30. (1 point)

An analysis of the net present value of underwriting loss for a reinsurance contract indicates the following:

- There is a 5% chance that the contract will generate an underwriting loss for the reinsurer.
- In all of the underwriting loss scenarios, the average underwriting loss to reinsurance premium ratio is 25%.

Based on this information, provide one argument which indicates the presence of risk transfer and one argument which indicates the absence of risk transfer.

SAMPLE ANSWERS AND EXAMINER'S REPORT

QUESTION 30	
TOTAL POINT VALUE: 1	**LEARNING OBJECTIVE: C4**
SAMPLE ANSWERS	

Sample 1:

Presence: ERD = 5% x 25% = 1.25% > 1%

Absence: According to the 10 -10 rule, 5% probability < 10% for the risk transfer to happen probability must be > 10%.

Sample 2:

ERD test = 0.05 x 0.25 = 1.25% > 1%, so present risk transfer

10-10 rule failed, since 5% chance of loss < 10% so absence risk transfer

EXAMINER'S REPORT

Candidates were expected to use the 10-10 rule to prove absence of risk transfer and to use the ERD > 1% rule to provide existence of risk transfer. Some candidates mentioned an ERD of 2% was required to provide the existence of risk transfer. We accepted this answer.

Candidates generally did well the question. A common error was to try to use the 10-10 rule to prove both existence and absence of risk transfer.