

EXAM 6 – UNITED STATES, SPRING 2016

14. (4.25 points)

An insurance company has prospective reinsurance contracts with only Reinsurers A and B. As of December 31, 2014, the following information is reported:

<u>Item#</u>	<u>Item</u>	<u>Unauthorized Reinsurer A</u>	<u>Authorized Reinsurer B</u>
1	Total Recoverable on Paid Losses and Paid LAE Excluding Amounts in Dispute	\$400,000	\$650,000
2	Total Reinsurance Recoverable Including Amounts in Dispute	700,000	750,000
3	Amounts in Dispute Included in Item #2	250,000	60,000
4	Funds Held By Company Under Reinsurance Treaties	50,000	100,000
5	Letters of Credit	200,000	400,000
6	Ceded Balances Payable	150,000	30,000
7	Miscellaneous Balances Payable	5,000	0
8	Reinsurance Recoverable on Paid Losses & LAE Over 90 Days Past Due Excluding Amounts in Dispute	300,000	145,000
9	Amount in Dispute Excluded from Item #8	0	50,000
10	Amounts Received Prior 90 Days	10,000	40,000

a. (3.75 points)

Calculate the insurer's 2014 Schedule F provision for reinsurance.

b. (0.5 point)

In 2012, the NAIC introduced a new category of reinsurers—certified reinsurers—to be used in the calculation of the Schedule F provision for reinsurance. Briefly describe a benefit that this new “certified” category provides to the reporting entity and a benefit that it provides to reinsurers.

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SAMPLE ANSWERS AND EXAMINER'S REPORT

QUESTION 14	
TOTAL POINT VALUE: 4.25	LEARNING OBJECTIVE: C1
SAMPLE ANSWERS	
Part a: 3.75 points	
<p><u>Unauthorized Reinsurer A:</u></p> <ol style="list-style-type: none"> Formula for unauthorized reinsurers: the total amount of reinsurance recoverable from each reinsurer, offset by any forms of security + 20% of the amount of recoverables in dispute+ 20% of amounts recoverable on paid losses that are more than 90 days overdue not in dispute. Total Collateral and Offset Items = \$405,000 = \$50,000 + \$200,000 + \$150,000 + \$5,000 Total recoverable minus offsets = \$295,000 = \$700,000 - \$405,000 20% amounts overdue and in dispute: \$110,000 = 20% x \$300,000 + 20% x \$250,000. Provision for Reinsurer A: \$405,000 = \$295,000 + \$110,000 <p><u>Authorized Reinsurer B:</u></p> <ol style="list-style-type: none"> Slow pay test formula = Overdue (excluding disputes) / (recoverables on paid excluding disputes + amounts received prior 90 days) <p style="margin-left: 40px;">Slow pay test = \$145,000 / (\$650,000 + \$40,000) = 21.0%. Therefore, reinsurer is slow-paying (as 21% > 20%)</p> If slow pay test = yes, formula for slow-paying authorized reinsurers = 20% times greater of total recoverables less offsets or recoverable on paid losses and LAE greater than 90 days overdue, including amounts in dispute. <ol style="list-style-type: none"> Total Recoverables Less Offsets = \$220,000 = \$750,000 – (\$100,000 + \$400,000 + 30,000). Paid Loss and LAE Overdue = \$195,000 = \$145,000 + \$50,000 Provision for Reinsurer B = 20% times maximum of \$220,000 and \$195,000 = \$44,000 If slow pay test = no, formula for not slow-paying authorized reinsurers = 20% recoverables over 90 days due, including amounts in dispute <ol style="list-style-type: none"> Paid Loss and LAE Overdue, Including amounts in Dispute = \$195,000 = \$145,000 + \$50,000 Provision for Reinsurer B = 20% times \$195,000 = \$39,000 <p><u>Total Provision:</u></p>	

SAMPLE ANSWERS AND EXAMINER'S REPORT

1. Provision for Reinsurers A + B (when slow-paying) = \$44,000 + \$405,000 = \$449,000
2. Provision for Reinsurers A + B (when not slow-paying) = \$39,000 + \$405,000 = \$444,000

Part b: 0.5 points

Benefits to Reporting Entity:

- Will reduce the provision for reinsurance
- Do not have to carry as large a provision for certified reinsurers as they do for unauthorized
- Will have less penalty in reinsurance provision for unauthorized reinsurer
- Reinsurer has lower collateral costs which they can pass on to the reporting entity through lower premiums
- Allows reporting entity to get reinsurance from alien/foreign reinsurers who are financially strong without increasing the provision for reinsurance

Benefits to Reinsurers:

- Being certified will require the reinsurer to post less collateral
- Can attract more business since ceding company may see them as more desirable due to certification
- Don't have to provide as much collateral (which is costly) as unauthorized reinsurers
- Can market their certified status and gain business
- If declared a certified reinsurer and ranked #1, reinsurer need post no collateral
- Depending on its financial strength rating given by NAIC, can get a multiplying effect on its posted collateral and can post a smaller amount of collateral to be considered fully collateralized

EXAMINER'S REPORT

- Candidates were expected to know provision for reinsurance formulas related to Schedule F. They also needed to know about a new "Certified" status and how this benefits both insurers and reinsurers

Part a

- Candidates were expected to know the Schedule F provision for reinsurance formulas for unauthorized and authorized reinsurers. This includes determining whether an authorized reinsurer is or is not slow paying.
- Candidates were expected to know formulas and how items provided in the question fit into the formula
- Unauthorized Reinsurer A common errors:
 - Many candidates did not recognize all necessary offsets. In particular, candidates did not include ceded balances payable and miscellaneous balances payable
 - Many candidates confused total amounts in dispute with disputes on paid losses and LAE over 90 days past due (e.g. using \$0 instead of \$250K)
 - Some candidates used total recoverable on paid losses and LAE instead of Total reinsurance recoverable (e.g. using \$400K instead of \$700K)
 - Some candidates used total recoverables excluding amounts in dispute instead of including disputed amounts (e.g. using \$700K - \$250K instead of using \$700K)
- Authorized Reinsurance B mistakes:

SAMPLE ANSWERS AND EXAMINER'S REPORT

- Many candidates did not recognize all necessary offsets. In particular, candidates did not include ceded balances payable
- Many candidates did not include amounts in dispute with reinsurance recoverables on paid losses and LAE over 90 days due (e.g. using \$145K and instead of \$145K + 90K)
- Some candidates used total recoverable on paid losses and LAE instead of Total reinsurance recoverable (e.g. using \$650K instead of \$750K)
- Some candidates used total recoverables excluding amounts in dispute instead of including disputed amounts (e.g. using \$750K - \$60K instead of using \$750K)

Part b

- Candidates were expected to know how the new “Certified” reinsurance category benefits reporting entities and reinsurers.
- Candidates needed to describe one benefit for reporting entities and one for reinsurers.
- Common mistakes:
 - Some candidates listed only one benefit when two were required
 - Some candidates listed multiple benefits for the reporting entity or the reinsurer but failed to list one for each
 - Candidates stated certified reinsurers would be treated the same as authorized
 - Candidates stated being certified eliminates the need for collateral, instead of needing less collateral