

A PUBLIC POLICY WHITE PAPER

# Estimating the Uncollectible Reinsurance Reserve for Property/Casualty Companies New GAAP Requirements

*July 2019*

Developed by  
the Current Estimate Credit Losses Work Group  
of the Financial Reporting Committee  
of the American Academy of Actuaries



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## Estimating the Uncollectible Reinsurance Reserve for Property/Casualty Companies New GAAP Requirements

A new Financial Accounting Standards Board (FASB) accounting requirement regarding uncollectible reinsurance reserves takes effect in 2020 for certain filers of US Generally Accepted Accounting Principles (GAAP) statements, and is effective the following year for others filing US GAAP statements. This new requirement, labeled ASU 2016-13,<sup>1</sup> establishes new rules for the determination of the uncollectible reinsurance reserve (URR) as well as creating new disclosure requirements. While these new rules may be consistent with current practice for some insurers, it will require new reserving practices for others.

A working group created by the Financial Reporting Committee of the American Academy of Actuaries<sup>2</sup> wrote this white paper to describe the new rules, how this may be a change from current practice for some companies, what methods might be used to estimate the URR under the new rule, and various issues involved in estimating such amounts under these methods. The paper will also discuss how the impact might vary for companies with a large number of reinsurers (typically the larger companies) versus the impact on those with only a few reinsurers. Lastly, the paper will discuss possible issues with regard to U.S. Statutory accounting as well as pointing out a few potentially relevant Actuarial Standards of Practice (ASOPs). (This paper does not address the disclosure aspects of these new rules, other than listing the new disclosures in an appendix.)

*Note that while these rules apply to reinsurance recoverables for all insurance companies reporting under U.S. GAAP, this paper only addresses the issue for property/casualty (P&C) companies.*

### 1. **What is the issue?**

Ceded reinsurance is a material part of many property/casualty companies' operations, and the collectability of ceded balances can be a material part of those companies' solvency and risk evaluations. This importance is reflected in the required comment on reinsurance collectability in P&C actuarial opinions,<sup>3</sup> and in the inclusion of a ceded reinsurance credit risk charge in the National Association of Insurance Commissioners' (NAIC's) Risk-Based Capital formula.

P&C companies carry a reserve to allow for reinsurance uncollectibility (called the uncollectible reinsurance reserve, or URR, in this paper), which is accounted for as an offset to their ceded reserve balances. These reserves exist for both GAAP and U.S. Statutory reporting, but with accounting guidance that has resulted in different approaches and measurement objectives by different companies. This is

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<sup>1</sup> ASU 2016-13 is the reference number for the new FASB accounting standard. The official name of this standards update is "Accounting Standards Update—Measurement of Credit Losses on Financial Instruments". Most of this standard focuses on financial instruments such as bond investments. The reason why this standard also scoped in reinsurance recoverables is discussed in Appendix 1. Also of note is the common name being given to this standard—"Current Expected Credit Losses", or CECL.

<sup>2</sup> The American Academy of Actuaries is a 19,500-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.

<sup>3</sup> Item 6D per the 2018 NAIC Annual Statement Instructions for P&C actuarial opinion.

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about to change, however, with respect to U.S. GAAP, with new Financial Accounting Standards Board rules (ASU 2016-13) issued in 2016 and effective in 2020 for public companies and 2021 for others.

### **2. What are the new rules?**

The new FASB rules will require that uncollectible reinsurance reserves related to credit risk (i.e., inability to pay) be set based on expected ultimate uncollectible amounts. This is akin to the requirement under International Financial Reporting Standard (IFRS) 17, Solvency II, and various market-consistent approaches such as those implemented in Bermuda. This will be a change for insurers that base their current URR estimate on only known impairments; i.e., reinsurers of an insurer that are known to be impaired or of weak financial standing as of the balance sheet date.

Note that the URR is meant to address uncollectible amounts due to both credit risk and dispute risk. As the new FASB rules only apply to the credit risk portion of the URR, the FASB rules relevant to the dispute risk portion of the URR are unchanged.<sup>4</sup> As a result, some companies may end up using an expected ultimate uncollectible approach for the credit risk portion of the URR and a known impairment approach for the dispute risk portion of the URR. This may cause a difference between accounting under the new FASB rules and the rules for IFRS 17 and Solvency II.

### **3. What is current practice?**

While not explicitly disclosed, our understanding is that individual companies generally use the same approach for setting the URR for both their U.S. GAAP filings and their U.S. Statutory filings.<sup>5</sup> That said, the approach varies across companies in the industry. Some set their URR estimate based on a policy of only reflecting known reinsurer impairments as of the balance sheet date. This is known as the “incurred loss model” within the accounting profession. Others set their URR estimate based on a policy of reflecting the ultimate amount uncollectible, presumably including some amounts for reinsurers not yet impaired. This is generally called the “expected loss model” within the accounting profession.

Our understanding of current accounting rules is that U.S. GAAP would support either approach, depending on the unit of account used in the valuation. Under U.S. GAAP, a loss (such as that from an uncollectible balance) is to be recognized when it is probable. If the unit of account is the balance with an individual reinsurer, a loss is only probable if that reinsurer is impaired. If the unit of account is the total balance spread over a large number of reinsurers, a company may determine that a loss for at least some portion of the total balance is very probable. Once the accounting decision is made that a loss is

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<sup>4</sup> The current rules prior to this new ASU, and still relevant to any URR due to dispute risk, are discussed in the following section.

<sup>5</sup> This understanding is due to the lack of disclosed GAAP versus Statutory accounting differences with regard to this reserve in publicly available financial statements. The lack of disclosure implies that this consistency extends to their estimate of both the credit risk and dispute risk portions of the URR.

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probable, financial statement preparers<sup>6</sup> are then required to produce their best estimate of that loss.<sup>7</sup> We note that the decision as to unit of account is an accounting policy decision and not an actuarial decision, although actuaries may be involved in the resulting measurement exercise.<sup>8</sup>

U.S. Statutory (accounting standards) generally start from the base of U.S. GAAP standards as issued by the FASB. Hence there is support for either approach under U.S. Statutory. An additional feature for U.S. Statutory is the inclusion of the URR in the loss reserve, with the additional requirement that write-offs of previous ceded loss amounts are to be recorded in the same account as the previously ceded amount. To the extent that the loss reserve is based on an ultimate valuation, some would argue that the URR should follow the same basis (which implies the use of the expected loss model). Nevertheless, current practice seems to be to treat the URR the same for both U.S. GAAP and U.S. Statutory.

#### 4. **Causes of reinsurance uncollectibility**

The obvious causes of uncollectibility are the inability to pay, known as credit risk, and questionable willingness to pay, known as dispute risk. Both risks may result in no payment, partial payment, or late payment.

##### **Credit risk**

Reinsurer impairments and insolvencies can result from the same risks that primary writers are exposed to, namely:

- *Reserving risk, especially that associated with long-tailed exposures*
- *Market and investment risk (although this tends not to be a major source of risk for property/casualty exposures)*
- *Accumulation risk (e.g., catastrophes, both manmade and natural)*
- *Pricing/underwriting risk*

##### **Dispute risk**

A reinsurer and ceding company may interpret contract provisions of a reinsurance agreement in meaningfully different ways. Reinsurance contracts may be written to cover unique exposures or be subject to rare events, or contain provisions untested in the courts. An event could also occur that was not contemplated by the contract, resulting in unforeseen ambiguities in how the contract would (or would not) react to such an event. Reinsurance contract disputes have been common for latent liabilities, such as asbestos and environmental pollution. Disputes can occur over:

- Missing policies (which are alleged to exist with only secondary evidence<sup>9</sup> as to their existence)
- Late notice of a claim

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<sup>6</sup> In this case, ceding companies.

<sup>7</sup> This presumes that a reasonable estimate is possible.

<sup>8</sup> We also suspect that actuaries are more likely to be involved when the estimate is based on ultimate uncollectibility as opposed to just known impairments.

<sup>9</sup> Secondary evidence may include correspondence between brokers, insurers, and reinsurers that refer to a policy that now cannot be found, or endorsements, declaration pages or other portions of an incomplete contract. Note that this refers to missing direct policies that the ceding company believes would be covered by a ceded reinsurance contract. This is not uncommon for some latent liability situations such as Asbestos & Environmental liabilities (A&E).

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- Settlements made without first consulting with the reinsurer (where such consultation is or is alleged to be a requirement under the reinsurance contract)
- Definition of an occurrence (e.g., with regard to policy limits, deductibles, or whether the event is covered at all)

Disputes can be lengthy and may be settled via litigation or arbitration, but even when a decision or judgment is reached in the ceding company's favor, the ceding company must still evaluate whether the reinsurer is willing and able to pay. In practice, the distinction between credit risk and dispute risk may be arbitrary as reinsurers which are either a credit risk or are in runoff may be more likely to dispute claims.

### **Less obvious causes of uncollectibility risk**

Reinsurance uncollectibility may also be influenced by less obvious causes, including:

- The aggressiveness (or caution) of the ceding company in identifying and presenting claims for reimbursement.
- The experience the company has in processing ceded claims (impacting the completeness and clarity of the ceded presentation, and hence its acceptance by the reinsurer).
- The experience the reinsurer has in the types of claims being presented. (The causes in this bullet and the prior bullet can interact. The longer the relationship between the parties regarding a certain type of claim, the more likely a common understanding will exist.)
- The current business relationship between the ceding and assuming companies. A ceding company in an ongoing business relationship with a reinsurer may be able to collect more easily than a ceding company in runoff (presumably due to the hesitancy of both parties to imperil their ongoing business relationship).<sup>10</sup>
- Commutations. Commutations for less than the full amount of the cessions can represent uncollectibility that the ceding company agrees to. A commutation may be enacted for only a percentage of what the ceding company believes it should collect. However, if the reinsurer poses a credit risk, the ceding company may be better off with a partial collection rather than a complete loss. In practice, it may not be possible to distinguish or separate the dispute from the credit risk portion of uncollectible amounts arising from commutations.<sup>11</sup> (*Note that the term "commutation" here is meant to include novations, as well as "schemes of arrangement"*<sup>12</sup> as might exist in the United Kingdom.)

## 5. **Estimation methods**

Before beginning a discussion of estimation methods, it is first necessary to clarify the term "reinsurance write-off," as the definition of that term can affect the design of the estimation method.

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<sup>10</sup> The above discusses when the ceding company goes into runoff and the impact on reinsurance collectability. A similar situation can occur if the reinsurer goes into runoff (either directly or via the purchase of the reinsurer by a runoff entity).

<sup>11</sup> Some commutations can result in a gain for the ceding company, perhaps due to a conservative (i.e., low) estimate of potential cessions being recorded prior to the commutation. This paper does not address such a situation.

<sup>12</sup> The United Kingdom legal system allows for "schemes of arrangement" which can act similarly to a commutation that can be forced upon all or a portion of the creditors for a corporation (such as an insurer).

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**Definition of ‘reinsurance write-off’**

At any point in time an insurer will have ceded amounts billed but not yet collected, ceded case reserves, and ceded incurred but not reported (IBNR). . The first category would clearly have a particular reinsurer associated with it, and the second category (ceded case reserves) will also likely be identifiable by reinsurer. In contrast, ceded IBNR in many cases will be the result of an allocation that may have varying degrees of reliability.

Amounts ceded to a particular reinsurer that are determined to be uncollectible are written off. In doing so, the cedent in question would write off the ceded billed amounts not yet collected. The cedent may also “write off” the ceded case, but this might be due to a reversal of the ceded case reserves in the cedent’s financial systems, with no official “write-off” the way the cedent defines that term for financial reporting purposes. The cedent may also retain the ceded case in its claim/reinsurance system, but with an offsetting URR entry. In that latter case the cedent may process a ceded bill later in its system when the ceded case would normally become a ceded paid, and simultaneously write off that bill. As a result, write-off histories for one insurer may not be directly comparable to write-off histories of another insurer solely due to definitional issues. This is a consideration in the development of a URR estimation method, and may explain why a method used by one insurer may not be appropriate for another insurer.

**Two methods**

There are two main types of methods available to estimate URR. One is the **experience-based** method, while the other is the **rating-based** method.<sup>13</sup> Broadly speaking, experience-based methods use historical reinsurance write-offs as the basis for estimates of URR. Rating-based methods use the financial strength ratings of reinsurers as the basis for estimates of URR. An important difference between the two is that experience-based methods can consider write-offs related to both credit and dispute, while rating-based methods address write-offs related to credit only.

These two classes of methods share similarities with well-established methods used in other applications, such as experience-based and exposure-based reinsurance pricing. However, there are special challenges in applying these methodologies to URR estimation, as will be discussed in this section. Due to the more generic nature of the method, rating-based methods will be discussed first.

***NOTE: The following examples are illustrative only, with the default probabilities chosen to illustrate the concepts and not based on any actual or expected default rates.***

**Rating-based method**

The rating-based method considers the financial strength of reinsurers to determine the URR. In this case, the URR will be for credit-related losses only; a separate provision will be needed for dispute-related losses.

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<sup>13</sup> See Blanchard, R., *Setting the Uncollectible Reinsurance Reserve (URR) under the new FASB Requirements*, 2018 Casualty Loss Reserve Seminar, September 2018.

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The concept underlying rating-based methods is that reinsurance credit risk can be quantified by considering the reinsurer’s probability of default. Consider the following simplified example:

- Insurer ABC has a reinsurance recoverable of \$1,000 from Reinsurer XYZ
- Insurer ABC holds \$400 in collateral from Reinsurer XYZ
- Insurer ABC estimates Reinsurer XYZ’s probability of default to be 1%
- Insurer ABC estimates its URR related to Reinsurer XYZ as \$6, based on the 1% default probability applied to the reinsurance recoverable net of collateral,<sup>14</sup> or \$600

This process can be applied to all of Insurer ABC’s reinsurers, with the aggregate result representing the URR estimate.

A key consideration in applying the rating-based method is that the payout of insurance liabilities often occurs over many years, and as a result the billing of ceded reinsurance occurs over many years.<sup>15</sup> A reinsurer could be financially strong today but face financial challenges at some future point, before the subject losses under a reinsurance contract have been paid and the associated ceded amounts have been billed. Therefore, rating-based methods require consideration of the probability of reinsurer default over the lifetime of the reinsurance recoveries.

How is the rating-based method applied in practice?

In order to apply the rating-based method, an insurer needs to break out its current reinsurance recoverables by reinsurer financial strength rating<sup>16</sup> and by future billing, as shown below for an insurer with a ceded balance of \$100.

**Table 1**  
**Rating-Based Method: Expected Future Ceded Billings by Reinsurer Rating (\$'s)**

	Reinsurer Rating	Year 1	Year 2	Year 3	Year 4	Year 5	Total
(1)	A	6	15	20	10	5	56
(2)	B	2	5	7	5	3	22
(3)	C	1	3	5	3	2	14
(4)	D	1	2	3	2	0	8
(5) = sum (1) thru(4)	Total	10	25	35	20	10	100

<sup>14</sup> Some methods would also evaluate the strength of collateral in the event of the reinsurer default. For our discussion here, we will assume that such a refinement would not make a material difference to the final indication. Note also that this collateral would also have an impact on the dispute risk, which has to be separately considered under a ratings-based method.

<sup>15</sup> In some cases (e.g., Workers Compensation, asbestos), the payout is over many decades rather than years.

<sup>16</sup> Note that some reinsurers may not have ratings from public rating agencies. Examples may include runoff companies and captives. This approach still needs to consider such reinsurance recoverable balances. Possibilities include having a single “unrated” category, or breaking up the unrated group into subclasses based on presumed default characteristics. In most cases this “unrated” category will be of a manageable size.



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For simplicity, we will assume that there is no collateral supporting the reinsurance recoverable. We also assume no currently outstanding amounts from previous bills. (If need be, those could be handled by adding a “Year 0” to the above table.)

Next, the insurer estimates the cumulative default rates by reinsurer rating over the five-year period, as shown below in Table 2:

**Table 2**  
**Rating-Based Method: Expected Cumulative Default Rates by Reinsurer Rating**

	Reinsurer Rating	Year 1	Year 2	Year 3	Year 4	Year 5
(1)	A	0.1%	0.2%	0.3%	0.5%	0.6%
(2)	B	0.2%	0.5%	0.9%	1.4%	2.0%
(3)	C	0.7%	1.8%	2.9%	4.3%	5.9%
(4)	D	2.2%	4.8%	7.2%	9.5%	12.0%

The default rates shown in Table 2 are meant to be illustrative only.

The insurer can now combine the expected billings with the expected default rates in order to estimate the rating-based URR, as shown below in Table 3:

**Table 3**  
**Rating-Based Method: Credit-Related URR Estimate**

<i>Part 1: Expected Future Billings by Reinsurer Rating and Lag Year (\$'s, from Table 1)</i>							
	Reinsurer Rating	Year 1	Year 2	Year 3	Year 4	Year 5	Total
(1)	A	6	15	20	10	5	56
(2)	B	2	5	7	5	3	22
(3)	C	1	3	5	3	2	14
(4)	D	1	2	3	2	0	8
(5) = sum (1)thru(4)	Total	10	25	35	20	10	100

<i>Part 2: Cumulative Default Rates by Reinsurer Rating and Lag Year (from Table 2)</i>							
	Reinsurer Rating	Year 1	Year 2	Year 3	Year 4	Year 5	
(1)	A	0.1%	0.2%	0.3%	0.5%	0.6%	
(2)	B	0.2%	0.5%	0.9%	1.4%	2.0%	
(3)	C	0.7%	1.8%	2.9%	4.3%	5.9%	
(4)	D	2.2%	4.8%	7.2%	9.5%	12.0%	

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<i>Part 3: Rating-Based Estimated Credit-Related URR (\$'s, from Part 1 * Part 2)</i>							
	Reinsurer Rating	Year 1	Year 2	Year 3	Year 4	Year 5	Total
(1)	A	0.006	0.030	0.060	0.050	0.030	0.176
(2)	B	0.004	0.025	0.063	0.070	0.060	0.222
(3)	C	0.007	0.054	0.145	0.129	0.118	0.453
(4)	D	0.022	0.096	0.216	0.190	0.000	0.524
(5) = sum (1)thru(4)	Total	0.039	0.205	0.484	0.439	0.208	<b>1.38</b>

The credit-related URR in this example is estimated as \$1.38.

Note that the above assumes that ceded balances do not include amounts from reinsurers already “written off.” Where that is not the case, and the insurer has a separately dedicated part of the URR for such identified uncollectible reinsurer balances, the insurer will probably have to exclude such balances from the above analysis, adding the separately dedicated part of the URR to the above result.<sup>17</sup>

Note also that the above process is very similar to the new NAIC P&C risk-based capital (RBC) charge for reinsurance credit risk implemented for year-end 2018. The only major difference is that the NAIC formula does not schedule out the future billings (and hence applies a single factor to receivable balances by reinsurer rating, regardless of when the balance will be billed).<sup>18,19</sup> This method also leverages a new required disclosure under the ASU 2016-13, whereby an insurer is required to disclose the breakout of its reinsurance recoverable balances by rating (see Appendix 2).

Does a reinsurer default imply that 100% of the associated reinsurance recoverable should be written off?

Defaults do not necessarily imply that 100% of the recoverable will be uncollectible. Amounts written off due to a reinsurer insolvency may be partially recovered upon final resolution of the insolvency process, when creditors are paid a percentage of their claim against the insolvent company. In other cases, entities that are in default and financially impaired at a point in time may be able to recover at a future point in time. Insurers using the rating-based URR method can consider including a recovery rate assumption in the event of reinsurer default.<sup>20</sup> Such an assumption would reduce the estimated URR described in the preceding example. Judgment is required in estimating the recovery rate, though the insurer may be able to refer to previous experience or industry studies as a guide.

When would you use incremental default rates rather than cumulative default rates?

The cumulative default rates in the above method are applied to projected future reinsurance billings. Incremental default rates would be used if instead a projection was made of future ceded balances on a

<sup>17</sup> An alternative approach would be to add an “insolvent” category to the list of ratings, with a default probability of 100%.

<sup>18</sup> The NAIC P&C RBC formula also treats collateralized balances differently from uncollateralized balances for lower-rated reinsurers.

<sup>19</sup> Solvency II uses a similar approach.

<sup>20</sup> This assumes that the default rates used do not already include an offset for eventual recoveries. Note that at least some rating agencies in the past have produced public reports on historic recovery rates (discussed below).

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runoff basis (i.e., not including new accident year reinsurance balances). If that method was used then the runoff balances would have to be reduced over time both due to billings and write-offs. The above method of applying cumulative default probabilities to future billings is probably simpler.

How is the cumulative probability of default by rating estimated?

There are several alternative sources for these default probabilities by rating and lag year, some of which are public. These include:

- A.M. Best Financial Strength Ratings and associated probability of impairment<sup>21</sup>
- Rating Agencies such as Standard & Poor’s, Moody’s, and Fitch Group for the probability of default by debt rating<sup>22</sup>
- The insurer’s history of reinsurer default rates by internal rating
- Transition matrices

How can transition matrices help insurers estimate cumulative default probabilities?

Transition matrices are often used to estimate default probabilities over time. Transition matrices show the probability of transition from a beginning state to an end state over the course of a period in time. Transition matrices recognize that the financial strength of an entity can change, potentially resulting in higher or lower likelihoods of default.

A transition matrix may be of particular use to an insurer that wishes to use its own experience to estimate reinsurer default probabilities but lacks a long-term history to use as a basis. Consider the illustrative transition matrix shown below in Table 4:

**Table 4**  
**Rating-Based Method: One-Year Transition Matrix**

Beginning of Year	End of Year				
	A	B	C	D	Default
A	93.0%	6.0%	0.7%	0.2%	0.1%
B	3.0%	93.0%	3.0%	0.8%	0.2%
C	1.0%	10.0%	82.0%	6.3%	0.7%
D	0.0%	7.0%	14.0%	76.8%	2.2%

The insurer can use the transition matrix above to construct multiyear cumulative default probabilities by rating level, similar to those shown in Table 2. For instance, the one-year cumulative probability of default for a C-rated reinsurer is 0.7%, just as in Table 2.<sup>23</sup> Table 4 provides additional information, however. At the end of year 1, C-rated reinsurers have a 1.0% likelihood of improving to A, a 10.0%

<sup>21</sup> See for example *Best’s Impairment Rate and Rating Transition Study: 1977 to 2015*, December 7, 2016.

<sup>22</sup> See for example *Standard & Poor’s 2018 Annual Global Corporate Default And Rating Transition Study*, April 9, 2019.

<sup>23</sup> Table 4 is not intended to fully replicate the default probabilities shown in Table 2, other than the year 1 default probabilities.

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likelihood of improving to *B*, an 82.0% likelihood of remaining *C*, and a 6.3% likelihood of deteriorating to *D*. The insurer can replicate this analysis for all financial strength ratings, resulting in a new distribution of reinsurers by financial strength rating at the beginning of year 2. By repeating this process, the insurer can construct a table of cumulative default probabilities over the lifetime of the expected reinsurance billings. These probabilities can be applied to the expected reinsurance billings as in Table 4 to estimate the credit-related URR. *(Note that several of the rating agencies mentioned previously publish both cumulative default probability tables and one-year rating transition matrices.)*<sup>24</sup>

### How is the URR provision for disputes treated in a rating-based method?

Rating-based methods focus only on the credit aspect of URR. Insurers using rating-based methods would have to use other methods in order to include a provision for disputes. This can include an assessment of the insurer's prior dispute-based reinsurance write-offs, industry data to the extent available and relevant, management's judgment, or a combination of all three.

In developing a dispute component in a rating--based approach, it may be helpful to study the source and nature of past disputes, and the likelihood of circumstances that led to disputes in the past being repeated in the future. For example, disputes may have been concentrated in a certain type of product, claim, or reinsurer. (See the earlier discussion in Section 4 as to dispute risk.)

### Avoiding double-counting uncollectible reinsurance risk

After estimating the URR provision related to disputes, insurers can consider applying the rating-based method to the reinsurance recoverable net of the dispute provision; this will allow the insurer to avoid double-counting by estimating both a credit-based and a dispute-based URR for same reinsurance recoverable.<sup>25</sup>

### **Experience-based method**

#### Overall concept

The experience-based method relies on the insurer's historical reinsurance write-offs as a basis for the URR estimate. Consider the following simplified example:

- Insurer ABC has written off 2% of its historical reinsurance receivables due to credit and dispute
- Insurer ABC has a reinsurance recoverable of \$100,000
- Insurer ABC estimates its URR as \$2,000, the result of applying the 2% historical uncollectible rate to its reinsurance recoverable of \$100,000

### How is the experience-based method applied in practice?

At its most simplistic, an experience-based method might look at the multiyear total of write-offs divided by the total ceded billed for the same time period. This value would then be applied to the

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<sup>24</sup> The complexity of a transition matrix may outweigh the benefit for many companies. This may be useful for simulations for Solvency II or for modeling capital for heavily reinsured companies. For many companies, this could be a very assumption-based process on what is already a very assumption-based calculation—better for ranges than best-estimate reserves.

<sup>25</sup> It is also possible to apply the credit risk adjustment first, apply dispute risk factors to balances net of credit risk.

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current total ceded balance to obtain a URR indication. (The use of multiyear periods is an attempt to overcome the impact of write-off delays and year-by-year variation.)

More sophisticated methods might look at the write-offs over time by billing lag year (i.e., the number of years since the original accident occurred), which would allow for reinsurer deterioration over time. Sophisticated methods might also allow for development of those write-off percentages over time, allowing for write-off lags as well as potential future (partial) recoveries of amounts previously written off. Any such methods would also need to be consistent with the company's definition of "write-off" discussed above. Additional considerations for an even more granular experience-based method include:

- Reinsurance structure (e.g., quota share, per-occurrence excess of loss, aggregate excess of loss)
- Line of business
- Ongoing versus runoff business
- Maturity of the reinsurance recoverables
- Quality of reinsurance purchased over time (e.g., via the implementation of new processes to evaluate reinsurer strength before purchasing reinsurance)
- Collateral backing the reinsurance recoverables (e.g., funds held, letters of credit)

### What are the challenges associated with experience-based URR methods?

Data availability is the primary challenge in applying experience-based URR methods. An insurer could have no experience at all if it has not had to write off reinsurance receivables in the past. Even if the insurer has written off past amounts, there may be very little data available to perform more than a high-level analysis along the lines of the simplified method mentioned earlier.

A partial list of related and additional considerations includes the following:

- Past uncollectible rates may not be indicative of future uncollectible rates, even with no change in the characteristics of the reinsurance recoverables (e.g., due to changes in some of the "less obvious causes" mentioned in section 4).
- Changes in the characteristics of the reinsurance recoverables (reinsurance type, line of business, ongoing vs. runoff, maturity, reinsurance quality at purchase date, etc.) can add further uncertainty to the relationship of past uncollectible rates to future uncollectible rates.
- Experience-based uncollectible rates can be heavily influenced by individual events, such as commutations and reinsurer insolvency; the treatment of such events in the analysis can potentially have a significant impact on the URR estimate.
- Billings and collections can extend over years, or even decades, meaning that it can be difficult to estimate an "ultimate" uncollectible rate as well as the timing of recoveries. (This is particularly relevant where the uncollectible rate is based on following a particular accident year cohort over time, but perhaps less so when analyzing billing year or calendar year cohorts.)
- It can be difficult to quantify the impact of collateral in the URR estimate, as experience-based methods will tend to consider aggregate reinsurance write-offs, while collateral applies at the individual reinsurer level.

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- Amounts in the analysis could require interpretation; e.g., if there are offsets of reinsurance premiums and losses embedded in the history of reinsurance receivables and reinsurance write-offs.
- Exposure to credit-related losses versus dispute-related losses may be difficult or impossible to separate in the analysis. (This would impact the split between credit and dispute, but not the overall indicated URR.)

Note that there is currently no industrywide data repository with regard to historical reinsurance write offs. Companies are constrained by their own history when using this method.

Where write-off rates are very different by line of business, separate experience-based rates may be warranted for the different lines.

### When is it appropriate for an insurer to use experience-based methods?

Some insurers cede business to hundreds or even thousands of unaffiliated reinsurers. Such insurers are likely to have write-off experience that can be assigned at least some degree of credibility in estimating URR. Insurers will be required to use judgment in determining the extent to which experience can be used for this purpose. For example, consider an insurer with significant asbestos and environmental (A&E) reserves. Such an insurer may have a robust history of reinsurance write-offs and therefore may choose to use an experience-based method to estimate URR related to future A&E reinsurance recoveries. The same insurer, however, may lack a sufficient history of reinsurance write-offs for its non-A&E reinsurance recoveries and as a result may choose to use a rating-based method, rather than an experience-based method, to estimate its URR for those non-A&E cessions.

### 6. **Data issues/cautions**

When considering an implementation approach for this new FASB requirement for the URR, it is important to account for both the quality and quantity of historical data that is available. This section will briefly discuss common data capture norms for reinsurance and their potential impacts on modeling of URR. The extent to which these need reflection in the URR approach and resulting estimate would likely depend on their relative materiality.

#### **100% Cede Data**

Many ceded reinsurance systems compute and capture technical accounting data (premium, commission, and loss/LAE<sup>26</sup>) at the level of reinsurance treaty. Where there might be more than one reinsurer participating on any given treaty, payables, receivables, and recoverables (reserves) are frequently apportioned among participating reinsurers downstream from the ceded reinsurance system. In that case, the ceded reinsurance system captures data as if the original treaty stayed fully in effect,

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<sup>26</sup> Loss adjustment expense.

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with 100% participation,<sup>27</sup> without acknowledging any subsequent changes (i.e., on a “100% Cede” basis).

In these cases the downstream systems capture the actual level of cessions through the use of participation percentages (a participation matrix) applied to each quantity. Participation percentages can and do change over time for a number of reasons, including commutations, insolvencies, novations, and other amendments of contractual wording. While the reasons for such changes are normally well documented in either legal or accounting files, these changes may not be captured electronically within the participation matrix being used in the analysis. If so, some work may be required to add these to the participation matrix for URR calculation purposes.

The usage of 100% Cede Data in many systems can be a positive or a negative. On the positive side, it may be easier to start with 100% Cede Data when trying to estimate future recoverables reflecting current solvent, non-commuted reinsurance. That is because the historic trends would not be impacted by a potentially erratic historic pattern of insolvencies and commutations. On the negative side, the level of ceded outstanding currently in the system does not reflect the actual level of reinsurance potentially collectible, necessitating some adjustment to the indicated cessions (and resulting collectibility). (Note that this process of working with 100% Cede Data may be easier where ground-up/granular analyses were performed, such as possibly for certain mass torts.)

### **Right of offset**

Many reinsurance contracts contain a contractual clause known as “right of offset.” This contractual provision allows ceding and assuming companies to settle their cash balances on a net basis, meaning that payables and receivables are combined before any remission of cash among the parties. For example, a ceding company that owes a reinsurer \$100 in ceded premiums but expects \$20 in ceding commissions and \$50 in ceded losses from the reinsurer might record a single entry in its accounts payable of \$30. The subsequent settlement would be for \$30 payable to the reinsurer. The support for the entry will be contained in accounting files, but there may be no electronic capture of the detailed individual entries for premiums, commissions, and losses with corresponding payables and receivables. If there is a funds held agreement, the issue becomes more complicated in that there may be no exchange of cash at all until either the funds held are depleted or contractual terms dictate a release of funds held to the reinsurer. This could distort the extent to which historical write-off experience is directly relevant to future write-offs for those using an experience-based method.

Note that these rights of offset may extend across multiple contracts between the two parties, allowing in some cases for netting receivables from one contract against payables from another. Such netting across contracts is assumed in the NAIC P&C RBC formula (and in Schedule F—Part 3), which makes the assumption that offsetting impacts at the balance sheet date will hold for the future runoff of ceded balances.

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<sup>27</sup> Some treaties may be worded in a manner that presumes that the full layer of the reinsurance will be placed, even if only a portion was ultimately placed. For example, the treaty may say that X% of the certain layer is ceded, with the participation by various reinsurers listed in an addendum to the contract, but with the layers in the addendum not adding up to the full amount listed in the contract.

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### **Billing lags**

Reinsurance contracts, unlike most consumer loan contracts, are typically individually negotiated contracts among the ceding and assuming parties.<sup>28</sup> Contractual provisions governing reporting of results and remission of funds differ widely among reinsurance contracts. Whereas in the U.S. market, the parties generally exchange information no less than quarterly, annual reporting is not unusual in the international marketplace. Not only does reporting frequency vary among reinsurance contracts, but reporting/settlement deadlines vary as well. Where some contracts may require reporting and settlement in as little as 10 days following the close of a month or quarter, 90-day provisions are not unusual, particularly in older historical periods before the process became more automated.

Billing lags can also exist where the contract allows for immediate billing after a covered payment. One cause of such lags may be the complexity of the reinsurance contract. The contracts can contain language not suitable or cost-effective for mechanization in the ceding company's systems. Instead, a manual effort may be required, leading to a delay of weeks or months. The cession may also require suitable documentation to accompany the billing, further increasing the lag between the direct payment and the ceding loss billing.

For latent liabilities, the cessions may also first require research into a ceded reinsurance program purchased decades ago. This may require searches into file archives and educating both the ceding company employees and the reinsurers as to the terms of the old contracts, including verification that the particular direct policy/claim was covered by the reinsurance contract. Depending on the volumes involved, these efforts may overwhelm the available resources for both the ceding and assuming companies. Billing lags can be as long as a year in some cases.<sup>29</sup>

In summary, one may not be able to compare ceded amounts to direct amounts from the same period—some adjustment may be needed to obtain a reasonably accurate ceded-to-direct comparison.

### **Procedural issues (consistency between gross, ceded, and URR)**

In establishing a provision for URR, insurance/reinsurance company processes are an important consideration. Within the governance structure of U.S.-based companies, it is the responsibility of the reserving actuary to present to management actuarial estimates of reserve needs. Management determines their estimate for booking purposes based on this input, but also on other input, including their own judgment. As a result, management's estimate may (or will likely) differ from those recommended by their actuaries, at least to some degree.

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<sup>28</sup> Mandatory pools and reinsurance facilities associated with involuntary markets are a notable exception in that they are not negotiated among the assuming and ceding entities. Rather, participants are required to accept the terms of the ceding entity by law, statute, or regulation.

<sup>29</sup> Even longer billing lags are possible. For example, an insurer may agree to resolve a dispute in a way that accelerates payment. The reinsurer may contest that acceleration as being extra-contractual, outside the terms of the reinsurance agreement, and only agree to pay cessions on a pro-forma basis, i.e., based on what would have been paid on a direct basis (and thereby triggering a cession) if the acceleration had not taken place.



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Seemingly small differences in the estimates of management and the reserving actuaries with regard to gross reserves can have a significant impact on ceded reserves. The actuarial indication for URR may therefore require material adjustment when applied to booked cessions. A process may need to be developed to account for this portion of the closing process.

### **Procedural issues (commutations)**

There may also be procedural issues with regard to commutations. Commutations may be treated separately in a company's accounting system from write-offs, or may be included in the write-off category. Some commutations also can occur for expediency purposes (e.g., to eliminate drawn-out future monitoring and billing procedures on old contracts) or due to option clauses under current contracts. Neither of these last two cases (i.e., expediency and contract clauses) would seem to fit the category of uncollectible reinsurance. Also, as mentioned earlier, it may be difficult or impossible to distinguish between commutations for dispute reasons versus credit reasons.

### **Current data sources on uncollectible risk and associated issues**

There are actually at least three data sources that should already be readily available to cedents attempting a URR valuation. Each of these are discussed below:

- **Note 23 of the statutory annual statement**—This note has sections for discussion of reinsurance disputes and for amounts written off as uncollectible during the year, including the names of the reinsurers (restricted just to those above a certain size with regard to disputes). Issues associated with this data source include the disclosure of just the current year's disputes/write-offs in each year's disclosure, the lack of any standardization in the form of the disclosure, and whether the write-off history is indicative of the future risk in the case of an evolving ceded reinsurance strategy or book.
- **Schedule F**—Starting with year-end 2018 this schedule has been substantially revised, showing many different data fields for all a cedent's reinsurers, no matter how small. Issues associated with this data source include the reliability of the ceded IBNR allocation to reinsurer, the point-in-time nature of the disclosure (e.g., it shows the held collateral by reinsurer for the reported year-end, but not how that value has changed or might change in the future), and the naming conventions that may exist for the entries. With regard to that last point, the same reinsurer may be listed several times under several different names in the same Schedule F, or the listing may show the reinsurer's name at the time of the original contract but not the current name.<sup>30</sup>
- **Risk-Based Capital filing**—Starting with year-end 2018 the RBC charge for P&C reinsurance credit risk was based on the ceded balances by credit rating (disclosed in the new Schedule F), net of collateral. The source for this charge may be very helpful in at least some URR estimation methods. Issues associated with this data include the lack of ratings for certain types of companies (e.g., runoff companies and captives), the reliance of this charge on the allocation of ceded IBNR to reinsurer (mentioned above with regard to Schedule F), and the lack of any ceded billing pattern for the ceded balances shown in the source data (which is a material deficiency, as credit risk rises with time for a given rating).

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<sup>30</sup> Note that Schedule F includes ceded unearned premium reserves in its calculation of total ceded reinsurance balances. Such balances are not typically included in the calculation of the URR.

### 7. **What if a company has only a few reinsurers?**

Estimating the URR poses several challenges for companies with only a few reinsurers. First, the more limited the number of reinsurers, the more any URR analysis is more of a series of binary scenarios and less an application of the law of large numbers. In the most extreme case, if there is only one reinsurer, the URR estimate is akin to a bet on the solvency of that single insurer.<sup>31</sup>

The new GAAP guidance attempts to address this situation. Per FASB 326-20-30-10:

*“An entity’s estimate of expected credit losses shall include a measure of the expected risk of credit loss even if that risk is remote, regardless of the method applied to estimate credit losses. However, an entity is not required to measure expected credit losses on a financial asset (or group of financial assets) in which historical credit loss information adjusted for current conditions and reasonable and supportable forecasts results in an expectation that nonpayment of the amortized cost basis is zero. ...”*

Some items to consider include the number of reinsurers, credit rating of the reinsurer, length of time until payment is made, and amount/type of collateral. For example, if there are a limited number of reinsurers with excellent credit ratings and the reinsurance relates to shorter tailed lines, it might be reasonably determined that based on current conditions, the ultimate expected uncollectible amount is zero. The longer the length of time that it takes until the payment is made, the greater the chance that a reinsurer’s current financial strength will change.

If it is determined that the ultimate expected uncollectible amount is likely to be greater than zero, the company may be able to use its historical data on previous ceded amounts written off (although there still may be an issue in determining whether the write-offs were due to credit defaults or disputes). However, as noted earlier, companies with a limited number of reinsurers may not have experienced uncollectible amounts in the past. Thus, company data may not be useful for analysis.

Hybrid situations may exist whereby part of an insurer’s business may involve many reinsurers and have a credible volume of previous ceded reinsurance write-offs (e.g., a runoff Asbestos & Environmental book), while the rest of the insurer may fit the zero-URR scenario described above. Note that the decision as to whether a URR needs to be booked (or not) is ultimately an accounting decision and not an actuarial decision.

### 8. **Statutory implications**

As mentioned previously, U.S. Statutory accounting standards (U.S. Stat) generally starts from the base of U.S. GAAP standards as issued by the FASB, with the NAIC reviewing any new GAAP guidance for possible inclusion (in full or part) into U.S. Stat. The NAIC also has the option of rejecting outright any new FASB pronouncement with regard to U.S. Stat. Currently one feature of U.S. Stat is the inclusion of

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<sup>31</sup> Note that this only addresses credit risk. Dispute risk on one or more individual claims may still be a possibility, although disclosure of a nonzero URR where the cedent only deals with a single reinsurer may result in public disclosure of the dispute risk valuation. This may cause concerns.

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the URR in the net loss reserve, with the additional requirement that write-offs of previous ceded loss balances are to be recorded in the claim/loss accounts.<sup>32</sup>

According to the NAIC statement of actuarial opinion instructions:

*“The Appointed Actuary’s comments on reinsurance collectability should address any uncertainty associated with including potentially-uncollectable amounts in the estimate of ceded reserves. Before commenting on reinsurance collectability, the Appointed Actuary should solicit information from management on any actual collectability problems, review ratings given to reinsurers by a recognized rating service, and examine Schedule F for the current year for indications of regulatory action or reinsurance recoverable on paid losses over ninety (90) days past due. The comment should also reflect any other information the Appointed Actuary has received from management or that is publicly available about the capability or willingness of reinsurers to pay claims. The Appointed Actuary’s comments do not imply an opinion on the financial condition of any reinsurer.”*

Actuarial Standard of Practice (ASOP) No. 36<sup>33</sup> section 3.4 states that the actuary should identify *“whether the potential for uncollectible recoverables is considered in the reserves, when recoverables are involved and, if so, the categories of such uncollectible recoverables considered and whether those categories reflect currently known collectibility concerns or potential ultimate collectibility concerns. Possible categories of uncollectibles include those related to disputes and those related to counterparties in financial difficulty (credit default);”*

To the extent that the loss reserve is based on an ultimate valuation, some would argue that the URR should follow the same basis. However, (as mentioned earlier) current practice seems to be to treat the URR the same for both U.S. GAAP and U.S. Statutory. The ASOP No. 36 excerpt above appears to address this potential ambiguity in its direction to opening actuaries to identify whether certain items *“reflect currently known collectibility concerns or potential ultimate collectibility concerns”*. .

As of June 2019, the NAIC was reviewing the new GAAP requirements and had not issued a final decision on whether statutory requirements will change to match the new GAAP requirements.

## 9. **Additional considerations**

The following topics may warrant additional discussion/consideration when implementing the new GAAP standard.

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<sup>32</sup> Under USU.S. Stat, when a reinsurer is billed for a ceded loss, the ceding company registers this as a negative paid loss. When that billed amount is then written off as uncollectible, the negative paid loss is reversed via a positive paid loss entry.

<sup>33</sup> ASOP No. 36 is titled *Statements of Actuarial Opinion Regarding Property/Casualty Loss and Loss Adjustment Reserves*.

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a. Unit of account considerations

The level of granularity for the URR estimation can be an important consideration. While contract by contract, or reinsurer by reinsurer, may be too granular for an IBNR-type calculation (such as an estimate of ultimate uncollectibility), some level of granularity below the total ceded balance may be desirable. Possibilities include grouping treaties or reinsurers by similar risk profile, or grouping ceded balances by line or loss type (such as long-tail Workers' Compensation or latent liabilities, due to similarities as to payment patterns or dispute risk). A common approach currently for required capital measures is to group ceded balances by reinsurer rating (e.g., NAIC RBC). The level of granularity will impact the data requirements and the resources required for the evaluation.

The unit of account will also be impacted by the business structure. Primary writers with hundreds of thousands (or millions) of direct policies and dozens (or hundreds) of reinsurers over time may use a broader unit of account, while professional reinsurers with fewer gross contracts and retrocessions may use a more granular unit of account.

Financial reporting requirements require that the final URR balance be assigned or allocated to accident year (to the extent net reserves are disclosed by accident year) and line of business. (Approaches for doing so are beyond the scope of this paper.)

b. Residual market cessions ("Mandatory pools")

Many residual market mechanisms in the U.S. take the form of reinsurance, with both cessions to the residual market pool and assumptions from the pool.

Cessions can occur both from facility arrangements, whereby insurers cede certain (unwanted?) risks to the pool, and from servicing carrier arrangements, whereby those obtaining insurance via the involuntary market are assigned to a carrier that services the account and cedes 100% to the pool. These pools generally are quasi-governmental, backed by the full voluntary industry. As a result, the uncollectibility risk for such cedes is essentially nil. This would encourage those determining a URR reserve to treat residual market cessions separately, probably as a credit risk-free cession.

Credit risk can exist for such residual market mechanisms, but the risk would be on the assumed side and not the ceded side of these arrangements. For many such mechanisms, the insolvency of a pool participant leads to an increased share for the remaining solvent participants to make up the shortfall. This is not under the scope of the new FASB standard.

c. Enterprise Risk Management (ERM)

As the URR is part of the GAAP financial statements, it will be of interest to any ERM function that monitors or models GAAP results.

The URR (or the risk that it represents) may also be reflected in capital modeling and in determining the capital requirements for the line(s) using the reinsurance that underlies the URR. It is not uncommon for the reinsurance purchase evaluation to be based *a priori* on

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reinsurer rating, using a rating matrix akin to bond quality. This may be most relevant for lines or business models that are more heavily dependent on external reinsurance. The creation of a URR based on ultimate uncollectibility may cause that evaluation to be revisited, resulting in a different assessment of the value of the reinsurance from the perspective of the buyer.

To the extent the held URR is now calculated and booked anticipating ultimate uncollectibility where previously it only reflected known impairments, the amount of loss from a given tail event may be reduced.<sup>34</sup>

d. Insurance-Linked Securities (ILS)

Reinsurance via insurance-linked securities (ILS), such as catastrophe bonds, have some unique features with regard to the URR calculation. These include the following:

- Reinsurance via a Single Purpose Vehicle (SPV) intermediary—For those ILS transactions accounted for as reinsurance, an intermediary is established that provides the reinsurance protection. That intermediary exists only for the purpose of that reinsurance transaction, with no other purpose. The intermediary issues bonds to raise funds that are held as collateral and invested. If losses don't occur, then those investments along with the reinsurance premium are used to pay back the bondholders. If losses do occur, those investments are used to pay the reinsurance claim, thereby defaulting on the bonds.
- The ceded balance from the insurer utilizing this form of reinsurance is solely in the form of a ceded unearned premium until and unless a covered loss occurs. That ceded unearned premium balance is not coded as a "reinsurance recoverable" under U.S. GAAP, hence is not within the scope of the new ASU. Only if a loss occurs is there a reinsurance recoverable balance under the scope of the new ASU.<sup>35</sup>
- That ceded loss if it does occur is then fully collateralized, but with no other source of recovery. As such, the uncollectibility risk is solely a function of the collateral quality.<sup>36</sup>

e. Other reinsurance balances

The ASU defines reinsurance receivables (on page 107) as strictly relating to claim and claim adjustment expenses. That said, the ASU also requires an estimate of ultimate uncollectibility for other "trade receivables." Such receivables relative to reinsurance may include:

- Premiums receivable under assumed reinsurance

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<sup>34</sup> This is because the URR under an ultimate uncollectibility standard would be larger or more conservative than that based only on known impairments. The more conservative the held liability for an item, the smaller the capital need for adverse development on that liability.

<sup>35</sup> Note that Schedule F of the USU.S. Statutory Statement for P&C insurers does include the ceded unearned premium with ceded losses. Hence while a USU.S. GAAP URR may not need to consider ceded balances from an ILS (unless a covered loss occurred), the situation will be different for a statutory URR with regard to ILS.

<sup>36</sup> This presumes the collateral is not released until the possibility of adverse emergence ends. Otherwise the risk is premature release of the collateral.

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- Contingent commissions receivable under both assumed and ceded reinsurance
- Funds held, including both the nominal fund and interested credited
- Retrospective premium adjustments
- Other contractual features impacting cash flows between ceding and assuming company

Custom treaty-level cash flow modeling may be needed to adequately address these items, especially where right of offset exists.

**10. Which actuarial standards may apply to this work?**

An actuary working on determining the appropriate treatment of the uncollectible reinsurance reserve may want to review ASOPs<sup>37</sup> Nos. 43, 38, and 36.

*ASOP No. 43, Property/Casualty Unpaid Claim Estimates, “applies to actuaries when performing professional services related to developing unpaid claim estimates. ... This standard applies to estimates of gross amounts before recoverables ... and estimates of amounts of such recoverables.”*

*ASOP No. 38, Using Models Outside the Actuary’s Area of Expertise (Property and Casualty), “applies to actuaries who use models that incorporate specialized knowledge outside of the actuary’s own area of expertise when performing professional services.”* The applicability of this ASOP will depend on the method used to calculate the URR. An actuary who bases the calculation on write-off history and historical default rates by financial strength rating by rating agencies may be comfortable that such work falls within his or her area of expertise, whereas an actuary who bases the calculation on a survival model developed elsewhere in the organization or externally may decide that ASOP No. 38 applies.

*ASOP No. 36, Statements of Actuarial Opinion Regarding Property/Casualty Loss and Loss Adjustment Expense Reserves,* may also be considered (as mentioned earlier), as any anticipated cession that turns out to be uncollectible will result in adverse reserve development, unless the write-off is already covered by the URR.

In addition, various other ASOPs may apply, such as the cross-practice standards on data (ASOP No. 23) and communications (ASOP No. 41).

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<sup>37</sup> The ASOPs, or Actuarial Standards of Practice, may be found at the website of the Actuarial Standards Board: <http://www.actuarialstandardsboard.org/standards-of-practice/>.

**APPENDIX 1—Why did ASU 2016-13 (with its main focus on financial instruments) include the uncollectible reinsurance reserve (URR) in its scope?**

At one time<sup>38</sup> the standard now known as IFRS 17 was a joint project between the International Accounting Standards Board (IASB) and the FASB. At that time, the FASB was considering how to treat uncollectible reinsurance in the proposed new insurance accounting standard. Possibly to simplify their task somewhat, the FASB decided during those deliberations to exclude the URR from the scope of their new proposed insurance standard, and to address those issues instead in their later discussion of financial instrument impairments. That decision to address the URR in their discussion of financial instrument impairments continued through to the final standard on such impairments, even after the FASB had decided to drop their project on short-duration insurance accounting. (Instead of a brand-new FASB standard for short-duration insurance contracts, the FASB issued ASU 2015-09 focusing solely on additional disclosures to accompany the current short-duration insurance financial statements.)

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<sup>38</sup> Per the 2013 FASB Exposure Draft dated June 27, 2013, the FASB decided in October 2008 to work with the IASB on a joint insurance accounting project. Based on the feedback to the FASB from the 2013 exposure draft, that effort ceased to be a joint effort. The IASB went on to produce IFRS 17, while the FASB focused instead (for short-duration contracts) on just enhancing the current disclosure requirements. Note that generally all P&C insurance contracts fit under the FASB definition of short duration.

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**APPENDIX 2—New GAAP disclosures under ASU 2016-13.**

The new GAAP requirements include various new disclosure requirements. Below is an attempted paraphrase of those requirements along with the paragraph within the ASU where the listed requirement may be found. The reader is cautioned that this summary is not to be treated as definitive, and any practitioner should contact the accounting experts in charge of the disclosure for a more definitive list.

Notes:

1. The original version of the ASU includes reinsurance receivables under the category of financial instruments on an “amortized cost basis.” That categorization may be changed at some point.
2. The ASU uses the term “credit quality indicator.” The list below translates that to “rating,” presuming that the most common credit quality indicator will be a financial strength or claims paying rating.

New disclosures

- Reinsurance Receivables by rating. (326-20-50-5b)
- Source of the rating used for these receivables (e.g., AM Best) (326-20-50-5a)
- The date or range of dates for when those ratings were last obtained or updated. (326-50-50-5c)
- If internal ratings are used, qualitative information on how the ratings relate to the likelihood of loss (326-20-50-8)
- The URR methodology (326-20-50-11a,b)
- Reinsurance Receivable risk characteristics (326-20-50-11c)
- Roll-forward of the URR from beginning of the reporting period to the end of that period, including
  - Beginning balance (326-20-50-13a)
  - Current period provision (326-20-50-13b)
  - Write-offs during the period (326-20-50-13d)
  - Recoveries of amounts previously written off (326-20-50-13e)
  - Ending balance (326-20-50-13f)

*Note that there does not seem to be any requirement to show current vs. prior accident year values.*

- The reason for significant changes in the amount of write-offs, if applicable (326-20-50-11f)
- Aging analysis of past-due amounts, including description of when an insurer would consider an amount to be past-due (326-20-50-14)