

and will not prevent any remedies, including rescission or termination that might be available for breach, misrepresentation, etc.)

Statutory Schedules and Exhibits

70. At the inception of the transaction, the transferring entity shall record the consideration paid to the assuming entity as a paid loss. If the consideration paid by the transferring entity is less than the loss reserves transferred, the difference shall be recorded by the ceding entity as a decrease in losses incurred. The assuming entity shall record the consideration received as a negative paid loss. In addition, the transferring entity shall record an increase to ceded reinsurance recoverable for the amount of the transferred reserve. Journal entries illustrating these transactions, including situations in which the transaction includes an unearned premium reserve, are included in Exhibit B of this Statement.

71. The assuming entity will report the business in the same line of business as reported by the original insurer or reinsurer. The assuming entity will report the business at the same level of detail using the appropriate statutory schedules and exhibits.

Disclosures

~~68~~-72. Unsecured Reinsurance Recoverables:

- a. If the entity has with any individual reinsurers, authorized or unauthorized, an unsecured aggregate recoverable for losses, paid and unpaid including IBNR, loss adjustment expenses, and unearned premium, that exceeds 3% of the entity's policyholder surplus, list each individual reinsurer and the unsecured aggregate recoverable pertaining to that reinsurer; and
- b. If the individual reinsurer is part of a group, list the individual reinsurers, each of its related group members having reinsurance with the reporting entity, and the total unsecured aggregate recoverables for the entire group.

~~69~~-73. Reinsurance Recoverables in Dispute—Reinsurance recoverable on paid and unpaid (including IBNR) losses in dispute by reason of notification, arbitration or litigation shall be identified if the amounts in dispute from any entity (and/or affiliate) exceed 5% of the ceding entity's policyholders surplus or if the aggregate of all disputed items exceeds 10% of the ceding entity's policyholders surplus. Notification means a formal written communication from a reinsurer denying the validity of coverage.

~~70~~-74. Uncollectible Reinsurance—Describe uncollectible reinsurance written off during the year reported in the following annual statement classifications, including the name(s) of the reinsurer(s):

- a. Losses incurred;
- b. Loss adjustment expenses incurred;
- c. Premiums earned; and
- d. Other.

~~74~~-75. Commutation of Ceded Reinsurance—Describe commutation of ceded reinsurance during the year reported in the following annual statement classifications, including the name(s) of the reinsurer(s):

- a. Losses incurred;
- b. Loss adjustment expenses incurred;

- c. Premiums earned; and
- d. Other.

72-76. Retroactive Reinsurance—The table illustrated in the NAIC Annual Statement Instructions for Property and Casualty Companies under Retroactive Reinsurance in the Notes to Financial Statements section shall be completed for all retroactive reinsurance agreements that transfer liabilities for losses that have already occurred and that will generate special surplus transactions. The insurer (assuming or ceding) shall assign a unique number to each retroactive reinsurance agreement and shall utilize this number for as long as the agreement exists. Transactions utilizing deposit accounting shall not be reported in this note.

73-77. Reinsurance Assumed and Ceded—The tables illustrated in the NAIC Annual Statement Instructions for Property and Casualty Companies under “Reinsurance Assumed and Ceded in the Notes to Financial Statements” section shall be completed as follows:

- a. The financial statements shall disclose the maximum amount of return commission which would have been due reinsurers if all reinsurance were canceled with the return of the unearned premium reserve; and
- b. The financial statements shall disclose the accrual of additional or return commission, predicated on loss experience or on any other form of profit sharing arrangements as a result of existing contractual arrangements.

74-78. A specific interrogatory requires information on reinsurance of risk accompanied by an agreement to release the reinsurer from liability, in whole or in part, from any loss that may occur on the risk or portion thereof.

75-79. Disclosures for paragraphs ~~76-84~~ 80-85 represent annual statement interrogatories, which are required to be included with the annual audit report beginning with audit reports on financial statements as of and for the period ended December 31, 2006. The disclosures required within paragraphs ~~76-84~~ 80-85 shall be included in accompanying supplemental schedules of the annual audit report beginning in year-end 2006. These disclosures shall be limited to reinsurance contracts entered into, renewed or amended on or after January 1, 1994. This limitation applies to the annual audit report only and does not apply to the statutory annual statement interrogatories and the reinsurance summary supplemental filing.

76-80. Disclose if any risks are reinsured under a quota share reinsurance contract with any other entity that includes a provision that would limit the reinsurer’s losses below the stated quota share percentage (e.g. a deductible, a loss ratio corridor, a loss cap, an aggregate limit or any similar provisions)? If yes, indicate the number of reinsurance contracts containing such provisions and if the amount of reinsurance credit taken reflects the reduction in quota share coverage caused by any applicable limiting provision(s).

77-81. Disclose if the reporting entity ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which during the period covered by the statement: (i) it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; (ii) it accounted for that contract as reinsurance and not as a deposit; and (iii) the contract(s) contain one or more of the following features or other features that would have similar results:

- a. A contract term longer than two years and the contract is noncancellable by the reporting entity during the contract term;
- b. A limited or conditional cancellation provision under which cancellation triggers an obligation by the reporting entity, or an affiliate of the reporting entity, to enter into a new reinsurance contract with the reinsurer, or an affiliate of the reinsurer;

- c. Aggregate stop loss reinsurance coverage;
- d. A unilateral right by either party (or both parties) to commute the reinsurance contract, whether conditional or not, except for such provisions which are only triggered by a decline in the credit status of the other party;
- e. A provision permitting reporting of losses, or payment of losses, less frequently than on a quarterly basis (unless there is no activity during the period); or
- f. Payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity.

~~78-82.~~ Disclose if the reporting entity during the period covered by the statement ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which during the period covered by the statement it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; excluding cessions to approved pooling arrangements or to captive insurance companies that are directly or indirectly controlling, controlled by, or under common control with (i) one or more unaffiliated policyholders of the reporting entity, or (ii) an association of which one or more unaffiliated policyholders of the reporting entity is a member, where:

- a. The written premium ceded to the reinsurer by the reporting entity or its affiliates represents fifty percent (50%) or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statement; or
- b. Twenty-five percent (25%) or more of the written premium ceded to the reinsurer has been retroceded back to the reporting entity or its affiliates in separate reinsurance contract.

~~79-83.~~ If affirmative disclosure is required for paragraph ~~77-81~~ or ~~7882~~, provide the following information:

- a. A summary of the reinsurance contract terms and indicate whether it applies to the contracts meeting paragraph ~~77-81~~ or ~~7882~~;
- b. A brief discussion of management's principal objectives in entering into the reinsurance contract including the economic purpose to be achieved; and
- c. The aggregate financial statement impact gross of all such ceded reinsurance contracts on the balance sheet and statement of income.

~~80-84.~~ Except for transactions meeting the requirements of paragraph 31 of *SSAP No. 62R—Property and Casualty Reinsurance*, disclose if the reporting entity ceded any risk under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during the period covered by the financial statement, and either:

- a. Accounted for that contract as reinsurance (either prospective or retroactive) under statutory accounting principles (SAP) and as a deposit under generally accepted accounting principles (GAAP); or
- b. Accounted for that contract as reinsurance under GAAP and as a deposit under SAP.

~~84-85.~~ If affirmative disclosure is required for paragraph ~~8084~~, explain in a supplemental filing why the contract(s) is treated differently for GAAP and SAP.

86. Disclosures for the Transfer of Property and Casualty Run-off Agreements

- a. Disclose if the reporting entity has entered into any agreements which have been approved by their domiciliary regulator and have qualified pursuant to SSAP No. 62R, subparagraph 31.e., Accounting for the Transfer of Property and Casualty Run-off Agreements.
- b. If affirmative, provide a description of the agreement and the amount of consideration paid and liabilities transferred.

82-87. Refer to the preamble for further discussion regarding disclosure requirements.

Relevant Literature

~~83-88.~~ This statement adopts *FASB Statement No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts* (FAS 113) with modification and *FASB Emerging Issues Task Force No. 93-6, Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises* with modification for the following:

- a. Reinsurance recoverables on unpaid case-basis and incurred but not reported losses and loss adjustment expenses shall be reported as a contra-liability netted against the liability for gross losses and loss adjustment expenses;
- b. Amounts paid for prospective reinsurance that meet the conditions for reinsurance accounting shall be reported as a reduction of unearned premiums;
- c. The gain created by a retroactive reinsurance agreement because the amount paid to the reinsurer is less than the gross liabilities for losses and loss adjustment expenses ceded to the reinsurer is reported in the statement of income as a write-in gain in other income by the ceding entity and a write-in loss by the assuming entity. The gain created by a retroactive reinsurance agreement is restricted as a special surplus account until the actual retroactive reinsurance recovered is in excess of the consideration paid;
- d. This statement requires that a liability be established through a provision reducing unassigned funds (surplus) for unsecured reinsurance recoverables from unauthorized reinsurers and for certain overdue balances due from authorized reinsurers;
- e. Some reinsurance agreements contain adjustable features that provide for adjustment of commission, premium or amount of coverage, based on loss experience. This statement requires that the asset or liability arising from the adjustable feature be computed based on experience to date under the agreement, and the impact of early termination may only be considered at the time the agreement has actually been terminated;
- f. Structured settlements are addressed in *SSAP No. 65—Property and Casualty Contracts*. Statutory accounting and FAS 113 are consistent in accounting for structured settlement annuities where the reporting entity is the owner and payee and where the claimant is the payee and the reporting entity has been released from its obligation. FAS 113 distinguishes structured settlement annuities where the claimant is the payee and a legally enforceable release from the reporting entity's liability is obtained from those where the claimant is the payee but the reporting entity has not been released from its obligation. GAAP requires the deferral of any gain resulting from the purchase of a structured settlement annuity where the reporting entity has not been released from its obligation; and

- g. This statement requires that reinsurance recoverables on unpaid losses and loss adjustment expenses be presented as a contra-liability. Requirements for offsetting and netting are addressed in SSAP No. 64.

~~84-89.~~ This statement rejects AICPA *Statement of Position No. 92-5, Accounting for Foreign Property and Liability Reinsurance*. This statement incorporates Appendix A-785 as applicable.

Effective Date and Transition

~~85-90.~~ This statement shall apply to:

- a. Reinsurance agreements entered into, renewed, or amended on or after January 1, 1994. An amendment is any revision or adjustment of contractual terms. The payment of premiums or reimbursement of losses recoverable under the agreement shall not constitute an amendment; and
- b. Reinsurance agreements in force on January 1, 1995, which cover losses occurring or claims made on or after that date on policies reinsured under such agreements.

~~86-91.~~ The guidance shall not apply to:

- a. Reinsurance agreements which cover only losses occurring or claims made before January 1, 1994, and which were entered into before January 1, 1994, and were not subsequently renewed or amended; and
- b. Reinsurance agreements that expired before and were not renewed or amended after January 1, 1995.

~~87-92.~~ The guidance in paragraphs 48 through 52 shall be effective for all accounting periods beginning on or after January 1, 1996, and shall apply to reinsurance agreements entered into, renewed or amended on or after January 1, 1994.

~~93.~~ ~~88~~This statement is effective for years beginning January 1, 2001. Changes resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors. Revisions to subparagraph 31.e., related paragraphs 68-71, and new disclosures in paragraph 86 documented in Issue Paper No. 137—Transfer of Property and Casualty Reinsurance Run-off Agreements* are effective for contracts entered on or after January 1, 2010.

AUTHORITATIVE LITERATURE

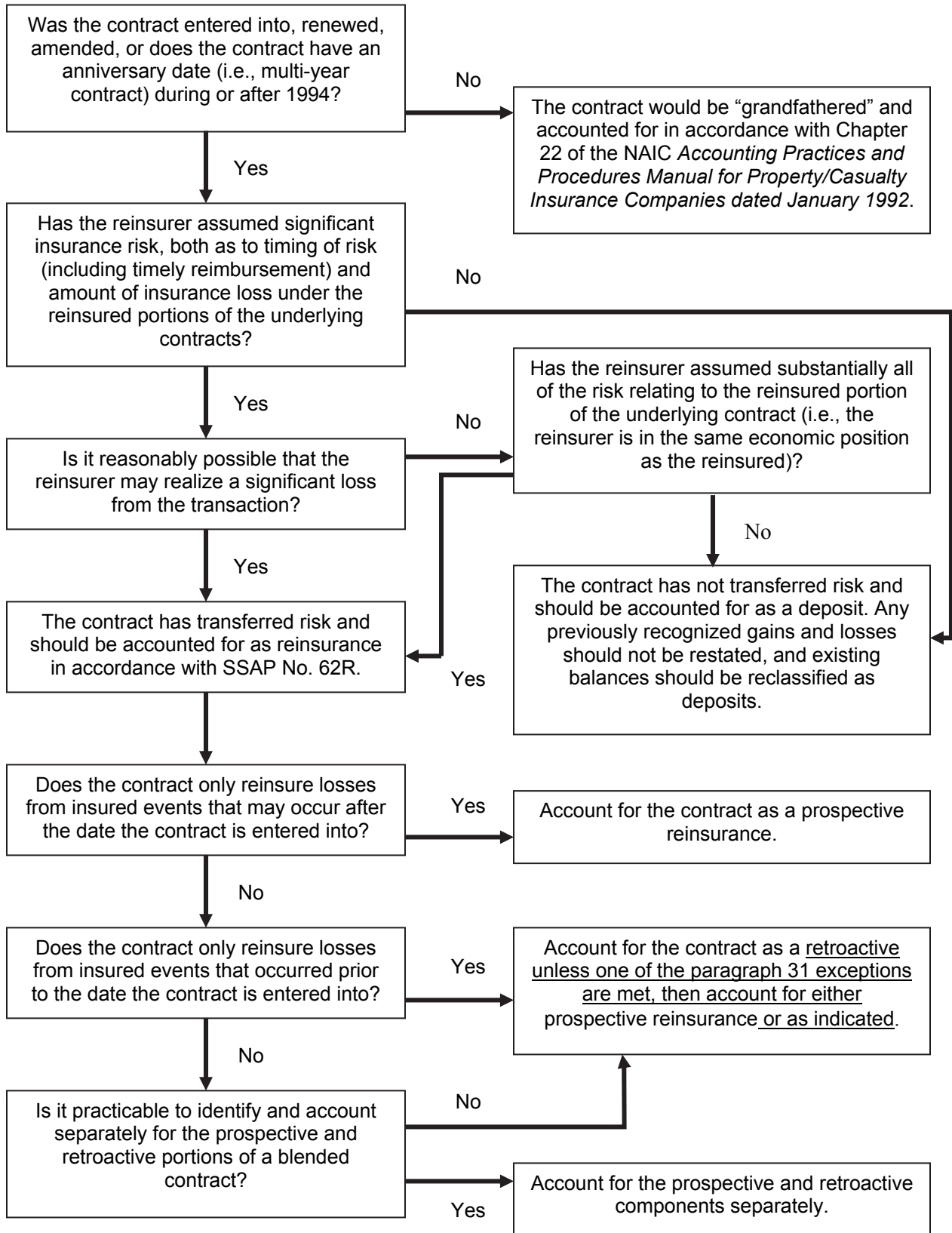
Generally Accepted Accounting Principles

- *FASB Statement No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*
- *FASB Emerging Issues Task Force Issue No. 93-6, Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises*

RELEVANT ISSUE PAPERS

- *Issue Paper No. 75—Property and Casualty Reinsurance*
- *Issue Paper No. 137—Transfer of Property and Casualty Reinsurance Run-off Agreements*

CLASSIFYING REINSURANCE CONTRACTS



SSAP NO. 62R—EXHIBIT A**Implementation Questions and Answers**Applicability

1. Q: The accounting practices in SSAP No. 62R specify the accounting and reporting for reinsurance contracts. What contracts are considered reinsurance contracts for purposes of applying these accounting practices?
- A: Any transaction that indemnifies an insurer against loss or liability relating to insurance risk shall be accounted for in accordance with the accounting practices included in SSAP No. 62R. Therefore, all contracts, including contracts that may not be structured or described as reinsurance, shall be accounted for as reinsurance when those conditions are met.
2. Q: The provisions of this statement will apply to (a) reinsurance contracts entered into, renewed or amended on or after January 1, 1994, and (b) any other reinsurance contracts that are in force on January 1, 1995 and cover insurable events on the underlying insurance policies that occur on or after that date. What contracts would be exempt from the new accounting rules included in SSAP No. 6262R?
- A: The only exempt contracts are:
- 1) Purely retroactive reinsurance contracts that cover only insured events occurring before January 1, 1994, provided those contracts were entered into before that date and are not subsequently amended and
 - 2) Contracts that expired before January 1, 1995 and are not amended after that date.
3. Q: This statement is to be applied to contracts which are amended on or after January 1, 1994. What if the change in terms is not significant, or the terms changed have no financial effect on the contract?
- A: In general, the term amendment should be viewed broadly to include all but the most trivial changes. Examples of amendments include, but are not limited to, replacing one assuming entity with another (including an affiliated entity), or modifying the contract's limit, coverage, premiums, commissions, or experience-related adjustable features. No distinction is made between financial and non-financial terms.
4. Q: Must the accounting provisions of SSAP No. 6262R be applied to an *otherwise exempt* contract if the ceding entity pays additional premiums under the contract on or after January 1, 1994?
- A: The answer depends on why the additional premiums are paid. If the additional premiums are the result of a renegotiation, adjustment, or extension of terms, the contract is subject to the accounting provisions of SSAP No. 6262R. However, additional premiums paid without renegotiation, adjustment, or extension of terms would not make an otherwise exempt contract subject to those provisions.
5. Q: Prospective and retroactive portions of a reinsurance contract are allowed to be accounted for separately, if practicable. Can the retroactive portion of an existing contract be segregated and, therefore, exempted with other retroactive contracts covering insured events occurring prior to January 1, 1994?
- A: No. The transition provisions apply to an entire contract, which is either subject to or exempt from the revised provisions of SSAP No. 6262R. A ceding entity may bifurcate a contract already subject to the new accounting rules in SSAP No. 6262R and then

account for both the prospective and retroactive portions in accordance with the new accounting standard.

Risk Transfer

6. Q: Do the new risk transfer provisions apply to existing contracts?
- A: Yes, the new risk transfer provisions apply to some existing contracts. SSAP No. ~~6262R~~ applies in its entirety only to existing contracts which were renewed or amended on or after January 1, 1994, or which cover losses occurring or claims made after that date. Therefore, those contracts must be evaluated to determine whether they transfer risk and qualify for reinsurance accounting. For accounting periods commencing on or after January 1, 1995, balances relating to such contracts which do not transfer insurance risk shall be reclassified as deposits and shall be accounted for and reported in the manner described under the caption Reinsurance Contracts Must Include Transfer of Risk.
- SSAP No. ~~6262R~~ does not apply to existing contracts which were entered into before, and were not renewed or amended on or after, January 1, 1994, and which cover only losses occurring or claims made before that date, nor to contracts which expired before, and were not renewed or amended on or after, January 1, 1995. Those contracts will continue to be accounted for in the manner provided by SSAP No. ~~6262R~~ before these revisions.
7. Q: How does the effective date affect the assessment of whether a significant loss to the reinsurer was reasonably possible?
- A: The risk transfer assessment is made at contract inception, based on facts and circumstances known at the time. Because that point in time has passed for existing contracts, some have suggested that the risk transfer provisions be applied as of the effective date. However, that approach to the risk transfer assessment would violate the requirement to consider all cash flows from the contract. Therefore, the test must be applied from contract inception, considering the effect of any subsequent contract amendments. Careful evaluation and considered judgment will be required to determine whether a significant loss to the reinsurer was reasonably possible at inception.
8. Q: Should risk transfer be reassessed if contractual terms are subsequently amended?
- A: Yes. When contractual terms are amended, risk transfer should be reassessed. For example, a contract that upon inception met the conditions for reinsurance accounting could later be amended so that it no longer meets those conditions. The contract should then be reclassified and accounted for as a deposit.
9. Q: How should the risk transfer assessment be made when a contract has been amended?
- A: No particular method is prescribed for assessing risk transfer in light of a contract amendment. Whether an amended contract in substance transfers risk must be determined considering all of the facts and circumstances in light of the risk transfer requirements. Judgment also will be required to determine whether an amendment in effect creates a new contract.
10. Q: For purposes of evaluating whether a contract with a reinsurer transfers risk, what constitutes a contract?
- A: A contract is not defined, but is essentially a question of substance. It may be difficult in some circumstances to determine the boundaries of a contract. For example, the profit-sharing provisions of one contract may refer to experience on other contracts and, therefore, raise the question of whether, in substance, one contract rather than several contracts exist.

The inconsistency that could result from varying interpretations of the term *contract* is limited by requiring that features of the contract or other contracts or agreements that directly or indirectly compensate the reinsurer or related reinsurers for losses be considered in evaluating whether a particular contract transfers risk. Therefore, if agreements with the reinsurer or related reinsurers, in the aggregate, do not transfer risk, the individual contracts that make up those agreements also would not be considered to transfer risk, regardless of how they are structured.

11. Q: If the assessment of risk transfer changes after the initial assessment at contract inception, how should the ceding entity account for the change?
- A: The status of a contract should be determinable at inception and, absent amendment, subsequent changes should be very rare. If the risk of significant loss was not deemed reasonably possible at inception, and a significant loss subsequently occurred, the initial assessment was not necessarily wrong, because remote events do occur. Likewise, once a reasonable possibility of significant loss has been established, such loss need not occur in order to maintain the contract's status as reinsurance.
12. Q: SSAP No. ~~6262R~~ requires that reasonably possible outcomes be evaluated to determine the reinsurer's exposure to significant loss. What factors should be considered in determining whether a scenario being evaluated is reasonably possible?
- A: The term *reasonably possible* means that the probability is more than remote. The test is applied to a particular scenario, not to the individual assumptions used in the scenario. Therefore, a scenario is not reasonably possible unless the likelihood of the entire set of assumptions used in the scenario occurring together is reasonably possible.
13. Q: In determining the amount of the reinsurer's loss under reasonably possible outcomes, may cash flows directly related to the contract other than those between the ceding and assuming companies, such as taxes and operating expenses of the reinsurer, be considered in the calculation?
- A: No. The evaluation is based on the present value of all cash flows *between the ceding and assuming enterprises* under reasonably possible outcomes and, therefore, precludes considering other expenses of the reinsurer in the calculation.
14. Q: In evaluating the significance of a reasonably possible loss, should the reasonably possible loss be compared to gross or net premiums?
- A: Gross premiums should be used.
15. Q: How does a commutation clause affect the period of time over which cash flows are evaluated for reasonable possibility of significant loss to the reinsurer?
- A: All cash flows are to be assessed under reasonably possible outcomes. Therefore, unless commutation is expected in the scenario being evaluated, it should not be assumed in the calculation. Further, the assumptions used in a scenario must be internally consistent and economically rational in order for that scenario's outcome to be considered reasonably possible.
16. Q: What interest rate should be used in each evaluated scenario to make the present value calculation?
- A: A reasonable and appropriate rate is required, which generally would reflect the expected timing of payments to the reinsurer and the duration over which those cash flows are expected to be invested by the reinsurer.
17. Q: SSAP No. ~~6262R~~ refers to payment schedules and accumulating retentions from multiple years as features that delay timely reimbursement of claims. Does the presence of those

features generally prevent a contract from meeting the conditions for reinsurance accounting?

- A: Yes. Payment schedules and accumulating retentions from multiple years are contractual features inherently designed to delay the timing of reimbursement to the ceding entity. Regardless of what a particular feature might be called, any feature that can delay timely reimbursement violates the conditions for reinsurance accounting. Transfer of insurance risk requires that the reinsurer's payments to the ceding entity depend on and directly vary with the amount and timing of claims settled under the reinsured contracts. Contractual features that can delay timely reimbursement prevent this condition from being met. Therefore, any feature that may affect the timing of the reinsurer's reimbursement to the ceding entity should be closely scrutinized.
18. Q: What if a contract contains a feature such as a payment schedule or accumulating retention but could still result in the reasonable possibility of significant loss to the reinsurer?
- A: Both of the following conditions are required for reinsurance accounting:
- a. Transfer of significant risk arising from uncertainties about both (i) the ultimate amount of net cash flows from premiums, commission, claims, and claim settlement expenses paid under a contract (underwriting risk) and (ii) the timing of the receipt and payment of those cash flows (timing risk); and
 - b. Reasonable possibility of significant loss to the reinsurer.
- Because both condition (a) and condition (b) must be met, failure to transfer significant timing and underwriting risk is not overcome by the possibility of significant loss to the reinsurer.
19. Q: Is it permissible to evaluate timely reimbursement on a present value basis?
- A: No. The word timely is used in the ordinary temporal sense to refer to the length of time between payment of the underlying reinsured claims and reimbursement by the reinsurer.
- While the test for reasonable possibility of significant loss to the reinsurer provides for a present value-based assessment of the economic characteristics of the reinsurance contract, the concept of timely reimbursement relates to the transfer of insurance risk (condition a above), not the reasonable possibility of significant loss (condition b above). Accordingly, timely reimbursement should be evaluated based solely on the length of time between payment of the underlying reinsured losses and reimbursement by the reinsurer.
20. Q: Are there any circumstances under which the conditions for risk transfer need not be met?
- A: Yes. An extremely narrow and limited exemption is provided for contracts that reinsure either an individual risk or an underlying book of business that is inherently profitable. When substantially all of the insurance risk relating to the reinsured portions of the underlying insurance contracts has been assumed by the reinsurer, the contract meets the conditions for reinsurance accounting. To qualify under this exception, no more than trivial insurance risk on the reinsured portions of the underlying insurance contracts may be retained by the ceding entity. The reinsurer's economic position must be virtually equivalent to having written the relevant portions of the reinsured contracts directly.
21. Q: In determining whether a reinsurance contract qualifies under the exception referred to in the preceding question, how should the economic position of the reinsurer be assessed in relation to that of the ceding entity?

- A: The assessment should be made by comparing the net cash flows of the reinsurer under the reinsurance contract with the net cash flows of ceding entity on the reinsured portions of the underlying insurance contracts. This may be relatively easy for reinsurance of individual risks or for unlimited-risk quota-share reinsurance, because the premiums and losses on these types of reinsurance generally are the same as the premiums and losses on the reinsured portions of the underlying insurance policies.

In other types of reinsurance, determining the reinsurer's net cash flows relative to the insurer is likely to be substantially more difficult. For example, it generally would be difficult to demonstrate that the ceding entity's premiums and losses for a particular layer of insurance are the same as the reinsurer's premiums and losses related to that layer. If the economic position of the reinsurer relative to the insurer cannot be determined, the contract would not qualify under the exception.

Accounting Provisions

22. Q: An existing contract that was accounted for as reinsurance no longer qualifies for reinsurance accounting under the new accounting rules included in SSAP No. ~~6262R~~. How should the ceding and assuming companies account for the contract in future periods?

- A: Because the statement of income cannot be restated, previously recognized gains and losses are not revised. If the contract was entered into before, and not renewed or amended on or after, January 1, 1994 and covers only losses occurring or claims made before that date, or the contract expired before January 1, 1995 and was not renewed or amended on or after that date, it would continue to be accounted for in the manner provided before these revisions.

For accounting periods commencing on or after January 1, 1995, existing balances relating to contracts which do not transfer insurance risk and which were entered into on or after January 1, 1994 (covering losses occurring or claims made after that date) would be reclassified as deposits.

Premium payments to a reinsurer would be recorded as deposits. Likewise, losses recoverable from a reinsurer would not be recognized as receivables. Rather, any reimbursement for losses would be accounted for upon receipt as a refund of a deposit.

23. Q: What is the definition of past insurable events that governs whether reinsurance coverage is prospective or retroactive? For example, could a reinsurance contract that covers losses from asbestos and pollution claims on occurrence-based insurance policies effective during previous periods be considered prospective if the reinsurance coverage is triggered by a court interpretation that a loss is covered within the terms of the underlying insurance policies?

- A: The distinction between prospective and retroactive reinsurance is based on whether a contract reinsures future or past insured events covered by the underlying reinsurance contracts. In the example above, the insured event is the occurrence of loss within the coverage of the underlying insurance contracts, not the finding of a court. Therefore, the fact that the asbestos exposure or pollution is covered under insurance policies effective during prior periods makes the reinsurance coverage in this example retroactive.

24. Q: Would the answer to the above question change if the reinsurance were written on a claims-made basis?

- A: No. The form of the reinsurance—whether claims-made or occurrence-based—does not determine whether the reinsurance is prospective or retroactive. A claims-made reinsurance contract that reinsures claims asserted to the reinsurer in a future period as a result of insured events that occurred prior to entering into the reinsurance contract is a retroactive contract.

25. Q: What is the effect of adjustments to future premiums or coverage in determining whether reinsurance is prospective or retroactive?
- A: Adjustments to future premiums or coverage may affect the accounting for a reinsurance contract. Whenever an adjustment results in a reinsurer providing new or additional coverage for past insurable events, that coverage is retroactive. For example, if subsequent years' premiums under a multiple accident year contract create additional coverage for previous accident years, the additional coverage is retroactive, even if the original coverage provided in the contract for those accident years was prospective. Likewise, if current losses under a multiple-year contract eliminate coverage in future periods, some or all of the premiums to be paid in those future periods should be charged to the current period.
26. Q: A reinsurance contract is entered into after the contract's effective date. Is the coverage between the contract's effective date and the date the contract was entered into prospective or retroactive?
- A: The portion of the contract related to the period of time between the effective date of the contract and the date the contract was entered into is retroactive because it covers insured events that occurred prior to entering into the reinsurance contract.
27. Q: How is the date the reinsurance contract was entered into determined?
- A: It is not uncommon for a reinsurance arrangement to be initiated before the beginning of a policy period but not finalized until after the policy period begins. Whether there was agreement in principle at the beginning of the policy period and, therefore, the contract is substantively prospective must be determined based on the facts and circumstances. For example, a contract may be considered to have been substantively entered into even though regulatory approval of that contract has not taken place.
- The absence of agreement on significant terms, or the intention to establish or amend those terms at a later date based on experience or other factors, generally indicates that the parties to the contract have not entered into a reinsurance contract, but rather have agreed to enter into a reinsurance contract at a future date. If contractual provisions under a contract substantively entered into at a future date covered insurable events prior to that date, that coverage is retroactive.
- In any event, SSAP No. ~~6262~~R provides that if a contract (except facultative contracts and contracts signed by the lead reinsurer and certain cover notes or similar documents signed by reinsurers representing more than 50% of the capacity on the contract) has not been finalized, reduced to written form and signed by the parties within 9 months after its effective date, it is presumed to be retroactive.
28. Q: Are contracts to reinsure calendar-year incurred losses considered blended contracts that have both prospective and retroactive elements?
- A: Yes. Most reinsurance contracts covering calendar-year incurred losses combine coverage for insured events that occurred prior to entering into the reinsurance contract with coverage for future insured events and, therefore, include both prospective and retroactive elements.
- In any event, SSAP No. ~~6262~~R provides that if a contract (except facultative contracts, contracts signed by the lead reinsurer and certain cover notes or similar documents signed by reinsurers representing more than 50% of the capacity on the contract) has not been finalized, reduced to written form and signed by the parties within 9 months after its effective date it is presumed retroactive.
29. Q: When the prospective and retroactive portions of a contract are being accounted for separately, how should premiums be allocated to each portion of the contract?

A: No specific method for allocating the reinsurance premiums to the risks covered by the prospective and retroactive portions of a contract is required. However, separate accounting for the prospective and retroactive portions of a contract may take place only when an allocation is practicable.

Practicability requires a reasonable basis for allocating the reinsurance premiums to the risks covered by the prospective and retroactive portions of the contract, considering all amounts paid or deemed to have been paid regardless of the timing of payment. If a reasonable basis for allocating the premiums between the prospective and retroactive coverage does not exist, the entire contract must be accounted for as a retroactive contract.

30. Q: A retroactive reinsurance contract contains a cut-through provision that provides the ceding entity's policyholders and claimants with the right to recover their claims directly from the reinsurer. May the ceding entity immediately recognize earned surplus associated with this type of contract?

A: No. SSAP No. ~~6262R~~ states that earned surplus may not be recognized "until the actual retroactive reinsurance recovered exceeds the consideration paid."

31. Q: A ceding entity enters into a retroactive reinsurance agreement that gives rise to segregated surplus. If the reinsurer prepays its obligation under the contract, may the ceding entity recognize earned surplus at the time the prepayment is received?

A: Segregated surplus arising from retroactive reinsurance transactions is earned as actual liabilities that have been transferred are recovered or terminated. Therefore, earned surplus is based on when the reinsurer settles its obligations to the ceding entity, and it may be appropriate to recognize earned surplus at the time the prepayment is received.

However, all of the facts and circumstances must be considered to determine whether the ceding entity has substantively recovered the liabilities transferred to the reinsurer. For example, if the ceding entity agrees to compensate the reinsurer for the prepayment, such as by crediting the reinsurer with investment income on prepaid amounts or balances held, the ceding entity has not, in substance, recovered its transferred liabilities but rather has received a deposit from the reinsurer that should be accounted for accordingly.

32. Q: If the ceding entity does not expect to receive any recoveries because the reinsurer has agreed to reimburse claimants under the reinsured contracts directly, would the ceding entity be considered to have recovered or terminated its transferred liabilities?

A: No. In the example given, the reinsurer is substantively acting as disbursing agent for the ceding entity. Therefore, the ceding entity cannot be said to have recovered amounts due from the reinsurer before payment is made to the claimant.

33. Q: What accounting entries would a ceding entity make to report a retroactive reinsurance contract?

A: Accounting Entries for a Ceding Entity to Report a Retroactive Reinsurance Contract:

Entry 1

Retroactive Reinsurance Reserves		
Ceded or Assumed (B/S)	10,000	
Retroactive Reinsurance Gain (I/S)		2,000
Cash		8,000

To record initial portfolio transfer see items #3 and #8. The ceding entity must establish the segregated surplus per item #4.

Entry 1A

Retro. Reins. Gain	2,000	
Profit/Loss Account		2,000

To close gain from retroactive transaction.

Entry 1B

Profit/Loss Account	2,000	
Special Surplus from Retro. Reins.		2,000

To close profit from retroactive reinsurance to special surplus.

Entry 2

Cash	2,000	
Retroactive Reinsurance Reserves Ceded or Assumed (B/S)		2,000

To record recovery of paid losses from the reinsurer. Outstanding ceded reserves after this recovery equals \$8,000, and special surplus from retroactive reinsurance account equals \$2,000; therefore, segregated surplus account is not changed per item #10.

Entry 3

Retroactive Reinsurance Reserves Ceded or Assumed (B/S)	3,000	
Retroactive Reinsurance Gain (I/S)		3,000

To record subsequent revision of the initial reserves ceded per item #10. The segregated surplus account is increased to \$5,000 as a result of this upward development.

Entry 3A

Retro. Reinsurance Gain	3,000	
Profit/Loss Account		3,000

To close profit from retroactive reinsurance.

Entry 3B

Profit/Loss (I/S)	3,000	
Special Surplus from Retro. Reins.		3,000

To close profit and loss account to special surplus. (Retroactive reinsurance reserves ceded or assumed account balance equals \$11,000. Special Surplus from retroactive reinsurance balance equals \$5,000.)

Entry 4

Cash	4,000	
Retroactive Reinsurance Reserves Ceded or Assumed (B/S)		4,000

To record recovery of paid losses from the reinsurer. Outstanding ceded reserves after this recovery equals \$7,000, therefore segregated surplus account is not changed per item #10.

Entry 5

Cash	3,000	
Retroactive Reinsurance Reserves Ceded or Assumed (B/S)		3,000

To record recovery of paid losses from reinsurer. Outstanding ceded reserves after recovery equals \$4,000, therefore the following entry is needed per items #6 and #10.

Entry 5A

Special Surplus—Retro. Reins.	1,000	
Unassigned Funds		1,000

Retroactive Reinsurance reserves ceded or assumed after this entry equals \$4,000.

Entry 6

Retroactive Reinsurance Loss (I/S)	1,000	
Retroactive Reinsurance Reserves Ceded or Assumed (B/S)		1,000

To record subsequent revision of the initial reserves ceded per item #10. The segregated surplus account is decreased as a result of this downward development to \$3,000. The following entry is needed per items #6 and #10.

Entry 6A

Profit/Loss Account	1,000	
Retro. Reins. Loss		1,000

To close loss to profit and loss account.

Entry 6B

Special Surplus from Retro. Reins.	1,000	
Profit/Loss Account		1,000

To close profit and loss account to special surplus. (Remaining balance of retroactive reinsurance reserve ceded or assumed account equals \$3,000.) (Special surplus from retro. reins. account balance equals \$3,000.)

Entry 7

Cash	2,500	
Retroactive Reinsurance Gain (I/S)	500	
Retroactive Reinsurance Reserves Ceded or Assumed (B/S)		3,000

Entry 7A

Profit and Loss Account	500	
Retro. Reins. Gain		500

To close other income to profit and loss account.

Entry 7B

Special Surplus from Retro. Reins.	500	
Profit/Loss Account		500

To close profit and loss account to special surplus. (Remaining balance of special surplus from retro. reins. account equals \$2,500.) (Remaining balance of retroactive reinsurance reserve ceded or assumed account -0-.)

Entry 7C

Special Surplus from Retro. Reins.	2,500	
Unassigned Funds		2,500

To close remaining special surplus account to unassigned surplus.

34. Q: How should the parties account for an adverse loss development reinsurance contract where, as of the statement date, the attachment level of the contract exceeds the ceding company's current case and IBNR reserves for the covered accident years (i.e. no surplus gain and no reinsurance recoverable as of the statement date), and the ceding company transferred cash to the reinsurer at the inception of the contract?

A: An adverse loss development reinsurance contract covering prior accident years meets the definition of "retroactive reinsurance" set forth in paragraph 22 of SSAP No. 6262R:

....reinsurance in which a reinsurer agrees to reimburse a ceding entity for liabilities incurred as a result of past insurable events covered under contracts subject to the reinsurance....

Subparagraph 29.k. of SSAP No. 6262R specifically provides that the consideration paid for a retroactive reinsurance contract is to be recorded as a decrease in ledger assets by the ceding entity and an increase in ledger assets by the assuming entity.

Question 33 illustrates the accounting entries for retroactive reinsurance contracts.

If the retroactive reinsurance contract transfers both components of insurance risk then, pursuant to paragraph 29 of SSAP No. 6262R, the ceding company would record the consideration paid as a decrease in ledger assets, recognize an expense for the reinsurance ceded through Other Income or Loss accounts as a write-in item identified as "Retroactive Reinsurance Ceded", and record the recoverable from the reinsurer as a contra liability.

No contra liability is established until and unless (and then only to the extent that) the ceding company establishes reserves which exceed the attachment point.

For the contract described, at inception no contra liability is recorded to offset current liability for the business ceded, since the ceded retroactive reinsurance premium relates to coverage in excess of the current liabilities recorded by the ceding company.

Once the ceding company's recorded liabilities exceed the attachment point of the adverse loss development reinsurance contract and triggers reinsurance recoverable from the reinsurer, a contra liability is established by the ceding company for the amount of the reinsurance recoverable. Any surplus resulting from the retroactive reinsurance is carried as a write-in item on the balance sheet designated as "Special Surplus from Retroactive Reinsurance Account." The surplus gain may not be classified as unassigned funds (surplus) until the actual retroactive reinsurance recovered exceeds the consideration paid.

If any portion of a retroactive reinsurance contract does not transfer insurance risk, then the portion which does not transfer risk is accounted for as a deposit pursuant to paragraph 35 of SSAP No. 6262R. The deposit is reported as an admitted asset of the ceding company if the reinsurer is licensed, accredited or otherwise qualified in the ceding company's state of domicile as described in Appendix A-785, or if there are funds held by or on behalf of the ceding company as described in that appendix. Receipts and disbursements under the contract are recorded through the deposit/liability accounts. Amounts received in excess of the deposit made are recognized as a gain in the Other Income or Loss account.

Accounting entries for a ceding entity to report a retroactive reinsurance contract at the inception of which the cedent’s reserves are lower than the attachment point of the reinsurance coverage:

Assume the company pays \$16m to purchase adverse development coverage of \$50m, above an attachment point.

Entry 1: Payment of Retrospective Reinsurance Premium

Retrospective Reinsurance Expense*	\$16m	
Cash		\$16m

The company pays \$16m premium for the retrospective reinsurance contract.
 *This is an Other Expense item, it does not flow through Schedule F or Schedule P.

Entry 2: Adverse Development Reaches the Attachment Point

Losses Incurred	\$25m	
Gross Loss Reserve		\$25m
Recoverable on Retro Reinsurance Contract**	\$25m	
Other Income*		\$9m
Contra – Retro Reinsurance Expense*		\$16m
Surplus***	\$9m	
Segregated Surplus***		\$9m

The company incurs \$25m development on reserves related to the contract.
 *These are Other Income/Expense items do not flow through Schedule F or Schedule P.
 **A contra-liability write-in item, not netted against loss reserves.
 ***Surplus is segregated in the amount of [\$25m - \$16m = \$9m] recoverables less consideration paid.

Entry 3: Cash is Recovered on Paid Losses

Cash	\$20m	
Recoverable on Retrospective Reinsurance Contract		\$20m
Segregated Surplus	\$4m	
Surplus		\$4m

The company recovers \$20m cash from reinsurer on this retro contract. Segregated Surplus decreases in the amount of [\$20m - \$16m = \$4m] (decreases for amount recovered in excess of consideration paid).

35. Q: How should a ceding company account for payment of the premium for a retroactive reinsurance contract by the ceding company’s parent company or some other person not a party to the reinsurance contract (for example, adverse loss development reinsurance contracts purchased by the parent company in the context of the purchase or sale of the ceding company)?

A: If the reinsurance premium is not paid directly by the ceding company but is instead paid on behalf of the ceding company by the ceding company’s parent company or some other entity not a party to the reinsurance contract, then the ceding company should (1) record an increase in gross paid in and contributed surplus in the amount of the reinsurance premium to reflect the contribution to surplus by the parent or third party payor, and (2) record an expense in the amount of the reinsurance premium and account for the contract as provided in Questions 33 and 34.

SSAP NO. 62R—EXHIBIT B

P&C Runoff Reinsurance Transactions

The following provides illustrative journal entries for P&C Runoff Reinsurance Transactions.

Example 1: Transfer of existing block of runoff business with no residual UPR on books of Transferor

<u>Cedent/Transferor</u>		<u>DR</u>	<u>CR</u>
<u>Day 1 - Cedent transfers 50,000 in reserves for 50,000</u>			
<u>Ceded Reinsurance Recoverable (U&I Part 2A & Sch. F)</u>	<u>Contra Liab ↑</u>	<u>50,000</u>	
<u>Cash</u>	<u>Asset ↓</u>		<u>50,000</u>
<u>Losses Paid (U/W Part 2 & Sch. P)</u>	<u>I/S ↓</u>	<u>50,000</u>	
<u>Change in Reserves - Incurred Losses (U&I Part 2-)</u>	<u>I/S ↑</u>		<u>50,000</u>
<i>Unlike novation –gross reserves stay on books of transferor</i>			
<u>Day 360 - Negative Development on Transferred Business - 3,000:</u>			
<u>Reinsurance Recoverable on Unpaid Losses (Sche. F)</u>	<u>Contra Liab ↑</u>	<u>3,000</u>	
<u>Reserves for Unpaid Losses (U&I Part 2A & Sch. P)</u>	<u>Liab ↑</u>		<u>3,000</u>
<u>Day 540 – Reinsurer Pays the Loss @ Reported Reserve</u>			
<u>Reserves for Unpaid Losses (U&I Part 2A & Sch. P)</u>	<u>Liab ↓</u>	<u>53,000</u>	
<u>Ceded Reinsurance Recoverable (U&I Part 2A & Sch. F)</u>	<u>Contra Liab ↓</u>		<u>53,000</u>
<u>Reinsurer/Transferee</u>			
<u>Day 1 - Cedent transfers 50,000 in reserves for 50,000</u>			
<u>Cash</u>	<u>Asset ↑</u>	<u>50,000</u>	
<u>Reported Losses on Reins. Assumed (U&I Part 2A & Sch. P)</u>	<u>Liab ↑</u>		<u>50,000</u>
<u>Change In Reserves – Incurred Losses (U&I Part 2)</u>	<u>I/S ↓</u>	<u>50,000</u>	
<u>Losses Paid or Incurred (negative) (U&I Part 2 & Sch. P)</u>	<u>I/S ↑</u>		<u>50,000</u>
<u>Day 360 - Negative Development on Transferred Business - 3,000:</u>			
<u>Change in Reserves – Incurred Losses (U&I Part 2)</u>	<u>I/S ↓</u>	<u>3,000</u>	
<u>Reserves for Unpaid Losses (U&I Part 2A & Sch. P)</u>	<u>Liab ↑</u>		<u>3,000</u>
<u>Day 540 – Reinsurer Pays the Loss</u>			
<u>Reserves for Unpaid Losses (U&I Part 2A & Sch. P)</u>	<u>Liab ↓</u>	<u>53,000</u>	
<u>Cash</u>	<u>Asset ↓</u>		<u>53,000</u>

Comments:

Since the Transferor is ceding incurred losses neither party should have premium impacted. To do that would distort many financial ratios.

Example 2: Transfer of existing block of runoff business with some residual UPR of 10,000 on books of Transferor (this should be less common).

Cedent/Transferor		DR	CR
Day 1 - Cedent transfers 50k in reserves & 10k UPR for 60,000			
Ceded Reinsurance Recoverable (U&I Part 2A & Sch. F)	Contra Liab ↑	50,000	
Unearned Premium Reserve (U&I Part 1& 1A)	Liab ↓	10,000	
Cash	Asset ↓		60,000
Ceded Premium Written (U&I Part 1B)	I/S ↓	10,000	
Losses Paid (U&I Part 2 & Sch. P)	I/S ↓	50,000	
Change in Reserves - Incurred Losses (U&I Part 2-)	I/S ↑		50,000
Change in UPR (U&I Part 1& 1A)	I/S ↑		10,000
<i>Unlike novation –gross reserves stay on books of transferor</i>			
Day 180 – Premium is Fully Earned (Assumes 80% Loss Ratio)			
Ceded Reinsurance Recoverable (U&I Part 2A & Sch. F)	Contra Liab ↑	8,000	
Reserves for Unpaid Losses (U&I Part 2A & Sch. P)	Liab ↑		8,000
<i>To mirror the increase in unpaid losses by the transferee</i>			
Day 360 - Negative Development on Transferred Business -3,000:			
Reinsurance Recoverable on Unpaid Losses (Sch. F)	Contra Liab ↑	3,000	
Reserves for Unpaid Losses (U&I Part 2A & Sch. P)	Liab ↑		3,000
Day 540 – Reinsurer Pays the Loss @ Reported Reserves (50+8+3)			
Reserves for Unpaid Losses (U&I Part 2A & Sch. P)	Liab ↓	61,000	
Ceded Reinsurance Recoverable (U&I Part 2A & Sch. F)	Contra Liab ↓		61,000

Reinsurer/ Transferee			
<u>Day 1 - Cedent transfers 50k in reserves & 10k UPR for 60,000</u>			
Cash	Asset ↑	60,000	
Reported Losses on Reins. Assumed (U&I Part 2A & Sch. P)	Liab ↑		50,000
Unearned Premium Reserve (U&I Part 1& 1A)	Liab ↑		10,000
Assumed Premium Written (U&I Part 1B)	I/S ↑		10,000
Change In Reserves – Incurred Losses (U&I Part 2)	I/S ↓	50,000	
Change in UPR (U&I Part 1& 1A)	I/S ↓	10,000	
Losses Paid or Incurred (negative) (U&I Part 2 & Sch. P)	I/S ↑		50,000
<u>Day 180 – Premium is Fully Earned (Assumes 80% Loss Ratio)</u>			
Unearned Premium Reserve (U&I Part 1& 1A)	Liab ↓	10,000	
Reserves for Unpaid Losses (U&I Part 2A & Sch. P)	Liab ↑		8,000
Change In Reserves – Incurred Losses (U&I Part 2)	I/S ↓	8,000	
Change in UPR (U&I Part 1& 1A)	I/S ↑		10,000
<i>To record the increase in unpaid losses by the transferee</i>			
<u>Day 360 - Negative Development on Transferred Business -3,000:</u>			
Change In Reserves – Incurred Losses (U&I Part 2)	I/S ↓	3,000	
Reserves for Unpaid Losses (U&I Part 2A & Sch. P)	Liab ↑		3,000
<u>Day 540 – Reinsurer Pays the Loss @ Reported Reserves (50+8+3)</u>			
Reserves for Unpaid Losses (U&I Part 2A & Sch. P)	Liab ↓	61,000	
Cash	Asset ↓		61,000

Comments:

In this second example, the portion of the runoff business that has an UPR associated with it is essentially booked as prospective reinsurance. Other elements of the example are the same except that we assumed an 80% loss ratio on the unearned portion of the business.

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