21. (2 points)

The following information from the DCAT analysis of a federally regulated property and casualty insurance company is available as of December 31, 2018. The three most adverse scenarios are shown below. All amounts are in thousands of dollars ($000s).

		Projection Year 1	Projection Year 2	Projection Year 3	Projection Year 4
Base Scenario	MCT ratio	230%	235%	241%	248%
	Equity	30,000	33,000	37,000	42,000
Misestimation of Policy Liabilities (Unpaid Claims)	MCT ratio	230%	130%	145%	165%
	Equity	30,000	10,000	15,000	23,000
Frequency/Severity (Single Large Claim)	MCT ratio	230%	150%	160%	170%
	Equity	30,000	15,000	20,000	28,000
Decline in the Stock Market (Common Shares Portfolio)	MCT ratio	230%	165%	170%	175%
	Equity	30,000	20,000	24,000	28,000

Under the Decline in Stock Market scenario, there is a very large drop in the value of the common shares portfolio. Investments other than common shares are not impacted. Assume there is no tax implication.

a. (0.5 point)

Assess whether the insurer's financial condition is satisfactory.

b. (1.5 points)

Describe the impact of the Decline in the Stock Market adverse scenario on the following MCT components:

i. Capital available
ii. Capital required for market risk
iii. Capital required for operational risk

CONTINUED ON NEXT PAGE

SAMPLE ANSWERS AND EXAMINER'S REPORT

QUESTION 21	
TOTAL POINT VALUE: 2	**LEARNING OBJECTIVE(S): C2**

SAMPLE ANSWERS

Part a: 0.5 point

Sample

The insurer's financial condition is satisfactory because:

- Base scenario > 150% for all the forecast period
- Base scenario and all plausible adverse scenarios have positive equity

Part b: 1.5 points

Sample 1

i. The capital available decreases because the drop in the value of the common shares portfolio decreases the total assets and the equity.
ii. The capital required for market risk decreases because the equity risk margin decreases due to the decrease in the value of common shares portfolio.
iii. The capital required for operational risk decreases because it depends on the market risk and the market risk decreases.

Sample 2

i. The capital available decreases because the drop in the value of the common shares portfolio decreases the total comprehensive income, which leads to a decline in the equity.
ii. The capital required for market risk decreases because it includes a risk margin based on the common share portfolio value.
iii. The capital required for operational risk decreases because both the formula and the cap decrease due to the market risk margin decrease.

EXAMINER'S REPORT

Candidates were expected to demonstrate knowledge of the requirements for financial condition to be satisfactory based on DCAT results and the impact of a scenario on different MCT components.

Part a

Candidates were expected to know how to assess the financial condition of a company based on the DCAT analysis results.

There were no common errors.

Part b

Candidates were expected to demonstrate knowledge of the impact of a specific adverse scenario on different MCT components.

Common errors included:

- Mistakenly assuming that the decline in stock market would impact the stock issued by the company

- Answering the capital required for market risk would increase

- Only considering the impact on the capped value of operational risk and not describing an impact if the capital required for operational risk was under the cap
- Only considering the impact on the operational risk margin formula and not describing an impact if the capital required for operational risk was capped and remain capped