

EXAM 6 – CANADA, FALL 2017

26. (1.5 points)

A.M. Best analyzed two property and casualty insurance companies for their stress-tested Best's Capital Adequacy Ratio (BCAR) score, and determined the following tolerance levels:

- Company A (rated A- for balance sheet strength): 30 points
- Company B (rated A- for balance sheet strength): 0 point

Additionally, the following information is available for the two companies:

Company	Company profile	Primary catastrophic exposure	Average combined ratio for the last ten years	Standard deviation of combined ratio for the last ten years
A	Subsidiary of an international insurance group	Earthquake	95%	9%
B	Domestic mutual company	Tornado	91%	15%

Describe three factors that could explain the lower tolerance level for Company B.

EXAM 6C FALL 2017 SAMPLE ANSWERS AND EXAMINER'S REPORT

QUESTION 26	
TOTAL POINT VALUE: 1.5	LEARNING OBJECTIVE(S): C2
SAMPLE ANSWERS	
<p><u>Sample 1</u></p> <ul style="list-style-type: none"> • Company A is a subsidiary of an international group, so it has easier access to capital compared to a domestic mutual company. • The primary CAT exposure of Company A occurs much less frequently compared to the primary cat of Company B. • The standard deviation of the combined ratio for Company A is lower than Company B, indicating stability in loss history. <p><u>Sample 2</u></p> <ul style="list-style-type: none"> • Flexibility of capital access: Company A is a subsidiary of international group, which has more access to capital than domestic mutual company • Historical volatility of operation performance: company A has a smaller standard deviation of combined ratio for the last ten years, which indicate stronger operation. • Frequency to catastrophic exposure: Company A is exposed to earthquake, and its frequency is much smaller than tornado, so more tolerance. 	
EXAMINER'S REPORT	
<ul style="list-style-type: none"> • Candidates were expected to demonstrate the knowledge of how to evaluate the financial health of an insurance entity based the A.M. Best rating system to identify the historic loss ratio volatility, capital accessibility and the multiple frequency nature of catastrophic events. • Common errors include: <ul style="list-style-type: none"> ○ Some candidates mistakenly stated that domestic company is less diversified, which was not mentioned in the question. ○ Some candidates were not able to provide enough details in the answer. For example, only partial credit was given to candidates who pointed out that the standard deviation of Company A's combined ratio is lower than Company B's without indicating what the implication of this is. ○ Some candidates were not able to identify the frequency nature of catastrophic events as one of the factors in A.M. Best rating system. 	