13. (2.5 points)

An insurance company has implemented an aggressive growth strategy.

a. (1.5 points)

Assuming the insurance company does not buy reinsurance, describe the impact of the growth strategy on the following statutory accounting items for the insurance company:

i. Net Underwriting Gain (Loss)

ii. Net Investment Gain (Loss)

iii. Net Income

b. (1 point)

Assuming the insurance company buys reinsurance that qualifies for reinsurance accounting, describe the impact of reinsurance on the following statutory accounting items for the insurance company:

i. Net Underwriting Gain (Loss)

ii. Net Investment Gain (Loss)

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- Mistakenly calculating Admitted Assets as Surplus minus Liabilities rather than Surplus plus Liabilities.
- Failing to recognize that Liabilities plus Surplus equals Admitted Assets, not Total Assets, and consequently failing to add non-admitted assets to Liabilities plus Surplus to get Total Assets.
- Failing to recognize that in the derivation of direct charges to surplus, the changes in non-admitted assets and provision for reinsurance should be prior less current, not current minus prior.
- Inclusion of extraneous items (such as policyholder dividends, finance/service fees or investment income) in the calculation of Total Assets.
- Treating the information as being GAAP and/or adjusting for taxes

The question asked for Total Assets; exam instructions dictate that unless specifically stated otherwise, all responses should be answered according to US statutory accounting principles and policies.

Part b

Candidates were expected to identify a specific example of a non-admitted asset and explain why it was treated as non-admitted for statutory reporting purposes.

Common errors include:

- Providing illiquidity as the reason for the asset being non-admitted when in fact it is because of concerns with collectability.
- Answers too vague, i.e. "the asset not being available in the event of insolvency" rather than giving collectability or illiquidity as the specific reason for it being treated as non-admitted.

FALL 2019 EXAM 6U, QUESTION 13	
TOTAL POINT VALUE: 2.5	**LEARNING OBJECTIVE: C1**
SAMPLE ANSWERS	
Part a: 1.5 points	

Sample Responses for subpart i.

- This may be a concern as insurance is growing a lot, they may not have understanding of exposure risk and without reinsurance protection underwriting gain (loss) may be lower, due to more losses.
- This would decrease the net underwriting gain (loss), lower profit/higher loss, as this likely means they have lower underwriting standards.
- As insurer writes more business, depending on quality of new business it can be a gain or loss.

Sample Responses for subpart ii.

- With more growth and not ceding any premium away, the insurer can invest more which will likely increase the net investment gain if the investment performance is not negative.

- Could invest in riskier assets to try and make more investment income. This could be very volatile and could either yield large profits or large losses.

Sample Responses for subpart iii.

- This will be the total underwriting gain plus investment gain and if the investment gain helps offset any losses, net income can be positive.
- Net Income will increase as underwriting profit and investment gain increase. If prior assumptions about new business remaining similarly profitable do not hold, net income may decrease as new growth leads to higher underwriting losses.

Part b: 1 point

Sample Responses for subpart i.

- Net underwriting gain (loss) may increase since they are ceding riskier business.
- This will stabilize underwriting gain/losses. This could limit the downside through XOL covers (i.e. loss cat exposed).
- Net underwriting gain (loss) may not change if the insurer buys reinsurance to maintain original net risk retention and cede additional acceptance to reinsurers.
- Usually, the underwriting gain will be slightly worse as the reinsurance premiums will necessarily (due to profit load, expenses, etc.) be higher than exposure the company cedes.
- Assuming the reinsurance company is able to add insight into the rapidly growing lines of business the company should see an increase in net underwriting gain.

Sample Responses for subpart ii.

- Since they are ceding out premium, there will be less premium to invest so dollar wise investment income may reduce.
- Net investment gain (loss) may not change if additional premium is spent for reinsurance cost, money available for investment remains unchanged.

EXAMINER'S REPORT

Question requires knowledge of income statement components with and without reinsurance, and application of knowledge to a specific business situation.

Part a

Candidates were expected to discuss how the income statement components would be impacted by a specific business situation in the absence of reinsurance.

Common errors include:

- Not providing an explanation.
- Stating that underwriting gain would decrease in the case of large/catastrophe losses without discussing the growth context.
- Stating that there would be no impact on investment gain.
- Stating the company will have higher expenses without making a connection to lower investment gain

- Not identifying that net income = net underwriting gain plus net investment gain.
- Underwriting gain will increase because premium will be earned immediately but losses won't materialize until later without an explanation why.

Part b

Candidates were expected to discuss how the income statement components would be impacted by reinsurance, given a specific business situation.

Common errors included:

- Stating that reinsurance would result in only ceded premium or only ceded losses.
- Stating that there would be no impact on investment gain.
- Stating that ceding commission would increase the amount of investable assets without further explanation (ceding commission offset the loss of assets from paying for reinsurance but doesn't produce a net increase in assets).
- Providing no explanation for the provided direction (gain/loss).

FALL 2019 EXAM 6U, QUESTION 14	
TOTAL POINT VALUE: 2.5	**LEARNING OBJECTIVE: C1**
SAMPLE ANSWERS	
Part a: 1.25 points	

Calculate claim closure rate

2014: (175 – 25) / 175 = 85.7%
2015: (180 – 29) / 180 = 83.9%
2016: (212 – 35) / 212 = 83.5%
2017: (245 – 44) / 245 = 82.0%

Or using closed with pay

2014: 135 / 175 = 77.1%
2015: 139 / 180 = 77.2%
2016: 159 / 212 = 75.0%
2017: 181 / 245 = 73.9%

Identify trend

The closure rate is decreasing

Any two of the following explanations for the trend:

- Reduction in staffing levels
- Growth in book without a commensurate increase in staff
- Influx of claims resulting from the occurrence of a catastrophe
- Increasing claim reported count or frequency
- Change in focus to settling large or complex claims
- Change in claims methodology or process that slowed closure

Part b: 0.5 point