

Statutory Issue Paper No. 88

Mortgage Guaranty Insurance

STATUS

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Original SSAP and Current Authoritative Guidance: SSAP No. 58

Type of Issue:

Property and Casualty

SUMMARY OF ISSUE

1. Mortgage guaranty insurance protects a lender against loss of all or a portion of the principal amount of a mortgage loan upon default of the mortgagor. It differs from other types of property and casualty insurance in that coverage is long-term, and in most cases premiums are level and paid monthly. Most states require issuers of mortgage guaranty contracts to be monoline insurers and impose limitations on the aggregate amount of risk insured based on geographic territories. Additionally, states may limit mortgage guaranty insurers to reinsure with only selected reinsurers.

2. Current statutory guidance for issuers of mortgage guaranty insurance contracts is provided in Appendix A of the Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies (P & C Accounting Practices and Procedures Manual) and the Mortgage Guaranty Insurance Model Act.

3. Although GAAP guidance for mortgage guaranty insurance is provided in *FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises* (FAS 60), certain aspects of accounting for mortgage guaranty insurance contracts are specifically excluded from FAS 60. The aspects of FAS 60 not applicable to mortgage guaranty insurance relate to premium revenue, claims cost recognition, and acquisition costs.

4. To fill this void in GAAP, the AICPA exposed a draft statement of position in October 1980. The statement of position proposed that premiums be recognized evenly over the anticipated policy term. Costs of acquiring business such as salaries and commissions, generally would be deferred and amortized as the related premiums were earned. Losses on claims, including expenses of settlement, such as appraisal fees, generally would be recognized as of the initial default date.

5. The statement of position was never issued and there has been no further GAAP guidance relating to accounting for premium revenue and claims cost recognition and acquisition costs relating to mortgage guaranty insurance contracts.

6. Although there is no promulgated GAAP guidance, common practice is to recognize revenue as follows:

- a. For single premium plans, revenues are recognized over the policy life in relation to the expiration of risk;
- b. For annual premium plans, revenues are earned on a pro rata basis over the applicable year;

- c. For monthly premium plans, revenues are earned either in the month received or the month due.

7. Losses and loss adjustment expenses are generally recognized on the default date regardless of when claims are reported to the insurer.

8. The purpose of this issue paper is to establish statutory accounting principles for recording premium revenue and the liability for unpaid losses and loss adjustment expenses that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).

SUMMARY CONCLUSION

Premium Revenue Recognition

9. Written premium shall be recorded in accordance with *Issue Paper No. 53—Property and Casualty Contracts - Premiums* (Issue Paper No. 53). Premium revenue shall be earned as follows:

- a. For single premium plans, revenues shall be earned over the policy life in relation to the expiration of risk;
- b. For annual premium plans, revenues shall be earned on a pro rata basis over the applicable year;
- c. Additional first year premiums on nonlevel policies shall be deferred and amortized to income over the anticipated premium paying period of the policy in relation to the expiration of risk;
- d. Initial renewal premiums that are higher than subsequent renewals shall be deferred and amortized over the remaining anticipated premium paying period in a manner consistent with additional first year premiums (i.e., in relation to the expiration of risk);
- e. For monthly premium plans, revenues shall be earned in the month to which they relate.

10. When the anticipated losses, loss adjustment expenses, commissions and other acquisition costs, and maintenance costs exceed the recorded unearned premium reserve, contingency reserve, and the estimated future renewal premium on existing policies, a premium deficiency reserve shall be recognized by recording an additional liability for the excess deficiency with a corresponding charge to operations. Commission and other acquisition costs need not be considered in the premium deficiency analysis since they have previously been expensed. If an insurer utilizes anticipated investment income as a factor in the premium deficiency calculation, disclosure of such shall be made in the financial statements.

Unpaid Losses and Loss Adjustment Expense Recognition

11. Unpaid losses and loss adjustment expenses shall be recognized in accordance with *Issue Paper No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses* (Issue Paper No. 55). For mortgage guaranty insurance contracts, the date of default shall be considered the incident that gives rise to a claim as discussed in Issue Paper No. 55. If a claim is ultimately presented, the date of default shall be considered the loss incurred date.

12. The process for estimating the liability shall include projections for losses that have been reported as well as those that have been incurred but not reported. The estimates shall be made based on historical data, trends, economic factors, and other statistical information including paid claims, reported losses, insurance in force statistics, and risk statistics.

13. Real estate and mortgages are acquired by mortgage guaranty insurers to mitigate losses. These assets shall be shown on the balance sheet at the lower of cost or net realizable value, net of encumbrances. Any gains or losses from the holding or disposition of these assets shall be recorded as a component of losses incurred. Any rental income or holding expenses shall be included in loss adjustment expenses.

Contingency Reserve

14. In addition to the unearned premium reserve, mortgage guaranty insurers shall maintain a liability referred to as a statutory contingency reserve. The purpose of this reserve is to protect policyholders against loss during periods of extreme economic contraction. The annual addition to the liability shall equal 50% of the earned premium from mortgage guaranty insurance contracts and shall be maintained for ten years regardless of the coverage period for which premiums were paid. With commissioner approval, when required by statute, the contingency reserve may be released in any year in which actual incurred losses exceed 35% of the corresponding earned premiums. Any such reductions shall be made on a first-in first-out basis. Changes in the reserve shall be recorded directly to surplus.

Disclosures

15. Mortgage guaranty insurers shall make all disclosures required by other issue papers within the codification, including but not limited to the requirements of Issue Paper No. 55, and *Issue Paper No. 77—Disclosures of Accounting Policies, Risks & Uncertainties, and Other Disclosures*.

DISCUSSION

16. This issue paper is not consistent with current statutory guidance as follows:

- a. Premium Recognition
 - i. The P & C Accounting Practices and Procedures Manual distinguishes premiums for high risk policies from other policies. The conclusions reached in this issue paper make no such distinction because the concept is implicit in the requirement to earn revenues in relation to the expiration of risk.
 - ii. Certain states dictate by statute that a specific formula, table, or earnings curve be utilized to determine earned premiums. To the extent that the requirements are based on the exposure period and the relative risk during that period, they are consistent with the concepts set forth in this issue paper.
 - iii. The Mortgage Guaranty Insurance Model Act provides no specific guidance on premium revenue recognition other than the requirement to establish an unearned premium reserve. The method of establishing such reserve is based on regulation of the state of domicile.
 - iv. Current statutory guidance has no requirement to establish a premium deficiency reserve.
- b. Contingency Reserve

The contingency reserve may be recorded through income or directly to surplus. This issue paper requires changes in the reserve to be recorded through surplus.

- i. The Model Act requires that the contingency reserve shall be computed as an amount equal to 50% of the unearned premium after the establishment of the unearned premium reserve. This issue paper requires the establishment of a contingency reserve based on earned premium. Consistent with the Model Act, this issue paper provides that reserves can be reduced if Commissioner approval is obtained. However, Commissioner approval of a reserve reduction will only be considered as a viable means of reducing a reserve where the reporting entity can clearly demonstrate to the commissioner that the existing reserves are excessive.

17. Issue Paper No. 53 requires recognition of premium on a pro-rata basis over the period of exposure except when specific issue papers require different methods because the level of risk may vary significantly over the exposure period. Losses related to mortgage guaranty policies can occur over an exposure period which extends for the term of the mortgage. The pattern of normal loss incidence is not uniform over the exposure period and tends to peak in the earlier years. This issue paper provides guidance for premium recognition that is based on the exposure period of the contract and the underlying risk. Recognizing premiums over the exposure period and in relation to the underlying risk allows insurers to determine methods appropriate to the contracts they write versus requiring insurers to use methods that may not appropriately reflect such risks. Premiums collected on an annual payment plan may not be sufficient to cover the risk in early years. Subparagraph 9 b. requires annual premiums to be earned over the applicable year and does not permit an insurer to accrue premiums which may be collected in future years. Additional first year premiums and initial renewal premiums that are higher than subsequent renewals may be front loaded to expedite the collection of premium. Subparagraphs 9 c. and 9 d. require an insurer to defer the revenue and amortize it in relation to the expiration of risk.

18. The changes referred to in paragraph 16 were made to improve consistency in reporting among insurers that offer mortgage guaranty contracts as well as to improve consistency in reporting between reporting periods. This is consistent with the Statement of Concepts which states:

Consistency

The regulators' need for meaningful, comparable financial information to determine an insurer's financial condition requires consistency in the development and application of statutory accounting principles. Because the marketplace, the economic and business environment, and insurance industry products and practices are constantly changing, regulatory concerns are also changing. An effective statutory accounting model must be responsive to these changes and address emerging accounting issues. Precedent or historically accepted practice alone should not be sufficient justifications for continuing to follow a particular accounting principle or practice which may not coincide with the objectives of regulators.

19. This issue paper expands current statutory guidance with respect to the recognition of losses. The P & C Accounting Practices and Procedures Manual provides guidance that losses shall be recognized when they occur. This issue paper defines the occurrence date as the date of default of a loan.

20. This issue paper is inconsistent with Issue Paper No. 22 which requires rental income on property to be recorded as investment income whereas this issue paper requires recognition of rental income as a reduction of loss adjustment expense.

21. The inconsistency between mortgage guaranty insurers and all other insurers in the reporting of all real estate obtained through foreclosure and in the recognition of rental income is reflective of the nature of the risks underwritten. Losses on real estate incurred by mortgage guaranty insurers can be viewed as resulting from underwriting activities and not investing activities. Because mortgage guaranty insurers are generally required to be monoline companies, and are prohibited from investing in real estate,

the inconsistency with all property casualty insurers will not hinder evaluation of the mortgage guaranty insurers results.

22. The contingency reserve does not meet the definition of a liability which is set forth in *Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets*. However, it is consistent with the “ultimate objective of solvency regulations” as stated in the Statement of Concepts. This states:

the ultimate objective of solvency regulation is to ensure that policyholder, contract holder and other legal obligations are met when they come due and that companies maintain capital and surplus at all times and in such forms as required by statute to provide an adequate margin of safety.

Additionally, recording the contingency reserve as a liability is consistent with the Statement of Concepts which states:

Liabilities require recognition as they are incurred. Certain statutorily mandated liabilities may also be required to arrive at conservative estimates of liabilities and probable loss contingencies (e.g., excess of statutory reserves over statement reserves, interest maintenance reserves, asset valuation reserves, and others).

23. This issue paper is inconsistent with the guidance set forth in the AICPA exposure draft for mortgage guaranty insurance for the following reasons:

- a. This issue paper requires that acquisition costs shall be accounted for in accordance with *Issue Paper No. 71—Policy Acquisition Costs and Commissions* rather than deferred as indicated in the exposure draft.
- b. Paragraph 14 of this issue paper requires insurers to establish a contingency reserve. The AICPA exposure draft has no such requirement.

24. This issue paper is consistent with Issue Paper No. 55 which requires the ultimate cost of all known and unknown claims as well as related settling costs to be recorded when an insured event occurs.

Drafting Notes/Comments

- U.S. Mortgage Guaranty Tax and Loss Bonds and Contingency Reserve (for tax purposes, the Mortgage Guaranty Account) are addressed in *Issue Paper No. 83—Accounting for Income Taxes*.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

25. Appendix A, Mortgage Guaranty Insurance Accounting Principles Supplement, of the P & C Accounting Practices and Procedures Manual provides the following guidance with respect to accounting for mortgage guaranty insurance: (only pertinent excerpts are included)

Insured Risk

The nature of the insured risk is influenced by certain factors which set the mortgage guaranty insurance product in some respects apart from other types of insurance.

1. Exposure Period

The period of exposure for a particular risk is significantly longer for mortgage insurance than for other property/liability insurance products. The exposure period for mortgage insurance can run for the term of the mortgage; however, the average policy life is seven years. The policy is terminated when the mortgage obligation is satisfied or the lender elects to cancel or not renew the policy.

Mortgage insurance is renewable at the option of the insured and at the renewal rate quoted when the policy commitment was issued. Disability income and certain life and health insurance products are other policies written with similar terms regarding renewal rate and cancellation.

In contrast to mortgage insurance, most property/liability products need not be renewed by the insurer at the expiration of the policy. The fact that mortgage insurance is guaranteed renewable at a definite rate is one of the factors necessitating the establishment of a contingency reserve. In effect, this reserve protects not only against catastrophic economic events, but also against a decrease in the quality of the insurance portfolio because of adverse selection at each renewal period.

2. Losses

The insured peril—the default of a borrower—arises from the credit risk associated with mortgage loans. The frequency of loss is strongly influenced by economic conditions. The likelihood of individual default is further increased if the property has deteriorated since a borrower in financial difficulty will be less able to sell the property at a price sufficient to discharge the mortgage.

Mortgage insurance losses can be divided into three categories:

- (a) Normal losses associated with regular business cycles, interruptions in the borrower's earning power and random errors made in evaluating the insured's willingness or ability to meet mortgage obligations.
- (b) Defaults caused by adverse local economic conditions.
- (c) Widespread defaults caused by a severe depression in the U.S. economy.

The possible magnitude of loss contemplated in the last category has no analogy in any other private property/liability line of insurance.

3. Loss Incidence

Losses are incurred over an exposure period which can, as previously discussed, run for the term of the mortgage. The pattern of normal loss incidence is not uniform over the exposure period. The loss incidence peaks in the earlier years.

When a loan has been delinquent two or four months, the mortgage insurance policy requires the lender to notify the insurer. Further, the lender agrees to institute foreclosure proceedings six to nine months from the date of delinquency. Foreclosure can require an additional 18 months which could mean a considerable delay between the delinquency and the date of the claim. Without adverse economic conditions, most delinquencies do not result in a claim. Once a claim is presented, payment normally is made within one or two months and ultimate loss costs can be known relatively quick. An exception is the case where an insurer chooses to take the title to the property and sell it. Thus, reporting of losses and loss payments occur within the period that title is held by the insurer.

Pool Insurance

In addition to insuring mortgage loans on an individual basis (primary insurance), mortgage guaranty insurance is provided on pools of mortgage loans. Typically, such insurance supports mortgage-backed securities or group sales. Unlike other pool or group products, each loan is individually underwritten.

Pool insurance may be provided on loans that are already insured by primary insurance, in which case the pool insurance provides an additional level of coverage, or it may be provided on loans without primary insurance (usually loans with loan-to-value ratios below 80%). Generally, pool insurance provides 100% coverage and includes a stop-loss limit of liability which may range from 5% to 20% of the initial aggregate principal balance. Because of regulatory requirements in some states, pool insurance usually uses participating reinsurance arrangements to limit the exposure of any one mortgage insurer of a pool of loans to 25% of each mortgage insured.

Pool insurance policies are not cancelable by the insurer except for nonpayment of premium. These policies are generally written on mortgage pools having terms of up to 30 years. However, for all practical purposes, it is expected that the life of each pool will be considerably shorter than 30 years and will result in average policy life of 8 to 12 years. This compares to an individual policy which has an average term of 7 years.

In the case of default, the insurer has the same options as with individual insured mortgage loans. However, pool insurance loss payments are reduced by any settlements under primary insurance and subject to the stop-loss limit.

Three kinds of mortgage-backed securities which use pool insurance are described as follows:

1. Mortgage-Backed Bonds

Issued by banks, savings and loan associations and other mortgage lenders as a general obligation of the issuing institution. These bonds are collateralized by a pool of mortgages and have a stated rate of return and maturity date.

2. Mortgage Revenue Bonds

Issued by state and local housing authorities to support housing affordability for targeted income groups.

3. Mortgage Pass-Through Certificates

Issued by banks, savings and loan associations, mortgage bankers and others providing an undivided interest in a pool of mortgages with principal and interest payment passed to the certificate holder as received.

Special Regulatory Requirements for Mortgage Insurers

1. Risk Ratio

Since the inception of the private mortgage insurance industry in 1957, private mortgage insurers have been required to operate within a 25-to-1 ratio of risk to surplus, a ratio which many state insurance commissioners have determined to be prudent for the protection of lenders. For the purposes of arriving at this risk ratio, the regulatory authorities have defined "risk" as the total amount of exposure (percentage coverage) relating to the insurance in force, and "surplus" as policyholders' surplus (capital, paid-in surplus, and unassigned surplus) plus the contingency reserve.

2. Statutory Contingency Reserve

This is a special statutory reserve designed to protect policyholders against loss during a period of extreme economic contraction. By law, insurers must set aside 50 cents of each premium dollar earned and maintain the contingency reserve for a period of ten years, regardless of the length of coverage of the particular policy for which premium was paid. In most states, with the approval of the insurance commissioner, the contingency reserve may be reduced when losses in a calendar year exceed 35% of earned premiums (20% in some states).

REAL ESTATE

Generally, real estate owned by mortgage guaranty insurance companies consists of two types; (a) properties occupied by the company; or (b) real estate owned as a result of claim settlement. Real estate owned and held for use by the company is accounted for in the same manner as other fire and casualty companies.

Claims Settlement Costs

The cost of real estate acquired in the settlement of claims is similar in computation to that acquired by other insurers through a foreclosure process. Generally the cost of real estate acquired through foreclosure or in settlement of claims includes the outstanding principal balance of the mortgage loan on the date of foreclosure, plus accumulated interest, unpaid real estate taxes, insurance premiums, and all other costs necessary to obtain clear title and place the property in good repair.

If a property acquired in settlement of a claim is rented prior to disposal, the rental income received on such property is recorded as a reduction of loss adjustment expenses. Generally, expenditures for ordinary repairs necessary to maintain the property in good operating condition, utilities, and real estate taxes paid after the acquisition of the property are recorded as loss adjustment expenses. Expenditures for major improvements made to the property are generally capitalized.

Statement Value

The statement value of real estate acquired in settlement of claims is generally accounted for at its net realizable value (the amount of cash, or its equivalent, expected to be realized upon disposal, net of costs such as maintenance and selling expenses required to be incurred prior to sale). In lieu of writing down real estate when realizable value is less than cost, a loss reserve may be established as a liability.

The excess of acquisition cost over realizable value on property disposed of at a later date is recorded to losses paid for the period in which the reduction in realizable value has been determined.

LOSSES

Recognition

The underlying goal of estimating unpaid losses is to have unpaid losses reflect the liability outstanding for losses that have been incurred as of the report date. Losses are recognized as they occur and not as they are reported to the company. Because of this basis of recognition, unpaid losses are grouped as (1) reported and (2) incurred but not reported (IBNR). Reported losses are those incurred losses of which the mortgage insurer has been notified by the lender through delinquent loan reporting and/or filing a claim for payment. The incurred but not reported losses are those losses that have occurred that have not been reported to the company.

Valuation

1. Estimation of Reported Losses Unpaid

Unpaid losses are estimated based on predictions of loss frequency and loss severity. These estimates are based on historic data, trends, economic information, and other statistical information.

Loss frequency and loss severity estimates are made for three separate categories:

- (a) Insured loans that have resulted in the conveyance of property which remains unsold
- (b) Insured loans in the process of foreclosure
- (c) Insured loans in default

2. Incurred But Not Reported Losses

With the reported and unpaid loss category of the reserve representing the liabilities for reported claims and delinquencies, the mortgage insurer must also record a liability for losses that are incurred but not reported.

Estimates of loss frequency and loss severity for incurred but not reported losses are made based on historic data, trends, economic factors, and other statistical data in relation to paid claims, the reserve for reported losses unpaid, insurance in force statistics, and risk statistics.

CONTINGENCY RESERVE

The contingency reserve, as described in several statutes, is established and maintained for the purpose of protecting insureds against the effect of adverse economic cycles. The reserve is variously described as a premium reserve, or loss reserve, or is not specifically described. The annual contribution to the contingency reserve is deductible in the computation of the federal income tax liability as described in the chapter on "Federal Income Taxes."

In most jurisdictions, the annual addition to the contingency reserve liability is 50% of earned premium. One jurisdiction requires that the reserve contribution be based upon the loan amount of outstanding mortgages insured or 50% of earned premiums, whichever is higher. In another jurisdiction, the annual addition applicable to the mortgage pool insurance business segment is based upon insured risk. Each annual addition to the contingency reserve must be maintained for 10 years before being released, except that releases are permitted (on a first-in, first-out basis) at an earlier date should actual losses exceed established percentages of earned premiums as set forth in the statutes.

There are two predominant practices being used to report the effect of contingency reserve transactions. "Practice One" is to report changes to the reserve in the income statement; "Practice Two" is to report changes as a direct adjustment to surplus.

Under Practice One, the liability for the contingency reserve is included in loss reserves and the net addition to (or deduction from) the contingency reserve liability is reported as a deduct from (or addition to) underwriting income in the income statement.

Under Practice Two, the liability for contingency reserves is reported as a separate line item among other liabilities. The net addition to (or deduction from) the contingency reserve liability is not recorded in the income statement, but rather it is reported as a direct adjustment to surplus.

Prior to computing financial ratios and results for an insurer: (1) underwriting income comparisons between insurers using the differing practices will require an adjustment to account for the

differing treatments of additions to (or deductions from) the contingency reserve, and (2) as with the risk ratio calculation, the contingency reserve must be added to policyholders' surplus. In addition, if appropriate, statutory net income should be adjusted for any federal income tax consequences arising from the purchase of tax and loss bonds (see Federal Income Taxes chapter). These adjustments may require information not found in the annual statement.

UNEARNED PREMIUMS

There are a variety of statutory accounting methods used by mortgage guaranty insurers to determine the earned and unearned portion of premiums written. The rate at which premiums are earned differs based on type of policy, the loan-to-value ratio of the mortgage and the policy term (single premium versus annual renewals).

Certain states dictate through statute or regulation a specific formula or table to be used for the above policy types. Special attention is placed on single premium (multiple year) policies and on the "excess risk" portion of the initial annual premium.

Renewal Premiums, Annual Premiums and Level Premiums

Renewal premiums and annual premiums on policies with a loan-to-value of 90% or less are earned on a monthly pro rata basis using the 13-month method (sometimes called the 1/24 method because 1/24 is earned in each of the first and last months, and 1/12 in each of the other 11 months). This method assumes that the effective dates of policies are spread evenly throughout the month and that the average date is the 15th.

Level premium policies are handled the same as the above. Thus, a three-year policy payable in three equal annual installments is booked the same way as the three successive one-year policies.

Annual Premiums on High-Risk Policies

In some jurisdictions, the portion of the first year's premium which exceeds twice the annual renewal rate is earned on a deferred basis. (These premiums usually relate to mortgages with loan-to-value ratios in excess of 90%.)

Single Premiums

Single premiums are typically recognized on a deferred basis and then earned according to various statutorily mandated earnings curves.

LOSS AND LOSS ADJUSTMENT EXPENSES INCURRED

Mortgage guaranty insurance accounting differs from property insurance accounting in that if real estate is acquired, salvage value is recognized. If a property is in claims settlement, the difference between the cost of the property and its estimated net realizable value is recorded as loss expense at the date of acquisition. Further, in some jurisdictions, net additions to the contingency reserve are reported as part of incurred losses (see chapter on Contingency Reserve).

26. The Mortgage Guaranty Insurance Model Act provides the following guidance: (only pertinent excerpts included)

Section 16. Reserves

A. Unearned Premium Reserves

A mortgage guaranty insurance company shall compute and maintain an unearned premium reserve as set forth by regulation adopted by the commissioner of insurance.

B. Loss Reserve

A mortgage guaranty insurance company shall compute and maintain adequate case basis and other loss reserves which accurately reflect loss frequency and loss severity and shall include components for claims reported and for claims incurred but not reported, including estimated losses on:

- (1) Insured loans which have resulted in the conveyance of property which remains unsold;
- (2) Insured loans in the process of foreclosure;
- (3) Insured loans in default for four (4) months or for any lesser period which is defined as default for such purposes in the policy provisions; and
- (4) Insured leases in default for four (4) months or for any lesser period which is defined as default for such purposes in policy provisions.

C. Contingency Reserve

Each mortgage guaranty insurance company shall establish a contingency reserve out of net premium remaining (gross premiums less premiums returned to policyholders net of reinsurance) after establishment of the unearned premium reserve. The mortgage guaranty insurance company shall contribute to the contingency reserve an amount equal to fifty percent (50%) of such remaining unearned premiums. Contributions to the contingency reserve made during each calendar year shall be maintained for a period of one hundred and twenty months (120), except that withdrawals may be made by the company in any year in which the actual incurred losses exceed thirty-five percent (35%) of the corresponding earned premiums, and no such releases shall be made without prior approval by the commissioner of insurance of the insurance company's state of domicile.

If the coverage provided in this act exceeds the limitations set forth herein, the commissioner of insurance shall establish a rate formula factor that will produce a contingency reserve adequate for the added risk assumed. The face amount of an insured mortgage shall be computed before any reduction by the mortgage guaranty insurance company's election to limit its coverage to a portion of the entire indebtedness.

D. Reinsurance

Whenever a mortgage guaranty insurance company obtains reinsurance from an insurance company which is properly licensed to provide such reinsurance or from an appropriate governmental agency, the mortgage guaranty insurer and the reinsurer shall establish and maintain the reserves required in this chapter in appropriate proportions in relation to the risk retained by the original insurer and ceded to the assuming reinsurer so that the total reserves established shall not be less than the reserves required by this chapter.

E. Miscellaneous

- (1) Whenever the laws of any other jurisdiction, in which a mortgage guaranty insurance company subject to the requirement of this act, is also licensed to transact mortgage guaranty insurance, require a larger unearned premium reserve or contingency reserve in the aggregate than that set forth herein, the establishment of such larger unearned premium reserve or contingency reserve in the aggregate shall be deemed to be in compliance with this chapter.

- (2) Unearned premium reserves and contingency reserves shall be computed and maintained on risks insured after the effective date of this chapter as required by Sections 16A and 16C. Unearned premium reserves and contingency reserves on risks insured before the effective date of this chapter may be computed and maintained as required previously.

Section 17. Regulations

The commissioner shall have the authority to promulgate rules and regulations deemed necessary to effectively implement the requirements of this chapter.

Generally Accepted Accounting Principles

- No specific GAAP guidance obtained.

OTHER SOURCES OF INFORMATION

27. The AICPA Exposure Draft on mortgage guaranty insurance provides the following guidance.

Conclusions with respect to earning premium

19. Single premiums should be earned on a pro rata basis throughout the policy term, or on a declining basis if the amount of coverage significantly declines during the policy term. Annual premiums should be earned on the same basis. Level annual premiums should be earned on a pro rata basis over the policy term (usually one year). Additional first-year premiums on nonlevel policies, that is, the difference between first-year and level renewal premiums, should be deferred and amortized to income over the anticipated premium-paying period of the policies in relation to total anticipated premium receipts excluding the additional first-year premiums. If the dollar amount of coverage significantly declines during the anticipated premium-paying period, the additional first-year premium should be amortized to income in relation to anticipated coverage. If the initial renewal premium rate is higher than subsequent renewal premium rates, the excess premiums should be deferred and amortized to income over the remaining anticipated premium paying period of the policies in the same manner as the additional first-year premiums (this does not apply to policies with reduced premiums in later years, such as the tenth year or later). Level renewal premiums and the portion of the first-year premium equal to the level renewal premium should be earned on a pro rata basis over the policy term (generally one year). When significant differences between anticipated and actual renewal premiums occur, the predetermined amortization of additional first-year premiums should be adjusted to reflect actual experience.

Conclusions with respect to premium deficiencies

36. When anticipated losses and loss adjustment expenses, maintenance expenses and unamortized deferred acquisition costs exceed unearned premiums and estimated renewal premiums on existing policies, a provision for the anticipated premium deficiency should be provided. Premium deficiencies should be determined by reasonable groupings of business based on line of business or geographical area. (Premium deficiencies should be recognized by writing off any unamortized deferred acquisition costs to the extent required. If the deficiencies are more than the unamortized deferred acquisition costs, a separate liability should be provided for the excess deficiency).

37. In addition, companies that consider anticipated investment income in computing premium deficiencies should disclose the fact in their financial statements, together with the effects on the financial statements.

Conclusions with respect to recording claims

49. Losses should be accrued as of the initial default date, however, if a company can demonstrate that another date is more appropriate, such as 60 or 90 days after the initial default losses may be accrued as of that date.

50. In addition, companies that discount loss or loss adjustment expense reserves (see paragraphs 56 through 59) should disclose that fact in their financial statements, together with the effects on the financial statements.

51. No conclusion has been reached regarding whether loss reserves should be discounted; that is, whether the time value of money should be considered in determining loss reserves. This issue, as it applies to all insurance companies, is being considered separately by the AICPA Insurance Companies Committee.

RELEVANT LITERATURE

Statutory Accounting

- Accounting Practices and Procedures Manual for Property and Casualty Insurers, Appendix A
- The Mortgage Guaranty Insurance Model Act
- *Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets*
- *Issue Paper No. 22—Leases*
- *Issue Paper No. 53—Property Casualty Contracts - Premiums*
- *Issue Paper No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses*
- *Issue Paper No. 65—Property and Casualty Contracts*
- *Issue Paper No. 71—Policy Acquisition Costs and Commissions*
- *Issue Paper No. 77—Disclosure of Accounting Policies, Risks & Uncertainties, and Other Disclosures*

Generally Accepted Accounting Principles

- *FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises*

State Regulations

- No additional guidance obtained from state regulations or laws.

Other Sources of Information

- AICPA Exposure Draft on Mortgage Guaranty Insurance
- California Insurance Code §§ 12640.01 to 12640.18 (1961/1993)
- Illinois Administration Regulation, TITLE 50 §§ 202.10 to 202.60 (1982/1986)
- New York Insurance Law §§ 6501 to 6507 (1984/1994)
- Wisconsin Administrative Code §§ 3.09 (1992)

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