



SOCIETY OF FINANCIAL EXAMINERS™

Supplemental Background Material

NAIC Examiner Project

Course CFE 3

Reinsurance

(Passing grade for this exam is 66)

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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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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 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: Accounting Practices and procedures Manual as of March 2000
Assigned Readings: SSAP 61

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Unit: 17

Topic: Property and Casualty Reinsurance

Text Required: Accounting Practices and procedures Manual as of March 2000

Assigned Readings: SSAP 62