

12. (3.5 points)

a. (0.5 point)

Define each of the following:

- i. Insolvency risk
- ii. Liquidity risk

b. (1 point)

Identify four proximate causes of the involuntary exits which have occurred in the Canadian property and casualty insurance industry.

c. (2 points)

Identify and briefly describe four company characteristics that play a role in most insolvencies.

## EXAM 6C FALL 2016 SAMPLE ANSWERS AND EXAMINER'S REPORT

<b>QUESTION 12</b>	
<b>TOTAL POINT VALUE: 3.5</b>	<b>LEARNING OBJECTIVE(S): B1</b>
<b>SAMPLE ANSWERS</b>	
<b>Part a: 0.5 point</b>	
<p><u>Sample Responses for Criterion (i)</u></p> <ul style="list-style-type: none"> <li>• Sample 1 – Insolvency risk: risk that the firm is unable to meet current and future obligations due to insufficient assets.</li> <li>• Sample 2 – Insolvency Risk: Risk that assets will not be sufficient to cover for the insurer's obligations.</li> </ul> <p><u>Sample Responses for Criterion (ii)</u></p> <ul style="list-style-type: none"> <li>• Sample 1 – Liquidity: Risk that the firm cannot convert assets into cash in time to pay obligations, although asset values are sufficient.</li> <li>• Sample 2 – Liquidity Risk: Assets are sufficient to cover obligations but there is a high level of risk that they could disappear.</li> </ul>	
<b>Part b: 1 point</b>	
<p>Any 4 of the following:</p> <ul style="list-style-type: none"> <li>• Inadequate pricing</li> <li>• Deficient loss reserves</li> <li>• Underwriting cycle profitability</li> <li>• Catastrophes</li> <li>• Investment market volatility</li> <li>• International exposure</li> <li>• Rapid growth</li> <li>• Foreign ownership</li> <li>• Alleged fraud</li> <li>• Reinsurance issues</li> <li>• Affiliate</li> </ul>	
<b>Part c: 2 points</b>	
<ul style="list-style-type: none"> <li>• Size – large firms have more financial capacity and less likely to fail following an adverse event with same \$ impact.</li> <li>• Age/maturity in life cycle – new firms lack expertise and face strong competition from older more mature firms. Therefore, more likely to fail.</li> <li>• Rapid Growth – associated with reserve deterioration and underpricing. Firms experiencing this more likely to fail.</li> <li>• Poor governance/control – unable identify and act on threats, companies with weak corporate governance more likely to fail.</li> </ul>	
<b>EXAMINER'S REPORT</b>	
<p>Candidates were expected to demonstrate knowledge of the risks facing insurance companies in Canada that could potentially lead to an involuntary exit from the market.</p>	

## EXAM 6C FALL 2016 SAMPLE ANSWERS AND EXAMINER'S REPORT

### Part a

Candidates were expected to define the two terms.

There were no common mistakes as most candidates received full credit.

### Part b

Candidates were expected to identify four proximate causes.

A common mistake was confusing the proximate causes of involuntary exits with the company characteristics that play a role in most insolvencies.

### Part c

Candidates were expected to demonstrate an understanding of the underlying characteristics that play a role in most insolvencies.

Common mistakes included:

- Responding with “Foreign ownership” as a characteristic leading to insolvency. The failure of a foreign parent is a proximate cause of involuntary exits in the Canadian market. However, provided that the company has appropriate governance and internal controls, the type of ownership would not be a characteristic that would play a role in most insolvencies.
- Providing fewer than four characteristics
- Overly brief descriptions