16. (2 points)

Given the following information for 2016 (in thousands of dollars):

	Company A	Company B
Direct Written Premium	2,200	6,500
Assumed Written Premium	1,000	300
Ceded Written Premium	700	200
Policyholders' Surplus	820	2,400
Net Underwriting Profit	250	400

Company A's distribution of net written premium:

Fire and Allied Lines	60%
Homeowners	40%

Company B's distribution of net written premium:

Commercial General Liability	55%
Workers Compensation	45%

a. (1 point)

Based on the information above, describe two reasons why a regulator may be more concerned about the financial health of Company A than Company B.

b. (1 point)

Based on the information above, describe two reasons why a regulator may be more concerned about the financial health of Company B than Company A.

CONTINUED ON NEXT PAGE

- Stating that is the insurer and not the reinsurer who became insolvent and then tried to describe the impact of the insurer's insolvency

QUESTION 16	
TOTAL POINT VALUE: 2	**LEARNING OBJECTIVE: C2**
SAMPLE ANSWERS	

Part a: 1 point

Any two of the following:

- Compare IRIS Ratio 1:
  Company A: (2200 + 1000)/ 820 = 3.9
  Company B: (6500+300)/2400 = 2.8.
  Company A is more leveraged (3.9 > 2.8)
- Compare IRIS Ratio 2:
  Company A: (2200+1000-700)/820 = 3.05
  Company B: (6500+300-200) = 2.75
  - Company A IRIS 2 > 300% outside of range of usual values OR
  - Company A IRIS 2 > Company B IRIS 2 (3.05 > 2.75) thus Company A is more leveraged.
- Disparity between IRIS 1 and 2 is larger for A (3.9 vs 3.05) than B, thus insurer A may be relying too much on reinsurance (higher credit risk).
- Compare Assumed Premium / Gross Written Premium. Company A has higher ratio 1000/(2200+1000) = 31.25% compared to B, 300/(6500+300) = 4.41%. An insurer generally has less control over assumed business
- Compare Ceded Premium / Net Written Premium. Company A has a higher ratio 700/2500 = 28% compared to B 200/6600 = 3%. A is more reliant on reinsurance which poses a credit risk for uncollectable reinsurance.
- Compare lines of business:
  - Company A writes property lines of business, which are prone to catastrophes OR
  - Company A writes lines that are not well diversified. HO and Fire and Allied Lines are both prone to fire risks OR
  - Company A writes personal lines insurance (HO) which has less sophisticated insureds/voter concerns

Part b: 1 point

Any two of the following:

- Compare Net UW profit/ NWP (A: 10% vs B: 6.1%) OR Net UW profit/GWP (A: 7.8% vs B: 5.9%) OR Net UW profit/Surplus (A: 30.5% vs B: 16.7%) – Company B is less profitable than Company A
- Compare line of business:
  - Company B has longer tail lines with a higher chance of
    - adverse development OR
    - Mass Torts OR
    - asbestos and environmental claims.

- o Company B has Worker Compensations which is a mandatory coverage
- Compare Ceded Premium / Net Written Premium. Company B only has 3% ceded. Given this is a long tail line, there is concern regarding adequacy of reinsurance protection.
- IRIS Ratio 2 for Company B is 275% which is close to 300%. Since Company B insurers long tail lines, they should have lower ratios and more surplus due to increase reserving risk.
- For Company B, Since IRIS Ratio 1 and 2 are close (2.8 vs 2.75) indicates a lack of reinsurance protection.

EXAMINER'S REPORT

Candidates were expected to analyze financial data for two companies and describe how a regulator might interpret the results in reviewing the financial health of the companies. Candidates were able to apply a wide range of syllabus material to perform the analysis.

Part a

Candidates were expected to calculate two metrics that show Company A is in a better financial condition than Company B and to briefly describe how a regulator might interpret each result.

Common errors include:

- Listing a reason without a valid justification for regulator concern. For example, simply listing IRIS ratios without noting unusual values or whether one value was higher than the other
- Basing justification on information not provided in the question. For example, a higher ceded premium may indicate a reliance on surplus aid but no information on reinsurance commission rates nor unearned premiums for non-affiliates was provided to make this determination
- Listing a low profit or surplus value without considering the magnitude of the value in relation to other information. Profit amount for A is 250 which is lower than B (400) but profitability of A in relation to Surplus is higher than B (250/820 = 30.5% vs 400/2400 = 16.7% respectively).

Part b

Candidates were expected to calculate two metrics that show Company B is in a better financial condition than Company A and to briefly describe how a regulator might interpret each result.

Common errors include:

- Listing duplicate reasons. For example, stating there should be more concern for company B because (i) these long tail lines have a higher chance of adverse development compared to the short tail lines in A and (ii) these long tail lines have a higher chance of mass torts compared to the short tail lines in A. Although the justifications are different, the reason is the same (e.g., compare the line of business).