

# EXAMINATION

27 March 2006 (pm)

## Subject CA1 — Core Applications Concepts

### Paper 2 (Liabilities and Asset Liability Management)

*Time allowed: Three hours*

#### **INSTRUCTIONS TO THE CANDIDATE**

1. *Enter all the candidate and examination details as requested on the front of your answer booklet.*
2. *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.*
3. *You must not start writing your answers in the booklet until instructed to do so by the supervisor.*
4. *Mark allocations are shown in brackets.*
5. *Attempt all 8 questions, beginning your answer to each question on a separate sheet.*
6. *Candidates should show calculations where this is appropriate.*

#### **AT THE END OF THE EXAMINATION**

*Hand in BOTH your answer booklet, with any additional sheets firmly attached, and this question paper.*

*In addition to this paper you should have available the 2002 edition of the Formulae and Tables and your own electronic calculator.*

- 1** Outline the reasons why a general insurance company models its claims experience. [5]
- 2** Outline the reasons why a life insurance company requires capital. [5]
- 3** An insurance company has made the following purchases during the year:

  - (a) a new city centre sales office
  - (b) a new computer system for the payment of annuities
  - (c) a new computer system for the payment of staff salaries
  - (d) the routine regular replacement of a proportion of staff cars

Describe how each of these items might be dealt with in the annual analysis and allocation of expenses. [8]
- 4** A director of a company is negotiating a financial settlement on divorce. The director is to retain his accrued pension rights but their value is to be taken into account in the financial settlement. An expert witness is providing independent advice on a suitable value of the director's final salary pension for this purpose.

  - (i) Discuss the factors that will influence the advice to be given. [6]

It has been suggested that the value of the accrued pension rights be taken as the value of the director's pension benefits disclosed in the company's accounts.

  - (ii) State the advantages and disadvantages of this suggestion. [3]

[Total 9]
- 5** A large motor insurer has noted that claims management expenses as a proportion of claims costs have been increasing steadily over recent years. The proportion is now 6.25% of claims costs compared with 5% five years ago.

  - (i) Discuss why this increase may have occurred. [3]
  - (ii) Discuss possible actions the company can take to reverse the position. [2]

It has been suggested to the company that it can reduce both claims management expenses and the costs of carrying out vehicle repairs, by acquiring a chain of vehicle repair garages and requiring that repairs are carried out at the insurer's own garages.

  - (iii) Describe how this approach may reduce costs. [3]
  - (iv) Outline the issues the company will need to consider before proceeding with the acquisition. [4]

[Total 12]

- 6** (i) List the principal aims of regulation of a financial market. [2]

The financial markets of a small developing nation are unregulated and underdeveloped. The firms and individuals operating in these markets subscribe to a voluntary code of conduct. The government is now intending to introduce regulation for these financial markets for the first time.

- (ii) Outline the reasons why the government may wish to introduce regulation of the country's financial markets. [5]

- (iii) Discuss the advantages and disadvantages of introducing the following systems of regulation:

- (a) self-regulation
- (b) statutory regulation

[9]

[Total 16]

- 7** A long-established company operates in a country with a developed economy and developed capital markets. The company sponsors a pension benefit scheme for its employees.

- (i) State the principles for setting the scheme's investment strategy. [2]

- (ii) Describe how the nature of the scheme's liabilities could influence its choice of assets. [10]

- (iii) List the controls over pension scheme investment that the country's regulatory authorities might impose. [5]

- (iv) Describe the process the company could use when assessing the scheme's investment experience. [6]

[Total 23]

**8** An employer currently provides a wide range of employee benefits for its 10,000-strong workforce in a developed country. It is reviewing the effectiveness of its benefits programme and is considering introducing a flexible benefits system.

- (i) Explain how a flexible benefits scheme can be useful for an employer's corporate human resource strategy. [6]
- (ii) Describe two examples of how employees could select against the employer in a flexible benefits system and for each suggest a way it could be mitigated. [3]

Company A is a general insurance company that writes an annual travel insurance policy with the following features:

- worldwide cover is provided for any number of trips during the year
- medical expenses abroad are covered up to \$10,000,000 per person
- repatriation costs are covered in the event of an accident while abroad
- the policy cover excludes business travel

Company A also writes single-trip travel insurance policies, normally purchased shortly before the trip starts.

Company A has suggested to the employer that an annual travel insurance policy, with monthly premiums deducted from salary, could be offered as an option in the flexible benefits system.

- (iii) Comment on how the risk profile of the policies that Company A would write under this arrangement might differ from the risk profile of its existing individual travel insurance portfolio. [5]
- (iv) List reasons why Company A may seek to purchase reinsurance. [5]
- (v) Outline the factors Company A will take into account when determining whether to purchase reinsurance to manage the risk on its travel insurance portfolio. [3]

[Total 22]

**END OF PAPER**