

EXAM 6 – UNITED STATES, SPRING 2018

9. (2 points)

Define each of the following Annual Statement entries and identify whether it is an asset, liability or an income statement item.

- i. Amount Recoverable from Reinsurers
- ii. Reinsurance Payable on Paid Loss & LAE
- iii. Funds Held under Reinsurance Contracts
- iv. Provision for Reinsurance

CONTINUED ON NEXT PAGE

## SAMPLE ANSWERS AND EXAMINER'S REPORT

QUESTION: SPRING 2018 EXAM 6U, QUESTION 9	
TOTAL POINT VALUE: 2	LEARNING OBJECTIVES: C1
<b>SAMPLE ANSWERS</b>	
<p><u>Sample Responses for i</u></p> <ul style="list-style-type: none"><li>• Amounts due to insurer from reinsurer for: Asset</li></ul>	
<p><u>Sample Responses for ii</u></p> <ul style="list-style-type: none"><li>• Amounts owed to insurer from assuming reinsurer for ceded Paid Loss and LAE. Liability</li><li>• Opposite of part i, for the reinsurer's perspective. Liability.</li></ul>	
<p><u>Sample Responses for iii</u></p> <ul style="list-style-type: none"><li>• Collateral from reinsurer held by insurer. Liability for ceding company.</li><li>• Collateral from reinsurer held by insurer. Asset for Reinsurance Company.</li><li>• Money held from reinsurer by insurer to reduce credit risk. Asset.</li></ul>	
<p><u>Sample Responses for iv</u></p> <ul style="list-style-type: none"><li>• Formulaic provision from Schedule F that estimates uncollectible reinsurance recoverables. Liability</li><li>• Minimum reserve estimate for uncollectible reinsurance. Liability.</li><li>• Direct charge against surplus for estimated reinsurance recoverables no collectible. Liability.</li></ul>	
<b>EXAMINER'S REPORT</b>	
<p>The candidates were expected to define annual statement items, specifically from Schedule F, and whether each item was an asset or a liability.</p>	
<p>i. Candidates were expected to know amounts due/to be reimbursed, from reinsurers, on Paid loss and LAE. Candidates were expected to know this was an asset.</p>	
<p>Common mistakes included:</p> <ul style="list-style-type: none"><li>• Using incurred loss or total loss instead of paid loss.</li></ul>	
<p>ii. Candidates were expected to mention that this is from assumed perspective, and that it was amounts owed on Paid Loss and LAE. Candidates were expected to know this was a liability.</p>	
<p>Common mistakes included:</p> <ul style="list-style-type: none"><li>• Using incurred loss or total loss instead of paid loss.</li><li>• Not specifying that it was from the assuming company's perspective</li></ul>	
<p>iii. Candidates were expected to mention collateral /security/amount held for credit risk, from reinsurers, held by insurer. Candidates were expected to know this was a liability for ceding company (or asset for reinsurer).</p>	

## SAMPLE ANSWERS AND EXAMINER'S REPORT

Common mistakes included:

- Saying this item was used to pay losses without mention of collateral, security, or administrative benefits

iv. Candidates were expected to mention uncollectability on recoverables from reinsurers, and that the amount was a formulaic or estimated number. Candidates were expected to know this was a liability.

Common mistakes included

- Saying this was the actual amount of uncollectible recoverables (not an estimate).

<b>QUESTION: SPRING 2018 EXAM 6U, QUESTION 10</b>	
<b>TOTAL POINT VALUE: 3</b>	<b>LEARNING OBJECTIVES: C1</b>
<b>SAMPLE ANSWERS</b>	
<b>Part a: 2 points</b>	
<ul style="list-style-type: none"> <li>• <math>EP = 29000, IL = (19600 - 100), LAE = 1300, OUE = 2400, \text{Inv Income Earned} = 3200, \text{Realized Gains} = 45, \text{Agents Balances} = -2.2, \text{Service Charges} = 3.5, \text{Agg Write Ins} = -1.5, PHD = 80</math>  <math>\text{Net Income} = 29000 - (19600 - 100) - 1300 - 2400 + 3200 + 45 - 2.2 + 3.5 - 1.5 - 80 = 8964.8</math></li> <li>• <math>\text{Net Income} = 29000 - 19500 - (3850 - 150) + 3200 + 45 - 2.2 + 3.5 - 1.5 - 80 = 8964.8</math></li> <li>• <math>29000 - (19600 - 100 + 1300) - 2400 = 5800, 3200 + 45 = 3245, -2.2 + 3.5 - 1.5 - 80 = -80.2,</math>  <math>\text{Net Income} = 5800 + 3245 - 80.2 = 8964.8</math></li> <li>• <math>29000 - (19600 - 100 + 1300) - 2400 = 5800, 3200 + 45 = 3245, -2.2 + 3.5 - 1.5 = -0.2,</math>  <math>\text{Net Income} = 5800 + 3245 - 0.2 - 80 = 8964.8</math></li> </ul>	
<b>Part b: 0.5 point</b>	
<ul style="list-style-type: none"> <li>• Inaccurate allocation of expense to appropriate line of business distorts company view of profitability. WC might appear more profitable than it is while other lines might appear less profitable due to other lines take on expense of WC.</li> <li>• Allocating this expense could cause other lines to subsidize WC if their earned premium is higher than WC line so WC might be viewed profitable when it is not.</li> <li>• This allocation would make WC look more profitable. The entire 1 million should be allocated only to WC.</li> <li>• It will make the worker's comp line look more profitable than it is because the allocated expense is less than the actual expense.</li> <li>• Expense directly attributed to a line of business should be directly allocated. Sharing with other lines of business will understate expense and overstate profits for WC.</li> <li>• Because CMP is the larger portion of the book it will get hit with the majority of the \$1m expense. WC will have lower expenses than what they actually/truly cost the company, overstating WC profitability.</li> </ul>	
<b>Part c: 0.5 point</b>	
<ul style="list-style-type: none"> <li>• Misallocation of expenses results in subsidies between lines of business</li> <li>• Misallocation of expenses will affect profitability of individual lines</li> </ul>	