INSTITUTE AND FACULTY OF ACTUARIES

BACKGROUND READING

Subject CA3 – Communications

(Written)

Scenario: Compulsory Insurance Scheme

Note to students

The information in this background reading document was provided to candidates during the day of the examination in advance of the examination itself. Under the current version of CA3 all the background information is included in the question paper.

Background information

The government's compulsory insurance scheme's main function is to provide state funded redundancy payments to employees, when there is a qualifying insolvency event in relation to their employer.

The Compulsory Insurance Scheme (CIS) is a statutory body run by the Board of the Compulsory Insurance Scheme, a statutory corporation established under the provisions of the Compulsory Redundancy Schemes Act 2003.

To help fund these redundancy payments, compulsory annual premiums are charged on all eligible employers.

How they are funded?

The CIS has several sources of income. These include:

- an annual redundancy insurance premium that is paid by all employers who are eligible for the compulsory insurance scheme

- an annual contribution from government agreed each year by the government; and

- investment income on any assets the fund holds that have not been used for making redundancy payments in previous years

Which employers are covered?

All private sector companies, as defined in section 126 of the Compulsory Redundancy Schemes Act 2003 have to pay an annual redundancy insurance premium to the Fund. There are, however, some exceptions:

- private sector companies with less than 10 employees; and
- private sector companies who are wholly owned by an overseas parent company

Invoicing

Employers will receive their invoice in November / December each year. Invoices should be paid within 30 days of the date that they were issued.

Included with their invoice will be detailed supporting information to help them understand how their premium for that year has been calculated.

A sample schedule setting out how the premium is calculated for a particular company is included as Appendix 1 of this document.

The "risk based premium factor" used in the calculation of the premium is set by the government in April of each year. It reflects the anticipated economic climate that will apply over that year.

How to query an invoice?

The calculation of a company's invoice depends on certain information that the government obtains from a company's submitted accounts. There are 2 parts to the premium – a part that is based purely on the number of employees a company has and a part that is based on the perceived risk that the company may become insolvent. If a company thinks that the information on which their invoice has been based is incorrect then they must raise a formal query within 14 days of the date that the relevant invoice has been issued.

The formal query must provide details of the information that the company believes is incorrect. Full information on the items that must be provided to support this request for a recalculation, or to demonstrate that the company is exempt from the scheme, are provided on the government's compulsory insurance website www.compulsoryinsurance.gov.uk.

Appendix 1

Schedule setting out the calculation of the Redundancy insurance premium for 2007/08

Name of company: XYZ Company
Risk based premium factor for 2007/08 = 0.49

Service	*Number of eligible employees*
Less than 2 years	22
2–5 years	90
more than 5 years	90
Total	202

Company redundancy score for 2007/08 = 77

(The attached table should be used for converting the redundancy score into the probability of the company becoming insolvent over the forthcoming year.)

Company based premium

- Defined in section 27 of the Compulsory Redundancy Schemes Act 2003 as amended by subsequent regulations.

- Company based global formulae that apply to all eligible private sector companies (see section 25).

Company based premium calculated as the sum of:

£2.43 per eligible employee where the total number of employees is less than 1000, and
£1.50 per eligible employee where these number greater than 1000.

In addition a fixed payment of £150 is made per Company.

Company based premium = 2.43 × 202 +150 = £640.86

Risk based premium

- Defined in section 28 (a)–(c) of the Compulsory Redundancy Schemes Act 2003 as amended by subsequent regulations.

Risk based premium is calculated as:

“Employees related premium” × “Risk based premium factor” × “Probability of company insolvency”

where:

- Employees related premium = number of eligible employees × “Redundancy payment factor”.
- The employees related premium is defined in section 6(a) of the relevant legislation. It is weighted heavily in favour of longer serving employees to reflect the assessed probability of obtaining future employment within specified parameters.

The following table shows the redundancy payment factors applicable to 2007/08 and the calculation of the "Employees related premium" applicable to the XYZ Company.

Service	*A* *Number of eligible employees*	*R* *Redundancy payment factor*	$A \times R$
Less than 2 years	22	10	220
2–5 years	90	20	1,800
more than 5 years	90	120	10,800
Total	202	n/a	12,820

Risk based premium = 12,820 × 0.49 × 0.1250 = £785.23

Total premium for 2007/08 = 640.86 + 785.23 = £1,426.09

Probability of company becoming insolvent

1. This table should be used for converting the redundancy score for the relevant company into the probability of the company becoming insolvent over the forthcoming year.

2. This table has been approved by the government for assessing the risk of insolvency for the purpose of section 8(b) of the Compulsory Redundancy Schemes Act 2003. The tables should not be relied on for any other purpose.

3. The table applies from 1 January 2000 until further notice.

Redundancy Score	*Probability of insolvency*
0–60	0.0035
61–65	0.0044
66–70	0.0054
71	0.0065
72	0.0083
73	0.0094
74	0.0181
75	0.0390
76	0.0806
77	0.1250
78	0.2501
79	0.3580
80	0.4975

END OF BACKGROUND READING