EXAMINATIONS

10 September 2001 (pm)

Subject 402 — UK Fellowship Life Insurance

Paper Two

**You must answer this subject only,
you may not attempt another subject in the 400 series.**

Time allowed: Three hours

INSTRUCTIONS TO THE CANDIDATE

1. *You have 15 minutes at the start of the examination in which to read the questions. You are strongly encouraged to use this time for reading only but notes may be made. You then have three hours to complete the paper.*

2. *You must not start writing your answers in the booklet until instructed to do so by the supervisor.*

3. *Write your surname in full, the initials of your other names and your Candidate's Number on the front of the answer booklet.*

4. *Mark allocations are shown in brackets.*

5. *Attempt both questions, beginning your answer to each question on a separate sheet.*

AT THE END OF THE EXAMINATION

Hand in BOTH your answer booklet and this question paper.

In addition to this paper you should have available Actuarial Tables and an electronic calculator.

1 A small UK mutual life insurance company closed its direct sales force in September 2000. The direct sales force provided 90% of the company's new business, the balance being from independent intermediaries and incremental business written directly with the company. The main reason for the closure was that the company's free assets had been severely eroded over the previous few years by the need to make compensation payments to policyholders mis-sold a particular type of policy. In the first half of 2000 the provision for future compensation increased by 30%, leaving the company with negligible free assets on the supervisory basis.

The company had sold a wide range of conventional with and without profits contracts, but in the last five years 85% of the business from the direct sales force was unit-linked. Regular premium contracts were written with nil allocation periods to recoup initial expenses. In 1999 the rate of return on capital employed in writing new business through the direct sales force was 5% pa.

The unit-linked and conventional without profits business now has significant value, on an embedded value basis.

The board and management of the company do not wish to seek a merger or sale to another company. The intention is to seek other business opportunities if this is possible.

(i) Discuss why the reduction in free assets would have made the company close to new business. [9]

(ii) Discuss how the closure of the direct sales force will affect the company's financial position over the next three years, both as presented in the supervisory returns and in terms of the underlying value of the business to the with profits policyholders. [11]

(iii) Describe the methods that can be used to present the results of the valuation at the company's year-end in December 2000 on Form 9 of the supervisory returns in the most favourable light, in order to continue to attract business from independent intermediaries. You should identify those actions that you consider reasonable to pursue in the company's circumstances. [12]

(iv) State, with reasons, the elements of the analysis of experience that will be most important to the company in the next three years. [8]

(v) Discuss the problems involved in distributing the embedded value of the conventional without profits and unit-linked business to the with profits policyholders and how these might be overcome. [12]

[Total 52]

2 A UK life insurance company currently sells conventional with profits endowment assurances and a range of unit-linked contracts, including a unit-linked single premium bond. It is considering issuing a unitised with profits single premium bond, the contract being sold over a one month period.

(i) State the advantages to the company and the policyholders of unitised with profits contracts over conventional with profits contracts. [7]

(ii) Discuss the reasons why the benefits under the unitised with profits bond might be smoothed and the factors which the company will have to consider when deciding on its smoothing policy for this contract. [13]

(iii) Explain the reasons for having the facility to apply a market value adjuster on the unitised with profits bond. [5]

(iv) Describe the factors which the company would take into account when deciding on whether it is appropriate to apply a market value adjuster at a particular point in time, noting any actions which the company currently needs to take to ensure that it can do this. [8]

(v) The Marketing Manager has said, that, in order to appear competitive, the product needs to have a high accumulation rate for units on launch. He suggests that the company should offer an additional bonus rate in the first year of the contract in order to help achieve this aim. He would also like to guarantee that no market value adjuster will be applied on the fifth policy anniversary. He has asked the Appointed Actuary for his comments.

Discuss the points the Appointed Actuary might make in his reply. [15]
[Total 48]