

EXAM 6 – UNITED STATES, FALL 2014

22. (2.75 points)

The following information is for an insurance company that writes only two lines of business. All figures are as of December 31, 2013 and are shown in millions of dollars:

Total net recorded loss and LAE reserve	750
Commercial automobile written premium	350
Private passenger automobile written premium	650
Statutory surplus	400
Net income	250
Total adjusted capital	400
Authorized Control Level RBC	150
Low end of actuary's range of unpaid loss and LAE	650
High end of actuary's range of unpaid loss and LAE	1,000
Actuary's point estimate	800

a. (2.25 points)

For each of the following work products, identify an intended user, propose an appropriate materiality standard, and justify its relevance.

- NAIC Statement of Actuarial Opinion
- Rate indication for commercial auto
- Opinion on the adequacy of reserves for a proposed merger or acquisition

b. (0.5 point)

Based solely on the proposed materiality standard for the NAIC Statement of Actuarial Opinion from part a. above, explain how the Appointed Actuary might address whether there are significant risks and uncertainties that could result in material adverse deviation.

SAMPLE ANSWERS AND EXAMINER'S REPORT

QUESTION 22	
TOTAL POINT VALUE: 2.75	LEARNING OBJECTIVE: D
SAMPLE ANSWERS	
Part a: 2.25 points	
<p>Regarding Statement of Actuarial Opinion:</p> <ul style="list-style-type: none"> • Intended user: regulator • Materiality standard: change in reserves to reach next RBC control level; a percentage of surplus; a percentage of reserves (the associated percentage and/or dollar amount of the selected materiality standard were also often provided by candidates) • Justification: Relevance to the company's solvency; issues related to regulation of solvency <p>Regarding commercial auto rate indication:</p> <ul style="list-style-type: none"> • Intended user: company management; line of business management; regulator • Materiality standard: a percentage of commercial auto premium (the associated percentage and/or dollar amount of the selected materiality standard were also often provided by candidates) • Justification: Relevance to the individual line of business <p>Regarding merger and acquisition:</p> <ul style="list-style-type: none"> • Intended user: company management; investors; management of the selling or acquiring company; regulator involved in approving a merger • Materiality standard: a percentage of surplus; a percentage of net income (the associated percentage and/or dollar amount of the selected materiality standard were also often provided by candidates) • Relevance: The value of the company is based on its net worth or potential earnings 	
Part b: 0.5 point	
<p>The answers for part b varied based on each candidate's materiality standard selected in part a. For example: The actuary's point estimate is 750 and the top of the range is 1000. The materiality standard is 100. Since the top of the actuary's range is greater than the point estimate plus the materiality standard, there is a risk of material adverse deviation.</p>	
EXAMINER'S REPORT	
Part a	
<p>Common errors included:</p> <ul style="list-style-type: none"> • Showing a correct calculation but an incorrect underlying basis (for example, using total auto premium rather than commercial auto only for the materiality standard for the commercial auto rate indication) • Providing overly general answers (i.e., "stakeholder") • Using a percentage of reserves as the materiality standard for M&A – the value of an entity for acquisition purposes is based on the entirety of its balance sheet or income statement, not any one particular item 	
Part b	
<p>A common error was to refer to the range below the actuary's point estimate – this is not relevant to the risk of material adverse deviation.</p>	