16. (2.5 points)

a. (0.5 point)

Briefly describe two items that must be discussed in Note 30 (“Premium Deficiency Reserves”) of the Notes to the Financial Statements.

b. (1 point)

An insurance company exclusively wrote private passenger automobile insurance from 2011 through 2012 and diversified into homeowners beginning in 2013. The company hired staff to exclusively write and market homeowners business, and the company employs a conservative investment policy with 3% annual returns.

Selected information from the company’s Annual Statements is given below (all figures are in thousands of dollars):

Data from 2013 through 2015 Underwriting and Investment Exhibits:

Statement Date	4. Homeowners multiple peril	
	Net Premiums Written	Premiums Earned During the Year
December 31, 2013	1,710	210
December 31, 2014	8,640	5,581
December 31, 2015	8,370	9,690

Data from 2015 Schedule P, Part 1:

Years in Which Premiums Were Earned and Losses Were Incurred	Total Losses and Loss Expenses Incurred – Net
	Part 1A – Homeowners/ Farmowners
2013	300
2014	7,500
2015	15,000

Fully discuss whether or not the company should carry a non-zero premium deficiency reserve in its 2015 Annual Statement.

c. (1 point)

Although recent Homeowners results have not achieved target profit, the company described in part b. above has decided it should remain in the market. Briefly describe four potential factors that could support such a decision.

CONTINUED ON NEXT PAGE

QUESTION 16	
TOTAL POINT VALUE: 2.5	**LEARNING OBJECTIVE: C1**
SAMPLE ANSWERS	
Part a: 0.5 point	

Any two of the following distinct thoughts:

- the amount of premium deficiency reserves
  - OR the liability carried for premium deficiency reserves
  - OR the size of deficiency
  - OR "the amount or notice there is no premium deficiency reserves"
- whether anticipated investment income was utilized as a factor in the premium deficiency calculation
  - OR whether or not anticipated investment income was utilized in the calculation
- the date of evaluation for premium deficiency reserves
  - OR the date of the most recent evaluation of this liability

Part b: 1 point

Sample answers include:
Sample 1

- Yes, a premium deficiency reserve should be booked.
- A premium deficiency reserve is established if the unearned premium of in-force business is not sufficient to cover the losses, LAE and maintenance expenses that will arise as that premium is earned.
- Homeowners has loss and LAE ratios greater than 100% each year and 2015 has a loss and LAE ratio of 155%; likely the 2015 unearned premium will be deficient compared to future expected losses and LAE.
- Investment Income would not be enough to overcome the underwriting losses.
- There is no offset between the PPA and HO lines of business based on how they are marketed and tracked separately.

Sample 2

- We do not know whether a PDR should be booked. There is not enough information to evaluate whether the 2015 UEPR is sufficient given there is no information about rate changes or the corresponding expected future losses.

Sample 3

- No, a premium deficiency reserve should not be booked if we believe the data is sparse because it is a new line of business and the business is priced appropriately.

Part c: 1 point

Any four of the following:

- The homeowners' line is still relatively new, so data is sparse.
- Data was severely impacted by large losses or CAT losses.
- Rate increases have been approved.
- The market has been soft and a hard market is expected.

- Implement underwriting changes
- There are regulatory restrictions on withdrawing from the market.
- Attempt to capture market share.
- Attempt to stimulate growth.
- Bundling or Cross-Selling – The company is ok tolerating high homeowners' loss ratios if it means writing profitable auto.
    - Be able to compete in a market with packaged policies
- Diversify risk
- It would cost more to wind down the business than to keep it going.
- The fixed expenses will be a smaller percentage of larger premium as the business grows.
- Could purchase reinsurance.
- Preserve the company's reputation.

EXAMINER'S REPORT

Candidates were expected to know the definition for premium deficiency reserves and the required disclosures in statutory financial reporting. The candidate was expected to understand why a company would continue to write a non-profitable line of business.

Candidates struggled with the concept that the premium deficiency reserve is a prospective analysis. Just like in ratemaking, the past historical information provides valuable insight, but the overall determination is whether the prices used in the unearned premium will be enough to pay for the losses that will occur on future accidents.

Part a

Candidates were expected to know the premium deficiency disclosure required in the notes in statutory financial reporting:

- the amount of premium deficiency reserves;
- whether anticipated investment income was utilized as a factor in the premium deficiency calculation; and
- the date of evaluation for premium deficiency reserves.

Common errors include providing responses that are not required as part of the financial statement disclosure, such as:

- "If" or "Whether" PDR exists.
- "Amount required by line of business."
- Reason why there is or is not a deficiency.
- Discussion of DPAC because the reference is to Note 30 which is an SAP requirement.
- A discount rate or interest rate, or whether a discount rate applies.
- Whether PDR was included in the UEPR.
- How the PDR was calculated or identification of a change in the PDR calculation from the prior year.

Part b

Candidates were expected to apply the definition of premium deficiency disclosure to evaluate some historical data and make assumptions about whether PDR should likely be recorded.

Common errors include:

- Calculation of historical loss ratios with no tie to expected future accidents/losses of in force business.
- Noting that development could occur to make past premiums more deficient. A premium deficiency reserve involves analysis of claims/losses that have not yet happened and are not yet reflected in reserves.
- Calculation of historical loss ratios using Written Premium.
- Saying that the PPA experience will offset the HO experience. Offsets would not be permitted given that the company "exclusively writes and markets HO business."

Part c

Candidates were expected to know some reasons why a company would continue to write a currently unprofitable line of business.

Common errors include:

- Stating that the company has enough surplus or the PPA line is profitable enough to handle a HO loss without explaining why the company should continue to write the unprofitable line.
- Stating that the company attains high investment returns without explaining that the investment strategy would be changed (because the investment rate of 3% was a given).