INSTITUTE AND FACULTY OF ACTUARIES

EXAMINERS' REPORT

April 2021

Subject SA3 - General Insurance Specialist Advanced

Introduction

The Examiners' Report is written by the Chief 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.

Paul Nicholas
Chair of the Board of Examiners
July 2021

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

1. The aim of the General Insurance Specialist Applications subject is to instil in successful candidates the ability to apply knowledge of the general insurance environment and the principles of actuarial practice to providers of general insurance.

2. Our expectation of a passing candidate at this stage is that, broadly, they should appear capable of stepping up to a head of function (pricing / reserving / capital) role at a small-mid sized organisation or being a senior member of a function team at a larger organisation. They should demonstrate not only a grasp of the technical aspects of general insurance actuarial work, but also a good sense for products, the competitive marketplace, regulatory environments and the operational aspects of an insurance company. They should be able to pull these areas of understanding together to provide well rounded advice to the users of their services.

3. Consistent with previous examiners' reports, we would offer candidates two key pieces of advice – (i) read the question properly and (ii) take the time to actually think about it.. Further to previous reports, we would stress that candidates do not need to get the majority of the points included in this report in order to pass (there are significantly more than 100 marks available for the points in this report). Time spent making sure that you are answering the question that is asked is therefore more valuable than a panicked rush to put down as many points as possible, regardless of whether they are relevant.

4. On the first issue, candidates should always work on the assumption that the question wording has been carefully chosen. Therefore, it is essential to read the question properly. Various examples from this paper of recurrent failure to read a question are noted in the commentary for the questions.

5. If something is not asked for then candidates will waste valuable time writing answers that will gain no marks. These broader answers may be a logical next step to the question and so may be appropriate for candidates to discuss in a professional context. However, this is an exam with a finite number of marks available and so the scope must necessarily be limited and specifically defined.

6. If a question does specifically mention something, candidates should also assume that there are marks available for this aspect of the question. During the exam setting process, any content that is superfluous will have been removed. A clear implication of that is that if there are numbers provided in the question paper then there are marks available for comment and consideration of those numbers.

7. Wording of question sections should also be considered in the context of the position within the overall question. Where new question information is provided between sections, candidates should recognise that this information is specifically relevant to the following section or sections. When answering preceding question sections, candidates should not consider any subsequent information in their answers (although it may cover similar ground).

8. On the second issue, candidates should note that SA3 is the key paper at which we test candidates' broader thinking. This is generally the final paper before qualifying as

a professional, and we consider a capacity for broader thinking to be one of the best indicators of a candidate's suitability to act in a professional capacity once qualified.

9. As such we aim to design exam papers so that it is difficult to pass without displaying some capacity for independent and broad thinking, as well as to reward instances where these skills are displayed. When reviewing past papers, candidates should assume that the marks available for generic points are generally fewer than those awarded for the more challenging points that would be the mark of high quality professional insight in a practising actuary. Marks available for list items from knowledge are lower still.

10. We strongly recommend that candidates step back and take the time to thoroughly think about what is actually going on in question situations proposed rather than simply considering numbers to be analysed with standard techniques. For example, candidates might stop to think about what claims actually are for a particular class of business, considering factors such as what event causes the claim, who reports the claim, how it is dealt with once reported, what makes one claim small while another substantial, etc.

11. This more grounded, real world perspective will help candidates to consider items such as practical issues, stakeholders involved and their potentially diverging objectives, wider impacts, regulatory or ethical issues, inappropriateness of certain actuarial techniques for the specific situation, current economic or cyclical effects etc. This is likely to lead to significantly broader point generation (and indeed reflects the thought processes of the examiners in drafting the questions and solutions) and a more rounded understanding of the underlying risks and dynamics which should also be of value to candidates when dealing with different stakeholders in their professional life.Some examples of this failure to think more widely on the current paper are noted in the commentary for the questions below.

12. More generally, we would also advise candidates to employ basic exam techniques such as well structured answers and effective time management. The transition to online exams should assist candidates with providing well structured answers. Bullet points within answers can help make answers clearer, and we would advise candidates to ensure that separate points are split into separate bullets and that they do not duplicate the same point across separate bullets.

13. Candidates should also consider the command words used and tailor the depth of their answers accordingly.

14. Candidates who give well-reasoned points relevant to the specific question being asked, which are not in the marking schedule, are awarded marks for doing so.

B. Comments on *candidate performance in this diet of the examination.*

A number of specific comments are provided next to the questions where there were repeated reasons for candidates to score badly. These include recurring issues with failure to read the question properly, lack of consideration of secondary factors to assist with point generation and time management.

C. Pass Mark

The Pass Mark for this exam was 62.
351 presented themselves and 106 passed.

Solutions for Subject SA3 – April 2021

Q1
(i)
No insurer covers their circumstances, eg region/vehicle type etc [½]
Ignorance – people unaware of the existence of insurance [½]
Ignorance – people do not understand how insurance works [½]
Cost may be excessive compared to typical income [½]
Premiums considered too high in relation to the benefits [½]
Design may not appeal, e.g. may only cover certain costs, or have large excesses [½]
Cover may be too wide, not fit for purpose [½]
Lack of trust in insurers [½]
Claim culture not established so less need for insurance [½]
No bank accounts and paying cash not an option [½]
Large number of illegal or unregistered drivers or vehicles [½]
Cover may not include personal accident or own damage [½]
Legal system does not successfully pursue 3rd party liability claims [½]
Cultural reasons e.g. religion [½]
Insurance not a priority [½]
Cost of living is low, can afford repairs themselves [½]
Low number of cars [½]
[Marks available 8½, maximum 4]

(ii)
Depends on the design of the insurance [1]
The greater the increase in the take up rate the greater the potential for impacting driver behaviour [1]
If there are incentives not to claim this should encourage safer driving which should ultimately lead to fewer fatalities [1]

- No claims discount (NCD) [½]
- Telematics [½]
- Could be argued some may be more careless if they know they are insured [1]
    - For example, moral hazard [½]
- The usage of cars may increase, with the increased exposure leading to more accidents [1]
    - For example, more cars purchased [½]
- Awareness of the risks involved when driving [1]
    - For example, choosing safer vehicles [½]

[Marks available 8½, maximum 4]

(iii)
Wider coverage should drive down average cost [½]
Bigger market may encourage new entrants and more competition [½]

Potential to cross-subsidise high and low risks [½]
Appropriate insurance design should improve driver behaviour [½]
Law may be ignored, particularly in rural areas [½]
How will it be policed? Is there appropriate technology to help? [½]
Consider the costs of checking compliance [½]
Many may not be able to afford it [½]
May be an unpopular move [½]
Insurers may be unwilling to take on certain risks, e.g. 14 year olds on motorbikes [½]
Government may need to implement price controls so insurance is affordable for all [½]
Helps to protect against uninsured drivers [½]
Boost to the economy and the standard of living [½]
Increased tax income for the government [½]
Attracts tourism [½]
Bring regulation in line with other countries [½]
Reduce anti-selection [½]

Other reasonable suggestions [½]
[Marks available 9, maximum 6]

(iv)
<u>Advantages of a state-owned insurer</u>

- More data perhaps? Leading to fairer pricing. [1]
- Could cover premiums through general taxation? [1]
- Insurance would be designed to comply with legislation [1]
- Opportunity for economies of scale [1]
- Greater security for the policyholders [1]
- Cheaper for the policyholders as no profit margins included [1]
- Easier to control and correct pricing, regulation [1]
- May introduce levees to secure funding [1]
- Take up rate could be higher if trust in government is high, or vice versa [1]

<u>Disadvantages of a state-owned insurer</u>

- Less incentive to be efficient [1]
- May lead to adverse selection if in conjunction with private insurers [1]
- Relevant expertise lacking [1]
- If not priced correctly may become costly to the government [1]
- Cost of set up and running state insurer [1]
- Discourages competition [1]

[Marks available 15, maximum 6]
[Total 20]

Candidates generally scored well on this question, for what was a reasonably straight forward question where we would expect the majority of candidates would score well across all parts. Some candidates failed to generate sufficient points to score full or close to full marks when listing advantages/disadvantages as part of question answers.

Candidates who did not score highly on this question generally did not score well on part (ii), at times mis-reading the question and providing answers that were not relevant, and at other times not generating sufficient points or giving sufficient detail to score marks.

Q2
(i)
Underwriting profitability is cyclical / underwriting cycle [½]
In a hard market there is a good level of profitability with competition for capacity / capital [½]
Premium rates are high in hard market [½]
Along with pure price strength, this is also often associated with stronger terms and conditions as insurers have more leverage [½]
Not all classes of business may be at the same point in the cycle / a hard market may only apply in certain classes [½]

- reinsurance may also be on a different cycle than insurance [½]

A hard market will often follow a period of losses for the market [½]

- or one or more major events [½]
- Katrina / Rita / Wilma or WTC [½]
- with weaker insurers exiting the market or being bought by stronger insurers [½]

Can be associated with a stronger point in the reserving cycle [½]
May also reflect macroeconomic conditions [½]

- better investment opportunities outside of insurance are likely to mean that margins are higher for insurance (less capital available) [½]

Hard markets are likely to be temporary as they will attract new entrants [½]

- or encourage existing insurers to expand into new products or territories [½]
- speed with which this occurs depends on investment alternatives [½]
- global supply of capital [½]
- barriers to entry [½]

[Marks available 9, maximum 5]

(ii)
Used to determine IELRs that are appropriate for a particular reserving cohort [1]

- for use in credibility weighted / BF / Cape Cod methods [½]
- or in IELR / plan loss ratio methods [½]

Description of a reserving method using IELRs [½]
Description of a reserving method using IELRs [½]

Can also be used to provide a sense check on loss ratio assumptions made rather than used directly [½]
Rate changes map most directly to underwriting year cohorts [½]

- and may require blending for accident year cohorts [½]

Rate changes can be applied to historical loss ratios to rebase to current terms [½]

- or to historical premium volumes to rebase to current rate environment premiums before comparing to loss ratios [½]
- this may be more appropriate if consolidating data to a higher grain for analysis as it reweights premiums as well [½]

The rate changes will impact unearned reserve calculations as well as the earned reserves calculations [1]

- rate changes will impact the calculation of UPR [½]
- Falling rates can lead to needing an AURR [½]

Other reasonable suggestions [½]
[Marks available 8½, maximum 4]

(iii)

Credibility

Consideration should be given to whether the rate change data itself is fundamentally credible [1]

- has it been produced from a pricing model rather than subjectively derived [1]
- does it provide proper adjustment for changes in risk since the previous period [1]
- for whatever method, has it been produced properly [1]
- with appropriate auditability, governance & controls [1]
- including calculation of the rate change prior to binding the risk [1]
- in particular around the use of subjective adjustments where underwriters may have discretion to distort the true rate change [1]

Rate changes on binder business may be particularly difficult to assess [1]

Benchmarking may indicate whether rate changes are consistent with the remainder of the market [1]

Basis of calculation

Is it including or excluding claims inflation? Should be considered with any additional trends allowed for [1]

Is it calculated on a gross gross or gross net basis [1]

- and is that consistent with the reserving basis or are further adjustments required [1]

How is it aggregated for any summary figures provided [1]

Have there been any changes in basis over time if using a multi-year rate change index [1]

- including any changes to underlying models used to generate rate change [1]

Relevance / completeness

If it is based on high proportion of the renewing risks, which makes the calculation of rate changes easier and more credible [1]

If it isn't for the entirety of the renewal portfolio, is it representative or is there the potential for the missing data to be showing higher or lower rate change [1]

Are renewal risks a high proportion of the overall portfolio [1]

Consider impact of new business [1]

Consider impact of lapsed business [1]

Consider impact of mix change on renewing business [1]

- which may be affected by the method used for aggregating up to any summary rate change figures used [1]

If there are significant rate increases, one might expect the better business to lapse rather than following the rate increases [1]

Catastrophe claims (*with explanation*) [1]

Latent claims (*with explanation*) [1]

ENIDs (*with explanation*) [1]

[Marks available 26, maximum 7]

(iv)

Non proportional property treaty

Changes in catastrophe exposures [½]

- both for the clients portfolio [½]
- or external factors such as climate change / sea surface temperatures [½]
- or flood defences / regulation [½]

Changes in model basis may complicate assessment of changes in catastrophe risk between years [½]

- in proprietary CAT models [½]

Changes to layer attachment structure [½]

- higher layers are likely to have gearing effects from claims inflation [½]
- do any exposure curves remain appropriate relative to previous year [½]
- for example ILFs [½]

Changes to reinsurance commissions [½]
or profit commissions [½]
Have insured property values been indexed appropriately [½]

- and has this been considered in any allowance for inflation to avoid double counting [½]

Reinstatements [½]
Stability clauses [½]

Credit for other sensible points [½]
Credit for other sensible points [½]

<u>UK Employers liability</u>
Regulatory changes [½]

- Ogden [½]
- any legal precedent cases [½]
- minimum level of compulsory cover [½]

Changes to inflation [½]

- including medical cost award inflation [½]
- extent of inflation inherent within exposure measures e.g payroll to avoid double counting [½]

Treatment of any subjective adjustments e.g. risk management practices, particularly where there has been a change [½]
Changes to fraud / propensity etc [½]
Any macroeconomic impacts [½]

- fewer jobs as a result of recession [½]
- change in yield curves [½]

Latent claims [½]

Credit for other sensible points [½]
Credit for other sensible points [½]

<u>Satellite launch</u>
Errors from previous launches can be learnt from and corrected to reduce risk on future launches [½]
Changes to technology may impact the risk profile [½]
Frequency of launches [½]
Changes to weather due to climate changes [½]
Increasing competition due to more launches [½]
Better understanding of risks and pricing [½]
Safety regulation changes [½]
Severity of claims increases/decreases due to changes in technology [½]

Credit for other sensible points [½]
Credit for other sensible points [½]

<u>Rolling monthly mobile phone</u>
What rate change is being considered – rate change from one binder year to the next or rate changes on underlying policies if analysing on some kind of look through basis? [½]
Likely that a number of renewing individuals may no longer own the phone but not have cancelled so may affect overall profitability [½]
Within a binder may have multiple elements so rate changes may not apply universally across all underlying policyholders [½]

- and rate changes may shift the balance of underlying policyholders within a binder [½]

Inflationary effects, e.g. changes in repair costs or material [½]
Risk of design flaws with new models [½]
Changes to commission rates [½]
Including profit commissions [½]
Economic impacts [½]

- increased thefts in recession [½]

<u>Binding authority</u>
poorer data [½]

- anti-selection [½]

Credit for other sensible points [½]
Credit for other sensible points [½]
Max 3 points for each subsection.
[Marks available 28½, maximum 8]
[Total 24]

The majority of candidates scored well for part (i), sufficiently describing a "hard" market.

Candidates generally did not score well across the remaining three parts of the question, and in particular struggled to appropriately describe the factors that should be considered when determining the extent of credibility to give to premium rate changes for part (iii). There were seven marks available for this part, and a number of different ways to approach the question and score well; however, many candidates failed to do this.

Candidates generally scored better for the types of business in parts (a) and (b) of part (iv), but struggled to generate sufficient points for the satellite launch and mobile phone insurance.

Q3
(i)
Lack of data [½]

 o or understanding of the risk, impacting [½]

- Pricing [½]
- Reserving [½]
- capital modelling [½]
- Anti-selection [½]

  - leading to financial loss [½]

Loose policy wording providing additional coverage [½]

  - or additional claims disputes [½]

Lack of relevant operational capability [½]

  - or adequate pre-launch testing impacting [½]

- Claims handling [½]
- IT [½]
- Sales [½]
- Customer service [½]

Wrong assessment of demand levels [½]

- Too low to cover fixed expenses [½]
- Too high to manage effectively [½]
- Concentrations in segments indicating anti-selection [½]
- Slow to market so lose first mover advantage [½]
- Competition higher than expected [½]
- Liquidity issues [½]

Reputational impacts [½]
Regulatory issues [½]
Reinsurance issues [½]

Credit for other valid points [½]
[Marks available 13, maximum 6]

(ii)
Online leading to – cyber hacking risk [1]

- IT failures [1]
- Risk of anti-selection [1]

If combined ratio is greater than (100% – fixed profit margin) targeted, company makes zero [1]
Monthly premiums – credit risk [1]
Charity choice may lead to customer dissatisfaction [1]
Enhanced regulatory scrutiny [1]
Need high investment into raising brand awareness, acquisition costs will be high [1]
Concentration risk – only one line, one product [1]

- limited demographic [1]

Increased admin cost associated with charity element [1]
Reputational risk if lose money so don't contribute to charity [1]

[Marks available 12, maximum 4]

(iii)
(a)
Employees may feel happier/satisfied knowing they are working for an innovative company that also addresses charity/ adds value to society and is fair and transparent [1]
Fresh challenge. Some of the management may be the founders so dedicated and work harder to make this company a success [1]
Low ongoing expenses [1]
Potential high profits [1]
Potential significant volumes [1]

(b)

May like the charity aspect of the company. [1]
Millennials in particular may prefer this product given recent cultural trends [1]
Online – no paperwork so environmentally friendly [1]
May be cheaper [1]

(c)
Investors may be impressed by the innovation and also the guaranteed profit margin by the company assuming they can target the combined ratios [1]
Online start-ups have cheaper running costs and easy to scale. [1]
Cheaper because no intermediary costs. [1]
Online companies may be valued / rated highly by investors which may make fund raising for company easier [1]
In times of hard underwriting cycle/ low loss ratios, this company has capped its upside. However this is unlikely as home insurance tends to run at higher loss ratios than typical lines of business given the competitive nature of this product [1]
Meet ethical investment goals [1]
Potential synergies with other online only investments [1]
Potential expansion into new products and new territories [1]
Significant growth potential with new product design and as a start up [1]

(d)
May favour / support that the company has transparent pricing for customers and aims to do social good [1]
May encourage competition [1]
Introduce younger demographic who have not traditionally purchased insurance [1]
May improve reputation of financial sector [1]
Encourage product innovation [1]

Other reasonable points [1]

[Marks available 24, maximum 8]

(iv)(a)
Online only – may be easier to collect data for rating factors, enhance data with other sources [½]
Costs are likely to be simple to calculate as it is a start-up company so efficient processes/systems - no legacy [½]
May change prices more frequently due to online model. [½]
Premium charged will be office premium plus the profit margin targeted. This may be slim at the start as the company tried to attract new customers [½]
Material judgements may be applied by underwriters given the company has no experience data at the start. [½]
May also take a commercial stance to have losses to gain market share at the start [½]
Limited data available [½]
Even benchmark / industry data will need to be adjusted [½]
New demographic, may need additional loadings for uncertainty [½]
Will require regular monitoring [½]
Premium collected monthly, may allow for credit risk [½]
Need to consider a loading for the charity donations [½]

(b)
Best practice is to use several reserving methods such as chain ladder, Bornhuetter Ferguson (BF) and Initial expected loss ratio (IELR) [½]
Chain ladder relies on experience data which the company does not initially have [½]
IELR relies on having a view of what the average loss ratio is for this class of business. [½]
This could be taken from industry resources such as ABI but the product may attract slightly different demographics so external data needs to be used carefully. [½]
Some underwriters hired may also have a view of what the loss ratio is likely to be at the end [½]
BF method could be used as the company build up experience but lower weighting would be placed on experience at the start and a higher weighting on IELR [½]
Claims handling should be easier to assess as home insurance is fairly simple as short tailed and is not exposed to inflation such as wage/carer like for bodily injury claims [½]
Will need to consider the level of assumed profits for the charity donations [½]
Limited data… [½]
difficult to select loss ratios initially [½]
difficult to select claims patterns [½]
Home insurance is short tail, so the experience will emerge quickly [½]
Online, direct only, can lead to better quality data [½]
Consider the speed of declaring profits and paying out the charity donations [½]
Assumed margin for the charity donations adds buffer for any deterioration [½]

(c)
Monoline – no diversification credit [½]
May have higher initial capital requirements due to uncertainty, especially for [½]
reserving risk [½]
premium risk [½]
Potentially difficult to find reinsurer due to new product [½]
The company is likely to have its own risk appetite which is a buffer over the minimum capital requirement from the regulator. [½]
This buffer is likely to be much higher in the initial years of inception given the operational risk at the start from lack of data and innovation [½]

Max 2½ for each subsection
[Marks available 16½, maximum 6]
[Total 24]

Candidates generally scored well on part (i) of this question.

For part (ii), many candidates performed poorly, as they did not read the questions and provide examples of risks that were specific to this type of product launch, i.e. which required careful reading/interpretation of the question.

There were a wide range of scores for parts (iii) and (iv), with stronger candidates generating a sufficient number of points related to the scenario in the question in order to score highly.

Q4
(i)
Lump sum claim settlements should reflect the present value of the future cashflows that the settlement is intended to cover [1]
Claims for someone with severe injuries may include:

- Immediate costs such as arranging living accommodation, wheelchairs, etc. to adapt to new circumstances [½]
- Long term logistical support such as drivers, housekeepers, childcare, etc. [½]
- Long term medical care costs [½]
- Loss of earnings [½]

Each of these will be subject to different inflationary pressures [½]
with medical care cost inflation a particular concern [½]
Offsetting this, any lump sum settlement would be expected to be invested to earn a return [½]
Depending on government appetite this may target a higher probability of sufficiency [½]
Allowances for investment returns would be expected to consider current investment conditions [½]
The timing of these cashflows will vary [½]

- as will the duration [½]
- based on mortality [½]
- and the age of the individual will be a major factor particularly in the likely duration of ongoing costs [½]

[Marks available 7½, maximum 4]

(ii)
Liability lines which have a bodily injury element such as Motor liability [½]
Usually cases such as these could be very long tailed as it may be a child in an accident so although life expectancy is diminished, the number of years to live is still a material number (> 20 - 40 years) and the cost of care is great for paraplegic patients. However, claims frequency unlikely to change [1]
Employer's liability for things like back ache or eye sight or noise induced deafness as correct equipment was not supplied [½]
If rates go down – causing the lump sum award to be higher, it is likely there are more ambulance chasing lawyers who convince employees to claim increasing the claims frequency/severity [1]
Professional indemnity (medical professionals) [½]
Unlikely for greater claims against medical professionals as usually medical professionals explain the risks to all procedures or medicines so the chance of winning a claim is lower [1]
Product liability (e.g. pharmaceuticals) [½]
Ambulance chasing lawyers may seek to produce class action cases against companies that have deep pockets such as pharma or tech companies especially when Ogden rate changes increase lump sums [1]

For each of four lines, give half a mark for mentioning a class (needs to be liability line with a bodily injury element, can do the same line twice as both insurance and reinsurance class if clearly distinguished), and up to 1 mark for appropriate statement about materiality).
Mark the best 4 examples
[Marks available 6, maximum 6]

(iii)
There may be a process of periodically reviewing (e.g. every 5 years) [1]
Or the review may be an ad-hoc review, for example [1]

- if Government believes the level of compensation is either too high or too low [1]

Perhaps caused by:

- Press coverage of this issue [½]
- Political motivation to change rates [½]
- Changes to taxation impacting awards received by claimants [½]
- If the uptake of lump sum compensation (compared to period payments) is changing may indicate that the rates are inappropriate [1]
- The Government may be updating the rates to allow for changes in the economic environment e.g. today we see lower bond yields than pre-financial crisis of 2007-8 [1]

The government may consider:
the yield returned on assets that are used to match PPO liabilities [½]
or bodily injury claims [½]
check rates used in other countries [½]
re-review the other indices/metrics that influence reserves [½]
Such as wage inflation and longevity [½]
Look at what insurers are using today and ask for their guidance/justification, i.e. essentially benchmarking [½]
Check stress and scenario results from insurers part of their Solvency II submissions [½]
To understand the sensitivity of these reserves to interest movements [½]
Some companies may be hedged so the industry as a whole is well protected [½]
Look at recent trends in reserves [½]
Have there been large releases/strengthening providing an indication of potential change needed [½]
Check real return curves i.e. nominal interest rate – inflation [½]
Engage an independent consultancy/expert body to review and guide [½]
Study whether claimants are being awarded fairly, for example [½]

- by re-opening old cases [½]

[Marks available 14, maximum 10]

(iv)
May increase reserves if discount rates fall and vice versa [½]
This will reduce profit [½]
And thus could reduce dividends to shareholders [½]
And affect the company's share price (is listed) if material in relation to the total reserves [½]
Any reinsurance coverage such as Adverse Development Cover may need to be increased [½]
If the risk exposure from PPO reserves is higher than risk appetite of the company [½]
The capital requirement and risk margin is likely to increase [½]
From an increase in reserves [½]
In the extreme, a company could become insolvent [½]
May lead to some companies reassessing its product mix [½]
And moving away from liability lines [½]
May change (increase) pricing structure for liability lines [½]

May change Terms and Condictions for liability lines [½]
May increase price of reinsurance or longevity swaps etc [½]
Particularly if all companies seek to increase reinsurance covers [½]
May change investment asset portfolio [½]
To better match the size of reserves [½]
May re-review other assumptions such as inflation used in reserving and capital modelling if these are on the prudent side of best estimate [½]
Companies may start lobbying government and other industry bodies if not in agreement to the changes [½]
May increase investment of insurers into health and safety in certain sectors to decrease the claims severity/frequency [½]
Reporting (e.g. annual report, accounts for Companies House, etc.) needs to be updated to explain the movement if material [½]
Would impact the excess of loss covers more due to leverage effect [½]
Impact on tax [½]
Consider impact on competition if insurers exit the market [½]

Credit provided for considering impact of either increase or decrease in rate

[Marks available 12, maximum 8]

(v)
Nothing has changed so the company has no obligation to do anything [1]
May only include a disclosure in the accounts [1]

<u>Negative:</u>
Not putting through any change may mean a huge impact in operating profit later if the change is material [1]
Putting in some change now will avoid surprises further down the line. It is likely there is some indication of the direction the government is going in various consultation papers and forums [1]
Some companies may put through some change to their rate to smooth results and so not doing the same may not be interpreted well by stakeholders such as shareholders, credit rating agencies, analysts, etc. … who compare the company to peers [1]
If the change will lead to significant deterioration, it may mean company strengthens reserves more than needed and then needs to reverse the change when the government finalises their review – this creates instability in the company's results [1]

<u>Positive</u>
Changing may encourage the government to put through a more drastic change whereas if the company is lobbying that the potential change being explored is not appropriate, it sends a mixed message [1]
Auditors and tax regulators may not favour/agree to the large provisions that result in reducing tax liabilities so doing nothing may be the right thing as per the tax authority views [1]
Changing assumptions means more explanation to internal stakeholders such as CFO and other sign off committees – more work for the actuarial teams [1]
Changing assumptions means more explanation to external stakeholders such as equity analysts (if listed), tax authorities, Solvency II external validation etc. [1]

[Marks available 10, maximum 4]

[Total 32]

Many candidates struggled with parts (i)-(iii) which represented a significant number of marks on the paper (20 in total), with candidates struggling to generate enough reasons why the Government may be reviewing rates in part (iii), and also the factors that should be considered in setting the rates.

Candidates scored better for parts (iv) and (v). For part (iv) many candidates showed strong broad commercial awareness of the implications on the broad insurance/reinsurance market of a significant change in discount rates.

[Paper Total 100]

END OF EXAMINERS' REPORT