



# SOCIETY OF FINANCIAL EXAMINERS<sup>SM</sup>

## *Supplemental Background Material*

NAIC Examiner Project

**Course CFE 3**

**Reinsurance**

(Passing grade for this exam is 74)

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**Reinsurance**

Unit: 1

Topic: Reinsurance: Indemnifying Insurers

Text  
Required: Reinsurance; edited and published by Robert W. Strain; Revised Edition,  
1997

Assigned  
Readings: Strain, pp. 9-32

**Introduction**

- I. Reinsurance
  - A. Definition
  - B. Inapplicability
  - C. Relationship between the parties – two or more insurers
  - D. Eligible reinsurers
  - E. Purpose – insurance for insurers
  
- II. Difference from Primary Insurance
  - A. Reinsurance tends to be less regulated.
  - B. More internationally oriented.
  - C. Transactions of large monetary value and risk.
  - D. Reinsurer relies on the reinsured to produce proper underwriting at proper rates.
  - E. Right to inspect records of the reinsured
  - F. Utmost good faith
  - G. Relies on reinsured to produce a profitable book of business.
  
- III. Reinsurance Contract
  - A. Kinds
    - 1. Proportional – pro rata
    - 2. Nonproportional – excess of loss
  
  - B. Types of Contracts

1. Treaty – covers losses on policies in one or more specific classes
  2. Facultative – covers certain individual policies on a stand-alone basis
- C. Classes of Insurance Business Reinsured
- D. Retrocession – reinsuring reinsurance
- IV. Fundamentals of Reinsurance and Customary Practices
- A. Mutual Trust
  - B. Utmost Good Faith
  - C. Follow the Fortunes
  - D. Declaratory Judgment Actions
  - E. Dispute Resolution by Arbitration

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**Reinsurance**

Unit: 2

Topic: Pro Rata Property Treaty

Text Required: Reinsurance; edited and published by Robert W. Strain; Revised Edition, 1997

Assigned Readings: Strain, pp. 36-52

**Origins and Functions of Treaties**

- I. Proportional Reinsurance functions
  - A. Increase underwriting capacity
  - B. Provide protection against insured losses from catastrophes
  - C. Provide relief in the short run financing or acquisition costs
  - D. Stabilize underwriting performance.
  
- II. Types of Pro Rata Property Treaties
  - A. Quota Share
    - 1. Benefits to ceding company
      - a. Replenish policyholders surplus
      - b. Encourage new lines of business
      - c. Afford fronting
      - d. Provide catastrophe coverage
      - e. Increase insurance liability retention
    - 2. Portfolio v. running account
    - 3. Net v. gross account
    - 4. Guaranteed profit quota share.
  
  - B. Surplus Share
    - 1. Definition
      - a. Varying percentages
      - b. Varying obligatory requirements
    - 2. Purpose
      - a. Maximum limit per risk
      - b. Multiples of net retention

- c. Minimum retention required
3. Advantages

III. Pricing

- A. Flat commission
- B. Contingent commission
- C. Sliding scale commission

IV. Significant Concepts and Practices

- A. Transfer of Risk
- B. Retention warranties
- C. Coverage and limits
- D. Attachment of liability
- E. Risk definition
- F. Follow fortunes, settlements and original conditions
- G. Protecting the surplus treaty
- H. Reporting transaction
- I. Termination

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Unit: 3

Topic: Property Per Risk Excess of Loss Reinsurance

Text Required: Reinsurance; edited and published by Robert W. Strain; Revised Edition, 1997

Assigned Readings: Strain, pp. 79-120

- I. Purposes and Characteristics
  - A. Increase capacity
  - B. Legal requirements
  - C. Financial rating requirements
  - D. Stabilize underwriting results
  - E. Economy of use
  
- II. Relationship to Other Reinsurance
  
- III. Determining Retention and Limit.
  - A. Reported claim counts
  - B. Experience rating
  - C. Ruin Model
  - D. Monte Carlo Simulation
  
- IV. Common Contract
  - A. Retention and limit
  - B. Net retained lines
  - C. Exclusions
  - D. Definition of Risk
  - E. Net Loss
  - F. Definition of occurrence
  - G. Allocated loss adjustment expenses
  - H. Losses in excess of policy limits, extra contractual obligation and punitive damages
  
- V. Rating Plans

- A. Prospective
- B. Retrospective
- C. Rating methodology
  - 1. Experience rating
    - a. Loss trending
    - b. Excess loss development
    - c. Benchmark data
    - d. Allocated LAE
    - e. Premium adjustments
    - f. Reinsurer loading
  - 2. Exposure
    - a. Property exposure rating scales
    - b. Expected loss component
    - c. Allocated LAE
    - d. Discount factors

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Unit: 4

Topic: Casualty Excess of Loss Treaty Reinsurance

Text Required: Reinsurance; edited and published by Robert W. Strain; Revised Edition, 1997

Assigned Readings: Strain, pp. 123-201

I. Purposes

- A. Write larger risks.
- B. Protect from large catastrophes
- C. Stabilize underwriting results

II. Types of Casualty Reinsurance Contracts

- A. Quota share
- B. Working layer excess of loss (per risk, per occurrence)
- C. Clash, excess of loss (per occurrence) catastrophe excess of loss
- D. Aggregate excess stop-loss

III. Considerations in using Casualty Excess

- A. Lines of insurance affected and reinsurance desired
- B. Ultimate net loss and expenses
- C. Integration of other reinsurance
- D. Methods of attachment and termination
- E. Retention and limits (loss caps and reinstatements)
- F. Definition of occurrence and loss trigger
- G. Event coverage or interlocking
- H. Aggregate extension and aggregate extraction
- I. Pricing tools
- J. Other issues
  - 1. Structured settlements
  - 2. Treaty special acceptance
  - 3. Loss notice requirements
  - 4. Errors and omissions



5. Loss settlement discretion (following fortunes or settlements)

IV. Evaluation and Contributions

1. Services
2. Claim audits

B Insurer

1. Management
2. Underwriting
3. Claims
4. Estimating reserve liabilities

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Unit: 5

Topic: Catastrophe Reinsurance

Text Required: Reinsurance; edited and published by Robert W. Strain; Revised Edition, 1997

Assigned Readings: Strain, pp. 206-242

I. Purposes

- A. To protect policyholder surplus
- B. Stabilize underwriting results.

II. Catastrophe Perils

- A. Large fires
- B. Earthquakes
- C. Winter Freeze
- D. Floods
- E. Riot
- F. Hurricanes
- G. Tornadoes

III. Occurrence Treaty contract provision

- A. Contract percentage coverage
- B. Layered coverages
- C. Reinstatements
- D. Exclusions
- E. Application of coverage.
- F. Definition of loss occurrence
- G. Claims
- H. Rating

IV. Designing the Catastrophe Program

- A. Catastrophe limit and retention

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Unit: 6

Topic: Aggregate Excess or Stop-Loss Reinsurance

Text Required: Reinsurance; edited and published by Robert W. Strain; Revised Edition, 1997

Assigned Readings: Strain, pp. 245-276

- I. Nature, Purpose and Benefit
- II. Criteria for Establishing Retention and Limit
  - A. Reinsured retention
    - 1. Insurance underwriting experience
    - 2. Reinsurance limit desired
    - 3. Strength of inuring reinsurance
    - 4. Primary insurance pricing validity
  - B. Reinsurer's limit
    - 1. Lesser of percentage of premium or dollar amount
    - 2. Other underwriting consideration
- II. Pricing
- III. Loss Settlement Provisions
  - A. Cutoff
  - B. Runoff
- IV. Clauses
  - A. Warranted reinsurance
  - B. Quota share reinsurance
- V. Suitability of Coverage

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Unit: 7

Topic: Financial Reinsurance

Text Required: Reinsurance; edited and published by Robert W. Strain; Revised Edition, 1997

Assigned Readings: Strain, pp. 279-292

*Assignment Seven:*

- I. Cause of Growth
- II. Optimum Environment for Financial (Finite Risk) Reinsurance
  - A. Single vs. Multi-year loss horizons
  - B. Profit sharing
  - C. Comparison with traditional covers
- III. Cost and Stability Trade-Off
- IV. Applications
- V. Regulations

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Unit: 8

Topic: Facultative Reinsurance

Text Required: Reinsurance; edited and published by Robert W. Strain; Revised Edition, 1997

Assigned Readings: Strain, pp. 295-319

I. Characteristics

- A. Reinsures individual risks
- B. Allows individual risk negotiation and is non-obligatory
- C. Operates in an environment of adverse risk selection

II. Uses of Facultative Reinsurance

- A. Increase Capacity
- B. Protect the reinsured's net lines
- C. Protect the reinsured's treaty
- D. Reduce loss from Catastrophe
- E. Offset treaty exclusions
- F. Provide underwriting assistance
- G. Provide marketing accommodation
- H. Achieve growth and expansion
- I. Permit withdrawal

III. Structures of Coverage

IV. Underwriting

- A. Primary Layer
- B. Buffer/working excess layer
- C. Catastrophe layer

V. Contracts used in Facultative Reinsurance

A. Certificate of reinsurance

B. Automatic and Program

VI. Facultative Marketplace

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Unit: 9

Topic: Pricing Reinsurance

Text Required: Reinsurance; edited and published by Robert W. Strain; Revised Edition, 1997

Assigned Readings: Strain, pp. 404-469

- I. Experience rating Excess of Loss
  - A. Premium adjustments
    - 1. Exposure base
    - 2. Rate changes
    - 3. Deviation changes
  - B. Loss adjustments
    - 1. Incurred versus frequency and severity
    - 2. Trend
    - 3. Development
  - C. Burning Cost Ratio
  - D. Time value of money
  - E. Loadings
- II. Exposure Rating Excess of Loss
  - A. Casualty covers
  - B. Per risk property covers
- III. Alternative Rating Structures
  - A. Retrospectively rated treaties
  - B. Aggregate deductible treaties
- IV. Casualty Contingency (Clash)
  - A. Basic Charge
  - B. Surcharges

- C. Reinstatements
- D. Extra contractual obligation and excess of policy limits
- E. Allocated loss adjustment expense
- F. Stacking policy limits
- G. Other exposures

V. Property Catastrophe

- A. Experience rating
- B. Exposure rating models
- C. Reinstatements

VI. Pro Rata Pricing

- A. Ceding commission structure
- B. Estimating ultimate loss ratio



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Unit:	10
Topic:	Markets and Marketing
Text Required:	Reinsurance; edited and published by Robert W. Strain; Revised Edition, 1997
Objectives:	To be able to describe the categories of reinsurance and transactions. To describe the accounting for reinsurance transactions and their effect on the ceding company.
Assigned Readings:	Strain, pp. 481-495

I. Distribution System

- A. Broker markets
- B. Direct markets

II. Services

- A. Actuarial
- B. Reinsurer financial security
- C. Letters of credit
- D. Contract wording
- E. Claims advise
- F. Accounting
- G. Information system

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Unit: 11

Topic: Underwriting the Reinsured

Text Required: Reinsurance; edited and published by Robert W. Strain; Revised Edition, 1997

Assigned Readings: Strain, pp. 501-543

I The Reinsured

- A. Banking Concept
- B. Living Business Enterprise
- C. Continuity

II. Measuring the Reinsured's Fiscal Health

- A. Sources of information
- B. Interpreting the
- C. Effects of the reinsured's insolvency on the reinsurer

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Unit: 12

Topic: Claims Management

Text Required: Reinsurance; edited and published by Robert W. Strain; Revised Edition, 1997

Assigned Readings: Strain, pp. 550-593

I. Introduction

- A. Individual loss
- B. Bordereau reports

II. Origin of Claims

- A. First-party claims
- B. Claims by third parties

- 1. Claims by claimants on policies reinsured
- 2. Parties to assumption agreements
- 3. Cut-through endorsements

C. Reasons for claim management

- 1. Establishing validity
- 2. Acknowledging prompt reporting and assessing the claim.
- 3. Establishing a loss reserve
- 4. Reporting reserves to underwriting and actuarial departments
- 5. Developing reserves with adjustments
- 6. Informing retrocessionaires

III. Functions

- A. Auditing
- B. Reserving and Development
- C. Recording and Reporting

#### IV. Common Contractual Provisions

- A. Retention
- B. Liability
- C. Loss notice
- D. Loss settlement (follow settlements made by company)
- E. Arbitration
- F. Business covered
- G. Commencement and term
- H. Loss settlements (pro rata or ultimate net loss)
- I. Loss adjustment expense
- J. Net retained lines
- K. Access to records
- L. Claim cooperation
- M. Loss occurrence
- N. Aggregate extension
- O. Loss in excess of original policy limits
- P. Extra contractual obligation
- Q. Errors and omissions
- R. Offset
- S. Insolvency
- T. Most favored terms
- U. Nondisclosure of settlements

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Unit: 13

Topic: Reinsurance Accounting

Text Required: Reinsurance; edited and published by Robert W. Strain; Revised Edition, 1997

Assigned Readings: Strain, pp. 600-693

**Insurance Company Financial Analysis**

- I. Dual Accounting Systems – SAP versus GAAP
  - A. Authorized vs. Unauthorized
- II. Reinsurance Accounts
  - A. Reinsurance Premium
  - B. Losses and Loss adjustment expenses
  - C. Commissions
- III. Differences between Insurance and Reinsurance Accounting
  - A. Accounting periods
  - B. Premium Bases
  - C. Terminating losses: cutoff or runoff
- V. Government and Self Regulation of Accounting
  - A. NAIC Accounting Practices and Procedures Manual
  - B. Schedule F
  - C. Terms of the reinsurance agreement
    - 1. Proportional treaties
    - 2. Nonproportional treaties

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Unit: 14

Topic: Life Reinsurance

Text Required: Reinsurance; edited and published by Robert W. Strain; Revised Edition, 1997

Assigned  
Readings: Strain, pp. 702-720

I. Reinsurance Agreements

A. Indemnity

1. Yearly renewable term
2. Coinsurance
3. Modco

B. Nonproportional

C. Assumption Reinsurance (Novation)

II. Important Treaty Clauses

- A. Parties to agreement clause
- B. Oversight clause
- C. Extra Contractual Damage
- D. Jumbo limit
- E. Termination
- F. Follow the fortunes

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Unit: 15

Topic: Accident and Health Reinsurance

Text Required: Reinsurance; edited and published by Robert W. Strain; Revised Edition, 1997

Assigned Readings: Strain, pp.731-740

- I. The Reinsurance Treaty
  - A. Quota share
  - B. Excess of loss
  - C. Catastrophe coverage
  - D. Facultative
  
- II. Reinsuring Accident and health Coverages
  - A. Long-term disability income
    - 1. Total disability
    - 2. Partial disability
  
  - B. Special risk reinsurance
    - 1. Personal accident
    - 2. Occupational accident
  
  - C. Medical expense reinsurance
    - 1. Portfolio medical excess
    - 2. Multiple employer trusts (METS)
    - 3. Organ transplant
    - 4. Reinsuring other medical
  
  - D. Stop-loss insurance
    - 1. HMOs
    - 2. Physician hospital provider excess

E. Long-term care expenses

- 1 Portfolio aggregate stop-loss
- 2 Proportional A & H quota share
3. Proportional claim only
4. Excess of loss



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Unit: 16

Topic: Life, Deposit-Type and Accident and Health Reinsurance

Text Required: The current NAIC Accounting Practices and procedures Manual

Assigned Readings: SSAP 61R

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Unit: 17

Topic: Property and Casualty Reinsurance

Text Required: The current NAIC Accounting Practices and procedures Manual

Assigned Readings: SSAP 62R