

# **INSTITUTE AND FACULTY OF ACTUARIES**

## **EXAMINERS' REPORT**

September 2017

### **Subject CP3 – Communications Practice**

#### **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 CP3 communications practice examination is designed to test the communication of an actuarial concept to a non actuarial audience. Sufficient technical detail on the scenario is provided in the advance material and the question so that candidates from all backgrounds are able to answer the question.

One approach to a solution is reproduced in this report; other valid approaches were given appropriate credit.

Luke Hatter  
Chairman of the Board of Examiners  
December 2017

**A. General comments on the *aims of this subject and how it is marked***

Subject CP3 consists of two parts as follows:

**1. Written communication (90 marks)**

Produce a written piece of communication that explains to a non-actuary a scenario that may typically be faced by an actuary in their day to day work.

The communication needs to be of a standard that it would be acceptable as a first draft. It is important that the recipient would both understand the communication and be satisfied with the response. The marking schedules include details of the marks awarded for including the necessary content. To the extent that it makes the communication unclear or confusing for the audience, marks may also be lost for including irrelevant content or details that candidates have specifically been asked to exclude from their solution.

**2. Reflective questions (10 marks)**

A set of questions designed to allow students to consider the approach that they took in their communication and justify certain decisions. For example, students may be asked what information they felt was relevant for this audience, or which terms they specifically excluded because they would constitute jargon.

Students are provided with some background reading a few days before the exam (the Advance Material) to allow them to familiarise themselves with the scenario without being under exam conditions. Students are expected to read the information provided, but are not required to do any further reading or research around the scenario.

**B. Comments on *student performance in this diet of the examination***

As a significant investor in the company, the audience for this letter can be assumed to understand at least the basics of the market in which PRESTIGE LIFE operates. However, no technical actuarial knowledge should be assumed, and one should not assume that they are familiar with the innovations brought to the market by another firm. They will be looking for an in-depth response that explains the ratios, opportunities and risks in clear and simple language.

In general students struggled with the language and content aspects of this paper, rather than the formatting and planning. The level of detail that most students produced was not sufficient to satisfy the audience. Explanations of financial ratios were often too technical (or in some cases no explanation was offered at all). While one could argue a large investor may understand some insurance ratios, these specific ratios should be clearly defined to ensure that there is no misunderstanding in their meaning.

Students tended to include too much jargon in their responses, or language that although explained served no purpose and only acted to confuse the recipient. A good example of this was the 'Combined Operating Ratio'. Although included in the background information for the question, there was no need to include this in the response. A clear and simple explanation of the claims and the expense position of the companies would be sufficient for the recipient to fully grasp the main differences between the companies and no additional information was conveyed by combining them.

There was a strong correlation between the marks scored for the main communication and the marks scored on the reflective question, suggesting that most students who identified the elements that are key to the communication were able to apply this in practice. Students should perhaps have spent more time at the start of the exam planning their communication and identifying the key objectives of the letter.

Following the release of the advance material the following issues were identified:

- In the definition of claims ratio on page 3, there was an inconsistency between references to gross and net premiums. It was confirmed to students that any reasonable interpretation of the ratios would be accepted by the examiners.
- In the table on page 4 the years 2014 and 2015 were listed as 2016. A correction was issued to students.
- The age band 18-24 in the table at the top of page 5 should have read 18-21. A correction was issued to students.

These issues were discussed at a meeting with all of those involved in the marking process. The examiners do not believe they affected the performance of students.

## **C. Pass Mark**

The Pass Mark for this exam was 62.

## SOLUTION

A possible solution is shown below. This is not intended to be a perfect solution, but would be considered a clear pass by the examiners. In practice, a wide number of solutions were acceptable, and there were many aspects of students' scripts that improved on the solution shown below. (For example, a stacked bar chart showing the financial ratios is likely to be easier to read at a glance than the two pie charts shown in this solution.)

### Question 1:

<My address>

<Shareholder address>

<Date>

Dear Mr Paulson,

### YOUTHSURE AQUISITION

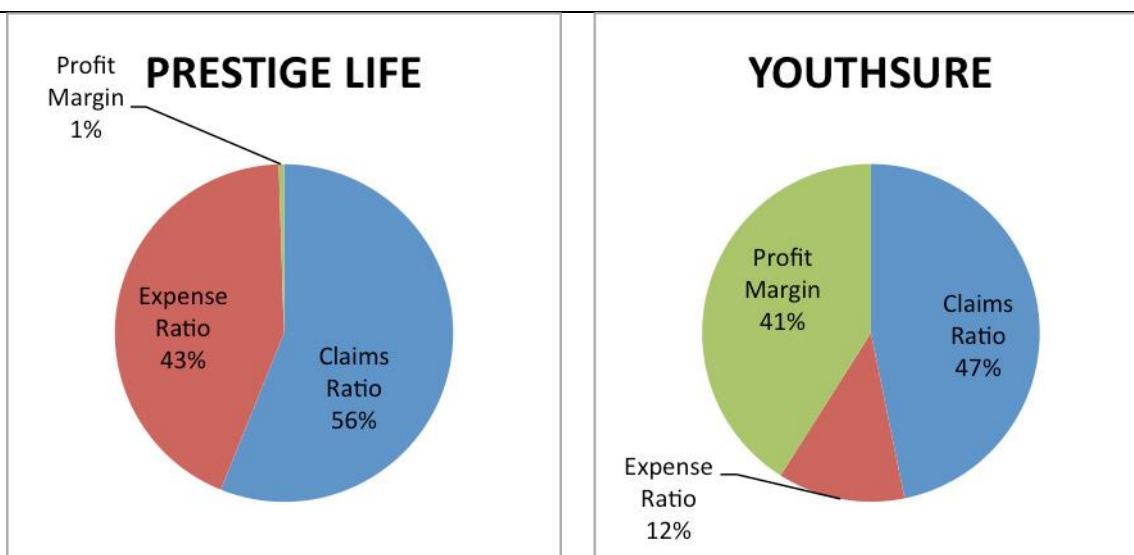
Thank you for your letter of 1 September addressed to my colleague Margaret Jones. You asked us to provide you with an update on the potential acquisition of YOUTHSURE, a relatively new company which is expanding in the online market. YOUTHSURE has a fundamentally different business model to PRESTIGE LIFE, which represents an opportunity to allow PRESTIGE LIFE to expand and appeal to a wider selection of policyholders.

However, it presents some challenges, and ensuring the operational efficiency of the company after the acquisition may be difficult. I shall explain in more detail below.

### *Financial Details*

The financial positions of PRESTIGE LIFE and YOUTHSURE are fundamentally different. YOUTHSURE has experienced higher levels of profitability than PRESTIGE LIFE by ensuring efficiency in their operations and claims processes through technology driven administration. Similarly, they have removed commission by offering online sales direct to their customers.

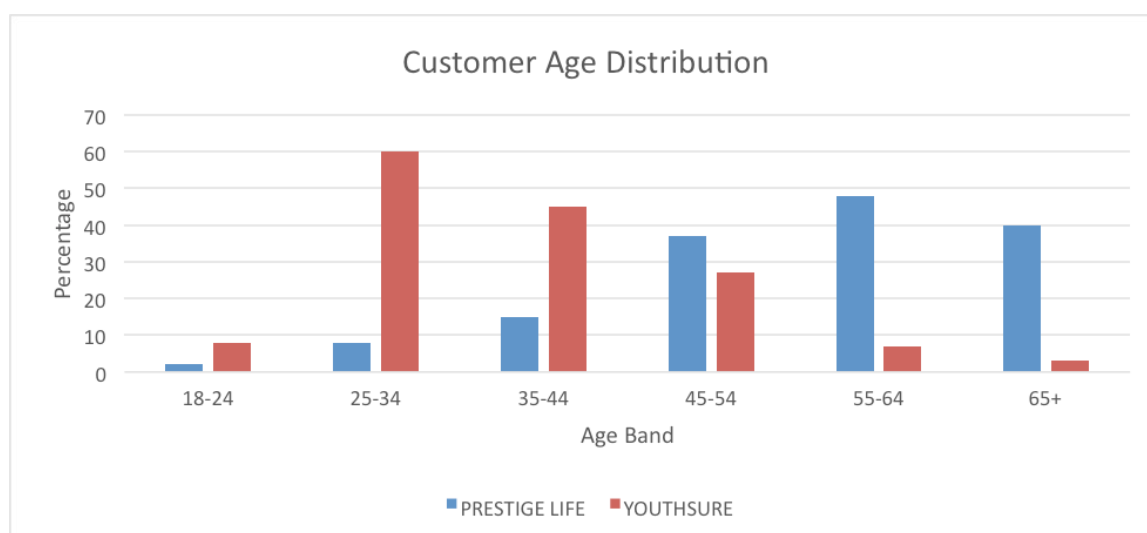
For PRESTIGE LIFE, more than half of the premium income goes towards paying claims with almost all the rest spent on expenses. Very little is left for profit; around £1 out of every £100 of income. For YOUTHSURE, just under half the premium income goes towards claims and a much smaller proportion towards expenses. This leaves much more for profit, approximately £40 out of every £100 of income.



While profit margins are higher for YOUTHSURE the average premium size is considerably smaller, at about one tenth the size. This means that they would require significant sales each month to create meaningful profits when compared to PRESTIGE. Positively, new sales have increased ten-fold over the last two years.

### ***Opportunities for PRESTIGE LIFE***

As can be seen in the graph below, YOUTHSURE targets younger customers than PRESTIGE LIFE with 75% of their policyholders below the age of 45. This is achieved by providing features which are attractive to their policyholders such as an online sales process, cheap premiums and easy to understand benefits.



Over time, as the YOUTHSURE customers age, the products offered by PRESTIGE LIFE may become more attractive and suited to their needs providing a natural source of new business for PRESTIGE LIFE.

YOUTHSURE owns software which allows it to operate the business very efficiently. By adopting some of these systems or processes it may be able to reduce the expenses of PRESTIGE LIFE.

Finally, YOUTHSURE currently only offers a single product. There is the opportunity to grow revenues by introducing new product lines. PRESTIGE LIFE's experience in a wider range of products may be able to assist.

### ***Challenges for PRESTIGE LIFE***

YOUTHSURE currently has very little competition in the market in which it operates. Internal research has revealed that about 65% of their customers are first-time life insurance purchasers compared to only 4% for PRESTIGE LIFE. This means there may be less brand loyalty among YOUTHSURE's customers. If competitors enter this market, YOUTHSURE may be at risk of either losing business or having to reduce premiums to maintain its market share.

Research appears to indicate that the YOUTHSURE management team has underinvested in some critical areas of the business such as customer service. As a result, 42% of YOUTHSURE customers reported a below average customer experience, in contrast with the high quality and standards associated with PRESTIGE LIFE.

Furthermore, due to limited resources, YOUTHSURE are passing on a large percentage of their risk to a third party through a reinsurance agreement. The effect being a reduction in long-term profitability.

The core sales strategy of YOUTHSURE relies on online sales with automatic computer based advice. PRESTIGE LIFE currently relies heavily on financial advisers to sell their products, and the idea of automating this may weaken our relationship with advisers resulting in a loss of PRESTIGE LIFE'S reputation.

The final risk to consider is that YOUTHSURE is still relatively young and working out their strategy. As a result, there is a risk that the company will experience volatile results over the short and medium terms.

### ***Summary***

The acquisition of YOUTHSURE offers significant opportunities for growth that PRESTIGE LIFE has not been able to achieve in the recent past. YOUTHSURE appears efficient and profitable based on our analysis so far, however, there are certainly risks in trying to align the objectives of the two organisations. If you have any questions you are welcome to contact Margaret directly.

Yours sincerely,

Jim Jones  
Training Actuary

[710 words]

**Question 2:**

**Part a:**

- I have used two types of chart to add variety to the document.
- The audience is well educated and able to understand charts.
- Where I discussed premium breakdown, I used a pie chart to illustrate volumes in % and used £ in the words to avoid simply replicating data.
- I have clearly labelled all charts to ensure they are clear to the reader.

**Part b:**

The research survey included a question asking customers about the main quality they look for in an insurance company. While it is important for both PRESTIGE LIFE and YOUTHSURE to understand what they need to improve to attract new potential customers, this was not relevant to the question being asked. While this information confirms that YOUTHSURE are performing on the dimensions which are important to new customers, the question was more forward-looking and interested in future potential opportunities which could arise from the acquisition.

Much of the information contained in the industry magazine article was not directly incorporated into the letter to Mr Paulson. While the information was useful in providing background to YOUTHSURE's operating environment, many of the specifics were not relevant here. For example, the large growth of fintech start-ups.

**Part c:**

The magazine article contained jargon which may not be familiar to the audience. For example, 'fintech', 'millenials' and 'robo-advice'. Given that the audience holds a large investment in an insurance company it may be that they are familiar with these terms, however, it was better to be cautious and avoid using this jargon, or explain clearly where a particular word was necessary.

**Part d:**

Using sub-headings, I was able to clearly distinguish between the positive and negative aspects of the acquisition. This ensured that I was able to focus on each independently to produce a balanced view, without influencing the comments with my personal opinions.

The language used was somewhat detached to allow the facts to be objectively presented and the reader free to make up his own mind. For example, contrast the following two sentences:

- "PRESTIGE LIFE currently relies heavily on financial advisers to sell their products, and the idea of automating this may weaken our relationship with advisers resulting in a loss of PRESTIGE LIFE'S reputation."
- "We rely heavily on financial advisers to sell our products, and if we upset them by introducing automated advice, we could lose a lot of support"

I avoided the use of emotional words such as harsh adjectives or hyperbole. Poor examples would be:

- “the incredible opportunity to acquire YOUTHSURE”
- “poor customer experience in YOUTHSURE could have devastating consequences for PRESTIGE LIFE’s operations”

## MARKING SCHEDULE

### OBJECTIVE MARKS for Q1

#### Length of answer

The number of words should be calculated counting all words after the address, heading, salutation, heading for the letter etc. up to the sign-off.

650–750 words	[5]
575–649, 751–825 words	[3]
500–574, 826–900 words	[1]
<500 or >900 words	[0]
<b>Total for length of answer</b>	<b>[Total 5]</b>

#### FORMAT

##### Letter format

[Max 3]

Clearly addressed to Mr Paulson:

[1]

Suitable title for letter – clear reference to YOUTHSURE acquisition

[1]

Date, author, addressed in appropriate places

[1]

##### Planning and presentation

[Max 12]

##### Grouping of ideas

Document is grouped into an appropriate number of sections (excluding introduction and summary).

- if 3–5 sections [2]
- 2 or 6 sections [1]
- otherwise [0]

##### Logical order of points.

Logical order between sections. When awarding marks here, consider the overall heading and purpose of the section rather than the content within it.

- If read once and clear [2]
- if needed to re-read parts then [1]
- otherwise [0]

Logical order of points within each section. When awarding marks here consider the order of points within each section.



- If read once and clear [3]
- if one section needed to be re-read [1-2]
- otherwise [0]
- Points within each section are directly relevant to the heading [1]

**Appropriate short headings on each section** [Max 2]

- Give a mark to each appropriate heading
- Long headings or headings that don't succinctly describe what follows don't get a mark.

**Sentences kept brief** [Max 2]

- Award 2 marks if there are no overly long sentences.
- Award 1 mark if there is one overly long sentence.
- If more than one overly long sentence, award 0 marks.
- The principle is that a sentence containing more than one message or too many sub-clauses is too long. Or, if spoken, needs repeated breaks to articulate.
- A guideline is that over 35 words is too long.

**Charts and Tables** [Max 5]

**Format of visual aids** [Max 3]

- Charts and tables are an appropriate format for the information being described, for example a pie or stacked bar chart used to illustrate a premium breakdown, a chart to compare and contrast age distributions. Award 1.5 marks for each appropriate chart or table to a maximum of 3 marks.

**Visual aids kept simple** [Max 2]

- Charts are not too complex, tables don't contain too many numbers. 2 marks if all charts & tables are simple and uncluttered; 1 mark if up to two charts/tables are overly complex, 0 marks if more charts/tables are complex.
- If no charts or tables in the answer, score zero.

**Total for format of answer** [Total 20]

**Language used**

**Overall language** [Max 7]

- Language used is simple and will be easily understood by the shareholder (noting that he will have some business knowledge but will have limited understanding of specialist insurance matters). Award:
  - if the document is understandable as a whole [5]
  - 4–3 marks if up to two points need to be redrafted [4-3]
  - 2–1 marks if three to four points or one section needs to be redrafted [2-1]
  - 0 marks if more than four points or more than one section needs to be redrafted [0]
- Professional tone (avoid comments which “talk down” to the shareholder, or comments which are derogatory to the industry in general). [1]
- Avoid colloquialisms, informal and/or emotive language. [1]

**Jargon and terminology** [Max 10]

- Absence of technical terms. Award 6 marks if there are no terms present which are too technical for the recipient. Award 4 marks if there is one unexplained technical term and 2 marks if there are two unexplained technical terms. If there are three or more unexplained technical terms, award 0 marks. A list of jargon terms is supplied below (but

is not necessarily exhaustive). Jargon includes unnecessary technical terms where a simpler term exists, or terms and/or abbreviations which may be acceptable but are unexplained. [6]

- Superfluous accuracy of numbers (such as too many decimal places) is avoided. Award a mark where there are no figures quoted to an inappropriate number of significant figures. In general, percentages should have no decimal places. Quoting monetary amounts below \$1,000 including cents is acceptable. [1]
- Absence of irrelevant points of content. Award 3 marks if no irrelevancies, award 2 marks if one irrelevant point, 1 mark if two irrelevant points. If more than two irrelevant points award 0 marks. Examples of irrelevancies might include for example detailed descriptions of the different policy types, or full results of the customer survey. [3]

**Grammar, spelling and punctuation [Max 3]**

- Award 3 marks if no significant grammatical, spelling or punctuation errors, 2 marks if one error, 1 mark if two errors. Award 0 marks if more than two errors. Each “error” should be significant enough to compromise the professionalism of the document or require sections to be redrafted

**Total for language used [Total 20]**

**Content**

Marks shown are to be awarded for each item of content identified in the candidate's answer. To be credited with the mark(s) the point needs to be clear and understandable. However, points that require only minor adjustment should be credited, as should valid points not included in the mark scheme.

Markers should use discretion when there is more than one mark for a point, awarding part marks to reflect the level of clarity. Markers should also use their discretion when considering clarity to ensure that, for example, candidates who cover most of the content items, but not very clearly, are still given some credit, rather than penalised for every point made.

**1. Introduction**

- Clearly shows understanding of what the shareholder has asked for [1]
- Clearly signposts to the rest of the letter, stating that it will cover
  - A review of the YOUTHSURE acquisition [1]
  - Letter on behalf of manager Margaret [1]

**2. Background**

- PRESTIGE LIFE has intention to purchase YOUTHSURE [1]
- There are clear differences between the two businesses [1]

**3. Product Economics**

- PRESTIGE LIFE... low profit margins [1]
- YOUTHSURE... efficiencies through technology in operations and claims processes [2]
- Chart or table showing breakdown of premium between expenses, claims and underwriting profits [3]
- Explanation of chart/table [2]

- Average premiums much smaller for YOUTHSURE... [1]
- Therefore they require more sales... [1]
- To achieve meaningful absolute profits [1]
- Fortunately sales have been steadily increasing... [2]
- ... ten fold growth in 2 years [2]

#### 4. Opportunities

- YOUTHSURE targets a younger customer base than PRESTIGE LIFE. [1]
- This is achieved through online sales process, cheaper premiums and easy to understand benefits [1]
- Chart or Table or Summary Statistics to support this [3]

Synergies existing in merger...

- As YOUTHSURE customers age and needs change, this will provide business opportunities to PRESTIGE LIFE. [1]
- Proprietary software and algorithms of YOUTHSURE can improve operational efficiencies at PRESTIGE LIFE. [1]
- PRESTIGE LIFE can offer product knowledge to help YOUTHSURE expand product offering. [1]

#### 5. Risks

- YOUTHSURE attractive to customers with no previous insurance... [1]
- ...65% of customers have no cover elsewhere vs. 4% at PRESTIGE LIFE. [1]
- However, low levels of competition are unlikely to endure as many new entrance looking to enter the market. [1]
- YOUTHSURE have been underinvesting in some core areas due to Financial constraints [1]
- - Large percentage of risk is reinsured...so long-term profits are being diluted. [1]
- - Poor customer service... [1]
- - 42% of customers report poor customer service [1]
- Robo-advice model could conflict with PRESTIGE LIFE's reliance of financial advisers. [2]
- Volatile returns can be expected in the short-medium term. [1]

#### 6. Summary, close of letter

- Acquisition offers opportunities for growth through new customers, higher profit margins, improved operational efficiencies... [2]
- But also risks [1]
- Offer to help, or similar close [1]

**Total for content** [Total 40]

#### Meeting of objectives

The shareholder is likely to be satisfied with the answer. [Total 5]  
 For guidelines see below.

**Reflective questions**

**[Max 2]**

**2a. Approach to visual aids**

**[½ each]**

- Visual aids are needed to add variety
- The addressee is a shareholder and will be well-educated
- He will be able to understand tables of figures
- Premium breakdown is best shown in a suitable chart...
- because this clearly shows the proportions (or appropriate justification for other format)
- Visual aids must add value and not just replicate the data
- Tables are kept brief if used at all
- Age distribution is best shown by chart... where comparing the client base of the companies

**2b. Filtering information and data (TWO examples required, 2 marks each)** **[Max 4]**

Markers should look for valid discussion points relevant for the question:

- The research survey included a question asking customers about the main quality they look for in an insurance company.
- While it is important for both PRESTIGE LIFE and YOUTHSURE to understand what they need to improve to attract new potential customers, excessive detail on this was not relevant to the question being asked.
- While this information confirms that YOUTHSURE are performing on the dimensions which are important to new customers,...
- ...the question was more forward-looking and interested in future potential opportunities which could arise from the acquisition
- Much of the information contained in the industry magazine article was not directly incorporated into the letter to Mr Paulson
- While the information was useful in providing background to YOUTHSURE's operating environment, many of the specifics were not relevant here...
- For example, the large growth of fintech start-ups.
- Lastly, the purpose of the magazine article is entertainment as well as education
- Therefore some elements, such as direct exaggerated quotes from YOUTHSURE's CEO were not appropriate.
- The reader, as a large shareholder of PRESTIGE LIFE, will already be familiar with most of the data on PRESTIGE LIFE.
- This information was not relevant in and of itself to the discussion...
- ...except as a reference point to compare against YOUTHSURE.
- It was therefore used sparingly.

Other examples to be given credit where appropriate. Where candidates have discussed more than two examples, markers should credit their highest scoring two. Do not credit more than one example from any one heading.

**2c. Jargon**

**[Max 1]**

Relevant comments on jargon that has been excluded, or jargon that has been used but explained should score one mark. One mark is awarded for a single well explained point.

**2d. Not giving financial advice**

**[Max 3]**

- Through the use of sub-headings I was able to clearly distinguish between the positive and negative aspects of the acquisition...
- This ensured that I was able to focus on each independently to produce a balanced view, without consciously or unconsciously influencing the comments with my personal opinions.
- The language used was somewhat detached to allow the facts to be objectively presented and the reader free to make up his own mind.
- 
- Relevant example of detached language.
- I avoided the use of emotional words such as harsh adjectives or hyperbole.
- Examples of good / bad language

**Total for reflective questions**

**[Total 10]**

**[Total 100]**

<b>Jargon</b>	<b>Possible jargon</b>	<b>Not jargon</b>
Reinsurance	Loading	Risk
Capital	Underwriting	
Combined Operating Ratio (or COR)	Algorithms	
Cross-sell	Proprietary software	
New Business Strain Quota Share (or other reinsurance structures)	Claims ratio	
Due diligence	Net earned premium	
Expense base	Claims incurred	
Robo-advisors		
Risk Retention		
Underwriting profit		
Fintech		

## **GUIDELINES FOR MEETING OF OBJECTIVES**

### **Shareholder is satisfied**

#### **4–5 marks**

**The shareholder will be completely satisfied with the response to the question and the responder has made a good impression on the shareholder.**

The communicated answer is clear and easy to read, the response flows through to a conclusion. It looks good, it is well set out, and it has the right tone of voice. It satisfactorily and completely answers the question. The responder has made a good impression on the shareholder.

#### **2–3 marks**

**The shareholder is left with some question marks over the responder, and therefore over aspects of the answer given.**

The shareholder has been given an answer that is partially understandable although the response does not quite flow freely through to a conclusion. Some information in the argument is obviously missing and/or there are one or two visual mistakes and anomalies in the look of the response. Some technical terms may have been used that are not entirely clear. The shareholder is left with some question marks over the responder, and perhaps therefore over aspects of the answer given.

#### **0–1 mark**

**The shareholder is left with a poor impression of the responder, is confused by the answer and/or does not trust the answer.**

The answer will leave the shareholder confused. The communication is poorly written or possibly too technical. There are some obvious mistakes in the arguments, tables or charts do not make sense and/or are not properly labelled. The answer does not flow, but rather jumps around. The layout is not consistent throughout the communication. There may be spelling mistakes or the shareholder has not been properly addressed. The tone of voice is wrong, perhaps too informal. The shareholder has been left with a poor impression of the responder and therefore does not trust the answer.

**END OF EXAMINERS' REPORT**