30. (1.5 points)

An insurance company that writes California homeowners business with a total insured value of $500 million is evaluating several reinsurance contracts to lessen the potential impact on its financial statements from a catastrophic California earthquake event. Two such contracts are detailed below.

- Contract 1: A contract that pays, on December 31, 2013, 95% of all of the Company's California earthquake losses incurred in 2012.
- Contract 2: A quota share that cedes 100% of the company's California homeowners business.

a. (1 point)

Evaluate whether or not each contract above would qualify for reinsurance accounting treatment under statutory accounting.

b. (0.5 point)

For the contract(s) that does not qualify for reinsurance accounting in part a. above, propose a modification that could be made so that the contract(s) qualify for reinsurance accounting treatment under SAP.

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30) Sample Answer

Answer 1

A) Contract 1: no, there is not timing risk. There must be both underwriting and timing risk.
Contract 2: yes, the risk transfer is substantially all; this is an exception.
B) Contract 1: modify it to eliminate the repayment date. Losses will be paid 30 days after primary insurer pays out the losses.

Answer 2

A) Contract 1: would not because it does not include timing risk (all losses would be paid on 12/31/13).
Contract2: would because substantially all of the insurance risk is being ceded to the reinsurer.
B) Contract 1 could be modified so that all losses are reimbursed to the ceding company within 30 days of when they are paid by the insured.

Examiner's Report

Common Part A mistakes:

1. Stating that Contract 1 would qualify for reinsurance accounting under the substantially all exception. This is not correct, as the company writes homeowners policies that cover more than just earthquake losses. To qualify for the substantially all exception the reinsurer would need to be in the position of the insurer.

2. Stating that Contract 2 would not qualify for reinsurance accounting as there is no insurance risk to the insurer. This is not correct, the question of insurance risk applies to the reinsurer not the ceding company. In addition, this contract does qualify under the substantially all exception.

Common Part B mistakes:

Changing Contract 1 to pay losses incurred in 2013 without addressing the payment date.