

INSTITUTE AND FACULTY OF ACTUARIES

EXAMINERS' REPORT

September 2017

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 pertaining to the date that the examination was set. Candidates should take into account the possibility that circumstances may have changed if using these reports for revision.

Luke Hatter
Chair of the Board of Examiners
December 2017

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

1. The aim of the Life Insurance Specialist Applications subject is to instil in the successful candidates the ability to apply knowledge of the United Kingdom life insurance environment and the principles of the actuarial practice of life insurance to a United Kingdom life insurance company.
2. 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. 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.

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

Both questions gave the opportunity to discuss technical problems. However, the candidates that performed well were able to think wider than the purely technical and consider the practical issues that might arise.

In question 1, for example, the practical considerations of designing a proxy model should have been considered.

In question 2, considering the interests of all of the affected stakeholders – the with-profits customers, the transferred non-profit customers and the existing non-profit customers in the NPF, as well as the shareholders – was necessary to do well.

Further, in question 2, candidates that considered the practical issues with the transfer of business, as well as the technical issues, scored well.

C. Pass Mark

The Pass Mark for this exam was 61.

Solutions

The marks indicated in the solutions are out of 200.

- Q1**
- (i) A proxy model is a simplification of a full model [1]
It is designed to reproduce results from the full model... [1]
...to within an acceptable degree of approximation.. [1]
...in a shorter timeframe than the full model [1]
Particularly for solvency projections... [1]
...where there would otherwise need to be nested stochastic calculations [1]
It would be used when there are tight timescales required for production of results [1]
Or when there is not the computational power to run the full model [1]
... for all of the different scenarios which are required [1]
E.g. for internal economic capital...
... or Solvency II reporting purposes...
... or producing Solvency II information outside the standard reporting cycle
...
... or for producing the risk margin ...
... or for analysis of surplus ...
... or for sensitivity tests
[up to 3 marks for valid examples]
Or when full accuracy is not required, [1]
E.g. high level decision making [1]
[Maximum 8]
- (ii) Statistical methods [1]
e.g. polynomial [1]
curve fitting [1]
Kriging (Gaussian processes) [1]
Replicating portfolio [1]
Closed form solutions [1]
[Maximum 4]
- (iii) **Longevity**
Longevity is a key risk for the immediate annuity product [2]
i.e. the risk of living longer than expected in the pricing of the product [1]
This could be in the base mortality assumptions... [1]
... or through misestimating the mortality improvements. [1]
There is a risk of significant unanticipated change (e.g. cure for cancer) that would have a significant impact. [1]
- Mortality risk**
Mortality risk is key for the term assurance product [2]
The risk of higher mortality than expected in the pricing of the product [1]
Or greater anti-selection than expected [1]
There is the risk of aggregation/pandemic. [1]

Both products may be subject to reinsurance which would change the significance of the risk [1]

Credit risk

The significance of credit risk... [2]

... i.e. the risk of loss if a counterparty fails to perform its contractual obligations. [1]

For example, corporate bond default... [1]

... and recovery rate. [1]

It depends on the proportion of corporate bonds invested in... [1]

and the ratings of the companies behind those bonds [1]

In addition, any credit exposure through reinsurance... [2]

and any other counterparties used e.g. outsourcing. [1]

Risk of widening spreads. [1]

Any example [1]

There is the market risk of corporate bond credit downgrades. [1]

[this mark is to be awarded if given under market risk below.]

Market risk

The level of market risk exposure... [2]

... i.e. the risk of loss as a result of market movements... [1]

... specifically in relation to interest rates / bond yields... [2]

... will depend on the extent of any liability matching strategy for the annuity business [2]

... since market risk will be relatively low for term assurance business... [1]

... due to small reserves [1]

Specifically, there is reinvestment interest rate risk if the duration of annuity liabilities is materially longer than the duration of the assets held/available [2]

Even if the annuity business is well matched, some interest rate risk will remain [1]

There is also currency risk. [1]

Liquidity risk

In addition liquidity risk [2]

... i.e. the risk arising from short-term cashflow mismatches... [1]

... may be material for the term assurance product... [2]

... depending on the investment strategy [1]

Particularly as the company is small [2]

... and there is no mention of it having cash holdings [1]

Operational risk

It may also model operational risk [2]

i.e. the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events [2]

[2 marks for a full description/definition, 1 for partial]

e.g. business disruption [1]

or model risk [1]

or conduct risk etc. [1]
 [Up to 3 marks for any valid examples of operational risks]

Other insurance and experience risk

And expense risk... [1]
 ... i.e. the risk of higher than expected expenses [1]
 There is also inflation risk (on expenses and inflation-linked annuities. [1]
 And possibly persistency risk... [1]
 ... for the term assurance business [1]
 e.g. lower than expected late duration lapses [1]
 and higher than expected early duration lapses [1]
 and selective lapsing... [1]
 ... resulting in higher mortality rates [1]

Group risk

It may model group risk if relevant to the structure of the company... [1]
 ... i.e. the risk that the activities of one firm within a group of companies can impact on the reputation or financial soundness of a different firm within the group [1]

New business risk

It may model risks relating to the volume of new business... [1]
 ... and the mix of new business... [1]
 ... if relevant to the projections being performed [1]

[Maximum 26]

(iv) Purpose

The purpose of the model will inform a number of things in the design so the purpose must be defined [2]
 For example regulatory reporting (Solvency II) at interim periods, management decisions, how often used. (*up to two examples*) [2]
 The purpose will help to inform the accuracy required from the model... [2]
 ...but a decision will also be required on the level of accuracy which is acceptable to the ultimate users [1]
 In particular, it would need to meet PRA approval standards if intended for use as the Solvency II internal model... [2]
 ... and the validation standards. [1]

Model form

Model form will need to be decided in line with the options in part (ii) [1]
 This may be influenced by expertise in the company... [1]
 ... or previous preference/usage [1]
 ... or the views of advisors/consultants used by the company [1]
 Model form may also be determined by the model purpose... [1]
 ... and requirement for ease of understanding... [2]
 ... and ease of calibration... [2]
 ... and computation time... [2]

... which will depend on any given deadlines for use of the outputs [1]
 ... and the power of existing IT capabilities [2]
 ... the requirement for flexibility [1]
 The availability of suitable proprietary model on the market may influence the form. [1]
 This is a small company with simple products, therefore complexity is not likely to be a limiting factor in model choice. [2]

Risk modelling

The most important of the risk types for the company will need to be identified... [2]
 ... in order to focus the calibration of the proxy model on these. [1]
 The risk dependencies would need to be set to determine the model structure [1]
 And allowance for diversifications [1]
 Fitting scenarios need to be chosen and generated [1]
 e.g. using expert judgement or least squares [1]
 Acceptance criteria/level of acceptable error from the full model would need to be set [2]
 Including a decision made on how to assess the error [2]
 e.g. setting tolerances for validation scenarios [1]
 This would tie into ongoing model validation, which would be needed at pre-determined intervals [2]
 And similarly the need for periodic re-calibration [1]
 Care must be taken to avoid over-fitting the proxy model, using too many factors and parameters [2]
 Equally, need to avoid under-fitting. [1]
 Need to consider the limitations of the model. [1]
 For example, whether it can deal with negative interest rates appropriately. [1]

Other

The cost of developing the model may be a factor... [2]
 ... especially as the company is small [2]
 Similarly, the maintenance cost should be considered. [1]
 The timescales to build the model could be a factor. [1]
 The company should consider if it has the necessary resources. [1]
 The requirements of Technical Actuarial Standards should be considered. [1]
 The approach adopted by competitors might help. [1]
 [Maximum 18]

- (v) Economic capital [1]
 Internal view of capital required based on risk profile, risk appetite and ongoing business needs [1]
 Regulatory capital [1]
 Solvency requirements prescribed by the regulator [1]
[Mark awarded for mention of MCR, SCR, ORSA]
 Rating agency capital [1]
 Capital adequacy standards to achieve or maintain particular credit ratings [1]

[Maximum 6]

- (vi) The **credit risk** exposure will increase [2]

Market/interest rate risk exposure may reduce... [1]

... if the introduction of the new asset class allows better liability matching [2]

For example if this asset class offers longer term investments than are currently available in the gilt or corporate bond market [2]

[Marks were awarded if the opposite was argued, i.e. increased risk if not so good matching.]

There is an increased risk of misestimating the returns as the asset class is new.

[1]

There may be a currency risk if the asset class is denominated in a different currency.

[1]

Liquidity risk may be impacted if this type of investment has more/less liquidity than the existing portfolio [1]

The higher returns may not be purely due to credit risk and may suggest that these loans are less liquid [2]

However, if the loans are assumed to be held until maturity, there would be no (or limited) liquidity risk exposure impact [1]

Operational risks may increase... [2]

... to the extent that the company does not have existing experience of dealing in and managing this type of asset [2]

[Any suitable example]

Operational risk may lead to reputational risk. [1]

There may also be regulatory risk (e.g. the class is not allowed for the Matching Adjustment).

[1]

Expense risks may increase... [1]

... if there is more uncertainty about the level of expenses incurred in respect of dealing in and managing this type of asset [1]

Model/parameter risk may increase... [1]

... e.g. modelling correlations between this type of asset and the existing investments... [2]

... since this type of asset has not previously been modelled... [1]

... and there appears to be no industry experience to use [2]

Other risks are likely to remain unchanged [1]

The amount of diversification benefit between credit risk, market risk and other risks may alter... [1]

... particularly if credit risk exposure increases significantly [1]

New business risk will change if the pricing changes. [1]

[Maximum 10]

- (vii) **General**

Overall the amount of risk capital held is likely to increase [2]

Particularly the default risk capital component [2]
 This is likely to require new methodology to assess the credit risk attached to the new investment type if the company is on an internal model basis [2]
 This asset class is new to the industry therefore methodology to value it and assess risk capital to hold against it may not be developed across the industry [1]
 This may make it challenging to develop. [1]
 However, offsetting the increase in other components of risk capital, market risk capital is likely to reduce if matching is improved [1]
 Correlation factors between risks may be adjusted [2]
 Including introducing a new correlation, between returns on the new asset class and the existing asset classes [1]

Regulatory capital

Under Solvency II this is mainly a risk capital approach (the SCR)... [1]
 ... unless the absolute minimum capital requirement bites... [1]
 ... which is possible since this is a small company [1]
 If it is not currently on an internal model basis, then it may have to move to it if it no longer considers its risks to be “standard” as a result of the new asset class ... [2]
 ... and gain regulatory approval [1]
 Solvency II is on a risk-neutral / market consistent basis... [1]
 ... and so no direct benefit of a higher expected return on the new asset class would be seen in the discount rate [2]
 However the company may utilise a matching adjustment... [2]
 ... in which case there may be a reduction in technical provisions [1]
 ... and consequently also in capital requirements [1]
 The regulator may need to approve use of this asset class [2]

Economic capital

The internal assessment of capital may be on a “real world” basis rather than risk-neutral [2]
 Or the Company may have a different view of the Matching Adjustment or Volatility Adjustment. [1]
 Therefore the benefit of the higher expected return on the new asset class would feed through directly to the base liabilities and hence also to the required capital calculations [2]

Rating agency capital

Rating agencies would factor into their approach the additional credit (and other) risk exposure and potentially the reduction to market risk exposure and the impact of this on the required capital [1]
 In determining the overall capital adequacy of the company, the rating agencies may look further as to the motivation of the company in this decision [1]
 And how this compares to others in the industry, with this being a new asset class [1]

They will also consider the risk management framework that supports this increased credit risk exposure [2]
[Maximum 16]

- (i) Some candidates confused a proxy model with the risk drivers used in Solvency II, rather than being a simplification of the full model.
- (ii) and (v) were testing areas of coursework.
- (iii) Most candidates were able to list the key risks. Those that scored more highly were able to relate those risks to the products set out in the question.
- (iv) The candidates who scored highly were able to elaborate on the purpose and form of the proxy model, as well as considering how the model would need to be calibrated for the specific risks.
- (vi) Most candidates were able to list the risks that might be impacted by the new asset class. Those that scored more highly were able to explain how the new asset class impacted the risk.
- (vii) Those that scored highly recognised that the extra yield from the new asset class would not be recognised in the Solvency II capital (unless through a matching adjustment), but that some benefit would be possible for the economic capital.

- Q2**
- (i) Determining payouts to policyholders [1]
 Annual bonus policy [1]
 Terminal bonus policy [1]
 Smoothing policy [1]
 Investment strategy [1]
 Business risk [1]
 Charges and expenses [1]
 Management of the inherited estate [1]
 Closure to new business [1]
 Achieving equity between policyholders and shareholders [1]
 [Maximum 10]
- (ii) **Transferring the existing business**
- The transfer would simplify the business... [2]
 ... potentially making it easier to sell parts of the business. [1]
 To avoid delaying the inevitable point at which action has to be taken, once there is no longer any with profits business to which to distribute profits from the immediate annuities. [2]
- To enable the company to recognise and distribute the profits from the annuity business to the remaining with profits policyholders. [2]

- And to avoid the “tontine” effect [1]
- i.e. to avoid having fewer and fewer with profits policies receiving the profit from the annuities... [1]
- ... or being exposed to the risks arising on that business. [1]

- To avoid the build up of longevity risk in the WPF [2]
- To enable the company to manage better the pace of distribution of the annuity profits in the WPF... [1]
- ... including ensuring that the distribution is fair and equitable to the remaining with profits policyholders. [1]
- To enable it to provide a special one-off bonus [2]

- To release the capital requirements held in respect of these products in the WPF [2]
- Particularly the SCR [1]
- And hence improve the capital position of the WPF [1]
- Thereby increasing the potential investment freedom in the WPF for the with profits business [1]
- And reducing the need for any future capital injection [1]

- The company may want to take on more longevity risk within the NPF [2]
- Particularly if there is a portfolio of protection business with mortality risk... [1]
- ... against which the longevity risk can be diversified [1]
- The company may prefer all the longevity risk to be in the NPF in order to manage its capital effectively. [1]
- For example, in the event that shareholder capital has to be injected in adverse conditions it may be difficult to get any surplus capital out again when conditions improve if this injection was made to the WPF. [2]

- The risk appetite within the WPF may be more risk averse in terms of investment strategy or longevity for the annuities, than that within the NPF. [1]
- Or the WPF may be more capital constrained than the NPF. [2]
- The NPF may be able to therefore change its investment strategy for the existing portfolio and invest in more risky assets... [1]
- ... to generate investment profit. [1]

- The volatility of profits of the annuity book within the WPF may not be a risk that the WPF wants to continue with... [2]
- ... due to the likely more limited diversification opportunities within the WPF. [1]

- To reduce investment expenses on the assets backing the annuity business... [1]
- ... if these were high due to being a ring-fenced portfolio within the WPF [1]

- There may be tax benefits of transferring the business [1]

- It may be to move the advantages of economies of scale (spreading overheads over a higher volume of policies) from the NPF to the WPF. [2]

There may be other efficiencies. [1]
 ... so that it benefits the shareholders directly. [1]

It may be cheaper and simpler than selling the business to another company. [1]

It may be that the NPF has spare capital available. [1]

It may be driven by the Regulator. [1]

It may be driven by the With-Profits Actuary or the With-Profits Committee. [1]

Future new business

So that shareholders can receive 100% of the profits on the future new business [2]

Rather than the 10% that they currently receive via the WPF [1]

This would increase the reported profit of the company... [2]

.... assuming that the annuities are generating a profit. [1]

It could lead to higher dividends [1]

It may also improve the share price [1]

Or the higher profits may be used to increase the retained surplus in the NPF [1]

This could improve the financial strength of that fund [2]

And thus make it more attractive to without profits new business [1]

Or to improve or support a credit rating [1]

Higher retained capital could be used to for strategic projects. [1]

The WPF may not be able to support the new business strain needed to write future new annuity business. [1]

If the annuities could be backed by more corporate bonds and fewer gilts in the NPF... [1]

... then the annuity rates that could be offered may improve [1]

So enable the company to sell higher volumes of business [1]

[Maximum 24]

(iii) Need the amounts to be fair to both sides of the transaction [2]

And in particular to be an appropriate view of the amount of assets needed to support the block of existing business being transferred. [1]

And ensure that no policyholders are materially disadvantaged [2]

Check the balance sheets before and after to ensure that policyholder security is not reduced. [1]

Start with the technical provisions under Solvency II... [2]

... the best estimate liabilities... [1]

... and some allowance for the risk margin. [1]

For just the immediate annuity business within the WPF [1]

Best Estimate Liabilities

It may be appropriate to net off the reinsurance in the balance sheet. [1]
However, adjustments may be needed if the Solvency II BEL is not deemed by the company to be truly “best estimate” [2]

In particular, it may not believe that the matching/volatility adjustments... [1]
... accurately represent the expected value of the illiquidity premium for the corporate bonds held [2]

Risk Margin

This is because the risk margin is intended to increase the technical provisions to the amount that would have to be paid to another insurance company in order for them to take on the best estimate liability. [2]

It therefore represents the theoretical compensation for the risk of future experience being worse than the best estimate assumptions... [1]
... and for the cost of holding regulatory capital against this. [1]
It therefore represents the amount that should be paid to the NPF, considering it as being equivalent to a separate insurance entity. [1]

The cost to the NPF of holding the required Solvency Capital Requirement (“SCR”) is allowed for in the risk margin which is being transferred across [1]
But this is only in respect of non-hedgeable risks [2]
The company may also need to transfer compensation across from the WPF to the NPF to cover the cost of holding the SCR for other (“hedgeable”) risks which are not included in the risk margin... [1]
... but which the company does not actually hedge [1]

The risk margin may need to be adjusted to reflect the different diversification benefits that the NPF could now recognise [2]
Also, the company may have a different view on the cost of capital to that prescribed in the Risk Margin. [1]
Both the BEL and the risk margin may initially be based on the current asset portfolio mix [1]
Allowance could then be made for any intended changes that are to be made to the asset portfolio [1]

Future New Business

The company may decide to provide the WPF with a one-off surplus in respect of the future profits from future annuities which the WPF will no longer receive. [2]

This is effectively equivalent to a goodwill item in a commercial transaction [2]

To do this it would need to place a fair value on these expected future profits. [1]

The key element will be the anticipated new business volume [1]
... and whether this new business is from maturing with profits policies or from external sources [1]
... if it comes from the with-profits business, then the WPF may be entitled to more value. [1]

Over an appropriate time horizon [1]
 Which should be set bearing in mind the reasonable expectations of current policyholders in relation to those profits [1]

Other

Need to allow for the costs of the transaction... [2]
 ... and how these would be split between the WPF and NPF [2]
 Need to consider any implications for the taxation status of the WPF and the NPF [2]
 The WPF will be taxed on the basis that it is a stand alone entity... [1]
 ... and the loss of the annuity business may change the taxation calculations significantly [1]

May use details from any similar recent transactions that have been made in the market [2]
 Or use external advisors [1]

Would need to consult with the With Profits Actuary... [2]
 ... and With Profits Committee... [2]
 ... and the Actuarial Function Holder/Chief Actuary... [1]
 ... and get their agreement to the transaction amounts [1]
 Need to check that the approach used is appropriate based on anything that is specified in the PPFM [1]
 And in particular the extent to which the PPFM suggests that there are expectations of profits from future new annuity business [2]
 Ultimately there would be a price range that the WPF would be willing to accept ... [1]
 ... and a separate range that would be acceptable to the NPF [1]

The NPF may accept a lower return on capital than would have been required for an equivalent external deal... [1]
 .. for example due to having more confidence over the assumptions used etc. [1]

[Maximum 28]

(iv) The company will need to ensure that TCF principles are met [2]

An Independent Actuary/Expert might need to be appointed... [1]
 to give assurance that policyholders are not materially disadvantaged [1]

The company may wish to complete the transaction on an “arms length” basis, with separate teams/advisors acting for the WPF and NPF [2]

The key groups of policyholders to consider are:
 Remaining with profits policyholders [1]
 Existing NPF policyholders [1]
 Annuitants being transferred [1]
 Future annuity policyholders [1]

The company will need to ensure that the existing annuity customers will not be placed at adverse risk by the transfer to the NPF in terms of the security of their benefits. [2]

And similarly that the additional risk taking on by the NPF in relation to these annuities would not jeopardise the security of the NPF for the other policyholders [2]

Will need to consider the PPFM... [1]

... and CFPPFM... [1]

... to ensure the transfer is actually allowed [1]

The company will need to ensure that PRE is met [2]

So will also need to consider...

... any past practice in similar situations [1]

... any other literature [1]

... possibly, the actions taken by competitors in similar circumstances. [1]

The company will also need to ensure the one-off transfer is fair to policyholders relative to shareholders [2]

There must be communications to all policyholders about the transfer... [1]

... which clearly set out its implications [1]

... possibly set up a help line [1]

... give a suitable amount of time for the policyholders to consider the material [1]

... so giving them time to raise objections with the Independent Expert. [1]

If, as a result of the transfer, the company decides to make a one-off bonus distribution to policyholders ... [1]

... e.g. as a result of released capital requirements (SCR) that no longer need to be held in respect of the annuity business in the WPF ... [1]

... then this also has to treat different groups of with profits policyholders fairly and equitably [1]

... e.g. by product type... [1]

... and by generation/duration... [1]

... and by policy size [1]

For example, it may be done in proportion to asset shares [1]

[Maximum 14]

(v) It may be necessary to include a statement describing the transaction in the background to the with profits fund [1]

Since it is a significant event for this WPF [1]

The description of asset share calculations may need to be amended... [2]

... if this includes a description of the allocation of profits from without profits business. [1]

- It may be necessary to change the description of the approach to the balance between reversionary bonuses and terminal bonus [2]
 ...as the company might choose to be more generous with reversionary bonus guarantees after the transfer as it will be less concerned about future longevity risk (or more certain about the value of the estate) [1]
- Any reference to receiving profits from future new without profits business would need to be removed due to these no longer being relevant. [2]
- The section on the smoothing policy may need to be changed... [1]
 ...as the degree of smoothing applied may be able to increase... [1]
 ... since there is more certainty about the value of the estate [1]
- The investment strategy section may need to be amended... [1]
 ... if it includes a description of how assets backing without profits business are invested [1]
 With the removal of annuities from the without profits block of business, there may be a need to change this section to reflect the strategy for any remaining without profits business [2]
- The section in the PPFM on the management of the inherited estate may need amending [1]
 Since the strategy relating to its distribution may now be changed due to the removal of this potential problem [1]
- The section on business risks may need amending [1]
 If this currently highlights longevity risk arising from the annuity business [1]
 It may be necessary to amend the expense section. [1]
 [Maximum 12]
- (vi) The Board of the company would need to agree to the transaction... [2]
 ... and in particular the additional risks being taken on by the shareholder [2]
 ... and the risk appetite of the company. [1]
 The regulators would need to be informed... [2]
 ... both the PRA and FCA... [1]
 ... and would need to give their consent (or no objection) [1]
 ... and consider any existing run-off plan for the WPF. [1]
- The parties would need to agree which assets should be transferred [2]
 ... and their values [1]
 ... especially if they are not quoted [1]
 ... the With-Profits Actuary's views will be taken into account. [1]
- A transfer date would need to be agreed [1]
 This would be both in terms of assets... [1]
 ... and the date of risk transfer [1]
 The company may want to combine it with a key valuation date... [2]
 ... for example the year end reporting date... [1]

... as this will reduce the additional amount of work required to do the transfer amount calculations as a Solvency II valuation will already be produced at that date [1]

The company will need to decide on which assets to sell and purchase ... [2]

... if it is decided to change the underlying investment strategy [1]

It may not be possible to transfer assets all at once [2]

And any amendments to the portfolio also may need to take place over a few months [1]

There may be tax implications of the asset transactions to consider [1]

It may be necessary to reapply for Matching Adjustment approval. [1]

The policies being transferred need to be identified [1]

... and ring fenced [1]

and the administration and valuation systems amended to include identification showing that they are now in the NPF [1]

And similarly all new annuity policies need to have a marker showing they are written in the NPF [2]

The asset share calculation will need to be amended to set the profits from the without profits annuities to zero [2]

There is a need to ensure that all data is correct [2]

and if necessary agree data clean up [1]

particularly ensuring that any death notifications are updated [1]

Warranties and indemnities need to be considered. [1]

Need to agree which fund is responsible for any past data issues... [2]

..., or potential mis-selling issues... [1]

... or errors... [1]

... and for how long [1]

Need to recalculate the Solvency II balance sheets following the transaction [2]

And amend any SCR and risk margin calculations and models accordingly [1]

Need to take appropriate actions if the solvency of the NPF is compromised by the transfer [1]

E.g. a further capital injection [1]

Would want to understand how the transaction will be accounted for in company results... [2]

...and in the analysis of surplus/profit... [1]

... and whether a stock market announcement may be required [2]

... and how this may affect the views of rating agencies. [1]

Consider who is going to manage the investment portfolio... [1]

... and the fees being charged. [1]

Need to update policy and marketing literature [2]

Additional staff training may be required [2]

The transfer may generate queries from policyholders [2]

Communications should be sent to distributors	[1]
It may be necessary to inform reinsurers, if the annuity business is reinsured	[2]
Additional resources will be required to support the project	[1]
The length of the implementation period needs to be considered	[1]
The transfer may distract management from other important strategic issues	[1]
A project manager will be vital	[1]
The total costs of the project will need to be managed	[2]
... and how they will be split between the NPF and WPF.	[1]
Risks relating to the project delivery need to be considered	[1]
E.g. additional costs arising due to delays (any example)	[1]
...Also, it may be necessary to change reporting templates	[1]
... It may be preferable to transfer all non-profit business out of the WPF at the same time for greater efficiency.	[1]

[Maximum 24]

It was recognised that some candidates may make some points in different question parts to those set out above. This was particularly true for parts (iii), (iv) and (vi). If a candidate made a point set out above, but when answering a different question part, then the mark was awarded.

(i) was a testing area of coursework.

(ii) Candidates who identified the benefits/risks for with-profits policyholders as well as shareholders scored well. The question provided scope for a detailed description of these areas.

(iii) Most candidates described the use of the technical provisions; better candidates described the adjustments that might be appropriate. Some candidates believed that the SCR should be transferred, whereas better candidates recognised that the cost of capital should be passed over, not the SCR. Those that scored highly discussed goodwill and the governance requirements.

(iv) Those that scored highly recognised the need to consider all groups of policyholders and that communication was a key aspect of treating customers fairly.

(v) Most candidates recognised the areas of the PPFM that would need to be changed. However, many candidates felt that this would lead to more restrictive practices (less investment freedom, lower regular bonuses), whereas the proposal is more likely to free up capital making actions like distributions from the estate possible.

(vi) This gave the opportunity for a wide ranging discussion. Those that scored highly were able to cover this range, such as the impact on administration and systems to changes in literature.

END OF EXAMINERS' REPORT