

19. (2.5 points)

a. (1 point)

Describe the two main components of the Risk-Based Capital (RBC) system.

b. (0.5 point)

Briefly describe two aspects of the RBC system that make it a reliable tool for identifying companies at risk of insolvency.

c. (0.5 point)

The RBC ratio for an insurer is currently 310% of the Authorized Control Level. Explain whether this insurer may currently be placed into receivership by state insurance regulators.

d. (0.5 point)

Briefly describe two concerns that state regulators might raise if the RBC system were to be replaced by internal company models to determine minimum capital requirements.

SAMPLE ANSWERS AND EXAMINER'S REPORT

QUESTION 19	
TOTAL POINT VALUE: 2.5	LEARNING OBJECTIVE: C2
SAMPLE ANSWERS (BY PART, AS APPLICABLE)	
Part a: 1 point	
<ul style="list-style-type: none"> • Component 1: RBC formula - formula results in a minimum level of required capital determined • Component 2: RBC Model Law - provides the state insurance regulator with authority to take specific action when a company's RBC ratio falls below certain thresholds 	
Part b: 0.5 point	
<p>The following provide examples of responses having the necessary components to demonstrate knowledge of the topic and obtain full credit; any two of the following received full credit:</p> <ul style="list-style-type: none"> • Considers material risks for insurance companies • Calculations reflect risks unique to the specific company • Based on Annual statement data or Statutory Account principles (Included in this bullet are the below acceptable answers): <ol style="list-style-type: none"> 1. Data is verifiable and reliable 2. Data is subjected to accuracy and completeness tests 3. Data is Audited and Reserved are opined upon 4. Standardized/uniform data and formula 5. Data is difficult to manipulate 6. Data is objective • Riskier Assets/LOB get higher RBC Charges 	
Part c: 0.5 point	
<p>Based on the RBC ratio, the company would not be placed into receivership. However, the RBC system is not the only tool to trigger receivership. A factor that a regulator may consider is: (sample from list below)</p> <ol style="list-style-type: none"> 1. Impairment, insolvency, or hazardous financial condition (including review of IRIS Ratios or Fast Track Ratios, liabilities greater than assets); 2. Improperly disposed property or concealed, altered, or destroyed financial books; 3. Best interest of policyholders, creditors or the public; 4. Dishonest, improperly experienced, or incapable person in control; or 5. Fraud by company 	
Part d: 0.5 point	
<p>The following provide examples of responses having the necessary components to demonstrate knowledge of the topic and obtain full credit; any two of the following received full credit:</p> <ul style="list-style-type: none"> • Higher cost to regulators, including additional resources, time to review, black box/transparency • Less comparability of results/lack of consistency across companies • Possible misuse/manipulation/artificially lowering capital requirements unintentionally or intentionally • Introduction of potential for competitive advantages (large companies have more resources to create models than smaller companies) 	

SAMPLE ANSWERS AND EXAMINER'S REPORT

EXAMINER'S REPORT (BY PART, AS APPLICABLE)

Candidates were expected to know details about the RBC system and its application. Candidates did not perform well on this question overall:

- The candidate was expected to know the components of the RBC system, but many confused this with components of the RBC formula. This was addressed in part a.
- Candidates also confused aspects of the RBC system that make it a reliable tool with the components of the RBC system. For instance, many answered the question stating that it provided action levels for regulators, which we believe to be more of an outcome of system. Some simply stated that it was conservative, which is a characteristic but does not explain why it is reliable. It is reliable because it considers material risks of the insurer, risks that are unique to the specific insurer, the charges vary by the degree of riskiness, and the methodology is standard across all insurer utilizing verifiable/audited data

The question is challenging. This particularly true on part c where a candidate needed to note other factors that a regulator would need to consider before placing an insurer under receivership.

Part a

- Candidate were expected to know the 2 main components of the RBC system, which are the RBC formula and RBC Model Law.
- To get full credit, a candidate needed to state both of these items and note that the RBC formula calculated the minimum required capital and the RBC Model Law grants authority to regulators to intervene if the RBC ratio reaches certain thresholds.
- Common errors included:
 1. Candidates confused RBC system components with the components of RBC formula.
 2. Candidates provided definition of the RBC ratio and not the RBC formula.

Part b

- To get full credit, a candidate was expected to be able to state something about the data being used (e.g. standardize, from the annual statement, Audited). We were also expecting candidates to comment on how the formula considers material risk to the company or unique risk of the company
- Common errors included:
 1. Stating that it provides action levels for the regulators
 2. Stating that it is conservative without any explanation about charges varying by the riskiness of the assets.
 3. Two answers about the data being verifiable(e.g., Data comes from the Annual Statement. The Annual Statement data is audited)

Part c

- The candidate was expected to know what RBC ratio triggers regulator intervention and also what other factors could trigger intervention.
- To get full credit, a candidate needed to state that regulators would not have to intervene with the given RBC ratio and also state a condition where the insurer could be placed in receivership.
- Common errors were candidates only noting that the RBC ratio would indicate no regulator intervention and, candidates not giving another condition where a company could be placed

SAMPLE ANSWERS AND EXAMINER'S REPORT

into receivership.

Part d

- The candidate was expected to be able to describe two regulatory concerns about moving to internal models. Candidates performed very well on this question.
- To get full credit we were looking for commentary on two of the following broad categories:
 1. Higher Cost/Additional Resource
 2. Comparability
 3. Misuse
 4. Competitive Advantages

A common error was a candidate giving two responses from a single category above. We granted credit for only one of the responses in this case.