10. (2 points)

Insurance company XYZ is licensed to transact insurance in a state and has been placed in liquidation. The following table shows XYZ's liabilities (all figures are in millions of dollars):

Category	Liabilities
Unearned premiums	10
Catastrophe loss reserves	40
Ocean Marine loss reserves	25
Inland Marine loss reserves	50
Employee pension liabilities	400

The following table gives data for insurance companies in the state (all figures are in millions of dollars):

Company	Written Premium	Earned Premium	Surplus
A	5,000	6,000	3,333
B	3,000	2,500	1,500
C	1,700	1,400	405
XYZ	300	100	(200)

a. (0.5 point)

Calculate the amount of XYZ's liabilities that are eligible for recovery from the guaranty fund.

b. (0.5 point)

Calculate the amount insurance company B will be assessed due to XYZ's liquidation.

c. (0.5 point)

Identify two guaranty fund limitations, other than lines of business covered, that affect insureds' recoveries.

d. (0.5 point)

Discuss whether or not guaranty funds have generally succeeded in covering the liabilities they were intended to cover.

QUESTION 10	
TOTAL POINT VALUE: 2	**LEARNING OBJECTIVE: B1-B3**
SAMPLE/ACCEPTED ANSWERS	

Part a: 0.5 point

Porter 12.12-12.13 (10M + 40M + 50M) = 100M

Part b: 0.5 point

Porter 12.15:
- 3B / (5B + 3B + 1.7B) = 30.9%--> 100M * 30.9% = 30.9M, from part a
- 3B / (5B + 3B + 1.7B) = 30.9%--> 200M * 30.9% = 61.8M, surplus given
- 3B / (5B + 3B + 1.7B) = 30.9%--> <Answer from (a)> * 30.9%

Part c: 0.5 point

- Unearned premium <u>may</u> not be fully recouped
- Claim limit
- Claim deductible
- Large net worth deductible
- Means test/restrictions
- Surplus lines don't qualify
- Risk retention groups don't qualify
- May be delay in payments
- Trigger of coverage, coverage only begins after a court declares the insurer insolvent
- Fund may be exhausted because there is a finite limit (2% of written premium) that can be assessed per a year

Part d: 0.5 point

- Critics have questioned whether there will be enough money because of percentage of premium limits following natural disasters, but both industry and NAIC studies have found state funds have generally had sufficient capacity.
- Have generally succeeded, assessments to remaining companies ensure that policy holders receive at least partial payout in the event of liquidation.
- Guarantee funds generally succeed in covering the liabilities they were intended to cover, since it does provide recoveries when insolvencies happen, which they otherwise now be recovered.
- Yes, guarantee funds have generally had the capacity and have been quick to pay for insolvency costs, with limited interruptions in the market.

EXAMINER'S REPORT

Part a
- The candidate was expected to know what items are covered by the fund (UPER, CAT losses, and inland marine), and which were not (ocean marine, pensions)
- Generally candidates did poorly here, common mistakes being
  - Including ocean marine (most common)
  - Including pensions
  - Excluding inland marine
  - Including all items
  - Simply stating the amount of surplus shortfall (question clearly asks for liabilities)
- This question was generally challenging because the candidate was expected to know exactly

	what was eligible to include in the fund.
Part b	

	• The candidate was expected to know to allocate the assessments based on written premium, and to exclude XYZ from the calculation
	• Almost every candidate got full credit on this question. For those that did not, these were common mistakes
	    o Including XYZ in the calculation (most common)
	    o Using earned premium or surplus to allocate
	• Most candidates knew to use the answer in (a) to complete the calculation. Some candidates used surplus and some stated just the percent allocated to company B and mentioned that it would be a percent of whatever the shortfall was after liquidation; we felt these were valid since the question did not provide all of XYZ's financial statements, so they got full credit.
	• If a candidate got (a) wrong, he or she could still get full credit on (b).

Part c	

	• The candidate was expected to know two limitations to the funds, except for LOB covered
	• Most candidates got full credit on this question. For those that did not, these were common mistakes
	    o Claiming UEPR was completely ineligible for recovery (most common)
	    o Stating the insured would not recover the entire amount owed (too vague)
	    o Stating the fund would allow for partial coverage after insolvency (the question asked for the impact on recoveries, not coverage)
	•

Part d	

	• The candidate was expected to know the purpose of the fund, and make an argument on whether its goal had been achieved.
	• This question was a mixed bag for most candidates. The biggest reason for point loss was failure to discuss. These were common mistakes:
	    o Lack of discussion (most common mistake)
	    o Arguing no, simply because often claims would not be paid in full; the point of the fund is not to completely make policy holders whole again
	    o Arguing no because it incentivizes risk taking by insurers (the question asked for success in terms covering liabilities meant to be covered, not the fund's impact on the marketplace)
	Some candidates were a little confused on this question, so we generally gave credit if the candidate took a stance and made a logical argument as to the nature of the fund's success in covering liabilities.