

EXAM 6 – CANADA, FALL 2016

20. (2.5 points)

a. (0.5 point)

Define stress testing.

b. (1 point)

Identify the four main purposes of stress testing.

c. (0.5 point)

Identify two ways which scenario testing is different from sensitivity testing.

d. (0.5 point)

Briefly describe two responsibilities of senior management in a property and casualty insurance company's stress testing program.

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

QUESTION 20

TOTAL POINT VALUE: 2.5

LEARNING OBJECTIVE(S): C2

SAMPLE ANSWERS

Part a: 0.5 point

Stress testing is a risk management technique used to evaluate the potential effects on an institution’s financial condition, of a set of specified changes in risk factors, corresponding to exceptional but plausible events.

Part b: 1 point

1. Risk identification and control

2. Complementing other risk management tools

3. Supporting capital management

4. Improving liquidity management

Part c: 0.5 point

Any two of the following differences:

Difference	Scenario Testing	Sensitivity Testing
Methodology	Involves testing how changes in a number of risk factors could affect the company’s operations	Involves an incremental change in a single (or a limited number of) risk factor
Time horizon	Conducted over a longer time horizon	Conducted over a shorter time horizon
Resources	More resource intensive	Require fewer resources

Part d: 0.5 point

Any two of the following:

• Responsible for implementation, management and oversight of the program

• Identifying and describing the company’s risk appetite

• Understanding the impact of stress events on the risk profile of the company

• Participating in reviewing and identifying potential stress scenarios

• Contributing to the development and implementation of risk mitigation strategies

EXAMINER’S REPORT

Candidates were expected to demonstrate understanding of the concept of stress testing and how it can be used to identify potential threats to the solvency of the insurers.

Part a

Candidates were expected to demonstrate a full understanding of the stress testing process.

Common mistakes included:

• Stating that stress testing is testing a scenario without providing additional details

• Overly brief descriptions

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

Part b

Candidates were expected to demonstrate understanding of the purposes of a stress testing program.

The four purposes are discussed extensively in the OSFI stress testing reading. Credit was also given if candidates mentioned an item that is an example of risk identification and control.

Common mistakes included:

- Answering “help set internal target” without additional details
- Answering “DCAT”, given that this is an example of stress testing and not a purpose
- Answering “establish policies to address risks” without additional details

Part c

Candidates were expected to contrast scenario testing and sensitivity testing.

Common mistakes included:

- Identifying fewer than two differences
- Simply stating that scenario testing is more complex without mentioning that it includes changes in multiple risk factors

Part d

Candidates were expected to demonstrate knowledge of senior management responsibilities with regard to stress testing.

Common mistakes included:

- Stating that key stress testing results are to be reported to the board, without additional details
- Some candidates listed implementation, management and oversight of the program as separate responsibilities; graders considered the overall execution of the program to be one of senior management's responsibilities.