

**SOA 2002 Valuation Actuary Symposium**

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**How Safe is Your Reinsurance Credit?**

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**What State Examiners Look for When  
Reviewing Reinsurance Reserve Credit**

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**Presentation Overview**

- **NAIC Credit for Reinsurance Model Law**
- **NAIC Life & Health Reinsurance  
Agreements Model Regulation**
  - **Appendix A-791 of NAIC Accounting  
Practices & Procedures Manual**
- **Financial Examiners Handbook**

## ***Credit for Reinsurance Model Law***

- **Is Reinsurer authorized?**
  - **If Reinsurer is not authorized**
    - **Financial benefit may only be reflected if such amounts are properly secured**
    - **Reinsurance agreement must contain service of suit provision where reinsurer agrees to submit to jurisdiction of U.S. court and appoint agent for service of process**
- **Proper insolvency clause**

## ***NAIC Life & Health Reinsurance Agreements Model Regulation***

### **Sets out Risk Transfer Rules**

- **Evaluation of risk transfer is quite different from that for P&C reinsurance**
- **Model defines “transfer of risk” in terms of transfer of all of the “significant risks” inherent in the business reinsured and does not address probability of loss to the reinsurer.**
- **Significant risks are defined with reference to a table of risks and contract types. Contracts which do not contain any of the conditions described are allowed reinsurance accounting treatment.**

## ***NAIC Life & Health Reinsurance Agreements Model Regulation***

### **Scope**

- **All Life and Health indemnity reinsurance agreements**
  - **Excludes YRT, Non-Proportional, Assumption**
- **Post-execution notification filing requirement of inforce business**
- **Imposes standards upon ceding insurers only**
- **Both Parties must sign contract by “as of” date**
- **Contract must contain “entire agreement” clause**

## ***NAIC Life & Health Reinsurance Agreements Model Regulation***

### **Accounting Treatment of Inforce Business - Section (4)C(2)**

- **Statutory gain at inception of contract is not reflected in the income statement**
- **Increase in surplus is posted only to the balance sheet at the inception of the contract**
- **Income statement impact is amortized over future years as reinsurance profits emerge on the block**

***NAIC Life & Health Reinsurance Agreements Model Regulation***

**Accounting Requirements**

- **A(1) Sufficient renewal expense allowances**
- **A(2) No termination of inforce by reinsurer**
- **A(3) No reimbursement of reinsurer losses**
- **A(4) No automatic recapture**
- **A(5) Reinsurer receives income only from reinsured policies**

***NAIC Life & Health Reinsurance Model Regulation***

**Accounting Requirements**

- **A(6) Significant risks must be transferred. Investment risk must be transferred on interest sensitive products**
- **A(7) Transfer or segregate assets on business with significant investment risks**
- **A(8) Quarterly settlements**
- **A(9)(10) Limits the reinsurer's rights to obtain representations and warranties from the ceding co not reasonably related to the business being reinsured**

***NAIC Life & Health Reinsurance Model Regulation:  
Appendix A-791 Life and Health Reinsurance Agreements***

**Background:** A question and answer document developed by the Life and Health Actuarial Task Force Reinsurance Working Group to provide guidance in interpreting model regulation provisions

***Financial Examiners Handbook***

- **Guide to assist state insurance departments in establishing and operating an effective examination system**
  - **Basic purpose of examination system:**
    - **To detect as early as possible those insurers in financial trouble and who are engaging in unlawful or improper activities**
    - **Develop the information needed for timely, appropriate regulatory action**

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**Audit Objective:**

- **That reinsurance contracts effectively transfer risk and contain provisions mandated by regulation**
- **Reinsurance Assumed is properly authorized, valued and recorded**
- **Amounts of reinsurance ceded are properly reflected in the financial statements**

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**Overall Risk Assessment: Evaluation of likelihood of a material adjustment to surplus based on the following criteria (rated as High medium, or low)**

- **Amounts Recoverable from Reinsurer's**
- **Reinsurance in Unauthorized Companies**
- **Commissions & Exp Allowances Due**
- **Funds Held under Reinsurance Treaties**

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**Preliminary Examination Approach –  
Reinsurance and Risk Transfer Instruments  
Cycle:**

- **Actual procedures to be performed is a matter of considerable judgment by the examiner**

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- **General Procedures**
  - **General description of company's reinsurance program is documented**
    - **Maximum reinsurance coverage provided by the ceding program**
    - **Maximum retained liability**
    - **Maximum reinsurance coverage provided by the ceding program**
    - **Pricing and ceding commission information**
    - **Anticipated loss ratios under contract**

## **Financial Examiners Handbook**

- **General Procedures**
  - All significant assumed and ceded reinsurance treaties reviewed to detect any unusual features that may significantly affect the company's financial condition, or that are violation of state laws, regulations, NAIC accounting practices and procedures.
  
  - Identify any of the following transactions
    - Cut-through endorsements
    - Fronting arrangements
    - Excessive risk assumed under treaty
    - Large portfolio reinsurance during the last 3 months of the year or period
    - Significant changes in reinsurance program
    - Excessively high reinsurance commissions

## **Financial Examiners Handbook**

- **Ceded Reinsurance**
  - Contracts reviewed to determine that risk transfer requirements are met and that overall accounting treatment complies with guidelines in SSAP 61
  
  - Financial information obtained of all significant reinsurers to determine financial strength of reinsurers to which business is ceded

## **Financial Examiners Handbook**

- **Amounts Recoverable from Reinsurers**
  - **Aging detail reviewed to identify recoverables over 90 days old**
  - **Reinsurance recoverables are agreed to a valid reinsurance contract and directly confirmed with the assuming company**
  - **Determine that recoverables written off or disputed have been properly disclosed in accordance with SSAP 61, para 41 and 61**

## **Financial Examiners Handbook**

- **Commissions and Expense Allowances Due**
  - **Schedule detailing C&E Allowances due by reinsurer obtained**
    - **C&E allowances due recalculated by utilizing percentages and amounts specified in the reinsurance contract**
    - **Significant C&E allowances confirmed directly with reinsurer**

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- **Commissions and Expense Allowances Due**
  - Verified to determine proper recording in accordance with SSAP 61, para 28-32
    - Excess Commissions
    - Renewal expense allowances paid by reinsurer must be sufficient s

**Financial Examiners Handbook**

- **Assumed Reinsurance**
  - Documentation evidencing required management review and approval of contract
  - Compliance with underwriting guidelines determined
  - Financial information of all significant ceding company's obtained to determine financial strength of cedents from which business is assumed

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- **Assumed Reinsurance**
  - **Verify that reserves for assumed reinsurance are in accordance with SSAP 61, para 38. Must be equal to the required reserves calculated using the same methodology and assumptions that would be used if the reinsurer had written the risk directly.**

**Financial Examiners Handbook**

- **Other Procedures**
  - **Comparison of Ceded Reserves to Reserve Liabilities established by Reinsurer**

***Thank You!***



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