ARIAS SPRING CONFERENCE 2017

A FRESH PERSPECTIVE ON THE BUSINESS ASPECT OF COMMUTATIONS

TOPICS TO COVER

- ●Differing approaches and techniques utilized in connection with the commutation of reinsurance agreements and the rationale for their use.
- ●Sources of disputes regarding commutations which lead to arbitrations.
- ●Key terms to include in commutation agreement and issues to consider regarding the drafting of the agreement.
- ●Keys to a successful commutation strategy and pitfalls to avoid.
- ●Functional disciplines involved and the types of analyses performed in connection with commutation agreements.
- ●Role of commutation agreements in managing runoffs in the current business environment.

COMMUTATION DEFINITION

- Two types of commutations
  - Contractual
  - Mutual agreement
- Buy-back of (re)insurance contract
  - Ceding company reassumes all remaining liability and risks
- Reinsurer pays ceding company consideration
  - Payment is to cover expected loss and other considerations
- Ceding Company releases reinsurer for all liability

Commutation Provisions In Reinsurance Agreements

1. Optional Commutation Provisions

2. Mandatory Commutation Provisions

3. Agreed Value Commutation

OPTIONAL COMMUTATION AGREEMENT SIMPLE FORM

Either party hereto may request commutation of the ceded reserves for outstanding losses as of any date. In the event the other party agrees to commutation, and upon payment by the Reinsurer to the Company of a mutually agreed amount representing the commuted value of the ceded reserves for outstanding losses, the Reinsurer shall be relieved of any further liability hereunder with respect to the losses so commuted.

MANDATORY COMMUTATION AGREEMENT

A. Within 36 months after expiration or termination of this Contract, the Company may, at its sole discretion, commute the Reinsurer’s liability with respect to all outstanding claims which have not been finally settled and which may cause a claim under Policies allocated to this Contract. It is understood and agreed that if the loss ratio is less than 60% at the time of commutation, the Reinsurer shall return to the Company 2.5% of the ceded Net Earned Premium hereunder. Any final amounts due hereunder in accordance with this Article shall be subject to mutual agreement.

PANEL OF ACTUARIES

If the Company and the Reinsurer cannot agree on the commutation amount and/or the projected payout pattern, the two parties will mutually appoint a panel of three actuaries to make the determination of such commutation amount and/or payout pattern. Each party shall name its own actuary prior to the commutation date. If either party fails to appoint its actuary within seven days after being requested to do so by the other party, the latter, after 10 business days' prior notice by certified or registered mail of its intention to do so, may appoint the second actuary. Prior to the commutation date, the two actuaries shall, by mutual agreement or, failing that, by drawing lots, choose an impartial third actuary who shall preside at the hearing. The actuaries will make their determination of the commutation amount within 30 days after being engaged of the commutation amount. The actuaries' determination will be final and binding on the parties. Each party shall bear the expense of its own actuary and shall jointly and equally bear with the other party the cost of the third actuary. The commutation amount determined by the actuaries will be set forth in a sworn statement expressing the actuaries' professional opinion that said amount is fair for the complete release of all liabilities being commuted.

KEY TERMS IN COMMUTATION AGREEMENTS

- Identify clearly the **Parties subject to the commutation agreement** (including identification of current and prior corporate names and definition of "affiliated" companies).
- Identify clearly and specifically in a separate schedule the **reinsurance agreements being commuted**.
- Include **clear payment terms** and date(s) of payment.
- Release provisions should be drafted to include **full and final satisfaction of all liabilities** (including known and unknown claims). Include California Section 1542 Clause.
- **Governing Law Provision** – spelling out the law governing the interpretation of the agreement and to be applied to resolve disputes over the reinsurance agreement.
- **Dispute Resolution Provision** – spelling out whether disputes over the commutation agreement are subject to arbitration and specifying the venue if arbitration not selected.

CEDED COMMUTATION CATEGORIES

Credit	To minimize future collection risk resulting from liquidation or reduce concentration risk with current trading partners
Mandatory	Required by contract or per Court Order.
Claim	Mitigate legal risk/cost related to a specific claim or group of disputed claims.
Opportunistic	Generate sizable premium beyond the estimated loss pick.
Administrative	Reduce or eliminate large transactional costs associated to contracts with small future recoverables.
Affiliated	While administrative in nature, commutations with affiliated companies that support strategic objectives.


Claim Analysis
Pricing
Contract Reconciliation
Offer/Negotiate
Understanding Exposure/Reinsurance
Legal
Data Collection
Commutation
Accounting/Reporting

APPROACHES/TECHNIQUES

Aggregate Portfolio Approach

By LOB/ RI Layers

Expected loss ratios

Various paid / reported loss development factors

Individual Claim Modeling (WC / PIP)

- Specific claim-level information
- No provision for future reopen claims or pure IBNR claims
- Various medical inflation

TESTING OF ESTIMATES/REASONABLE AND CONSISTENT?