INSTITUTE AND FACULTY OF ACTUARIES

EXAMINERS' REPORT

September 2012 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.

D C Bowie
Chairman of the Board of Examiners

December 2012

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 April 2012 paper

In general, candidates showed good knowledge of the Core Reading.

Question 1 part (iii), (vi), question 2 parts (ii) and (iii) in particular served as good differentiators, with the better candidates applying their knowledge to question.

The key to question 1 part (iii) was to consider why the change might have been proposed by the government, both in terms of tax revenue and the impact on the market.

Question 1 part (vi) required candidates to consider how rationale for the existing methodology might be adopted in the new reporting environment, but also to consider the practical implications and the impact on the level and variability of shareholder transfers.

For question 2 parts (ii) and (iii) it was recognised that many candidates did not segregate their answers between the two parts as envisaged in the marking schedule. Marks were awarded for each part, even if candidates wrote the point in their answer to the other part of the question. For part (ii), impact of the error on all customers should be considered. Few recognised that, due to the smoothing approach, the customers who did not leave or pay in premiums during the time of the error, were also impacted.

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

1 (i) Pensions business is treated as Gross Roll-up business (GRB).
GRB is liable to tax on its Case VI profit.

This is derived from amounts brought into account in the FSA Returns

as: $P + I' + A' - E - C - (V_1 - V_0) - L$
where

P = premiums receivable in respect of GRB contracts
I' = GRB share of investment and other income brought into account
A' = GRB share of change in value of the assets brought into account – this may be negative
E = expenses including commission attributable to GRB
C = benefit payments made in respect of GRB contracts, including terminal bonus
V_0 = value of GRB liabilities at beginning of year
V_1 = value of GRB liabilities at end of year – including cost of bonuses declared at end of year
L = absolute amount of any Case VI "loss" brought forward from previous year end
I' and A' are a part of the "investment income", increase/(decrease) in value of investments, and "other income" that are brought into account in Form 40 of a UK company's FSA Returns.

The amount of tax payable is calculated using the corporation tax rate.

(ii) It is the pensions business that would be directly affected, since the tax for GRB is based on FSA Returns profits.

Generally speaking, the accounts would tend to have less overall prudence in the basis.

For an individual policy, the accounts would tend to show higher profits up-front and lower ongoing profits.

In the first year of implementation the amount of taxable profit is likely to be larger than under the previous approach since V_1 is likely to be smaller under the accounting regime or alternatively there may be a DAC which has the same effect of increasing profits.

This would mean more tax payable in the first year of implementation, through the release of the prudence.

Although it is possible that some form of transitional arrangement would be implemented, whereby the additional tax bill is spread.
Going forward there would be lower tax bills due to lower ongoing profits (subject to any spreading of the initial difference).

For new business it is likely that the use of accounting trading profits will mean more tax payable up front and less ongoing.

It is important to note that the total tax amount paid (over the lifetime of the portfolio) will not change, just the timing of its payment.

The degree of the difference depends on the materiality of the differences between the FSA basis and accounting basis.

For the BLAGAB business there would be less impact.
Since this is taxed on an "I-E" basis.

This would only be affected if NCI profits were being used.

If any of the apportionments of income etc used in the current calculations are based on figures from FSA Returns then these may also change.

In future amounts of tax are likely to be more volatile.

(iii) The proposal brings the taxation of life insurance companies more in line with that of non-insurance companies.

The government will want to maximise its tax revenue.

By making this change, the government will expect more revenue from investment products because the taxable income can no longer be offset by protection expenses (excess E).

There should also be more revenue from the protection products as these are expected to generate profits.

If the government were thinking of making changes to existing taxation rules, then aligning these with other changes driven by Solvency II would make sense.

It is easier for companies to implement significant tax changes all at the same time.

Marks were awarded to candidates who make equivalent comments, but which recognise the delay in implementing Solvency II.

Such implementation considerations include changing the administration and systems underlying the tax calculation.

And performing tax management which might help the company to minimise its tax bill.

The "I-E" regime for protection business might have been causing problems for insurance companies.

In particular it may have been distorting the protection market and inhibiting new entrants.

For example, depending on the mix of business written, some companies can find themselves inevitably producing excess E, e.g. if writing large volumes of term assurance business.

This is because protection business tends to have relatively low reserves (compared with investment or savings business) and hence relatively low I compared with the level of expenses E.

This can lead to such companies facing a tax incentive to write certain types of business, and of course a disincentive to write others.

Conversely companies with business producing excess I have a tax incentive to write business producing excess E, so that they can get immediate relief on expenses and thus can write protection business more cheaply.

Eliminating these resultant tax distortions could increase the government's tax revenue.

The proposal to implement this change only for new policies written after a certain date is sensible because it would otherwise create potential losses due to tax in the company which could not be recoverable from policyholders.

(iv) The company will want to carry out a projection to see if the change is material.
If so, the company may try to lobby against this change.

The company may adjust its investment mix as gains may be preferable to income.
But this is unlikely for PRE reasons.

The company will need to change its tax calculations to reflect the change, and this would have practical implications, such as system changes.

In particular, calculations and accounting records will now need to be split between existing and new protection business, which is a major change.

The pricing for protection business will need to change.

So premiums would increase.

This will make these contracts less competitive, but since all of the companies are having to do the same, it should not be an issue.
But it would be helpful to see what competitors are planning.
Alternatively the company may leave the premiums as they are, and reduce profit margins.
This could lead to unsustainable volumes of unprofitable new business.

Savings business may also need to be repriced if it was previously subsidised in respect of its tax basis.

If any of the benefits of the previous tax rules were being used to enhance asset shares, this may also need to be changed.

The company may change its new business strategy, either in the short or long term (for example, it might cease writing protection business or high income earning business), because it can no longer utilise the tax rules to its advantage.
It will be necessary to educate the Board on the change.

(v) The company is likely to calculate asset shares for the with profits business and so this is likely to be the starting point, and would need information on the assets hypothecated to individual asset shares in order to determine the returns directly attributable to the BLAGAB asset shares and separately to the pensions asset shares.

However these returns may not be split between income and gains, which may be important if there is differing tax treatment.

In some cases, the company may not have individual asset shares, for example where they use sample asset shares to set bonuses, or where a prospective valuation is used (e.g. for whole life business).
This means that additional work may have to be done to come up with the required apportionment.
Similarly, future policy related liabilities, such as costs of guarantees will need to be considered.

For the without profits business, the company will need to use some other means of apportioning the income and gains to the products.

For example it may use the return implicit on individual policy reserves under Solvency II.

However it could be that the actual income received does not accurately reflect the returns assumed in the reserving calculations (for example if risk-free rates were used to determine the reserves, but high yielding bonds are held).

Also, reserves may be negative which could complicate the calculation.

The company may need to do a notional asset hypothecation for the without profits business, e.g. by specific product type and/or by duration.
It is likely that more information on the assets will be required than at present.

The company also needs to consider income and gains on assets backing other liabilities that are not attributed to individual policies.

Attribution of the effects of assets such as whole portfolio derivatives may not be straightforward.

For the assets backing other liabilities, the company would need to determine a methodology which fairly splits the income and gains. This may not be easy and so some approximate apportionment based on the results of the above calculations may be appropriate.

The apportionment should also take into account the specific nature of each liability, and in particular whether it can be related to a specific type of product (e.g. a pensions mis-selling provision).

Determining the apportionment of the income and gains on the inherited estate is more complex.
The inherited estate is not allocated to any individual policies or products and until it is distributed, it is unknown whether the income or gains are likely to benefit the BLAGAB or pensions business.

A simple method based on the asset share apportionment could be used.

In addition the company needs to be careful that policyholder expectations are not set as a result of the how the income and gains are allocated to policies.

There may also be reference to the tax calculations in the PPFM which may need to change, although this level of detail is unlikely to be set out in the PPFM.

The pricing basis may also need to change if the tax basis changes significantly.

There are also practical issues:

- Need to make systems changes.
- Need for additional resources to implement and possibly also to do the work going forwards.
- Could take longer to do than before.
- Costs of making the change.

(vi) Might discuss approach with FSA and consider professional guidance (TAS)
For all options, the PPFM and articles of association need to be checked to ensure that the option is consistent with these.
In addition the With-Profits Actuary will need to be consulted.
Practices or principles may need to be changed.

The company will need to consider what communication to policyholders is required.
The effective change to benefits may be minimal, and any communications may be complex.

Option A

This means no change and so there is no impact on PRE/TCF.

It is easier to explain, at least in the short term and the shareholder transfers and embedded value are not impacted.

However, it will result in an extra set of calculations (on top of Solvency II) being done each year, and hence additional cost.

The models and assumptions are currently audited, but going forwards this control will not be there.

This option means having to maintain the determination of Peak 1 assumptions.
Since Peak 1 assumptions require prudence, there is judgement involved in setting the assumptions.

There is potential for a conflict of interest between shareholders and policyholders in terms of the assumptions used, which is worse now, due to the absence of external review.

In particular, very prudent assumptions would transfer higher amounts to shareholders, to the detriment of policyholders.

Option B

This option is consistent with the current approach in terms of being in line with the increase in regulatory liabilities that arises from the reversionary bonus declaration.

The figures are more likely to be subject to external review, and the models and assumptions will form part of the reporting process as part of Solvency II.

Any stochastic modelling will probably be based on sample model points.
This is likely to be different from the current approach and it may be questionable as to whether this is accurate enough.

The results (and hence shareholder transfers) could be volatile due to being dependent on volatilities and moneyness of guarantees.
For example if the contracts are some way out-of-the-money then it could imply that there is no cost of bonus (and hence no shareholder transfer), since the cost of guarantees might not increase.

Also, an increase in asset shares could reduce the impact for similar reasons.
This is a change in current practice as currently an increase in asset shares would not impact the transfers.

Furthermore the impact is dependent upon the level of asset shares at the time of transfer, which will not reflect the ultimate actual cost which may be higher or lower.

Other factors such as changes in management actions could also impact the cost, e.g. an increase in reversionary bonus could mean a reduction in equity backing ratio which reduces the cost of guarantees.

There could be PRE/TCF issues if any adverse changes to asset shares as a result of differing shareholder transfer amounts as it removes the prudence from the current method.

However it is likely that the level of shareholder transfers would on average be lower under this option than at present, as it should be expected that the guarantees should be more often out-of-the-money over a long term and the shareholder is not taking a direct share in the investment return being used to support the annual reversionary bonus declaration.
This option is also likely to make the embedded value complex to model, as in theory it would require projected stochastic calculations to value the shareholder transfers.
This would be more complex to explain and communicate.

Option C

This method will probably result in a reduction in shareholder transfers due to the basis being more realistic than is currently the case.

So the embedded values will reduce.

However there are unlikely to be any PRE/TCF issues with this approach.

The assumptions are more likely to be subject to external review than under option A, and so less conflict of interest is possible.

The method is simpler than option B.

However it may mean that additional model requirements are needed, so there may be costs involved.
The resulting transfers are likely to be more volatile than A, but less so than B.

(vii) Carry out a trial run.
Reconcile the existing ICA to the trial run SCR.
Ensure there is a thorough testing process for the new model / model changes.

It is not clear whether the results of Solvency II will be required to be audited, but the company could ask their external audit firm to perform an audit on the balance sheet.

Alternatively, the company may ask a different firm to carry out an independent review.

The Directors would need to put in place arrangements for tightly managed internal audit controls.

The manager responsible for internal audit might be the Chief Financial Officer or, as is more common, might be positioned separately from the finance function with clear reporting lines to the Board of the insurer.

Control accounts would be set up to ensure that different sources of data within the company reconciled with each other.
For example, they would demonstrate reconciliation between the accounts and Solvency II balance sheets.

Management information:

- Reconcile Solvency II projected items with actual items (e.g. management expenses, premium income, investment income, new business, lapses, claims), with each item being subdivided into detailed categories as required;
- an analysis of surplus on a Solvency II basis.

Ensure compliance with all relevant actuarial standards (e,g. TAS D, TAS M, Insurance TAS).

Part (i) – This is a relatively straight forward question that can be answered with good knowledge of the Core Reading. This was either answered very well or very badly.

Part (ii) – The better answers were those which identified that this mainly affected the pensions business and which then took a methodical approach to how the profits and therefore tax may change, although relatively few students recognised that there would also be impact on BLAGAB business if the NCI test was used.

Candidates, who scored well on this part, recognised that the level of tax is affected due to the change in timing of profits.

Part (iii) – This question was a good differentiator between candidates. Some candidates did extremely well, managing to explain the "I-E" issue and deduce that the changes would both give more revenue to the government and also bring in some consistency across industries and companies. A number of candidates failed to think through the logic of why the change may be desired and gained very few marks.

Part (iv) – This was, again, another good differentiator. Those who scored well were able to consider what the company may do in terms of deciding whether to re-price, or change the new business strategy. Some candidates incorrectly thought that premiums may reduce. The better candidates also acknowledged the wider potential impact on the savings business.

Part (v) – This proved to be one of the more challenging question parts on the paper. Candidates did not always focus on practical issues, as per the question wording. Many candidates did not answer in the given context: i.e. how to allocate the returns for tax purposes, and discussed instead the implications of changing the investment policy for asset share. In addition, many thought this approach meant that the inherited estate needed to be allocated between shareholders and policyholders, whereas the point was that the change to tax allocations should NOT create expectations for policyholders with regards to the estate.

The question was asking the candidate to consider practical issues relating to the calculation of the accrued investment income and gains on the assets hypothecated to each individual policy each year, and then the allocation of these directly to BLAGAB and GRB as appropriate. Very few candidates realised that they needed to consider what the individual policy meant. In most cases an appropriate measure would be asset shares, but where there are no individual asset shares there will be many related practical issues – as reflected in the model solution.

Part (vi) – This should not have been too difficult a question if worked through methodically; however many answers were disappointing. Many candidates described how B was best as it allowed for the time value of the guarantee – which does not recognise the related issues that arise when being used for this specific purpose. For example, in the case of a policy being heavily out of the money, the cost of guarantee reserve may not increase at all with a declaration - which clearly cannot give the shareholders a share of the profits. Many candidates suggested that C could end up with a zero value, which is not the case. Some candidates talked about lack of allowance for shareholder transfers on terminal bonus under some of the methods, not apparently having appreciated that the question was only asking for consideration of change to the regular bonus component. To do justice to this question, candidates needed to think about what the shareholders transfers represent and think through the potential change in reserves for the different methods under varying scenarios to see how the shareholder transfers may be impacted. Although skimming the surface, very few candidates delved into the idea that for A, the method and assumptions are no longer audited and so this would make the potential conflict of interest between shareholders and policyholders difficult to manage.

Part (vii) – This was reasonably well answered overall. The better candidates thought through how, in practice, they would check the results, using the relevant part of the Core Reading.

2 (i) Ensure TCF is embedded in company culture and processes.
Have in place a process to identify customer needs when designing products.
Design products and services to meet those needs.
Understand customers' financial capabilities and how the company's communications help the customers to understand complex issues.
Provide clear, fair and not misleading advertising, marketing and disclosure material.
This includes communications after the point of sale.
Engage with distributors to ensure that appropriate sales messages are being given.
Maintain a balance between increasing sales and not exposing customers to inappropriate risks.
Measure and monitor risks arising for new and existing customers from its products.
Stress test against possible future changes in the environment considering customer impact.
Test against possible risks arising from its retail business allowing for specific products and sales methods.
Put in place appropriate control functions to deliver the overall TCF strategy.

Provide timely, informative and relevant management information to monitor the effectiveness of strategy.
Provide adequate staff training.
Set appropriate levels of service standards.
Remove any potential “post sale barriers”, i.e. make it relatively straightforward for policyholders to change product or make a complaint.

(ii) The key decision for the company is whether to correct this error or not.
TCF suggests that the main consideration should be the impact this will have on the customers involved.
The magnitude of the error should be considered and whether there was a material impact on the unit price.
Smoothing may be at the company’s discretion, depending on what has been communicated to policyholders.
Therefore correcting an error in the shadow fund price would not necessarily result in a change to customer payouts.
However, it is unlikely that this could be regarded as smoothing.

Considering potential customer impacts:
As the unit price has been too high then, all else being equal, customers leaving in the five days of the error will have left when their asset share is valued on too high a unit price.
This is an actual cost to the with profits fund and so the fund will need to receive compensation from shareholder funds.
Specifically, using the inherited estate is likely to be unfair to other customers.
However, customers paying premiums when the price is too high will have received too few units.
These customers will need to be credited with extra units to put them in the correct position.
The with profits fund has received the correct premium, which would have been invested and so is not a cost to the fund.
But is more complicated if the customer has since made a claim.
In addition, as smoothing profits and losses are recycled into the fund, the price may be increased or reduced by these profits/losses during a correction depending on whether the fund is being smoothed up or down.
This recycling means the price continues to be wrong, not just for that period of five days.
So, quickly correcting the situation will limit the costs.
Due to these interactions each customer’s correct position can only be known once prices have all retrospectively been corrected.

TCF customer outcomes 1, 3 and 5 are most relevant in this situation.
Outcome 1 considers the fair treatment of all customers.
As the fund recycles its smoothing profits or losses all policyholders will be affected, not just those with transactions during the error period.
Therefore ensuring the underlying asset price is now correct is not enough to ensure fair treatment.
Smoothing profits and losses recycled would be large if the company is smoothing a lot during the error period and there is a large number of

transactions, which is especially possible if there have been large market movements.
The current fund value of a customer who paid in a large premium during this time could be materially affected even with a small pricing error.
Outcome 3 states that customers should be appropriately informed and receive clear information.
Any annual statements issued since the error occurred will contain incorrect information.
These should therefore be re-run and reissued once policies have been corrected.
If the error is corrected a letter should be drafted to send to customers to inform them of this and how they can obtain more information if required.
Care will be required in the wording of this to ensure it is of a suitable technical level for the audience.
Information on how to make a complaint should be included.
It should also go through the required governance and compliance.
Outcome 5 implies that the company should ensure the contract performs as expected for the customer.
Here, a customer would expect the units to be priced correctly.
PRE will also play a part in this.
If the company has had previous pricing errors the action taken then must be considered as this could have set a precedent.
There may be a unit pricing error policy that applies to all funds.
Similarly if competitors have recently had pricing errors this may influence what action customers expect the company to take.
Literature for the product must be examined to discover if any expectation for company action in the case of pricing errors is set by this.
Relevant literature will include policy documents and the company's PPFM.
If the pricing error resulted in too high a price then the stakeholder charging cap could have been breached.
Discussions should take place with the FSA regarding this breach relating to the fairness issues.
If the FSA consider unfair treatment, this could result in fines for the company as the product has not then performed as expected.
The company's PPFM will state, in the smoothing section, the target range for customer payouts around asset share.
When prices are corrected the new asset shares, for those policyholders that have retired, died or transferred, should be compared to these ranges to ensure compliance.
The AFH and WPA should be consulted to ensure they are comfortable with the proposed action.
The company needs to bear in mind that whatever action is taken could set a precedent for the future.

(iii) The length of the smoothing period should be considered.
If the company smoothes over a long period, the error will have a larger impact than if they smooth over a short period.

Correcting the pricing error could be expensive.
There will be a cost in manpower correcting the prices and related work, as well as the cost of communicating with customers.
Resources may not be readily available to achieve this.
Depending on the size of the error there may be a requirement for staff to be trained up to deal with queries on this error.
There may be a cost to the company as they are likely to own a small part of the fund (the box) and this part will have to be revalued.
In addition, extra assets may need to be bought if the error is material and there have been a large number of transactions.

It will be complicated to calculate the correct prices as the smoothing profit and losses are recycled daily.
Therefore one day's price must be calculated and all transactions on that day recalculated in order to recalculate the smoothing profit/loss for that day before the next day's price can be calculated.
Systems may require new capability to correct the error.
A policy roll back and forward is required for each policy once the correct prices have been determined, or alternatively an all-in-one solution could be created that rolls back all the policies then moves them all forward one day at a time calculating the prices at the same time.
Testing of any solution created will be required.
Expertise may be needed.
Consultants could be used who have experience of these corrections if the company has no experience itself.
Given the complex nature it is likely to take some time to correct the prices, but until corrected each day's price continues to be incorrect, hence increasing the number of incorrect transactions.

Once each customer's correct position is determined there are other practical considerations:
Overpaid claims, on death or retiring, could be claimed back.
However, this may be very difficult to do in practice.
And there is a large reputational risk to this, especially as many providers write stakeholder products in order to provide the full product range to maintain relationships with distributors.
If retirees have taken an annuity the annuity rates may since have changed and so to ensure customers are left in the same position, the company may have to "top-up" the annuity at a cost.
Retirees are also likely to have taken tax-free lump sums which will also be affected.
Incorrect transfer values, either over or under-valued, will require contact with other providers.
For external transfers there may be a minimum amount the other company can accept as a transfer, so it should be considered whether the difference in claim amount could be paid directly to the customer if it is below a certain threshold.

As customers can also invest in unit-linked funds within the same policy there may be switch transactions, which means other funds are also affected.
This could affect the box position in these funds as well leaving a number of adjustments required post-correction.
There could be an impact on the company's reputation from the error arising, which could affect sales or the relationships with distributors.
Communications should be drafted for the distributors, particularly IFAs as customers may turn to them for explanation.
The FSA is likely to put in place additional scrutiny of the company's controls around their pricing.
If the FSA is not satisfied with the company's actions they could impose a fine.
Which could more publicly damage the company's reputation.
Which could damage the share price.
And increase withdrawals.
There may be implications for the company's tax calculations.
And for the tax position of the affected customers.
If customers are not satisfied with the company's actions they could complain to the ombudsman, which could place additional strain on the company to respond.
Consider additional compensation for inconvenience to customers.
The company will want to investigate how the error occurred.
The issue will be added to the Risk Register.
The company will want to check that no other funds are affected by similar errors.
The company will wish to prevent a similar error happening again and so will look to implement additional controls.
These could include tolerances around asset price or fund price movements or additional checking.
The governance around unit pricing should be reviewed to ensure it is fit for purpose.
There may be a lot of governance and sign-offs required for the company to correct the error which could take time.
If the error occurred due to information provided by an external party, then they could explore compensation from that company to reimburse them for costs incurred.

A further possible issue would arise if the prices were incorrect on a balance sheet date for financial reporting.
It may be appropriate to hold an addition al reserve until the position is resolved.
In addition, the time taken to process the corrections may impact the reporting timetable.

(iv) The impact of the fall will depend on the equity holding and whether there is any hedging in place.
If the company smoothes over a long period then a market fall will be of greater cost to the fund than if they smooth over a short period.
PPFM will contain principles and practices about smoothing. These should be examined to check whether they allow smoothing to be suspended.

And, if so, whether different approaches should be adopted for surrenders (as opposed to deaths and maturities), if not then, as a change to a principle requires three months' notice, it is not practical to change it in order to suspend smoothing in relation to this market crash.
However it may just need a change in practice, which permits notification after the event.
No smoothing means the asset share will be paid out.
Whether this will be beneficial to the fund depends on how the smoothed price compares to the asset shares at present.
If the market had recently risen rapidly then the asset shares could still be above smoothed values despite the fall.
In this situation removing smoothing would not be beneficial to the company.
If smoothing is not suspended, policyholders surrendering could select against the company as the smoothed value may be much higher than the asset shares.

TCF should be considered since, as noted above, the proposal could result in lower payments to policyholders and remaining policyholders need to be considered.
Has smoothing ever been suspended in the past?
Does the policy literature, or terms and conditions provide information?
Has there been a market movement like this previously and, if so, what action did the company take then?
What competitors are doing should also be considered as they are likely to have experienced the same market movements?
Seek advice on the likelihood that markets will quickly recover.
The action chosen could create expectations for future actions in similar situations.
If smoothing were to be suspended, it is likely only to happen on surrenders, as deaths and maturities do not select the timing and so should not be penalised for their policy finishing when markets are depressed.

It should be checked whether there is system functionality to be able to suspend smoothing temporarily as this may not have been built originally.
The functionality would have to differentiate between surrenders and maturities/deaths.
If there isn't system functionality it is likely to be a complex system build and unlikely to be quick to do.
Also, consider how smoothing would be reintroduced.

Consider the impact on the balance sheet.
If weak, suspension may be necessary.
If smoothing is suspended it could affect the company's reputation and lead to future surrenders when markets recover or to less new business.
Removing smoothing could lead to a temporary reduction in surrenders which then build up until smoothing is reinstated resulting in a spike then.

It should be considered the extent to which customer communications are required to advise of this change.
Customer service advisors may need training around this issue to be able to deal with queries.

Internal documentation may allow the company to apply partial smoothing rather than full suspension.
Or consider charging smoothing costs to the inherited estate rather than recycling within this product.
The company needs to agree the approach with the WPA and with profits committee, and comply with relevant professional guidance relating to discretion e.g. the Insurance TAS.

Part (i) – This was relatively straightforward for those candidates with a good knowledge of the relevant section of the Core Reading.

Part (ii) – Candidates who scored well on this part considered how the error will have affected different groups of candidates and the actions that should be taken as a result, applying the answer to part (i) where applicable. Many candidates did not recognise that, due to the operation of the smoothing, the error would go on for longer than the five days, impacting all remaining customer, irrespective of whether they had cancelled units or paid premiums during the period of the error.

Most candidates had some points in either (ii) or (iii) which sat in a different part in the examiner's report. These were given a mark irrespective of where the point was made.

Part (iii) – Candidates who scored well on this part considered a broad range of practical difficulties.

Most candidates had some points in either (ii) or (iii) which sat in a different part in the examiner's report. These were given a mark irrespective of where the point was made.

Part (iv) – Most candidates were able to make a reasonable attempt at this, although some did not appear to have understood correctly the nature of the product as described in the question and discussed MVRs, which are not relevant.

END OF EXAMINERS' REPORT