

EXAM 6 – UNITED STATES, FALL 2018

10. (3.5 points)

The following information is from an insurer's 2017 Annual Statement (all figures are in thousands of dollars):

Investment	Original Cost	Amortized Cost	Fair Value
Bonds NAIC Class 1	5,000	4,500	4,250
Bonds NAIC Class 2	6,250	6,350	6,500
Bonds NAIC Class 3	5,850	6,000	5,750
Admitted Common Stocks	1,000	N/A	1,750

- Assume the investments above represent the insurer's entire investment portfolio.

Cash	1,250
Office Equipment	500
Agents' Balances <= 90 Days Past Due	200
Agents' Balances > 90 Days Past Due	100
Loss and Loss Adjustment Expense Reserves	10,000
Liability for Pending Litigation	250
Other Statutory Balance Sheet Liabilities	125

a. (1.25 points)

Calculate the value of the insurer's investment portfolio that would appear in its 2017 statutory balance sheet.

b. (1.75 points)

Calculate the insurer's 2017 statutory surplus.

c. (0.5 point)

Briefly explain the impact on the insurer's reported 2017 statutory surplus for each of the following events:

- The agents' balances previously greater than 90 days past due were collected after the balance sheet date but before the financial statements are issued.
- The company's litigation is settled for \$350,000 after the balance sheet date, but before financial statements are issued.

SAMPLE ANSWERS AND EXAMINER'S REPORT

- Not explaining the funding mechanisms of the state WC fund (goal is to be self-sufficient and cannot levy taxes at will).
- Stating that the taxpayers would be liable if the state fund has a bad year (or few years) of performance.
- Arguing that bundling / packaging discounts no longer available for insureds.
- Stating that the state would lack necessary expertise to run WC fund (e.g. no actuaries or claims professionals) / state lacks data to price. A state fund would have the ability to hire experts.

Part c

Candidates were expected to know the basic mechanisms of a residual market and its operations and compare / contrast to an exclusive or competitive government WC fund.

Common errors include:

- Stating that the residual market is either in direct competition with the private market or state WC fund, or that it is operated directly by the state
- Stating that the state WC fund is involved with the federal government or is backstopped by the federal government.
- Not understanding the purpose of the residual market as a mechanism for high risk insureds
- Stating that one or the other of the programs has a profit motivation while the other does not.
- Simply stating availability as a similarity without describing the “take all comers” approach.
- Describing affordability as a similarity. Affordability is not a primary concern for residual markets.

FALL 2018 EXAM 6US, QUESTION 10

TOTAL POINT VALUE: 3.5

LEARNING OBJECTIVE: C1

SAMPLE ANSWERS

Part a: 1.25 points

Sample 1

- Bond 1: Carried at amortized cost – 4,500
- Bond 2: Carried at amortized cost – 6,350
- Bond 3: Lesser of amortized cost and fair value – 5,750
- Common Stock: Fair value – 1,750
- Total = 4,500+6,350+5,750+1,750 = 18,350

Part b: 1.75 points

Sample 1

- Total Admitted Assets = 18,350+1,250+0+200=19,800

SAMPLE ANSWERS AND EXAMINER'S REPORT

- Bonds + Common Stock from Part a. – 18,350
- Cash – 1,250
- Office Equipment: non-admitted – 0
- Agents Balances <= 90 days Past Due – 200
- Total Liabilities = 10,000+250+125=10,375
 - Loss and Loss Adjustment Expense Reserves – 10,000
 - Liability for pending litigation – 250
 - Other liabilities – 125
- Surplus=(Total Admitted Assets)-(Total Liabilities) = 19,800-10,375 = 9,425

Sample 2

Assuming that pending litigation is included in the Loss and LAE

- Total Admitted Assets = 18,350+1,250+0+200=19,800
 - Bonds + Common Stock from Part a. – 18,350
 - Cash – 1,250
 - Office Equipment: non-admitted – 0
 - Agents Balances <= 90 days Past Due – 200
- Total Liabilities = 10,000+125=10,125
 - Loss and Loss Adjustment Expense Reserves – 10,000
 - Liability for pending litigation – 0
 - Other liabilities – 125
- Surplus=(Total Admitted Assets)-(Total Liabilities) = 19,800-10,125 = 9,675

Part c: 0.5 point

Sample Responses for part i

- The insured cannot include these as admitted assets when preparing its balance sheet. \$0 impact to surplus
- Immaterial impact, no change to surplus

Sample Responses for part ii

- The insured should reflect this additional liability. Surplus would decrease by 100,000
- The insured should reflect this additional liability. Surplus would decrease by 349,750
- This is only \$100,000 on a surplus of \$9M, so may not be material enough to require a change
- Immaterial impact, no change to surplus

EXAMINER'S REPORT

Candidates were expected to know how to properly value various investments in a portfolio, calculate the statutory surplus based on existing liabilities and admitted assets, and opine on the impact of subsequent events to the surplus.

Part a

Candidates were expected to know how to properly value each of the Bond NAIC classes as well as the Admitted Common Stocks and add them together to get the full value of the investment portfolio.

Common errors include:

SAMPLE ANSWERS AND EXAMINER'S REPORT

<ul style="list-style-type: none"> • Not adding together the investments • Selecting the wrong valuation base • Including cash or other admitted assets
Part b
Candidates were expected to know how to differentiate admitted and non-admitted assets, calculate total liabilities, and subtract liabilities from assets to obtain the 2017 statutory surplus.
A common error was including the non-admitted assets such as "Office Equipment" in the calculation of admitted assets.
Part c
Candidates were expected to know how to adjust surplus for subsequent events.
Common errors include: <ul style="list-style-type: none"> • Stating that the non-admitted assets would be reflected in the surplus • Stating that the liability for pending litigation would not impact surplus without commenting on materiality • Stating that the events are Type 2 subsequent events and therefore would not be reflected in the financial statements (both events are Type 1 subsequent events).

FALL 2018 EXAM 6US, QUESTION 11	
TOTAL POINT VALUE: 2.25	LEARNING OBJECTIVE: C1
SAMPLE ANSWERS	
Part a: 0.75 point	
<u>Sample 1</u>	
Net investment income earned = 500 – 50 = 450	
Part b: 1 point	
<u>Sample 1</u>	
Changes to surplus = -50 + 100 = 50	
Investment Gain = 450 + 100 = 550	
1700 + 50 + 550 + UW Income = 2350	
UW Income = 50K*	
*(Ignores Federal Tax)	
<u>Sample 2</u>	
Prior Surplus	1700
Net income	+X
Δ Unrealized Cap Gains	(50)
Δ Reins	<u>-100</u>
	2350
UW Inc =	X
Net II	+ 450
Net Cap Gain	+ 100
	Net income = 800