

EXAMINATIONS

6 April 2001 (pm)

Subject 403 — UK Fellowship General Insurance

Paper Two

**You must answer this subject only,
you may not attempt another subject in the 400 series.**

Time allowed: Three hours

INSTRUCTIONS TO THE CANDIDATE

1. *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.*
2. *You must not start writing your answers in the booklet until instructed to do so by the supervisor.*
3. *Write your surname in full, the initials of your other names and your Candidate's Number on the front of the answer booklet.*
4. *Mark allocations are shown in brackets.*
5. *Attempt both questions, beginning your answer to each question on a separate sheet.*

AT THE END OF THE EXAMINATION

Hand in BOTH your answer booklet and this question paper.

*In addition to this paper you should have available
Actuarial Tables and an electronic calculator.*

- 1 You are an actuary who has just joined a proprietary general insurance company. You have been asked by the Chief Executive Officer to assist in the setting of the business plans for the next three years. This planning process will include a major review of the business as the company is currently experiencing poor results, with a steady deterioration in profits over the last two years.

The company writes all of its five classes of business through brokers. The gross written premium is similar for each class. Two classes have experienced poor and deteriorating underwriting results over the last three years, two others have experienced volatile results whilst the fifth has seen small but steady profits. The overall results for the last two years have led to returns on shareholders' capital of -12% and -20% respectively. The corresponding budget figures for these two years were +4%, 0%.

From an initial investigation of the problems, you have noted that:

- there has been poor risk selection with a large influx of unprofitable business
- one of the classes has experienced three very large losses
- blanket premium increases have been applied across all lines of business
- the average cost of claims has spiralled
- prior year losses are emerging owing to under-reserving for reported claims
- expenses are escalating and exceeded the budget by 30% last year

The objectives of the company are to turn the situation around over the next three years, with target returns of -4%, +4% and +12% respectively on the shareholders' capital.

In the past, the financial planning has been carried out by taking the overall loss ratio from the previous 12 months, adjusting for the planned premium increases, and increasing claims costs for one years' inflation. Expenses, commission and investment return were based on the previous 12 months. The only monitoring in place was the monthly management accounts on a year to date basis.

Draft a report to the Board of Directors explaining the problems associated with the current method used for financial planning. You should also mention how you might be able to help the Board to gain a better understanding of their business by introducing a more realistic financial planning process, with key actions to support it, and clear measures in place to monitor the business.

In your report you should consider

- (a) volume of business
- (b) premiums
- (c) claims
- (d) expenses
- (e) reinsurance
- (f) financial results

You should also consider the key actions and monitoring measures that might be implemented to mitigate the recent problems experienced by the company.

[60]

[4 marks for drafting]

2 A mortgage lender has decided to offer an equity release product, targeted at the over 65s. No interest is payable until the mortgage is surrendered, either voluntarily or on death. Interest and loan principal will be paid out of the house sale proceeds.

(i) State the product terms and conditions that will need to be finalised. [5]

(ii) Discuss the underwriting considerations the lender will have to address, and the data it should consider. [12]

(iii) Consider the example of a loan advanced to a pensioner with a life expectancy of 20 years. The loan is 30% of the property value. Interest will accrue at 8% p.a.

Discuss the risks to the lender; illustrating each risk with a numerical example. [6]

(iv) Suggest ways the lender could mitigate these risks. [6]

(v) A general insurance company has decided to offer a product that pays a fixed sum if house prices do not increase over a 10 year period.

Discuss the issues relating to the pricing of this particular insurance product. [11]
[Total 40]