24. (2.5 points)

An insurer wants to exit the homeowners market in a single state. The insurer has stopped writing new business and wants to enter into a property-casualty run-off agreement with a reinsurer.

a. (0.5 point)

Briefly explain the difference between a property-casualty run-off agreement and a novation.

b. (0.5 point)

Identify two situations where an insurer would not be eligible for reinsurance accounting treatment under a novation.

c. (1 point)

Identify and briefly describe two items that a regulator might review before approving reinsurance accounting treatment for a property-casualty run-off agreement.

d. (0.5 point)

Describe how the primary insurance company would record the amount paid to the assuming entity for a property-casualty run-off agreement.

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SAMPLE ANSWERS AND EXAMINER'S REPORT

QUESTION 24	
TOTAL POINT VALUE: 2.5	**LEARNING OBJECTIVE: E**

SAMPLE ANSWERS

Part a: 0.5 point

- Runoff company remains primarily liable in case where reinsurer goes bankrupt/is unable to pay vs. novation → company (primary insurer) is completely released from all liability
- Runoff agreement covers adverse development and obligations for a line no longer actively marketed by the ceder, the ceder is still the primary insurer, the assumer is the reinsurer. Novation transfers all risks, the assumer is primary and the ceder breaks all ties.
- Runoff: when you cede 100% of the line of business to a third party and you're no longer marketing the business but may still be liable if 3rd party defaults. Novation: you're also transferring your line of business to the 3rd party except you'll no longer be liable for the business ceded.
- Novation is when one party is absolved of any legal responsibility. In a runoff agreement the primary insurer is still responsible but the reinsurer agrees to pay for the claims.
- Runoff = insurer retains 1st responsibility. Novation = no responsibility
- Under the runoff agreement insurer still has liability when reinsurer gets insolvent vs. novation doesn't (because it extinguishes all liabilities)
- Runoff agreement: would be reinsurance with 100% ceded. Insurer is still primary responsible. Novation: contract is completely replaced by another one. Insurer would not have any more responsibility.
- Runoff: insurer is still contingently liable for ceded reserves. Novation: completely extinguishes liability for ceded reserves for ceding company
- Novation exhausts liabilities entirely including claims handling, runoff does not

Part b: 0.5 point

- retroactive reinsurance; novation with affiliated company
- (1) The parties to the transaction are affiliates and the transaction has no prior approval of the domiciliary regulators of the parties. (2) The accounting for the original reinsurance agreement will be altered from retrospective to prospective.

Part c: 1 point

Any two of the following:

- That the reinsurer is properly licensed
- The transferred risks should contain the same policy limits, deductibles (same coverages basically)
- Ensure no guarantee of profit to either side
- Ensure that contract limits and coverages are the same as the primary insurer
- Has the ceding company stopped all marketing of the line it intends to discontinue?
- Is there any contingent commission or loss sharing involved in the contract?
- Make sure there are no additional agreements between the reinsured and reinsurer that could reduce risk of significant loss or timing of payments (i.e., ensure that the reinsurance agreement meets the requirements of risk transfer)
- Make sure there is <u>no</u> chance of cancellations in the contract – runoff agreements cannot be cancelled
- Reinsurer must undergo property assessment (e.g., guarantee fund)

• Reinsurer needs to be rated from at least 2 organizations and the rating must be at least the same as insurer
Part d: 0.5 point
• Amount is recorded as a paid loss • If the amount paid is less than the reserves transferred, the difference is recorded as a decrease in incurred loss
EXAMINER'S REPORT
Part a
Candidates generally struggled with this part, and some candidates provided definitions for both runoff and novation without highlighting the primary difference (who is primarily liable after the novation or run-off).
Part b
Candidates struggled to identify situations where an insurer would not be eligible for reinsurance accounting treatment under a novation.
Part c
Candidates performed better on this part, and SSAP 62R has a large list of items for a regulator to review before approving reinsurance accounting treatment for a property-casualty run-off agreement. Common errors included: • Referencing financial strength but not including that the reinsurer financial rating must be greater or equal to the ceding insurer • Listing that there had to be risk transfer and then explaining risk transfer rather than providing a second item • Describing risk transfer methods such as the 10-10 rule or ERD for one of the items
Part d
Candidates generally struggled with this part. There were many references to changes in income statements and balance sheets but not how the amount paid to the assuming entity for a property-casualty run-off agreement was recorded. Many candidates stated that reserves would be reduced which does not explain how the amount was recorded. Some candidates incorrectly stated that the amount is recorded as a ceded paid loss or a reduction to paid loss.