

EXAM 5, FALL 2014

13. (1.5 points)

The importance of accurately estimating unpaid claims can be examined from three points of view: internal management, investors, and regulators.

a. (0.75 point)

Briefly describe how a redundant unpaid claim estimate can impact decisions for each of these three groups.

b. (0.75 point)

Briefly describe how an inadequate unpaid claim estimate can impact decisions for each of these three groups.

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EXAM 5 FALL 2014 SAMPLE ANSWERS AND EXAMINER'S REPORT

QUESTION 13	
TOTAL POINT VALUE: 1.5	LEARNING OBJECTIVE: B1
SAMPLE ANSWERS	
Part a: 0.75 point	
<p>Sample Answers:</p> <p>Internal Management</p> <ul style="list-style-type: none"> • It would make a book appear less profitable, causing a rate increase where one may not have been needed. • May purchase unnecessary reinsurance contracts or choose to increase reinsurance limits • Internal management will allocate capital towards meeting these liabilities which could have been invested elsewhere. • Lead to wrong interpretation of results and wrong decision to exit a LOB <p>Investors</p> <ul style="list-style-type: none"> • Investors may see the decline in profitability and pull out their investments <p>Regulators</p> <ul style="list-style-type: none"> • They may not correctly evaluate the liabilities of this insurer and thus take unnecessary measures to protect its solvency 	
Part b: 0.75 point	
<p>Sample Answers:</p> <p>Internal Management</p> <ul style="list-style-type: none"> • May decide to decrease rates since their loss ratios look good • May decide to grow their business when they should not because their profits are not as high as they believe • May be overly optimistic and may reduce reinsurance limits • Could lead internal management to hold less than required capital to pay future claims <p>Investors</p> <ul style="list-style-type: none"> • Inadequate unpaid claim estimates mean ultimate loss estimates will be low and the company will look really profitable to investors. Investors may decide to invest based on this even though they shouldn't. <p>Regulators</p> <ul style="list-style-type: none"> • May delay their intervention because they think the company is in a good position 	
EXAMINER'S REPORT	
<p>Many candidates received full credit on this question.</p>	
Part a	

EXAM 5 FALL 2014 SAMPLE ANSWERS AND EXAMINER'S REPORT

Overall, candidates did well on part a. Common mistakes included not providing enough detail on specific impacts to decision making of the three viewpoints, not understanding the definition of a redundant unpaid claims estimate, and confusing the role of regulators with the role of rating agencies.

Part b

Candidates had a bit of a harder time correctly responding to Part B, specifically regarding the regulators. The most common mistake was for candidates to assume that the regulators recognized the inadequacy in unpaid claim estimates and would step in to address solvency concerns. However, the question was specifically addressing the impact on regulator's decision making in the situation where they believed the unpaid claim estimate to be accurate. Some candidates also lost points for not providing enough detail around their answers.