

Errata #1

Financial Reporting through the Lens of a Property/Casualty Actuary (Version 4.0)

Edits from posting of version 4.0 through September 30, 2014

Note: all page/table number references refer to version 4.0 which is currently on the Exam 6US Syllabus for the Fall 2014/Spring 2015/Fall 2015/Spring 2016 Exam/Fall 2016.

1. Chapter 14, Schedule F

- a. Within SCHEDULE F — PART 1: ASSUMED REINSURANCE AS OF DECEMBER 31, CURRENT YEAR (000 OMITTED), section titled “*Continent Commissions*”, page 113, the following sentence should be corrected to read:

“The amount of ~~commissions payable~~ **assumed premium receivable** in column 10 would be \$500,000, and the contingent commissions payable in column 9 would be \$125,000, which is the amount of expected commission at the onset of the contract.”

- b. Within SCHEDULE F — PART 3: CEDED REINSURANCE AS OF DECEMBER 31, CURRENT YEAR (000 OMITTED), section titled “*Footnotes to Part 3*”, page 120, the word “reinsurer” should be corrected to “reinsured” as follows:

“Instead of receiving 35% of ceded premium in commission, the company (~~reinsurer~~ **reinsured**) will end up getting only 20%. If a 20% fixed commission rate was considered at the onset, the premium-to-surplus ratio would have been 309%, triggering an unusual value for IRIS Ratio 2.”

- c. Within SCHEDULE F — PART 5: PROVISION FOR UNAUTHORIZED REINSURANCE AS OF DECEMBER 31, CURRENT YEAR (000 OMITTED), section titled “*Provision for Unauthorized Reinsurance*”, page 126

Table 24 should refer to Reinsurer E, not Reinsurer D.

- d. Within SCHEDULE F — PART 7: PROVISION FOR OVERDUE REINSURANCE AS OF DECEMBER 31, CURRENT YEAR, page 131

Formula for Schedule F, Part 5, column 20 should be:

Unauthorized reinsurer (Schedule F, Part 5, column 20, total):

$$\begin{aligned} &= \text{Minimum} [(A) \text{ and} \\ &\quad [(A) - (B)] \\ &\quad + \text{Minimum} [(B) \text{ and } 20\% * (C)] \\ &\quad + \text{Minimum} [(B) \text{ and } 20\% * (D)]] \end{aligned}$$

2. Chapter 15, Schedule P

- a. Within SCHEDULE P — PART 1, section titled “*Salvage and Subrogation*”, page 150

The “Notes” in TABLE 34 are incorrect. They should instead read as follows (corrections noted in red font within the table below):

TABLE 34

Data from 2011 Schedule P — Part 1 — Summary for Fictitious Insurance Company (000 omitted)			
Column	Item	Amount	Notes
13	Direct and assumed case basis losses	24,945	
14	Ceded case basis losses	5,343	
	Net case basis losses	19,602	= Column 13 — Column 14
15	Direct and assumed IBNR losses	26,330	
16	Ceded IBNR losses	4,038	
	Net IBNR losses	22,292	= Column 15 — Column 16
17	Direct and assumed case basis DCC	2,424	
18	Ceded case basis DCC	258	
	Net case basis DCC	2,166	= Column 17 — Column 18
19	Direct and assumed IBNR DCC	5,401	
20	Ceded IBNR DCC	499	
	Net IBNR DCC	4,902	= Column 19 — Column 20
21	Direct and assumed A&O unpaid	2,599	
22	Ceded A&O unpaid	4	
	Net A&O unpaid	2,595	= Column 21 — Column 22
24	Total net losses and expenses unpaid	51,557	= (Columns 13 + 15 + 17 + 19 + 21) — (Columns 14 + 16 + 18 + 20 + 22)

b. Within “SCHEDULE P — PART 6”, on page 183

We would like to clarify the following paragraph:

“The premium displayed in Part 1 of Schedule P is that which is earned at the end of each specified year and is not updated for subsequent adjustments. It is equal to the left-most diagonal in Part 6. Adjustments made after the first year of report come through in the remaining columns of Part 6.”

We can see how this paragraph can be confusing. The point we were trying to make is that Part 1 does not adjust each respective year’s premium for subsequent adjustments. As we say “*The premium displayed in Part 1 of Schedule P is that which is earned at the end of each specified year and is not updated for subsequent adjustments.*” Rather, for a particular year, “*It is equal to the left-most diagonal in Part 6. Adjustments made after the first year of report come through in the remaining columns of Part 6.*” The focus in this paragraph is really Part 6 as opposed to Part 1.

We would like to edit the paragraph to read as follows (changes noted in red font below):

“The premium displayed in Part 1 of Schedule P is that which is earned ~~during at the end of~~ each specified ~~calendar~~ year; it is not updated for

subsequent adjustments **to the specified exposure year premium**. It is equal to the left-most diagonal in Part 6 **plus adjustments that come through during the specified calendar year to premiums on prior exposure years**. Adjustments made after the first year of report are **included in the appropriate column of Part 6.**”

3. Chapter 19, Risk-Based Capital

- a. Within “THE RBC CHARGE FOR ASSET RISK ASSOCIATED WITH INSURANCE COMPANY SUBSIDIARIES (R_0)”, section entitled “Insurance Subsidiaries Subject to RBC — Ownership in Common Stock”, pages 236 and 237

In Version 4.0 of the publication we note that there is an inconsistency between the NAIC’s written instructions and the formulas contained in the spreadsheet contained in the corresponding CD-ROM with respect to the calculation of R_0 for common stock investments in insurance affiliates subject to RBC. We further state “*we will update this publication when this issue is resolved and provide examples to illustrate the calculation of R_0 at that time.*”

We do not believe that this issue has been resolved as of the writing of these errata. However, we stress that this issue is specific to the calculation of R_0 for common stock investments in insurance affiliates subject to RBC and does not apply to any other calculations of RBC as described in Chapter 19.

We remind the student that the previous paper on the Exam 6 US Syllabus pertaining to the topic of RBC (“NAIC Property/Casualty Insurance Company Risk-Based Capital Requirements”, authored by Sholom Feldblum) was published over 17 years ago (in 1996). There have been changes to the RBC Instructions since that paper was published. Therefore, examination questions regarding this topic will be based on the description of the calculations of RBC as contained within the current publication on the Exam 6US Syllabus and not the Feldblum paper published in 1996.

- b. Within “RBC CHARGE FOR CREDIT RISK (R_3)”, section titled “*Reinsurance recoverables*”, page 259

The RBC charge for reinsurance recoverable is split 50%/50% between R_3 and R_4 if the reserve RBC (see discussion below) exceeds the sum of the credit risk RBC for non-invested assets and one-half reinsurance recoverables. The current version of the text does not specify the “one-half”. Therefore, the following paragraph should be corrected as follows:

“The RBC charge for reinsurance recoverable is split 50%/50% between R_3 and R_4 if the reserve RBC (see discussion below) exceeds the sum of the credit risk RBC for non-invested assets and **one-half the RBC for** reinsurance recoverables. Otherwise, the full amount of the reinsurance recoverable RBC charge is included in R_3 .”

- c. Within "RBC CHARGE FOR RESERVE RISK (R₄)", section entitled "*Reinsurance RBC*", page261

Similarly, the paragraph explaining the adjustment to R₄ for half of R₃ should read as follows:

"The reinsurance RBC within R₄ is equal to the other half of the reinsurance recoverable amount computed in R₃ unless the reserve RBC is less than **one-half** the RBC for reinsurance plus noninvested assets. If this is the case, the entire reinsurance RBC charge is included in R₃ and the reinsurance RBC within R₄ is zero. The reserve RBC limitation is put in place so the insurance company cannot diversify away a portion of its credit risk in the situation where the company has limited net reserves."

- d. Within "RBC CHARGE FOR RESERVE RISK (R₄)", section entitled "*Illustration of reserve RBC calculation*", page270

The figure in the first sentence of the paragraph underneath Table 98 should read \$6,573,735 (to match row (16), *Net Loss & LAE RBC * 1,000*, in Table 98) instead of \$6,215,668.

Errata #2

Financial Reporting through the Lens of a Property/Casualty Actuary (Version 4.0)

Edits on October 11, 2014

Note: all page/table number references refer to version 4.0 which is currently on the Exam 6US Syllabus for the Fall 2014/Spring 2015/Fall 2015/Spring 2016 Exam/Fall 2016.

Chapter 18: Insurance Expense Exhibit, PART II — ALLOCATION TO LINES OF BUSINESS NET OF REINSURANCE

The unearned premium reserve figures provided in Tables 65 and 66 should reconcile to the total amount in column 19, row 35 of the Insurance Expense Exhibit (IEE) for Fictitious. This total amount should also reconcile to the Underwriting and Investment Exhibit (U&IE), Part 1A, Total line 35, column 4, divided by 1,000 within the Annual Statement for Fictitious. In the current version of the text, the unearned premium reserve figures are incorrectly shown as the amount in U&IE Part 1A, Total line 38, column 4, divided by 1,000.

This correction does not impact the balances shown in Fictitious' IEE. However, certain tables within the text should be corrected as follows (corrected values are shown in red font):

TABLE 65

Data from Fictitious Insurance Company 2011 IEE and Annual Statement (USD in 000s)					
<u>All Lines of Business</u>	<u>2011 Current Year</u>	<u>2010 Prior Year</u>	<u>Mean</u>	<u>2011 IEE Part II Total, Line 35</u>	<u>Annual Statement</u>
(1) Net Investment Gain Ratio	5.0%				= (2) current year divided by (3) mean
(2) Net Investment Gain (loss) before Capital Gains Tax	4,404				Statement of Income Page 4, Line 11 plus Capital Gains Tax of \$99 per Line 10
(3) Investable Assets	87,540	87,080	87,310		= (4) + (5) + (6) + (7) + (8) - (9)
(4) Net Loss Reserve	41,894	40,933	41,414	Column (13)	U&IE, Part 2A, Total line, Column 8, divided by 1,000
(5) Net Loss Adjustment Expense Reserve	9,663	9,664	9,664	Column (15) + (17)	U&IE, Part 2A, Total line, Column 9, divided by 1,000
(6) Net Unearned Premium Reserve	11,691	11,451	11,571	Column (19)	U&IE, Part 1A, Total line 35, Column 4, divided by 1,000
(7) Policyholders' Surplus	31,024	31,608	31,316		Liabilities, Surplus and Other Funds, Page 3, Line 37, divided by 1,000
(8) Ceded Reinsurance Premiums Payable	440	608	524		Liabilities, Surplus and Other Funds, Page 3, Line 12, divided by 1,000
(9) Agents' Balances	7,172	7,184	7,178	Column (21)	Equals the portion of Assets Line 15.1 plus 15.2, divided by 1,000, for Agents' Balances

TABLE 68

Data from Fictitious Insurance Company 2011 IEE and 2010 and 2011 Annual Statement (USD in 000s)					
<u>All Lines of Business</u>	2011 Current Year	2010 Prior Year	Mean	2011 IEE Part II Total, Line 35	Annual Statement (AS)
(1) Surplus Ratio	35.1%				= (2) / [Sum of means of (3) through (5) plus (6) for current year]
(2) Policyholders' Surplus	31,024	31,608	31,316		Liabilities, Surplus and Other Funds, Page 3, Line 37, Columns 1 and 2, respectively, divided by 1,000
(3) Net Loss Reserve	41,894	40,933	41,414	Column (13)	U&IE, Part 2A, Total line, Column 8, divided by 1,000; and prior year AS
(4) Net Loss Adjustment Expense Reserve	9,663	9,664	9,664	Column (15) + (17)	U&IE, Part 2A, Total line, Column 9, divided by 1,000; and prior year AS
(5) Net Unearned Premium Reserve	11,691	11,451	11,571	Column (19)	U&IE, Part 1A, Total line 35, Column 4, divided by 1,000; and prior year AS
(6) Net Earned Premium	26,512			Column (3)	U&IE, Part 1, Total line 35, Column 4, divided by 1,000

TABLE 69

Data from Fictitious Insurance Company 2011 IEE and 2010 and 2011 Annual Statement (USD in 000s)					
<u>Line of Business: Homeowners Multiple Peril</u>	2011 Current Year	2010 Prior Year	Mean	2011 IEE Part II Total, Line 35	Annual Statement (AS)
(1) Surplus Allocable to Line of Business			2,872		= (2) * [Sum of means of (3) through (5) plus (6) for current year]
(2) Surplus Ratio	35.1%				Calculated in Table 68
(3) Net Loss Reserve for Line of Business	1,311	1,161	1,236		U&IE, Part 2, Line 4, Columns 5 and 6, divided by 1,000
(4) Net Loss Adjustment Expense Reserve for Line of Business	144	170	157		U&IE, Part 2A, Line 4, Column 9, divided by 1,000; and prior year AS
(5) Net Unearned Premium Reserve for Line of Business	2,401	2,290	2,346		U&IE, Part 1A, Line 4, Column 5, divided by 1,000; and prior year AS
(6) Net Earned Premium for Line of Business	4,445			Column (3)	U&IE, Part 1, Line 4, Column 4, divided by 1,000

Note item (1) in Table 69, surplus allocable to the Homeowners line of business, changes only due to rounding of the surplus ratio (35.1%). This had no impact on any of the other figures.