

# **INSTITUTE AND FACULTY OF ACTUARIES**

## **EXAMINERS' REPORT**

### **Subject CA3 – Communications**

#### **(Written Paper)**

#### **Scenario: XYZ Compulsory Insurance Scheme**

##### **Introduction**

The Examiners' Report is written by the Principal Examiner with the aim of helping candidates, both those who are sitting the examination for the first time and using past papers as a revision aid and also those who have previously failed the subject.

The Examiners are charged by Council with examining the published syllabus. The Examiners have access to the Core Reading, which is designed to interpret the syllabus, and will generally base questions around it but are not required to examine the content of Core Reading specifically or exclusively.

The Examiners' preferred approach to the solution is reproduced in this report; other valid approaches are given appropriate credit.

D C Bowie  
Chairman of the Board of Examiners

January 2013

A possible answer is given below. This is not intended to be a model solution. In practice, a wide number of solutions was acceptable and candidates would have achieved good pass standards without having the same level of detail as the specimen solutions.

Candidates were asked to draft a response to a letter from an irate Finance Director explaining why there has been a nine-fold increase in the premium payable to the compulsory redundancy scheme. Candidates were expected to focus on the two component parts of the premium and explain that the large increase in premium was primarily due to the increase in risk based premium.

The main points that the examiners were looking for and some common problems encountered were as follows:

1. Most candidates had a suitable opening paragraph to the letter. Scripts gained marks for a clear summary of the query, but not where the opening paragraph was lengthy and repetitive or did not refer to the initial query.
2. There was no evidence of candidates running out of time and therefore not completing the answer.
3. Poor scripts were unstructured and simply repeated a lot of the information provided in the question paper. They did not attempt to exclude any information that was not relevant for the Finance Director.
4. Majority of candidates confirmed that the 2008/2009 premium was correct.
5. Poor scripts simply repeated the information provided in the question paper. They did not explain succinctly that the premium was composed of two parts and it was predominantly a significant increase in one element that led to a large increase in the 2008/09 premium compared to the previous year.
6. Many candidates lost marks for not getting to the point indicating that they did not identify the key objectives of the letter.
7. A number of candidates used language and tone that would not be appropriate for a Finance Director. These scripts were dumbed down significantly.
8. A large number of scripts explained that the premium was made up of 2 parts: a company based premium and a risk based premium.
9. Most candidates explained that there was only a small increase in the company based premium and that the large increase was in respect of the risk based premium (RBP).
10. Candidates gained marks for further explaining that increase in the RBP was due to the
  - (a) number of employees falling into the more than 5 years' service bracket
  - (b) increase in the risk based premium factor
  - (c) rise in the company redundancy score
11. Good candidates explained that whilst the increase in the RBP was a multiple of 15 and the company based premium was relatively small, the overall impact was a nine-fold increase in the total 2008/2009 premium.

12. Better scripts included a summary of the effect of the three factors and related it back to the query.
13. Candidates lost marks because of the use of jargon such as reference to sections of the Compulsory Redundancy Schemes Act 2003, insolvency probability etc.
14. Poor scripts added too much detail on the redundancy regulations and the formula used in determining the premium.
15. A number of scripts suffered from poor spelling, grammar and punctuation.
16. The guideline length was 450 to 500 words. Scripts which were below 400 words generally missed out some of the explanation. Scripts which were longer than 550 words often lost marks for including unnecessary repetition or irrelevant detail.

Mr Smith  
Finance Director  
XYZ Company

Date

Dear Mr Smith

Re: Compulsory redundancy scheme premium for XYZ Company

Thank you for your letter of 12 March 2008 asking for information on why the insurance premium for the XYZ Company has increased by so much for 2008/09 compared to the previous year. I apologise if this was not made clear to you in our previous response.

I confirm that the calculation is correct and that the premium for XYZ Company has increased from £1,426 in 2007/08 to £12,480 for 2008/09.

The compulsory redundancy scheme premium is made up of 2 parts, a “company based premium” and a “risk based premium”.

### **Company based premium**

The company based premium is paid by all private sector companies whose employees would be eligible for government funded redundancy payments if their employer were to become insolvent.

For the XYZ Company this part of the premium has increased from roughly £641 in 2007/08 to £698 in 2008/09 (i.e. in absolute terms this accounts for only a £57 increase in your premium). This relatively small increase mainly reflects an increase in the number of your employees who would be eligible for redundancy payments for 2008/09 compared to 2007/08.

### **Risk based premium**

This part of the premium reflects both the overall amount of the redundancy package that would be payable should XYZ Company become insolvent and the perceived risk of the insolvency of the company.

For the XYZ Company this part of the premium has increased from £785 in 2007/08 to £11,782 in 2008/09 (i.e. this part of the premium has increased by 15 times). The reason for this large increase is as follows:

- There was an increase in XYZ Company’s overall redundancy payments that would have become payable. This was mainly due to a large number of employees falling into the “employed for 5 years or more bracket”. The redundancy payment increases significantly for employees who have been employed for more than 5 years. This had the effect of increasing this element of the premium by nearly 50%.
- There was an increase in the risk based premium factor that was used by the government to set the premium level from 0.49 to 2.46 i.e. this factor increased by a multiple of 5

times. This applied to all companies who are covered by the compulsory redundancy scheme and reflects the current economic climate.

- There was a rise in the company redundancy score for the XYZ Company between the dates that the premiums were calculated. As you are aware, the company redundancy score is an indicator of the probability of the sponsoring company becoming insolvent. This had the effect of more than doubling the risk based element of your premium.

Overall the combination of these 3 changes has had the effect of producing an increase in your risk based premium for 2008/09 by roughly 15 times compared to the premium for 2007/08 (i.e.  $1.50 \times 5 \times 2 = 15$ ).

I therefore confirm that your premium for 2008/09 is correct.

Please don't hesitate to contact me if you have any further questions.

Yours sincerely,

A Jones  
Redundancy compensation scheme

**END OF EXAMINERS' REPORT**