

16. (4.5 points)

On January 1, 2010, Insurer AA sold a workers compensation policy to Manufacturer EE and entered into a 30% quota share treaty with Reinsurer CC, with this treaty being the primary reinsurance agreement. Insurer AA also began participating in a 50% intercompany pooling arrangement with lead member Insurer BB, which is secondary to the quota share agreement with Reinsurer CC.

On July 1, 2011, a claim valued at \$900,000 with an accident date of November 15, 2010, was reported to Insurer AA.

On October 1, 2011, Insurer AA and Insurer BB purchased retroactive reinsurance from Reinsurer DD to cover each of their shares of the claim.

On September 1, 2012, the intercompany pooling arrangement between Insurer AA and Insurer BB was changed to 25% for Insurer AA and 75% for Insurer BB.

On October 15, 2012, \$100,000 of adverse development was recorded and \$400,000 was paid to the claimant.

As of December 31, 2012, Insurer AA had not been reimbursed for this claim. Assume that the claim does not influence bulk reserves or IBNR reserves.

a. (1.5 points)

Calculate the entries for this claim for the following parts of Insurer AA's 2012 Schedule P:

- Part 2D - Workers' Compensation
(Incurred Net Losses & DCC Reported at Year End)
- Part 3D - Workers' Compensation
(Cumulative Paid Net Losses & DCC Reported at Year End)

b. (1.75 points)

Calculate the entries for this claim in Schedule F – Part 3 (Ceded Reinsurance) in Insurer AA's 2012 Annual Statement. Do not show any unaffected columns.

c. (0.5 point)

Briefly explain the treatment and effect of the retroactive reinsurance contract on Insurer AA's 2012 balance sheet. Do not perform any calculations.

d. (0.75 point)

Identify three places in Insurer AA's Annual Statement other than Schedule P, Schedule F, and the balance sheet that are affected by the claim reported on July 1, 2011.

SAMPLE ANSWERS AND EXAMINER'S REPORT

QUESTION 16			
TOTAL POINT VALUE: 4.5		LEARNING OBJECTIVE: C1	
SAMPLE/ACCEPTED ANSWERS			
Part a: 1.5 points			
Example 1:			
2D			
AY	2010	2011	2012
2010	0	157,500	175,000
3D			
AY	2010	2011	2012
2010	0	0	70,000
Example 2			
All Entries in the AY 2010 row			
For Part 2D:			
For CY 2011 column: $900k \times (25\% \times 70\%) = \$157k$			
For CY 2012 column: $(900k + 100k) \times (25\% \times 70\%) = \$175k$			
For Part 3D:			
For CY 2012 column: $400K \times (25\% \times 70\%) = \$70k$			
Example 3:			
Retroactive reinsurance has not effect to Sch P			
Pooling rate should be adjusted according to latest rate			
2D			
AY	2010	2011	2012
2010	0	157,500	175,000
		$(900 \times .7 \times .25)$	$(1000 \times .25 \times .7)$
3D			
AY	2010	2011	2012
2010	0	0	70,000
			$(400 \times .25 \times .7)$
Part b: 1.75 points			
Example 1:			
Reinsurer	Rein. Recov. On Paid Loss	Rein. Recov. On Case Loss	
Insurer BB	210,000	315,000	
Reinsurer CC	120,000	180,000	

SAMPLE ANSWERS AND EXAMINER'S REPORT

Example 2:

From Reinsurer CC

Reinsurance Recoverable on Paid = $400,000 \times 30\% = 120,000$

From Reinsurer BB

Reinsurance Recoverable on Paid = $400,000 \times (1-30\%) \times 75\% = 210,000$

From Reinsurer CC

Reinsurance Recoverable on Unpaid = $(900,000 + 100,000 - 400,000) \times 30\% = 180,000$

From Reinsurer BB

Reinsurance Recoverable on Unpaid = $(900,000 + 100,000 - 400,000) \times (1-30\%) \times 75\% = 315,000$

Part c: 0.5 point

Listing two or more of the following with no other incorrect statements:

- Consideration paid reduces cash asset
- Loss reserves unaffected
- Total liability reduced
- Write-in contra-liability on balance sheet
- Difference recorded as special surplus
- In order to move to unrestricted surplus, the recoveries must be greater than the consideration paid
- Retroactive reinsurance must use deposit accounting

Part d: 0.75 point

Listing three of the following:

- Income Statement/Capital & Surplus Accounts
- Notes to the Financial Statement/Notes to the Annual Statement
- Underwriting and Investment Exhibit (U&IE)/Underwriting & Investment Expense Exhibit
- Schedule T
- Exhibit of Premiums and Losses/Statutory Page 14/Page 14
- 5 Year Historical Data/5 year exhibits
- Statement of Cash Flows

EXAMINER'S REPORT

The candidate was expected to know a number of different annual statement exhibits, treatment of retroactive reinsurance, quoted share reinsurance, and pooling percentage changes.

Candidates had difficulty with this question. There were a few challenging concepts, including retroactive reinsurance and pooling percentage changes. There were also a number of places to lose partial credit. Overall, candidates struggled with subpart B (schedule F) which was expected given some of the nuances of the exhibit. Candidates were pretty split and either got most of the points or very few of the points on that subpart (not many in between.) Candidates did great on subpart c.

Part a

The candidate was expected to know the setup of Schedule P Parts 2D and 3D. This included showing calculations for the inputs of the incurred and paid triangles, showing it was net of reinsurance and pooling arrangements, but not impacted by retroactive reinsurance. Also, the

SAMPLE ANSWERS AND EXAMINER'S REPORT

candidate was expected to correctly reflect the most recent pooling percentage change.

Common Mistakes:

- Not showing the CY 2011 calculation in part 2D
- Not using the correct ceding or pooling percentages (particularly for the CY 2011 calculation)
- Including retrospective reinsurance recoveries in the triangle
- Calculating incremental incurred (part 2D should be cumulative occurred)
- Showing the wrong accident year
- Showing a calculation for CY 2010 (as there was no incurred loss in 2010).
- Math mistakes

Part b

The candidate was expected to know the setup of Schedule F Part 3 – Ceded Reinsurance and how retroactive reinsurance did not impact it. This included showing calculations for the paid and unpaid reinsurance recoveries of the two different reinsurers separately. Also, the candidate was expected to correctly reflect the most recent pooling percentage change.

There was a lot happening in this question, and a lot of little errors that candidates could make.

Common Mistakes:

- Showing calculation for multiple years instead of the latest year only.
- Not listing the recoveries separately for BB and CC, or only showing one of the reinsurers not both.
- Including recoveries from DD, the retroactive reinsurer, which should not be included.
- Showing paid and incurred recoveries instead of paid and unpaid.
- Confusing part 3 with the aging schedule and bucketing recoveries by how overdue they were.
- Not showing enough work to get partial credit. For example, if the candidate only listed their final answer without showing any work/formulas to support their answer and the answer provided did not match the sample answer, there was not a way to determine the candidate knew what they were doing so partial credit was minimal.
- Using the incorrect ceding percentage or pooling percentage in their calculations.
- Forgetting to pick up the adverse development in their unpaid recoveries calculation.

Part c

Candidate was expected to know the accounting treatment of retroactive reinsurance in the balance sheet. The candidate needed to show they knew the unique aspects of retroactive reinsurance accounting versus traditional insurance/reinsurance accounting.

Most candidates received full credit. Common errors included mixing up treatment or not actually stating the effect on the balance sheet (increase in surplus, decrease in liability, decrease in assets, etc.) Some candidates listed impacts for other exhibits instead of balance sheet (impact on income statement or schedule P or schedule F.) Please note, if the candidate did this, but also showed they know the effect on the balance sheet, they could still receive full credit. A few candidates stated loss reserves were reduced or cash was increased by reinsurance recoverable or surplus was moved to unassigned when consideration was less than recoveries which are all

SAMPLE ANSWERS AND EXAMINER'S REPORT

incorrect.

Part d

The candidate was expected to list three additional places in the annual statement impacted by incurred loss and/or retroactive reinsurance (see list of sample accepted answers above.)

Based on the context of the question (which gave three examples of exhibits and asked for three more) we expected the candidate to list three different exhibits or places in the annual statement. Quite a few candidates listed multiple section/components of the same exhibit. In this case, the candidate only received credit for one response. A few candidates listed one of the given exhibits (for example listing a part of the balance sheet when balance sheet was in the question itself.)

The question asked other places in the annual statement, so we accepted only exhibits in the annual statement itself and did not accept answers from the annual statement supplements (for example Statement of Actuarial Opinion, Insurance Expense Exhibit, or Actuarial Opinion Summary.) The supplements are separately referenced in the syllabus, filed at different times and may be confidential.