

# Reinsurance Matters

IASA  
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Presented by:



[Insurance Resolutions, Inc.](#)

# Today's Topics

- ▶ Part I: Accounting for reinsurance:  
Evaluating Risk Transfer Revisited
- ▶ Part II: Accounting for reinsurance:  
Reinstatement Premiums
- ▶ Part III: The worlds largest reinsurer?:  
Update on TRIA

# Part I

# Evaluating Risk Transfer Revisited

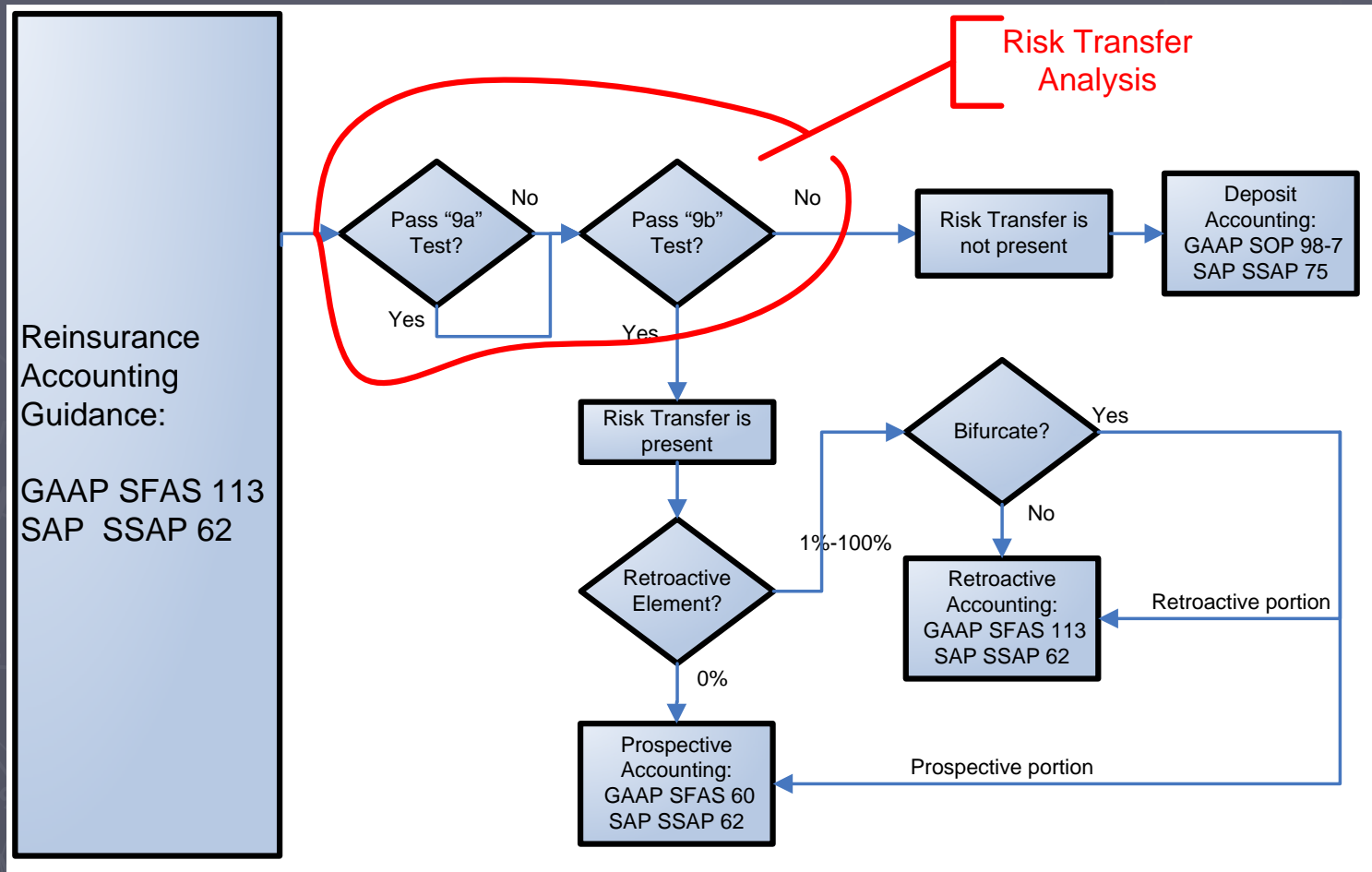
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# Risk Transfer - In the News

- ▶ *“Regulators are raising concerns about low-risk policies sold by reinsurers that may do little more than dress up financial statements”*

(The Wall Street Journal October 29, 2004 – Front Page)

# Accounting For Reinsurance: Overview of Guidance



# Risk Transfer - Resources

- ▶ Your independent auditor
- ▶ Case studies
  - Available at [www.ins-resolutions.com](http://www.ins-resolutions.com) content from 2003 IASA Conference "Risk Transfer Case Study"
  - Available at [www.swissre.com](http://www.swissre.com) technical publications paper on "A Change of paradigms in financial accounting?"
- ▶ Recent AICPA industry expert panel paper on "Evaluating Risk Transfer in Reinsurance of Short-Duration Contracts"
  - Available at [www.aicpa.org/download/acctstd/exprtpnl](http://www.aicpa.org/download/acctstd/exprtpnl)

# Part II: Accounting for Reinsurance: Reinstatement Premiums

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# Unprecedented Catastrophe Activity in 2004

- ▶ 4 separate events occurring in 2004 enter the ISO's list of the "Ten most costly hurricanes in the United States" (source: Insurance Information Institute)
- ▶ Many companies catastrophe reinsurance coverages will be activated
- ▶ Reinstatement and similar mechanisms will be triggered



# Example of Reinstatement clause

REINSURED:	Seaport Insurance Company
PERIOD:	Losses occurring during the period August 1, 2004 to July 31, 2005
CLASS:	Property Catastrophe
TERRITORY:	USA
RETENTION:	\$750,000 ultimate net loss Each and every loss occurrence
LIMIT:	\$2,250,000 ultimate net loss Each and every loss occurrence
PREMIUM:	Minimum and Deposit \$400,000 Adjustable at 1.25% of subject premium income
REINSTATEMENT:	One full reinstatement 100% additional premium as to time, pro rata as to amount reinstated
PRIORITY:	All other reinsurance of the reinsured to be applied first, whether collectible or not

# What is a reinstatement provision?

- ▶ Reinsurance contracts provide coverage limits for losses
- ▶ Limited versus Unlimited coverage
- ▶ Additional premiums may be triggered by losses
- ▶ If limited the additional premium to be paid to the reinsurer as losses are presented which "exhaust" the limits are called "reinstatement premiums"

# How do reinstatement provisions work?

- ▶ May be “Free” but if not;
- ▶ Additional “reinstatement” premium is usually a function of (one or more):
  - the amount of coverage limit which is exhausted (“AMOUNT”)
  - the proportion of time left in the contract for future events to be covered (“TIME”)
  - The ultimate premium payable without the loss

# Calculating Reinstatement Premiums

- ▶ The additional premium may be calculated in several ways:
  - PRO RATA: Time and/or Amount may be calculated "Pro Rata"
    - ▶ For Time:  $[\# \text{ days remaining} / \# \text{ days total}]$
    - ▶ For Amount:  $[\text{amount of loss} / \text{total amount of cover}]$
  - FIXED PERCENTAGE: Time and/or Amount may be calculated using a fixed percentage
    - ▶ For Fixed Percentage: multiply by selected %

# Some examples

## ▶ GIVEN:

- ▶ LIMIT OF COVER: US\$ 2,000,000
- ▶ PERIOD : 1 Jul 2004 to 20 Jun 2005
- ▶ LOSS TO COVER: US\$ 1,000,000
- ▶ DATE OF LOSS: 30 Sep 2004
- ▶ ULTIMATE PREMIUM W/O LOSS: US \$300,000

## ▶ EXAMPLES:

- ▶ #1: "100% additional premium, Pro Rata as to Amount and Pro rata as to Time"
- ▶ #2: "100% additional premium, Pro Rata as to Amount and 100% as to Time"
- ▶ #3: "50% additional premium, Pro rata as to Amount and Pro Rata as to Time"

# Accounting and Reporting

- ▶ What accounting period should the additional reinstatement premiums be charged to?
  - GAAP Guidance: SFAS 113 paragraph 21
    - ▶ Recognize the “ultimate” premium over the life of the contract in proportion to the amount of coverage provided
  - SAP Guidance: SSAP 62 paragraph 25
    - ▶ “Reinstatement premium, if any, shall be earned over the period from the reinstatement of the limit to the expiration of the agreement”

# Premium Recognition Alternatives

Period	1 Jul 04 - 1 Jul 05					
Deposit Premium	300,000					
Reinstatement for 30 Sep 04 claim	150,000					
Ultimate Premium	450,000					
<b>ALTERNATIVE PREMIUM RECOGNITION STREAMS</b>						
<b>OPTION 1</b>						
<u>Calendar Qtr</u>	<u>Deposit Amort</u>	<u>Reinst Amort</u>	<u>Total Amort</u>			
3Q04	75,000		75,000	}	CY 04 - \$200,000	
4Q04	75,000	50,000	125,000			
1Q05	75,000	50,000	125,000	}	CY 05 - \$250,000	
2Q05	75,000	50,000	125,000			
Total	300,000	150,000	450,000			
<b>OPTION 2</b>						
<u>Calendar Qtr</u>	<u>Ult Prem Amort</u>	<u>Reinst Amort</u>	<u>Total Amort</u>			
3Q04	112,500		112,500	}	CY 04 - \$225,000	
4Q04	112,500	-	112,500			
1Q05	112,500	-	112,500	}	CY 05 - \$225,000	
2Q05	112,500	-	112,500			
Total	450,000	-	450,000			
<b>OPTION 3</b>						
<u>Calendar Qtr</u>	<u>Deposit Amort</u>	<u>Reinst Amort</u>	<u>Total Amort</u>			
3Q04	75,000		75,000	}	CY 04 - \$300,000	
4Q04	75,000	150,000	225,000			
1Q05	75,000	-	75,000	}	CY 05 - \$150,000	
2Q05	75,000	-	75,000			
Total	300,000	150,000	450,000			

# Part III: The Worlds Largest Reinsurer? TRIA Update

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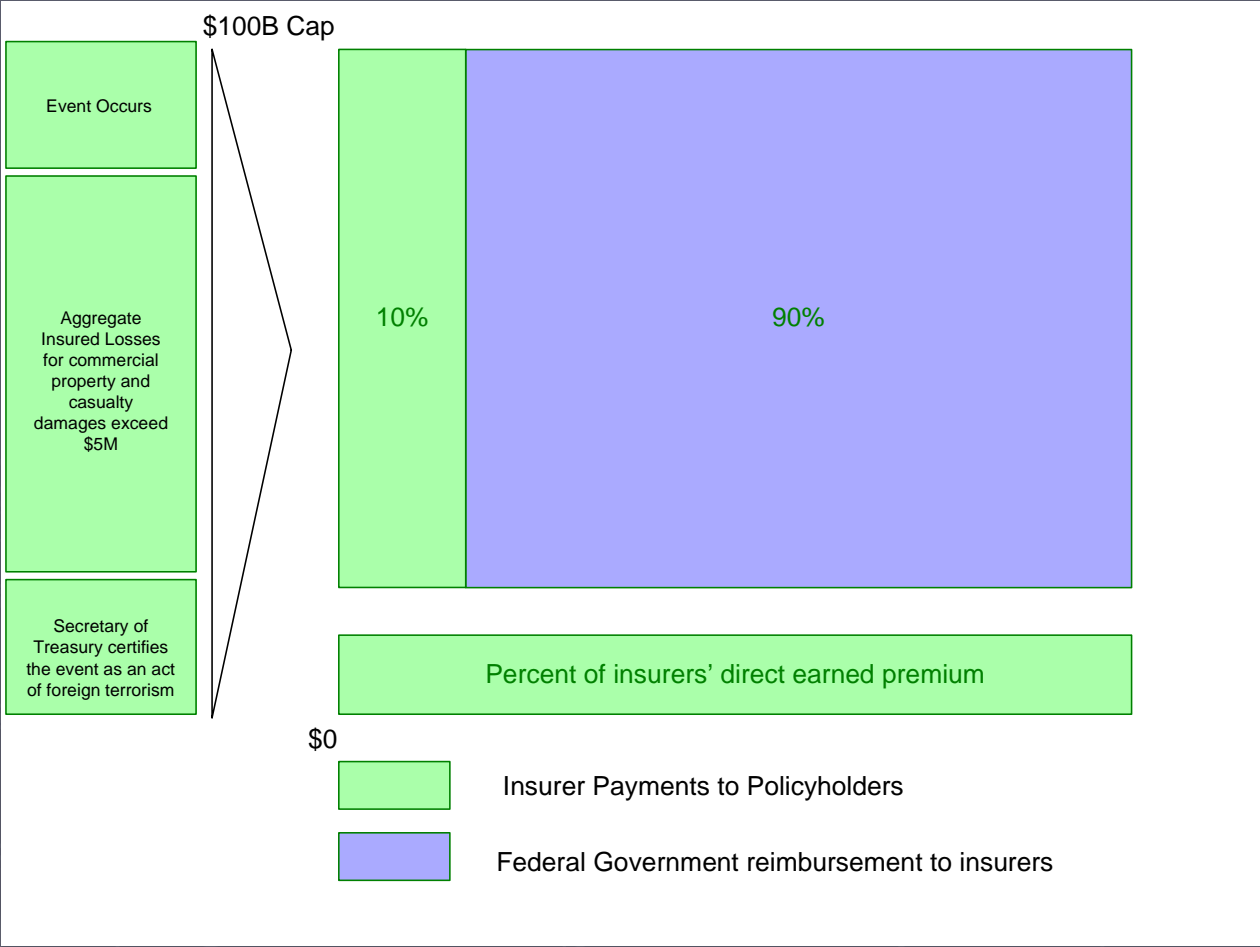


# TRIA Basics

- ▶ “Terrorism Risk Insurance Act of 2002” signed into law on November 26, 2002
- ▶ Goals:
  - Make terrorism insurance widely available and affordable to policyholders
  - Provide a transitional period for insurance industry to develop products to address this risk
- ▶ Will expire on December 31, 2005

# How TRIA works

(source: GAO )



# TRIA Status

- ▶ Has not been extended past December 31, 2005 as had been anticipated
- ▶ The “take-up rate” has recently increased to almost 50%
- ▶ Companies are negotiating and will soon issue policies with coverage extending past the expiration date
- ▶ **BOTTOM LINE:** Most people expect an extension to be passed during 2005

# TRIA Claims Process

- ▶ The Department of Treasury has established the "Terrorism Risk Insurance Program (TRIP) office"
- ▶ Insurers must be able to accumulate subject losses, calculate their deductibles, and report and bill the Treasury for covered claims above the deductible
- ▶ Small companies are at a disadvantage administratively

# TRIA Open Issues

- ▶ Will the Act be extended? In what form?
- ▶ How will insurers address their exposure to terrorism losses on policies that extend beyond the expiration of TRIA?
- ▶ Mechanisms for handling claims reporting, auditing, and settlement must be designed, tested, and implemented

# TRIA resources

- ▶ Go to: [www.treas.gov/offices/domestic-financial/financial-institution/terrorism-insurance/](http://www.treas.gov/offices/domestic-financial/financial-institution/terrorism-insurance/)

# Disclaimer

- ▶ The opinions or positions expressed in this presentation do not necessarily reflect the opinions or positions of Insurance Resolutions, Inc., Horizon Management Group LLC, or any of our clients.

# Questions ?





# Thank You

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