16. (3.5 points)

A primary insurance company is reinsured by an authorized reinsurance company. The reinsurance company has provided a letter of credit of $3 million. As of December 31, 2012, the primary insurance company has the following reinsurance recoverables from 2012 (all figures are in millions of dollars):

Amount of Recoverable	Status of Primary Insurer's payment	Due date for Reinsurer's payment	Status of Reinsurer's payment
5	Paid	February 3	Paid
1	Paid	February 27	In Dispute
12	Paid	June 20	Paid
2	Paid	July 6	In Dispute
3	Paid	August 2	Unpaid
4	Paid	October 5	Paid
10	Paid	November 17	Unpaid

a. (1 point)

Determine whether the reinsurer is "slow-paying."

b. (0.75 point)

Calculate the insurer's provision for reinsurance.

c. (0.75 point)

Assume that the reinsurer is unauthorized instead of authorized. Calculate the revised provision for reinsurance.

d. (1 point)

Propose two potential enhancements to Schedule F, and briefly explain how each would improve its capacity to monitor reinsurer credit risk.

CONTINUED ON NEXT PAGE

Parts a and d were straightforward questions. Parts b and c asked candidates to critically evaluate the allocation method and justify an improved method.

a. The common errors were confusing the surplus allocation with the investible assets or the funds attributable to insurance transactions. In addition, some candidates confused which metrics were averages while others only provided the components without explaining how they are used to allocate to line.

b. While the majority got full credit for their argument, some candidates failed to construct a complete argument against the current methodology. In some cases, candidates commented on short-tail and long-tail lines of business but didn't provide any detail, such as how cat risk leads to more surplus needed in some short-tail lines.

c. Many candidates did not provide an answer, while in other cases candidates would propose a method without any justification. Numerous candidates were able to tie in material from other parts of the syllabus or draw from their own experiences.

d. The vast majority received credit for their descriptions.

16. Sample Answers

a.

Ratio = (Reinsurance recoverables over 90 days overdue)/(total recoverable on paid loss & LAE + recovery in last 90 days)

3/(3+10+4) = 17.65% which is less than 20%. Reinsurer is not slow-paying.

b.

Provision = 20% * amount > 90 days overdue (include dispute)
20%*(3+2+1) = 1.2M

c.

Provision = unsecured recoverables + 20% amount > 90 day late + 20% dispute
[1+2+3+10-3]+20%[3]+20%[1+2]= 14.2M

d. Any two of the following:
- It could disclose contract terms. The largest threat to solvency is inadequate reinsurance and it would help identify gaps in coverage.
- Schedule F could be supplemented by management's best estimate of uncollectibility, which would give an insight into how management views the reinsurer's stability and ability to pay.
- Provide analysis of reinsurer financial stability in an adverse situation. If a major catastrophe happens, this would ensure the reinsurer has the funds to handle all its obligations.
- Focus on reinsurer's ratings, since credit risk should vary based on this. Schedule F does not do this at all right now.
- Redefine arbitrary "20% slowpaying" threshold and focus on reasons for being slowpaying which may be more indicative of credit risk.

- Identify financially strong unauthorized reinsurers and modify their provision. Large provision given to reinsurance placed with unauthorized reinsurers when they could indeed be safe.
- Include exhibit of capital structure of reinsurers. This would give insight of reinsurer financial stability and its risk of uncollectibility.
- Add exhibit of any prior collectability issues with reinsurers. This would allow consideration of ongoing risk associated with the provision.
- It should monitor the quality of collateral that reinsurers are holding. Collateral is worthless if it is unlikely to be redeemable.

16. Examiner's Report

Parts a through c represent a fairly straightforward and typical Schedule F question. Part d is much more open-ended, but allows candidates to receive credit if they provide logical and well-supported enhancements. Most candidates were able to provide an answer worth full credit. For those that did not, common errors are listed by part.

a. Common errors on the slow pay test ratio:
   - Calculation errors
   - Included disputes in the calculation
   - Did not apply the table amounts provided to the formula correctly

b. Common errors on provision for reinsurance for non slow-payer reinsurer:
   - Calculation errors
   - Used the slowpay calculation when concluded the reinsurer was not a slow payer in Part A.
   - Did not include disputes
   - Did not apply the table amounts provided to the formula correctly

c. Common errors on provision for reinsurance for unauthorized reinsurer:
   - Included paid amounts in the recoverables amount
   - Used unsecured recoverables to cap the final answer instead of total recoverables
   - Calculation errors
   - Did not include disputes
   - Did not apply the table amounts provided to the formulas correctly

d. Common errors on proposing two enhancements to Schedule F:
   - Didn't propose an enhancement, just pointed out shortcoming
   - Didn't explain how suggestion would improve the capacity to monitor credit risk

17. Sample Answers

a. Any two of the following:
   - Uncollectible reinsurance written off from reinsurer A
     Purpose: To show retrospective fact of how much reinsurance was deemed uncollectible and can be used to compare with provision for reinsurance
   - Unsecured collectibles of 4 million from reinsurer C (> 3% of surplus)
     Purpose: to show potential credit risk of the recoverables