

EXAM 6 – CANADA, FALL 2015

24. (2.25 points)

a. (0.75 point)

Identify three components of the A.M. Best's financial strength ratings.

b. (1.5 points)

Identify and briefly describe three risk categories used in the calculation of A.M. Best's net required capital.

CONTINUED ON NEXT PAGE

EXAM 6-CANADA SAMPLE ANSWERS AND EXAMINER'S REPORT

QUESTION 24	
TOTAL POINT VALUE: 2.25	LEARNING OBJECTIVE: C2
SAMPLE ANSWERS	
Part a: 0.75 point	
<p>The following three items, or a similar idea, were required to get full credit:</p> <ul style="list-style-type: none"> • Balance sheet strength • Operating performance • Business profile <p>The following was accepted in place of balance sheet strength:</p> <ul style="list-style-type: none"> ○ BCAR ○ Underwriting leverage ○ Financial leverage ○ Asset leverage ○ Balance sheet risk ○ Underwriting risk, credit risk and market risk ○ Capital and surplus ○ Capital adequacy ○ Adjusted surplus ○ Soundness of balance sheet <p>The following was accepted in place of operating performance:</p> <ul style="list-style-type: none"> ○ Operational management ○ Operating risk ○ Financial leverage ○ Asset leverage ○ Earning performance ○ Operational risk ○ Operational strength ○ Historical results and stability <p>The following was accepted in place of business profile:</p> <ul style="list-style-type: none"> ○ Qualitative management e.g. ERM practice ○ Evaluation of company's risk management ○ Quality of risk management ○ Enterprise risk management policies (qualitative assessment) ○ Company structure and size ○ Quality and experience of management 	
Part b: 1.5 points	
<p>Candidates obtained full credit for identifying the three risk categories and providing a brief description for each from the following:</p> <ul style="list-style-type: none"> • Investment risk or Market risk or Liquidity risk or Asset risk <ul style="list-style-type: none"> ○ Three main risk components: fixed-income securities, equities and interest rate. ○ Risk arising out of change in interest rate, foreign exchange rate, equity, real estate 	

EXAM 6-CANADA SAMPLE ANSWERS AND EXAMINER'S REPORT

<p>and other.</p> <ul style="list-style-type: none">○ Capital charges are applied to different asset classes based on the risk of default, illiquidity and market-value decline.○ It is the risk of loss resulting from decrease of investments value. <ul style="list-style-type: none">● Credit risk<ul style="list-style-type: none">○ Capital charges are applied to different receivable balances to reflect third-party default risk.○ Counterparty is not able to pay or does not pay what he was supposed to. i.e. possibility of default on obligations.○ It is the counterparty default risk that pertains to the collection of receivables.○ The risk that receivables or recoverables are uncollectible.● Underwriting risk or Insurance risk<ul style="list-style-type: none">○ Capital charges are applied to loss and loss-adjustment expense reserves and the net premiums written.○ Measure how the company is exposed to adverse claim development and underwriting risk.○ Pricing and reserving risk from selling insurance including, as components, net loss reserves and net written premiums.
EXAMINER'S REPORT
Candidates were expected to know what A.M. Best considers when determining companies' financial strength ratings. Very few candidates obtained full marks and part a. was generally not well answered. The question required a certain level of comprehension of A.M. Best overall rating process and not only knowledge of BCAR formula.
Part a
Candidates were expected to know that A.M. Best considers financial and non-financial information when determining companies' financial strength ratings. This part was not well answered as most of the candidates only focused on balance sheet related items, which is only one of the components of A.M. Best's analysis of a company.
Part b
Candidates generally scored well on this part. The most common errors were to provide two risks that were part of the same category and to not properly describe the risk categories identified.