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Permitted Practice: Treatment of Ceded Incurred Losses and IBNR Reserves in the Context of Certain Swing-Rated Reinsurance Agreements of Nevada-Domiciled Property and Casualty Insurers

This bulletin provides guidance and clarification regarding the issuance of a limited permitted practice to a property and/or casualty insurer domiciled in Nevada, applicable to the specific circumstances where any such insurer may be ceding premiums and losses to a reinsurer or reinsurers by means of a reinsurance agreement containing a *swing-rate provision*, as that term is described below.

This limited permitted practice is not intended to alter the intentions of the parties to any reinsurance contract, but rather to reinforce what appears to be a common understanding within the insurance and reinsurance markets about the manner of operation of many swing-rating provisions in reinsurance agreements. Furthermore, this limited permitted practice is not intended to encourage, discourage, or take a position on the desirability or lack of desirability of purchase of any particular reinsurance contracts by a Nevada-domiciled insurer, as any such determination must be made on a case-by-case basis in consideration of a given insurer's financial situation, the terms of the reinsurance agreement(s) in question, and any other available options.

This permitted practice applies to the following circumstances, all of which must be satisfied:

(1) The entity seeking to utilize the permitted practice is a property and/or casualty insurer domiciled in Nevada.

(2) The entity seeking to utilize the permitted practice is a party to a reinsurance agreement as a *ceding insurer*.

(3) The reinsurance agreement in part (2) above is an *excess-of-loss* reinsurance agreement, which generally provides for the reinsurer(s) to cover a certain layer per claim or per loss occurrence above a specified retention applicable to each claim or loss occurrence.

(4) The reinsurance agreement in part (2) above includes a *swing-rate provision*, whereby ceded premium is adjusted on the basis of ceded loss experience using a loss load by means of which any additional ceded premium would be expressed as a function of ceded losses, often within a specified range of loss experience.

(5) The swing-rate provision in part (4) above requires periodic reporting of the ceded incurred losses from the ceding insurer to the reinsurer(s) and provides that the swing-rated ceded premium would be adjusted on the basis of such periodic reports.

(6) The swing-rate provision in part (4) above calculates the swing-rated ceded premium by reference to "incurred" or "reported" losses but does not specifically mention or require the inclusion of "incurred but not reported" (IBNR) reserves as part of the calculation of swing-rated ceded premium.

Nature of the Permitted Practice

In the event that all of the circumstances enumerated in parts (1) through (6) above are present, then the Nevada-domiciled ceding insurer is required to include case reserves, as established by that ceding insurer, in the calculation of the expected additional or return premium pursuant to the swing-rate provision of the reinsurance agreement. However, as is consistent with the terms of such a reinsurance contract described above, the Nevada-domiciled ceding insurer is not required to include "incurred but not reported" (IBNR) reserves in calculating the expected additional or return premium pursuant to that swing-rate provision, until such a time as any claims previously considered to be in the IBNR category become known and reported to the ceding insurer.

Limitations of the Permitted Practice

This permitted practice presupposes that, at the time of each periodic claim report to the reinsurer, the ceding insurer provides to the reinsurer(s) the most current and accurate information regarding both paid losses and case reserves as known by the ceding insurer at that time. Furthermore, this permitted practice presupposes that the ceding insurer has set its case reserves accurately to the satisfaction of the reinsurer(s) and the Division. The reinsurer(s), as well as the Division, would maintain the prerogative to request a revision of such case reserves in the event that the case reserves are not considered to be accurate.

Moreover, this permitted practice does *not* apply to the accounting for any reinsurance agreement which clearly and specifically requires an estimate of ceded IBNR reserves be reported to the reinsurer(s) for purposes of the swing-rate calculation.

The Nevada-domiciled ceding insurer would still be required to include IBNR Reserves as part of the Loss Reserves in the Annual Statement in accordance with the NAIC Annual Statement Instructions.

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