

**EXAM 6 – CANADA, SPRING 2017**

26. (1.75 points)

a. (0.75 point)

Identify three considerations in determining the interest rate used to discount policy liabilities.

b. (1 point)

Describe how the following two situations can be addressed when calculating an interest rate to discount the policy liabilities of an insurance company:

- i. Positive net cashflow
- ii. Negative net cashflow

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**EXAM 6C SPRING 2017 SAMPLE ANSWERS AND EXAMINER'S REPORT**

<b>QUESTION 26</b>	
<b>TOTAL POINT VALUE: 1.75</b>	<b>LEARNING OBJECTIVE(S): D1</b>
<b>SAMPLE ANSWERS</b>	
<b>Part a: 0.75 point</b>	
<p>Three of the following:</p> <ul style="list-style-type: none"> <li>• Method of valuing the assets</li> <li>• Allocation of those assets among line of business</li> <li>• Return on assets at the balance sheet date</li> <li>• Yield on assets acquired after balance sheet date</li> <li>• Yield on assets acquired after the calculation date</li> <li>• Investment expenses</li> <li>• Credit risk</li> <li>• Default risk</li> <li>• Gain and losses from assets sold after balance sheet date</li> </ul>	
<b>Part b: 1 point</b>	
<p>Sample responses for positive net cash flow include the following:</p> <ul style="list-style-type: none"> <li>• Need to consider the reinvestment rate of the new money and need to consider the company's investment strategy</li> <li>• Reinvest those positive net cash flows. Consider what would be the market interest rate when we need to reinvest those assets</li> <li>• Extra will be reinvested, reinvested assets could have lower rates</li> </ul> <p>Sample responses for negative net cash flow include the following:</p> <ul style="list-style-type: none"> <li>• Need to consider the expected future cash flow of the payments from liabilities / claims, need to consider the liquidity of the assets, and consider capital gains or losses from premature liquidation of assets.</li> <li>• Liquidate some assets to meet the obligation. Consider the gains / losses realized on the sale of those assets</li> <li>• Difference will be made up by liquidating assets. Bonds that are not mature are forced to sell would yield a lower return than otherwise.</li> </ul>	
<b>EXAMINER'S REPORT</b>	
<p>Candidates were expected to know the considerations in the selection of discount rate and know how to address the situations of positive and negative net cash flow.</p>	
<b>Part a</b>	
<p>Candidates were expected to know the considerations to determine the discount rate.</p> <p>Common errors include:</p> <ul style="list-style-type: none"> <li>• Stating considerations related to selecting interest rate MfAD, such as volatility of market changes</li> <li>• Stating considerations that are general but not specific to discount rate, such as market environment, market condition, economic condition</li> </ul>	

## EXAM 6C SPRING 2017 SAMPLE ANSWERS AND EXAMINER'S REPORT

- Stating considerations related to the estimated of undiscounted claim liabilities, such as payment pattern

### **Part b**

Candidates were expected to know how to address the situations of positive and negative net cash flow.

Common errors include only stating the action without description. For example:

- reinvesting positive cash flow
- liquidate assets to address negative cash flow