Inter-Affiliate Pooling Arrangements
Inter – Affiliate
Pooling Arrangements

NAIC
National Association
Of Insurance Commissioners
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I. REPORT OF THE WORKING GROUP

The Inter-Affiliate Pooling Company Working Group was appointed by the Special Insurance Issues (E) Committee in 1997 to address the following charge:

Consider amending either the Model Holding Company Act or the Rehabilitation and Liquidation Model Act to prevent the unfair treatment of policyholders of insolvent affiliated pooling companies.

Arnold Dutcher (Ill.) was appointed chair of the working group. Other members of the working group were Sherwood Girion and Robert Loo (Calif.), Thomas Burke (N.H.), Raymond Conover (N.J.), Kevin Brady (Texas), Alfred W. Gross (Va.) and Brian Hogan (Wis.).

Issue

The working group defined the issue presented by the charge as follows:

Failure of the reinsurance recoverable from an assuming reinsurer in an inter-affiliate reinsurance pooling arrangement (a "pool") because of the reinsurer’s insolvency can result in the impairment or insolvency of the ceding companies, since the claims of ceding companies in the pool have a lower liquidation priority than the claims of the reinsurer’s direct policyholders. This can result in a benefit to the reinsurer’s direct policyholders at the expense of the direct policyholders of the other members of the pool.

Inter-Affiliate Pooling Arrangements

An inter-affiliate pooling arrangement is a reinsurance agreement among two or more affiliated companies whereby each participating company shares in the underwriting results of the participating insurers on a predetermined percentage basis. The policy issuing company retains primary liability to policyholders and third party liability claimants and each of the other pool participants is liable as a reinsurer for its respective share of the other pool participants’ obligations.

The benefits of pooling arrangements include more efficient use of surplus, the opportunity to participate in a more diversified book of business, premium tax advantages, flexibility as to rate and form filings, the opportunity to obtain a rating based upon the combined financial strength of all pool participants and the ability to achieve more consistent underwriting results.

There are two basic types of pooling arrangements. In a “lead company” scenario, one of the participating insurers acts as the lead company, assuming the pooled business from the other participants, combining the assumed business with its own direct business, and retroceding to each participating company its predetermined share of the pooled business. In an “independent participant” scenario, each participating company retains its predetermined share of all direct and assumed business and cedes the remainder to the other pool participants.

Survey of Receivers of Insolvent Insurance Companies

The working group asked the International Association of Insurance Receivers (IAIR) to conduct a survey of its members. The purpose of the survey was to identify insurer insolvencies involving
participants in inter-affiliate pooling arrangements and the problems encountered by receivers in dealing with pooling agreements. The problems identified by the receivers responding to the survey were (1) the potential for fraud, (2) the potential for the insolvency of one pool participant to lead to the insolvency of other members of the pool, (3) issues as to which company is responsible for collecting external reinsurance, (4) the difficulty of sorting out complicated reinsurance arrangements and determining the respective liabilities and credits, and (5) the liquidation priority issue previously identified by the working group.

Discussion of Issues and Possible Solutions

The working group met numerous times to discuss the central issue and several proposed solutions. One proposal suggested to address the problem involved the amendment of state liquidation priority statutes to elevate the claims of cedents to the same priority as the claims of direct policyholders of the insolvent company. This proposal was considered at length and ultimately rejected as not feasible because of the perceived difficulty of achieving uniformity of the liquidation priority statutes in all of the states. Also, it was noted that the amendment of liquidation priority statutes as proposed might conflict with existing case law on liquidation priorities established by the U.S. Supreme Court in Dept. of Treasury v. Fabe.¹

A second proposal considered by the working group involved using the authority of the insurance commissioner under state insurance holding company laws to grant conditional approval of pooling agreements and require the collateralization of reinsurance recoverables in the event the lead company or another assuming company becomes financially troubled. This proposal was also rejected by the working group. The working group recognized that there would be substantial costs involved in maintaining and transferring assets between affiliated insurers. The working group also noted that the domiciliary regulator of the lead company would have little or no incentive to approve use of the company’s assets to securitize reinsurance recoverables.

A third proposal discussed by the working group involved the constructive consolidation of pool participants under the authority of a single receiver. Several obstacles to the use of this approach were identified. The legal authority for constructive consolidation is unclear. Constructive consolidation would require the cooperation of regulators in all states where pool participants are domiciled. Also, there likely would be substantial assets and liabilities outside the pool. The working group ultimately rejected this proposal as not practical.

Finally, the working group considered whether existing regulatory authority is sufficient to address problems presented by inter-affiliate pooling arrangements. With the assistance of a technical support group, the working group researched the scope and adequacy of existing NAIC model laws and regulations and state authority applicable to pools. The technical support group found that inter-affiliate pooling arrangements are subject to extensive financial reporting and disclosure requirements under existing law. Regulators have the authority to review inter-affiliate pooling arrangements and to order corrective action if the arrangement is unfair or unreasonable. The technical support group concluded that existing accounting and other regulatory guidance relative to inter-affiliate pooling arrangements is sufficient and that none of the proposals put before the working group would improve upon the tools currently available to regulators. The group noted that pooling arrangements have not been a significant factor in insurer insolvencies but, to the contrary, have had a positive effect on insurer solvency.


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The working group also investigated the policy and procedures used by rating agencies in assigning financial strength ratings to companies that participate in inter-affiliate pools. Rating agencies have traditionally considered pool participants to have a virtual guarantee from the lead company. Consequently, rating agencies have considered the combined financial strength of the participating companies and assigned the same rating to all participants. However, rating agencies have taken notice of a changing business environment in which companies that are financially weak or not important to the overall operation may be cut out of the group. As a result of this trend, rating agencies have begun to concern themselves with the termination provisions of pooling agreements. Typically, agreements may be terminated on relatively short notice, 60 days in many cases. Also of importance is whether termination of a pooling agreement is done on a "run off" or "cut off" basis. Two major rating agencies have recently announced changes to their rating procedures regarding pool participants, indicative of their recognition that "group" ratings may not always be a reliable indicator of the strength or strategic importance of individual companies within the group.

**Conclusion and Recommendations**

The working group concluded that the existing regulatory framework provides sufficient disclosure of relevant information and the authority to order corrective action with regard to participants in inter-affiliate pooling arrangements. Although the working group considered several proposals that were responsive to the issue, the working group determined that the proposals were not practical. The working group recommends that its report and the appendices be distributed to each state insurance department.
II. APPENDIX

A. OVERVIEW OF POOLING ARRANGEMENTS

Jeff Alton
CNA

Definition of Inter-Company Pooling

- A reinsurance agreement among two or more affiliated insurers

- Each company in the agreement shares, on a predetermined percentage basis, in the underwriting results of the participating insurers

- Primary liability to policyholders or claimants is retained by the policy issuing company and other pool participants are liable as reinsurers for their share of other pool participants’ obligations

Organizational Structure

- Dictated by the pooling agreement

- Inter-company pooling agreements can be formed to share either specific risks or all risks underwritten by pool participants

- Inter-company pooling agreements contain provisions similar to traditional reinsurance agreements, e.g., insolvency, settlement, etc.

- Inter-company pools typically exchange participants’ underwriting activities including
  - Written premium
  - Loss and loss adjustment expenses incurred
  - Acquisition and other underwriting expenses
  - Underwriting assets and liabilities, including unearned premium reserves, loss and loss adjustment expense reserves and premiums receivable

- Does not include invested assets or premium taxes

- Pooling percentages are typically based upon the relative levels of surplus of each participant
Benefits of Pooling

- Efficient use of surplus
  - Ability to allocate written premium to participants based on surplus capacity
  - Provides relief to participants with a high level of direct premiums written to surplus
- Participation in a more diversified book of business
  - Diversification among numerous lines of business
  - Diversification of risks among affiliates
  - Geographic dispersion of risks
- Premium tax advantages
  - Efficiencies from tax strategies provide savings for participants that can be passed onto the entire pool, and ultimately, to the policyholders
  - A pool may have participants domiciled in states with favorable premium tax treatment
  - A pool may have participants that qualify for premium tax incentives (e.g., having state branch offices and having investments in a state)
- Flexibility of rate and form filing by state
  - Multiple companies licensed in a state allow the pool to participate in several tiers of a particular line of business
- Ratings advantages
  - Insurers participating in inter-company pools receive ratings on a pooled basis, reflecting the combined financial strength of all participants
  - Obtaining a more favorable pooled rating lowers the cost of transacting business, producing savings that are ultimately passed on to policyholders
- Consistent underwriting results
  - Diversified pools provide participants with more stable, consistent underwriting results
  - Consistent underwriting results provide regulators with a clearer picture of the financial condition of a pool at a point in time
Operation of Pools

- Lead company scenario
  - Lead company assumes pooled business from other participants
  - Combines the other participants’ business with its own
  - Retrocedes to each participant its predetermined share of the pooled business
  - Lead company may also be responsible for:
    - billing and collection
    - claims handling
    - general administration of pool’s business
    - payment of other operating expenses
    - assuming and ceding external reinsurance
  - Lead company allocates all operating expenses paid or accrued back to participants based on pooling percentage
- Example
  - Lead Company A assumes 100% of the direct business of companies B and C. Lead Company A then retrocedes 25% of the total pooled business back to both B and C.

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<table>
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<tbody>
<tr>
<td><strong>Direct Written Premiums</strong></td>
<td></td>
</tr>
<tr>
<td>Lead Company A</td>
<td>$100M</td>
</tr>
<tr>
<td>Company B</td>
<td>$25M</td>
</tr>
<tr>
<td>Company C</td>
<td>$25M</td>
</tr>
<tr>
<td><strong>Total Pooled</strong></td>
<td><strong>$150M</strong></td>
</tr>
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</table>

<p>| | |</p>
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<tr>
<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td><strong>Net Written Premiums</strong></td>
<td></td>
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<tr>
<td>Lead Company A (50% of Total)</td>
<td>$75.0M</td>
</tr>
<tr>
<td>Company B (25% of Total)</td>
<td>$37.5M</td>
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<tr>
<td>Company C (25% of Total)</td>
<td>$37.5M</td>
</tr>
</tbody>
</table>

- Insurers that use the Lead Company structure:
  - CNA
  - Travelers Group
  - St. Paul Insurance Group
  - John Deere Insurance Group

- Independent participant scenario
  - Each participant retains its predetermined share of all direct and assumed business and cedes the remainder to the other pool participants

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- Reinsurance purchased from non-affiliated reinsurance companies by the benefit of the pool is shared proportionally by each participant.

- Related assets and liabilities are reported on the balance sheets of each participant.

- Each participant is responsible for its own respective:
  - Policy issuance, billing and collection
  - Claims handling
  - General administration of business
  - Other operating expenses
  - Assuming and ceding external reinsurance

- Example
  - Company A retains 50% of its direct and assumed business, and cedes 25% each to companies B and C.

<table>
<thead>
<tr>
<th></th>
<th>A (50%)</th>
<th>B (25%)</th>
<th>C (25%)</th>
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<tbody>
<tr>
<td>Direct Prem.</td>
<td>$100</td>
<td>$25</td>
<td>$25</td>
</tr>
<tr>
<td>Assumed (from):</td>
<td>$12.5 (B)</td>
<td>$6.25 (C)</td>
<td>$6.25 (B)</td>
</tr>
<tr>
<td>Assumed (from):</td>
<td>$12.5 (C)</td>
<td>$25 (A)</td>
<td>$25 (A)</td>
</tr>
<tr>
<td>Ceded (to):</td>
<td>$25 (B)</td>
<td>$12.5 (A)</td>
<td>$12.5 (A)</td>
</tr>
<tr>
<td>Ceded (to):</td>
<td>$25 (C)</td>
<td>$6.25 (C)</td>
<td>$6.25 (B)</td>
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<tr>
<td>Net Prems.:</td>
<td>$75</td>
<td>$37.5</td>
<td>$37.5</td>
</tr>
</tbody>
</table>

- Insurers that use an Independent Pooling Structure:
  - Chubb Group of Insurance Companies

- Reasons why pools have multiple companies
  - The ability to write business in sub-standard, standard and preferred tiers in the same state
  - The ability to write participating and non-participating contracts in each tier in the same state (A pool would need a minimum of six companies)

- Historical reasons
  - Mergers and acquisitions
  - A company may stop writing business in a particular state, but may wish to do so again in the future
B. Report of Technical Support Group

(Letter from Robert D. Graham)

General
Re

General Reinsurance Corporation
Financial Centre
PO Box 10350
Stamford, CT 06904-2350
203-328-5591

Robert D. Graham
Vice President and
Assistant General Counsel

March 13, 1998

Arnold Dutcher, Acting Director
Illinois Department of Insurance
320 West Washington
Springfield, Illinois 62767

Re: Inter-Affiliate Pooling Company Working Group

Dear Mr. Dutcher:

The technical support group has not met since the December 8, 1998 meeting of the working group. In order not to delay the work of the working group, I’ve prepared this letter and distributed it to the members of the technical support group as a suggested basis for the technical support group’s report. While I believe it is reasonably consistent with the public statements of its members, I cannot currently represent it as the consensus of the technical support group. I anticipate speaking to a number of the members prior to the working group’s March 16, 1998 meeting and will report further at that meeting on whether this letter reflects the consensus of the technical support group.

The minutes of the December meeting of the working group reflect that the technical support group will review NAIC model laws and regulations relevant to the issue of interaffiliated pooling arrangements and the extent to which those model laws and regulations have been adopted by the states. The working group appears to be in general agreement that the issue can be summarized as follows:

Failure of the reinsurance recoverable from an assuming reinsurer in an interaffiliated reinsurance pooling reinsurance arrangement (a “pool”) because of the reinsurer’s insolvency can result in the impairment or insolvency of the ceding companies, since the claims of ceding companies in the pool have a lower liquidation priority than the claims of the reinsurer’s direct policyholders. This can result in a benefit to the reinsurer’s direct policyholders at the expense of the direct policyholders of the other members of the pool.

The working group has heard several suggestions for possible solutions to the problem, each of which would require some changes in the existing regulatory scheme. One was to require the provision of security by interaffiliated reinsurers (so as to put collateral in the hands of pool cedants). A second was to limit the lead reinsurer in a pool to assuming but not ceding pool business. A third was to amend the liquidation laws to give reinsurance claims arising out of interaffiliated pooling arrangements the same
priority as the claims of direct policyholders and permit constructive consolidation of all pool members instead of one liquidator for each pool participant.

The working group has also heard that there are practical, legal and political problems with each of those suggested solutions. Those suggestions started from the premise that the issue is one which requires a change in the existing scheme of regulations. This letter starts from the premise that there is sufficient statutory and regulatory authority currently available to regulators to deal with the problem.

Mr. Alton of CNA has previously submitted materials describing the benefits of interaffiliated pooling arrangements for insurers and insurance consumers. Those benefits include the efficient use of surplus, diversification of risks, more stable and consistent underwriting results, pooled ratings by ratings agencies, premium tax advantages, and flexibility of rate and form filings.

He then described the requirements of the accounting procedures, annual statement forms and instructions, and NAIC models applicable to interaffiliate pooling arrangements for property and casualty insurers. I’ll also summarize those requirements in this letter.

**Accounting Requirements**

Statement of Statutory Accounting Principles ("SSAP") No. 97 – *Underwriting Pools and Associations Including Intercompany Pools*, soon to be adopted as a part of the codification process, is clearly applicable. It assures disclosure of interaffiliated pooling arrangements in the financial statements filed by insurers with regulators.

Paragraph 8 of SSAP 97 requires:

- underwriting results to be recorded on a gross basis;
- premiums and losses to be recorded as direct, assumed or ceded as applicable;
- premiums and losses ceded to the pool to be recorded as in any other ceded reinsurance arrangement; and
- business assumed from the pool to be recorded as in any other assumed reinsurance arrangement.

Paragraph 10 requires financial statement disclosure by pool members of:

- the basic terms of the pooling arrangement;
- the lead company, the other participating insurers and their percentages;
- the lines and types of business subject to the pooling arrangement;
- cession to non-affiliated reinsurers (pre and post pooling);
- the pool member’s rights, if any, to direct recovery from external reinsurers; and
- discrepancies, if any, between assumed and ceded schedules of the lead and other participants.
Annual Statement Requirements

The annual statement instructions for Note 5 – Information Concerning Parent, Subsidiaries and Affiliates require the reporting insurer to disclose if it is a member of a pooling arrangement and, if so, to list each pool member and its respective pooling percentage. In Schedule F, pool participants report assumed reinsurance associated with interaffiliated pooling arrangements in Part 1 and ceded reinsurance in Part 3. And Schedule P requires each pooling arrangement member to report:

- its percentage of total combined pool business as “Direct and Assumed” and “Ceded” business as appropriate;
- claim counts in accordance with the pooling arrangement;
- the pooling percentage at year end (and to subsequently restate Schedule P if retroactive changes in those percentage are made); and
- any significant changes in the pooling arrangement in Item 8 of the Schedule P interrogatories.

NAIC Model Laws and Regulations

A. Holding Company Act and Regulation

The principal NAIC model laws and regulations relevant to the issue of interaffiliated pooling arrangements are the Insurance Holding Company System Regulatory Act (originally adopted in June 1969 and last amended in March 1995) and the Insurance Holding Company System Model Regulation With Reporting Forms and Instructions (originally adopted in December 1970 and last amended in June 1993).

As of July 1997, the holding company act has been adopted by 49 of the 54 U.S. insurance regulatory jurisdictions (the exceptions are New York, Wisconsin, Guam, Puerto Rico and the Virgin Islands). As of October 1997, 47 of those 54 jurisdictions have adopted the model regulation (the exceptions are Florida, Michigan, Nevada, New York, Guam, Puerto Rico and the Virgin Islands).

1. Registration Requirements

Section 4 of the holding company model act requires all licensed insurers to register on a form prescribed by the NAIC which contains current information regarding, among other matters:

- capital structure, general financial condition, ownership and management of the insurer and any person controlling the insurer;
- the identity and relationship of every member of the insurance holding company system; and
- eight categories of agreements in force and transactions currently outstanding or which have occurred during the previous year between the insurer and its affiliates, including all management agreements, service contracts, cost-sharing arrangements and reinsurance agreements.
No item need be reported under Section 4 if it is not material. Subsection 4D provides that transactions involving 0.5% or less or an insurer's admitted assets are not deemed material unless the commissioner by rule, regulation or order provides otherwise.

2. **Standard of Review**

Paragraph (1) of Subsection 5A of the model holding company act provides the following relevant standards for transactions within a holding company system:

- terms must be fair and reasonable;
- charges or fees for service must be reasonable;
- income and expense must be allocated in conformity with customary accounting practices consistently applied; and
- books and records must clearly and accurately disclose the nature and details of transactions and have sufficient detail to support the reasonableness of fees and charges.

3. **Transactions Requiring Approval**

Paragraph (2) of Subsection 5A of the model holding company act provides that certain transactions are subject to prior review and disapproval by the commissioner, including reinsurance agreements or modifications of those agreements in which the reinsurance premium or a change in the insurer's liabilities exceeds 5% of the insurer's policyholder surplus. That requirement applies to agreements which may require as consideration the transfer of assets from an insurer to a non-affiliate, if there is an agreement or understanding between the insurer and the non-affiliate that any portion of those assets will be transferred to one or more affiliates of the insurer. Paragraph (3) of Subsection 5A of the model holding company act prohibits an insurer from entering into a series of separate transactions to avoid the statutory threshold amount and thus avoid review.

4. **Examination Authority**

Section 6 of the model holding company act gives the commissioner the power, in addition to any examination power provided under other sections of the insurance laws, to order any insurer registered pursuant to Section 4 to produce records, books or other information in its possession or in the possession of its affiliates as is reasonably necessary to determine the financial condition of the insurer or to determine compliance with the insurance laws.

If the insurer fails to comply with the examination order, the commissioner is empowered to examine the affiliates to obtain the information. The insurer is liable for the expenses of the examination, including the expense of attorneys, actuaries, accountants and other experts not otherwise a part of the commissioner's staff as reasonably necessary to conduct the examination.

5. **Injunctive Relief and Other Sanctions**

Subsection 9A authorizes the commissioner to seek injunctive or other equitable relief whenever it appears that an insurer or any director, officer, employee or agent has committed or is about to commit a violation of the holding company act.

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Subsection 10A provides for imposition, after notice and hearing, of a daily monetary penalty for failure, without just cause, to file any registration statement required by the holding company act.

Subsection 10B provides for imposition, after notice and hearing, of a monetary civil forfeiture from any director or officer – in their individual capacities – who knowingly violates, participates in, assents to, or knowingly permits any of the officers or agents of the insurer to engage in transactions or make investments which haven’t been properly reported or submitted pursuant to the holding company act.

Subsection 10C provides that if the commissioner finds that an insurer or any director, officer, employee or agent of the insurer has engaged in any transaction or entered into a contract subject to the holding company act and which would not have been approved if approval had been requested, the commissioner may order the insurer to cease and desist immediately any further activity under that transaction or contract. In addition, after notice and hearing the commissioner may also order the insurer to void any contracts and restore the status quo if the action is in the best interests of the policyholders, creditors or the public.

Subsection 10D provides for a fine, or imprisonment up to 3 years, or both, for any willful violation of the holding company act by an insurer, director, officer, employee or agent.

Subsection 10E similarly provides for a fine or imprisonment for willfully and knowingly making a false statement, a false report or a false filing.

6. Receivership

Section 11 gives the commissioner the additional authority to place the insurer into receivership if the commissioner concludes that any person has committed a violation of the holding company act which so impairs the financial condition of a domestic insurer as to threaten insolvency or make the further transaction of business hazardous to its policyholders, creditors, shareholders or the public.

7. License revocation, suspension or nonrenewal

Section 13 gives the commissioner authority, on notice and hearing, to suspend, revoke or nonrenew an insurer’s license if the commissioner finds that any person has committed a violation of the holding company act which makes the continued operation of the insurer contrary to the interests of the policyholders or the public.

B. Credit for Reinsurance Law and Regulation

In addition, because interaffiliate pooling arrangements are typically effected through a reinsurance contract or contracts, the Credit for Reinsurance Model Law (originally adopted June 1984 and last amended September 1996) and the Credit for Reinsurance Model Regulation (originally adopted December 1990 and last amended December 1996) are also relevant. Like the holding company act and regulation, they have had a similarly broad adoption (although because of their more recent amendments not as broad).

The model credit for reinsurance law and regulation essentially require credit for reinsurance ceded to authorized reinsurers, and require that unauthorized reinsurers provide security (in the form of cash, securities, letters of credit or other security acceptable to the commissioner). They apply to interaffiliate
pooling arrangements in the same way as any other reinsurance arrangement — that is, ceding members of the pool would take credit for reinsurance to the extent that their affiliated reinsurers meet the requirements of Section 2 of the model act, and would provide security to the extent that they fall within Section 3.

C. Conclusion

This somewhat lengthy recitation of the accounting standards, annual statement reporting requirements and applicable NAIC model laws and regulations demonstrates the breadth and depth of the regulatory tools currently available to regulators regarding interaffiliate pooling arrangements.

Material interaffiliate pooling arrangements must be submitted to the domestic regulator of each of the pool members — with a 5% of assets materiality threshold — for prior review, and subject to prior disapproval. Prior review permits regulators to evaluate the fairness and reasonableness of the arrangement, to disapprove unfair or unreasonable arrangements, and to suggest changes in the arrangement which would make it fair and reasonable and enable the regulator to approve the arrangement. Interaffiliate pooling arrangements which don’t reach the prior review materiality threshold are subject to after the fact reporting in holding company act registration statements, with a 0.5% of assets materiality threshold for reporting, which means that all but the least of such arrangements will be subject to review for fairness and reasonableness.

Interaffiliate pooling arrangements are subject to extensive financial reporting disclosure requirements, which gives regulators sufficient information to evaluate the ongoing fairness and reasonableness of the pooling arrangement to each pool member.

Examination authority gives the regulator the ability to further review in force interaffiliate pooling arrangements for fairness and reasonableness, and to order corrective action if the arrangement has become unfair or unreasonable.

Suspected violations of the holding company act — including unfair and unreasonable interaffiliate pooling arrangements — subject insurers and their officers, directors, employees, agents and owners to a broad array of possible regulatory remedies and sanctions depending on the nature of the offense, including but not limited to cease and desist orders, injunctions, license suspension or revocation, receivership, monetary penalties and imprisonment.

Coupled with other regulatory evaluation tools (such as risk-based capital filings), the holding company act permits the early detection and avoidance of problems associated with unfair and unreasonable interaffiliate pooling arrangements. It does not appear that amendments to the holding company act creating additional regulatory authority are necessary or desirable.

Very truly yours,

/original signed/

Robert Graham

cc: Members of the Technical Support Group

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C. NAIC GUIDANCE REGARDING POOLING ARRANGEMENTS

STATE OF ILLINOIS
DEPARTMENT OF INSURANCE
320 WEST WASHINGTON STREET
SPRINGFIELD, ILLINOIS 62767-0001

JIM EDGAR
GOVERNOR

ARNOLD DUTCHER
ACTING DIRECTOR

TO: Inter-Affiliate Pooling Company Working Group and Interested Parties

FROM Arnold Dutcher (original signed)

DATE: April 15, 1998

SUBJECT: Inter-affiliate Pooling

Attached is NAIC guidance for such arrangements:

- Annual Statement Instructions for Footnote 19
- Annual Statement Instructions for Schedule F (pertinent parts)
- Annual Statement Instructions for Schedule P (pertinent parts)
- Statement of Statutory Accounting Principles No. 63
- Statutory Issue Paper No. 97
- Guidance from the Financial Analysis Handbook
- Guidance from the Accounting Practices and Procedures Manual

This I believe is the extent of NAIC guidance that addresses intercompany pooling.

http://www.state.il.us/ins/
Printed on recycled paper
1. **Annual Statement Instructions for Footnote 19**

19. Intercompany Pooling Arrangements

**Instruction:**

If the company is part of a group of affiliated insurers which utilizes a pooling arrangement that affects the solvency and integrity of the insurer’s reserves under which the pool participants cede substantially all of their direct and assumed business to the pool, describe the basic terms of such arrangement[s] and the related accounting. The disclosure should include:

- Identification of the lead company and of all affiliated companies participating in the intercompany pool (include NAIC Company Codes) and indication of their respective percentage shares of the pooled business.

- Description of the lines and types of business subject to the pooling agreement.

- Description of cessions to non-affiliated reinsurers of business subject to the pooling agreement, and indication of whether such cessions were prior to or subsequent to the cession of pooled business from the affiliated pool members to the lead company.

- Identification of all pool members which are parties to reinsurance agreements with non-affiliated reinsurers covering business subject to the pooling agreement and which have a contractual right of direct recovery from the non-affiliated reinsurer per the terms of such reinsurance agreements.

- Explanation of any discrepancies between entries regarding pooled business on the assumed and ceded reinsurance schedules of the lead company and corresponding entries on the assumed and ceded reinsurance schedules of other pool participants.

- Description of intercompany sharing, if other than in accordance with the pool participation percentage, of the Provision for Reinsurance (Schedule F, Part 7) and the write-off of uncollectible reinsurance.
2. Annual Statement Instructions, for Schedule F (pertinent parts)

SCHEDULE F

Index to Schedule F

Part 1 – Assumed Reinsurance
Part 2 – Portfolio Reinsurance
Part 3 – Ceded Reinsurance
Part 4 – Aging of Ceded Reinsurance
Part 5 – Provision for Unauthorized Reinsurance
Part 6 – Provision for Overdue Authorized Reinsurance
Part 7 – Provision for Overdue Reinsurance (Authorized Over 20%)
Part 8 – Restatement of Balance Sheet to Identify Net Credit for Ceded Reinsurance

Due Date

All parts of Schedule F are to be filed with the annual statement.

Please note that Parts 1, 3, 4 and 5 of this schedule are reported with thousands omitted. Parts 2, 6, 7 and 8 are reported in whole dollars.

“Federal ID Number”

Most parts of Schedule F require that the “Federal Employer Identification Number” be reported for assuming or ceding insurers. Reinsurance intermediaries should not be listed because Schedule F is intended to identify only risk-bearing entities.

Use of Federal Employer Identification Number

The Federal Employer Identification Number (FEIN) must be reported for each U.S. domiciled insurer and U.S. branch of an alien insurer. The FEIN should not be reported as the “Federal ID Number” for other alien insurers even if such a number has been issued by the federal government.

Alien Insurer Identification Number (AIIN)

In order to report transactions involving alien companies correctly, the appropriate Alien Insurer Identification Number (AIIN) must be included on Schedule F instead of the FEIN. The AIIN number is assigned by the NAIC and is listed in the NAIC Listing of Companies. If an alien company does not appear in that publication, an application for a number should be filed with the NAIC Reinsurance Department. The application must be submitted along with a copy of the license or other document issued by the company’s domiciliary regulator authorizing it to transact insurance or reinsurance business. Documents submitted in a language other than English must be accompanied by an English translation.
Once a number has been assigned, the applying company will be advised so that its Schedule F may be completed or corrected. Newly assigned numbers are incorporated in revised editions of the NAIC Listing of Companies which are available semi-annually.

Pool and Association Numbers

To report transactions involving pools or associations consisting of non-affiliated companies correctly, the company must include on Schedule F the appropriate Pool/Association Identification Number. These numbers are listed in the NAIC Listing of Companies. The NAIC number should be used instead of any FEIN which may have been assigned. If a pool or association does not appear in that publication, the NAIC Reinsurance Department should be contacted. The NAIC will request a letter from the pool or association administrator listing the pool members and their participation in percentages, the type of business the organization writes and when it was formed.

Once a number has been assigned, the applying company will be advised so that its Schedule F may be completed or corrected. Newly assigned numbers are incorporated in revised editions of the NAIC Listing of Companies which are available semi-annually.

Alien pools and associations should be reported on Schedule F under the category “Other Non-U.S. Insurers” rather than under “Pools, Associations and Similar Facilities.”

Pools and associations consisting of affiliated companies should be listed by individual company names rather than by pool or association identification.

NAIC Company Code

No NAIC Company Code is assigned to insurers domiciled outside of the U.S. or to pools or associations. The “NAIC Company Code” field should be blank for those organizations.

Domiciliary Jurisdiction

In those parts of Schedule F requiring disclosure of the “Domiciliary Jurisdiction,” for each domestic reinsurer or U.S. branch listed, the column should be completed with the state where the reinsurer maintains its statutory home office. For alien reinsurers, this column should be completed with the country where the alien is domiciled.

Lloyd’s of London

The following procedure will apply as respects annual statement filings for 1995 and subsequent years:

Cessions to Lloyd’s under reinsurance agreements having an inception date on or before July 31, 1995, and which are not amended or renewed thereafter should continue to be reported using the collective Lloyd’s number, AA-1122000, on an aggregated basis, under “Authorized – Other Non-U.S. Insurers.” As respects continuous reinsurance agreements, the anniversary date shall be deemed to be the renewal date of the agreement. Any revision of terms and conditions shall be deemed to be an amendment of the reinsurance agreement.

Cessions to Lloyd’s under reinsurance agreements having an inception, amendment or renewal date on or after August 1, 1995, must be reported using the specific number of each subscribing syndicate, as

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listed in the alien section of the *NAIC Listing of Companies*. Such syndicates should be listed individually, under “Authorized – Other Non-U.S. Insurers.”

Syndicates for which an identification number does not appear in the *NAIC Listing of Companies* must be treated as unauthorized securities as respects cessions under reinsurance agreements having an inception, amendment or renewal date on or after August 1, 1995, and should be reported, on an aggregated basis, under “Unauthorized – Other Non-U.S. Insurers,” using a new collective number, AA-1123000.

Reinsurance assumed from syndicates at Lloyd’s should continue to be reported on Schedule F, Part 1 using the original collective Lloyd’s number, AA-1122000.

**Dates**

All dates reported in Schedule F must be in the format MM/DD/YYYY. For example, the date December 31, 1992, should be reported as 12/31/1992.

**Aggregation of Companies**

The aggregation of certain companies is permitted only as provided in the instructions to Part 1. In all other Parts, all companies must be identified.

**Determination of Authorized Status**

The determination of the authorized or unauthorized status of an insurer or reinsurer listed in any part of Schedule F shall be based on the status of that insurer or reinsurer in the reporting company’s state of domicile.

**U.S. Intercompany Pooling Arrangements**

Participations in intercompany pooling arrangements, whereby direct and/or assumed business written by any company participating in the pool is ceded first to the lead company and then redistributed among pool members, shall be reflected under the appropriate categories in the appropriate Parts of Schedule F (e.g., cessions from participating affiliates to the lead company in Part 1 for that company and in the ceded schedules for the affiliates). Subsequent redistribution of the pooled business from the lead company to participating affiliates shall be reported in similar fashion (e.g., cessions to the affiliates in the ceded schedules for the lead company, and as an assumption from the lead company in Part 1 for each of the affiliates participating in the pool).

Cessions to unaffiliated reinsurers, whether prior to cession of the pooled business to the lead company or subsequent thereto, shall be reported in the usual manner in the ceded schedules for the company or companies effecting such cessions, or identified as parties to the reinsurance agreement under which such cessions are effected, as appropriate (e.g., both the initial cessions to the lead company and the subsequent cessions of pooled business from the lead company to the participating affiliates shall reflect any applicable cessions to unaffiliated reinsurers). Such cessions shall be reflected in the calculation of the “Provision of Reinsurance” (Part 7 of Schedule F), and described in the Notes to the Financial Statements regarding “Intercompany Pooling Arrangements” and “Uncollectible Reinsurance.”

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**SCHEDULE F – PART 1**  
**ASSUMED REINSURANCE**

If an insurer has any detail lines reported for any of the following required groups, categories, or subcategories, it shall report the subtotal of the corresponding group, category, or subcategory, with the specified subtotal line appearing in the same manner and location as the preprinted total or grand total line and number:

<table>
<thead>
<tr>
<th>Group or Category</th>
<th>Line Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Affiliates - U.S. Intercompany Pooling</td>
<td>01999999</td>
</tr>
<tr>
<td>Total Affiliates - U.S. Non-Pool</td>
<td>02999999</td>
</tr>
<tr>
<td>Total Affiliates - Other (Non-U.S.)</td>
<td>03999999</td>
</tr>
<tr>
<td>Total Affiliates</td>
<td>04999999</td>
</tr>
<tr>
<td>Other U.S. Unaffiliated Insurers – Reinsurance for which the total of Column 6 is less than $50,000</td>
<td>05999999</td>
</tr>
<tr>
<td>Total Other U.S. Unaffiliated Insurers*#</td>
<td>05999999</td>
</tr>
<tr>
<td>Pools and Associations – Reinsurance for which the total of Column 6 is less than $50,000 – Mandatory Pools</td>
<td>06999998</td>
</tr>
<tr>
<td>Total Pools, Associations or Other Similar Facilities* – Mandatory Pools</td>
<td>06999999</td>
</tr>
<tr>
<td>Pools and Associations – Reinsurance for which the total of Column 6 is less than $50,000 – Voluntary Pools</td>
<td>07999998</td>
</tr>
<tr>
<td>Total Pools, Associations or Other Similar Facilities* – Voluntary Pools</td>
<td>07999999</td>
</tr>
<tr>
<td>Total Pools and Associations</td>
<td>08999999</td>
</tr>
<tr>
<td>Other Non-U.S. Insurers – Reinsurance for which the total of Column 6 is less than $50,000</td>
<td>09999998</td>
</tr>
<tr>
<td>Total Other Non-U.S. Insurers*</td>
<td>09999999</td>
</tr>
<tr>
<td>Totals</td>
<td>99999999</td>
</tr>
</tbody>
</table>

*Reinsured companies for which Column 6 is less than $50,000 may be aggregated and reported separately by category and reported only on Lines 05999998, 06999998, 07999998 and 09999998. The aggregation of certain companies is permitted only as provided in the instructions to Schedule F, Part 1. In all other Parts, all companies must be identified.

# Unaffiliated U.S. Branches of alien insurers should be included with “Total Other U.S. Unaffiliated Insurers.”

Reinsurance assumed from pools or associations may be reported in the name of the pool or association instead of in the names of the insurers which ceded the reinsurance to the pool or association.

Column 2 –  Reinsurance on Paid Losses and Loss Adjustment Expenses  
Report loss adjustment expenses due and payable to the reinsured. Total multiplied by 1000 should agree with Page 3, Line 1A, Column 1.

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Column 3 – Known Case Losses and LAE
Known case reserves, obtained from Underwriting and Investment Exhibit – Part 3A, Line 32, Column 1b, must be combined with assumed LAE. There is no direct tie-in to Underwriting and Investment Exhibit – Part 3A or Schedule P.

Column 4 – Totals of Columns 2 + 3 for each category.

Column 5 – Contingent Commissions Payable
Profit commissions generated from assumed reinsurance contracts due the reinsured and reflected as part of the liability on Page 3, Column 1, Line 3. Report commissions net of return profit commissions. Negative commissions are possible, i.e., when a contingent commission is receivable.

Total of Schedule F, Part 1, Column 5 should agree with assumed commission total reported in Note 14b of Notes to Financial Statements.

Column 6 – Assumed Premiums Receivable
Amounts reported should be net of commissions payable. This column reflects assumed reinsurance, premiums receivable less commissions payable, included as part of agents’ balances on Page 2.

Column 8 – Funds Held By or Deposited with Reinsured Companies

Column 9 – Letters of Credit Posted

Column 10 multiplied by 1000 should agree with Page 2, Line 11, Column 4.
If yes, show amount. If no, show “N.”

SCHEDULE F – PART 2
PREMIUM PORTFOLIO REINSURANCE

This schedule should list by portfolio any original premiums and reinsurance premiums for portfolio reinsurance transactions effected or canceled during the year. Portfolio reinsurance is the transfer of the entire liability of an insurer for in force policies as respects a described segment of the insurer’s business.
**SCHEDULE F – PART 3**  
**CEDED REINSURANCE**

If an insurer has amounts reported for any of the following required groups, categories, or subcategories, it shall report the subtotal amount of the corresponding group, category, or subcategory, with the specified subtotal line number appearing in the same manner and location as the preprinted total or grand total line and number:

<table>
<thead>
<tr>
<th>Group or Category</th>
<th>Line Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Authorized – Affiliates – U.S. Intercompany Pooling</td>
<td>01999998</td>
</tr>
<tr>
<td>Total Authorized – Affiliates – U.S. Non-Pool</td>
<td>02999998</td>
</tr>
<tr>
<td>Total Authorized – Affiliates – Other (Non-U.S.)</td>
<td>03999998</td>
</tr>
<tr>
<td>Total Authorized – Affiliates</td>
<td>04999998</td>
</tr>
<tr>
<td>Total Authorized – Other U.S. Unaffiliated Insurers</td>
<td>05999998</td>
</tr>
<tr>
<td>Total Authorized – Pools – Mandatory Pools*</td>
<td>06999998</td>
</tr>
<tr>
<td>Total Authorized – Pools – Voluntary Pools*</td>
<td>07999998</td>
</tr>
<tr>
<td>Total Authorized – Other Non-U.S. Insurers#</td>
<td>08999998</td>
</tr>
<tr>
<td>Total Authorized</td>
<td>09999998</td>
</tr>
<tr>
<td>Total Unauthorized – Affiliates – U.S. Intercompany Pooling</td>
<td>10999999</td>
</tr>
<tr>
<td>Total Unauthorized – Affiliates – U.S. Non-Pool</td>
<td>11999999</td>
</tr>
<tr>
<td>Total Unauthorized – Affiliates – Other (Non-U.S.)</td>
<td>12999999</td>
</tr>
<tr>
<td>Total Unauthorized – Affiliates</td>
<td>13999999</td>
</tr>
<tr>
<td>Total Unauthorized – Other U.S. Unaffiliated Insurers</td>
<td>14999999</td>
</tr>
<tr>
<td>Total Unauthorized – Pools – Mandatory Pools*</td>
<td>15999999</td>
</tr>
<tr>
<td>Total Unauthorized – Pools – Voluntary Pools*</td>
<td>16999999</td>
</tr>
<tr>
<td>Total Unauthorized – Other Non-U.S. Insurers#</td>
<td>17999999</td>
</tr>
<tr>
<td>Total Unauthorized</td>
<td>18999999</td>
</tr>
<tr>
<td>Totals</td>
<td>99999999</td>
</tr>
</tbody>
</table>

*Pools and Associations consisting of affiliated companies should be listed by individual company names.

#Alien Pools and Associations should be reported on Schedule F under the category “Other Non-U.S. Insurers.”

**NOTE:** Disclosure of the five largest provisional commission rates should exclude mandatory pools and joint underwriting associations.

**Reinsurance Contracts Ceding 75% or More Direct Premiums Written** –

Each individual contract, except those listed below, which provides for the cession of 75% or more of direct premiums written under such cession during the year, should be identified by inserting a 2 in this column. The reinsurance transactions so identified shall include both treaty and facultative cessions of direct business written by the company.

Exclude: Intercompany reinsurance transactions with affiliates.
Reinsurance transactions involving any group, association, pool, or organization of insurers which engage in joint underwriting activities and which are subject to examination by any state regulatory authority or which operate pursuant to any state or federal statutory or administrative authorization.

Any reinsurance transaction in which the annual gross premium ceded is less than 5% of policyholder surplus.

Reinsurance transactions involving captive insurance companies.

Column 1 – Reinsurance Premiums Ceded
Total multiplied by 1000 should equal Underwriting and Investment Exhibit, Part 2B, Line 32, Column 3a plus Column 3b.

Column 2 – Reinsurance Recoverable on Paid Losses

Column 3 – Reinsurance Recoverable on Paid LAE
The total of (Columns 2 plus 3) multiplied by 1000 should agree with Page 2, Line 13, Column 4.

Column 4 – Known Case Loss Reserves
Total multiplied by 1000 should agree with Underwriting and Investment Exhibit, Part 3A, Line 32, Column 2.

Column 5 – Known Case Loss Adjustment Reserves
Exclude: Unallocated Loss Adjustment Reserves.

Column 6 – IBNR Loss Reserves
Total multiplied by 1000 should agree with Underwriting and Investment Exhibit, Part 3A, Line 32, Column 4c.

Column 8 – Unearned Premiums
Total multiplied by 1000 should equal Page 3, Line 9 parenthetical amount.

Column 9 – Contingent Commissions
Include: Contingent commissions receivable from a reinsurer. Regular commissions should be netted with ceded balances payable in Column 11.

Total of Schedule F, Part 3, Column 9 less negative contingent commissions reported in Schedule F, Part 3, Column 12, should agree with ceded commission total reported in Note 14b of the Notes to Financial Statements.
If Column 9 is less than zero, report the amount in Column 12.

Column 11 – Ceded Balances Payable
Column 11 multiplied by 1000 should agree with the sum of Page 2, Line 10.1 plus Line 10.2 plus Line 10.3 parenthetical amounts.

Column 12 – Other Amounts Due to Reinsurers
Both Column 11 and Column 12 are liabilities owed to the reinsurer.
Exclude: Funds held by company under reinsurance treaties which are included in Column 14.
Items entered in Column 12 may represent miscellaneous balances owed by the reinsured to the reinsurer on ceded transactions.

Column 13 — Net Amount Recoverable from Reinsurers
Offsets should be included to the extent allowable or appropriate.

Column 14 — Funds Held By Company Under Reinsurance Treaties
Final Total multiplied by 1000 should agree with Page 3, Line 11, Column 1.
3. Annual Statement Instructions for Schedule P (pertinent parts)

SCHEDULE P — PART 1

Report in Column 24 the estimated amount of anticipated salvage and subrogation that has been taken as credit (netted) in the reserves for unpaid losses and loss adjustment expenses reported in Column 25. (Note: Column 24 is a memo column only as the amounts contained therein have already been taken into consideration in Columns 14 through 21).

The definitions of the named lines are the same as used in the Underwriting and Investment Exhibit or on the State Page, except that the reinsurance lines are defined:

Reinsurance A includes all non-proportional reinsurance in the following lines: Fire, Allied Lines, Ocean Marine, Inland Marine, Earthquake, Group Accident and Health, Credit Accident and Health, Other Accident and Health, Auto Physical Damage, Boiler and Machinery, Burglary and Theft and International (of the foregoing).

Reinsurance B includes all non-proportional reinsurance in the following lines: Farmowners Multi peril, Homeowners Multi peril, Commercial Multi peril, Medical Malpractice, Workers’ Compensation, Other Liability, Products Liability, Auto Liability, Aircraft (all peril) and International (of the foregoing).

Reinsurance C includes all non-proportional reinsurance in the following lines: Financial Guaranty, Fidelity, Surety, Credit, and International (of the foregoing).

All proportional reinsurance must be allocated to appropriate lines.

As used in this instruction “non-proportional reinsurance” means reinsurance in excess of a retention by the ceding company, and “proportional reinsurance” means fixed percentage of all losses.

For contracts that afford both proportional and non-proportional reinsurance, allocate premiums and losses to their component parts.

Pooling

Pooled business is that which, if retained, would be pooled among the affiliated companies who are party to the pooling agreement. Any such business that is ceded by the pool participants to non-pooled companies prior to the pooling distribution among the participating companies is considered pooled business ceded. Non-pooled business includes all direct, assumed and ceded business not subject to pooling, as well as any pooled business that is ceded after the pooling distribution has been made.

The Schedule P, Part 1 reporting principle for pooled business is that each company reports its share/percent of the total, combined pooled business as its “Direct + Assumed” and “Ceded” business respectively.

Direct and Assumed columns include the participation in any pool. In addition, all direct business not pooled plus assumed business from other than the pool is to be included. Ceded columns include the company’s participation in the pool such as any ceding by the company to companies independent of the pool.

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Claim counts will be in accordance with the pooling arrangement and will reflect the company's proportionate share of the total number of claims.

The pooling percentage is to reflect the company's participation in the pool as of year-end. Any retroactive change in pooling participation will require appropriate restatement of Schedule P.

Any significant changes in pooling arrangements should be reported in Interrogatory 8 of the Schedule P Interrogatories.

An illustration for reporting pooled business is attached as Exhibit A.

**EXHIBIT A**

**Pooled Business – Schedule P Reporting Example**

This example has been prepared as a clarification of the NAIC *Annual Statement Instructions* to demonstrate how business subject to pooling among affiliated companies should be incorporated in the "Direct + Assumed" and the "Ceded" columns of Schedule P for each affiliated company.

Company A – The Flagship company, does the pooling and cedes some business before pooling.
Company B – Cedes some pool business before ceding to Company A for pooling.
Company C – Cedes business after pooling.
Company D – Cedes nothing except to the pool.

**Sample Situation**

<table>
<thead>
<tr>
<th>Pool Business:</th>
<th>Company A</th>
<th>Company B</th>
<th>Company C</th>
<th>Company D</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Direct &amp; Assumed (a)</td>
<td>90,000</td>
<td>15,000</td>
<td>10,000</td>
<td>5,000</td>
<td>120,000</td>
</tr>
<tr>
<td>2. Pool Assembly Assumed (Ceded)</td>
<td>25,000</td>
<td>(10,000)</td>
<td>(10,000)</td>
<td>(5,000)</td>
<td>-</td>
</tr>
<tr>
<td>3. (Ceded) Before Pooling Dist. (a)</td>
<td>(15,000)(c)</td>
<td>(5,000)(b)</td>
<td>-</td>
<td>-</td>
<td>(20,000)</td>
</tr>
<tr>
<td>4. Net Before Pooling Dist.</td>
<td>100,000</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>100,000</td>
</tr>
<tr>
<td>5. Pooling Dist. Assumed (Ceded)</td>
<td>(25,000)</td>
<td>15,000</td>
<td>7,000</td>
<td>3,000</td>
<td>-</td>
</tr>
<tr>
<td>6. Net Retained – Amount</td>
<td>75,000</td>
<td>15,000</td>
<td>7,000</td>
<td>3,000</td>
<td>100,000</td>
</tr>
<tr>
<td>– Percent Specified</td>
<td>75%</td>
<td>15%</td>
<td>7%</td>
<td>3%</td>
<td>100%</td>
</tr>
</tbody>
</table>

| Non-Pool Business: | | | | | |
| 7. Direct & Assumed (e) | 5,000 | 4,000 | - | - | 9,000 |
| 8. (Ceded) | (2,000)(e) | (1,000)(e) | (5,000)(d) | - | (8,000) |
| 9. Net | 3,000 | 3,000 | (5,000) | - | 1,000 |

**Total Business:**

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### Sample Situation

<table>
<thead>
<tr>
<th></th>
<th>Company A</th>
<th>Company B</th>
<th>Company C</th>
<th>Company D</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct &amp; Assumed Before</td>
<td>95,000</td>
<td>19,000</td>
<td>10,000</td>
<td>5,000</td>
<td>129,000</td>
</tr>
</tbody>
</table>

**Pooling**

<p>| | | | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>11. Pool Assembly Assumed (Ceded)</td>
<td>25,000</td>
<td>(10,000)</td>
<td>(10,000)</td>
<td>(5,000)</td>
<td>-</td>
</tr>
<tr>
<td>12. (Ceded) Other Than Pooling</td>
<td>(17,000)</td>
<td>(6,000)</td>
<td>(5,000)</td>
<td>-</td>
<td>(28,000)</td>
</tr>
<tr>
<td>13. Pooling Dist. Assumed (Ceded)</td>
<td>(25,000)</td>
<td>15,000</td>
<td>7,000</td>
<td>3,000</td>
<td>-</td>
</tr>
<tr>
<td>14. Net</td>
<td>78,000</td>
<td>18,000</td>
<td>2,000</td>
<td>3,000</td>
<td>101,000</td>
</tr>
</tbody>
</table>

(a) – Business which, if retained, would be pooled
(b) – Ceded before pool assembly (Line 2)
(c) – Ceded before pooling distribution (Line 5), before and/or after pool assembly (Line 2)
(d) – Ceded after pooling distribution (Line 5)
(e) – Business which, if retained, would not be pooled

### Schedule P Reporting

**Reporting Principle for “Pool Business”** – Each company reports its share/percent of the total pooled “Direct + Assumed” and the total pooled “Ceded” business respectively.

<table>
<thead>
<tr>
<th></th>
<th>Company A</th>
<th>Company B</th>
<th>Company C</th>
<th>Company D</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct + Assumed</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15. Pool % of Line 1, Total Col.</td>
<td>90,000</td>
<td>18,000</td>
<td>8,400</td>
<td>3,600</td>
<td>120,000</td>
</tr>
<tr>
<td>16. Non-Pooled (Line 7)</td>
<td>5,000</td>
<td>4,000</td>
<td>-</td>
<td>-</td>
<td>9,000</td>
</tr>
<tr>
<td>17. Total</td>
<td>95,000</td>
<td>22,000</td>
<td>8,400</td>
<td>3,600</td>
<td>129,000</td>
</tr>
</tbody>
</table>

(Ceded)

<p>| | | | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>18. Pool % of Line 3, Total Col.</td>
<td>(15,000)</td>
<td>(3,000)</td>
<td>(1,400)</td>
<td>(600)</td>
<td>(20,000)</td>
</tr>
<tr>
<td>19. Non-Pooled (Line 8)</td>
<td>(2,000)</td>
<td>(1,000)</td>
<td>(5,000)</td>
<td>-</td>
<td>(8,000)</td>
</tr>
<tr>
<td>20. Total</td>
<td>(17,000)</td>
<td>(4,000)</td>
<td>(6,400)</td>
<td>(600)</td>
<td>(28,000)</td>
</tr>
<tr>
<td>21. Total Net</td>
<td>78,000</td>
<td>18,000</td>
<td>2,000</td>
<td>3,000</td>
<td>101,000</td>
</tr>
</tbody>
</table>
4. Statement of Statutory Accounting Principles No. 63

Underwriting Pools and Associations Including Intercompany Pools

Status
Type of Issue: Common Area
Issued: Initial Draft
Effective Date: January 1, 2001
Affects: No other pronouncements
Affected by: No other pronouncements

SCOPE OF STATEMENT 30

SUMMARY CONCLUSION 30

Disclosures 31
Effective Date and Transition 32

RELEVANT ISSUE PAPERS 32
This page is intentionally left blank
Underwriting Pools and Associations Including Intercompany Pools

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for underwriting pools and associations.

SUMMARY CONCLUSION

2. Underwriting pools and associations can be categorized as follows: (a) involuntary, (b) voluntary, and (c) intercompany.

3. Involuntary pools represent a mechanism employed by states to provide insurance coverage to those with higher than average probability of loss who otherwise would be excluded from obtaining coverage. Reporting entities are generally required to participate in the underwriting results, including premiums, losses, expenses, and other operations of involuntary pools, based on their proportionate share of similar business written in the state. Involuntary plans are also referred to as residual market plans, involuntary risk pools, and mandatory pools.

4. Voluntary pools are similar to involuntary pools except they are not state mandated and a reporting entity participates in the pool voluntarily. In addition, voluntary pools are not limited to the provision of insurance coverage to those with higher than average probability of loss, but often are used to provide greater capacity for risks with exceptionally high levels of insurable values (e.g., aircraft, nuclear power plants, refineries, and offshore drilling platforms).

5. Intercompany pooling relates to business which is pooled among affiliated entities who are party to a pooling arrangement.

6. Participation in a pool may be on a joint and several basis, i.e., in addition to a proportional share of losses and expenses incurred by the pool, participants will be responsible for their share of any otherwise unrecoverable obligations of other pool participants. In certain instances, one or more entities may be designated as servicing carriers for purposes of policy issuance, claims handling, and general administration of the pooled business, while in other cases a pool manager or administrator performs all of these functions and simply bills pool participants for their respective shares of all losses and expenses incurred by the pool. In either case, liabilities arising from pooled business are generally incurred on a basis similar to those associated with non-pooled business, and should therefore be treated in a manner consistent with the guidelines set forth in SSAP No. 5—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5).

7. Intercompany pooling arrangements involve establishment of a conventional quota share reinsurance agreement under which all of the pooled business is ceded to the lead entity and then retroceded back to the pool participants in accordance with their stipulated shares. In these arrangements, only the policy issuing entity has direct liability to its policyholders or claimants; other pool participants are liable as reinsurers for their share of the issuing entity’s obligations. Although participants may use different assumptions (e.g., discount rates) in recording transactions, the timing of recording transactions shall be consistently applied by all participants.

8. Underwriting results shall be accounted for on a gross basis whereby the participant’s portion of premiums, losses, expenses, and other operations of the pools are recorded separately in the financial statements rather than netted against each other. Premiums and losses shall be recorded as direct,
assumed, and/or ceded as applicable. If the reporting entity is a direct writer of the business, premiums shall be recorded as directly written and accounted for in the same manner as other business which is directly written by the entity. To the extent that premium is ceded to a pool, premiums and losses shall be recorded in the same manner as any other reinsurance arrangement. A reporting entity who is a member of a pool shall record its participation in the pool as assumed business as in any other reinsurance arrangement.

9. Equity interests in, or deposits receivable from, a pool represent cash advances to provide funding for operations of the pool. These are admitted assets and shall be recorded separately from receivables and payables related to a pool’s underwriting results. Receivables and payables related to underwriting results shall be accounted for in accordance with the guidance in paragraphs 6 to 8, above. If it is probable that these receivables are uncollectible, any uncollectible amounts shall be written off against operations in the period such determination is made. If it is reasonably possible a portion of the balance is uncollectible but is not written off, disclosure requirements outlined in SSAP No. 5 shall be followed.

Disclosures

10. If a reporting entity is part of a group of affiliated entities which utilizes a pooling arrangement under which the pool participants cede substantially all of their direct and assumed business to the pool, the financial statements shall include:

a. A description of the basic terms of the arrangement and the related accounting;

b. Identification of the lead entity and of all affiliated entities participating in the intercompany pool (include NAIC Company Codes) and indication of their respective percentage shares of the pooled business;

c. Description of the lines and types of business subject to the pooling agreement;

d. Description of cessions to non-affiliated reinsurers of business subject to the pooling agreement and indication of whether such cessions were prior to or subsequent to the cession of pooled business from the affiliated pool members to the lead entity;

e. Identification of all pool members which are parties to reinsurance agreements with non-affiliated reinsurers covering business subject to the pooling agreement and which have a contractual right of direct recovery from the non-affiliated reinsurer per the terms of such reinsurance agreements;

f. Explanation of any discrepancies between entries regarding pooled business on the assumed and ceded reinsurance schedules of the lead entity and corresponding entries on the assumed and ceded reinsurance schedules of other pool participants;

g. Description of intercompany sharing, if other than in accordance with the pool participation percentage, of the Provision for Reinsurance (Schedule F, Part 7) and the write–off of uncollectible reinsurance.

11. Refer to the preamble for further discussion regarding disclosure requirements.
Effective Date and Transition

12. This statement is effective for years beginning January 1, 2001. A change 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.

RELEVANT ISSUE PAPERS

- Issue Paper No. 97—Underwriting Pools and Associations Including Intercompany Pools
5. Statutory Issue Paper No. 97

Title:
Underwriting Pools and Associations Including Intercompany Pools

Status:
Finalized March 16, 1998

Type of Issue:
Common Area

SUMMARY OF ISSUE:

1. Underwriting pools and associations can be categorized as follows: involuntary, voluntary, and intercompany.

2. Involuntary pools represent a mechanism employed by states to provide insurance coverage to those with higher than average probability of loss who otherwise would be excluded from obtaining coverage. Reporting entities are generally required to participate in the underwriting results, including premiums, losses, expenses, and other operations of involuntary pools, based on their proportionate share of similar business written in the state. Involuntary plans are also referred to as residual market plans, involuntary risk pools, and mandatory pools.

3. Voluntary pools are similar to involuntary pools except they are not state mandated and a reporting entity participates in the pool voluntarily. In addition, voluntary pools are not limited to the provision of insurance coverage to those with higher than average probability of loss, but often are used to provide greater capacity for risks with exceptionally high levels of insurable values (e.g., aircraft, nuclear power plants, refineries, and offshore drilling platforms).

4. Intercompany pooling relates to business which is pooled among affiliated entities who are party to a pooling arrangement.

5. Current statutory accounting provides limited guidance on accounting for a reporting entity’s participation in underwriting pools and associations. Although it is not specifically stated in the Accounting Practices and Procedures Manuals for Life and Accident and Health and for Property and Casualty Insurance Companies (Life/A&H and P&C Accounting Practices & Procedures Manuals), certain annual statement schedules do require that the reporting entity’s participation in the pools’ underwriting results be recorded on a gross basis. However, the guidance does not address whether participation in the pools should be recorded using accrual or cash basis accounting. Reporting entities are currently utilizing both approaches. GAAP guidance related to underwriting pools and associations is limited to FASB Statement No. 113 - Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts (FAS 113). FAS 113 states that involuntary plans are included within the scope of the statement; therefore the reinsurance activity should be recorded on a gross basis.

6. The purpose of this issue paper is to establish statutory accounting principles for underwriting pools and associations that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).
SUMMARY CONCLUSION:

7. Issue Paper No. 5 - Definition of Liabilities, Loss Contingencies and Impairments of Assets (Issue Paper No. 5), defines a liability and states that the definition “includes but is not limited to liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims and reserves for incurred but not reported claims).” Issue Paper No. 5 requires liabilities to be recorded on a reporting entity’s financial statements when incurred.

8. Participation in a pool may be on a joint and several basis, i.e., in addition to a proportional share of losses and expenses incurred by the pool, participants will be responsible for their share of any otherwise unrecoverable obligations of other pool participants. In certain instances, one or more entities may be designated as servicing carriers for purposes of policy issuance, claims handling, and general administration of the pooled business, while in other cases a pool manager or administrator performs all of these functions and simply bills pool participants for their respective shares of all losses and expenses incurred by the pool. In either case, liabilities arising from pooled business are generally incurred on a basis similar to those associated with non-pooled business, and should therefore be treated in a manner consistent with the guidelines set forth in Issue Paper No. 5 and in paragraph 7 of this issue paper.

9. Intercompany pooling arrangements involve establishment of a conventional quota share reinsurance agreement under which all of the pooled business is ceded to the lead entity and then retroceded back to the pool participants in accordance with their stipulated shares. In such arrangements, only the policy issuing entity has direct liability to its policyholders or claimants; other pool participants are liable as reinsurers for their share of the issuing entity’s obligations. Although participants may use different assumptions (e.g., discount rates) in recording transactions, the timing of recording transactions shall be consistently applied by all participants.

10. Underwriting results shall be accounted for on a gross basis whereby the participant’s portion of premiums, losses, expenses, and other operations of the pools are recorded separately in the financial statements rather than netted against each other. Premiums and losses shall be recorded as direct, assumed, and/or ceded as applicable. If the reporting entity is a direct writer of the business premiums, losses shall be recorded as directly written and accounted for in the same manner as other business which is directly written by the entity. To the extent that premium is ceded to a pool, premiums and losses shall be recorded in the same manner as any other reinsurance arrangement. A reporting entity who is a member of a pool shall record its participation in the pool as assumed business as in any other reinsurance arrangement.

11. Equity interests in, or deposits receivable from, a pool represent cash advances to provide funding for operations of the pool. These are admitted assets and shall be recorded separately from receivables and payables related to a pool’s underwriting results. Receivables and payables related to underwriting results should be accounted for in accordance with the guidance in paragraphs 7 to 10, above. If, in accordance with Issue Paper No. 5, it is probable that these receivables are uncollectible, any uncollectible amounts shall be written off against operations in the period such determination is made. If it is reasonably possible a portion of the balance is uncollectible but is not written off, disclosure requirements outlined in Issue Paper No. 5 shall be followed.

12. If a reporting entity is part of a group of affiliated entities which utilizes a pooling arrangement under which the pool participants cede substantially all of their direct and assumed business to the pool, the financial statements shall include:

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a. A description of the basic terms of the arrangement and the related accounting;

b. Identification of the lead entity and of all affiliated entities participating in the intercompany pool (include NAIC Company Codes) and indication of their respective percentage shares of the pooled business;

c. Description of the lines and types of business subject to the pooling agreement;

d. Description of cessions to non-affiliated reinsurers of business subject to the pooling agreement, and indication of whether such cessions were prior to or subsequent to the cession of pooled business from the affiliated pool members to the lead entity;

e. Identification of all pool members which are parties to reinsurance agreements with non-affiliated reinsurers covering business subject to the pooling agreement and which have a contractual right of direct recovery from the non-affiliated reinsurer per the terms of such reinsurance agreements;

f. Explanation of any discrepancies between entries regarding pooled business on the assumed and ceded reinsurance schedules of the lead entity and corresponding entries on the assumed and ceded reinsurance schedules of other pool participants;

g. Description of intercompany sharing, if other than in accordance with the pool participation percentage, of the Provision for Reinsurance (Schedule F, Part 7) and the write–off of uncollectible reinsurance.

DISCUSSION:

13. This issue paper applies Issue Paper No. 5 to underwriting pools and associations.

14. There are a variety of types of underwriting pools and associations. Examples include, but are not limited to Assigned Risk Plans, Joint Underwriting Associations, Reinsurance Pools, Fair Access to Insurance Requirements Plans, Comprehensive Health Insurance Plans, and Workers Compensation Pools.

15. Certain underwriting pools and associations, such as Assigned Risk Plans, require the reporting entity to accept a share of the undesirable risks based on the percent of the premium written in that state. The reporting entity is then responsible for collecting premiums and paying claims on policies issued to these applicants. Other underwriting pools and associations, such as Joint Underwriting Associations, require all entities in the state to participate in the underwriting results, however, a servicing company is designated to issue the policies and pay the claims for these risks on behalf of the pool.

16. Current statutory practice related to underwriting pools and associations is varied. A “pay-as-you-go” (cash basis) approach has been adopted by many entities. This issue paper rejects that treatment because it is inconsistent with the concepts of conservatism and recognition outlined in the Statement of Concepts. It is also inconsistent with the accounting principles set forth in Issue Paper No. 5. With respect to conservatism, the Statement of Concepts states:

Financial reporting by insurance enterprises requires the use of substantial judgments and estimates by management...In order to provide a margin of protection to policyholders, the concept of conservatism
should be followed when developing estimates as well as establishing accounting principles for statutory reporting.

17. With respect to recognition, the Statement of Concepts states that:

"Liabilities require recognition as they are incurred. Accounting treatments which tend to defer expense recognition do not generally represent acceptable SAP treatment."

18. Many reporting entities have adopted the practice of netting the underwriting results related to their participation in underwriting pools and associations. Although the Life/A&H and P&C Accounting Practices and Procedures Manuals do not specifically state that the reporting entity’s participation in the pool’s underwriting results shall be recorded on a gross basis, the Annual Statement Instructions for Property and Casualty Insurance Companies require a separate disclosure of “the net reserves for losses and expenses for the entity’s share of underwriting pools’ and associations’ unpaid loss and expenses which are included in reserves.” The instructions also require that reinsurance assumed from and ceded to underwriting pools and associations be disclosed separately thereby establishing the requirement to record reinsurance on a gross basis.

19. All forms of underwriting pools and associations should be accounted for consistently. It would be inconsistent to require reporting entities to account for underwriting results related to assigned risk plans on a gross basis and underwriting results related to joint underwriting associations on a net basis. Accounting for the plans consistently enables regulators to more effectively compare results of the individual entities participating in the plans.

20. The consistency requirement of paragraph 19 is supported by the Statement of Concepts which states that:

The regulator’s 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.

21. There is no specific GAAP guidance related to underwriting pools and associations other than in FAS 113 which states that involuntary risk pools are included within the scope of the statement and thereby requires the reinsurance activity to be recorded on a gross basis.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE:

Statutory Accounting

22. The P&C Accounting Practices and Procedures Manual, Chapter 14, Premiums, discusses the following:
Underwriting Pools, Associations, and Syndicates

Companies also participate as members of an underwriting pool, association, or syndicate organized to provide special insurance coverages. Operating results, including the applicable premiums, are distributed to member companies based on their prescribed share.

Usually, statements are received by the company showing the total premiums written, as well as the member company’s participation. These premiums are recorded on a summary basis (usually by line of business) as direct or assumed business depending on the requirements of the particular association.

23. The P&C Accounting Practices and Procedures Manual, Chapter 22, Reinsurance, discusses the following:

Fronting arrangements, servicing carrier business, and pools and association business are often accomplished using reinsurance contracts. The guidance included in this chapter also applies to these types of contracts, except as specifically exempted.

24. The Annual Statement Instructions for Property and Casualty Insurance Companies, General Section, discusses the following requirements related to the actuarial opinion:

8. The scope paragraph should contain a sentence such as the following:

“I have examined the actuarial assumptions and methods used in determining reserves listed below, as shown in the Annual Statement of the Company as prepared for filing with state regulatory officials, as of December 31, 19__.”

The paragraph should list items and amounts with respect to which the actuary is expressing an opinion. The list should include but not necessarily be limited to:

A. Reserve for Unpaid Losses (Page 3, Line 1);
B. Reserve for Unpaid Loss Adjustment Expenses (Page 3, Line 2);
C. Reserve for Unpaid Losses - Direct and Assumed (Schedule P, Part 1, Totals from Cols. 13 and 15); and
D. Reserve for Unpaid Loss Adjustment Expenses - Direct and Assumed (Schedule P, Part 1, Totals from Cols. 17, 19, and 22).

If the actuary includes the Excess of Statutory over Statement Reserves to the above list, the actuary must also opine on the reserves excluding this amount.

9. The actuary should state that the items in paragraph 8, on which he or she is expressing an opinion, reflect the following items:

A. ...
B. ...
C. The net reserves for losses and expenses for the company’s share of voluntary and involuntary underwriting pools’ and associations’ unpaid losses and expenses which are included in reserves shown on Page 3 - Liability, Surplus and Other Funds, Lines 1 and 2, $__________.
11. The actuary should comment in the scope section on each of the following topics, describing the effect of each on loss or loss expense reserves: ...underwriting pools or associations,...

25. The Annual Statement Instructions for Property and Casualty Insurance Companies, Section referring to Assets, discusses the following disclosure requirement:

Line 17 - Equities and Deposits in Pools and Associations

In the event that the insurer has equity in, or deposits receivable from, underwriting associations, pools, etc., the equity interests and deposits receivable should be reported here.

26. The Annual Statement Instructions for Property and Casualty Insurance Companies, Section referring to Schedule F-Part 1-Assumed Reinsurance and Schedule F-Part 3-Ceded Reinsurance, requires reinsurance assumed from and ceded to mandatory pools and associations be disclosed separately from voluntary pools and associations.

27. The Property and Casualty Reinsurance Study Group of the Accounting Practices and Procedures (EX4) Task Force adopted the following disclosure requirements for intercompany pooling arrangements at its September 29, 1996 meeting.
k. Review the results of the Actuarial Opinion General Checklist procedures. Were any concerns noted regarding the collectibility of reinsurance recoverables?

☐ Yes ☐ No

The analyst should consider the responses above and any other factors which, in the analyst’s judgment, indicate that collectibility concerns exist. Are there collectibility concerns relating to recoverables from reinsurers?

☐ Yes ☐ No

5. Determine whether reinsurance between affiliates involves any unusual shifting of risk from one affiliate to another.

a. Are Assumed Premiums from Affiliates to Gross Premiums (Company Profile Reports) greater than 50%?

☐ Yes ☐ No

b. Are Affiliated Ceded Premiums to Gross Premiums (Company Profile Reports) greater than 50%?

☐ Yes ☐ No

c. Is there a significant change in either of the above two ratios from the prior year (+/-25%) or over the past three years (+/-50%)?

☐ Yes ☐ No

d. Are reinsurance Recoverables from Affiliates to Surplus greater than 20%?

☐ Yes ☐ No

e. Review Notes to Financial Statements #5, Information Concerning Parent, Subsidiaries and Affiliates. Were there any changes in intercompany pooling agreements during the year?

☐ Yes ☐ No

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f. Review Schedule F – Part 2. Were there any premium portfolio transfers involving affiliates?

☐ Yes  ☐ No

The analyst should consider the responses above and any other factors which, in the analyst’s judgment, indicate concerns relating to reinsurance between affiliates. Are there concerns relating to reinsurance between affiliates?

☐ Yes  ☐ No

6. Determine whether reinsurance is being used for fronting purposes and, if so, whether any potential abuses exist.

a. Are Ceded Premiums to Gross Premiums (Company Profile Reports greater than 75%?)

☐ Yes  ☐ No

b. Are Ceded Premiums to Gross Premiums Written for any single line of business greater than 90%?

☐ Yes  ☐ No

c. Are Ceded Commissions to Ceded Premiums Written (Company Profile Reports) significantly higher or lower (+/- 50%) than the insurer’s underwriting expense ratio?

☐ Yes  ☐ No

The analyst should consider the responses above and any other factors which, in the analyst’s judgment, indicate that possible abuses exist. Are there concerns about the use of reinsurance for fronting purposes?

☐ Yes  ☐ No
Financial Analysis Handbook

<table>
<thead>
<tr>
<th>Section:</th>
<th>Annual Statement General Checklist</th>
<th>Date Issued:</th>
<th>December 6, 1994</th>
</tr>
</thead>
<tbody>
<tr>
<td>Segment:</td>
<td>Property – Casualty</td>
<td>Date Updated:</td>
<td>February 3, 1997</td>
</tr>
<tr>
<td>Topic:</td>
<td>B.6 – Reinsurance</td>
<td>Page Number</td>
<td>28 (cont.)</td>
</tr>
</tbody>
</table>

7. Determine whether any unusual reinsurance intermediary agreements or reinsurance assumed agreements exist.

a. Are Assumed Premiums From Non-Affiliates to Gross Premiums (Company Profile Reports) greater than 50%?

☐ Yes ☐ No

b. Is the total amount of funds withheld for payment of losses by ceding companies greater than 10% of surplus?

☐ Yes ☐ No

c. Is the Assumed Loss Ratio significantly higher or lower (+/- 50 points) than the Gross Loss Ratio (Company Profile Reports)?

☐ Yes ☐ No

The analyst should consider the response above and any other factors which, in the analyst’s judgment, indicate that potentially unusual reinsurance intermediary or…
...may not choose to continue to take credit for such disputed balances. The ceding insurer may not take credit for reinsurance recoverables in dispute with an affiliate.

*Procedures #3 and #4* assist the analyst in determining whether reinsurance recoverables are significant and, if so, whether the amounts involved are collectible. Under a reinsurance contract, the primary insurer transfers or "cedes" to another insurer (the "reinsurer") all or part of the financial risk of loss for claims incurred under insurance policies sold to the policyholder. Reinsurance does not modify in any way the obligation of the primary insurer to pay policyholder claims. Only after loss claims have been paid can the primary company seek reimbursement from a reinsurer for its share of paid losses. As a result, evaluating the collectibility of the recoverables, as well as the overall credit-worthiness of the reinsurers, is a key concern. Evaluating the collectibility of reinsurance recoverables requires an understanding of the specific facts and circumstances relating to each reinsurer. However, this evaluation is frequently oriented towards the type of reinsurer from whom the reinsurance was obtained. Reinsurance is generally obtained from one of the following categories of insurers:

1. **Professional Reinsurers** – The main business of professional reinsurers is assuming reinsurance from non-affiliated insurers. In general, the large and well-capitalized professional reinsurers will not pose a serious collectibility concern.

2. **Reinsurance departments of Primary Insurers** – Many insurers assume reinsurance from non-affiliates, but also write significant business on a direct basis. These types of insurers may pose a larger collectibility concern than professional reinsurers since the specialized reinsurance expertise may not be as strong.

3. **Alien Insurers** – Reinsurers domiciled in another country assume approximately 35% of the non-affiliated reinsurance ceded in the U.S. These alien insurers may pose unique collectibility issues.

*Procedure #5* assists the analyst in identifying whether reinsurance between affiliates involves any unusual shifting of risk from one affiliate to another. A group of affiliated insurance companies may use reinsurance as a mechanism to diversify the portfolios of individual companies and to allocate premiums, assets, liabilities, and surplus among affiliates. Intercompany pooling, where each company reinsures a fixed proportion of all business written by pool members, is a standard practice among companies under common management. From an economic standpoint, reinsurance transactions between affiliated insurance companies do not reduce risk for the group, but instead shift risk among affiliates. Reinsurance between affiliated companies presents opportunities for manipulation and potential abuse. In a group of affiliated insurers, intercompany reinsurance may serve to obscure one insurer’s financial condition by shifting loss reserves from one affiliate to another. Improper support or subsidy of one affiliate at the expense of another may adversely affect the financial condition of one or more companies within the group.

PROPOSED INSTRUCTIONS
PROPERTY/CASUALTY ANNUAL STATEMENT FOOTNOTE

Intercompany Pooling Arrangements

Instruction:

If the company is part of a group of affiliated insurers which utilizes a pooling arrangement that affects
the solvency and integrity of the insurer’s reserves under which the pool participants cede substantially
all of their direct and assumed business to the pool, describe the basic terms of such arrangement[s] and
the related accounting. The disclosure should include:

♦ Identification of the lead company and of all affiliated companies participating in the
intercompany pool (include NAIC Company Codes) and indication of their respective percentage
shares of the pooled business.

♦ Description of the lines and types of business subject to the pooling agreement.

♦ Description of cessions to non-affiliated reinsurers of business subject to the pooling agreement,
and indication of whether such cessions were prior to or subsequent to the cession of pooled
business from the affiliated pool members to the lead company.

♦ Identification of all pool members which are parties to reinsurance agreements with non-
affiliated reinsurance reinsurers covering business subject to the pooling agreement and which
have a contractual right of direct recovery from the non-affiliated reinsurer per the terms of such
reinsurance agreements.

♦ Explanation of any discrepancies between entries regarding pooled business on the assumed and
ceded reinsurance schedules of the lead company and corresponding entries on the assumed and
ceded reinsurance schedules of other pool participants.

♦ Description of intercompany sharing, if other than in accordance with the pool participation
percentage, of the Provision for Reinsurance (Schedule F, Part 7) and the write–off of
uncollectible reinsurance.

Illustration

ALTERNATIVE 1: EXTERNAL REINSURANCE PRIOR TO POOLING

The Company participates in an intercompany reinsurance pooling arrangement in which The ABC
Insurance Company is the lead company. Under the terms of the arrangement, all of the property-
casualty underwriting risks of the intercompany pool participants except other accident & health are
reinsured with the lead company after each individual company’s external reinsurance is transacted
among third parties. This pool of property-casualty net underwriting risks is then retroceded from the
lead company to the other non-lead pool participants based on pool participation percentages.
The names, NAIC company codes and pool participation percentages of the ABC Group’s intercompany pooling arrangement are as follows:

<table>
<thead>
<tr>
<th>Pool Participant</th>
<th>NAIC Company Code</th>
<th>Pool Participation %</th>
</tr>
</thead>
<tbody>
<tr>
<td>The ABC Insurance Company</td>
<td>00001</td>
<td>75%</td>
</tr>
<tr>
<td>The ABC Casualty Company</td>
<td>0000100002</td>
<td>10%</td>
</tr>
<tr>
<td>The ABC Indemnity Company</td>
<td>00003</td>
<td>10%</td>
</tr>
<tr>
<td>ABC Fire Insurance Company</td>
<td>00004</td>
<td>5%</td>
</tr>
</tbody>
</table>

**ALTERNATIVE 2: EXTERNAL REINSURANCE AFTER POOLING**

The Company participates in an intercompany reinsurance pooling arrangement in which The ABC Insurance Company is the lead company. Under the terms of the arrangement, all of the property-casualty underwriting risks of the intercompany pool participants except other accident & health are reinsured with the lead company. After reinsurance is transacted among third parties by the lead company, the remaining pool of property-casualty underwriting risks is then retroceded to the other non-lead pool participants based on pool participation percentages.

The names, NAIC company codes and pool participation percentages of the ABC Group’s intercompany pooling arrangement are as follows:

<table>
<thead>
<tr>
<th>Pool Participant</th>
<th>NAIC Company Code</th>
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</tr>
</thead>
<tbody>
<tr>
<td>The ABC Insurance Company</td>
<td>00001</td>
<td>75%</td>
</tr>
<tr>
<td>The ABC Casualty Company</td>
<td>0000100002</td>
<td>10%</td>
</tr>
<tr>
<td>The ABC Indemnity Company</td>
<td>00003</td>
<td>10%</td>
</tr>
<tr>
<td>ABC Fire Insurance Company</td>
<td>00004</td>
<td>5%</td>
</tr>
</tbody>
</table>

**Generally Accepted Accounting Principles**


29. FAS 113 discusses the following:

50. Several respondents questioned whether servicing carriers for involuntary risk pools should be included in the Statement’s scope. Servicing carriers generally retain the primary obligation to the policyholder and have no right to offset claim liabilities against amounts due from other pool participants. Although the credit risk associated with involuntary pools may be reduced because of the pool membership’s joint and several liability, the servicing carrier is still dependent on the ability of other pool members to pay their proportionate share of claims. State authorities oversee such pools and may act to support the solvency of pool, but that action generally is voluntary. The Board concluded that it was unable to effectively distinguish servicing carrier business from
other types of reinsurance for accounting purposes. Separate presentation or disclosure of servicing carrier activity is not precluded by this Statement.

RELEVANT LITERATURE:

Statutory Accounting
- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies, Chapters 14 and 22
- The Annual Statement Instructions for Property and Casualty Insurance Companies
- Issue Paper No. 5 - Definition of Liabilities, Loss Contingencies and Impairments of Assets

Generally Accepted Accounting Principles
- AICPA Audit and Accounting Guide: Audits of Property and Casualty Insurance Companies, Chapter 1, Nature, Conduct, and Regulation of the Business, Section 1.08
- FASB Statement No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts

State Regulations
- No additional guidance obtained from state statutes or regulations.

ACCOUNTING PRACTICES/PROPERTY/CASUALTY pp. 14-1 ff.

CHAPTER 14
PREMIUMS

An insurance company is a service organization that performs the function of selling protection in the form of insurance policies for which it charges a price, referred to as a premium.

Different methods of recording written premiums are used and generally follow the company’s plan of operation. For example, premiums may be recorded when the daily report is processed, when the premium is due, or when the premium is paid. Many companies use combinations of these methods. Whatever recording method is used, premiums written include the following categories: direct premiums, assumed reinsurance premiums and ceded reinsurance premiums.

Direct Premiums

The major portion of most companies’ premiums written is direct premiums. Direct premiums include all premiums arising from policies issued by the company acting as the primary insurance carrier. These premiums should be adjusted for any return or additional premiums arising from endorsements, cancellations, audits, and retrospective rating plans.

Direct written premiums are generally recorded for the full policy term. See Chapter 7-Agents’ Balances or Uncollected Premiums, for recording of uncollected premiums.

Endorsement entries generally follow the same recording path as the original entries. Those policies subject to audit may be adjusted on a monthly, quarterly, semi-annual, or annual basis with the premium

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resulting from a physical review of the exposure immediately recorded as written. Adjustments resulting from retrospective rating plans are immediately recorded as written premiums.

Assumed and Ceded Reinsurance Premiums

Assumed reinsurance premiums include all premiums (less return premiums) from contracts issued to reinsure another insurance company. Ceded reinsurance premiums include all premiums (less return premiums) transferred to another insurance company for reinsurance purchased.

Pooling

Pooling is a term used to describe the practice of sharing the business group of insurance companies affiliated or under common management. Premiums written by the associated companies are customarily ceded to or reinsured by one company; then, after provision for any outside reinsurance, the premiums are ceded back to the pooling participants as provided by the contract.

Underwriting Pools, Associations, and Syndicates

Companies also participate as members of an underwriting pool, association, or syndicate organized to provide special insurance coverages. Operating results, including the applicable premiums, are distributed to member companies based on their prescribed share.

Usually, statements are received by the company showing the total premiums written, as well as the member company’s participation. These premiums are recorded on a summary basis (usually by line of business) as direct or assumed business depending on the requirements of the particular association.

ACCOUNTING PRACTICES/PROPERTY/CASUALTY pp. 8-3 ff.

Board statements (FASB) 13, 28 and 66 are commonly used as guidelines where not in conflict with statutory accounting practices. Conservatism and policyholder protection are the objectives.

(f) Funds held by or deposited with reinsured companies, whether they are premiums withheld for unearned premium and outstanding loss reserves or advances for loss payments, are admitted assets provided they do not exceed the liabilities they secure and provided the reinsured is solvent. Those funds which are in excess of the liabilities, and any funds held by insolvent reinsureds, should be nonadmitted.

(g) Bills receivable taken for premiums are admitted assets provided that the current installment is not past due, and the balance due does not exceed the unearned premium on the policy for which the note was accepted.

(h) Reinsurance recoverable on loss payments is an admitted asset. Unauthorized reinsurance is included in this asset and reflected separately as a liability to the extent required. Penalty for overdue on authorized companies will be reflected as a liability. (See Chapter 22 — Reinsurance.)

(i) Federal income taxes recoverable represents tax refunds due from United States and Canadian federal or local governments.

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Electronic Data Processing Equipment

Various states permit showing the depreciated value of electronic data processing apparatus and related equipment constituting a data processing record keeping or accounting system as an asset. This is subject to limitations such as a percentage of total assets, minimum purchase price and period of depreciation. Operating system software may also qualify as an asset. The operating system is a program or a series of programs controlling the data job and task management operations of a computer or a computer network through executive scheduling and monitoring. It increases the productivity of a computer installation by managing the allocation of all available computer resources including the control processing unit, main storage and input/output devices. Application systems software such as language processors, library routines and debugging aides and other computer software are not considered operating system software and may not be recognized as admitted assets (See Chapter 9).

Interest, Dividends and Real Estate Income Due and Accrued

1. The rents accrued and owing to the company on real and personal property, directly or beneficially owned
2. Interest or rents accrued on conditional sales agreements, chattel mortgages and real or personal property under lease to other corporations
3. The fixed and required interest due and accrued on bonds and other like evidences of indebtedness, not in default
4. Dividends receivable on shares of stock, provided that the market price taken for valuation purposes does not include the value of the dividend
5. The interest or dividends due and accrued, but not credited, on deposits in banks and trust companies or on accounts with savings and loan associations
6. Interest accrued on tax anticipation warrants
7. Interest accrued on secured loans

Amounts due from affiliated companies are unsecured current accounts receivable. To the extent that the affiliate has liquid assets with which to repay the balance, and to otherwise maintain its account on a current basis, the amount may be admitted.

Equities and deposits in pools and associations generally are admitted assets.