

## EXAM 6 – CANADA, FALL 2012

17. (1.75 points)

The Property and Casualty Insurance Compensation Corporation (PACICC) is designed to provide recovery to policyholders when an insurer doing business in Canada fails. Since its inception in 1988, it has successfully managed several such failures.

a. (1 point)

Insurers that failed in the past were relatively small. Considering the consolidation and growth of the P&C insurance market, evaluate whether PACICC is well positioned financially to handle insurer insolvencies in the future.

b. (0.75 point)

Other than company size, briefly describe three common characteristics of insolvent companies.

CONTINUED ON NEXT PAGE

- If government has a relief program flood prone areas will continue to be developed
- Will encourage you make less effort to control flood damages
- Government rates would be subsidized, some cross subsidy between low and high risk
- Could create a social burden
- Would not have claims settlement expertise
- Market would not be competitive

**Actual candidate answer for full marks:**

- Because it will create an antiselection, only people who need it will purchase the insurance. To pay for those damages, premiums would have to be very expensive.
- To cover all types of flood and to adapt bounding approach (include to base coverage) to have higher penetration rates.
- Risk base rates (actuarially sound)
  - Presence of deductibles and variation of those with premium paid to encourage prevention behaviour.
  - Exclude high risk clients/areas (flood prone areas).
- To have enough fund for compensations (and not subsidize)
  - Encourage preventive behavior/awareness of the risk by the public.
  - To maintain premiums affordable for low level risks
- It is not actuarially sound (subsidizing by the government)

**Examiner's report:**

Common mistakes:

- Because insureds assumed their HO policy included coverage (not logical since insurers knew it ...) Difficult to price (many risks are difficult to price are done nonetheless e.g., CN tower)
- ok
- Common mistake on deductibles: first portion of loss
- Comment: The order of the points was not considered in grading.
- Common mistake: private insurance is better ... (not a sufficient answer)

## Question 17

**Answer key:**

- Need 4 to get full credit.  
Possible arguments to support that PACCIC is in good financial position:
  - Because PACCIC could decide to make special assessment or increase the assessment rates
  - Because a small reserve already exist
  - Letter of credit
  - Acquiring firms usually have experienced management, so not as worrisome ...
  - The plan only provides basic compensation only, not full
  - OSFI will allow only acquisitions that are "safe", will not jeopardize financial soundness
  - Canada less prone to catastrophe, ex: less hurricane and tornadoes than US (arguable)
  - Etc

Also Accepted:

- Less liability from unearned premium as policyholder pay monthly premium (less money owned by insurer that is due to policyholder)
- OSFI, MCT and other tests help reduce the likelihood of an insolvency, but if it happens, likely to be smaller
- PACCIC recover insurers assets when sold (liquidity risk)
- Access to subrogation (third party payer)

Possible arguments to support that PACCIC is not in good financial position:

- Because assessments rates are not high enough.
- The plan was initially designed to deal with a median insurer but the size has now increased
- Reserve is too small
- Top 10 insurers are now too big
- Etc

b) Any 3 of the following 6

- Ownership : 31% were subsidiaries or branches of a failed parent company
- Type of license : two-thirds were federally supervised
- Age : 28% of insolvent Canadian insurers operated for less than 10 years
- Growth : 68 % experienced unusual growth in premiums
- Underwriting : 70% occurred in property and auto lines (type of business)

Also Accepted:

- Lack of internal controls
- Poor management/not very experienced management
- One or both of "Inadequate pricing and reserves "

**Actual candidate answer for full marks:**

a) No, the PACICC is not well positioned financial to handle future insolvencies because:

- the avg insurer has grown substantially
- general assessment that can be applied to members has a cpa
- compensation fund needs to increase
- needs to increase capital available to handle an insolvency quickly and fully

b) –rapid growth

- firms that grow too rapidly face threats of insolvency when UW cycle hits a soft market and profitability deteriorates

c)

–foreign parent

- Firms with foreign parents sometimes need to provide capital to the parent firms to offset their losses and provide policyholder dividends
- The capital strain from being responsible for a parent company's profitability could influence insolvency in secondary markets

–Years in business

- experience in the current industry and market greatly affects an insurers ability to make strategic and operational decisions

→the wrong decision can result in losses and insolvency

**Examiner's report:**

- a. This is a question to evaluate a candidate ability to make a judgment. Therefore, many answers could be acceptable and there are no "right" answers per se. Solid arguments could be made on both sides. But by mentioning to the candidate to focus on the financial capacity, we narrow it down and avoid a discussion about operational concerns.
- b. Common Mistake: Failure from a reinsurer  
Answer not acceptable :
  - Size : 68% had less than \$10 million in capitalComment: This part was generally responded to well, with many candidates received full credit.

## Question 18

**Answer key:**

- a. No, only private passenger vehicles can be ceded
- b. Yes, motorcycle can be ceded to the pool
- c. No, the premium transferred for the risk must have been determined according to the Insurer's Standard Rate Manual
- d. Yes, the risk meets the compulsory minimum limit. Can be ceded even though the vehicle is stored.
- e. Yes, a risk transferred shall be insured under third party liability for at least the Quebec compulsory minimum limit, which is \$50,000.

**Actual candidate answer for full marks:**

- (a) No, this a residual risk
- (b) Yes. No restrictions in PQ for motorcycle & limits can be endorsed
- (c) No, special discount not allowed, premiums must be approved
- (d) Yes allowed, no restrictions on seasonality of use as long as insurer is ok with sharing the risk
- (e) Yes allowed, meets standards for transfer in PQ

**Examiner's report:**

Very few candidates received full marks on this question. It appeared to the graders that numerous candidates had guessed the answers. Common mistakes include the following:

- Most candidates did not know that motorcycles are not accepted in the Ontario RSP but are in the Quebec PRR (RSP).
- A number of candidates did not know that winter storage is not problematic when ceding a risk to the RSP.
- Very few candidates knew that the minimum limit for cessions in Quebec is \$50,000.

On a different note, most candidates know that "flexing" (special discount) was not allowed when ceding to the Quebec RSP, and some even knew that if the broker had flexed the premium, the company could still cede the risk, as long as the unflexed premium was ceded.