INSTITUTE AND FACULTY OF ACTUARIES

EXAMINERS' REPORT

September 2015

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.

F Layton
Chairman of the Board of Examiners
December 2015

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*

1. Question 1 considered embedded values from a number of different viewpoints. Well prepared candidates were able to provide good solutions on all aspects of knowledge, application and higher skills.

2. Question 2 considered two key areas, product design and the identification/mitigation of risk. Despite being a long discursive question, 2(i) gave candidates the opportunity to demonstrate how standard bookwork could be applied to the product in question. The latter parts were answered well by candidates that considered all aspects of outsourcing.

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

C. Comparative pass rates for the past 3 years for this diet of examination

Year	*%*
September 2015	46
April 2015	38
September 2014	43
April 2014	32
September 2013	38
April 2013	41

Reasons for any significant change in pass rates in current diet to those in the past:

The pass rate is towards the upper end of the typical range. Some variation in the pass rate between sessions is expected as different cohorts of students sit the examination.

Solutions

Q1 (i)

- European Embedded Value (EEV) is a measure of the shareholder interest in the covered business.
- The business covered has to be disclosed/identified clearly.
- The EEV comprises the value of free surplus plus the present value of future shareholder profits from in-force business…
- … plus the value of required capital less the cost of holding it.
- Free surplus is the market value of capital and surplus allocated to, but not required to support, the in-force covered business.
- Required capital includes any assets attributed to the covered business, whose distribution to shareholders is restricted.
- The present value of future shareholder profits must be reduced by the value of financial options and guarantees.
- This allowance must include the time value of the options and guarantees…
- … based on stochastic techniques.
- The value of future new business (i.e. value from the sale of future new contracts) is excluded from the EEV.
- Assumptions for future experience should be set with regard to past, current and expected future experience and any other relevant data.
- Future changes should be allowed for if sufficient evidence exists for them and they are reasonably certain.
- The assumptions should be actively reviewed.
- Economic assumptions must be internally consistent…
- … and consistent with observable, reliable market data.
- No smoothing (e.g. of market values, unrealised gains or investment return) is permitted.
- For participating business, assumptions about future bonus rates and shareholder/policyholder profit allocation…
- … should be consistent with other assumptions established company practice and local market practice.
- EEV results should be disclosed at consolidated group level.

(ii) The EEV profit on the in-force business can be written as:

PVIF1 + T – PVIF0

Where T = profit made in the year

T = premium income + investment income – deferred annuity death and withdrawal claims – immediate annuity benefit payments – expenses – increase in reserves

All figures in £000.

Premium income = 24,500
Expenses = 0.25% × 134,400 + 0.25% × 2,204,400
= 336 + 5,511 = (5,847)

Deferred annuity death claims = 0.01 × 1,345,000 = (13,450)

Deferred annuity withdrawal benefits = (3,200)

Immediate annuity benefit payments = (125,670)

Investment income = 0.04 × (2,204,400 – 5,511 – 125,670)
+ 0.055 × (134,400 + 24,500 – 336)
– ($1.055^{0.5}$ – 1) × 13,450
= 91,285

Change in reserves = 2,076,900 + 145,900 – 2,204,400 – 134,400
= (116,000)

Therefore

T = 24,500 + 91,285 – 13,450 – 3,200 – 125,670 – 5,847 – (116,000)
= 83,618

Also:

PVIF1 – PVIF0 = 214,675 – 254,659 = (39,984)

Contribution from new business = 2,000 + 33,000 = 35,000

So total EEV profit = 83,618 + (39,984) + 35,000 = 78,634

(iii) Net assets reduce by P.

Net assets increase by £1bn in respect of the reduction in liabilities due to the business reinsured.

Net impact on net assets therefore depends on the relationship between *P* and £1bn.

P will likely be greater than the best estimate expected value of the liabilities reinsured.

This reflects the profit margin required by the reinsurer.

Including a margin for the longevity risk that it is taking on.

And a contribution to the cost of its capital.

However, the liabilities transferred will have contained significant prudential margins.
These are likely to exceed the profit margins (or "fee") required by the reinsurer.

Similarly, the reinsurer might be expecting to invest *P* in higher yielding assets than the insurer
hence expecting greater profit on investment return.

There may be other reasons, such as tax or solvency arbitrage, why *P* could be lower than if set on the insurer's basis.

So *P* is likely to be lower than the reserves that were held.

Overall, net assets would therefore be expected to increase by the excess of the prudential margins within the liabilities over the profit (i.e. "fee") taken by the reinsurer.

If the reinsurance transaction includes a "deposit back" arrangement then the company's assets will increase by these deposit back assets but the liabilities will also increase by the same amount and so there will be no impact on net assets.

Releasing the reinsured reserves reduces the value of PVIF for this business, due to there no longer being any release of the prudential margins.

The discount rate and investment returns are the same…
… therefore there is no "frictional cost" of having this capital locked in…
… so the reduction in PVIF offsets the increase in net assets resulting from no longer having to hold prudential margins for these liabilities.

Further required capital can also be released.

The overall impact is therefore a reduction in EEV equal to the "fee" charged by the reinsurer.

However, there may be additional impacts if the risk discount rates are changed.

Longevity risk has reduced.

But counterparty risk has increased.

The reduction in longevity risk will be more significant than the increase in counterparty risk, therefore the risk discount rate may be reduced.

This reduction in discount rate will increase the PVIF.

There may be a second order impact on the mortality assumptions for the annuities not reinsured due to a smaller remaining book.

An additional second order effect may be seen in the risk discount rate from a reduction in diversification benefit between the protection and annuity business.

EEV may reduce due to the additional costs of administering the reinsurance agreement.

(iv) Need to bear in mind the following EEV principles (details as in part (i)):

Principle 9: relating to the general assessment of future assumptions.

Principle 10: specifically relating to setting economic assumptions.

It is likely that the year end basis for withdrawal rates is based on experience up to the half year as the basis setting work will be done in advance of year end so the second half year experience will be too late to use.

Withdrawal rates – Individual deferred annuities

Half year experience was lower than the year end 2013 basis.

Having experienced better persistency during the first half year this may be continuing a downward trend from the previous year, with no indication that this is a one-off.

The company would also have considered previous years' withdrawal experience investigations.

The company may have decided that there was evidence enough to reduce the long-term basis.

However, due to only having experienced this reduction short term they may not have wanted to take full credit for the lower experience and so smoothed the long term basis to a value between the previous basis and most recent experience.

Alternatively, it may have been apparent (even without the formal experience analysis completed) that in the second half of the year withdrawal experience was higher than in the first half of the year and so the company only partially reduced the rate.

A change in mix, or the impact of new business may mean past experience is less relevant.

There may have been an error in last year's assumption.

Withdrawal rates – Group deferred annuities

Experience during the first half year was significantly worse than the year end 2013 basis yet the year end 2014 basis was unchanged.

As the EEV basis should reflect expected long-term experience, any one-off short term events that are not expected to be repeated could be removed from experience when setting the new assumptions.

Group deferred annuity withdrawal assumptions are likely to be due to a mix of individual members leaving; e.g. when they change jobs and whole schemes leaving; e.g. scheme review prompts a move to another provider to gain a lower premium.

Individual member withdrawal rates could be expected to be fairly consistent over time whereas scheme withdrawal rates could be expected to occur in peaks as a scheme leaving will happen less frequently and will result in a large number of members leaving.

The higher than expected rate in the first half year may have been due to a very large scheme leaving, and this was not expected to be repeated.

If this was the case, that scheme could have been excluded from the analysis.

If observed experience in the second half of 2014 was nearer to expected levels, this would have given additional evidence supporting retention of the basis.

Investment return – Immediate annuities

The return at half year was in line with the year end 2013 basis rate, yet the year end 2014 yield was higher.

It is likely that fixed interest assets are used to back the immediate annuities. Therefore the investment return is likely to be set based on the yields on these fixed interest assets.

As immediate annuities tend to be closely matched by fixed interest assets…
… the assumption change may simply have reflected an increase in bond yields over the year.

It is likely to represent the average yield over the appropriate duration of the annuity liabilities, e.g. medium to long.

In order for the EEV calculation to be consistent with the value of assets (and hence net assets), it should be based on the yield as at the valuation date, i.e. the year end, so the half year yield is not of direct relevance.

However, the change is significant and is unlikely to be solely due to yield curve changes.

The most likely scenario is that the investment strategy for the assets backing the annuities was changed in the second half of 2014.

The assets held at the start of 2014 may have been gilts, yielding risk-free rates.

In the second half of 2014, the company may have proposed and had agreement to take more risk in its investments backing annuities or greater investment freedom or less matching and so moved to investing more in corporate bonds, or other higher risk asset classes.

Alternatively, the reinsurance arrangement may have altered the duration of the matching assets and, hence, the yield.

If the yields are net of investment charges, then the change could be as a result of a change in the investment fees.

If this is the case then the investment return assumption at year end 2014 would reflect the expected long term return on these corporate bonds rather than gilts.

This would be higher than the return on gilts as the market rates are higher to reflect the default …
… and illiquidity risks.

However, the full differential between gilts and corporate bond yields would not be reflected in the basis as a margin would be deducted …
… to allow for expected defaults.

If the annuities are Purchased Life Annuities, the taxation basis could have moved from BLAGAB to XSE, resulting in a move from net yields to gross yields.

(v) Deferred Acquisition Cost (DAC) refers to an accounting treatment used in Modified Statutory Basis (and other) accounting whereby the acquisition costs incurred are deferred
… for a temporary period…
… so that they are not allowed to depress profits …
… at issue of the insurance contract …
but instead are used to reduce margins arising in the future (or anticipate future margins) where these margins are not needed to cover ongoing renewal costs of the insurer.

DAC creates an asset on the balance sheet.

However, it is not a "real" asset and as such does not impact the actual cashflow to/from the company.

In effect lower (unstable) profits at outset and higher profits later on are exchanged for higher (more stable) profits now and lower profits later on.

Acquisition costs should not be deferred in some circumstances:

- The costs in question have already been recovered.

- The contracts are not expected to generate enough margins over their lifetime to cover the acquisition costs after meeting other costs.

- The receipt of future premiums or future margins is insufficiently certain, based on prudent estimates of future expected discontinuance rates or other experience.

The amortisation period should be the period over which the costs are expected to be recoverable out of margins in matching revenues at a rate that is commensurate with the pattern of such margins emerging.

The DAC is written off over this period.

(vi) Under the Retail Distribution Review (RDR), new group deferred annuity schemes would be regarded as investment products …
… and so commission is no longer permitted on new group deferred annuity schemes.

Initial commission is the main acquisition expense on these contracts that would be deferred under DAC.

Therefore the scope to set up a DAC asset for new group deferred annuity business post-RDR would be limited.

However, if margins were low then the level of DAC asset may already have been restricted.

The inability to set up a DAC asset will be counteracted by the lack of commission payments.

So there will be no direct impact on the accounts balance sheet.

However, the reduction in commission may be offset to some extent by greater relationship management costs.

Existing DAC assets from previous years' new business would be unaffected by this …
… as they continue to run off according to the pre-set amortisation pattern.

Part (i) This question was well answered by candidates who had studied the relevant part of the core reading.

Part (ii) This was generally well answered. Alternative solutions/ approaches were possible and were marked accordingly. However, candidates that adopted a logical step-by-step approach tended to do better. Candidates that tried to do too much in one step were more likely to make mistakes.

Part (iii) Some candidates wasted time by describing how the reinsurance arrangement would work; the question did not ask for this. Most candidates got the main points, but the better candidates commented on the likely size of the premium relative to the size of the reserves by considering the likely relationship of the prudential margins in the reserves and the profit loading of the reinsurer. Hence, the likely movement in the value could be assessed.

Part (iv) Most candidates made appropriate comments on why the assumptions set may differ from the immediate experience. With regard to the investment assumption, it was disappointing that some candidates stated that the higher return assumed was based on the company's view of markets. It is highly likely that assets will be cash flow matched to the liabilities and so the yield can be taken from the yield on those assets.

Part (v) This was generally well answered, although several candidates confused the amortisation period of the DAC (dependent on future margins) with the seven year period for tax relief on initial expenses.

Part (vi) This was generally well answered.

Q2 (i) **Profitability**

The company will want to maximise profit or at least meet the defined target level of profit.

Could be a combination of net present value, IRR or payback period.

Profit measures should take into account Solvency II capital measures…
… thus evidencing for the "Use Test".

Would need to set an appropriate basis for the cashflow projections.

Given no current experience in group pensions…
… may need to get assistance or conduct market research.

Key assumptions will be lapses of individual members, withdrawals of whole schemes, expenses and unit fund growth rates.

Margins may need to be high due to the uncertainty relating to lack of experience.

Product structure

Need to consider the matching of charges and expenses…
… in terms of both timings and amounts.

The structure is likely to have a combination of fixed policy fees …
… and annual management charges expressed as a % of unit fund.

It is likely that initial set-up expenses will be high.

Therefore may wish to include an initial charge.

However, competition may prevent preferred charging structure.

It is likely that large employers will ask for a bespoke structure, so the product structure may need to be flexible.

Need to decide on the choice of unit funds to offer.

This needs to be sufficient to be competitive…
… but not overly wide to create administration issues.

Could end up with a lot of very small funds if no limit is imposed.

Need to decide whether to allow unlimited switching between funds or whether to restrict this…
… and also whether to charge for switching.

Need to allow flexibility in terms of premiums being paid.

May consider having a similar charging structure as for its existing personal pensions products…
… in order to reduce the admin/systems change burden.

Consider any guarantees if adopting a Variable Annuity structure.

Marketability

Need to assess the likely volume of new business sales for a particular design.

In order to do this, need to assess other products on the market and what competitors offer.

Consider the potential for the product in the context of auto-enrolment.

If charges are higher or less attractive than those levied by other companies then new business sales will be low …
… which could lead to non-recovery of development/fixed costs.

If charges are too low then there is a danger that new business volumes will be high…
… leading to potential issues with administration …
… and/or financing.

Need to consider whether charges are guaranteed or variable.

Guaranteed may be more attractive as it provides certainty.

However, some employers may prefer charges that can be re-negotiated throughout the lifetime of the contract.

It also may be that after a few years in-force, the employer reviews its pension scheme provision – and hence need to ensure product remains on advisor panels.

Customer needs

The product should satisfy the identified customer need for the target market. In this case, both the needs of the employer…
… and the employees should be considered.

The insurance company would want to ensure that the product is in line with TCF requirements.

In particular that charges are fair and appropriate and are fully disclosed and cannot be increased unfairly at the company's discretion.

Customers should not face undue barriers to exit
… given that individual members are likely only to leave (or stop paying premiums) when they leave employment.

Therefore need to be able to offer an easy transfer out mechanism for employees.

Distribution methods

Consider how the product will be distributed.

The insurance company would initially be targeting employers rather than individual members.

May consider targeting particular employers or industries.
This may mean that a different distribution channel needs to be used than at present.

Likely to use financial advisers who operate on an independent advice basis

Or specialist brokers …
… or consulting actuaries who will be acting on behalf of the employers.

Advice will be on a fee basis rather than commission.

Would want to ensure that the product can be put onto the panels of key financial advisers, but this will require a lot of discussions about company financial strength, administration process, investment performance etc.

Financing / capital requirements

Need to ensure that have sufficient available capital to launch the product …
… including covering the development costs.

Once the product has been launched, each scheme is also likely to have high initial expenses.

Would want to design the product such that initial strain can be limited.

Would need to consider the current and projected solvency position, to understand whether the projections for new business threaten solvency …
… and hence whether additional financing may be required.

Sensitivity of profit / key risks

Would need to conduct sensitivity analysis on the profit test to key assumptions.

Also need to look at any cross subsidies – particularly around scheme size.

. As charges are likely to be related to the number of members and/or fund size, …
… profit will be sensitive to the numbers of members joining….
… and to retention rates.

There will be investment risk (lower than expected investment returns)
… to the extent that charges (and hence profits) are related to the size of unit funds.

There will also be expense risk (under-estimation of administrative costs)
… including inflation risk
… which can be reduced if charges are linked to a suitable index.

Counterparty risks may differ from those under the existing personal pensions due to a change in distribution channel (depending on current method).

In addition, it would be necessary to consider how the risks of this product affect the overall risk profile of the company.

This would include any diversification benefits achieved with other products.

The level of additional risk arising from the product design needs to be within the risk appetite of the company…
… and in the available capital.

Administration

Need to consider whether current administration systems can be adapted or whether a new system will need to be developed/purchased.

May be able to adapt any individual pension system, but group overlay may cause issues.

Administration staff will need to be trained …
… and potentially recruited.

May consider outsourcing administration to a specialist company.

New product literature will be required.

Each employer may require bespoke literature, which would increase the complexity.

If charges are bespoke for larger employers, then the administration system needs to be able to cope.

Group pensions are likely to involve more administration, given dealing with both employer and employees.

Need to be able to deal with contributions from two different sources.

Likely to have a higher level of member movements than for individual personal pensions …
… given that membership is linked to the employment of the individual.

Need to develop illustration systems for individual members.

For large schemes would want a lot of administration to be automated…
… or linked straight to employers' HR systems.

Need to have efficient systems for providing values of unit holdings …
… and ability to change unit holdings and switch funds.

This may require customer access via the internet.

Need to consider whether will use existing unit funds or need to set up new ones.

If decide to use the same funds and annual management charges differ from those on existing products, then may need separate sets of prices.

Service standards

Given that the schemes will be sold through financial advisers and brokers…
… service standards are critical.

If service standards fall then the company could suffer reputational damage…
… and hence risk the whole scheme being transferred.

It is therefore vital that staff are thoroughly trained on the new product and the systems are in place and tested well before launch.

Reputation

The reputation of the insurance company needs to be good before gaining access to financial adviser panels (if it isn't good then, whilst the product might be competitive, the financial adviser is unlikely even to consider the company as a pension provider).

Issues around company mergers or other financial uncertainty may mean that the company cannot get on panels or may get removed from them.

Need to consider the importance of investment performance – whilst not entirely in the direct control of the insurer, it will reflect on them.

Reinsurance

May consider financial reinsurance …
… to finance any new business strain.

Taxation

Charging needs to fit in with the taxation regime, and any taxation rules need to be allowed for in the pricing of the products.

Need to consider possible changes to the taxation regime.

Regulation

In light of recent pension freedoms, may want to consider allowing alternative options at retirement, e.g. regular withdrawals ("drawdown")…
or may wish to offer a deferred annuity to provide a longevity guarantee.

Need to consider the potential for further regulatory changes in relation to retirement benefits.

Need to consider the impact of the introduction of the product on the ICA.

Need to consider the implications of Solvency II for the product
… in terms of both capital requirements and ORSA risk management aspects.

Need to comply with relevant charge caps (e.g. stakeholder and auto-enrolment).

(ii) Operational risk will increase.

Administration

There could be increased conduct risk.

There could be additional risk of a leak of confidential data breaching the Data Protection Act.

There is a risk that the staff being used to administer the business are not sufficiently skilled, particularly in understanding the company's products.

Therefore more mistakes could be made, mistakes may take longer to rectify.

Service standards could fall and there could be more unhappy customers and complaints.

There is a risk that call centre helpline and/or internet access availability may not be as extensive or as effective as at present.

Overall there is therefore considerable reputational risk.

This risk is increased if customers have contact with outsourcing staff only.

There may be either significant redundancies of current staff, or transfer of current staff to the outsourcer.
There is a risk that this may create both local and national reputational damage.

The company may underestimate the costs of managing the relationship with the outsourcer.

Systems

The outsourcing contract requires transfer of data from the insurer systems to the outsourcer systems, which would expose the company to risks of delays in transfer, with consequent impacts on costs and service standards.
There is the risk of errors on transfer.

Data migration may cost more than expected.

There will be a delay in system developments on the current system, which may put future new business or product developments at risk.

There is a risk that systems are not easily capable of being linked to other retained systems (e.g. Finance/Actuarial valuation systems).

Treating customers fairly (TCF)

Because the company is now exposed to additional risks outside its direct control, there is further risk of contravening TCF requirements.

New business / retention

Poor service standards could have a knock-on impact: the risk of lower future new business…
… particularly for group pensions where administration service is critical.

There is a risk that the focus of the company is diverted away from generating new business, whilst the outsourcing arrangements are being implemented or if problems arise.

As a result of any negative reputational impact, there is a further risk of increased withdrawals.

Lower new business and/or higher withdrawals lead to increased risk of not meeting overhead expenses.

Unit pricing

The company will be exposed to the risk of lack of controls within the outsourcer's unit pricing function.

This could lead to significant additional risk of providing compensation for any unit pricing errors…
… and the cost of the resources required to rectify client records.

Regulatory risk

There is also a risk of regulatory intervention.

And the potential to be fined.

Outsourcer may fail to provide customers with required disclosures.

Counterparty risk

The outsourcer may not fulfil its contractual obligations…
… in a timely manner.

In the extreme, there is a risk that the outsourcer could default and walk away from the agreement.

There is then the risk that the company would not be able to take the administration back in-house sufficiently quickly to enable it to continue to provide adequate service…
…. or the risk that it would not be able to find another outsourcing company quickly enough
… at an acceptable price.

Contract

The outsourcing contract will introduce legal risk.

Poor wording may lead to disputes.

The contract will be for a specific period and likely to have a schedule of charges to be made.

The company will therefore be exposed to uncertainties at the end of that contract…
… with the potential need for in-sourcing or alternative outsourcing.

(iii) The level of mitigation required will depend on the risk appetite of the company.

Administration

In setting up the outsourcing agreement, the company could provide detailed process documentation for maintenance of policyholder records so that the outsourcing administrators can follow the same processes as currently.
Only outsource the basic tasks, and leave more complex tasks in house – at least initially whilst the outsourcer staff increase skill levels.

Provide significant training to the outsourcer during a transitional period including potentially transferring some current staff to provide the training.

Ensure new systems are thoroughly tested.

Build in sample checking of basic administration tasks– the samples may be more extensive initially whilst the arrangement beds in.

Restrict access to confidential data.

Set appropriate performance standards for the outsourcer with payments/penalties dependent on reaching certain levels.

Build appropriate service level agreements into the agreement.

For example, turn around times…
… including call centre opening times.

Monitor key risk indicators such as numbers of complaints.

Manage redundancies and related communications carefully, working with unions (where relevant).

Systems

Develop a detailed project plan.

This should cover transfer of data to new systems, the development of product structures, and the links to in-house systems (e.g. Finance/Actuarial, Sales etc.)

Have thorough testing of the data and valuation, comparing them before and after the transfer.

Likely to do the transfer in tranches…
… starting with the most recent tranche.

Older cohorts would be migrated only when the first migrated cohorts have been thoroughly tested.

Outsourcer should have data recovery sites.

TCF

The company will need to continually monitor its TCF performance.

It should require the outsourcer to provide appropriate management information to allow the company to monitor compliance.

The company may only transfer customer facing functions after the outsourcer has proved it can cope with basic administration.

New business / retention

Careful communication will be needed with key distributors.

And, where necessary, with customers.

This should include details of how it affects them.

There will be a need to ring-fence any resources involved in developing and selling new business, so that their focus is not diverted.

Monitor persistency performance regularly via management information.

Conduct sensitivity analysis on persistency assumptions to build into the outsource contract.

Unit pricing

Parallel pricing could be carried out for a period.

There will be a need for an in-house monitoring/checking of unit prices …
… so that any errors/issues can be recognised quickly.

A detailed process for dealing with errors and compensation will need to be developed with the outsourcer (also to ensure that any issues are quickly identified and dealt with)

Counterparty risk

Significant due diligence on the outsourcing firm would need to be undertaken including investigating financial strength, credit rating (if applicable), current skill/staff levels and discussions with any third parties already using the company.

Continue to monitor these items.

The outsourcing firm's track record for administering this type of contract would be considered.

Regular visits (insurance company management to outsourcer) should be arranged.

The insurance company may ask its auditors (internal and external) to review the outsourcer.

Have a back up plan in case of default.

Ensure the contract facilitates the transfer of proprietary administration software and staff in the event of outsourcer insolvency.

Contract

The legal contract will need to be carefully worded.

This should include appropriate break points.

And actions to be taken if appropriate standards are not met…
… including the compensation payments to be made.

The contract should give clarity as to who is responsible for paying regulatory fines for poor service.

Part (i)	This was generally well answered. Whilst possible to score well using simple knowledge of the Core Reading, the higher scores were achieved by candidates that considered each point in relation to the product described.
Part (ii)	Many candidates considered the risks arising once the outsourcer was operating the business. Fewer candidates described the risks associated with the transfer itself.
Part (iii)	Most candidates described the ongoing mitigations, but, again, the better candidates considered the mitigations associated with the transfer (data checks before and after, parallel processing and effective project management).

END OF EXAMINERS' REPORT