



Investigations and Subpoenas and Disclosures

The NAIC and Industry Response

CAS Spring Meeting
May 9th, 2006

Kenneth Kruger

Willis

Initial Debate

1. How widespread was the problem?

2. What exactly was the problem?

- Compliance with the existing accounting rules, or
- The accounting rules themselves

“Side Agreements”

- Mentioned in many of the stories on finite reinsurance
- What exactly were they?
- Were they standard industry practice?

“Side Agreements” Defined

“A reinsurance agreement consists of the wording itself (including the reinsurers’ individual Interest and Liability Agreements), any amendments, and any documents expressly incorporated by reference in the wording or amendments and considered in the transfer of risk analysis.

All other documents will be considered separate written or oral agreements...”

Risk Transfer

- Reinsurance accounting requires the transfer of insurance risk
- Insurance risk =
 - Underwriting Risk (uncertainty as to amount) +
 - Timing Risk (uncertainty as to timing)

Why the focus on “Finite” Reinsurance?

- “Finite” features in a reinsurance contract serve to reduce risk
- “Reduce” not “Eliminate”

What is “Finite” Reinsurance?

- Products had changed substantially since the early 90’s
- Grafting of “finite” elements onto “traditional” covers
- No longer black and white but a broad spectrum

Early Insurance Department Responses

- Mostly focused on Sarbanes-Oxley type “attestation”, some subpoena action
- New York’s response – “Circular Letter No. 8” issued March 29th 2005
- Other states (Florida, Mass, etc.) followed with similar pronouncements

NY Circular Letter No. 8

- Expressed concern about the improper use of finite reinsurance to “manipulate financial reporting results”
- Recognized that their were “legitimate” uses of finite reinsurance
- Focused on situations where there was “no actual transfer of risk”

NY Circular Letter No. 8

- CEOs of insurers under examination were required to attest:
 - There were no separate written or oral agreements which could affect the potential loss to either party, and
 - For each reinsurance agreement the reporting entity had a underwriting file documenting “economic intent” and demonstrating risk transfer consistent with the accounting treatment

NAIC Action

- Attempted to address the issue on a more uniform basis
- Worked closely with industry to understand the problem and find effective solutions
- Work on this ran from February – October 2005

The Results

- Annual Statement Changes
 - Disclosures
 - New Interrogatories
 - New Supplemental Filing
 - Attestation
 - New Supplemental Filing
 - Signed by CEO and CFO
- Effective for the 2005 Annual Statement

Disclosures

- Five new interrogatories added for 2005
- Previous “finite” interrogatories, 7.1 and 7.2, dealt with quota shares
- New ones pull in excess contracts as well as other non-finite reinsurance arrangements

New Interrogatory 9.1

- Aimed at identifying “finite” contracts but applies to any contract
 1. The contract has to be accounted for as reinsurance,
 2. The contract has to pass a materiality test, and
 3. The contract has to contain one of six “finite” features

Other New Interrogatories

- 9.2 - Aimed at Identifying certain reinsurance arrangements
- 9.4 – Aimed at identifying contracts treated differently for Stat vs. GAAP
- 9.3 & 9.5 – Require you to complete a new Supplemental Filing if you answered “yes” to any of the above

Attestation

- Not directly linked to disclosure
- Not limited to “finite” contracts or those contracts disclosed under the new interrogatories
- Applies to your reinsurance program as a whole

What Do You Attest To?

- There are no separate written or oral agreements which could affect the risk,
- For contracts for which risk transfer is not “reasonably considered to be self-evident”, there is documentation concerning economic intent and risk transfer,

What Do You Attest To?

- You're in compliance with SSAP 62, and
- You have the appropriate controls in place to make sure you're in compliance with SSAP 62

Where Does That Leave Us?

- New Disclosure and Attestation requirements applied to the 2005 Annual Statements filed by February 28, 2006
- NAIC released draft guidance to assist preparers
- AAA released a Practice Note to assist actuaries assisting CEOs and CFOs

Continuing Action

- Interested Parties Group (RAA) is providing comments on implementation issues and general risk transfer concerns
- Newly formed AAA Risk Transfer Working Group is looking at technical issues



Investigations and Subpoenas and Disclosures

The NAIC and Industry Response

CAS Spring Meeting
May 9th, 2006

Kenneth Kruger

Willis