27. (2 points)

An insurer entered into a quota share reinsurance agreement on January 1, 2017. Financial information for the insurer is given below (in thousands of dollars):

Balance Sheet ($000s)

	12/31/2016 (Before Quota Share Inception)	12/31/2017 (After Quota Share Inception)
Total Assets	3,600	4,870
Liabilities		
Gross Loss Reserves	1,100	2,700
Ceded Loss Reserves	0	1,530
Net Loss Reserves	1,100	1,170
Gross Unearned Premium	500	1,500
Ceded Unearned Premium	0	850
Net Unearned Premium	500	650
Total Liabilities	1,600	2,160
Surplus	2,000	2,710

Income statement items ($000s)

	2016	2017
Net Written Premium	500	1,500
Net Loss Ratios	110%	90%

a. (1.5 points)

Based on the financial results, describe three ways in which the reinsurance contract may have benefited this insurer.

b. (0.5 point)

Based on the 12/31/2017 Balance Sheet, explain whether the ceding company has accounted for the reinsurance as prospective or retroactive.

END OF EXAMINATION

- Providing an incorrect formula for the expected reinsurer deficit
- Incorrectly comparing to the threshold, (e.g. saying risk transfer exists if the ERD < 1%, instead of greater)

QUESTION: SPRING 2018 EXAM 6U, QUESTION 27	
TOTAL POINT VALUE: 2	**LEARNING OBJECTIVE: E**
SAMPLE ANSWERS	
Part a: 1.5 points	
• NWP has increased substantially from 500 to 1500. The surplus relief from reinsurer has given the company the capacity to write more business. • The reinsurance contact may have helped the insurer expand operations and gain more market share, evidence by premium increasing 300% year over year from 500 to 1500 • Provided surplus relief most likely due to ceding commissions seen by the decrease in loss reserve / surplus ratio • Reinsurer may have provided underwriting guidance which helped the insurer lower the loss ratio from 110% to 90% • Mitigate loss reserves while increasing surplus; surplus increase from 2,000 to 2,710 while net loss reserves remain stable • Finance increasing NWP (500 to 1500) by sharing the financial burden of its reserves. Since the ceding company is using quota share reinsurance, they are able to write more by sharing premium and loss reserves.	
Part b: 0.5 point	
• The company has accounted for this contract as prospective reinsurance. With a retrospective contract, the loss reserved would not have been reduced by the ceded amounts • Prospective as there is no negative write-in liability	
EXAMINER'S REPORT	
Candidates were expected to understand benefits of reinsurance contracts that were applicable with the balance sheet data given. Candidates were also expected to understand the difference between prospective and retrospective accounting.	
Part a	
Candidates were expected to identify 3 benefits the of the reinsurance contract and provide a brief explanation. Common mistakes include: • Providing a benefit that was not applicable to the situation, such as: o Improved loss ratio due to CAT protection or stabilizing loss experience; QS will usually not cap loss ratios due to a CAT event, and an XoL, CAT, or FAC treaty would be more effective in removing large swings in financial results	

- Providing support from the balance sheet which was not an improvement to the ceding insurer, such as:
    - Improved the NWP to surplus leverage ratio. The ratio increased from 25% to 55% from 2016 to 2017 which is a deterioration in the ratio.
- Providing only a benefit, but not an explanation of the benefit. For example, just stating "surplus relief" or "ceding commission" as a benefit without expressing surplus relative to the net reserves would only receive partial credit.
- Commenting only on an increase in nominal surplus
- Indicating that it would facilitate withdrawal, which is not applicable because NWP is growing

Part b

Candidates were expected to identify how the reinsurance was accounted for and provide a brief explanation.

Common mistakes include:

- Stating "prospective" without a supporting explanation.
- Stating that the contract was retroactive.