25. (1.75 points)

An insurance company formed on January 1, 2015 has gross written premium of $2 million and surplus of $10 million at September 30, 2015. The company only writes General Liability coverage up to $500,000 per occurrence for agriculture risks in a single state. The company has no ceded reinsurance.

a. (0.75 point)

Identify three risks specific to this entity that could result in material adverse deviation.

b. (0.5 point)

For two of the risks identified in part b. above, briefly describe one change the company could make to mitigate each risk.

c. (0.5 point)

For both of the changes described in part b. above, briefly describe how poor execution of the change could add significant risk to the company.

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<table>
<tr><td colspan="2">QUESTION 25</td></tr>
<tr><td>TOTAL POINT VALUE: 1.75</td><td>LEARNING OBJECTIVE(S): D1a</td></tr>
<tr><td colspan="2">SAMPLE ANSWERS</td></tr>
<tr><td colspan="2">Part a: 0.75 point</td></tr>
<tr><td colspan="2">Any three of the following:
Company writes high limits relative to surplus
Company writes only general liability
Company writes business in a single state
Company specializes in underwriting risks in a single industry
The company has no reinsurance protection in place
Company is new and may not have sufficient experience to underwrite/price/reserve correctly</td></tr>
<tr><td colspan="2">Part b: 0.5 point</td></tr>
<tr><td colspan="2">Any two of the following:
Company Management could write lower limits so one or two large claims won't have a detrimental impact on surplus
Company management could enter into a reinsurance agreement to mitigate development on net losses.
Company management could expand business into other lines to diversify their business
Company Management could expand business into other states to diversify their business.
Company Management could expand business into industries other than agriculture to diversify their business
Company Management could hire consultants or use industry data to assist in underwriting/pricing/reserving</td></tr>
<tr><td colspan="2">Part c: 0.5 point</td></tr>
<tr><td colspan="2">Any two of the following:
Reducing the limits of insurance, all things equal, would cause less premium to be earned. The company could consider expansion, to maintain current premium levels. However, the reduction in limits may limit their ability to sell new policies and increase adverse selection. Caution must be used to make sure they aren't underwriting bad risks
Reinsurance placed with a poor performing reinsurer could lead to more reinsurance collectability concerns.
Changes in underwriting new lines of business, new industries, or new states must be done carefully so an insurance company doesn't experience adverse selection from improper pricing. Company will not have their own experience in setting prices and reserves. Or using available industry benchmark data to set prices and reserves could result in improper pricing and reserving if the benchmarks aren't appropriate for the business underwritten.
If outside expertise is too expensive or ineffective, this could lead to deterioration in the combined ratio due to either adverse UW losses or increase expenses.</td></tr>
</table>

- If the reinsurance is too expensive or they don't cede enough risk, either their combined ratio will be adversely affected or the Company has not been properly addressed the inherent risk involved in their business model.

EXAMINER'S REPORT

Candidates were expected to understand identify risks specific to the company and to understand the concept of risk of material adverse deviation

Part a

Candidates were expected to understand were expected to identify three possible risks specific to the Company that could lead to risk of material adverse deviation could be identified by an opining actuary as risks that could lead to RMAD.

Common errors include listing the following risks because they are not specific to the Company:

- Catastrophes - due to the nature of GL coverage, catastrophe type losses are excluded.
- A&E and Environmental – because this Company starting writing insurance in 2015, it would not be exposed to legacy A&E and Environmental exposures.
- Mass Tort – This risk was not considered specific to the Company's circumstances as this would be an exposure that exists for the industry and not for this particular company.
- Rapid growth, without relating to reserve adequacy

Part b

Candidates were expected to provide a change the company could make to reduce the risks mentioned in part a.

Common errors include:

- Providing changes that would not mitigate the risk
- Providing changes that were not relevant from the insurer's perspective.

Part c

Candidates were expected to identify a reasonable risk of implementing the risk mitigation strategy identified in part b.

Common errors include not relating the problem to part b. Or the problem identified in part c. was not an issue the insurance company could face. For example, no insurance company would buy excess of loss reinsurance that attached above the per claim limit of the underlying book of business.