Faculty of Actuaries **Institute of Actuaries**

EXAMINERS' REPORT

April 2010 examinations

Subject SA3 — General Insurance Specialist Applications

Introduction

The attached subject report has been written by the Principal Examiner with the aim of helping candidates. The questions and comments are based around Core Reading as the interpretation of the syllabus to which the examiners are working. They have however given credit for any alternative approach or interpretation which they consider to be reasonable.

R D Muckart
Chairman of the Board of Examiners

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Comments

Individual comments are shown after the solutions to each part question that follows.

1 (i) *Basic structure of Solvency II:*

- Based on 3 pillars:
- **Pillar 1**: Minimum capital requirements
- Solvency Capital Requirement (SCR) and Minimum Capital Requirement (MCR)
- **Pillar 2**: Supervisory Review Process
- Supervisors may require additional capital against risks not covered in Pillar 1.
- **Pillar 3**: Disclosure
- To harness market discipline by requiring firms to publish certain details of their risks, capital and risk management.

Comments on Q1(i): *Generally well answered, although many candidates could not describe Pillars 2 and 3 and a number of candidates were not able to name the three Pillars.*

(ii) *To undertake to:*

- Coordinate/oversee the calculation of technical provisions;
- ensure the appropriateness of the methodologies and underlying models used as well as the assumptions made in the calculation of technical provisions;
- assess the sufficiency and quality of the data used in the calculation of technical provisions;
- compare best estimates against experience;
- inform the administrative or management body of the reliability and adequacy of the calculation of technical provisions;
- express an opinion on the overall underwriting policy;
- express an opinion on the adequacy of reinsurance arrangements;
- contribute to the effective implementation of the risk management system, in particular with respect to the risk modelling underlying the calculation of capital requirements.

Comments on Q1(ii): *Very few candidates could give a full range of requirements for Actuarial Function. Candidates were expected to be sufficiently up to date on such issues as Solvency II to answer this question. Many candidates' descriptions of the Actuarial Function were rather lightweight. Most recognised the actuarial role in overseeing the technical provisions but failed to recognise the wider aspects of the role, e.g. the input into the overall management functions and confused the formal role of the actuarial function with the day to day work of actuaries.*

(iii)

- The Solvency II regime will be maximum harmonizing, aiming to apply consistent regimes across all member states
- These new solvency requirements will be more risk-based and more sophisticated than in the past, enabling a better coverage of the real risks run by any particular insurer

- The new requirements move away from a crude "one size fits all" approach to estimating capital requirements to more entity specific requirements
- More comprehensive – covering liabilities & assets, e.g. harsher asset recognition rules
- New "total balance sheet" approach, with interactions considered
- Now need to hold capital for insurance, market, credit, liquidity and operational risk
- New rules will compel insurers specifically to focus on and devote significant resources to the identification, measurement and proactive management of all risks
- Prospective basis
- Introduction of "Own Risk and Solvency Assessment", or ORSA
- Different disclosure rules,
- … including Solvency and Financial Condition Report, or SFCR
- More recognition of the differences between insurers and reinsurers
- Penalises underpricing/ underreserving

Capital requirements:

- MCR – Minimum Capital Requirement – if net assets fall below which a firm will be de-authorised
- SCR – Solvency Capital Requirement – further up regulatory ladder of intervention
- These can either be based on standard formula or an internal model

Comments on Q1(iii): *The main thrust of this part was to recognise the more risk focussed regime under Solvency II, and while most candidates commented to this effect, only a minority were able to provide sufficient detail. Candidates generally did better on many of the high level differences but many failed to give the detailed, deeper points required.*

(iv) The actions and measures should be sufficient to ensure that the operation is on target to follow its strategy and meet its goals.
If the measures being used to monitor the progress of the plan don't produce the results expected, then there may be a need to revise the key actions in the light of the new knowledge to ensure that the plan is back on track.

Problems with the current method

Aggregation across business lines / mix change / rate change issues

- Even for internal purposes, there are clear weaknesses with aggregating business lines in this manner/better to take each class separately
- It is likely that different lines of business will be at different levels of profitability, and as such any mix changes could significantly affect average loss ratios.
- There would be shifts in mix between years of account with different strategic focuses in response to market opportunities and challenges
- Mix changes are particularly to be expected following the blanket premium increases imposed,

- …as competition is ignored,
- …and the insurance cycle is rarely consistent across classes and so the change is likely to be too high for some classes and too low for others
- There may well be mix change effects even within lines of business
- E.g. creditor business has been displaying significantly worse profitability in the construction sector following the recent property market issues
- The premium increases may also have unexpected effects on profit even within classes, as good business is cherry-picked by competitors with such high rate increases mainly only achievable on distressed or undesirable business

Issues with starting loss ratio

- A single year's experience is highly unlikely to be representative as even the largest portfolios will display some degree of volatility
- This is in particular the case for the lines of business covered here with exposure to:
  - Large claim events from D&O
  - Catastrophe claims from commercial property
  - Aggregation issues on creditor business due to macroeconomic conditions
- Some credit for other suggestions, e.g. macroeconomic factors on EL or natural catastrophes having some impact on motor *(each, max)*
- Using a single year makes no allowance for potential trends
- The previous 12 months data may also be difficult to interpret without some consideration of trends for longer tailed classes in particular, as business earned over that year may come from a number of different origin periods, e.g. with different coverage conditions.
- and on an earned premium basis the rate increases will not be fully in effect over a year
- The historical under-reserving of the business suggests that there may be further weaknesses in the reserves for the previous 12 months for which some adjustment should be made
- These under-reserving factors may also lead to distortions in the data because of the effects of prior years, and the analysis may be clearer if the results are separated.

Claims inflation issues

- Use of single static claims inflation figure whichever year the planning exercise is considering is clearly inappropriate
- The claims inflation assumption should be updated regularly to take account of any mix changes as the expected inflation is likely to be significantly different
- …depending on the classes of business (so rather than using one average claims inflation figure better to plan each class separately each with its own inflation figure)
- …and within classes by claim type
- …and within a class/claim type, from one year to the next

- Claims inflation fluctuates in proportion to expected claims costs, so the weighting between different business lines is likely to be different to the weighting by premium for average rate increases
- Most critically, creditor business is enormously sensitive to macroeconomic conditions,
- e.g. with the recent economic downturn producing dramatic increases to loss ratios across the market
- with the possibility that this continues to deteriorate in the future
- The higher average claims costs across all lines of business suggest that other classes are also experiencing some degree of claims inflation beyond that expected

Other issues

- Assuming the same absolute expense costs as in the previous year is likely to be wholly unsuitable
- Also as expenses exceeded the budget in the past they might also do so in future
- There is likely to be some degree of expense inflation over the year
- Expenses can be split into variable and fixed
- The variable part would not be expected to scale with any increases in premium purely attributable to rate change
- and is dependant on whether new or renewable business
- There may also be one-off items present or absent in the previous year that should be adjusted for appropriately
- There are also issues with focusing on absolute monetary amounts for expenses as combined ratios are then heavily dependent on correct premium volume assumptions
- In this instance, the method used is highly simplistic and likely to significantly overstate premium volumes following such a high requested rate increase
- Average commission rate may change due to mix change effects
- May also be higher on average if brokers request better commission rates for successfully implementing the relatively high rate increases requested

- Investment returns could vary significantly between years according to market conditions / prevailing base rates etc.
- and are likely to be depressed because of the current economic climate
- and would be expected to vary if there were any changes in the mix of assets backing the liabilities
- The plan also makes no consideration for any changes to reinsurance arrangements or the related costs.
- Monitoring should be implemented more frequently than annually and should allow for seasonality

Solvency II considerations

- A key consideration in Solvency II is that all financial planning must closely match the underlying business.

- This would ideally involve splitting the business into relatively homogenous groups
- At a minimum there is a standard segmentation into broad business categories that must be observed for SCR purposes
- Although this does not need to be matched for internal reporting
- As such the aggregation of all lines of business for planning would clearly not be compliant.
- If an internal model is approved for calculating SCR this would be required to be used as part of the planning process and so a clear link would need to be evidenced
- Other appropriate comments linking the internal issues discussed below to a Solvency II framework

Comments on Q1(iv): *A number of candidates set out a proposed methodology rather than focussing on the shortcomings of the current process. Whilst there was some overlap with what the question required, this approach cost many marks. Also, many of the candidates were trying to solve the problem of why the company's results were poor, and what to do to turn the results around, rather than considering the problems associated with the planning process. Most focused on the need to analyse at a more granular level, but many failed to go into sufficient detail of how the analysis would need to change. A number of candidates pointed out the problems with the analysis but did not suggest any suitable improvements to be Solvency II compliant.*

(v) ***Run-off of existing gross reserves***

General points

- Past under-reserving issues suggest that latest reserves may still be significantly flawed and a thorough reserve review should be performed

- Priority should be given to the areas of the business / aspects of the reserving process responsible for the most material past shortfalls
- Especially where such issues may affect business going forward.
- Reserves would need to be set on a discounted best estimate basis and a risk margin assessed for Solvency II
- Consideration should also be given to reserve uncertainty to ensure there is adequate capital backing for any further deterioration
- Stress and scenario tests/stochastic modelling should be used
- Allow for past & future inflation appropriately.
- Allow for any recent events which may be likely to produce losses which have not yet shown up in reserves, e.g. recessionary impacts on D&O
- Expense analysis, including finding the cause of the escalation and reviewing expense allocation
- Consideration of split of claim amounts:
  - Opening
  - Closing
  - Reopening
  - Speed of settlement

  - Frequency vs severity
  - Nil claims
  - Court award fees
  - Any other reasonable suggestion

Individual case estimates

- Consideration should be given to the overall quality of case estimation, particularly for large claims
- Review all large case reserves above a particular threshold
- General spot checks on all reserves

Initial loss ratio expectations

- Longer tailed classes such as EL are likely to use loss ratio expectations for immature years, – review these
- Such a review should take account of
  - Historical experience
  - Adjusted as appropriate for large claims etc.
  - Any viable benchmarks
  - Rate changes
  - Including coverage changes
  - And claims inflation
  - Mix changes

- Any assumptions used should be consistent with internal modelling for Solvency II

Individual case estimates/Initial loss ratio expectations:

Watch for fraud
Ongoing individual case review
Creation of a large claim monitoring committee
Peer review process for claims departments
External consultants

Development projections

- Obtain triangles of data in order to assess the adequacy of the reserves for each class of business.
- Possible projections include:
  - Paid
  - Incurred
  - Premiums
  - Numbers
  - Gross & Net
  - Accident or underwriting year cohorts
  - Other valid suggestions
- These triangle should be segmented at an appropriate level balancing the need for homogeneity with credible data volumes

- Although more granular segmentations could be used with aggregated or benchmark development profiles
- These more detailed segmentations could be used to identify or examine in more detail any problem areas
- Using such segmentations in any actual vs expected analysis might also highlight more quickly areas of the business where existing development profiles are inappropriate.
- Key segmentations would include
  - Business line
  - Sub-category (e.g. EL / PL, comp / 3rd party)
  - Types of claim (property damage / injury)
  - Broker
  - Large / attritional / cat
  - Nil claims (claim number projections)
  - Other valid suggestions

- Distortions from the presence or absence of large claims / catastrophes / heavy / light experience should be adjusted for
- Along with any changes in claim reserving methodology / recording of claims etc.
- Coverage changes should also be considered, especially when they affect development profile (e.g. claims made vs losses occurring)
- Inflationary distortions to development profiles should be considered (likely to only be an issue where there are changes to settlement rate or levels of claims inflation)

Also:

Regular reserve review
AvE analysis
Establishment of a reserve committee with primary responsibility for reviewing the actuarial numbers
Greater use of external auditors / peer reviewers / consultants etc.

Comments on Q1(v): *This was generally poorly answered, with many candidates only detailing high level issues. Very few candidates suggested the projections which should be considered, or the segmentations which may be useful and to give detail of how a reserve review would be carried out.*

(vi) ***Future business volumes and gross performance***

General points

- Speak to management/ marketing/ underwriters / consultants / analysts etc.
- Review underwriter incentives for accurate planning, e.g. charge for capital on the basis of original plan, make bonuses conditional on performing close to plan (whether over or under)
- Integrate seasonal targets, road maps etc. so that performance can be tracked on e.g. a monthly/quarterly basis to give warnings about the full year
- Implement DFA

Projecting future volumes:

- Starting point for projections should be existing business volumes
- This information should be segmented as far as is practically feasible into groups where the expected changes going forward are reasonably similar.

- And where starting profitability is similar for the future profit expectations (or regrouped to fit as appropriate)
- Segmentations that bear some resemblance to rating factors used in pricing can be of value, particularly in future monitoring.
- Expiring business should be adjusted for expected retention levels
- This should take account of the following issues:
  - Normal level of churn based on average historical experience
  - Likely impact of rating levels / rate movements relative to the market
  - Any strategic changes such as non-renewal of specific areas
- Adjustments should be made for likely changes in premium volumes on retained business:
  - Average exposure growth, e.g. from wage-roll inflation / sum insured increases
  - Consideration should be given to unusual economic conditions that might make these averages inappropriate
  - Any other exposure changes such as limits, line sizes, deductibles etc.

  - Any rate increases after allowances for such exposure changes should follow through as increases to premium volumes
  - Currency movements will produce changes in volume in the base accounting currency.
- New business should be allowed for
  - Changes to market share
  - Influenced by price differentials
  - quality of coverage
  - broker relationships
  - direct marketing / website quality / advertising spend
  - Changes to overall market volumes (economic cycles, expanding levels of coverage etc.)
  - Strategic considerations, particularly on a segmental level
  - Competition
  - Elasticity of demand
  - Position in market cycle

  Movement analysis: lapses, cancellations, conversion rates.

Future business profitability

- Reserving analysis in part (v) should suggest appropriate starting point for projections of future profitability
- Note that such projections should consider average expectations such as IELRs for BF NOT actual experience for the most recent year
- Although they should be appropriately adjusted to the relevant rating environment

- And claims environment
- From that starting point, projections with the appropriate segmentations above should produce reasonable results
- Although differential rate movements by segment should be considered if market conditions are likely to produce this
- Along with different levels of claim inflation
- Antiselection
- Consider uncertainty related to creditors because of industry concerns, e.g. Competition Commission.

Comments on Q1(vi): *This was not particularly well answered, with many candidates failing to suggest issues which can affect new business volumes, and relatively few mentioning how you should look at future business profitability. Very few candidates gave any consideration to the key elements of any planning process – the expiring volumes and the likely retention, growth and new business given the current market conditions.*

(vii) ***Reinsurance***

General points

- All internal or external models used for reinsurance analysis for planning should be consistent with those used for capital modelling in order to be solvency II compliant.
- Consider capital implications of reinsurance purchasing.
- – hire consultants to benchmark any of the aspects below
- – define regular review of any parameters, perhaps quarterly, with the process documented for solvency II compliance
- Alternatives to reinsurance: derivatives, cat bonds etc.
- Technical assistance from reinsurers
- Other appropriate actions or measures not covered elsewhere (must be specific and workable approaches)

Estimation of reinsurance spend

- Starting point would be:
- …assessing value for money
- …reviewing existing arrangements, covers, limits etc.
- … reinsurance spend from current year adjusted for intended changes to programme
- Adjustments should allow for both changes in modelled loss experience and changes to likely capital charges from reinsurers
- Capital charges should particularly be considered if the level of attachment for the programme is changing significantly.
- Also consider level of recent claims passed to reinsurers and any potential resulting rate increases / decreases
- and whether reinsurance programme has been effective with respect to recent large claims etc.
- Along with major market events that might impact capacity even if these did not impact the company

- Consider the position in the reinsurance cycle.
- …which may be at different stages for different lines of business
- If the programme is being changed significantly, consider any discounts for volume or cross-subsidies that may exist between layers / business lines etc in the current reinsurance purchases, e.g. costs for other layers may increase if one layer is dropped.
- Consider cost allocation between units for shared programmes
- – Speak to reinsurance brokers / reinsurers for indicative quotes

- – review planning assumptions whenever there are company or market events which would affect this or when intended purchase changes

Estimation of reinsurance recoveries

- Model recovery rates for the historical and planned future purchase
- using a stochastic model, e.g. the internal capital model for Solvency II compliance
- The cost of purchase should give some indication of likely recovery rates based on some assumptions about target loss ratios / capital costs for reinsurers – this can be used as a benchmark to the internal model.
- Past recoveries (adjusted for programme changes as necessary) can also be used as a sense check on the internal model although experience may not be particularly credible or stable.
- External software such as RMS can also be used for the catastrophe accounts.

Bad debt adjustments

- Consider potential bad debt issues that might reduce the recovery rate / increase capital costs
- Some allowance should possibly be made for current economic conditions

- with defaults arguably more likely at what is currently a low point in the economic cycle, with additional capital difficult to raise by the company or its reinsurers.
- Historical and current Credit ratings for all reinsurers will be available, along with market information such as S&P default studies to suggest likely default rates.
- Consideration should be given to any interaction between extreme events for the company and events that might trigger defaults for reinsurers – for example high CAT losses might be combined with reinsurer default whereas individual risk losses on EL are unlikely to be significant for any reinsurers.

Comments on Q1(vii): *A significant number of candidates answered incorrectly parts (v) to (vii). Specifically, rather than commenting on the planning process, they focussed on the underlying issues themselves. In part (vii) a discussion of how to monitor the effectiveness of reinsurance was required, not a detailed description of the types that may be appropriate.*

Many candidates appeared to be answering a standard "how would you decide on the appropriate reinsurance programme" question.

2 (i) ***Reasons for Transferring General Insurance Business***

Where the businesses is no longer a core part of the sellers' portfolio.

For example:

The business represents a small proportion of the total business, but requires a disproportionate amount of management time or capital.
The business was purchased as part of a larger acquisition, but was not the reason for undertaking the transaction
The business is, or is anticipated to become, not sufficiently profitable for the current owner. This may be because it has been making losses for a number of years, or regulatory/other changes mean the outlook is unfavourable
Easing balance sheet strain (particularly an issue where reserves are discounted)
Simplification of company structures, e.g. portfolio diversity
Where the company or owner is in run-off, e.g. has become insolvent and is unable to write business.
If the company lacks the support expertise to manage the business effectively (perhaps due to the loss of a key underwriter)
The efficiency savings made by SID allow them to offer a better price than the expected value of the business
Presence of the business line is viewed unfavourably by the stock market / regulators / rating agencies
Freeing up capital would allow the company to take part in other upcoming market opportunities
The business is in a different currency to the core business causing significant exchange rate issues
Reinsurance is no longer available or is too expensive.
To remove uncertainty, e.g. for latent claims.
Other appropriate reasons

Comments on Q2(i): *A bookwork question which was generally well answered.*

(ii) ***Reasons for Accepting Transfer***

SID will be attempting to make a profit from the transfer, that is, obtain a satisfactory return on the capital employed by SID on the transferred business.

Through portfolio transfer, SID may obtain a viable underwriting business.
Purchasing a whole company gives SID the benefit of company assets, for example, existing licences, intellectual property, renewal rights, skilled staff etc.
This allows SID rapid entry into a market.
May be lower cost than starting business from scratch.

Businesses which are not performing satisfactorily for the seller may become viable with an alternative management/more efficient management.
SID will benefit from diversification by buying a number of unrelated portfolios.
In the case of portfolios in run-off, it may cost less to administer several portfolios together through economies of scale
Diversification could result in reductions in capital requirements for a larger group of businesses than for each business individually.
By combining businesses with common insureds, SID would have greater negotiating power in commutations.
Acceptance of portfolios in this manner is core to SID's business and hence utilises internal resource (legal departments etc.)
Acquisition of a substantial share of a particular pool of risks may give SID significant bargaining power to run the business off profitably
It may also accumulate sufficient in house expertise to price and reserve the portfolios accurately
Cross-selling opportunity.
May be tax advantages. *(with reasonable explanation, e.g. arbitrage).*

Comments on Q2(ii): *A bookwork question which was generally well answered.*

(iii) ***Possible exit strategies***
(Marks are given to the opposite opinion on whether a strategy is attractive or vice-versa for each of Travel/EL Re if the reason given is valid)

Run-off to exhaustion
Cease to write any new business or renewals in the lines being exited, but continue to retain responsibility for administration and claim payments for the existing business.
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, although can outsource
Re-entry to the market easier than with other strategies

Travel – strategy likely to be attractive
Short tail business – all claims should be paid in not much more than a year
Mojo is a large business, so should have the capacity/resources to complete the run-off (even when the volume of claims has declined to very low levels).

This does however waste the value inherent in the website which could be sold separately

EL Re – strategy unlikely to be attractive
Mojo wishes to eliminate all its exposure as soon as reasonably possible. Run-off for this business will take a long time.

Reinsurance
Fully reinsuring all future claims under business written historically.

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.

Travel – strategy unlikely to be attractive
Mojo is financially strong, so unlikely to need reinsurance (which would pass profit outside the group).

EL Re – strategy unlikely to be attractive
Given these are long tail liabilities, counterparty default risk cannot be ignored.
Or: EL Re – strategy likely to be attractive
Simple solution subject to the reinsurer's credit rating being high enough to suggest that claims will be paid in the long term

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.

Mojo would likely attempt to commute both inwards and outwards business.

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

Travel – strategy unlikely to be attractive
Not practical, as agreement of all policyholders required
EL Re – strategy unlikely to be attractive
As insurer is unlikely to agree as may then wish to commute the underlying business which requires the individual agreement of every policyholder.

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.

Travel – strategy unlikely to be attractive
Not practical, as agreement of all policyholders required
EL Re – strategy likely to be attractive
Mojo's contractual liability completely removed but depends on the terms.

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.
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 either (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.
Can transfer reinsurance asset.
Consideration should be given to the premium charged by a third party to take on exposures such as these (which can be highly volatile and have significant latent potential)
Onerous legislation and disclosure requirements/ action required by FSA, court, independent actuary, company lawyers
Transfers subject to FSMA 2000
…which requires court sanction/approval

Travel – strategy unlikely to be attractive
While it would achieve Mojo's aims of totally eliminating exposure, there would likely be considerable costs involved. Therefore it would be more efficient to allow the business to run off.

EL Re – strategy unlikely to be attractive
Because of onerous legislation etc.
Or: EL Re – strategy likely to be attractive
Completely removes Mojo's contractual liability and has less problems than a novation, dependant on price/terms
It may be best to retain the exposures for a few years until they have largely stabilised before taking this approach

Schemes of arrangement
Effectively a mass commutation of policies of an insurance company.
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.
Mojo would not need the individual agreement of all policyholder 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).
Can be put in place for both solvent and insolvent insurers.
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.

Travel – strategy unlikely to be attractive
While it would achieve Mojo's aims of totally eliminating exposure, there would likely be considerable costs involved. Therefore it would be more efficient to allow the business to run off.
Personal lines customers may find the process confusing.

EL Re – strategy unlikely to be attractive
Given Mojo is financially strong, many policyholders would prefer to maintain cover than receive a payout. It may be difficult to obtain the required votes.
Reputational risk to Mojo by removing cover from insureds. May have a negative impact as Mojo continues to write other lines of business.
In any case, preparing for the scheme and gathering the required votes could take a long time. Mojo wishes to eliminate exposures as soon as possible

Sale of business
Sell the whole company, which achieves finality for the seller.
Not viable when a company only wishes to cease underwriting part of its business.

Sales of certain business assets are also possible.
Examples of assets that can be sold are the renewal rights or reinsurance recoveries.

Travel – consider sale of renewal rights or website
We do not know why Mojo has exited the business. The business may be profitable (or could be made profitable), and another company could be interested in purchasing.

EL Re – consider sales of renewal business
However, because this is London market business the broker, rather than the insurer, "owns" the account. This can limit the value of the renewal rights.

Combinations of the above strategies are also possible.
e.g. pursue run off initially while agreeing commutations where possible, then sell business.

Comments on Q2(iii): *A methodical approach helped many candidates score well in terms of discussing the different strategies although too many failed to actually comment on the attractiveness of each for the two classes.*

(iv) Loadings will need to be applied to the best estimate cost to allow for SID's profit, contingencies, and expenses, which would differ for A and B

The type of portfolio transfer mechanism may be different for portfolios A and B.

Transferring company may retain a share of portfolio A
E.g. a large/particularly uncertain claim may be retained *(or other example)*
One of the transferring companies may continue to do administration, resulting in different expense loadings.

SID may charge a minimum premium for any transactions to cover its overheads, or the work required to prepare a quote.

SID may disagree with the best estimate prepared by the company transferring the liabilities.
E.g. one company may tend to over reserve, one under reserve. Estimates may or may not be discounted *(or other example).*

There may be differences in the nature of reinsurance on each portfolio. Differences include whether reinsurance is being transferred to SID, the quality of the reinsurers, and whether there are any disputes with the reinsurers.
Also whether claims have exceeded or are close to any policy or aggregate limits

SID may be applying different contingency loadings for each portfolio.

E.g. one portfolio may be considered to be more uncertain, because of:
…long tail vs short tail,
… e.g. asbestos liabilities, / latency
…the quality of data being poor
…currency considerations
…in run-off or ongoing
…any other reasonable suggestion

SID may not want to acquire Portfolio B, but be keen to acquire Portfolio A, for strategic reasons.
Competition – premium will reflect market conditions, that is, willingness of buyers and sellers to reach a deal.
SID's costs may be very different for different lines of business due to synergies with existing liabilities
Similarly, SID's capital costs may be very different due to different diversification credits
Consideration should be given to the number of years of business included in the transfer and the total original liability – although a portfolio may be largely run off, any late stage or latent development could well bear more resemblance to the original liabilities than the current best estimates
Liabilities may have been assessed on a discounted basis and the choice of discount rate may vary between the two portfolios
There may be an error in the figures

Comments on Q2(iv*):* *Marks for this part were low in general. Very few candidates covered all the obvious points, e.g. different methodologies and bases used by the companies, different level of uncertainty in the outstanding claims (for many reasons) and the impact of competition on the price or considered the wider issues around the potential strategic or operational issues for SID. Some candidates concentrated on the possible volatility of the portfolios and didn't cover anything else although they generally remembered that SID may not agree with the beat estimates of the liabilities..*

Overall: *Q2 was generally better answered than Q1. Marks for the Q1(v) to Q1(vii) part of the paper were particularly low, to such an extent that the average mark awarded for Q1, with 57 available, was lower than for Q2, with 43 available.*

END OF EXAMINERS' REPORT