

EXAMINATIONS

September 2001

Subject 403— UK Fellowship General Insurance

Paper Two

EXAMINERS' REPORT

Introduction

The attached subject report has been written by the Principal Examiner with the aim of helping candidates. The examiners are mindful that a number of interpretations may be drawn from the syllabus and Core Reading. The questions and comments are based around Core Reading as the interpretation of the syllabus to which the examiners are working. They have however given credit for any alternative approach or interpretation which they consider to be reasonable.

The report does not attempt to offer a specimen solution for each question - that is, a solution that a well prepared candidate might have produced in the time allowed. For most questions substantially more detail is given than would normally be necessary to obtain a clear pass. There can also be valid alternatives which would gain equal marks.

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Chairman of the Board of Examiners
20 November 2001

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- (i) Consumer requirements
 - Product coverage should match needs of intended purchaser
 - Intermediary requirements
 - Product should meet needs of intended sellers
 - e.g. remuneration should reflect sales effort required
 - Insurer requirements
 - Coverage offered should reflect insurer's limitations
 - e.g. processes, systems
 - particularly policy administration and claims handling
 - needs clear /tight policy wording
 - risks should be independent, quantifiable and finite in size
 - there should be a low probability of a claim
 - and in particular of unexpected claims / accumulation of risks
 - Regulatory requirements
 - Product must satisfy legislation
 - Including voluntary codes of trade / consumer bodies
 - Method of Sale
 - Complexity of product should reflect distribution method
 - Saleability
 - Product should have defined market
 - and be appropriate to needs of market
 - Simplicity
 - Product should be simple enough to be understood by buyers + sellers
 - Fraud prevention
 - Product design should minimise potential for fraudulent claims
 - This will keep down claims costs + premium rates
 - Pricing
 - Should be able to rate product accurately
 - And selection against the insurer avoided
 - Should not be expensive to rate relative to the expense loadings
 - Price should be acceptable to target market,
 - i.e. should offer value for money
 - Cost reduction
 - if price is too great for customer, coverage should be scaled back
 - e.g. Comp to TPO cover in motor insurance
 - Evolution
 - Product should be capable of development over time
 - to meet changes in demand, environment, etc.,
 - Product differentiation
 - Products capable of tweaking to differentiate them from competitors' products.
- Shareholders/Company owners
 - Produce profit commensurate with risk to produce required level of return on capital employed
 - At an acceptable level of volatility
- Reinsurers point of view – there is a need to cover for the extreme claims

Most candidates considered all of the interested parties and the question was answered reasonably well.

- (ii) Customer does not understand what he is buying
Causes could be policy design, documentation,
policyholder ignorance or misinterpretation

e.g. MIG premium to cover lender and not borrower
Product sold is not appropriate for customer's needs
Inadequate cover or exclusions
No legal requirement for a fact find as in life or investment products.
This could be introduced
Insurer is about to go insolvent
Poorly trained staff
Pushy or aggressive marketing
Solution could be to establish a hierarchy of personal insurance needs
and consumers given info to determine if level of cover meets min.
requirements.

The product duplicates cover already given
Travel is an example if it replicates similar all risks cover in a household policy

No obligation on insurers / intermediaries to offer the most appropriate product.

e.g. insurer launches revised / renamed product while renewing on old version.
Product provides no cover at all.
e.g. travel insurance sold to elderly with claims declined on age grounds.
Product appears to be compulsory
e.g. travel insurance with a holiday or household cover with a mortgage.
solution is to require mortgage borrowers to positively opt in to buy household
ins.
Insurance industry manufactures needs that are artificial
Deliberate misrepresentation by the intermediary
ABI Code of Conduct outlaws this
Better training of staff
Change remuneration basis for sales staff
Improved policy design / documentation
Introduce a cooling off period

*Overall, this was answered well, but a few candidates did not understand the
concept of mis-selling*

- (iii) Characteristics
Telephone
Mass media advertising is used to generate direct enquiries to insurers by phone

Aim is to achieve cost advantage compared with traditional insurers by
selecting good risks to minimise claim costs +
low admin costs through heavy investment in technology + communication
large business volumes + economies of scale
efficient + flexible customer service staffing levels
optimum management + support staff structure

- higher renewal rates
- effective advertising strategies
- no commissions, especially at renewal

Internet

- Aim is similar to telephone but
- Initial technology spend higher for internet on-line service
- But long term running costs are lower
- difficult to select risks on-line compared with telephone
- requires more complicated rule algorithms
- smaller target market than telephone

Product Design

Telephone

- Products were initially standardised as focus was on cost advantage
- Complex pricing systems possible because of big IT investment
- Junior staff can handle sales because IT systems can implement rules
- Human intervention required for difficult cases
- Most expenses in acquisition, with renewal + servicing costs minimal
- Maintaining high retention rates is critical

Internet

- Similar to telephone

Sales Motivation Techniques

Telephone

- Sales performance depends on generating cost effective enquiries which requires effective marketing campaigns
- Need to convert enquiries into policies
- requires staff to be skilled and motivated
- implies training and financial performance incentives
- retaining policies at renewal
- depends on price and quality service
- Good brand means new business comes from referrals and unprompted enquiries
- reducing distribution costs

Internet

- does not apply to fully on-line internet as all sales are electronically generated
- should imply cost savings compared with telephone
- “Half and half” systems mean humans required to close sale

Quality Issues

Telephone

- Telephone lines open for long periods to ensure accessibility to customers

- IT technology means all correspondence is computer generated

- This presents a better image than pre-printed forms

- but depends on postal system with possible delays

- Insurer has greater control over recruitment standards, training, supervision

- because all sales staff are company employees

- Conversation with customer enables him to understand risk
- and avoid completing proposal / claim forms

also identify fraud at underwriting + claims handling stage

Internet

24 hour access in internet

Correspondence similar to telephone

less need for staff implies less worries about training, standards

More exposed to underwriting fraud due to less personal contact

Claim handling similar

requires adequate user testing of system

Security

Telephone

Need for post implies less security than internet

where everything completed on-line

Internet

Encryption techniques enable easier payment facilities with fool-proof security

Cross Selling

Telephone

Focus on clearly defined segments means less interest on cross-selling

Cross selling needs to be verbally prompted

Success depends upon training of staff

Internet

Depends upon ease of use of site

Easier to cross sell on internet by clicking on screen icon

Claims Handling

Telephone

Phone enables quick notification of accidents + check on cover

Direct repairs contracted to dedicated repairer network

No conflicts on interest from intermediaries in claims process

Claim can be assessed without regard to intermediary relationship

Internet

Need to set up claims handling centre

On-line handling not really feasible

Otherwise similar to telephone

Data

Telephone

Information captured efficiently + quickly

Quotation details recorded as given

Immediate policy acceptance

All info recorded at a policy level

Data captured can be modified quickly

Good MIS can be developed to monitor marketing and underwriting performance

Extensive database facilitates quicker response to trends

Internet

Customer inputs information so no need for staff to do so

Opportunity to capture softer, lifestyle info from customer
which could be used in rating

Overall, this was answered poorly. For part (a), many candidates described the sales process rather the characteristics of the method. For part (c), a number of candidates interpreted Sales Motivation Techniques as applying to potential policyholders, rather than the insurer's staff, as intended.

2 Data

A's data availability and format should be unchanged, unless
new IT system (hardware and / or software) impacts, and / or
backlogs or processing problems can impact on both A + B's data
Large claim data may be available in one company but not the other
Net of reinsurance data may be available in one company but not the other
Latent claim data may be available in one company but not the other
B's data maybe lost or corrupted during migration
Introduction / removal of formula reserving may impact data availability,
e.g. delay until manual estimates are put on claims
Different level of detail of policy data for the companies
Change in mix of business

New Business written since the merger

When and how were products integrated.
Did A's or A+B's handlers handle A's claims pre new business integration
What happens post integration of products

Claims Handling Process

Pre-merger

One company may pay out more slowly due to greater use of litigation, or
more claims handled per person in one company than the other
Different approaches to building up surplus / margins
e.g. one company may inflate to present date / settlement date
Handlers' view of future inflation may be different
Direct Claims handling expense cost / allocation may be different because of:
greater use of external solicitors / adjusters, fight more cases in court,
Different attitudes to settlement and / or reopened claims
Different definitions of claims, treatment of nil claims and partial payments
Different exposure measures

Post-merger

Integration of 2 claims departments will affect handling process
backlogs until integration beds down,
staff may retire, leave affecting experience levels.
handling philosophy may change, e.g. best of both companies practice

Actuarial Reserving Methodology

A + B's pre-merger cohorts run off separately
Pre-merger actuarial reserving cohort definitions may be different
e.g. U/W, Acc, Trading year
Difficulties in restating data triangles if cohort definition changes
Choose cohort definition for post-merger business
May not be able to use all the current reserving methods
because A or B's data may not exist,
e.g. settled cost data may not be collected

A + B's underwriters may have different views of loss ratios for BF methods
A + B use different CHE and investment return amounts in APUR
calculations

Premium rating basis may continue to be different for two sets of business each
hence need to consider of say A + B motor business needs to be assessed
separately or together for APUR calculations.

*This question was not answered particularly well by a number of candidates.
Many listed the common problems with data, but didn't apply them to the
situation of a merger of two companies.*