20. (1.75 points)

An insurer became insolvent on April 1, 2012. Calculate the amount each of the following insureds would receive from the PACICC plan.

a. (0.75 point)

Paul's vehicle has been insured for the past five years. His last claim of $500 occurred four years ago and was paid in full by the insurer. The annual premium for his one-year policy that began on October 1, 2011 is $2,200.

b. (1 point)

Mary had a homeowner's policy with a $5,000 deductible. The annual premium on her one-year policy effective February 1, 2012 was $450. A fire on March 14, 2012 caused $315,000 of damage. To date, the insurer has not made any payments.

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- Monetary – permit liability claims when the economic loss portion exceeds a specified dollar amount
    - ✧ Alternative answer: based on level of loss

Actual candidate answer for full marks:

a) – Does away with the principle of retribution
   – Higher compensation for victims with a high income

b) – Less delays to receive compensation
   – Less court related expenses
   – Can be compensated if minimally at fault
   – Less uncertainty as to payment recovery

c) – Monetary: If amount of award is higher than threshold, can bring action against liable
   – Descriptive: If injury meets threshold criteria can bring actions.

Examiner's report:

a. Common Mistake: Limits are low
b. Ok
c. Comments : This part was generally responded to well, with many candidates receiving full credit

Question 20

Answer key:

a) We need to calculate the unearned premium, so for the period of April 1st to September 30th. The compensation would be 70% of that amount, limited to $700.
   i. Unearned premium (April 1st 2012 to September 30th 2012) = 6 / 12 * $2,200 = $1,100 ¼
   ii. Compensation = 70% * Min($1,000; $1,100) = $700 ½

b) There are two parts to this compensation: the unearned premium and the claim. So the total premium is $450 = $450

   i. Unearned premium (April 1st 2012 to January 31st 2013): = 10 / 12 * $450 = $375 ¼
   ii. Compensation for the premium = 70% * $375 = $262.5 ¼
   iii. Compensation for the claim for personal property policies is limited to $300,000.
   iv. Mary's loss = $315,000 - $5,000 (deductible) = $310,000 ¼
   v. Compensation = Min($300,000; $310,000) = $300,000 ¼
   vi. Total = $300,262.50

Actual candidate answer for full marks:

a) Recovery = 70% x min (1000$; unearned premium)
   Unearned premium = 6/12 x 2200 = 1100
   Recovery = 700$

b) Unearned premium = 10/12 x 450 = 375$
   Recovery = 0.7 x 375 + min (315 000 – 5 000; 300 000$) = 300 252.58

Examiner's report:
Common mistakes : maximum of $250,000 instead of $300, 000
Forgot to multiply by 70% or used wrong percentage
For part b), a lot of candidates forgot about unearned premium calculation

Question 21

Answer key:
a. (**Students may receive credit for any 3 of the following ratios)**
Return on GAAP Equity: Minimum recommended is 5.4%, so actual 6.2% is favorable. Calculated as net income / Equity. This higher-than-benchmark value for this ratio means that the shareholders are receiving a greater return per unit of invested capital. This can mean that net income was high for 2011, or alternatively, the company may have a smaller equity base that it is using to generate profits.

Return on Revenue: Minimum recommended is 6.2%. Calculated as underwriting income + investment income excluding gains + income from subsidiaries as a percentage of gross written premiums. The 2011 result for the company was less than the minimum recommended benchmark (1.0% < 6.2%). Since the ROE was favorable, it is possible that the company had significant investment income gains or other income in 2011 that would have been included in ROE, but excluded from ROR. It is also possible that the company had very high gross written premium in 2011, with a smaller equity base causing the conflicting result for these ratios.

Return on Assets after Tax: Minimum recommended is 2.6%. Actual 2011 result is higher than the benchmark at 3.5%. Calcualted as after tax net income / average assets. This favorable result is consistent with the ROE favorable result, and both include items like investment income gains and other income, reinforcing the possibility that 2011 net income is driven from at least one of these sources. Alternatively, the company could be generating moderate income from a smaller-than-average asset base.

Cash Flow From Operations to NPW: Minimum recommended is 0%. Actual 2011 result is less than the benchmark at 0%, so unfavorable result. The ratio is calculated simply as cash flow from operations / net premiums written. The company paid out cash from claims, expenses and other operations than it received from premiums, investment income (excluding gains/losses), and other operations. Given the favorable result from ROE/ROR and unfavorable ROA, this reinforces the possibility that 2011 net income is driven from investment income or other income sources that would flow through Cash Flow from Investment Activities or Cash Flow From Financing Activities.

Overall, the net income generated by the company in 2011 was positive and significant. However, it appears that the source of the income may have been from one-time sources such as investment gains or other income, and not from underwriting income. If true, then this income may not continue into the future.

b.
Insurance Return on Net Premiums Earned = (U/W income + investment income excl capital gains) / net premiums earned

Return on Revenue = (U/W income + investment income excl gains + income from subs) / GPW