

23. (2.5 points)

a. (2 points)

A primary insurer with significant exposure in the United States and in Great Britain is considering buying an excess of loss contract with a reinsurer. Explain whether each of the following should be incorporated into the cash flow analysis required to prove risk transfer per FAS 113 and SSAP 62 guidelines:

- i. Reinsurer Brokerage Expenses
- ii. Insurer Ceding Commission
- iii. Potential changes to the exchange rate between US Dollars and British Pounds
- iv. Potential for reinsurer to default and be placed into bankruptcy

b. (0.5 point)

Briefly describe how the following are recorded on a Statutory Balance Sheet:

- i. Reinsurance Recoverables on Paid Losses
- ii. Reinsurance Recoverables on Case + IBNR Reserves

SAMPLE ANSWERS AND EXAMINER'S REPORT

Common mistakes include:

- Incorrectly applying the materiality standard to the carried reserves rather than the indicated point estimate reserves without clearly stating assumptions as to why materiality standard used deviates from 10% of the indicated point estimate
- Incorrectly identifying that RMAD exists for this company and not providing sufficient explanation as to why there is RMAD
- Stating reasons for possible RMAD without applying materiality standard

Part c

Candidates were expected to provide considerations for a new line of business as it pertains to the Statement of Actuarial Opinion (SAO).

A common mistake was providing considerations that were too similar and not distinct. For example, "company provides no loss data" and "there were no claims as of evaluation date".

SPRING 2019 EXAM 6US, QUESTION 23

TOTAL POINT VALUE: 2.5

LEARNING OBJECTIVE: E

SAMPLE ANSWERS

Part a: 2 points

Sample responses for part (i)

- No, it is not a cash flow between insurer and reinsurer

Sample responses for part (ii)

- Yes, it represents a cash flow between insurer and reinsurer
- Depends, profit commissions should be excluded but commissions as a part of original premium transactions are included

Sample responses for part (iii)

- No, currency risk is not an aspect of insurance risk
- No, interest rate risk and exchange rate risk should not be considered or parametrized in risk transfer

Sample responses for part (iv)

- No, credit risk is not an aspect of insurance risk
- No, default risk is not considered in this determination; underwriting risk and timing risk is the main consideration

Part b: 0.5 point

Sample responses for part (i)

- As an asset line item in the Balance Sheet

SAMPLE ANSWERS AND EXAMINER'S REPORT

Sample responses for part (ii)

- They will be netted against the liability for gross for loss+LAE and reported in the liability section
- Not accounted for directly, subtracted from reserves in liability section (reserves are net of reinsurance recoverables)
- It offsets unpaid loss & LAE liabilities
- Contra-liability
- As an asset (assuming deposit accounting)

EXAMINER'S REPORT

Candidates were expected to understand the factors considered when determining whether a reinsurance contract qualifies for risk transfer and understand the treatment of reinsurance recoverables on a Statutory Balance Sheet.

Part a

Candidates were expected to understand that cash flows between the reinsurer and ceding insurer would need to be included in a risk transfer analysis and that risk transfer only considers insurance risk; non-insurance risks such as currency or credit risk are not considered.

Common mistakes included:

- Not providing a supporting explanation for why an item should or should not be incorporated in the cash flow analysis to determine whether risk transfer exists between reinsurer and ceding insurer
- Confusing ceding commissions with contingent commissions
- Stating that the reinsurer brokerage expenses are cash flows between the reinsurer and ceding insurer
- Incorrectly stating that non-insurance risks are considered in risk transfer analysis

Part b

Candidates were expected to understand that reinsurance recoverables on paid losses are an asset on the Statutory Balance Sheet and that reinsurance recoverables on case + IBNR reserves are netted against the liability for gross loss + LAE and reported in the liabilities section.

Common mistakes included:

- Incorrectly identifying a category in which the items are recorded in the asset section
- Stating that reinsurance recoverables on case + IBNR reserves are not accounted for on the Statutory Balance Sheet. They are not explicitly shown, but they are accounted for.