

Finite Reinsurance

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Finite reinsurance is a type of reinsurance that only transfers a limited amount of risk from an insurer to a reinsurance company. Unlike other reinsurances, finite reinsurance sets a limit to how much a claim can receive and not allow for unlimited coverage past a certain amount the insurer is responsible for. Therefore the insurer will receive a lower premium on finite reinsurance than traditional reinsurance. This type of reinsurance can have a highly complex structure and companies can abuse those structures. Sometimes with finite reinsurance companies do not transfer any risk while making it appear their income is improved. Also, in the United States property and casualty insurance companies are usually not allowed to discount their insurance reserves and by using finite reinsurance, they can transfer insurance liabilities off its balance sheet at a price that is at the present value of the liabilities.

In 2006, a grand jury indictment and an SEC civil enforcement action were filed by the United States against AIG because it was alleged that a few individuals were using finite reinsurance contracts to mislead investors about AIG's loss reserves. Finite reinsurance has been a standard type of insurance protection for years which is perfectly legal. The issue with AIG is that they were improperly accounting for finite reinsurance, in particular when they are considered as insurance when no risk transfer takes place. This allows for a company to distort some of their financial statements and it acts as an earnings management tool. Allegedly these tactics helped AIG inflate its loss reserves by 500 million over five years. Other companies are now being watched more closely when they work with finite reinsurance. Due to these individuals' actions, the National Association of Insurance Commissioners, NAIC, will take action on this issue. The goal

of the NAIC is to eliminate the abuse of finite reinsurance contracts. Finite reinsurance will still be used in the future, but the regulations put on its use will be much most likely being stricter.