12. (3.5 points)

The following excerpts are from a company's 2013 Annual Statement (all figures are in thousands of dollars):

ASSETS				
	Current Year			Prior Year
	Assets	Nonadmitted Assets	Net Admitted Assets	Net Admitted Assets
Cash	13,000	0	13,000	11,100
Stocks	1,200	250	950	900
Deferred premiums and agents' balances	2,000	150	1,850	0
Total	16,200	400	15,800	12,000

LIABILITIES, SURPLUS AND OTHER FUNDS		
	Current Year	Prior Year
Losses	8,500	5,500
Loss adjustment expenses	500	500
Unearned premiums	1,200	1,000
Total liabilities	10,200	7,000
Surplus as regards policyholders	5,600	5,000

Net investment income earned	25
Net realized capital gains	75
Change in net unrealized capital gains	50
Dividends to policyholders	5
Dividends to stockholders	100
Nonadmitted assets as of December 31, 2012	225

The company's reserving actuary asserts that the company's significant increase in liabilities for Losses & Loss adjustment expenses in 2013 was due to reasons other than reserve inadequacy.

a. (1.25 points)

Calculate the insurance company's 2013 net income.

b. (2.25 points)

Identify three Exhibits, Notes, Interrogatories, or Schedules in the Annual Statement that could support the reserving actuary's assertion. Describe how each could support the actuary's assertion.

CONTINUED ON NEXT PAGE

QUESTION 12	
TOTAL POINT VALUE: 3.5	**LEARNING OBJECTIVE: C1**
SAMPLE ANSWERS (BY PART, AS APPLICABLE)	
Part a: 1.25 points	
Surplus(prior) + Net Income + Direct Charges to Surplus = Surplus(Current) Surplus(prior) + Net Income + Change in Unrealized capital gain – Change in Non-Admitted assets – Dividends to stockholders = Surplus (Current) 5000 + Net Income + 50 - (400-225) - 100 = 5600 NI = 5600 - 5000 - 50 + 175 +100 = 825 Because the change in net unrealized capital gains is presented both pre- and post-tax in the annual statement, credit was also given when candidates assumed a 35% tax rate (e.g. a deferred tax liability) on the change in net unrealized capital gains. 5000 + Net Income + 50 × (1-35%) - (400-225) - 100 = 5600 NI= 5600 - 5000 - 32.5 + 175 +100 = 842.5	
Part b: 2.25 points	

The following provide examples of thorough responses having the necessary components to demonstrate knowledge of the topic and obtain full credit; any three of the following were accepted:
• Notes to the Financial Statements: If the Note on Change in Incurred Loss and Loss Adjustment Expense showed that there was minimal development on prior year losses, this would support the actuary's assertion that reserves were adequate
• Notes to the Financial Statements: Note of reinsurance, specifically Section E, would note if there were any commutations in the past year. Commutations of previously ceded reinsurance would increase the net reserves since the loss reserves are recorded as net and associated ceded balances are eliminated.
• Notes to the Financial Statements: The notes (and/or Schedule F, Part 1) could indicate if there was an increase in an intercompany pooling percentage. Reserves could be adequate but still greater this year than past years if the company has a greater share of the intercompany pooling.
• General Interrogatories: Merger and/or acquisition activity in the past year which involved an increase in business and/or prior year reserves could result in an increase in reserves for reasons other than reserve inadequacy
• Five Year Historical Data: Several answers from this exhibit were accepted to the extent that they suggested an increase in reserves that would not imply a reserve inadequacy in prior years:
  o Significant growth in net premium would result in an increase in reserves
  o A change in the mix of business from property (short-tail) to liability (long-tail) lines generally increases the reserves
  o A change in the mix of business from liability to property lines if coupled with catastrophes in the current AY would increase the reserves
  o An increase in the percentage of retained premium (net premium / gross premium) would indicate that more reserves are being retained in the current accident year	

- Schedule F, Part 3: Decreased usage of reinsurance compared to prior years since reserves are recorded net of reinsurance
- Schedule F, Part 1: Increased assumption (and retention) of reinsurance over the calendar year since reserves are recorded net of reinsurance
- Schedule P, Part 2: If there was minimal development of incurred (ultimate) losses and loss adjustment expense in prior years, this would support the actuary's assertion
- Schedule P: If ultimate losses remained unchanged but loss payments slowed down in CY 2013, then reserves would increase for reasons other than reserve inadequacy. Payment patterns in particular could be evaluated through Schedule P, Part 3.
- Other areas of the annual statement that were used to support an increase of reserves in the current year included
    - Schedule T
    - IEE
    - Underwriting & Investment Exhibit
    - Page 14 (state pages)

EXAMINER'S REPORT (BY PART, AS APPLICABLE)

Candidates generally received at least partial credit on part a. but many did not perform well on part b.

Part a

Candidates were expected to solve for the net income as presented in the Capital and Surplus Account section of the Income Statement. Based on the information given in the problem (e.g. not underwriting income, investment income, etc.), they were expected to recognize that the change in surplus and related direct charges to surplus should be used.

Common errors included incorrectly including extra components in the formula, incorrectly omitting components, and/or using the wrong signs for the direct charges to surplus.

Part b

Candidates generally performed poorly on part b). Many candidates that were able to identify acceptable parts of the annual statement were not able to describe how those parts could be used to support the actuary's assumption. Common errors included:

- Identifying items not found in the annual statement sections described in the question
- Describing items that would support an increase in prior accident year reserves which would contradict the actuary's assertion
- Specifically many responses addressed average case reserves or suggested independently calculating incurred (ultimate) loss and loss adjustment expenses. These responses were given no credit when they were used to conclude that the total loss and loss adjustment expense reserves (including IBNR) were inadequate.
- Failing to describe how the identified part of the annual statement would support the actuary's assertion

QUESTION 13	
TOTAL POINT VALUE: 4.25	LEARNING OBJECTIVE: C1
SAMPLE ANSWERS (BY PART, AS APPLICABLE)	