INSTITUTE AND FACULTY OF ACTUARIES

EXAMINERS' REPORT

April 2015 examinations

Subject SA3 – General 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 at the date 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

July 2015

General comments on Subject SA3

Consistent with previous examiners reports, we would offer candidates two key pieces of advice – read the question properly and take the time to actually think about what is going on. 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.

On the first issue, candidates should always work on the assumption that the question wording has been carefully chosen. It is therefore essential to read the question properly.

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. This is an exam however with a finite number of marks available and so the scope must necessarily be limited and specifically defined.

If a question does specifically mention something, candidates should also assume that there are definitely 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.

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).

Various examples from this paper of recurrent failure to read the question are below.

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.

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 heavily reward instances where these skills are displayed. When reviewing past papers, candidates should assume that the marks available for generic points are substantially less 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 bookwork are lower still.

Even among passing candidates, this capacity for broader thinking is not always in evidence. 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 actually causes the claim, who brings the claim, how it is dealt with once brought, what makes one claim small while another is substantial etc.

This more grounded, real world perspective will help candidates to consider such things 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.

Again, some examples of this failure to think more widely on the current paper are below.

More generally, we would also advise candidates to employ basic exam techniques such as well structured answers and effective time management.

Comments on the Examiners' Report

When using this report for exam preparation, candidates should note the following:

- There are significantly more than 100 marks available
    - It would be extremely unlikely for any one candidate to single handedly come up with the collective range of valid points accumulated across the setting team, institute staff and assistant examiners (>10 qualified actuaries).
    - Even if a candidate somehow could come up with all the points on offer nobody has fast enough handwriting to actually get them all down on paper
    - The marking schedules also tend to contain open ended marks for other sensible comments in some sections where they are deemed necessary.

- As such these should not be viewed as "model answers".
    - We provide the full range of valid points considered by the team involved to provide the best possible material for candidates to use for their own personal learning.
    - In general the points on the schedule or similar equivalents should continue to be valid in similar questions for future exams (unless the specific question situation is designed to render those points invalid!)

- Judgement should be exercised when determining which are key points.
    - In general this report will show key points first, although it also aim to group points into broad categories for clarity so some supplementary points within a section may appear before key points from a different category
    - However the points which are particularly key on similar looking questions may vary, where the design of the question / situation posed emphasises one aspect over another

- We also provide a more comprehensive wording to answers than would be required in the exams.
  - Again this is to support use of the reports for candidate's own learning, hopefully making it easier to understand the points being made
  - In the exams, candidates can write more concise answers and only need to write enough for it to be clear to the marker that they have grasped the point
  - Excessive brevity is not advised however, outside of "list" command words a single word response will rarely be sufficient to demonstrate any meaningful understanding to examiners

- The general style of the report is to be encouraged, namely:
  - Clear bullet point type answers, splitting separate elements of a point into different lines even where this means breaking mid-sentence. Candidates that write rambling paragraphs with multiple points put significantly more pressure on markers to accurately identify that they have covered several points and usually score less well as a result
  - Grouping into broad categories for longer questions. It is surprising when candidates do not do this even when the question itself sets out the categories to use. Candidates that do not take this clear cue tend to perform less well on those questions

Comments on the April 2015 paper

Performance on this paper was mixed. In line with previous SA3 exams, a significant number of candidates undermined themselves by providing generic or off-topic answers. Specific observations are provided by question throughout this report.

1 (i) **Lloyd's**

A society, incorporated by the Lloyd's Act 1871, that provides a market place and regulatory framework
within which individual and corporate members may participate in the underwriting of insurance risks on their own account

London Market

The part of the insurance market in which insurance and reinsurance business is carried out
on a face-to-face basis in the City of London.
Contains Lloyd's
Can also be called London Reinsurance Market

This was only a 2 mark question. Candidates should be disciplined with their time management and not write excessive content for small questions

(ii) **Ease of entering market**

Mr Rich could participate in an existing Lloyd's syndicate by just providing capital.

Establishing a wholly owned subsidiary would be more complicated.
…would need to set-up admin processes / do admin
…may not have necessary expertise in house/need to hire staff
…would need premises
… IT
… CAT models
… Internal Model
… insurance licenses
…and so this may take more time.

This may also lead to a difference in start-up costs of entering market (that is, start-up costs likely to be lower for Lloyd's).

Risk of entering a new market likely to be greater if start-up costs are greater.

Barriers to Entry

It may not be possible for Mr Rich to join the syndicates it wishes to (they may have enough capital already).

There may not be syndicates that Mr Rich would like to participate in.
Good syndicates may not have spare capacity

As an individual with no insurance experience, it may not be straightforward for Mr Rich to obtain an insurance license for RIL.

May be hard to grow profitably due to soft property market

May have new entrant capital load

May struggle to get well priced RI without track record

Should also consider ease of leaving market – may be easier at Lloyd's
…due to RITC market

Control
Lloyd's syndicates are run by managing agents, who make key decisions such as appointing underwriters.

The ability of individual names to control the syndicate may be limited (although Mr Rich's influence will be greater if it provides a significant amount of the syndicate's capital).
…also depends on whether leasehold or freehold capital

Mr Rich could control every aspect of a wholly owned underwriter, subject only to regulatory constraints.

Mr Rich may have valuable industry contacts that a subsidiary could exploit. If Mr Rich participated as a name on a syndicate, it may be reluctant to share this with the managing agent.

Mr Rich may want to use RIL to insure his other business interests on preferable terms. It is unlikely a syndicate would accommodate this.

Access to preferred risks
Underwriters on a syndicate may already be writing the type of business Mr Rich wishes to write.

There may be advantages to writing renewal business on a syndicate than considering risks for the first time at a new subsidiary.

This may particularly be the case given Mr. Rich's lack of personal insurance expertise

The Lloyd's credit rating may assist Mr Rich in accessing business.

Lloyd's may give the start-up more credibility than would be attached to a small start-up (value of Lloyd's brand).

Deploying Mr Rich's risk appetite as part of a broader syndicate may provide a more meaningful market line improving access to business

Ability to benefit from Lloyd's licences.

Existing Lloyd's syndicates would have links to brokers to access risks, and underwriters may have special relationships.

May only see distressed business as startup

May be able to mitigate by hiring good underwriters with their own relationships

Mr Rich may have industry contacts of his own to exploit
. . . and may be unwilling to share without full ownership

Diversification
Mr Rich may be able to participate in a number of syndicates in future if a corporate name, obtaining diversification.

May get more diversification if participating as part of an existing syndicate
…e.g. other lines
…or at a minimum underwriting & reserving risk diversification

Future strategy
Consider the long term strategy for RIL. For example, if more lines of business are planned in the future, may prefer to operate an insurer outside Lloyd's.

Regulation
There may be differences in the regulatory requirements that make one option preferable.
Credit for relevant examples, e.g. SBF oversight

There may be differences in capital requirements.
Credit for relevant examples, e.g. ECA uplift

There may be differences in the permitted assets.

SII may be challenging to implement for a new entrant and an existing syndicate should be well advanced
… but a new entrant may have a grace period for full compliance

Tax
There may be differences in tax that make one option preferable.
Credit for relevant example, e.g. phasing of profit release given funded accounting

Expected profitability
There may be differences in the expected profitability that make one option preferable.
Credit for relevant example, e.g. Lloyd's fees

Many candidates misunderstood the question, and compared starting a Lloyd's operation with starting a non-Lloyd's operation. A frustrating number of candidates missed the three key areas of interest set out in the question pre-amble and missed content and clarity of structure as a result.

(iii) **What is meant by regulatory minimum?**
Not entirely clear what is meant by regulatory minimum - theoretically the regulatory minimum is the MCR but to all practical purposes the minimum would be the ICA / ICG / ECA

If this is the MCR then they should expect to hold significantly more than this . . . . And should consider some calculation of appropriate capital using similar methods to that for deriving the ICA or ECA
. . . . Or at the least the SII standard formula as a simple proxy

If this is from an ICA or ECA type method then it should already reflect the business's reasonable view of their risk profile considering all reinsurance, market cycle, CAT exposures etc

The credibility of this analysis will affect the extent to which RIL may want to hold additional capital

For example the geographical profile may be relevant as it impacts CAT model credibility

Regulation
SII is either already applicable in Lloyd's or is imminent outside of Lloyd's

They should consider capital requirements that would leave them SII ready

There may be additional capital requiremements appropriate to a new entrant

Or the SII SF may be the only viable benchmark to use given the time to build an appropriate internal model that would pass IMAP

Operational
Additional capital will provide extra flexibility to management.

For example, greater flexibility with investment policy.

Or more discretion in RI or business strategy

If the company if very thinly capitalised, it may receive unwanted regulatory attention which could distract management.

Rating agencies – what level of capitalisation does RIL require in order to obtain the desired rating.
Do potential policyholders or broker require a particular level of capital / rating in order to place business with the company?

Strategic
Consider how much capital Mr Rich has
. . . As well as his desire to achieve investment as well as underwriting retuns on RIL

Consider the required returns (cost of capital) of Mr Rich and the return of RIL under various levels of capitalisation.

Opportunity cost – consider any alternative uses of capital that Mr Rich has, and the returns on those activities.

Consider alternatives to Mr Rich providing capital, for example, RIL could raise money on the stock exchange

RIL could purchase additional reinsurance to reduce its capital requirements.

However any revised calculation may not be accepted by regulators

Consider whether additional capital may be available at a later date if required

For example, Mr Rich may want to limited the amount of capital held in RIL (subject to any regulatory requirements), and provide additional capital as required

Consider the capitalisation/ratings of competitors.

Consider how the capital requirements are expected to change over time, for example, as the business grows

The company should consider whether it needs to fund future capital requirements initially.

There may be options that don't require this to be funded initially, for example, through retained profits anticipated in the business plan.

Although soft market conditions and new business strain may limit scope for profit to fund growth

Mr Rich will also need to finance the start-up costs of RIL.

RIL should estimate the probability of breaching regulatory insolvency for different initial levels of capitalisation

RIL should also estimate the probability of other adverse events, for example, credit rating downgrade, requirement for cash injection from Mr Rich

RR's own liquidity should be considered

Along with any clash potential with his broader assets

Mr Rich should set capital targets that reflect his risk appetite

This may involve probabilistic statements, for example, target a less than x% chance of needing to recapitalise

How does the 100m compare to line / CAT profile

Credit for any sensible comments on the 100m

Many candidates misinterpreted the question and discussed how capital requirements would be calculated in an ICA / ECA type method. The question was instead about how to decide what capital to actually hold relative to a regulatory minimum. Many candidates wrote significant volumes with some apparent understanding of capital issues yet scored very low marks, potentially failing on this issue.

(iv) **Capital Requirements**
Consider impact on regulatory capital requirements of not purchasing reinsurance

Consider impact on economic capital requirements of not purchasing reinsurance, given Mr Rich's risk appetite

Capital requirements will reflect the assumed distribution of claim costs
… some CAT / large claim potential so could be high capital if no reinsurance is purchased

Return on Capital
Compare the increase in capital requirements from not purchasing reinsurance to the premium saved

Consider whether the reinsurance saving provides an appropriate return on the additional capital

I.e the company should consider the risk reward trade-off when purchasing reinsurance, that is, the cost of the reinsurance and the benefit to RIL.

RIL's expected profitability will be higher if reinsurance is not purchased (reinsurance premium is saved).

Risk Profile / RI Needs
Potential for large risk losses on commercial property

This would depend on the underwriting practices of RIL, for example it may be taking very small shares of risks

As such could potentially avoid purchasing Risk XoL

If there is available and reasonably priced surplus this could be an alternative if there are occasional large lines

However, RIL remains exposed to accumulations of risk, which could result in large claims.

CAT modelling should assist with this

Credibility may vary depending on territories for modelling

Additional uncertainty speculating on target portfolio

Reinsurers or brokers may be able to assist

Strategic
Consider whether Mr Rich has the extra capital available that could be required if reinsurance is not purchased.
and what is the opportunity cost of the extra capital.

Note that commercial property insurance can give rise to very large claims, so even Mr Rich may not want to cover the costs in full

Consider any concentrations of risk, for example, Mr Rich's assets may include commercial properties which are exposed to losses

RIL's profits will be more volatile without reinsurance.

Consider whether Mr Rich is prepared to accept more volatile profits in return for higher expected profitability.

Given Mr Rich is so wealthy, he may be prepared to accept very high levels of volatility

The highly volatile nature of the risk may have attracted Mr Rich to invest in the insurance industry

Consider what the regulator might think about RIL not purchasing reinsurance.

Since reinsurance was assumed in the business plan, an immediate change of strategy may attract attention from the regulator

Commercial
Consider the availability of reinsurance.

And the current level of premium rates / reinsurer profitability

If reinsurance rates are particularly strong at present, it may be appropriate to purchase less reinsurance than was assumed in the business plan

Consider the credit quality of reinsurers

If Mr Rich is very wealthy, his credit quality may rival that of the available reinsurers

Consider rating agency views.

Consider the views of others, e.g. expert staff employed at RIL

Consider competitors' reinsurance strategies.

This was another misinterpreted question, with many candidates instead answering a made up generic question about how to work out what sort of reinsurance to buy. As with 1(iii), apparent underlying knowledge wrongly deployed scores few marks.

(v) **General Observations**
It would be useful to understand the reason Mr Rich is leaving the industry, as this may impact the decision about exit strategies.
For example, RIL may have underwritten such poor business that it is not possible to find a buyer at a reasonable price (or other example)

Combinations of strategies are also possible.

e.g. pursue run off initially then sell business.

This is likely to be the most viable and practical approach

At the least run-off until there are no live policies would substantially increase certainty

. . . Given the short tail nature of the portfolio

This would likely leave a limited number of large and potentially contentious claims that could feasibly be commuted

. . . . with a residual portfolio of limited volatility that should be attractive for a reinsurer

. . . But may reduce the viability of sale of any ongoing renewal value relative to a quick sale

Other sensible answers or suggestions

Sale of business
Sell the whole company, which achieves finality for the seller.

Sales of certain business assets are also possible.

Examples of assets that can be sold are the renewal rights or reinsurance recoveries.
Although these may not really be a relevant concept for commercial property

May be a good option for RIL

Unlike the other options, allows Mr Rich to realise some value from his investment in establishing RIL,

i.e. the value will reflect that RIL is licensed insurer with staff, new computer systems etc. no legacy liabilities may be of value to someone looking to enter in industry

Although after only one year value in the operating platform may be limited

Regulatory approval may be lightest

May be a good option for RIL if there is an appropriate buyer at an acceptable price

Certainly is quickest option if there is demand

Run-off to exhaustion
Cease to write any new business or renewals, but continue to retain responsibility for administration and claim payments for the existing business.

Short tail nature of property may mean that this is not an overly long process

May need to buy additional RI for run-off which could be expensive

Once the business has run down to a certain point, expense and management costs involved in running off the remaining exposure are likely to be sufficiently high that it will become an ineffective way of maximising return on capital

And may be difficult to retain quality staff necessary to see the process through well

Although there may be options to reduce costs, for example, outsourcing

This option may be attractive for RIL in the short term.

It should be possible to produce a reliable estimate of claim costs within –2 years, at which point options could be reviewed again

Once likely future costs become more certain, the ability to realise value through other options (such as a transfer) may increase

Therefore a period of run-off could increase Mr Rich's return from the investment

However, RIL remains on risk during the run-off, and some residual risk would remain for many years

The strategy does not achieve Mr Rich's wish to eliminate exposure to potential claims as soon as possible.

But is likely to limit any premium payable to a third party to assume the liabilities, particularly if used in conjunction with other methods

Note that if there is any value in the ongoing business (for example, underwriting tools, renewal rights) these would need to be sold separately to realise value

Reinsurance
Fully reinsuring all future claims under business written to date.

Risk transfer may be partial, e.g. there may be a cap on the reinsurer's liability, or the reinsurer may only pay part of the claims.

The insurer remains ultimately liable for the claims cost, e.g. if the reinsurer becomes insolvent.

In some cases, the reinsurer may also administer the claims run-off.

Cover for the policyholder is maintained.

May be hard to sell if there are any particular areas of uncertainty

For example a recent CAT or disputed claim or RI

May also be harder than normal if there is limited confidence in the case assessment as RIL is new

In general property portfolios are not unattractive to the RI market due to their short tail and standard nature

Strategy may be attractive depending on demand and terms

Would be quick if a willing buyer can be found at reasonable terms

Would be hard to avoid some profit cession

Mr Rich does not appear to like reinsurance

Some risk would remain with RIL, so only part of Mr Rich's capital could be released

Commutations
Insurance (or reinsurance) policies are cancelled with the agreement of both parties, subject to a return premium, so that no further claims can be made under the policies.

Active commutation strategies can accelerate the run-off of the businesses.

Negotiation is key

RIL would likely attempt to commute both inwards and outwards business (if any).

Reinsurers may not agree to commutations

Could be antiselection as agreement to commutation is at option of insured

Unlikely to be attractive

RIL has been underwriting for less than 2 months, so most policies will still be in force

Many policyholders unlikely to want the inconvenience of finding alternative insurance

As such could be hard to commute until partial run-off

Commutation values may be too low to justify the expense for RIL

Or the acceptance of potential downsides for policyholders

If policies have expired and no losses are expected, low commutation value would not make it worthwhile for the policyholder to undertake a commutation

Would need to commute with every policyholder to eliminate exposure – this is not practical

Unless policies written were very large

If there are significant claim liabilities / disputed claims, policyholder would be reluctant to offer a settlement that is financially favourable to RIL

Novation
The complete transfer of insurance business from one insurer to another, with the agreement of all three parties (insured, old insurer and new insurer).
The old insurer is replaced with the new insurer, with no contractual liability remaining with the old insurer.

The old insurer pays the new insurer to make this arrangement.
Cover for the policyholder is maintained.

Negotiation is key

Not practical, as agreement of all policyholders required

Other insurer would expect to make a profit on the transfer, so expected profitability for RIL is higher if RIL retains the business.

Insurance business transfer or Part VII Transfer
Complete transfer of business from one insurer to another, so that no contractual liability remains with the original insurer

Cover for the policyholder is maintained.

Part VII transfer can be used to smooth the process to a scheme or arrangement, e.g. by removing business that cannot be part of the scheme.

There is no voting mechanism for policyholders for a Part VII transfer (unlike schemes of arrangement).

However, policyholders are entitled to be heard by the court sanctioning the transfer.

Achieves the same effect as a novation, but can be effected for a large number of policies at the same time and does not require the agreement of policyholders.

May not be huge numbers depending on profile

Can transfer any reinsurance asset.

Consideration should be given to the premium charged by a third party to take on the exposures

Onerous legislation and disclosure requirements, and need for regulatory involvement, court, independent actuary, company lawyers

Also court involvement
Including disclosure which RR may not want

Strategy unlikely to be attractive

Given RIL has only been in business for a year, expenses could be significant relative to the amount of business involved (or other valid reason)

It may be best to retain the exposures for a few years until portfolio is largely run off before taking this approach

Schemes of arrangement
Effectively a mass commutation of policies of an insurance company.

Less regulatory involvement than part VII

Can be solvent or insolvent

Reputational risks to insolvent scheme

Must be sanctioned by the court.

Specified majorities of policyholders (both by number and value) must vote in favour of the scheme in order for it to proceed.
RIL would not need the individual agreement of all policyholders affected by the scheme in order for it to proceed.

All creditors are bound by the scheme once it has been approved by the court (even if they voted against the scheme, or were unaware of the scheme).

It is possible to include all policyholders or just some policyholders. The scheme document will specify which policyholders are included.

Reinsurers are not contractually bound by the scheme.

Strategy unlikely to be attractive

Given RIL has only been in business for a year, expenses could be significant relative to the amount of business involved

Generally implemented for run-off business. Trying to apply to in force business may involve additional expense and complication, and ultimately be unsuccessful

Reputational risk to Mr Rich by removing cover from insureds.

Marks are given to the opposite opinion on whether a strategy is attractive or vice-versa if the reason given is valid.

This was well answered, having been a relatively recurring topic over the last few years.

2 (i) **Reserving Characteristics**

Need enough separation to recognise differences between businesses, but enough volume to do credible analysis and no excessive complexity when the overall materiality is minimal

Should consider appropriate groupings from an actuarial perspective as well as any other factors, including:

- Materiality
- Credibility
- Homogeneity
- Potential for spike losses
- Tail
- Reporting delay
- Settlement delay
- Court awart potential

- Inflation & other trends
- CAT potential
- Reinsurance
- Latent claims
- Profit commissions
- Currency
- Seasonality
- Distribution channel
- Direct / binder

Other sensible answers or suggestions

Materiality
Should be considered in terms of:

- Company B in relation to company A
- Both overall and by line of business
- A is unlikely to make major operational changes for a small acquisition
- Unless the acquisition has lines A has not previously written

This may determine the proportionate effort required for reserving

But it will be important for company A to understand the business of company B even if it is less material.

One product class vs another;
Typically material classes will be reserved separately but homogeneity should be considered.

One peril type vs another:
Some classes may be broken into perils or claims types to further segment the business

Segmentation should only be done if volumes are acceptable, considering:
Premium size, reserve size, or contribution to the profit and loss of the company (profitability).

For example some products may have small reserves but may be an important source of profit that the company chooses to monitor separately.

Need to consider split between case estimates and IBNR in determining materiality of reserves.

For example a class with large negative IBNR may appear to be non-material but the overall size of reserves and the reserve risk could be far more substantial.

Should consider future position as well

For example areas identified for growth or portfolios that management may be withdrawing post sale

It may be necessary to split these out to support management decision making or to ensure that historical claims development is appropriate to the future expected claims development.

Size of reserving team & available level of resource affects materiality

Credit was given for other sensible solutions - e.g. do a one off exercise to test out various alternatives and compare a granular analysis to a higher level assessment to determine whether the impact is material.

Alignment with current business
Similarity / overlap of business between Company A and Company B for appropriate analysis

Alignment of data from both companies
Ability to group in similar manner
May need to maintain consistency with other stakeholders/deliverables
Pricing groups
PRA reporting groups
SII groupings
Reinsurance programmes: business splits
Alignment with internal planning classes
Internal capital modelling classes where volatility traits are different (e.g. large claims etc.)
Alignment with underwriters for variable remuneration calculations

Credit for sensible solutions - e.g. do at high level then allocate to allow aggregation up to required reporting levels, or engage with stakeholders to agree viable alternative etc.

Market Practice
How does the market reserve for such classes. Is the portfolio acquired similar to the market?

Regulatory requirements

Consider the other uses for reserving analysis and ensure that the reserving output meets these needs.

Identify why B had particular groupings / what output was used for to ensure no unintentional loss of key functionality

Need to consider whether there are any changes in the external market which will impact on the reserving methods applied.

Up to 2 suitable examples (legislative developments: LASPO, MoJ for motor. ELTO for EL. Market impacts on policyholders (e.g. CMCs))

Credit was given for other sensible solutions, e.g. engage external provider to opine

Data
Legacy claims system

Are source systems being maintained post merger

How quickly is data available – can automatic feeds be sourced for reserving
Will the systems be merged with existing systems post merger

May not all be available and may not follow the segmentations used by Company A.

May require more granular claims data than may ordinarily be used to investigate distribution of claims sizes, cause of claim, reporting and settlement delays.

May be IT solutions to address legacy issues

May be external providers who can assist with addressing data issues, e.g. forensic review

Credit for other sensible suggestions, e.g. appropriate proxies.

Many candidates spent a long time on generic observations for reserving grouping, e.g. variants on homogeneity & credibility. Few gave thought to the specifics of the question and focused on operational & business aspects of reserving groupings, missing many marks. Again a number of candidates did not take the cue to structure their answer in alignment with the question bullets and tended to do worse as a result.

(ii) **General Observations**
Need enough separation to recognise differences between businesses, but enough volume to do credible analysis and no excessive complexity when the overall materiality is minimal

Variety of granularity may need to be considered for different stakeholders, i.e. detailed reserving classes for ground up analysis but reported at a smaller number of reserving classes for management / reserve committee etc.

The approach to reinsurance modelling should consider the reinsurance limits. In particular it may be appropriate to group all claims over £3m in order to assess the reinsurance recoveries.

Sensible comments on methods for analysis

Reserving should support future pricing as well
. . . So should where possible enable analysis of overall performance of individual schemes
Or industries / key affinity groups
Or distribution channels

. . . And reflect ongoing business potential
e.g. excluding discontinued business such as the salons

Depending on reserving approach, may group for analysis and then carry out some form of allocation to get to the ideal groupings for pricing / business assessment

Credit given for sensible comments on quantum of numbers
Credit given for sensible comments on relativities of numbers

Motor
Motor is clearly material

Motor claims should be split into damage and injury claims as:
These claims have very different settlement patterns
It is market practice to do so.
Different inflation
Reinsurance potential
PPO potential

Consideration should also be given, subject to sufficient data quality and quantity, to splitting these further into:
Damage: Windscreen, policyholder damage to own vehicle, third party property damage
Damage: comp / non comp
Injury: Small bodily injury, Large bodily injury

It may also be appropriate to band claims by size
And split referral fees

Either of these may assist with recent regulatory developments (MoJ proposals / LASPO act)

and to separate out legal costs from indemnity payments so that management can manage understand the impact of the regulation and net impact on reserves.

Property
The Commercial Property portfolio is sufficiently material that it should probably be reserved separately.

The exception to this may be if the business interruption coverage is sold as contingent business interruption and therefore a business interruption claim is contingent on a property claim creating a causal link between the two classes.

However given the longer tail nature of business interruption claims consideration should be given to reserving claims separately but using an approach that takes consideration of this causal link

For example: business interruption claims frequency as a proportion of commercial property)

May be important to consider specific types, e.g. housing associations which may perform differently to other commercial particularly on BI

Liability
The public and product liability claims are both smaller so it may be more appropriate to combine these classes.

Employers Liability may be substantial enough to review separately to the other liability classes

However, it may create more homogenous data bandings to group all three liabilities together

And then split the claims by size

For example; less than £100k and more than £100k (potentially indexed)

Given the age of the company it may be also appropriate to separate any historical latent claims from the policies and reserve for these separately because they require different reserving techniques

and because they should not be projected forward into future accident years

May have specific known issues e.g. salon product to review separately

Data & Practical Issues
As the business is sold on a package basis some information on exposure (such as earned premium and number of policies) may not be available for each coverage type

This may therefore impact the choice of reserving classes

It may be necessary to segment the business by type of company insured.

For instance: Contractors portfolios are likely to have a lower proportion of commercial property claims (they may not own any).

The recorded exposure measure may differ by trade type which will impact on the range of frequency severity analysis that can be conducted.

Where there have been large growth areas these should be reviewed separately

Such as the growth in housing association.

For example these policies may cover tens of properties rather than a couple resulting in much higher frequency of claims per policy

Areas they have withdrawn from should be considered in case they influenced the past data.

However, given the small relative size of the Beauty Salon product it is unlikely to impact most claims types
However, it would be appropriate to conduct a review of the employer's liability portfolio to see if it's historic impact was material (and shouldn't be projected forwards)

This question had a significant amount of pre-amble and a table of numbers so candidates should have been aware that generic answers without any comments that reflected the specifics and numbers provided would not score well. Many candidates showed a complete disconnect between their expressed theoretical understanding and their resulting suggestions. For example, a number of candidates would state that it is important to not subdivide to a level where any credibility is lost, then suggest subdividing the £3m public liability portfolio into a large number of subgroups. This rather undermines examiner confidence that the candidates actually understand the topic rather than simply regurgitating standard points.

END OF EXAMINERS' REPORT