4. (1.75 points)

   a. (0.25 point)

      Briefly describe why financial strength ratings are more important for insurance companies than grocery stores.

   b. (0.5 point)

      Briefly describe two reasons why financial ratings of reinsurance companies are important. Do not use the reason provided in part a. above.

   c. (0.5 point)

      Briefly describe two reasons why rating agencies may prefer stability over responsiveness when issuing financial strength ratings.

   d. (0.5 point)

      An insurer becomes aware of a potential for material adverse development of its reserves.

      i. Briefly describe one argument in favor of the insurer sharing this information proactively with its rating agencies.

      ii. Briefly describe why an insurer may be concerned with sharing this information proactively with its rating agencies.

CONTINUED ON NEXT PAGE

Part c
Candidates were expected to know the weaknesses of the credit reporting system and how those led to regulatory concerns for rating purposes. Common errors include: • Omitting the impact to premiums or rates. • Listing privacy as a regulatory concern. This is unrelated to determining premiums.

FALL 2018 EXAM 6US, QUESTION 4	
TOTAL POINT VALUE: 1.75	**LEARNING OBJECTIVE: A3**
SAMPLE ANSWERS	
Part a: 0.25 point	
• It helps to know whether the insurance company is able to pay for my losses as promised and this is not expected of grocery stores • For insurance companies need a high rating (A) to write certain types of insurance (like surety). Grocery stores don't need financial strength ratings to sell certain produce. • Independent agent use the ratings to place business with higher rated insurers. Independent agents do not place business with a grocery store. • Insurance company customers are more uninformed than grocery store customers and thus use financial strength ratings to help them decide where to buy their product (insurance policy)	
Part b: 0.5 point	
• Most reinsurers are not located/domiciled in the U.S. so this can assist in providing an idea of how financially strong a reinsurer is • Insurers may be hesitant to cede business to low rated reinsurers so could affect reinsurer's ability to be competitive in the market • Financial ratings also signal to primary insurers the ability of a reinsurance company to be able to fulfill covered claims in case of a CAT. Many insurers have gone liquidated due to reinsurance uncollectable especially during/after a CAT. • Reinsurers with high financial strength ratings may be able to charge more premium to primary insurers • It directly impacts their collateral required to post to ceding companies. A better rating leads to less collateral needed. • Small reinsurers w/ strong rating can compete against larger reinsurers. • Some insurers require the use of highly rated reinsurers • If a reinsurance company rating drops, the insurers may wish to exercise a commutation • Insurers don't want higher liability on their balance sheet for the provision for reinsurance so may opt for higher ratings. • Insurer's Appointed actuary looks at these when commenting in SAO relevant comments about reinsurance collectability • Investors use them to see if they want to invest in company • So primary insurers can efficiently choose a reinsurer	
Part c: 0.5 point	

- They'll lose clients if too responsive and wrong
- If they are too responsive and they issue wrong ratings people won't trust their ratings so they'll lose the trust of the people who depend on ratings to make decisions
- Results often vary year to year, looking too short term may not identify long term issues
- Stability is a better indicator of long-term financial health of a company than responsiveness. Since rating agencies cannot update ratings frequently due to resource constrains and the negative view of overturning ratings often, they must look at the long-term health of a company.
- Overly responsive companies may take more risks in order to respond to immediate needs. Companies that take on too much risk may be concerning to rating agencies.

Part d: 0.5 point

- Shows they have integrity. It would be detrimental to their ratings if they do not disclose this and the rating agency finds out.
- They can show they are being proactive about it and management is taking steps to mitigate the risk
- They don't want to receive a downgrade
- Could negatively impact ratings but never occur to the extent anticipated

EXAMINER'S REPORT

Candidates were expected to describe the purposes of financial strength ratings, and to understand the rationale behind how both the rating agencies and insurers approach the rating process.

Part a

Candidates were expected to give a reason why financial strength ratings would be important for insurers, and not as important for grocers.

Common errors include:

- Explaining a purpose of financial strength ratings without explaining why it's more important for insurers over grocery stores.
- Providing an answer that doesn't explain the importance of the ratings for insurance companies.

Part b

Candidates were expected to briefly describe two ways that financial strength ratings are particularly important to reinsurers. There were many acceptable possible answers.

Common errors include:

- Confusing rating agencies with regulators and attributing legal authority to rating agencies.
- Responding for as a primary insurer and not a reinsurer.
- Repeating the reason from part a.

Part c

Candidates were expected to give two reasons why rating agencies would prefer to have stable ratings year to year instead of highly responsive rating. Some candidates interpreted the question to mean why rating agency would rate a stable insurer more highly than a responsive insurer.

Common errors include:

- Stating that a downgrade would be harmful for the insurer or other stakeholders tied to the insurer, without noting any consequences for the rating agency.
- Stating that a changing a rating would be more expensive for the rating agency than maintaining the rating for an insurer.
- Not being able to define what a "responsive insurer" is, what they would be responding to, or what action they would take that would be viewed unfavorably.
- Implying a causal relationship between the fact that markets are already responsive and that rating agencies prefer stability. For example, stating that markets can respond quicker so therefore rating agencies prefer to keep their ratings stable.

Part d

Candidates were expected to briefly describe one reason why an insurer would want to disclose a potential material adverse deviation to their rating agency, and one reason why they would not want to disclose this.

Common errors include:

- Confusing rating agencies and regulators or indicating that not fully disclosing information to a rating agency was illegal.
- Stating that allowing the rating agency to come to a lower rating is a reason to disclose.

FALL 2018 EXAM 6US, QUESTION 5	
TOTAL POINT VALUE: 2.25	**LEARNING OBJECTIVES: A3, A4**
SAMPLE ANSWERS	
Part a: 0.75 point	

Bolded sample answers indicate unique subject responses, any one of which was required. Italicized sample answers are common variations on the unique response.

Assembles insurance data from various organizations

- *Collect data on insurance industry*
- *Gather data on insurance from insurers and even NAIC*
- *Aggregate/gather data for insurance industry*

Identifies insurance activities that could contribute to a broader US financial systemic crisis

- *ID activities that could lead to a systemic financial crisis*
- *Help identify practices that could lead to systemic crisis*
- *They compile/aggregate insurance information from multiple sources*
- *Monitors the insurance industry*