INSTITUTE AND FACULTY OF ACTUARIES

EXAMINERS' REPORT

September 2014 examinations

Subject SA2 – Life Insurance Specialist Applications

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.

For numerical questions the Examiners' preferred approach to the solution is reproduced in this report; other valid approaches are given appropriate credit. For essay-style questions, particularly the open-ended questions in the later subjects, the report may contain more points than the Examiners will expect from a solution that scores full marks.

The report is written based on the legislative and regulatory context at the date the examination was set. Candidates should take into account the possibility that circumstances may have changed if using these reports for revision.

F Layton
Chairman of the Board of Examiners

December 2014

General comments on Subject SA2

The Examiners' Report covers more points than would be expected to get full marks. This is so that alternative approaches to questions by different candidates can be accommodated within the marking scheme. Whilst candidates are expected to show knowledge of the relevant content of the Core Reading, it is much more important in this exam to tailor answers and apply that knowledge to the specifics of the question than it is in earlier exams.

Comments on the September 2014 paper

This paper contained a significant with profits question (Q1). The first consideration for any management action in relation to with profits business must be the fair treatment of customers. The inherent conflicts of interest between various groups of customers, as well as the more obvious conflict with shareholders, were the key to this question. Whilst the impacts of various actions on the company were valid points for part (iv), focussing the answer, for example, on assumption changes showed a lack of judgement.

Candidates approaching the subject should use this Report, and previous Examiners' Reports, to practice the application of knowledge.

1 (i) **Treating customers fairly**

The asset share of a policy is widely considered to be the starting point for assessing a fair and equitable payout to with profits policyholders.

This does not mean, however, that a payout different to asset share is, necessarily, unfair.

Any difference between payout and the asset share means a profit or loss for the fund.

Due to the fundamental role that the asset share plays in the management of a with profits fund, the definition and the way in which the company uses asset shares must be consistent with the description in the PPFM.

Maturity payouts and terminal bonus

The primary role of asset shares is to aid the determination of payouts.

Most notably, it will be used to determine maturity payouts via the terminal bonus process.

Either the asset shares of the maturing cohort…
… or of a typical example policy…
… will be compared to the contractual benefits of the policy(ies).

The excess of the asset share over contractual benefits will indicate the scope for payment of any terminal bonus...
… depending on the application of the smoothing policy.

Asset shares are used within the process of smoothing bonus rates.

Or, additionally, a smoothed asset share may be calculated.

Comparing the asset shares to the actual payouts to policyholders can be used to monitor the level of smoothing profits/losses.

Monitoring this over time can help the company ensure that it pays out an average of asset share over time.

Thus ensuring fair smoothed payouts overall.

The fund's PPFM will state target payout ranges as a percentage of asset share.

Surrender values

In a similar way, asset share will guide the determination of surrender values. And, for unitised business, for determining market value reduction factors.

Although there may be less smoothing applied to surrenders than to maturities. And the surrender value may deviate from the asset share in the run up to maturity…
… in order to ensure a steady glide path to the maturity value.

Similarly, at early durations, the zero or low surrender values implied by the asset shares…
… might not meet PRE.

Asset shares may also be used to ensure that altered benefits are supportable e.g. for paid-up policies.

Regular bonus

Asset shares will be used as the starting point in regular bonus investigations. For example, the asset shares could be equated to a realistic bonus reserve valuation…
… using the regular bonus as the variable.

The resulting regular bonus would be adjusted to give a level of terminal bonus rate margin.

This provides the company with an indication of the sustainable level of regular bonus.

More likely, the company's stochastic models would be used.

These would allow for the company's policy on the relationship between regular and terminal bonuses…
… and would give a probability distribution for supportable regular bonus rates.

Asset shares can further be used to help compare the bonus earning power of new versus in-force business in the context of the need for a new bonus series and / or premium rates.

Policy projections

Certain regulatory documents that the company is required to provide to policyholders have to show estimated maturity values.

The starting point for these projections would be the current asset share.

The projection to maturity would have to follow the described asset share methodology.

Regulatory reporting

The asset shares form a key part in the determination of the realistic reserves …
… in the Pillar 1 Peak 2 regulatory solvency assessment.

As asset shares form the basis for payouts for with profits policies, they are a suitable starting point for the reserves.

In particular they can be used directly as the with profits benefit reserve.

They will also be used in the calculation of the future policy related liabilities.

In particular, the cost of smoothing.

And the cost of guarantees.

And the cost of financial options.

The cost of planned future enhancements will also need to use asset shares as a reference point.

Asset shares are also likely to form the starting point for realistic reserves used in ICA calculations.

And for technical provisions etc. under Solvency II.

And will be used to project solvency.

Other

Asset shares may be used to determine how inherited estate is distributed, if the company decides to make such an allocation.

Or may be used as the basis for any reattribution.

[15]

Most candidates covered many of the main points; those that scored the highest marks went into more detail on each area, noting the “Discuss” command verb (which is looking for depth and detail) and the high number of available marks.

(ii) The uses to which the estate is put will need to be consistent with what has been described in the PPFM.

This will set the basis for the fair treatment of customers.

Capital

The estate provides the regulatory capital required to cover the business written in the with profits fund.

The estate provides the necessary capital to write new business within the fund by funding the new business strain.

Further, a large estate demonstrates a strong fund.

The strength of a with profits fund has often been used in marketing with profits products.

It could provide the capital to support higher guarantees on new products.

It could also improve the company's credit rating…
and hence reduce its cost of borrowing.

Investment strategy

A large estate will allow greater risk-taking in the fund's investment strategy.

For example, this might include investing more in equities and property.

Which could lead to higher bonuses and payouts for the with profits policyholders

And so also increases the attractiveness to new business.

It would also support the credit risk of investing in corporate bonds and government debt.

The converse would be true for small estates.

Expenses

The estate may be used to meet some of the expense overruns incurred by the fund.

Or exceptional costs and development costs.

So if actual expenses turn out to be higher than might be considered reasonable to charge directly to policyholders, the company might only charge some of the expenses to asset shares…

… and charge the balance to the estate.

Indeed, it may the case that some more modern contracts specifically state that the expense charged to asset shares will be the contractual charges.

In these cases, the excess of the expenses incurred and shareholder transfers over the contractual charges will be charged to the estate.

Tax

For a proprietary company, it is not unusual for the estate to meet the cost of the shareholder tax on shareholder transfers.

It is not obvious that this is an appropriate use of the fund…
… but is generally considered appropriate if the practice has been in place for many years.

Payouts

The estate is used to fund the costs of policy payouts in excess of their asset share…
… which are not otherwise charged back to with profits policyholders in the asset share calculations.

This might be due to smoothing…
… or due to policy guarantees.

The larger the estate, generally the greater the degree of smoothing that can be applied.

It would enable the fund to maintain bonus rates for longer (or reduce them more slowly) in a falling market.

[9]

Again, many candidates were able to identify the main areas that needed to be covered. The better answers gave more detailed and fuller descriptions, as appropriate to the fairly high mark allocation. Some candidates wasted time by discussing how the estate could be distributed. The question was asking for a description of the uses of the estate within the fund, not how it could be given away. Students should also always read through the full question and understand what is being asked for in each question part before starting answers. Given what is asked for in part (iii), suspicions should have been aroused that methods of estate distribution were not also required in part (ii).

(iii) The first step might be to refund part/all of any charges to asset share for guarantees or cost of capital…
… as existing policyholders who have paid these charges have contributed directly to the estate.

The overall surplus distribution could be done implicitly, through an addition to asset share, …
… or explicitly through the addition of bonuses.

Which policyholders

The Board would need to decide who would be eligible for such a distribution.

Paramount in these decisions is the need to demonstrably treat all customers fairly.

And to be equitable between different groups and generations of policyholders.

Further, the Board needs to decide whether it was desirable to favour one group of policyholders over another.

For example, those who had suffered particularly low bonus rates due to low investment returns over the period of their contract might be favoured.

Or the Board may wish to reward those policyholders who have invested over the longest periods.

[Marks were awarded for any sensible examples]

To the extent possible, it should be distributed to the in-force policyholders who contributed to the estate
e.g. those policies which have contributed via the de-risking exercise.

The company needs to consider carefully whether it would be fair to distribute less to policyholders simply because they chose a product with a strong guarantee.

Similarly, would it be fair to give more to a bond policyholder who invested when markets were high and so has not achieved strong investment returns compared to one who invested at a market low; such outcomes are in the nature of the contract.

[Marks were awarded for any sensible examples]

The additional surplus has occurred at a point in time (i.e. now) and so it could be argued that all current policyholders have an equal right to any distribution. Thus favouring those who have invested longer might look arbitrary and hence unfair.

The company needs to ensure that there is fair treatment between the two main types of with profits policyholder (conventional and unitised)…
…and may need to consider whether different treatment is appropriate in order to achieve this.

General considerations

Consideration would need to be given to any past practice.

Or any past communications.

Such as any indications given by the PPFM.

Industry practice may be relevant.

The views of the Actuarial Function Holder would be sought…
… in relation to the amount of any distribution …
… and hence the impact on solvency.

The views of the With-Profits Actuary…
… and the With-Profits Committee…
… would help inform the Board's view on fairness.

Addition to asset share method (or increase to shadow fund)

This is probably the simplest way in which to achieve the distribution.

All asset shares could be increased by a flat percentage.

However, it would not be as simple as using a percentage increase found by dividing the desired distribution amount by the aggregate asset share…
… as the increase in asset share would alter the cost of any guarantees.

The increase in asset share would feed through into policy benefits through the terminal bonus mechanism.

Similarly, an increase in asset shares would impact surrender values through the normal process.

It is possible that an increase in asset shares could lead to an increase in regular bonus, but this would only be likely if the increase in asset shares was significant,
… noting that once declared as regular bonus it is guaranteed…
… and so increases reserves and reduces flexibility under future conditions.

As the asset share is seen as the starting point for fair value, this approach can be seen as equitable.

However, it would not result in an increase in policyholder payout if the guaranteed value exceeds the revised asset share.

Addition to benefits method (special bonus)

An alternative approach would be to declare a special bonus.

Typically, this would be in a similar form to regular bonus.

This would be more transparent for policyholders than an asset share increase.
It can be more easily communicated to policyholders…
… generating some goodwill.

It will be clearer that it is a one-off distribution not to be repeated.

It will still be necessary to enhance asset shares as above…
… otherwise, the terminal bonus process would effectively remove the addition.

A cash bonus would not be permitted under regulation.

If the same addition to asset share is applied to all policy types, then the resulting special bonus rate may differ by product type, depending on each policy type's run-off profile and guarantee costs.

The resulting shareholder transfer arising from the special bonus would need to be allowed for when setting the special bonus.

Unlike the asset share addition method using terminal bonus, this approach would increase the guaranteed benefits within the fund.
Although this might be preferred by the policyholders …
… it increases the reserves and regulatory capital requirements for the fund

And thus offsets to some extent the de-risking benefits which generated the additional surplus in the first place.

Shareholders may prefer a distribution method that results in shareholder transfers sooner.

Selection

Any policyholder communication should be after the addition.

In order to prevent policyholders exploiting the distribution.

For example, bond policyholders temporarily switching in from (and then back out to) unit-linked funds to qualify for the bonus.

The company would also wish the communications to be phrased to avoid mass withdrawal. [18]

The better marks were achieved by those candidates who clearly set out the pros and cons for the various approaches (noting the "Discuss" command verb), considering the impacts on customers and the fund. Weaker solutions did not include any discussion about which policyholders should be eligible and the extent to which the distribution should vary between different groups. Some candidates wasted time by discussing alternative uses for the estate, such as a riskier investment strategy, but this did not answer the question.

(iv) As the volumes of new business have been low in recent years, the fund will have been in run-off already.

It may be that there is no need to change the way in which the fund is managed…
… as the issues have already been considered…
… and appropriate actions taken.

This will be particularly true if the company has an effective risk appetite framework in place.

Firstly, the company will need to understand how the business will run off.

This includes how the balance between different product types changing over time might influence changes in management actions.

COBS has specific rules in place that have to be followed on formal closure. The company has to produce, and submit to the FCA, a run-off plan.

It also has to write to all policyholders in the fund giving prescribed information.

The PPFM may already give some guidance on how the fund might managed in this situation.

However, the closure of the fund will, almost certainly, require changes to the PPFM.

Changes to Principles may be necessary.

This has regulatory communication requirements.

Investment strategy

The fund is currently strong and so is likely to adopt a relatively free investment strategy…
.. with a high proportion of equities and property.

Understanding the pattern of run-off of the business will indicate how/if this strategy might change over time.

If the mix of business moves towards products dominated by guarantees…
… then the investment strategy might need to become more constrained…
… i.e. a higher proportion of fixed interest assets.

But if there is an active guarantee hedging process in place…
… this may not be necessary.

The impact of different investment approaches on different groups of policyholders should be considered.

For example, adopting a low risk investment strategy would reduce capital requirements…
… and could advance possible distributions.

This would favour those about to mature…
… possibly at the expense of those with many years left…
… particularly since lower payouts (lower bonuses) would be expected (on average) under a lower risk investment strategy.

As the fund shrinks, it will be necessary to sell large properties.

As cash outflow rises relative to outflow, liquidity will need to be managed.

Expenses

Consideration of expenses in administering the with profits business will become important in the run-off.

Per policy costs might be expected to increase…
… particularly if the administration is performed in-house.

The company should consider what action may be taken to prevent fixed costs becoming an increasing burden on policy asset shares…
… and hence on future payouts.

It may be considered reasonable for fixed costs directly attributable to with profits business to be charged to the with profits fund...

But policyholders may expect these to be shared over the wider company operations that remain open.

The single premium bond may continue to be offered as a unit-linked product. So the accumulating with profits bond policyholders would continue to benefit from being administered on a system with a stable policy count.

Whereas the endowment assurances are likely to be on older in-house administration systems built specifically for these contract types and so cannot benefit from sharing fixed costs with new (without profits) policies.

If it has not already done so, the company should consider the possibility of outsourcing.

It might be worth an increase in per policy costs now…
… to lose (or at least reduce) the escalating effect of fixed costs on a declining number of policyholders.

Alternatively, the Board could consider limiting the increase in per policy costs that can be charged to asset shares, with the balance being charged to the estate.

The inherent cross subsidy between product types would need to be considered.

There may be changes in tax.

Bonus philosophy/distribution of the estate

The fund is strong and so distributions from the estate may become a regular feature of the management of the fund.

Managing distributions in order to distribute the estate equitably over the run-off will be key.

Specifically, the company will wish to avoid disproportionately large payouts to the last few policyholders (tontine effect).

If surplus is distributed each year as relatively small increases to asset share, then this will benefit policyholders that exit a long time after distributions start relative to those that exit soon after.

The company would have to determine whether it considers this to be fair.

Distributions can only be made to the extent that they do not reduce benefit security to below the company's target.

This would mean that policies exiting in the short term would not benefit from the estate to its full extent.

In these circumstances, an explicit estate reattribution exercise could be a way to pass some value to these policyholders.

The company may find that it needs to reduce reversionary bonuses as the business runs off.

In order to avoid too much build-up of guarantees that will require high retention of supporting capital and thus a greater chance of a tontine
Shifting the balance more to terminal bonus will improve flexibility for the company during the run-off phase.

But the company will have to consider the expectations of policyholders in doing this…
… and the possible impact on withdrawal rates.

Policyholder communication

The company should consider what messages need to be communicated to policyholders.

And how that might be best achieved.

But it is likely that the company would wish to communicate the future management of the fund in a more customer friendly way.

Any significant changes would need to be communicated so that customers can assess the likely impact on their potential benefit.

Closure to new business has, in the past, been associated with weak funds and so closure could alarm policyholders unnecessarily.

The company would wish to prevent a large exodus from the fund.

As this would exacerbate the fixed expense issue.

Furthermore, policyholders may be tempted to cancel policies with valuable guarantees erroneously.

The company might decide to set up a retention team.

Communicating possible future distributions will need to be worded carefully.
The company would not wish to set unreasonably low expectations.

So policyholders leave thinking that it is not worth waiting.

Also it would not wish to encourage anti-selective behaviour by policyholders hoping to maximise their value from distributions.

For example through policy increments…
… and switching in from unit-linked funds to accumulating with profits.

More admin staff may be required to handle the additional queries.

There should be a communications strategy for distributors to support remaining new business.

There should be a communications strategy to the market to support the share price.

Other points

The company needs to make sure that all of its actions are consistent with the principle of TCF.

The AFH and WPA will have to follow professional guidance.

The approach taken to the calculation of the realistic balance sheet (Pillar 1 Peak 2) changes under run-off.

Pillar 1 Peak 1 valuation assumptions may need to change, e.g. expenses.
Operational risks may increase in the short-term.

Staff morale may fall.

There is a danger that service standards could fall as the portfolio runs down…

… which could lead to higher customer complaints…
… and higher withdrawals.

If the company intends to increase without profits new business materially, it will need to ensure it has sufficient shareholder capital.

And this decision will need to be consistent with the company's risk appetite.

Also need to consider what effect the removal of the accumulating with profits fund option might have on unit-linked sales.

There may be an impact on the embedded value...
… per policy costs may increase
… there may be a different investment mix
… and clearly, future embedded values will not benefit from additional with profits new business.

[24]

This was the biggest differentiating question part. Most candidates mentioned some or all of the key areas around the fair treatment of customers, investment freedom, distribution of estate, impact on expenses, communications and the impact on reporting measures, but those who did better expanded on these areas (reflecting the high number of available marks), picking up significantly more marks than those who did not.

2 (i) The company needs to obtain court approval for the Part VII transfer.

The company needs to obtain an independent expert nominated or approved by the PRA.

The company needs to produce a report on the scheme of transfer, which is included in the petition to the court.

The scheme of transfer report needs to be in a form approved by the PRA.

The scheme of transfer report would need to contain:

- Details of the business being transferred.
- Information showing that Company Y is authorised to carry on this type of business.
- Information showing that after the transfer Company Y would still be able to cover its regulatory capital requirement.

If the report is not approved by the PRA then the petition would not succeed. In advance of the court hearing(s) the company would need to have:

- Adequately publicised the scheme.
- Sent all policyholders and shareholders (where relevant) a formal notice informing them of the proposed transfer.
- Informed policyholders that they have the right to appear at Court.
- The formal notice would need to be approved by the PRA, involving consultation with the FCA.
- The formal notice would set out the terms of the scheme.
- The formal notice would contain a summary of the independent expert's report …
- … which is sufficient to indicate their opinion on the effect of the transfer on the interests of the policyholders involved.

[5]

This bookwork question was answered well by most candidates with a number of candidates picking up full marks. Those who did not do well had presumably not revised this part of the core reading.

(ii) **Advantages**

The company would only undertake a Part VII transfer if it provided a financial benefit, which outweighs the costs.

The type of financial benefit the company may gain could be:

Tax

By combining the long term business of two companies there may be tax efficiencies generated that were not available previously.

Such efficiencies could be utilising one company's excess expenses to cover the second company's excess income, leading to a reduced tax bill.

Business efficiencies/synergies

By transferring the long term business out of Company X, Company Y will then be able to close down Company X.

Closing down Company X could be advantageous as Company Y may be able to free up locked-in capital.

Alternatively Company Y may be able to reduce the overall regulatory capital requirement by utilising unused reinsurance in the LTICR calculation under Pillar 1 Peak 1 reporting.

Or the company may be able to reduce its Pillar 2 capital requirement by gaining from increased diversification.

Future expenses could be lower when one business is closed.

It may make it easier to reduce overheads such as property costs, administration system expenses and investment management charges.

Closing down Company X means that its regulatory reporting would no longer be required; only one set of annual returns to the regulator would now be required, similarly only one set of accounts.

Longer term audit fees would be reduced.

Overall the company structure is simplified.

Disadvantages

Undertaking a Part VII transfer is time consuming.

It can take many months to prepare the necessary documentation required for the court submission.

In addition, sufficient time needs to be provided to those affected by the scheme in order for them to raise their complaints.

The regulator will need time to review the scheme documents in order to provide their approval.

It can be a distraction to senior management.

It will use up resources that may be required for other development/project work e.g. Solvency II.

Undertaking a Part VII transfer is costly.

The company would need to pay for the work of the independent expert.

Legal costs would be high, preparing for the court hearing.

The required communications are costly.

A dedicated team would need to set up by the company to work on the Part VII transfer.

This could either be sourced externally …
… particularly to the extent that expertise is required which the company cannot provide internally.

Or, if using existing staff, the company would need to back-fill the "business as usual" work.

It is not guaranteed that the Part VII will be approved by the court on the first hearing…
…so there may be additional work required by the court.

This additional work will incur further costs…
… and add to the time taken to complete the transfer.

The Part VII transfer may generate ill-feeling from the policyholders.

It may result in a worsening of the company's persistency.

A sense of the level of dis-satisfaction can be obtained from the number of complaints that the company receives following the communication of the scheme to the policyholders.

In order to obtain the benefits from the transfer, additional costs will be incurred
e.g. in combining the reporting processes.

Systems changes will be needed.

This may increase operational risk as systems as migrated.

This could also lead to a reduction in service standards.

New style literature will be required for the Company X policyholders.

Audit fees may be higher in the first year after the transfer. [15]

A number of candidates did not read the question properly and appear to have assumed that this was effectively a merger/takeover as opposed to a Part VII internal transfer of business. As described in the question, Y already owned X and so comments about cross-selling and taking on mis-selling risks, for example, were not relevant. Those who did well recognised the benefits of fewer reporting requirements and potential diversification and also recognised the costs of the Part VII.

(iii) For Company Y not to be in an excess E tax position prior to the Part VII transfer, the tax charge from the "I-E" tax computation must have been higher than that from the profits test.

The shift to excess E overall suggests that Company X is in an excess E position on a standalone basis.

And these unrelieved expenses must be higher than the difference between the "I-E" tax and "minimum profits" test for Company Y.

Company X may have a more significant BLAGAB portfolio than Company Y and hence dominates the combined BLAGAB tax position.

Company X might have particularly high expenses.

This may be from not running the business efficiently.

It has recently been sold so it is possible that this was part of the reason behind the sale.

The unrelieved expenses originating in Company X may have been a result of high acquisition costs from previous years being spread over future years.

Company X is relatively recently established so it is possible that the unrelieved expenses result from high initial costs in establishing the company…
… with little opportunity to grow the amount of investment income it generates.

There might be a high burden of fixed or overhead costs…
… which could be due to Company X not having been open to new business for very long.

In addition it has sold protection business before 1 January 2013, which will be high in expenses and will generate low investment income.

This protection business might have formed the majority of what was sold.

Similarly for the unit-linked business there will be limited investment income generated by the non-unit reserve.

Additional expenses arising as a result of extracting the synergies from the Part VII transfer may be partly allocated to BLAGAB and hence increase Company Y's expenses in the short term.

Company X may have invested in low yielding assets.

Company Y may wish to weaken the valuation basis going forward…
… leading to increased profits being generated and therefore more likely to be XSE.

For example, it may do this in order to free up capital to support the merger.

Company Y may expect to write significantly higher levels of new BLAGAB business after the Part VII, which will incur high initial expenses.

[6]

Candidates were required to think about why, after the transfer, the company's position would change. So those who did better recognised that X must be XSE and Y must be XSI to begin with. Once this was established, the reasons for being in this position and why X pushed Y into XSE should have followed on, including using ideas from the core reading description of possible reasons for becoming XSE.

(iv) For Company Y to be in an excess E tax position overall after the transfer there must be a certain level of unrelieved expenses.

The level of these unrelieved expenses will dictate the extent to which the tax position can be mitigated.

If the unrelieved expenses are high then there may be little that the company can do.

A potential action that Company Y could consider is whether a transfer of all of the business needs to be undertaken, or whether the transfer is the best option.

One option that it could consider is whether to do a partial transfer of business and not close down Company X.

Company Y could transfer across just enough business so that it remains in an XSI position overall.

That way the excess unrelieved expenses would remain with Company X.

Using this approach and dependent upon the split of the business, Company Y might be able to improve the overall tax efficiency of the proposal.

An alternative option could be to do a two way Part VII transfer whereby part of the business in Company X is transferred to Company Y and part of the business of Company Y is transferred to Company X.

Again, Company Y could structure this approach to produce a more tax efficient scheme.

The disadvantage of both of these options is that the potential process efficiencies that Company Y could have made would not materialise as there are still two companies in existence.

In addition the structure of the group of companies may be more complicated, increasing on-going costs.
Assuming that the unrelieved expenses are not too high to mitigate, then the following actions could be considered by Company Y:

It can try to increase the sales of investment income generating products …
… such as conventional endowment assurance and whole life products or investment bonds.

Single premium policies will provide more immediate investment incomes than regular premium policies.

Over a period of time the additional investment income would allow the excess E to be utilised.

If justified, the company could strengthen the valuation basis being used for either or both blocks of business.

Particularly if there were insufficient margins being used in the Company X valuation…
… or if it felt that the basis had been unduly weakened.

The company may decide to review the assets backing the liabilities originating from Company X …
… and move into assets which have higher expected returns.

But this would also increase the risk within the company.

Company Y could temporarily reduce its new business sales in order to reduce the burden of acquisition expenses.

The company would be more likely to consider reducing new business that generates excess E.

It could attempt to reduce its expenses by other means i.e. cost-cutting exercises, efficiency improvements, outsourcing.

This may happen naturally once merger synergies are achieved. [8]
[Total 34]

Most candidates touched on cutting costs and changing the investment strategy. Those who did better also considered changing the new business mix and the valuation basis (which again relates to core reading reasons for becoming XSE) and transferring only part of the business.

END OF EXAMINERS' REPORT