INSTITUTE AND FACULTY OF ACTUARIES

EXAMINATION

15 September 2021 (am)

Subject CP3 – Communications Practice

Core Practices

Time allowed: Three hours and five minutes

In addition to this paper you should have available the 2002 edition of the Formulae and Tables and your own electronic calculator.

If you encounter any issues during the examination please contact the Assessment Team on T. 0044 (0) 1865 268 873.

You are an actuary in the pricing team of Company ABC, and you are involved in the annual review of the premiums for new policyholders. You receive the following email from a colleague, who is head of the company’s medical underwriting department.

To: sam@companyabc.com
From: meghan@companyabc.com
Re: Underwriting loadings in pricing

Dear Sam,

I recently attended a conference at which there was a session on the treatment of policyholders who had received an underwriting loading. The speaker was an actuary and said that when setting their standard pricing for life insurance, they reduce the standard premium rates because premium loadings applied to less healthy policyholders are higher than they need to be. To properly reflect the true claims cost, analysis apparently suggests that underwriting loadings should be lower. This led to more competitive standard rates but arguably means that policyholders that are loaded as a result of medical underwriting will receive poor value for money.

I have to say that the session surprised me. When we underwrite applicants at ABC, we always try to ensure that any premium loadings accurately reflect the additional risk. Though I appreciate the merit in being cautious, this would lead to an overall bias, which is certainly not what we aim for.

I wanted to check if you see a similar pattern when you price our business? Do you allow for any adjustments like the ones described – cross subsidising between standard and loaded policies? If so, how do they work – how do you decide what the correct adjustment is? It would be good to understand how this has impacted our most recent pricing analysis.

I am a bit concerned about this, and I wonder if we need to investigate and, if necessary, revise our procedure for setting premiums. If we do adopt a degree of prudence when applying underwriting loadings, is this a problem? Would our position in the market change if we no longer took this approach?

Perhaps you could write a note on this that I can share with my team, covering:

- how experience is allowed for in pricing.
- how underwriting loadings feed into this analysis.
- examples from the latest pricing exercise.
- the impact of eliminating any prudence in the underwriting loadings.

Kind regards,
Meghan.

You have discussed this with your manager, who made the following points:

- The most recent experience analysis was typical – we do see lighter mortality on lives with an underwriting loading than on standard lives, once the mortality expectations are adjusted by the loading.
- This is seen across the industry – it would be very unusual to see a book of business where business with an underwriting loading shows heavier experience relative to expectations of the increased mortality than standard business.
- Given the pricing philosophy of adopting prudence to reflect significant uncertainty as set out in the pricing manual, it does not seem unreasonable to err on the prudent side when determining the loadings to premiums during underwriting.
- A project to eliminate prudence in the loadings would seem worthwhile where this is possible. Reducing prudence would appear to be fairer to policyholders who buy a policy with a loading. Note that the expected outcome of such a project would be to remove any cross subsidy. The overall level of prudence and profit would not be affected.
- The pricing team would need to consider the commercial implication of using loadings that are out of line with the rest of the market. It would attract more loaded business, but without the cross subsidy it would push up premiums for standard business, and therefore the impact on business volumes is not straightforward.

Instructions to candidates

Remember that CP3 is a test of your ability to filter information and communicate it to a particular audience. Use only information that is contained in this examination paper and the scenario material provided. Do not draw on prior knowledge of a particular market, legislation or company.

Questions

1 Draft a paper for Meghan to share with her team that addresses the concerns and questions raised. [90]

2 (i) Give TWO examples of prior knowledge needed to understand your paper, explaining, for each, why it is reasonable to expect Meghan and her team to have this knowledge already. [4]

(ii) Explain how you have structured the information in your paper to ensure the audience can follow the explanation of the main concepts. [4]

(iii) Give TWO examples of words or phrases that would be considered jargon to this audience, explaining, for each, why it would be considered jargon. [2]

[Total 10]

END OF PAPER