

22. (2 points)

A property and casualty insurance company offers auto and property insurance products for personal and commercial lines of business. The products are sold through various distribution channels including a recently developed mobile application using sophisticated technology. The company operates in Ontario, Alberta, British Columbia and New Brunswick. The investment portfolio is composed primarily of common shares and government bonds.

a. (0.5 point)

Discuss how an Own Risk and Solvency Assessment (ORSA) can help insurers assess their internal targets.

b. (1.5 points)

Indicate whether each item below is accounted for in the MCT calculation and briefly explain whether it should be considered in the company's internal capital target.

- i. Cyber risk
- ii. Interest rate risk
- iii. Geographical diversification

SAMPLE ANSWERS AND EXAMINER'S REPORT

QUESTION 22	
TOTAL POINT VALUE: 2	LEARNING OBJECTIVE(S): C2
SAMPLE ANSWERS	
Part a: 0.5 point	
<p><u>Sample 1</u> ORSA is an internal capital assessment procedure that is tailored to an insurer's own risk appetite and risk profile. It takes into account risks that are relevant to the insurer and helps the insurer develop and assess its internal capital target.</p> <p><u>Sample 2</u> ORSA considers all risks specific to the insurer and helps management relate risk profile to capital. Setting the internal target is part of the ORSA. It's based on business scale and complexity of the insurer.</p> <p><u>Sample 3</u> Use ORSA to set internal capital target based on insurer's own risk profile. Relate risk to capital based on nature, scale and complexity of the risk to assign capital to each risk category.</p>	
Part b: 1.5 points	
<p>i) Cyber Risk</p> <p><u>Sample 1</u> Cyber risk is not accounted for in the MCT calculation. It should be considered in the company's internal capital target as the company is exposed to cyber risk from the new technology used in selling products through a mobile application.</p> <p><u>Sample 2</u> Cyber risk is accounted for in the MCT as an insurance risk if it is a product underwritten by the company. Otherwise, if as a systematic risk to the insurer, it's not included. It should be accounted for in the company's internal target because the company's products are sold through sophisticated technology.</p> <p><u>Sample 3</u> Cyber risk could be accounted for in the MCT as part of operational risk. The company should include it in internal targets because of the mobile app distribution.</p> <p>ii) Interest Rate Risk</p> <p><u>Sample 1</u> Interest rate risk is included in the MCT under market risk. It should be included in the company's internal target since government bonds are interest rate sensitive.</p> <p><u>Sample 2</u> Interest rate risk is accounted for in the MCT and should be accounted for in the company's internal capital target because the discounted liabilities and the government bonds are affected by changing interest rates.</p>	

SAMPLE ANSWERS AND EXAMINER'S REPORT

iii) Geographical Diversification

Sample 1

Geographical diversification is not accounted for in the MCT calculation. It should be considered in the internal capital target since the company operates in multiple provinces.

Sample 2

Geographical Diversification is partially included in the MCT in the catastrophe earthquake component; but is not part of the diversification credit, which is only for insurance vs asset risk. It should be included in the company's internal target, since they operate in many provinces.

EXAMINER'S REPORT

Candidates were expected to understand how the ORSA, internal target and MCT are related, and how they differ.

Part a

Candidates were expected to understand how insurers use the ORSA process to assess risks that are material to their own risk profile and then relate the assessed risk to capital through determining an internal capital target.

Common errors included:

- Only discussing the ORSA process without relating it to the internal targets
- Simply stating that ORSA can be used to set internal targets without relating the target selection to the insurer's own risk

Part b

Candidates were expected to understand which risks are incorporated into the MCT formula and which should be recognized in the internal target.

Common errors included:

- For each risk, stating situations in which each item should be included in a company's internal target without relating the decisions to the situation of the company described.
- For each risk, simply stating the risk is company-specific risk, without relating the answer to the company described.
- For each risk, stating that the risk should be included in the internal capital target because all risks should be considered.
- For interest rate risk, stating that the risk should be included in the internal target because it is already part of the MCT.
- For geographical diversification, stating it is included in the MCT as part of the diversification credit without clearly relating the answer to the earthquake component of the catastrophe risk.