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October 4, 2017

Dale Bruggeman, Chair  
Statutory Accounting Principles (E) Working Group (SAPWG)  
National Association of Insurance Commissioners  
1100 Walnut St.  
Kansas City, MO 64016

Sent via email to Julie Gann

Re: Exposure Draft 2017-28

Dear Mr. Bruggeman:

On behalf of the Committee on Property and Liability Financial Reporting (COPLFR) of the American Academy of Actuaries,<sup>1</sup> I appreciate the opportunity to provide comments on the Statutory Accounting Principles Working Group's proposal regarding *Reinsurance Risk Transfer*, Exposure Draft No. 2017-28. Our comments are restricted to the proposed modifications to Statement of Statutory Accounting Principle (SSAP) No. 62R: *Property and Casualty Reinsurance*.

Our understanding is that the proposed changes to SSAP No. 62R involve two new paragraphs (28 and 29—included in the appendix to this letter) and glossary changes. We have no comments on the glossary changes. We have significant concerns with the two proposed new paragraphs and recommend these not be adopted without further study.

Overall, the changes that are being proposed have the potential to require substantial changes to current reporting for ceded reinsurance contracts. Evaluating such proposed changes should involve a more extensive exposure process, with multiple illustrative examples, field testing, and input from a wide variety of constituents. Similar changes were explored in 2006 by the Financial Accounting Standards Board (FASB) in its invitation to comment on bifurcation of reinsurance contracts. The comments received by the FASB were almost uniformly against bifurcation, noting the costs greatly outweighed the benefits and the situations where the existence of risk transfer may be questionable could be handled through enhanced disclosure.

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<sup>1</sup> The American Academy of Actuaries is a 19,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

We have comments below on the SAPWG exposures that address specific concerns separately for each paragraph.

### **Proposed Paragraph 28 (for SSAP No. 62R)**

As we note above, the proposed language represents a material (substantive) change to the current accounting for property/casualty reinsurance contracts.<sup>2</sup> Hence we believe that it was mislabeled as “nonsubstantive.”

Furthermore, also as noted above, previous proposals have considered the approach proposed in this paragraph, but those proposals have not been adopted in part due to the complexity of calculations required for compliance. The loss-sharing features mentioned in this paragraph are relatively common in reinsurance contracts, and in most cases represent a relatively minor portion of the overall cash flows and economics. There are numerous challenges with implementation of such a proposal:

- The proposal assumes that the overall calculations including the actuarial components are calculated on a per-policy basis; in many cases, these amounts are calculated on an aggregate basis and multiple financial statement items are involved.
- Calculating these adjustments can be very complex, partly due to the fact that the loss-sharing is typically not complete but is proportional. For example, a ceding commission that reacts to 20 percent of the loss dollars within a corridor would require partial recognition of loss dollars in that corridor. Some current contracts have multiple layers of sharing with varying percentages by layer. As loss estimates change, the portion of dollars offset for this sharing would change, resulting in volatility in published results that would make trends nontransparent.
- Actuarial reserves are calculated at an aggregate level for property/casualty claims with only rare exceptions. The estimation of losses within the loss-sharing corridor of a ceded reinsurance contract would require a more granular calculation than may be performed for the actuarial gross reserves. The level of granularity may be beyond the level that would normally be recommended and believed to be reliable. Evaluating the reasonableness of this less reliable calculation would be an additional source of complexity.
- In current practice for these contracts, insurers incorporate in the ceded reserves a provision reflecting an estimate of the aggregate portion of the ceded losses covered by the contracts.

Several other challenges would result from the proposal:

- Such a change would affect the accounting for several different income statement components (e.g., premiums, losses, commissions), hence the impact on currently published financials and/or metrics is not easy to predict nor understand without detailed knowledge of the underlying contracts.

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<sup>2</sup> The rationale for this statement is contained in the following discussion (i.e., the second point raised on the proposed paragraph 28).

- Another concern with the proposed approach is that it would obscure the risk from losses potentially developing beyond that loss-sharing portion of the contract. The proposal would have losses for the reinsurer that are just below the loss-sharing maximum being identical to losses that are well below the loss-sharing maximum (assuming 100 percent loss-sharing for the layer in question).
- The proposal as it stands is also inconsistent with regard to accounting for retrospective reinsurance on direct contracts.

The decision in the past with regard to similar proposals has been to handle situations where the existence of risk transfer is questionable via disclosure. The referenced current SSAP No. 62R paragraph 93 is an example of such a disclosure.

Given the substantive nature of the proposed paragraph 28 and the variance of this proposal from previous decisions in this area, we believe that this proposal needs further study and consideration.

### **Proposed Paragraph 29 (for SSAP No. 62R)**

We do not understand why this paragraph was proposed for property/casualty reinsurance accounting and believe that it should be rejected. Reasons for this recommendation are as follows:

- The paragraph says that “non-proportional reinsurance aggregates experience.” While property/casualty contracts for aggregate excess do exist, per claim excess reinsurance is much more common. That is incorrect for “Excess Per Risk Reinsurance”<sup>3</sup> where “risk” is defined as a per claim or per occurrence basis within a single policy.<sup>4</sup>
- The phrase “the use of statutory assumptions underlying the insured policies” is confusing in the property and casualty (P&C) context and has no meaning. It may be the case that it refers to the Standard Valuation Law or actuarial guidelines that exist for the regulation of life insurance policies but that don’t exist for P&C policies.
- The language seems to ignore the existence of working layer excess of loss contracts that are on a non-aggregated basis. This could be due to the fact that partial losses do not exist for life insurance contracts, but are the norm for property/casualty (e.g., the typical homeowners claim is not for a total loss of the home, while there is no such thing as a partial death and hence a partial loss for life insurance). For such P&C working layers, the normal approach would be to record ceded earned premium and ceded unearned premium in accordance with the policy effective dates and portion of the term that has expired, with losses ceded as events occur and estimates made. One would also expect loss ratios greater than 0 percent but less than 100 percent for the ceded contract (for working layers), while the proposed language for paragraph 29 envisions loss ratios of either zero or over 100 percent.

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<sup>3</sup> SSAP No. 62R, paragraph 5.I.B.

<sup>4</sup> The proposal seems to focus solely on non-proportional treaty contracts, but the concerns mentioned in our letter also apply to non-proportional facultative contracts.

- Even in the case of aggregate cover (a reinsurance agreement that attaches on a combined occurrence or policy basis), the meaning of the language of the proposal related to taking no reinsurance credit “unless the aggregate attachment point has in fact been penetrated” is unclear. If it means penetrated by paid losses plus case reserves plus incurred but not reported (IBNR), then that is current practice. If it means penetrated either paid losses alone or by case reserves plus payments, the definition is incorrect.

In summary, we believe that the logic underlying the proposed SSAP No. 62R paragraph 29 may be valid for life reinsurance but is invalid for P&C reinsurance and should not be adopted.

Thank you for this opportunity to provide our views on the SAPWG’s proposal. If you have any questions or would like to discuss this letter in more detail, please contact Marc Rosenberg, the Academy’s senior casualty policy analyst, at [rosenberg@actuary.org](mailto:rosenberg@actuary.org) or 202-785-7865.

Sincerely,

Lisa Slotznick, MAAA, FCAS  
Chairperson, COPLFR  
American Academy of Actuaries

Appendix attached

## Appendix—Proposed additions to SSAP No. 62R

28. Prospective reinsurance agreements that meet the conditions for reinsurance accounting shall only reflect reinsurance credit (claims and loss reserves reduction) for the portion of risk which is ceded. Provisions that would limit the reinsurer's losses (e.g. a deductible, a loss ratio corridor, a loss cap, an aggregate limit or any similar provisions) shall be reflected as reductions in coverage (claims and losses ceded) caused by any applicable risk limiting provision(s). *(Drafting Note: This includes concepts from SSAP No. 62R, paragraph 93 disclosure.)*

29. No reserve credit shall be taken for non-proportional reinsurance unless the aggregate attachment point has in fact been penetrated. In order for an entity to reflect reserve credits for non-proportional reinsurance on a prospective basis, the entity will need to demonstrate that the present value of expected recoveries, using realistic assumptions, to be realized from the reinsurer are in excess of the present value of the reinsurance premiums guaranteed to be paid by the ceding entity under the terms of the contract. Because non-proportional reinsurance aggregates experience and does not indemnify the ceding entity for each policy loss, the use of statutory assumptions underlying the insured policies is inappropriate for determining any reserve credit to be taken by the ceding entity. Historical experience, pricing assumptions shall be considered in determining if the reinsurer may be reasonably expected to pay any claims. The reserve credit taken shall only reflect these reasonable expectations. *(Drafting Note: This includes concepts from SSAP No. 61R, paragraph 38.)*