cession logic and IBNR for Sunset and WC/asbestos reserving issues
- Identify magnitude of problem potential write-off if the Sunset applies

Goals for second meeting

- Obtain a good faith Assumed payment to be held in trust pending audit, reserve the right to pursue interest at a later time, if not, then offset reinstatement premium only
- Agree to full data reconciliation to be complete within 45 days of the audit
- Agree all claims were reported under the Sunset clause
- Agree data date for claims subject to mandatory commutation should be the current date
- Agree PVD at low value, no interest on paid loss due, agree annual medical inflation rate

Revised goals for transaction

- Minimal charges to Surplus resulting from decreased cessions

Value	Issue
\$43.3M	OSLR + IBNR as booked (\$48.3M - \$5M for sunset issue)
\$5M	Addition to IBNR for WC and asbestos case reserves and 5% WC medical inflation
\$19M	Paid Loss Due, reduced for sunset clause issues, and offset by reinstatement premium
\$1M	Interest on Paid Loss Due
\$(6.6M)	3% Present Value Discount at a 5 year duration
\$61.7M	Transaction Target

Act 2 preparing for the second meeting and offer revision

Scene 2 the assuming reinsurer– CFO meeting

ACT 1 – Issues recap

- Cedent in need of liquidity and surplus gains
- Reinstatement premium was not paid by the Cedent
- Assumed payments are being withheld and the Cedent is incurring penalties (Follow the Settlements)
- Assuming Reinsurer will not agree to reconcile the data until after the audit has taken place
- Missed mandatory commutation date
- Sunset clause in XS agreement was not adhered to (last claim to be reported 12/31/2004)
- Allocation issue in Construction asbestos book
- Potential under reserving on the WC and asbestos claims
- Disagreement on application of Present Value Discount
- Actuary carries IBNR for assumed business on a bulk basis
- Ceded IBNR was approached on a “butter knife” basis
- Cedent target \$77.5M, Assuming Reinsurer target \$46.1M
- RICO may want to be part of the discussions

ACT 2 – Preparing for the initial meeting and developing the offer – The assuming reinsurer recap...

Initial Goals for transaction

Value	Issue
26.1M	Current OSLR
TBD	IBNR (determine appropriate allocation of bulk to these contracts & audit)
\$20M	Paid Loss Past Due
TBD	Reduction for Sunset Clause and other issues
TBD	Present Value Discount
\$46.1M	Current balance

Issues

- Determine if the IBNR is substantially different using Commutation clause date vs current date
- Reinstatement premium was not paid, agree to offset if moves the audit forward
- Resolve handling of any disputed claims as per Honorable Engagement Clause
- Sunset clause in XS agreement expiring in 1994 was not adhered to (last claim to be reported 12/31/2004), annual bordereau's do not constitute notice. Follow the Settlements does not apply when there has been a breach of terms
- Incorporate audit findings impacting reserves for the WC and asbestos books into IBNR (discussion of potential reduction in cession with cedant)
- Adjust case reserves of the direct claims based on audit

Next steps to prepare

- Assess Commutation value under the date defined in Agreement as well as current date
- Determine IBNR allocation if appropriate with reflection of audit findings
- Determine Present Value Discount & assess Commutation value

Goals for second meeting

- Work with Leverage to get RICO to the table to resolve the asbestos claims simultaneously with the Leverage exposures
- Limit any initial payment to the offset value of reinstatement premium due as precedent to audit
- Explain Follow the Settlements does not apply to follow the allocation (if wrong), nor does it apply to claims submitted beyond the Sunset date
- Agree the Sunset clause is in enforce and payments after the agreed date should be excluded from cessions
- Discuss valuation date for claims subject to mandatory commutation

Revised goals for transaction

- Minimal charges to Surplus

Value	Issue
\$24.2M	OSLR reduced for potential sunset, and claims issues
\$8.5M	IBNR
\$17.0M	Paid Loss reduced for sunset, and claims issues
\$0	Interest on Paid Loss Due
\$(6.8M)	3.75% Present Value Discount at a 7 year duration
\$42.9M	Transaction Target Offer

ACT 2 – Issues recap

- Cedent in need of liquidity and surplus gains
- Cedent target \$61.7M, Assuming Reinsurer target \$42.9M
- Need to agree upon validation date for Commutation clause
- Reinstatement premium was not paid by the Cedent
- Assumed payments are being withheld and the Cedent is incurring penalties (Follow the Settlements/Honorable Engagement)
- Validate any Sunset clause adjustments for XS agreements (last claim to be reported 12/31/2004)
- Potential under reserving on the direct WC and asbestos claims
- Whether RICO is interested in resolving the relationships
- Disagreement on application of Present Value Discount
- Actuary carries IBNR for assumed business on a bulk basis
- Ceded IBNR was approached on a “butter knife” basis

Question 4

Should the data as of date that serves as the basis of the Commutation for books subject to a Mandatory Commutation clause be the data as it defined in the contract, or the current date?

- 1. As defined in the Contract**
- 2. The current date (of the commutation)**



Question 5

For the claims potentially subject to the sunset clause, does a Bordereaux statement constitute notice of claims falling to an Excess of Loss Agreement?

1. Yes
2. No



Question 6

What should the Present Value be based on?

- 1. Cedent's average rate of return in the last calendar year**
- 2. Annual T-Bill rate**
- 3. S&P 10 Year Real Interest Rate**
- 4. 7 year rate treasury yield curve**



Question 7

Should interest be paid for over 90 day balances if they were withheld pending an audit and later found to be covered under the agreement?

1. Yes
2. No



Appendix

Identify targets and assess motivators

Reasons as to why a reinsurer or reinsured would commute:

- Reinsurer/Cedent wants finality/Cease processing/Cut off administrative costs
- Reinsurer desire to avoid adverse loss development
- Cedent in need of liquidity (cash)
- Reinsurer at risk for insolvency
- Disputes between the reinsurer and reinsured

Leading practices:

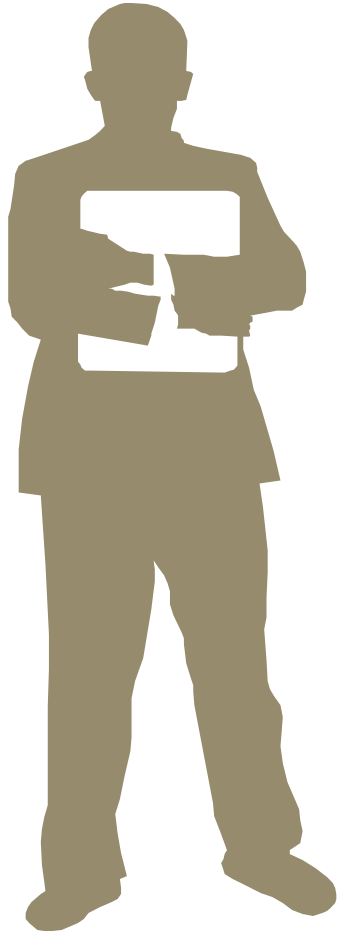
- Annual assessment of all reinsurers
 - Penalties
 - Disputes
 - Payment patterns
 - Ongoing versus run-off relationship
 - Number of claims/Contracts being processed
 - Agreements with last man standing
 - Credit worthiness
 - Schedule F

Information gathering



- Identify all relationships
- Contracts (Ceded and Assumed)
 - Mandatory commutation terms
 - Sunset clauses
- Schedule F data (all parties)
- Accounting records
 - Premium/Loss data
 - Loss sensitive calculations
 - Collateral
 - Offsets
- Precautionary claims
- Past interactions
 - Total premium and losses paid
 - Length of business relationship
 - Disputes and outcomes
- Current relationship
 - Volume of business and premium
 - Contacts
 - Future expectations

Example – Treaty information



- Reinsurer treaty #
- Cedent treaty #
- Broker treaty #
- Treaty period
- Treaty Name
- Type of agreement
- Treaty limit, retention, aggregate extension
- Reinstatements
- Written line % or value
- Signed line %
- Class of business
- Gross and ceded premium
- Gross and ceded paid loss
- Gross and ceded outstanding reserve
- # of open claims
- # Precautionary claims
- Estimates for development on existing claims
- IBNR
- Funds held
- LOC details/listing

Assessment

- Reconciliation of balances
 - Premium reconciliation offset
 - Paid/Outstanding position
 - Deductibles
 - Loss Sensitive Premium
 - Collateral
- Payment history
- Funds held by broker
- IBNR
 - Development on existing, precautionary and unreported claims
 - Frequency and severity analysis
 - Limit and aggregation analysis
 - Estimate payment patterns
 - Determine Survival Ratios and other methodologies
 - Estimate present value discounts
 - Determine inflation factors
 - Establish a range
- Solvency of Cedent/Reinsurer
- Credit worthiness of Reinsurer
- Pending Litigation/Arbitration issues
- Schedule F balances Cedent/Reinsurer
- Schedule F Penalties
- Cost benefit analysis
 - Estimated obligations of reinsurer less:
 - Dispute risk
 - Credit risk
 - Administrative costs
 - Legal costs
 - Penalties
 - Stress of relationship/Ongoing business
 - Negative publicity/Reputation
 - Establish range first offer to minimum level of acceptance
 - Impact on balance sheet

The first meeting

- Requesting the meeting
 - Initiated by party requesting commutation
 - Location typically the “other party” or industry event (i.e. AIRROC)
 - Requestor sets agenda
- Attending the meeting
 - Who - primary negotiator and data/Accounting representative
 - Introductions – roles and background
 - Express purpose of meeting/Goals
 - Stated in terms of exploring possible finality of the relationship
 - Define advantages for both parties
 - Discuss potential disadvantages if do not commute
 - Data cut offs and define time frames in which to complete
 - Contracts/Relationships to include
 - Procedures Roles and Responsibilities
 - Data exchange for reconciliation timing and protocols/Formats
 - Audit time frames and scope
 - Establish next meeting date, post data reconciliation

Party to party reconciliation and audits

- Define data to be exchanged
- Understand format
- Reconcile accounting issues
- Exchange information (i.e. copies of agreements, etc.)
- Audit
 - Clearly define scope and what will be made available
 - Requirements for receiving audit list
 - Confidentiality agreement
 - Logistics: systems access, office hours
 - Copies of materials
 - Discussions with counsel
 - Audit reports timing and distribution

On going negotiations

- Requestor of the commutation typically is party that pursues adherence to an agenda
- Substantive negotiations often do not take place until reconciliation initiatives and audits are complete
- Disputed issues and positions are discussed on a high level
- IBNR calculations may be shared and discussed
- Contracts with mandatory commutation clauses are highlighted
- Typically values are not agreed based upon initial offers
- Deals not completed by the agreed cutoff date require data updates and restatement of offers

Elements of a commutation agreement

- **Preamble:** identify participants and participating shares, intent and general agreement
- **Consideration:** amount, timing and method of payment
- **Release of Obligations and Liabilities:** known, unknown, and future obligations under the agreements that are to be released
- **Waiver of future claims:** prohibits cedent from submitting future claims
- **Confidentiality clause:** limiting disclosure to third parties
- **Jurisdiction:** usually consistent with the terms of the reinsurance agreement
- **Dispute resolution:** usually consistent with terms of reinsurance agreement
- **Good faith transaction:** knowledgeable parties entering into the commutation agreement
- **Exhibits:** known contracts included

Post commutation activities

- Notify brokers, intermediaries and managing agents
- Allocate sums received to appropriate reinsurance agreements
- Write off any appropriate balances
- Establish contra coding or other mechanism to shut off logic that generates cessions
- Maintain copies of the commutation agreement

Thank you

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