

EXAM 6 – UNITED STATES, FALL 2018

16. (3.75 points)

Given the following information from an insurance company's 2016 and 2017 Annual Statements and Insurance Expense Exhibits (all figures are in millions of dollars):

Insurance Expense Exhibit, Part II	2017
Premiums written	501
Premiums earned	402
Dividends to policyholders	13
Incurred losses	154
Defense and cost containment expenses incurred	35
Adjusting and other expenses incurred	26
Unpaid losses	1,557
Defense and cost containment expenses unpaid	358
Adjusting and other expenses unpaid	259
Unearned premium reserves	201
Agents' balances	302
Commission and brokerage expenses incurred	113
Taxes, licenses & fees incurred	54
Other acquisition, field supervision, and collection expenses incurred	45
General expenses incurred	66
Other income less other expenses	-17
Investment gain on funds attributable to insurance transactions	98
Investment gain attributable to capital and surplus	129

Balance Sheet and Statement of Income	2016	2017
Nonadmitted assets	191	150
Net realized capital gains before capital gains tax	162	141
Capital gains tax (on net realized capital gains)	73	72
Federal and foreign income taxes incurred	84	83
Provision for reinsurance	185	134
Dividends to stockholders	116	105
Change in net unrealized capital gains after capital gains tax	-37	-46
Surplus as regards policyholders	358	

Calculate the company's 2017 IRIS ratio 7 (Gross Change in Policyholders' Surplus), and identify whether it is within the range of usual values.

SAMPLE ANSWERS AND EXAMINER'S REPORT

- Identifying the reinsurer as slow paying without stating the reason (i.e. the ratio is >20%).
- Correctly determining that reinsurer A is slow paying, but incorrectly using the non-slow pay formula to determine the provision for reinsurance.
- Calculating the slow pay ratio incorrectly by including total recoverable amounts (both paid and unpaid) rather than just the unpaid recoverables in the denominator.
- Not including amounts in dispute in the Reinsurer A provision calculation.
- Incorrectly multiplying the unsecured recoverables in the reinsurer B provision calculation by 0.2.

Part b

Candidates were expected to briefly explain two ways in which the primary insurer could reduce its provision for reinsurance while continuing to cede a portion of its losses.

Common errors include:

- Stating that the insurer should write more reinsurance with authorized reinsurers without stating that the insurer should make a change to its existing reinsurance arrangements (i.e. writing more reinsurance or ceding more of its book will not lower the provision).
- Changing overdue threshold from 90 days to some other number of days. This is incorrect since the provision is the result of a mandated formula.
- Stating that the insurer should change the due date rather than stating that the insurer adjust the reinsurance contract to require payment within a certain window of time after the due date (e.g. 60 days) to prevent a slow-paying designation.
- Stating that Reinsurer B should become certified or authorized. However, the question asked what actions the primary insurer could take to reduce its provision.

FALL 2018 EXAM 6US, QUESTION 16

TOTAL POINT VALUE: 3.75

LEARNING OBJECTIVE: C1, C2

SAMPLE ANSWERS

Sample 1:

EP:	402
Inc Loss:	-154
DCC Inc:	-35
A&O Inc:	<u>-26</u>
UW Gains:	187
 	
Comm+Brok:	113
TLF:	+54
Other Acq:	+45
Gen Exp:	<u>+66</u>
Other Exp:	278

SAMPLE ANSWERS AND EXAMINER'S REPORT

Div to PH:	-13
Other Inc less Exp:	<u>-17</u>
Other Inc:	-30
Inv gain from Ins:	98
Inv gain from cap and surplus:	<u>129</u>
Net Inv Inc:	227
IEE's Profit:	106 (=402+187-278-30+227)
Cap Gains Tax:	-72
FIT:	-83
Change in Nonadm Assets:	+41 = -(150-191)
Change in Prov for Rein:	+51 = -(134-185)
Change in Net Unreal Cap Gns:	-46
Div to SH:	<u>105</u>
Change in PHS:	-108
IRIS Ratio 7:	-30% = -108/358

This is outside the range of normal values of -10% to 50%

Sample 2:

Same as Sample 1 through -108

2017 PHS:	250 = -108+358
IRIS Ratio 7:	-30% = 250/358 -1
This is outside the range of normal values of -10% to 50%	

EXAMINER'S REPORT

Candidates were expected to be able to identify which components from a set of financial data were needed to calculate IRIS Ratio 7, then calculate and interpret the Ratio.

Common errors include:

- Including Net Realized Capital Gains
- Calculating the Change in Unrealized Capital Gain incorrectly
- Not including the Federal and foreign income tax
- Not including the Capital gains tax