

EXAMINATION

6 October 2009 (pm)

Subject SA3 — General Insurance Specialist Applications

Time allowed: Three hours

INSTRUCTIONS TO THE CANDIDATE

1. *Enter all the candidate and examination details as requested on the front of your answer booklet.*
2. *You have 15 minutes before the start of the examination in which to read the questions. You are strongly encouraged to use this time for reading only, but notes may be made. You then have three hours to complete the paper.*
3. *You must not start writing your answers in the booklet until instructed to do so by the supervisor.*
4. *Mark allocations are shown in brackets.*
5. *Attempt both questions, beginning your answer to each question on a separate sheet.*
6. *Candidates should show calculations where this is appropriate.*

AT THE END OF THE EXAMINATION

Hand in BOTH your answer booklet, with any additional sheets firmly attached, and this question paper.

<p><i>In addition to this paper you should have available the 2002 edition of the Formulae and Tables and your own electronic calculator from the approved list.</i></p>
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1 Lloyd's managing agency A is considering taking over a smaller Lloyd's managing agency B whose single syndicate has recently had some extremely poor experience. This has left it without the capital strength necessary to compete effectively and attract business, although it is currently still solvent.

- (i) Set out the key issues and risks that need to be considered in this takeover, indicating any specific aspects that could materially impact these risks. [22]

One of the units in B's syndicate that is causing particular concern is the Special Situations Unit. Agency B uses this unit to group a variety of individual niche products that don't fall into the target markets of their main underwriting units, including a number of contingency risks.

- (ii) Outline the general advantages and disadvantages of such a business unit. [5]

- (iii) (a) Define contingency business.

- (b) Give two examples of the types of risk that could fall into this category (excluding prize indemnity insurance).

[3]

One major source of premium written to this unit is a portfolio of prize indemnity insurance risks. The portfolio is written under a binding arrangement with a third party coverholder that manages the underwriting and claims handling with the syndicate providing the capital backing.

The policies written cover fixed prize lotteries each with their own weekly draw and various levels of ticket sales, with tickets often sold through affiliate groupings or business connections. All the draws are on the same basis, with five unique numbers per £1 ticket chosen from 50 possible numbers (the order of the numbers is not important) and three fixed prize levels as follows:

- All five numbers: £100,000
- Any four out of five: £1,000
- Any three out of five: £100

The insurance covers the top two prizes at a premium of 25p per ticket, 20% of which is paid to the binding authority underwriter to cover commission and expenses.

- (iv) Deduce the planned loss ratio that Agency A would estimate for this business. [5]

- (v) Discuss the likely advantages and disadvantages of continuing to write this type of risk. [8]

Analysing the business in more detail has shown that one of the major sources of the recent poor experience has been its professional indemnity business. This originally focused on high value international clients, and has recently expanded rapidly to develop a strong regional presence underwriting small to medium sized businesses, particularly in the solicitors' indemnity market.

As the board of agency A has little experience of this business it would benefit from an introduction to the type of experience that might be expected and the way that this business is written.

- (vi) List the key features of professional indemnity insurance. [6]

The board would also like to understand the risks relating to this book of business, including any key historic and ongoing features of this particular account and any current market conditions that might affect these risks.

- (vii) Outline the key exposures to Agency A from this book of business and the main investigations into this account that they should consider in order to understand the risks better. [14]

The board of Agency A has decided to go ahead with the takeover, but is unsure of the ways in which it could be done and the key regulatory requirements that must be observed in setting up a combined Managing Agency.

- (viii) Outline the options available for a takeover, including the regulatory issues that should be considered. [6]
[Total 69]

- 2 An investment banker is considering two UK general insurance companies as potential acquisition targets for a client. The client is a multinational group of insurance companies. The following information on the target companies has been provided. The project is at an early stage so that at present only limited information is available on the targets.

<i>Amounts in £ millions</i>	<i>Company A</i>	<i>Company B</i>
MCR	10	10
ECR	15	17
ICA	20	16
ICG	20	18

Note: Both target companies have the same premium income.

- (i) State the meaning of each of the abbreviations MCR, ECR, ICA and ICG and give a brief description. Details of how these amounts are calculated are not required. [5]

The bank is meeting with its client tomorrow, and capital requirements will be discussed at the meeting. The banker would like to understand the likely reasons for differences in the numbers, and in particular the following features of the data:

- Company B has a higher ECR, although both companies have the same MCR.
- Company A has a higher ICA than company B.
- Company B has an ICG greater than its ICA, but the ICA and ICG are the same for company A.

- (ii) Write notes describing the possible key reasons for the differences noted in the list above. [18]

The banker believes that the client may want to consider alternative levels of capitalisation, other than the capital requirements given in the table above, when considering which company to acquire.

- (iii) Discuss examples of capital requirements, other than those listed above, which should interest the client. [8]

[Total 31]

END OF PAPER