11. (2.25 points)

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

Balance Sheet	Current Year	Prior Year
Total Surplus	2,350	1,700

Additional information for this insurer for calendar year 2017:

Losses Paid	600
Loss Adjustment Expenses Paid	70
Other Underwriting Expenses Incurred	300
Gross Investment Income	500
Investment Expense	50
Net Realized Capital Gains	100
Change in Net Unrealized Capital Gains (Losses)	(50)
Change in Provision for Reinsurance	100

a. (0.75 point)

Calculate the insurer's 2017 net investment income earned.

b. (1 point)

Calculate the insurer's 2017 underwriting income.

c. (0.5 point)

Describe the circumstances under which an insurer should record a non-zero premium deficiency reserve on its balance sheet.

CONTINUED ON NEXT PAGE

• 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: • 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	
Sample 1 Net investment income earned = 500 – 50 = 450	
Part b: 1 point	
Sample 1 Changes to surplus = -50 + 100 = 50 Investment Gain = 450 + 100 = 550 1700 + 50 + 550 + UW Income = 2350 UW Income = 50K⋆ ⋆(Ignores Federal Tax) *Sample 2* Prior Surplus 1700 Net income +X Net income = 800 Δ Unrealized Cap Gains (50) Δ Reins -100 2350 UW Inc = X Net II + 450 Net Cap Gain + 100	

Net Income = 800 UW Inc = 250 Assume No tax
Part c: 0.5 point
• When a Co has reason to believe that the unearned premium reserve will not be sufficient to pay for associated losses + expenses. • A non-zero PDR should be recorded if the unearned premium is less than the expected loss + LAE and maintenance costs on the unexpired portion of the policy. This is evaluated consistent with how policies are marketed and serviced. • If the insurer suspects that the unearned premium reserve is not adequate to cover expected future losses, they should recognize a premium deficiency reserve. This is not the same as deterioration in losses which have already occurred; the premium deficiency reserve only covers future losses. • If the UEPR is inadequate to cover expected losses/expenses. May consider investment income, but must be disclosed and would still be nonzero if UEPR + II < losses/expenses. • If the unearned premium reserve and deferred acquisition cost is smaller than the expected losses and policy maintenance costs for the unexpired portion of the policy. • When UEPR is not enough to cover exp. Loss & LAE, policy's maintenance expense. Investment income can be used to offset cost in profit determination – will disclose. If SAP, no DAC considered. If GAAP, DAC can be considered. UEPR – Exp Loss & LAE – Main. Expense If this eq'n < 0 and DAC (if GAAP) is exhausted, then PDR >0. • If there is a premium deficiency reserve that is still possible (and positive, can't be negative) after subtracting investment income and DPAC (deferred policy acquisition costs) then a non-zero PDR is recorded. • When it is not offset by deferred premium acquisition costs.
EXAMINER'S REPORT
Candidates were expected to have an understanding of the statutory financial statements and the statutory definition of values contained therein.
Part a
Candidates were expected to calculate net investment earned as it is defined in line 9 of the income statement. Common errors include: • Calculating Net Investment Gain instead of Net Investment Income Earned • Including the change in net unrealized capital gain/loss • Subtracting taxes
Part b
Candidates were expected to understand net income, including underwriting, investment and other income, is added to beginning of year surplus along with other surplus changes to calculate end of year surplus in the Capital and Surplus Account section of the Statement of Income.

Candidates were expected to solve for underwriting income given other items from the balance sheet and Capital and Surplus section. Common errors include: • Including or excluding needed items from the table of information. • Adding deferred tax savings from the change in net unrealized capital gains. This isn't necessary. Net unrealized capital gains is already net of deferred taxes. • Subtracting taxes from net realized capital gains. The notes in line 10 provide the capital gains taxes where "net" means net of taxes. Capital gains gross of taxes is found in the Exhibit of Capital Gains (Losses).
Part c.e
Candidates were expected to provide the specifics of when a premium deficiency reserve (PDR) needs to be recorded as a liability on the balance sheet. Specifics based on either statutory or GAAP guidance were accepted. Common errors include: • Timing of premiums or losses/expenses unclear or imprecise. For example, an insurer should record a PDR if it expects that collected premiums will not be enough to cover losses and expenses. Premiums could have been collected years ago and associated losses and expense may have already occurred. The point of the PDR is to recognize an anticipated deficiency in future earnings which the insurer can do nothing to address (either through rate increases or non-renewal). • Timing of premiums or losses/expenses is in the past. For example, an insurer should record a PDR when premium earned is less than incurred losses and incurred expenses. This deficiency would impact surplus through the income statement without the existence of a PDR through an underwriting loss.

FALL 2018 EXAM 6US, QUESTION 12	
TOTAL POINT VALUE: 2	**LEARNING OBJECTIVE: C1**
SAMPLE ANSWERS	
Part a: 1 point	
Sample Responses for Medical Professional Liability – Claims-Made • Report Year • By date claim was reported to insurer *Sample Responses for Commercial Auto Liability/Medical - Occurrence* • Accident Year • Calendar/Accident Year • By date the loss occurred • Occurrence Year *Sample Responses for Products Liability – Tail Coverage* • Policy Year • Accident Year	