15. (1.5 points)

A company is performing a cash flow simulation for risk transfer analysis.

a. (0.5 point)

Briefly describe how parameter risk can be accounted for explicitly and implicitly.

b. (0.5 point)

Briefly describe one advantage and one disadvantage of using reinsurance pricing assumptions.

c. (0.5 point)

Explain why it would be reasonable to use an interest rate above risk-free rate and identify one of its flaws.

QUESTION *15*	
TOTAL POINT VALUE: 1.5	**LEARNING OBJECTIVE:** *C1*
SAMPLE ANSWERS	

Part a: *0.5* point

Explicit: By including a distribution of the parameter and doing a Monte Carlo analysis/distribution around each of the parameters

Implicit: By increasing the parameter by a PfAD/higher expected loss or increase volatility of losses/ be conservative when selecting parameter

Part b: *0.5* point

Advantage: More in line with reinsurer's view on the risk transfer, and incorporates market view of the risk/Provides view as how reinsurer or market see the contract

Disadvantage: Pricing assumption is more market driven and hard/soft market stage will impact pricing assumptions, but should not impact risk transfer analysis/ Risk transfer shouldn't fluctuate based on market conditions

Part c: *0.5* point

Reasonable: Because reinsurer's average rate of return is above the risk free rate

Flaw: Investment strategies of different reinsurers should not have impact on the risk transfer itself as it may result in different conclusions drawn for reinsurers with good or bad investment strategies./An analysis of risk transfer shouldn't take into account the reinsurer's investment strategy.

EXAMINER'S REPORT

Part a

This was a very challenging question with many candidates receiving no credit. Only a few candidates received full marks and a few received partial credit. A common error was for candidates to have mixed the implicit/explicit concepts. Some candidates were confused by the concept of deterministic versus stochastic models.

Part b

This was a very challenging question with many candidates receiving no credit. Only a small number received full marks.

Part c

Candidates performed better on this part compared to parts a) and b). Most candidates could explain why a higher rate was reasonable but often had trouble identifying a flaw.