27. (2.25 points)

In the context of a Statement of Actuarial Opinion:

a. (0.5 point)

Define "Qualified Actuary."

b. (0.75 point)

Describe the necessary conditions for an insurance policy to be considered a long-duration contract.

c. (0.5 point)

Describe how an insurance company would qualify for the financial hardship exemption.

d. (0.5 point)

Describe the disclosures that the Appointed Actuary must make when there are significant risks and uncertainties that could result in material adverse deviation.

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- Listed IEE or AOS as alternative locations. These are not part of the Annual Statement.

There were also numerous candidates who listed correct locations for the net reserves, but did not comment on D&A at all. The question clearly said to "Identify whether <u>each</u> value" appears elsewhere "and if so identify one location".

27. <u>Sample Answers</u>

a. "Qualified Actuary" is a person who is either:
   1. A member in good standing of the CAS, or
   2. A member in good standing of the American Academy of Actuaries (AAA) who has been approved as qualified for signing casualty loss reserve opinions by the Casualty Practice Council of the AAA.

b. Refers to contracts, excluding financial guaranty contracts, mortgage guaranty contracts and surety contracts, that fulfill both of the following conditions:
   1. The contracted term is greater than or equal to thirteen months
   2. The insurer can neither cancel nor increase the premium during the contract term

c. Financial hardship is presumed to exist if the projected reasonable cost of the Actuarial Opinion, exceeds the lesser of:
   1. 1% of the insurer's latest quarterly reported statutory surplus
   2. 3% of the insurer's direct plus assumed premiums written during the calendar year.

d. The actuary should include an explanatory paragraph in the statement of actuarial opinion. The explanatory paragraph should include the following:
   1. The amount of adverse deviation that the actuary judges to be material with respect to the statement of actuarial opinion
   2. A description of the major factors or particular conditions underlying risks and uncertainties that the actuary believes could result in material adverse deviation.

27. <u>Examiner's Report</u>

All parts of this question required straightforward recall from COPLFR.

a. Common errors included:
   - It is not sufficient to simply mention that you be a member of the CAS, "Good standing" is key.
   - Saying you need to be an FCAS is wrong, despite mentioning one needs to be in good standing.
   - Not enough to mention in good standing with the AAA, should also mention something relevant to being qualified by the AAA to sign opinions.

b.
   - Many candidates missed the need to mention excluding financial guaranty contracts, mortgage guarantee contracts and surety contracts, etc.

c.

- Some candidates failed to mention the *lesser* of those two conditions (or include an either/or statement since this implies lesser and is therefore acceptable).
- Statement on premium or reserves <$1M is not appropriate for this question, this is geared towards the small company exclusion.
- Some candidates swapped the 1% / 3% figures, or included incorrect amounts.

d.

- Answers similar to “Deviation Standard” implies amount and is acceptable.
- There were many variations for this answer. Any answers with the correct ideas were accepted.

28. Sample Answers

a.

Sample 1. The contract does not pass the threshold since 0.9% < 1.0%
Sample 2. No, since ERD = 0.9% < 1%
Sample 3. It does not pass as it does not exceed the 1% threshold. Not enough risk is transferred.

b.

Sample 1. Cannot use reinsurance accounting
-reserves cannot be shown net of reinsurance
-will have to account for as a deposit
Sample 2. This contract is recorded as a deposit with the reinsurer and loss reserves are not shown net of this contract.
Sample 3. The insurer accounts for this contract as a deposit, whereby the reserves are not reduced by the recoverable amount.
Sample 4. This will receive deposit accounting, and will not receive the surplus benefits of reinsurance accounting

c. Candidates could provide any three of the following answers:

- Reinsurer expenses should not be included because only transactions between insurer and reinsurer should be considered.
- Profit commission should not be considered as there will be no commission in a loss scenario.
- Assumptions from pricing analyses should be used with extreme caution, as pricing analyses focus on the expected value of losses under all scenarios. ERD/risk transfer analyses only focus on the tail of the distribution.
- Parameter Risk: can be accounted for explicitly (distribution around parameter) or implicitly (higher expected loss and standard deviation).
- Selection of Payment Patterns: Select the ceding company’s payment pattern carefully because this affects the tail of the distribution.
- Loss distribution needs to be considered, especially for reasonable results in the tail.
- Interest rate should be reasonable and the same for premiums and losses. Interest rate risk should not be a factor to consider.
- Parameter Selection: the model will be sensitive to the loss distribution parameters that we select. So be diligent in the study of those parameters.
- Commutation Clause: If commutation clause exists, how does this impact reinsurer’s potential loss.
- Loss sensitive business: appropriately reflect structure of contracts when evaluating, especially those factors that would limit a reinsurer’s loss.