

21. (1.75 points)

An insurance company is considering entering into a Loss Portfolio Transfer (LPT) reinsurance agreement whereby the reinsurer will assume 100% of the insurer's loss reserves from discontinued business. Prior to the agreement, the insurer's loss and LAE reserves and Appointed Actuary's range of unpaid claim estimates were summarized as follows (all figures in thousands of dollars):

Line	Carried Reserve	Range of Unpaid Claim Estimates		
		Low	Central	High
On-Going	750	660	700	740
Discontinued	250	240	270	300
Total	1,000	900	970	1,040

a. (1 point)

Justify the type of Statement of Actuarial Opinion (SAO) that the Appointed Actuary would issue:

- i. Before implementation of the LPT
- ii. After the implementation of the LPT

b. (0.75 point)

Fully explain how the reserves assumed by the reinsurer under the LPT would be treated by the reinsurer's Appointed Actuary in the SAO.

SAMPLE ANSWERS AND EXAMINER'S REPORT

QUESTION 21	
TOTAL POINT VALUE: 1.75	LEARNING OBJECTIVE: D1
SAMPLE ANSWERS	
Part a: 1 point	
<p><u>Sample Responses for i.</u></p> <ul style="list-style-type: none"> • Before LPT: Reasonable opinion; because the total carried reserve is within the appointed actuary's range of unpaid claim estimates. The A.A. is opining on the total business. • Reasonable because the company carried of \$1000 is within the actuary's range of (900,1040) <p><u>Sample Responses for ii.</u></p> <ul style="list-style-type: none"> • LPT is treated as retroactive reinsurance. Therefore does not reduce the reserves so the total net carried reserve does not change, therefore type of opinion is still Reasonable opinion. • Retroactive agreement is recorded as contra-liability, which doesn't impact reserve, therefore, same as i. Reasonable opinion. • LPT is treated as retroactive reinsurance. Reserves aren't adjusted, but negative liabilities are established. So the answer is the same as (i) 	
Part b: 0.75 point	
<p><u>Sample 1</u></p> <p>The reinsurer's A.A. shall list this item as "Retroactive Reinsurance Reserves Assumed" in the exhibit A in the SAO.</p> <p>Furthermore, the reinsurer's AA shall review the reasonableness of this reserving and disclose in the SAO if he relied on the provision on the insurer's A.A. The reinsurer's A.A. shall provide the name and qualification of the insurer's A.A. in addition as well.</p> <p>If the reinsurer's A.A. cannot conclude the reasonableness of the insurer's A.A.'s provision due to inadequate data or other reason, "Qualified Opinion" shall be provided if the amount is significant compared to reinsurer's existing business volume.</p> <p><u>Sample 2</u></p> <p>Reserves would be treated as "Retroactive Reinsurance Assumed." They would be identified in Scope, and listed on a different line in Exhibit A. Opinion would be based on reserves in total. Reinsurance contract would be discussed in relevant comments section.</p> <p><u>Sample 3</u></p> <p>Reserves would be treated as retroactively assumed. Thus, they wouldn't appear in Schedule P and not impact the appointed actuary's range of unpaid claim estimates. The appointed actuary</p>	

SAMPLE ANSWERS AND EXAMINER'S REPORT

would comment on the retroactively assumed reserves in the "Relevant Comments" section of the SAO.

Sample 4

- Assuming that retroactive reinsurance due to not fulfilling the Run-off agreement criteria
- Will be reflected in Part 5 of Exh A
- Reinsurer's actuary should likely conduct own independent analysis and state own opinion -> based on where range is
- If not enough time, should review analysis for reasonability -> doesn't need to be qualified but should be disclosed
- If not enough time/data for independent review and material to reinsurer, should issue a qualified opinion and state reasons and carried amounts
- If not enough time/data and not material, don't need to make qualified opinion, but may need to disclose.

EXAMINER'S REPORT

The candidates were expected to be able to determine what type of opinion the appointed actuary should issue given the actuary's estimate of reserves and the company carried amount. Additionally, the question tested if the candidate knew how to account for a Loss Portfolio Transfer (retroactive reinsurance) in the SAO.

A majority of candidates were able to identify the type of opinion that should be issued given the carried reserves and the actuarial estimates. Only a few candidates recognized that a Loss Portfolio Transfer should be accounted for as retroactive reinsurance. Of those who did, a minority were fully aware of all of the procedures to be followed with retroactive reinsurance.

This question was complicated by the fact that the handling of retroactive reinsurance in the SAO is masked by the LPT.

Part a

For part i, the candidates were expected to know that the appointed actuary issues an opinion on the total book of reserves, regardless of the breakdown by segment. Thus, the appointed actuary should issue a reasonable opinion.

For part ii, the candidates were expected to realize that LPT's are accounted for as retroactive reinsurance. Since reserves ceded under a retroactive reinsurance agreement are accounted for as a contra-liability on the balance sheet, the reserves are NOT reduced by the retroactive ceded reserves, and thus the type of opinion issued would not change.

SAMPLE ANSWERS AND EXAMINER'S REPORT

Common mistakes included:

- Not specifying which reserves the candidate reviewed to identify the type of opinion. E.g. "Redundant opinion because the carried reserve is above the range"
- Identifying the type of opinion as "Adequate" or "Sufficient" rather than "Reasonable". The NAIC specifies "Reasonable" as the appropriate terminology.
- Not recognizing that the LPT should be accounted for as retroactive reinsurance, and therefore should not impact the type of opinion issued. A majority of candidates reviewed the "On-Going" reserves for part ii. Candidates who correctly identified the type of opinion given the reserves that they reviewed were awarded partial credit.

Part b

The candidates were expected to identify three of the following ways that assumed retroactive reinsurance reserves are incorporated in the SAO

- The assumed retroactive reinsurance reserves are NOT included in the reinsurer's loss & LAE reserves reported in Schedule P/lines 1-4 of Exhibit A
- The assumed retroactive reinsurance reserves are reported as a separate item in Exhibit A of the reinsurer's SAO.
- The retroactive reinsurance should be commented in the "Relevant Comments" section of the SAO
- The appointed actuary would either include the assumed reserves reported in Line 5 of Exhibit A within the scope of his/her opinion (and render an opinion thereon) or explicitly exclude them from the scope of the opinion, thereby rendering a "Qualified Opinion", if the reserves are material.

Common mistakes included:

- Most candidates did not realize that the assumed reserves should be classified as retroactive reinsurance and just treated them like regular prospective reinsurance.
- Discussing other impacts to the assuming company, such as how to incorporate the retroactive assumed reserves in the Income Statement, or how it impacts the company surplus. The question specifically requested the impacts to the appointed actuary and the SAO.
- Commenting from the ceding company's perspective, when the question asked how these reserves would impact the assuming company's SAO.