AMERICAN ACADEMY *of* ACTUARIES

PROPOSED SURVEY ON RISK TRANSFER FOR FINITE REINSURANCE PRODUCTS

REPORT TO THE NAIC CASUALTY ACTUARIAL TASK FORCE

American Academy of Actuaries
P/C Risk Transfer Subgroup

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In April 2005, the National Association of Insurance Commissioners' (NAIC) Casualty Actuarial Task Force (CATF) requested assistance from the American Academy of Actuaries in evaluating the current industry practices regarding the evaluation of risk transfer for property and casualty reinsurance products.

One area of assistance involved the development of a survey, for which the NAIC would submit and request responses from insurance companies. We are responding to this request with the proposed survey questions listed below. We understand that the CATF will review this proposed survey and provide us with an opportunity to comment upon any changes.

Attached as a second document is a listing of possible topics that CATF may want to consider in drafting a cover letter that would accompany the survey.

<u>Background Questions</u>

1. For year-end 2004, provide the following background information for your group of companies:

   Net Premium Volume: (a) under $200 million, (b) $200 million to $2 billion, and (c) $2 billion or greater.

   Policyholder Surplus: (a) under $100 million, (b) $100 million to $1 billion, and (c) $1 billion or greater.

   Type of company: (a) mutual, (b) stock company that is publicly traded or part of a group that is publicly traded, (c) stock company that is not publicly traded

2. Is your group's definition of Finite contracts substantially similar to that defined in the cover letter? Y/N. If No, provide your group's definition of Finite. ______________________

3. Does your group's definition of Finite consider contracts containing the following features to be Finite? List all that apply.

   (a) quota shares with sliding scales and/or retained loss corridors of less than 10 loss ratio points
   (b) quota shares with sliding scales and/or retained loss corridors of more than 20 loss ratio points
   (c) quota shares with aggregate loss ratio caps
   (d) funds withheld arrangements coupled with experience refund accounts
   (e) contracts with commutation clauses with ceding company having unilateral right to commute that, at inception, it is viewed as likely the ceding company would commute the contract shortly after the exposure period expires
   (f) retroactive reinsurance
   (g) whole account stop loss or aggregate reinsurance covers
   (h)contracts that cover more than one year

(i) contracts where the ratio of premium to maximum reinsurer's loss is greater than a given percentage
(j) treaties with retrospective premium adjustments (other than property catastrophe covers, or per risk covers)
(k) N/A

4. Has your company entered into material <u>assumed</u> reinsurance contract(s) in the past four years that your group would consider to be a Finite product? Y,N

5. Does your group of companies have a business unit or segment that is designed to reinsure Finite products? Y,N

6. Has your company entered into material <u>ceded</u> reinsurance contract(s) in the past four years that your group would consider to be a Finite product? Y,N

<u>Criteria</u>

7. Does your company have a formal written policy regarding the evaluation of reinsurance accounting and the application of appropriate accounting rules and regulations to its ceded reinsurance products? Y,N,N/A

8. Does your company have a formal written policy regarding the evaluation of reinsurance accounting and the application of appropriate accounting rules and regulations to its assumed reinsurance products? Y, N, N/A

9. Does your policy include mandatory signoff on each assumed or ceded contract from (a) regulatory authorities (Y,N) and (b) auditors (Y,N)?

10. Are there classes of contracts that you deem to be clearly reinsurance and which therefore do not require detailed review to determine risk transfer or appropriate accounting treatment? Y,N

11. For ceded reinsurance, which reinsurance contracts are reviewed in detail for accounting treatment and risk transfer?

    (a) all ceded reinsurance contracts,
    (b) material ceded reinsurance contracts,
    (c) material non-catastrophe ceded contracts,
    (d) contracts having one or more non-traditional contract features (e.g., experience refund accounts, NPV caps, etc.)
    (e) only those contracts that are viewed to be "Finite",
    (f) some blend of the above,
    (g) none or N/A

12. For ceded reinsurance, what documentation is typically contained in the contract file? Check all that apply.

    (a) relevant correspondence between the parties
    (b) each draft of the contract
    (c) risk transfer calculation
    (d) memorandum from management describing the business purpose of the contract and other relevant concerns
    (e) sign-offs of accounting treatment from internal accounting management
    (f) sign-offs of risk transfer analysis from internal actuarial management
    (g) sign-off from regulator and/or auditor.

13. For assumed reinsurance, which reinsurance contracts are reviewed in detail for accounting treatment and risk transfer?

    (a) all assumed reinsurance contracts,
    (b) material assumed reinsurance contracts,
    (c) material non-catastrophe assumed contracts,
    (d) contracts having one or more contract features (e.g., experience refund accounts, NPV caps, etc.)
    (e) only those contracts that are viewed to be "Finite",
    (f) some blend of the above,
    (g) none or N/A

14. For assumed reinsurance, what documentation is typically included in the contract file? Check all that apply.

    (a) relevant correspondence between the parties
    (b) each previous draft of the contract
    (c) risk transfer calculation
    (d) memorandum from management describing the business purpose of the contract and other relevant concerns
    (e) sign-offs of accounting treatment from internal accounting management
    (f) sign-offs of risk transfer analysis from internal actuarial management
    (g) sign-off from regulator and/or auditor.

<u>Risk Transfer Testing and Threshold</u>

15. Does your company have a formal written policy regarding the evaluation of risk transfer for its ceded reinsurance products? Y,N,N/A

16. Does your company have a formal written policy regarding the evaluation of risk transfer for its assumed reinsurance products? Y, N, N/A

17. For most or all ceded reinsurance meeting the criteria discussed in question (8), is the evaluation of risk transfer led by (a) internal actuaries, (b) the underwriter, (c) accounting department, (d) external actuaries, (e) the intermediary, (f) the counterparty to the transaction, (g) other ______________________________?

18. For most or all assumed reinsurance meeting the criteria discussed in question (12), is the evaluation of risk transfer led by (a) internal actuaries, (b) the underwriter, (c) accounting department, (d) external actuaries, (e) the intermediary, (f) the counterparty to the transaction, (g) other _______________?

19. For ceded reinsurance contracts, what type of testing is performed in the evaluation of risk transfer for contracts meeting the criteria discussed in question (10)?(Check all that apply) (a) stochastic testing simulating results under many scenarios, (b) confidence level testing, (c) review of historic results, (d) the development of a single scenario via judgment that could be viewed as reasonably possible (e) other _______________

20. Which of the types of testing listed in Question (18) is predominately used? (a) stochastic testing simulating results under many scenarios, (b) confidence level testing, (c) review of historic results, (d) the development of a single scenario via judgment that could be viewed as reasonably possible (e) other _______________

21. Which of the following risks are explicitly considered in the calculations used to evaluate risk transfer? (Check all that apply)
    (a) Process risk
    (b) Parameter risk
    (c) Timing risk / acceleration of payout patterns
    (d) Other ________

22. Does your group compare actual results under contracts to expectations from the risk transfer calculations? (Y,N) If yes, over many contracts, do actual results suggest:

    (a) more actual risk transfer or variation in results than expected from risk transfer calculations,
    (b) actual risk transfer or variation in results approximately estimated to be the same as those expected from risk transfer calculations,
    (c) less actual risk transfer or variation in results than expected from risk transfer calculations,
    (d) unknown

23. For both ceded and assumed contracts, what models are used to evaluate risk transfer for most or all contracts? (a) an internally-developed model, (b) an externally-developed model, (c) a separate spreadsheet-based model for each contract.

24. Which of the following describes the approach you use to equate a numerical criteria to the risk transfer standard of a reasonable possibility of a significant loss:
    (a) Each part of the standard is equated to a single percentage which is applied consistently across all tested contracts

(b) As in (a) but excluding some or all property catastrophe coverages
(c) As in (a) but the standard is a guideline rather than an absolute and exceptions are made based on other appropriate considerations
(d) Numeric calculations are the starting point for a judgmental assessment of risk transfer
(e) Other ________________

25. If the answer to question 23 was (a) or (b) or (c) what numerical criteria equates to a reasonable possibility of significant loss for most contracts?

(a) a 10% chance of a 10% loss
(b) a 10% chance of a 15% loss
(c) a 15% chance of a 10% loss
(d) a 15% chance of a 15% loss
(e) a 1% expected value loss (i.e., 10% chance times a 10% loss)
(f) a 10% expected value loss
(g) other ________________

Results, Disclosure

26. Do your financial statements and/or related disclosures describe your company's accounting policy as it regards accounting and risk transfer evaluation for Finite reinsurance products? Y,N,N/A

27. Does your group account for any ceded finite products as a deposit? Y,N,N/A

28. Does your group account for any assumed finite products as a deposit? Y,N,N/A

29. For ceded Finite products, how does your internal accounting policy treat the topic of bifurcation (i.e., having different accounting treatments for the insurance and financing portions of Finite contracts):

(a) contracts are not bifurcated as a matter of policy. If there is risk transfer, then the entire contract is accounted for as reinsurance.
(b) for those contracts where it is practical, the accounting for Finite ceded contracts is bifurcated into insurance and financing components.
(c) bifurcation is only applied if the contract contains separable coverage elements that have readily estimatable market values.

30. What disclosures are made in your financial statements regarding ceded reinsurance for material Finite products?

(a) No explicit disclosures; contracts are treated the same as other reinsurance arrangements for purposes of disclosure in financial statements
(b) There are explicit disclosures - - however, such disclosures are not deemed sufficient for a user of

the financial statements to clearly and fully understand the impact to the financial statements of such contracts
(c) There are explicit disclosures, and such disclosures are deemed sufficient for a user of the financial statements to clearly and fully understand the impact to the financial statements of such contracts

NAIC Survey Cover Letter
Suggested Points

- Background
- Purpose of survey
- Deadlines
- Confidentiality
- Clarification on how survey is to be filled out
    - There are many potential definitions of Finite reinsurance. The following definition is based on one developed by the AICPA, as provided in a FASB Alert from April 2005, "Accounting by Noninsurance Enterprises for Property and Casualty Insurance Arrangements That Limit Risk" may be of interest to COPLFR. . For purposes of this questionnaire, please assume this definition of finite reinsurance unless your company has an established usage which is different:

      Finite reinsurance contracts are contracts that transfer a clearly defined and restricted amount of insurance risk from the cedant to the reinsurance company, and the cedant retains a substantial portion of the related risks under most scenarios. Nevertheless, under certain finite contracts there may be a reasonable possibility that the reinsurance company will incur a loss on the contract.

    - If your group has more than one entity, answer with respect to the largest US statutory reporting entity

    - Answer with respect to current policy and practice within your group. Answers should correspond to how you would treat a contract that you might enter into in 2005.

    - The questions are meant to solicit your general practice, with the understanding that there may be legitimate exceptions to your general practice.