

15. (2.5 points)

A primary insurance company writes only homeowners insurance. The following excerpt is from the company's 2012 Notes to Financial Statements:

23. REINSURANCE

A. Unsecured Reinsurance Recoverable

The company had three reinsurers whose aggregate recoverable for ceded losses, loss adjustment expenses, and unearned premiums recoverable as of December 31, 2012, exceeded 3% of the Company's Surplus. Information concerning these companies is as follows:

	Net	Recoverable's Percentage of	A.M. Best
Reinsurer	Recoverable	Company's Surplus	Rating
X	6,223,000	4.0%	B+
Y	6,223,000	4.0%	B-
Z	5,445,000	3.5%	A

Reinsurer X has always made its payments within 120 days.

Reinsurer Y has always been current on its payments.

Reinsurer Z has always been current on its payments.

B. Reinsurance Recoverable in Dispute

The company has no material recoverables in dispute.

...

D. Uncollectible Reinsurance

The company has no material uncollectible reinsurance.

a. (1.5 points)

Identify three questions the Appointed Actuary might raise to the primary insurer regarding Note 23, and briefly describe the motivation behind each question.

b. (1 point)

The insurer's book of business was exposed to a catastrophic winter storm during the final week of December 2012. Reinsurer Y provides substantial catastrophe coverage to the insurer. Identify two additional questions the Appointed Actuary might raise to the primary insurer relating to the reinsurance for this catastrophe, and briefly describe the motivation behind each question.

## SAMPLE ANSWERS AND EXAMINER'S REPORT

<b>QUESTION 15</b>	
<b>TOTAL POINT VALUE: 2.5</b>	<b>LEARNING OBJECTIVE: C1</b>
<b>SAMPLE/ACCEPTED ANSWERS</b>	
<b>Part a: 1.5 points</b>	
<ul style="list-style-type: none"> <li>• Was there a catastrophe that led to a large amount of recoverable? <ul style="list-style-type: none"> <li>○ Motivation: Want to see whether the large amount of recoverable is temporary/permanent or usual/unusual issue.</li> </ul> </li> <li>• Why wasn't security provided? <ul style="list-style-type: none"> <li>○ Concern that Y may not be able to pay the recoverable.</li> </ul> </li> <li>• Are there concerns of the financial health of these reinsurers? <ul style="list-style-type: none"> <li>○ Concern that Y has a low AM Best rating.</li> <li>○ Concern that X has been late in its payments.</li> </ul> </li> <li>• Do the reinsurers have high capital to insurance in force? <ul style="list-style-type: none"> <li>○ Higher capital would have less chance to default.</li> </ul> </li> <li>• Has X been current in their recovery payments? <ul style="list-style-type: none"> <li>○ It may create cash flow issues when Reinsurer X doesn't pay claims right away.</li> </ul> </li> <li>• Are X and Y affiliated (with each other)? <ul style="list-style-type: none"> <li>○ Recoverable amount is the same; might be increased credit risk if these two reinsurers are affiliated.</li> </ul> </li> <li>• Are any of these reinsurers affiliated with the insurer? <ul style="list-style-type: none"> <li>○ Disputes may be less likely, increasing chance of recovery.</li> </ul> </li> <li>• Double-check the numbers – is there a transcription error? <ul style="list-style-type: none"> <li>○ The recoverable amounts for X and Y are the same, and this looks suspicious.</li> </ul> </li> <li>• Have any of these reinsurers recently experienced ratings downgrades? <ul style="list-style-type: none"> <li>○ Might be indicative of financial trouble?</li> </ul> </li> <li>• Why are you doing business with low-rated and/or slow-to-pay reinsurers? <ul style="list-style-type: none"> <li>○ To gain a better understanding of why the insurer is comfortable with what would ordinarily be increased credit risk.</li> </ul> </li> <li>• What is the materiality standard used for notes B or D? <ul style="list-style-type: none"> <li>○ Amounts not material to the insurer's management may be material to the actuary.</li> </ul> </li> <li>• Has there been a history of disputes or payment delays? Or, more generally, what has the past working relationship between the insurer and reinsurers been like? <ul style="list-style-type: none"> <li>○ Past experience may be predictive of future recoverability problems.</li> </ul> </li> <li>• Is any of this reinsurance through an involuntary pool or association? <ul style="list-style-type: none"> <li>○ Especially with respect to X, pools or associations might pay late due to reimbursement schedules although collectability risk is negligible.</li> </ul> </li> <li>• Is the company relying too much on reinsurance? What are the ceding commissions involved with these contracts? <ul style="list-style-type: none"> <li>○ Concern that the company is using these reinsurers for surplus relief, artificially inflating surplus at the cost of assuming additional credit risk.</li> </ul> </li> <li>• What is management's opinion of future uncollectibility? <ul style="list-style-type: none"> <li>○ Management's insight in this area is important. Note 23 is retrospective, while management's insight is prospective.</li> </ul> </li> <li>• Might any of the arrangements qualify as financial reinsurance?</li> </ul>	

## SAMPLE ANSWERS AND EXAMINER'S REPORT

- This needs to be disclosed.

### Part b: 1 point

- To what degree will retrocessions between these reinsurers or to another reinsurer expose them to systemic credit risk?
  - Reinsurers could be exposed to systemic credit risk and may not have enough resources to pay claims.
  - Risk could be decreased if the reinsurer has a well-designed reinsurance program with well-capitalized counterparties.
- Would high concentration of recoveries from X/Y be an issue?
  - X is slow to pay; Y has a low rating.
- What are the terms of the contracts with these reinsurers?
  - Limits, layers, reinstatement premiums, coverage triggers, facultative/treaty and so on all have a bearing on how much liability the insurer will ultimately bear for the catastrophe.
- To what extent was the catastrophe reflected in the financial statement?
  - Would like to know the total recoverables, including the catastrophe's impact on surplus.
- Is there information that can tell to what degree Reinsurer Y is exposed to the winter cat?
  - Want to know whether Reinsurer Y is exposed to it through multiple channels (i.e., does it reinsure other insurers that were impacted by this catastrophe).
- Additionally: any answer that was acceptable for A which would also be appropriate to ask in light of this catastrophe.

### EXAMINER'S REPORT

For both parts of this question, the candidate was expected to develop questions (and associated motivations) whose answers, which could not be found in the information given, could reasonably be expected to be relevant to the work of the Appointed Actuary. For the second part of this question, candidate responses were expected to relate to the reinsurance for the catastrophe described in the prompt.

### Part a

This portion of the question was challenging, and candidates generally had difficulty on this part. Many candidates responded with less than the three requested questions.

Other common errors:

- Many candidates confused the role of the Appointed Actuary and the company actuary, with large number of responses related to the provision for reinsurance and the calculation thereof (including questions about whether the reinsurer was slow paying and/or authorized). The mechanics of the calculation of the provision for reinsurance is ordinarily not a concern of the Appointed Actuary.
- Many candidates responded with questions without providing an associated motivation.

## SAMPLE ANSWERS AND EXAMINER'S REPORT

- Many candidates provided motivations that were substantially identical to their associated questions (e.g., “Why does Reinsurer Y have such a low rating? Want to know why low rated.”)
- Many candidates responded with questions that could be answered from the information provided in the prompt (e.g., “What is the rating of Reinsurer Y?” or “What lines of business does the primary insurance company write?”).

### **Part b**

Candidates had more success on this portion of the question, with candidates generally scoring very well. Almost all candidates were able to respond with two questions. In addition to the common errors listed for the first portion of this question, some candidates lost points because they supplied answers for the second portion of this question which were not related to the reinsurance for the catastrophe described in the prompt.