21. (1.25 points)

a. (0.25 point)

Describe the reason for the capital required for future premium risk being higher under the A.M. Best approach than the MCT calculation.

b. (0.5 point)

Identify two company characteristics that would generate a low BCAR value.

c. (0.5 point)

Identify one similarity and one difference between the covariance adjustment in the A.M. Best BCAR and the diversification credit in the MCT calculation.

CONTINUED ON NEXT PAGE

QUESTION 21	
TOTAL POINT VALUE: 1.25	LEARNING OBJECTIVE(S): C2

SAMPLE ANSWERS

Part a: 0.25 point

Sample

In contrast to the MCT calculation, a significant proportion of capital is required to support future premium risk. Reflecting A.M. Best's views that balance sheet strength must support the risks associated with a company's current book of business as well as those it plans to insure in the upcoming year.

Part b: 0.5 point

Sample responses (any two of the following)

- More aggressive investment portfolio
- Depends heavily on pyramided capital
- Has excessive credit risks
- Depends excessively on reinsurance
- Higher underwriting leverage
- Greater indicated reserve deficiency
- Unstable or unprofitable business

Part c: 0.5 point

Sample (similarity)

- They both reflect an adjustment for the diversification between the different risk categories.

Sample (difference, any one of the following)

- A.M. Best adds an adjustment for the distortion on top of the square root rule
- MCT uses a simplified square root rule to account for correlation between insurance and asset risk

EXAMINER'S REPORT

Candidates were expected to know the key differences between A.M. Best's BCAR approach for the calculation required capital versus the MCT. Specifically, they were expected to know the differences in the treatment of the future premium risk and the covariance adjustment.

Part a

Candidates were expected to describe the reason capital required for future premium risk is higher under A.M. Best than under the MCT.

A common error was:

- Identifying a difference between the A.M. Best approach and the MCT, not specifically related to future premium risk.

Part b
Candidates were expected to identify two company characteristics that would generate a lower BCAR value. Common errors included: • Identifying a company characteristic that is not relevant to the BCAR value • Listing characteristics(s) that would generate a higher BCAR value rather than lower
Part c
Candidates were expected to identify a similarity and a difference between the covariance adjustment in the A.M. Best BCAR calculation and the diversification credit in the MCT calculation. A common error was: • Simply stating that the formula is different without providing any additional detail.