13. (2.25 points)

An insurance company owns the following bond portfolio:

NAIC Rating	Amortized Cost	Fair Value	Actual Cost
1	21,000	18,000	20,000
3	79,000	75,000	71,000
6	8,000	9,000	7,000

The insurance company has only the following additional assets on its balance sheet:

	Total Assets	Nonadmitted Assets	Admitted Assets
Preferred Stocks	29,000	0	29,000
Common Stocks	71,000	5,000	66,000
Cash	5,000	0	5,000
Other invested assets	40,000	5,000	35,000
Uncollected premiums and agents balances	28,000	12,000	16,000
Deferred premiums and agents balances	32,000	5,000	27,000
Amounts recoverable from reinsurers	7,000	1,000	6,000
Net deferred tax asset	30,000	11,000	19,000
Other non-invested assets	14,000	4,000	10,000
Total Assets excluding Bonds	256,000	43,000	213,000

a. (0.75 point)

Calculate the total adjusted carrying value of bonds under SAP.

b. (1.5 points)

Describe three concerns a regulator may have regarding the overall health of this insurer based on its assets.

CONTINUED ON NEXT PAGE

iii) Candidates were expected to know that net income is not immediately increased or decreased in the event of a gain or loss on a retro reinsurance contract, but that the gain/loss is deferred and amortized into income over the period of payments

iv) Candidates were expected to know that any gain or loss is deferred and/or gives no immediate surplus change

Common mistakes included:

- Stating that reserves are stated net of retroactive reinsurance
- Stating that total liabilities would be unchanged because a reinsurance asset would be established
- Stating that income would increase by the gain in the contract, but not mentioning that the gain is amortized over the payment period of the contract, and thus income is not immediate
- Stating that surplus would increase due to a gain, without mentioning that such an increase would not be immediate.

QUESTION 13	
TOTAL POINT VALUE: 2.25	**LEARNING OBJECTIVE: C1**
SAMPLE ANSWERS	
Part a: 0.75 point	

Sample Answer:

Bond 1 = Amortized Cost = 21,000

Bond 3 = minimum (Fair Value, Amortized Cost) = 75,000

Bond 6 = minimum (Fair Value, Amortized Cost) = 8,000

Total Carrying value = 21,000 + 75,000 + 8,000 = 104,000

Part b: 1.5 points

Sample answers:

- Cash is only 1.6% of admitted assets so a regulator would be concerned about liquidity, the insurer's ability to quickly pay out claims.
- 42.9% of the uncollected premiums is not admitted and is too high, suggesting that much of this is due to the balance being overdue by over 90 days. The regulator would be concerned about credit risk, the insurer's ability to collect premium balances.
- The company has a high portion of stocks relative to bonds. Stocks can result in more volatile earnings. Most insurers' holdings are made up predominantly of bonds.
- Too large of a portion of bond investments are in low grade bonds (greater than class 2) which exposes the insurer to credit risk.
- The proportion of uncollected premiums and agents balances and deferred premiums and agents balances are high. They are not as liquid as other assets.

- There is a large proportion of non-admitted assets meaning they can't be liquidated quickly and could be at risk of being uncollectible.

EXAMINER'S REPORT

Candidates were expected to complete the bond carrying values on a balance sheet and use the balance sheet to evaluate any concerns on the financial health of the insurance entity.

Part a

Candidates were expected to calculate the carrying value of each bond. This meant the use the amortized cost for the bond rated 1, and the minimum of the fair value and amortized cost for bonds rated 3 & 6.

Common errors include:

- Using the amortized cost for the bond rated 3
- Using amortized cost for the bond rated 6
- Using the actual cost for the bond rated 6.

Part b

Candidates were expected to identify and explain three concerns with the balance sheet.
Common errors include:

- Identifying a concern, but not giving an explanation on why it is concerning
- Only identifying 2, 1, or no concerns
- Listing the proportion of preferred to common stocks as a concern, but not the amount of total stocks as a concern
- Listing that the 6 rated bond was a concern, but not the overall mix of bond ratings.
- Listing amount recoverable from reinsurance. There is not enough information available, without looking at Schedule F, to determine whether the level of recoverables is problematic

QUESTION 14

TOTAL POINT VALUE: 2.5	**LEARNING OBJECTIVE: C1**

SAMPLE ANSWERS

Part a: 2 points

Sample 1

1) 900
2) 80
3) 0
4) 150
5) 20
6) 150
7) 1300