

EXAM 6 – UNITED STATES, SPRING 2016

24. (3.5 points)

Given the following information for a personal lines insurer as of December 31, 2014 (all figures in thousands of dollars):

Statutory Surplus	250
Total Net Recorded Loss and LAE Reserve	400
Total Adjusted Capital	250
Authorized Control Level RBC	50
Low End of Actuary's Range of Reasonable Unpaid Loss and LAE	350
High End of Actuary's Range of Reasonable Unpaid Loss and LAE	500

a. (1.5 points)

Using the information provided above, propose and calculate three materiality standards based on different metrics.

b. (1 point)

Justify the selection of one materiality standard from part a. above and determine whether the Appointed Actuary might conclude that there is a risk of material adverse deviation.

c. (1 point)

Identify four risk factors that an Appointed Actuary might consider when preparing the Statement of Actuarial Opinion for a personal lines company.

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SAMPLE ANSWERS AND EXAMINER'S REPORT

QUESTION 24	
TOTAL POINT VALUE: 3.5	LEARNING OBJECTIVE: D
SAMPLE ANSWERS	
Part a: 1.5 points	
<ul style="list-style-type: none"> • <u>Percent of Surplus</u>: For example, 5% of surplus = 12.5: 10% of surplus = 25.0: 15% of Surplus = 37.5; or 20% of surplus = 50.0. • <u>Percent of Held Reserves</u>: For example, 5% of Held = 20; 10% of Held = 25; or 15% of Held = 60. • <u>Amount of Deviation to cause RBC to fall to the next action level</u>: Company Action Level = 2 X ACL = 100. Next level = Total Adjusted Capital – Company Action Level= 250-100 = 150. 	
Part b: 1 point	
<ul style="list-style-type: none"> • Selection and Justification: <ul style="list-style-type: none"> ○ Selected X because it is the lowest of the 3 calculated or most conservative ○ Selected X because it is the middle of the 3 calculated ○ Selected X because it would trigger an IRIS ratio ○ Selected Surplus because it is most commonly used ○ Selected RBC level because a company action level (200%) would be triggered. If a company might get to the next action level, then the company will be at company action level, causing it to take action and submit a plan to the regulators. • Calculate Standard: <ul style="list-style-type: none"> ○ Show the calculation of reserve + materiality standard selected above and its relativity to 500 (high end of range) • Determine RMAD: <ul style="list-style-type: none"> ○ RMAD exists if the Reserve + materiality standard is less than 500 ○ RMAD does not exist if the Reserve + materiality standard is greater than 500 	
Part c: 1 point	
<ul style="list-style-type: none"> • Catastrophic weather events (or Hurricanes, flooding, earthquake, etc.) • New Products or new markets (or Short time in the business, Limited knowledge of exposures) • Rapid growth in one or more lines of business (or expansion into new states) • Lack of data or unexpected and unexplained changes in data. (or Quality / accuracy of data (this implies Lack of data)) • Operational Changes that are not objectively quantified • Sudden unexplained changes in frequency or severity of reported data for a line of business or segment (or Bad economy; or Changes in economic conditions, such as unemployment, housing prices etc.) • Changes in adequacy of known case reserves (or Adverse development in existing losses; or Inadequate Reserving in past; or Change in claim settlement practice; or Change in reserving practice) 	

SAMPLE ANSWERS AND EXAMINER'S REPORT

<ul style="list-style-type: none">• Effect of Anticipated Salvage and subrogation to be received.• Reinsurance Collectability (Risk that reinsurers or the creditors default)• Residual Market and involuntary pools• Change in legislation or court rulings
EXAMINER'S REPORT
<p>This question on the Statement of Actuarial Opinion asked the candidate to propose three materiality standards based on some relevant data given and then to select one standard and justify its use in the opinion and conclude whether or not there is a risk of material adverse deviation. The candidate also needed to identify four risk factors that the actuary might consider when preparing the Statement of Actuarial Opinion.</p>
Part a
<ul style="list-style-type: none">• The candidate was expected to know at least three possible standards. Most candidates were able to identify three standards that could be calculated based on the information given.• Most candidates were able to calculate the three common values.• Common errors included: some candidates assumed Total Adjusted Capital was the actual capital and used it for calculating a ratio, while others selected random numbers such as the high point of the range, said calculating "Authorized Control Level" but calculated "Company Action Level" or vice versa
Part b
<p>In selecting a material standard from the standards calculated above, most candidates correctly selected the lowest value standard calculated and identified that this standard indicated that there was a risk of MAD.</p> <ul style="list-style-type: none">• Some candidates selected RBC and were required to give a more detailed reason why this was selected since it was not the lowest, was a large % of surplus, and there was not an expectation of MAD.• The common mistake made was not justifying the answer selected or selecting a value that was not the lowest without a well thought out reason.
Part c
<ul style="list-style-type: none">• The last part of the question asked the candidates to identify four risk factors that an Appointed Actuary might consider when preparing the Statement of Actuarial Opinion for a personal lines carrier.• The instructions in the practice note require the opining actuary to comment in the Relevant Comment Section on major risk factors underlying the significant risks and uncertainties considered even when no risk of MAD is judged to exist.• A common mistake was to identify risk factors relating to Commercial lines such as Work Comp and General Liability etc. The question asked for risk factors relating to a Personal lines carrier. Some wrong answers included the following factors<ul style="list-style-type: none">○ Asbestos. Construction Defect (Chinese Dry Wall), Exposure related to mortgage defaults, High Excess layers, Impact of soft market conditions, large deductible worker comp claims, medical professional liability legislative issues.• Other wrong answers came from a long list of items, including the ones listed below.

SAMPLE ANSWERS AND EXAMINER'S REPORT

- Geographical range of company without mentioning catastrophe risk
- Retroactive reinsurance or cessions to reinsurers without stating anything regarding significant/high level of collectability risk
- Political environment, as this is a general risk (unless it was stated that this specific to the company for a particular reason)
- Risk of material adverse development, since the question is looking for risk factors for purposes of determining whether or not there are significant risks that could result in material adverse deviation
- Risk that reserves are inadequate, for the same reason as noted above (i.e., what are the risk factors that could result in material adverse deviation)
- Fraud, as this is a general risk (unless it was stated that this specific to the company for a particular reason)
- Credit Risk, Premium Risk, Reserving Risk, Interest Rate Risk, as these are general risks (unless it was stated that these risks were specific to the company for a particular reason(s))
- The economy, as this is a general risk (unless it was stated that this specific to the company for a particular reason)
- Intercompany pooling
- Salvage and subrogation, without stating anything regarding collectability of such
- Shift in long tail vs short tail, since the question was specific to personal lines
- Foreign exchange rates, since the question was specific to personal lines