Supplemental Background Material

Course CFE 3

Reinsurance

(Passing grade for this exam is 74%)

Please note that this study guide is a tool for learning the materials you need to effectively study for this examination. As new editions of the textbooks are published, the SOFE Testing committee makes every effort to update the references in this guide, but it is not always possible to keep it current. Therefore, it is the student’s responsibility to see the topic listed in the study guide and find it in the required textbooks. If you are unable to locate the topic anywhere in the textbook you are using, please e-mail SOFE headquarters at info@sofe.org and tell us the topic you cannot locate, where that topic is in the study guide and what version of the textbook you are using.

The following reading materials/textbook are required for this course:

- Reinsurance Principles and Practices, 3rd Edition, Published by The Institutes, Edited by Susan J. Kearney (Feb 2017)
- NAIC SSAP No. 61R – Life, Deposit-Type & Accident and Health Reinsurance
- NAIC SSAP No. 62R – Property and Casualty Reinsurance

Note: Material to be tested is not exclusive to Learning Objectives listed in the following pages. The Learning Objectives merely define areas that are likely to be covered.

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<table>
<thead>
<tr>
<th>Test Section</th>
<th>Unit # per Study Guide</th>
<th>Reading Materials</th>
<th>Number of Questions</th>
</tr>
</thead>
<tbody>
<tr>
<td>CFE3 Test - Section 1</td>
<td></td>
<td></td>
<td>17</td>
</tr>
<tr>
<td>Unit 1: Introduction to Reinsurance</td>
<td>Chapter 1 - Introduction to Reinsurance</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Chapter 2 - Types of Reinsurance and Reinsurance Program Design</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Chapter 3 - The Reinsurance Placement Process</td>
<td></td>
<td></td>
</tr>
<tr>
<td>CFE3 Test - Section 2</td>
<td></td>
<td></td>
<td>6</td>
</tr>
<tr>
<td>Unit 2: Reinsurance Treaties</td>
<td>Chapter 4 - Common Reinsurance Treaty Clauses, Part 1</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Chapter 5 - Common Reinsurance Treaty Clauses, Part II</td>
<td></td>
<td></td>
</tr>
<tr>
<td>CFE3 Test - Section 3</td>
<td></td>
<td></td>
<td>13</td>
</tr>
<tr>
<td>Unit 3: Types of Reinsurance Treaties</td>
<td>Chapter 6 - Quota Share Treaties</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Chapter 7 - Surplus Share Treaties</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Chapter 8 - Property Per Risk Excess of Loss Treaties</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Chapter 9 - Casualty Excess of Loss Treaties</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Chapter 10 - Catastrophe Reinsurance</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Chapter 11 - Aggregate Excess of Loss Treaties</td>
<td></td>
<td></td>
</tr>
<tr>
<td>CFE3 Test - Section 4</td>
<td></td>
<td></td>
<td>6</td>
</tr>
<tr>
<td>Unit 4: Reinsurance Oversight</td>
<td>Chapter 12 - Reinsurance Audits</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Chapter 13 - Reinsurance Regulation</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Chapter 14 - Reinsurance Aspects of the NAIC Annual Statement</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unit 5: Loss Reserving Methods</td>
<td>Chapter 15 - Loss Reserving Methods</td>
<td></td>
<td></td>
</tr>
<tr>
<td>CFE3 Test - Section 5</td>
<td></td>
<td></td>
<td>8</td>
</tr>
<tr>
<td>Unit 6: NAIC SSAP Guidance Regarding Reinsurance</td>
<td>NAIC SSAP No. 61R - Life, Deposit-Type &amp; Accident &amp;Health Reinsurance</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>NAIC SSAP No. 62R - Property &amp; Casualty Reinsurance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Test (All Sections)</td>
<td></td>
<td></td>
<td>50</td>
</tr>
</tbody>
</table>
Unit: 1

Topic: Introduction to Reinsurance

Text Required: Reinsurance Principles and Practices, 3rd Edition, Published by The Institutes, Edited by Susan J. Kearney (Feb 2017)

Learning Objectives: To familiarize the financial examiner with the characteristics of reinsurance, types of reinsurance, reinsurance program design and the reinsurance placement process.

Assigned Reading: Chapters 1, 2, & 3

Chapter 1 - Introduction to Reinsurance

Learning Objectives to Master:

- Describe reinsurance and its principal functions.
- Describe treaty reinsurance and facultative reinsurance.
- Describe the three sources of reinsurance.

Chapter 2 - Types of Reinsurance and Reinsurance Program Design

Learning Objectives to Master:

- Describe the types of pro rata reinsurance and excess of loss reinsurance and their uses.
- Describe finite reinsurance and other methods that rely on capital markets as alternatives to traditional and nontraditional reinsurance.
- Describe the factors that should be considered in the design of a reinsurance program.
- Identify the reinsurance needs of an insurer and recommend appropriate reinsurance program to address those needs.

Chapter 3 - The Reinsurance Placement Process

Learning Objectives to Master:

- Describe the direct writing and broker reinsurance marketing systems.
- Describe the major steps in the reinsurance placement process.
- Explain how facultative reinsurance is placed through the direct writing marketing system.
- Explain how treaty reinsurance is placed through the broker marketing system.
Unit: 2

Topic: Reinsurance Treaties

Text Required: Reinsurance Principles and Practices, 3rd Edition, Published by The Institutes, Edited by Susan J. Kearney (Feb 2017)

Learning Objectives: To familiarize the examiner with the common types of treaty clauses used in reinsurance treaties and their purposes.

Assigned Reading: Chapters 4 & 5

Chapter 4 - Common Reinsurance Treaty Clauses, Part 1

Learning Objectives to Master:

- Describe the purpose of each of the following reinsurance treaty clauses:
  - Preamble
  - Affiliated companies clause
  - Reinsuring clause
  - Definitions clause
  - Access to records clause
  - Federal excise tax clause
  - Currency clause
  - Governing law clause
  - Exclusions clause
  - Arbitration clause
  - Offset clause
  - Errors and omissions clause

- Describe the purpose of each of the following reinsurance treaty clauses that may be required under state regulations for primary insurers to qualify for financial statement credit for reinsurance:
  - Service of suit clause
  - Insolvency clause
  - Intermediary clause
  - Unauthorized reinsurance clause
  - Funding clause

- Describe the purpose of the interests and liabilities agreement that may be attached to a reinsurance treaty.
Chapter 5 - Common Reinsurance Treaty Clauses, Part II

Learning Objectives to Master:

- Describe the purpose of each of the following reinsurance treaty clauses:
  - Commencement and termination clause
  - Reports and remittances clause
  - Excess of policy limits clause
  - Extra-contractual obligations clause
  - Territory clause
  - Self-insured obligations clause

- Describe the purpose of each of the following ancillary agreements and endorsements:
  - Special acceptance agreement
  - Cut-through endorsement
  - Guarantee endorsement
  - Indemnity agreement
Unit: 3

Topic: Types of Reinsurance Treaties

Text Required: Reinsurance Principles and Practices, 3rd Edition, Published by The Institutes, Edited by Susan J. Kearney (Feb 2017)

Learning Objectives: To familiarize the examiner with the types of reinsurance treaties used in the insurance industry.

Assigned Readings: Chapters 6, 7, 8, 9, 10, & 11

Chapter 6 - Quota Share Treaties

Learning Objectives to Master:

- Describe the operation, functions, and use of quota share treaties and how quota share treaties are used in a primary insurer’s reinsurance program.
- Describe the purpose of the following common clauses that are modified for use in quota share treaties:
  - Reinsuring clause
  - Definitions clause
  - Commencement and termination clause
  - Reports and remittances clause
- Describe the purpose of the following clauses designed or adapted for quota share treaties:
  - Retention and limits clause
  - Reinsurance Premium clause
  - Sliding scale commission clause
  - Portfolio transfer clause
  - Losses, loss adjustment expenses, and salvages clause
  - Outside reinsurance clause
  - Warranties clause
  - Original conditions clause
- Describe the key factors a reinsurer takes into consideration when negotiating the ceding commission of a quota share treaty.
- Calculate the profit-sharing ceding commission for a quota share treaty.
- Explain how to evaluate the effectiveness of a quota share treaty.

Chapter 7 - Surplus Share Treaties

Learning Objectives to Master:

- Describe the operation, functions, and use of surplus share treaties.
- Describe the purpose of the following common clauses that are modified for use in surplus share treaties:
  - Reinsuring clause
  - Liability of the reinsurer clause
Society of Financial Examiners

Reinsurance

- Definitions clause
- Exclusions clause
- Reports and remittances clause

- Describe the purpose of the following clauses designed or adapted for surplus share treaties:
  - Surplus liability clause
  - Net retention clause
  - Retention and limits clause
  - Methods of cession clause

- Explain how limits profiles and line guides aid in determining surplus share treaty pricing.
- Explain how to evaluate the effectiveness of a quota share treaty.

Chapter 8 - Property Per Risk Excess of Loss Treaties

Learning Objectives to Master:

- Describe the operation, functions, and use of property per risk excess of loss treaties.
- Describe the purpose of the following clauses designed or adapted for property per risk excess of loss treaties:
  - Retention and limits clause
  - Loss notices and settlements clause
  - Reinsurance premium clause
  - Net retained lines clause
  - Ultimate net loss clause
  - Pools, associations, and syndicates exclusion clause
  - Total insured value exclusion clause
- Explain how property per risk excess of loss treaties are priced.

Chapter 9 - Casualty Excess of Loss Treaties

Learning Objectives to Master:

- Describe the operation, functions, and use of casualty excess of loss treaties.
- Explain how the reinsuring clause and the definitions clause are modified for use in casualty excess of loss treaties.
- Describe the purpose of the following clauses designed or adapted for casualty excess of loss treaties:
  - Retention and limits clause
  - Reinstatement clause
  - Claims and loss adjustment expense clause
  - Declaratory judgment clause
  - Sunset and sunrise clauses
  - Commutation clause
- Explain how casualty excess of loss treaties are priced.
Chapter 10 - Catastrophe Reinsurance

Learning Objectives to Master:

- Describe the operation, functions, and use of catastrophe treaties.
- Describe the purpose of the following clauses designed or adapted for catastrophe treaties:
  - Term clause
  - Retention and limits clause
  - Ultimate net loss clause
  - Loss occurrence clause
  - Other reinsurance clause
  - Reinstatement clause
- Explain how catastrophe treaty pricing is affected by attachment points, layers and limits, underlying insurance analysis, inuring reinsurance, payback prior losses, and reinsurance limits.
- Summarize the key components and outputs of a catastrophe model.
- Given the results of a catastrophe modeling analysis, determine options that a primary insurer can employ to manage its catastrophe exposures.
- Describe the following alternatives to traditional catastrophe reinsurance:
  - Lines of credit
  - Catastrophe bonds
  - Catastrophe options
  - Catastrophe risk exchanges
  - Industry loss warranties
  - Reinsurance sidecars

Chapter 11 - Aggregate Excess of Loss Treaties

Learning Objectives to Master:

- Describe the operation, functions, and use of aggregate excess of loss treaties.
- Explain how a retention and limits clause is adapted for use in aggregate excess of loss treaties.
- Explain how aggregate excess of loss treaties are priced.
Learning Objectives: To familiarize the examiner with the types of oversight in the reinsurance industry by reinsurers, regulators, and the NAIC.

Assigned Readings: Chapters 12, 13, & 14

Chapter 12 - Reinsurance Audits

Learning Objectives to Master:

• Explain why reinsurance audits are conducted.
• Describe the steps in the reinsurance audit process.
• Describe the objectives, sources of information, and possible recommendations for each of the following types of reinsurance audits:
  o Underwriting audits
  o Transactional audits
  o Claim audits
• Describe the considerations involved when performing a reinsurance audit of a managing general agent.

Chapter 13 - Reinsurance Regulation

Learning Objectives to Master:

• Explain how the following aspects of state insurance regulation apply to reinsurers:
  o Licensing
  o Rates and forms
  o Financial and market conduct oversight
• Explain how each of the following regulatory tools developed by the NAIC is used by state insurance regulators as part of a comprehensive state-based national system of insurance regulation to monitor insurer solvency:
  o NAIC Annual Statement
  o NAIC Model Laws and Guidelines
  o NAIC Accreditation Program
  o Off-Site Monitoring and Analysis
  o On-Site, Risk-Focused Examinations
  o Insurance Regulatory Information System (IRIS)
  o NAIC Risk-Based Capital System
• Describe the concerns of and actions taken by insurance regulators around each of the following:
  o Credit for a reinsurance transaction
  o Creditworthiness of reinsurers
Chapter 14 - Reinsurance Aspects of the NAIC Annual Statement

Learning Objectives to Master:

- Describe the major assets and liabilities found on the balance sheet of an insurer’s NAIC Annual Statement, particularly those that pertain to reinsurance transactions.
- Describe the information contained in the Underwriting and Investment Exhibit of an insurer’s NAIC Annual Statement, particularly that pertaining to reinsurance transactions.
- Describe the information contained in Schedule F of an insurer’s NAIC Annual Statement.
- Describe the information contained in Schedule P of an insurer’s NAIC Annual Statement.
Unit: 5

Topic: Loss Reserving Methods

Text Required: Reinsurance Principles and Practices, 3rd Edition, Published by The Institutes, Edited by Susan J. Kearney (Feb 2017)

Learning Objectives: To familiarize the examiner with various loss reserving methods.

Assigned Reading: Chapter 15

Chapter 15 - Loss Reserving Methods

Learning Objectives to Master:

- Describe the role of loss reserves, including the relationship over time between incurred losses, paid losses, reserves, and policyholders’ surplus.
- Explain why a reinsurer has a direct interest in the adequacy of its primary insurer’s loss reserves.
- Explain how case reserves are established for the following categories of loss reserves:
  - Reported losses – payment certain
  - Reported losses – payment uncertain
  - Allocated loss adjustment expenses
- Explain how bulk reserves are established for the following categories of loss reserves:
  - Reported losses – payment uncertain
  - IBNR reserves
  - Loss adjustment expenses, both allocated and unallocated
- Describe the following combined methods that can be used to estimate loss reserves:
  - Two-part combination method
  - Bornhuetter-Ferguson method
  - Three-part combined method
- Describe salvage and subrogation and their effect on loss reserves.
- Explain why excess of loss reinsurers encounter difficulties when estimating loss reserves or applying reserving techniques.
Unit: 6

Topic: NAIC SSAP Guidance Regarding Reinsurance

Assigned Reading: NAIC SSAP No. 61R – Life, Deposit-Type & Accident and Health Reinsurance

NAIC SSAP No. 62R – Property and Casualty Reinsurance

NAIC SSAP No. 61R – Life, Deposit-Type & Accident and Health Reinsurance

Learning Objectives to Master:

- Indemnity reinsurance
- Retention
- Reinsurance arrangements
- Types of Reinsurance arrangements
- Transfer of risk
- Accounting and Reporting of Reinsurance
- Reinsurance premiums
- Reinsurance benefit payments
- Reinsurance of deposit type contracts
- Expenses
- Experience refunds
- Credits for ceded reinsurance
- Reserves for reinsurance assumed
- Accounting for modified coinsurance arrangements
- Accounting for coinsurance with funds withheld arrangements
- Uncollectible reinsurance
- Reinsurance ceded to a certified reinsurer
- Unauthorized reinsurance
- Syndicated letters of credit
- Funds held under reinsurance treaties with unauthorized reinsurers or certified reinsurers
- Accounting for interest maintenance reserve
- Gains or losses on indemnity reinsurance
- Recaptures and commutations
- Deposit accounting
- Assumption reinsurance
- Accounting for assumption reinsurance transactions
- Accounting for non-economic assumption reinsurance transactions
- Glossary
Learning Objectives to Master:

- General
- Characteristics of reinsurance agreements
- Reinsurance terms for reinsurance agreements
- Reinsurance agreements with multiple cedents
- Reinsurance contracts must include transfer of risk
- Accounting for reinsurance
- Accounting for prospective reinsurance agreements
- Accounting for retroactive reinsurance agreements
- Deposit accounting
- Assumed reinsurance
- Ceded reinsurance
- Adjustable features/retrospective rating
- Commissions
- Unauthorized reinsurance
- Reinsurance ceded to a certified reinsurer
- Funds held under reinsurance treaties
- Provision for reinsurance
- Asbestos and pollution contracts - counterparty reporting exception
- Syndicated letters of credit
- Disputed items
- Uncollectible reinsurance
- Commutations
- National flood insurance program
- Accounting for the transfer of property and casualty runoff agreements
- Disclosures