

EXAMINATION

September 2006

Subject ST2 — Life Insurance Specialist Technical

EXAMINERS' REPORT

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.

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Chairman of the Board of Examiners

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Comments

Individual comments are shown after each question.

- 1** For unit-linked business, the amount payable on surrender is likely to be defined in policy terms. Therefore, it is unlikely that the amount will be changed for existing policies.

The company can amend the terms for new policies only, for marketing purposes

The surrender value scale will have formed part of the profit test originally carried out when the product was priced. Therefore, if the company wishes to alter this amount, it will need to re-run its profit tests assuming the new proposed surrender payment definition.

The company would need to consider whether to amend its profit testing basis in light of its proposed action. For example, if it is increasing surrender values, then it may increase the lapse rate it assumes in the profit test. Alternatively it may use its existing lapse experience, but reflect increased risk by increasing the risk discount rate used to discount the cash flows.

The company would consider whether increasing the cost of surrenders still gave rise to an acceptable level of profit.

The company would also consider whether there would be any impact on supervisory reserves. The reserve cannot be less than the surrender values payable so these reserves may increase. The capital strain from writing new business would therefore also increase which, all other things being equal, would lead to a reduction in free assets. If the capital available is limited, it may not be able to increase surrender values.

If the company reduced the initial commission it paid, and increased the renewal commission, then it may be able to offer higher surrender values with little financial impact.

The company should consider whether competitors offer higher surrender values and therefore whether higher volumes of new business may be obtained.

There may be regulatory restrictions on the surrender values that it offers.

The company should consider the possible impact on surrender rates resulting from this move.

Comments on question 1: Question 1 was not well answered. Most candidates were able to comment on the likely impact on profits and sales and the desire to maximise total profitability. However, few considered fully the impact changes in surrender values may have on reserves and the knock on impact on the capital position of the company. In addition only the strongest candidates showed an understanding of practical issues such as the impact on administration systems and restrictions from regulators.

2 The company is likely to use cashflow model, based on existing model.

It needs to select a set of model points representing the expected new business under the product. It could use profile of historic new business to set model points, but allowing for any expected changes in the future. It needs to amend the model to allow for any new features — model points for any new features could be derived using profile of similar product or by taking advice from the marketing department.

For each model point cashflows will be projected, allowing for reserving and solvency margin requirements using a set of assumptions.

Assumptions for mortality, lapses and expenses will be based on the most recent investigations — allowing for any known distortions in the investigations and any likely future changes. The assumptions for lapses and mortality may need adjusting if the reprice is likely to change the customer profile from that in the past.

Economic, and valuation bases will be required. A risk discount rate will be set based on the return required by the shareholders and allowing for a level of risk attached to the cashflows.

The premium will be set so as to produce the required level of profit.

The premiums would then be considered for marketability.

This may lead to a reconsideration of:

- the design of the product e.g. may add or remove features
- the distribution channel to be used
- the company's profit requirement
- whether to continue with the product

The net cashflows for each of the model points will be scaled up for the expected new business under the product and incorporate into a model of the business of the whole company.

An analysis of the sensitivity of profit to changes in assumptions would need to be conducted to assess any risks inherent in the premium rates.

The desired level of profitability may not always be reached for all individual model points, but the overall level of profitability may be reached. In this case cross-subsidies need to be considered — particularly as there is a risk that the assumed business mix will not be borne out in practice.

The capital requirements of the new contract can be considered by examining the modelled cashflows in terms of timing and amounts. This may lead to further redesigning of the product, or re-assessing the financing requirements (e.g. use of reinsurance).

The company will also need to consider whether reinsurance terms need to be renegotiated and allow for any revised terms in the profit test.

It needs to allow appropriately for tax and to consider the possibility of lapse and re-entry.

Comments on question 2:

Question 2 was well answered by many. A number of candidates described a cashflow projection giving a good overview of the process and inputs required. Stronger candidates also covered in their answers the iterations the company may go through to reach the final premium rates, e.g. changing premium rates or redesigning product features and the benefits of sensitivity analysis.

Some candidates lost marks by focussing too much on the detailed investigations behind certain basis assumptions and failing to adequately describe the overall profit test process.

- 3** (i) The amount of the reserves should be such as to ensure that all liabilities arising out of the contract can be met by the life insurance company.

The amount of these reserves should be calculated by a suitably prudent actuarial valuation of all future liabilities for all existing policies including:

- guaranteed benefits, including guaranteed surrender values (the amount of the reserves for each policy should be at least as great as any surrender value guaranteed and therefore should not be negative)
- options available to the policyholder
- expenses, including commission
- taking credit for the premiums which are due to be paid under the terms of each policy

A prudent valuation is not a “best estimate” valuation, but should include an appropriate margin for adverse deviation of the relevant factors.

The valuation should take account of the nature, term and method of valuation of the corresponding assets.

The use of appropriate approximations or generalisations should be allowed.

The rate of interest used in the calculation of the non-unit reserves should be chosen prudently, taking into account the currency in which the policy is denominated, and having regard to the yields on the corresponding existing assets and to the yield which it is expected will be obtained on sums to be invested in the future.

The elements of the statistical basis, that is the demographic and withdrawal assumptions, and the allowance used for expense in the calculation of reserves, should be chosen prudently, having regard to the type of insurance,

the country where the insured people live, and the administrative costs and commission expected to be incurred.

If the method of valuation defines in advance the amount of expenses to be used in the valuation, the amount so defined should not be less than a prudent estimate of the relevant future expenses.

The method of calculation of the reserves from year to year should be such as to recognise profit in an appropriate way over the duration of each policy and should not be subject to discontinuities arising from arbitrary changes in the valuation basis.

Each life insurance company should disclose the methods and bases used in the valuation.

- (ii) The reserve will need to ensure that the policyholder liabilities are met on death surrender and maturity. In addition, the reserve will need to ensure that the expenses of the company are met.

The reserve cannot be less than the guaranteed surrender value. It is unlikely that the company will pay out a surrender value higher than that guaranteed in the policy conditions.

The reserve will consist of two parts: a unit reserve and a non-unit reserve.

The unit reserve will be the face value of the units. As there is a penalty on the Capital Units the company may choose to use Actuarial Funding as a method to reduce the reserve.

Non-unit reserve

By allowing for future premiums and the allocation of those premiums to units in accordance with the policy conditions, it is possible to project the unit fund in the future.

Again, with reference to the policy conditions, it will be possible to project the charges that the company might receive from the policy.

It will also be necessary to project the expected outgo:

- Cost of death benefit
- Renewal expenses
- Termination expenses
- Investment expenses
- Renewal commission

The expenses may be increased above a current prudent estimate to allow for their possible level if the company were to close to new business. It will also be necessary to allow for future surrenders if this increases the reserve, but this is not usually the case.

It is important to ensure that if the Capital Units have been Actuarially Funded, then the annual management charge associated with those units cannot be used in the above projections of income and outgo.

The assumptions should all be prudent and the assumption regarding the growth rate of units should have regard to the assets into which the units are invested.

The outgo less income is discounted at a prudent rate of interest that reflects the currency of the policy and the assets in which the resulting reserve will be invested. It is prudent to discount those future net cashflows only up to the last point where there is a net cash outflow. This is because any subsequent positive cashflow to the company may not be received if the policyholder were to surrender at this point.

Whilst it is allowable to group policies together and value the group, it is much more likely that policies will be valued individually so that the comparison with guaranteed surrender value can easily be made.

Where the individual policy reserve calculation does not allow for a specific risk a prudent global reserve for that risk may be set up

Comments on question 3:

Part (i) of question 3 was well answered with a number of candidates scoring full marks

Many candidates struggled on part (ii), however. Most identified the need for a unit reserve and a non unit reserve but were unable to describe the calculation of non-unit reserves in any detail, failing to utilise the contract details given in the question. Few demonstrated the understanding of how these two types of reserve met the principles from part (i).

4 (i) The company could use underwriting at the policy application stage.

It could use medical underwriting to identify policyholders who were a higher than normal risk, to assess what special terms or conditions should apply in such cases, to make sure a fair premium is charged for each risk, or to determine whether the life should be declined.

It is used to ensure that the company is not selected against.

It may also be required to comply with conditions of reinsurance arrangements.

In addition the company may use financial underwriting to ensure the benefits sought are reasonable given the applicant's current earnings.

The underwriting may use questions on the proposal form to identify high risk individuals for example through questions on health, occupation, hobbies,

place of residence, and to identify applicants with current symptoms or conditions which may influence the insurance risk.

These may be supplemented by further questions or medical reports or tests in order to clarify the extent of any conditions and how they should be reflected in terms given.

In addition the company may use underwriting at the claim stage to ensure claims are valid. In practice this is likely to be straightforward involving receipt of a death certificate but may be enhanced if the product offers any rider benefits relating to ill health. In addition, at the claim stage it may investigate non disclosure of pre-existing conditions or whether an exclusion clause has been triggered.

(ii) **General**

Underwriting should pay for itself and only be used if the cost is outweighed by the benefit through the increase in premium rates for loaded cases and/or lower claims costs.

The main outgo in Term Assurance is the cost of claims. As such underwriting can significantly alter the overall costs incurred. Underwriting is therefore appropriate for this type of business.

Whole of Life Assurance

The cost of death claims is again significant for this type of policy but less so than for Term Assurance as the only risk is the timing of the death not whether it occurs in the policy lifetime.

Initial underwriting may therefore be used but is likely to be less cost effective than for term assurance.

Endowment Assurance / Deferred Annuity

For these products the main payout is in the form of a cash sum available to spend, reinvest or purchase an annuity at the end of the policy term.

For endowments, early in a policy's life the death benefit may be high in relation to premium paid and so underwriting will be required, but perhaps not to the same extent as for whole of life

It is also possible that it may be suitable for term assurance rider benefits which may attach to the Deferred Annuity product or for Endowment Assurance products written under trust to older lives.

Immediate Annuities

For annuity contracts the key cost element relates to the annuity payments made. This is driven by the life expectancy of the policyholder.

Underwriting could therefore be used in defining appropriate terms, but, with the exception of “impaired lives” annuities, it is not standard practice to underwrite annuities.

Conversely to Term Assurance a higher death risk from “impaired lives” would improve terms available to an annuitant. Using underwriting would therefore identify lives to which the company can give better terms.

To make the process economic the company would need to cover the costs of underwriting and enhanced terms through reductions in benefits to standard lives.

The company would need to consider the marketability of such consequences and whether other companies used this approach. If the company is out of line with the market by not underwriting, then a higher proportion of its business may be “normal” lives, which would impact on its profitability.

Comments on question 4:

Part (i) of question 4 was bookwork and was well answered by most candidates but many found part (ii) more challenging. Most candidates covered marketability and cost benefit considerations in deciding whether to underwrite. Weaker candidates failed to consider the principle features of the different contracts in the question, limiting themselves to a more general discussion thus missing a number of marks.

Stronger candidates who showed understanding of the possible merits of and issues with underwriting the different product types scored much better.

5 (i) Term assurance

Pays a lump sum on death within a specified period. For example, might set the period as being until any children are no longer expected to be dependants.

This is needed in order to protect the spouse and any children against financial loss due to loss of the main household income. It could also be needed to repay the balance outstanding under a mortgage (if on a repayment basis) or other loan.

It may not be needed if either are employed and the employer provides adequate death in service benefits.

It is normally conventional without profits.

Endowment assurance

Pays a lump sum on the earlier of death or survival to a stated date. It may be needed to repay an interest only mortgage.

Normally with profits or unit-linked.

Pension contract, in either deferred annuity or endowment assurance form.

The key benefit is payment of a regular income (or a cash lump sum, which can be used to buy an immediate annuity) provided the customer survives to a specified date. It enables the customer to save part of their income now whilst economically active in order to provide income in retirement.

It would not be needed if either are employed and the employer provides an adequate corporate pension scheme.

Normally with profits or unit-linked.

School/University fees plan

This could be in the form of a savings contract, the proceeds of which can be used to purchase a temporary immediate annuity when the children are of school age or when they go to university.

It enables the customer to save in advance for payment of school fees, to provide private education to the children when they are of an appropriate age.

The savings component would normally be with profits or unit-linked; the annuity would normally be conventional without profits.

(ii) **Individual (“keyman”) term assurance**

Would be written on the lives of key personnel, providing payment of a lump sum on their death. It gives the company protection against financial loss from the death of key members of staff.

Normally conventional without profits.

Group term assurance

Provides benefits on the death of a member of staff, normally to their dependants. Offering such benefits as part of the employment contract meets the customer’s need of retaining and attracting good staff.

Normally conventional without profits.

Group pension scheme, in either deferred annuity or endowment assurance form.

Provides retirement benefits for the staff. The cost could be shared with the employees by making the scheme contributory.

As above, this meets the customer’s need of retaining and attracting good staff.

Normally with profits or unit-linked.

Immediate annuities

The company might purchase immediate annuities in order to provide retirement benefits emerging from the pension scheme. This removes longevity risk from the company.

Normally conventional without profits.

Comments on question 5:

Answers to question 5 were mixed. Most candidates were able to identify the basic needs in both situations and identify suitable contracts. Some candidates thinking was however fairly narrow, being limited to death benefits and savings in part (i) and death benefits and pensions in part (ii). Candidates who thought more widely generated more marks. In particular only the strongest candidates considered keyman assurance in part (ii).

A number of candidates lost marks as they failed to explain their choice of whether a contract would be likely to be conventional or unit-linked etc. Marks were given for valid reasons as to why a contract was likely to be conventional, unit-linked etc.

- 6** (i) Premium
Investment income
Realised capital gains/losses
Unrealised capital gains/losses
A share in the profits from without profits business sold by the with profit fund
Initial commission
Renewal commission
Expenses associated with acquiring and setting up new policies
Ongoing administration expenses
Investment expenses
Cost of any death benefits
Cost of any further benefits under the policy (e.g. waiver of premium)
Surrender profits or losses
Charges of any options or guarantees
Tax
Contribution to the transfer of profits to the shareholders
Cost of capital to the contract whilst asset share is negative
Contribution to free assets to support a smoothing policy
- (ii) It is unlikely that different returns will be allocated to each individual policy.
In fact this would go against the pooled nature of with profits business.

Key will be to decide the asset mix appropriate for the class of business.

First, consider whether the overall asset mix of the fund is appropriate for the endowments. If not, actual assets held will be hypothecated to the separate classes of business written by the company. This will give the actual assets for the endowment policies we are considering.

Next it will be necessary to decide how these assets are hypothecated between different subsets of the endowments. The same asset mix could be assumed for all of the endowments. Or a more sophisticated hypothecation could be used within the endowments.

For example, it may be reasonable to allow for some matching of assets and liabilities. So more of the fixed interest assets may be allocated to the policies very close to the maturity date. Similarly, shorter dated fixed interest assets would be allocated to these policies. Alternatively, there may be a large element of terminal bonus so that policies close to maturity have a high proportion of real assets.

This will lead to the grouping of the policies into reasonably homogeneous groups, but practical considerations will dictate the number of these groups.

Again, for practical reasons, this is likely to be simplified to an asset mix that varies as the policy ages.

The asset mix may be influenced by the information provided to the policyholder.

The historic year on year returns for each asset class would then be applied to these asset shares in each year of the policy. As investment expenses are usually expressed as a percentage of funds under management, it is common for this to be netted off against the yield.

The tax impact could be based on the actual tax paid. Or it could be based on notional tax rates applying each year. The latter approach would require an assumption about the turnover rate of assets so that an estimate of the tax on unrealised gains is made.

Further practical issues would be:

One-off jumps in asset values (for example, the sale of a large property)?

Uneven flows of premium over the year when returns are not even over the year?

Data quality issues and timeliness of receiving data.

Deciding how frequently to carry out the calculations.

(iii) **Surrender value**

The asset share is likely to be the long term average payout for surrender values.

Unless the company has a policy of trying to build up free assets and this policy has been communicated to the policyholders.

The surrender value will depend upon other factors, other than asset share, such as ease of calculation, consistency with other values (e.g. blending into maturity value), competition, past practice (and hence policyholders' expectations) and smoothing.

Maturity value

May be subject to a guaranteed minimum so asset share has no impact of the guaranteed minimum bites.

Again, the maturity value will be based on average asset share over time.

It will depend heavily on the smoothing policy and so a particular maturity value may be above or below its asset share.

The bonus rates are likely to be based on the asset share for an average policy, rather than each individual policy

Death benefit

It is likely that the death benefit will be guaranteed in some way.

As such the asset share is unlikely to play a part in the calculation of the death benefit.

However, close to maturity it is possible that the asset share is greater than the guaranteed minimum and so this is likely to be paid in this case.

Comments on question 6:

Answers to question 6 were in general disappointing. Part (i) was reasonably well answered but many candidates lost marks by not giving as much detail as was possible. For example many mentioned expenses but did not split this into initial and renewal expenses, administration and investment expenses etc.

Very few candidates scored well on part (ii). The question required consideration of how the overall investment returns would be allocated to different tranches of policyholders through the hypothecation of assets. This was only covered by a few candidates.

In part (iii), many candidates were able to set out basic considerations but failed to enrich their answers with examples of situations where there may be deviations from normal policy.

For example few set out how guaranteed death benefits may exceed asset share in the early years of a contract.

7 Throughout this solution, the terms lapse and surrender have been used interchangeably.

- (i) High lapse rates are often an indication that products are not meeting customers' needs and that there might be a mis-selling issue.

It may be that one sales channel is worse than the others.

If the company sells some business through a sales force and this is the channel where the lapse rates are highest, then it is likely that the following problems exist:

- The sales force may be incentivised to write as much new business as possible without any incentives to ensure that policies do not lapse at renewal. The sales force's remuneration/bonuses may all be geared to writing new business rather than rewarding renewing business in any way.
- The sales force may be suffering from a lack of training and product knowledge and hence selling products to customers that do not meet customers' needs, resulting in customers lapsing their policies in the first few months/years after inception.
- The company may offer uncompetitive premium rates. The sales agent may be able to make a sale but shortly after the policy may be lapsed by the policyholder when they find out that a similar product is available elsewhere for a lower premium. This is likely to be a significant risk for term assurance business.

If the company sells business through independent advisers and/or third party distributors such as banks and it is these channels that have the highest lapse rates then it may be that the company is remunerating the independent advisers/3rd parties more than other life insurance companies in the market, which is encouraging the mis-selling of policies in order to get the high commissions on offer.

The company may have charging structures that are out of line with the rest of the market and in particular it may not have imposed surrender penalties (or sufficiently high surrender penalties) to disincentivise policyholders from surrendering their policy.

For example, if the company offers a single premium unit linked savings contract with little or no penalty on withdrawal, then policyholders may lapse their policies when they require the funds for an alternative purpose — there is no disincentive for them to invest in the product for only a short period of time unless some kind of surrender penalty is applied.

Alternatively, on unitised business, rather than applying a surrender penalty on early withdrawal, the company may incentivise policyholders by awarding bonus units if their contract remains in force. However, the level of bonus units that this company awards may be too low and may not provide sufficient incentive for policyholders to keep their policies in-force.

The company may be experiencing high surrenders if the fund performance is poor when compared to the rest of the market/other investments.

The policyholder may have too many opportunities to lapse their policy.

For example, for regular premium business, if the company does not offer an electronic form of premium collection and the premium has to be paid by cheque or cash then the insurer is relying on the policyholder taking an action at each premium anniversary to keep the policy live.

If, on the other hand, all of the insurers competitors are offering electronic premium collection for regular premium business, their policies are much less likely to lapse since the policyholder has to take some positive action (such as cancelling an electronic payment order) to lapse the policy.

It may be that competitors have introduced new products that are more attractive resulting in policy lapses. Since the company is young, its policyholders are unlikely to have built up any strong loyalty to the company and hence policyholders may be more likely to lapse their policies than if they had been investing with the company for many years.

There may have been adverse press reports about the company resulting in policy lapses e.g. if there is uncertainty about the ownership of the company/it is the subject of merger/takeover rumours, policyholders may lapse their policies and invest in a company with a better reputation. In addition, policyholders will be more likely to lapse their policies if there are concerns regarding the solvency position/financial strength of the company especially if this has been reported on in the press.

The company is relatively new so it may have had teething problems with its administration systems and customer service especially as business volumes started to grow. Hence policyholders may be lapsing their policies due to the poor level of customer service they are receiving.

It is possible it is due to increases in the companies own reviewable premiums or charges

(ii) Losses on individual policies

Whether high lapse rates lead to losses for the company will depend on whether the initial losses have been recouped and the relationship between the surrender value paid and the value of the future profits lost.

If the initial loss has been recouped, then the company has not made a loss on that policy, but it will have lost out on any future profits. The financial impact of those lost future profits will depend on the level of any surrender penalty charged.

In some markets, the level of commission that can be paid to an agent may be controlled by regulations and may be relatively low and hence the risk of loss on early lapses may not be as great as in markets where commission levels are high (a multiple of the annual premium for example).

Clearly where the asset share is negative at the time of lapse, then the company is making a loss, with initial expenses and commissions paid being higher than the premium income received and the company will want to concentrate its efforts on ensuring that in such classes of business (e.g. term assurance where initial underwriting costs are likely to be relatively high compared to the premium) lapses are minimised.

For unit linked business it is likely that the company will have incurred high up front costs and these are unlikely to have been matched well by the up front charges on the contract. Hence if a unit linked contract is lapsed early in the policy term, the insurer is likely to make a loss and the insurer will no longer have a chance to recoup its expenses from the annual management charges it would have taken had the contract remained in force.

However even if the company is not financially worse off due to a policy surrendering, the fact that the company is experiencing high lapse rates will still be an area of concern:

Indicative of underlying problems

The life insurer is likely to be concerned about the high lapse rates it is experiencing because the high lapse rates are likely to be indicative of underlying problems/risks that the company is facing.

For example, the high lapses may be indicative of problems regarding the competitiveness of its premium rates or contract design, which will not only affect the company's lapse rates but also its ability to write new business as well.

The high lapse rates may be indicative of mis-selling practices, which may lead to the company being forced to pay compensation at a later date. If the distribution channels are owned/controlled by the company, for example, a tied agency force, then the company will want to ensure that business is not mis-sold by them, since not only will this affect the reputation of the company in the market but it may also mean that the company is exposed to the risk of litigation in the future due to the mis-selling.

The high lapse rates may also be indicative of problems such as a lack of training/product knowledge.

It is possible that poor customer service is a cause. This could lead to the brand name suffering and volumes of new business falling.

For savings contracts, the fund performance may have been worse than that of competitors.

Lower level of in force business/expense overruns

One of the main causes for concern for a relatively new insurance company suffering from high lapse rates will be the impact that the high lapse rates have on the level of in-force premium.

The high lapse rates will erode the in-force premium, so that even if the company is writing relatively high levels of new business premium income, the in-force book will not be growing in the way that was anticipated in business plans.

In the early years of operation a new insurer will have expense overruns, meaning that the expenses it suffers are higher than the expense loadings incorporated into its products when pricing the business. This is because the company suffers from relatively high set-up costs (e.g. establishing a head office, building distribution channels such as branch networks and so on) in the initial years when business volumes are low. Only once the in-force volumes of business are sufficiently large will the expense loadings built into the premiums charged be sufficient to meet the actual expenses being incurred by the company.

If the in-force premium is eroded by high lapse rates then the company is likely to be in a position of having an expense overrun for more years than anticipated, resulting in the insurer requiring capital support for more years than expected from shareholders.

In addition, the higher expenses are likely to mean that higher reserves will be required.

Also, the high level of lapses will lead to higher than budgeted levels of administration costs due to the processing of the claims and handling any complaints.

The surrenders may also be selective and so may lead to worsening mortality experience for the company.

- (iii) The actions the company can take to improve its lapse experience include:

Carrying out a detailed study of the lapse experience to identify the contracts where the lapse rates are out of line with the market and the distribution channels where the lapse rates are out of line with the market.

For the policies that have lapsed, carry out a survey of customers to find out why the policy lapsed to identify the root causes of the lapses occurring.

Use the survey to assess whether poor customer service is contributing to the high lapse rates and take actions to improve service if this is the cause of the problem.

Ensure the sales process leads to best advice to reduce the risk of mis-selling.

Establish a customer service unit/sales force unit to target policies that lapse and try to reinstate them.

Provide the sales team with information regarding policies coming up for renewal to ensure that the policies are actually renewed and that they don't lapse on the renewal date.

Identify if there are deficiencies in the sales remuneration structures offered by the insurer. If deficiencies are found (for example, there are no incentives to renew business only to write new business), make amendments to the schemes to achieve a better balance between incentivising the writing of new business and the rewarding of business that renews and remains in force.

Identify if there are technical deficiencies in the service offered to customers that is likely to increase lapse rates e.g. for regular premium paying policyholders, ensure that premiums are collected efficiently by introducing automated payment methods.

Compare the company's products to those available in the market and assess their competitiveness, in terms of premium rates and the attractiveness of the features offered.

If the company's products are not as attractive as others available, consider repricing some or redesigning them to make them more attractive.

Equally ensure that policyholders have a disincentive to lapse their policies by applying adequate surrender penalties when a policy lapses.

Alternatively, introduce loyalty bonuses to encourage them to keep the policy.

If the company has a poor solvency position then the shareholders could inject more capital to increase confidence in the company.

If one of the reasons for policyholders lapsing their policies appears to be concerns regarding the company's brand image/reputation, then the company will need to invest by spending on advertising and promotion to improve its brand image in the market place.

If the company has poor investment performance, it could change its investment management team to improve performance.

The company could also look to change its target market or distribution channels

Comments on question 7:

Question 7 required significant application of understanding and most candidates made a good attempt at it.

In part (i) most candidates identified the potential for mis-selling, poor service or poor investment performance to be driving the problem. Stronger candidates also considered softer factors including the brand loyalty and media image of the company.

In part (ii) most candidates were able to identify the basic financial issues including the potential loss on early surrenders and impact on covering fixed expenses. However few enriched their answer by describing how the charging structure of products may impact on these issues.

Part (iii) gave candidates the opportunity to think widely about how the situation could be managed. A number of good examples were given. Weaker candidates lost marks by not following through ideas from earlier parts of the question, failing to suggest changes for particular problems they had previously identified. Candidates who were more systematic in this regard tended to score more highly.

END OF EXAMINERS REPORT