

# Statutory Issue Paper No. 97

## Underwriting Pools and Associations Including Intercompany Pools

### STATUS

Finalized March 16, 1998

**Original SSAP and Current Authoritative Guidance: SSAP No. 63**

### 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:

- 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.

#### **Drafting Notes/Comments**

None

### **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.

**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:

<u>Pool Participant</u>	<u>NAIC Company Code</u>	<u>Pool Participation %</u>
The ABC Insurance Company	00001	75%
The ABC Casualty Company	0000100002	10%
The ABC Indemnity Company	00003	10%
ABC Fire Insurance Company	00004	5%

## 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:

<u>Pool Participant</u>	<u>NAIC Company Code</u>	<u>Pool Participation %</u>
The ABC Insurance Company	00001	75%
The ABC Casualty Company	0000100002	10%
The ABC Indemnity Company	00003	10%
ABC Fire Insurance Company	00004	5%

**Generally Accepted Accounting Principles**

28. The AICPA Audit and Accounting Guide: Audits of Property and Casualty Insurance Companies describes several types of involuntary plans in Chapter 1, *Nature, Conduct, and Regulation of the Business*.

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.

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