

11. (1.75 points)

Given the following for a large deductible commercial general liability policy:

\$500,000	Per occurrence deductible
90.0%	Loss elimination ratio for a \$500,000 deductible
10.0%	ALAE/ground up loss ratio
\$2,000,000	Ground up loss estimate
\$100,000	Fixed expenses
12.0%	Variable expenses as % of premium
4.0%	Underwriting profit as % of premium
3.0%	Deductible processing cost as a % of losses below the deductible
1.0%	Credit risk as a % of losses below the deductible
7.0%	Additional risk margin as a % of excess losses

- The insurer will handle all claims, including those that fall below the deductible.
- The insurer will make the payments on all claims and will seek reimbursement for amounts below the deductible from the insured.
- The deductible is for loss only.
- All ALAE is paid by the insurer.

Calculate the premium for the large deductible policy.

EXAM 5 FALL 2018 SAMPLE ANSWERS AND EXAMINER'S REPORT

QUESTION 11	
TOTAL POINT VALUE: 1.75	LEARNING OBJECTIVE: A11
SAMPLE ANSWERS	
<p><u>Sample 1</u></p> <p>Losses below ded = 1,800,000 = 2M x 0.9 Losses above ded = 200,000 = 2M x 0.1 ALAE = 200,000 = 2M x 10% Fixed Expense = 100,000 Var Expense = 0.12 Profit = 0.04 Ded processing cost = 54,000 = 0.03 x 1,800,000 Credit risk = 18,000 = 0.01 x 1,800,000 Add'l risk margin = 14,000 = 0.07 x 200,000</p> <p>$(200,000 + 200,000 + 100,000 + 54,000 + 18,000 + 14,000) / (1 - .12 - .04) = 697,619$</p> <p><u>Sample 2</u></p> <p>$\{2,000,000 \times [10\% + (1 - 90\%) \times 1.07 + 90\% \times (3\% + 1\%)] + 100,000\} / (1 - 12\% - 4\%) = 679,619$</p>	
EXAMINER'S REPORT	
<p>Candidates were expected to calculate the premium for a large deductible policy by correctly applying the loss elimination ratio then further including the appropriate costs and expenses.</p> <p>Common mistakes include:</p> <ul style="list-style-type: none"> • Forgetting to include Fixed Expense, ALAE, or Excess Loss in the final calculation • Calculating the Excess Deductible Loss as (Ground Up Loss x LER) or (Ground Up Loss – 0.5M per occurrence deductible) instead of (Ground Up Loss x (1-LER)) • Using incorrect loss amount for the Credit Risk and Deductible Processing Fee calculation • Including one or several of the following: Credit Risk, Deductible Processing Fee, and Risk Margin, in the denominator • Including losses below the deductible in the final premium calculation instead of losses above the deductible • Only including ALAE related to the Excess Deductible Loss amount, while the problem clearly states that all ALAE is paid by the insurer 	