



Institute
and Faculty
of Actuaries

EXAMINERS' REPORT

SP1 - Health and Care
Specialist Principles

April 2023

Introduction

The Examiners' Report is written by the Chief Examiner with the aim of helping candidates, both those who are sitting the examination for the first time and using past papers as a revision aid and also those who have previously failed the subject.

The Examiners are charged by Council with examining the published syllabus. The Examiners have access to the Core Reading, which is designed to interpret the syllabus, and will generally base questions around it but are not required to examine the content of Core Reading specifically or exclusively.

For numerical questions the Examiners' preferred approach to the solution is reproduced in this report; other valid approaches are given appropriate credit. For essay-style questions, particularly the open-ended questions in the later subjects, the report may contain more points than the Examiners will expect from a solution that scores full marks.

For some candidates, this may be their first attempt at answering an examination using open books and online. The Examiners expect all candidates to have a good level of knowledge and understanding of the topics and therefore candidates should not be overly dependent on open book materials. In our experience, candidates that spend too long researching answers in their materials will not be successful either because of time management issues or because they do not properly answer the questions.

Many candidates rely on past exam papers and examiner reports. Great caution must be exercised in doing so because each exam question is unique. As with all professional examinations, it is insufficient to repeat points of principle, formula or other text book works. The examinations are designed to test "higher order" thinking including candidates' ability to apply their knowledge to the facts presented in detail, synthesise and analyse their findings, and present conclusions or advice. Successful candidates concentrate on answering the questions asked rather than repeating their knowledge without application.

The report is written based on the legislative and regulatory context pertaining to the date that the examination was set. Candidates should take into account the possibility that circumstances may have changed if using these reports for revision.

Sarah Hutchinson
Chair of the Board of Examiners
July 2023

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

The aim of the Health and Care Specialist Principles subject is to instil in successful candidates the ability to apply, in simple situations, the principles of actuarial planning and control needed in health and care matters on sound financial lines.

Candidates who approach the questions, especially the more substantial elements of each question, in a methodical and detailed manner are far more likely to satisfy the examiners and receive a pass in the subject. Candidates will gain few marks if they do not address the question asked but merely write around the topic of the question.

The mark allocation for each question part gives an indication of the relative length of answer or number of points to be made to gain full marks. The Examiners' Report covers more points than would be expected to get full marks. This is so that alternative approaches to questions by different candidates can be accommodated.

It is often helpful to structure and use subheadings when answering long part questions.

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

The paper was a relatively straightforward one and well-prepared candidates scored well across most of the questions.

Questions that focussed on knowledge of the Core Reading were well answered by those who had prepared thoroughly. However, the paper included several part questions requiring wider thinking or application of core reading to specific circumstances, such as Questions 2(iv), 3(iii), 3(iv), 4(i), 4(ii) and 5(ii). Candidates should recognise that these are generally the questions which differentiate those Candidates with a good grasp and understanding of the subject.

It is pleasing to see many candidates providing their answers under subheadings, making them easier to follow and mark. This also helps show that they have applied their knowledge to the specific scenarios described.

C. Pass Mark

The Pass Mark for this exam was 60.
240 presented themselves and 109 passed.

Solutions for Subject SP1 - April 2023

Q1

(i)

Reasons applicable to both (a) reduction in new business & (b) increase on lapses

Product design:

Product design may no longer meet customer needs [1/2]

The list of diseases covered may no longer be suitable, or the definitions of the diseases may no longer be suitable (Company A might be using outdated and market-inconsistent definitions) [1/2]

If the product only offers guaranteed premiums, policyholders who prefer reviewable premiums will go elsewhere, and vice versa [1/2]

The product may not offer specific features which policyholders may prefer, e.g.: [1/2]
(1/2 mark for any two examples below) [1/2]

Tiered benefits

Continuation / guaranteed insurability options

Children's benefit

Total permanent disability (TPD) benefit

Terminal illness benefit

Company A may offer Standalone CI but policyholders may want (and need) Accelerated CI (or vice versa) [1/2]

Product pricing:

Premium rates may have become uncompetitive in comparison with the market [1/2]

This could be specific to certain age / gender / smoker status / sum assured size / occupational class groups (1/2 mark for any two examples) [1/2]

Competition:

Losing business to competitors due to the increased level of competition, either due to: [1/2]

(1/2 mark for any two examples below) [1/2]

More insurers writing CI business

The products offered by competitors are more attractive / suitable

Lower premium rates

Better reputation / brand image

Better customer services

Free gifts / financial incentives offered by its competitors

The increased levels of competition could be due to the position in the underwriting cycle [1/2]

If the individual CI market had become saturated, then even if there were no new competitors, competition could still have increased [1/2]

There could have been reduced marketing for the product [1/2]

Customer services:

There could have been a deterioration in the insurer's general customer services standard, such as: [1/2]

(1/2 mark for any two examples below) [1/2]

Unprofessional / incompetent / rude customer services staff
 Inefficient / slow customer services
 Difficult and unsympathetic claims management process
 Errors / inefficiencies / delays in claims handling / management

Reputation / Brand image:

Damage to reputation / brand image, which could be a result of:
(½ mark for any two examples below) [½]

High claims declinature rates
 Customer complaints
 Bad press coverage
 Unethical practices conducted by management. e.g. investment in unethical industries
 Fines by the regulator
 Inappropriate advice given by sales team / mis-selling

Socio / economic trends:

The market may have lost favour in CI products, and damage to the reputation of CI insurers as a whole [½]

Some of the diseases may no longer be considered as critical due to medical advances. [½]

There could have been a downturn in the economy which affected demand / ongoing needs for CI products [½]

There could be a loss of faith in the insurance industry as a whole [½]

Regulations / Other:

Changes in regulation may have taken the financial incentives away from policyholders, e.g. tax relief on premiums [½]

Changes in state provisions may make the CI product less of a necessity to policyholders [½]

If group CI had been made compulsory for employers to provide for employees, this could have reduced the demand for individual CI [½]

Medical advances may mean that CI insurance is needed less altogether [½]

A significant regulatory breach, such as losing customer data, breaching data protection requirements etc. [½]

(a)

A reduction in new business volumes - specific reasons

Product pricing:

Increase in new premium rates caused by adverse experience specific to this company, such as: [½]

(½ mark for any two examples below) [½]

Regulatory changes such as increase in reserve / capital requirements

Changes in tax position

Increases in operational expenses

Increase in costs of reinsurance / reinsurance premium rates

The premiums could be uncompetitive because of general margins in assumptions being higher [½]

Customer services:

- Losing business because of a badly designed application/sales process, such as inefficient / onerous underwriting process [1/2]
Underperformance by sales staff / intermediaries [1/2]

Socio / economic trends:

- A reduction in demand for CI products could be a result of the reduction in loan / mortgage lending if the CI products are generally used for providing protection for loans / mortgages [1/2]

Distribution channels:

- There may be a shift in the distribution method for CI sales (towards a distribution channel that Company A does not use, e.g. the internet) [1/2]
Distributors may not be adequately remunerated for selling Company A's CI product (so opt to sell other products instead) [1/2]
Distributors may be put off by the product design / price (rather than the potential policyholders themselves) [1/2]

Regulations / Other:

- If Company A has tightened up its underwriting process, this might have led to more applications being declined [1/2]

(b)

An increase level of lapses on in-force business - specific reasons

Product pricing:

- Significant reduction in Company A's own premium rates on new contracts may cause lapse and re-entry. [1/2]
Significant reduction in competitors' premium rates may cause lapse and purchase business elsewhere [1/2]

Product reviews:

- For product with reviewable premiums, the increase in premiums may be too high following a review [1/2]
The insurer may have had to increase prices due to adverse experience or increased expenses [1/2]

Socio / economic trends:

- Financial hardship encountered by existing policyholders could give rise to higher lapses, and paying premiums on their CI policies may no longer be affordable [1/2]
The default in loans / mortgages by existing policyholders removes the need for a loan / mortgage protection policy [1/2]

Distribution channels:

- Increased lapses may be a result of inappropriate commission arrangements that were in place, e.g. if there is no clawback arrangements in place (so distributors might actually benefit from encouraging lapses and new sales) [1/2]
Poor past sales practices might mean product sales were inappropriate for policyholders [1/2]

Financial advisers could have churned their existing business (i.e. encourage their existing customer to lapse existing policies and take out new policies) to get more commission [1/2]
 [Marks available 22 , maximum 12]

(ii)

Actions applicable to both (a) increase new business & (b) reduce lapses

Customer services:

Improve customer services standard, which could include: [1/2]

(1/2 mark for any two examples below) [1/2]

Enhanced end to end customer journey

Staff / intermediaries training

Responding to questions / requests from policyholders

Efficient and fair claims management process

Reputation / Brand image:

Improve the company's image through: [1/2]

(1/2 mark for any two examples below) [1/2]

Improved customer services standard

Treating customers fairly

Dealing with customer complaints effectively

Stop conducting practices that may be considered to be unethical. e.g. investment in unethical industries

Improve financial strength / solvency position

Increase awareness of the company / needs for CI cover through social media / advertising [1/2]

(a)

Increase new business sales

Product design

Improve product design to make the product more attractive to potential policyholders, and meet customer needs, which could include: [1/2]

(1/2 mark for any two examples, 1 mark for any four examples below) [1]

Adding new diseases to cover

Updating the definitions of diseases (if they are outdated or inconsistent with the market)

Offers an option of guaranteed or reviewable premium rates

Offer tiered benefits structure

Offers rider benefits

Continuation / guaranteed insurability options

Children's benefit

Permanent total disability (PTD) benefit

Terminal illness benefit

Start selling group CI as well as individual CI [1/2]

Product pricing:

Reduce premium rates, which could be achieved through: [1/2]

(1/2 mark for any two examples, 1 mark for any four examples below) [1]

Removing costly diseases
 Removing costly guarantees (e.g. introducing reviewable premiums)
 Obtaining assistance from reinsurers,
 Differential pricing for large and small sum assured policies
 Reduction in expense loading through improved operational efficiency
 Reduction in reserve and capital requirement through de-risking exercises
 Reduction in the Risk Discount Rate / Required Rate of Return / Profit Margin.
 More stringent underwriting (so better risk classification and lower margins being required in premiums)
 Including lower pricing / profit margins in assumptions

Customer services:

Improve customer services standard, which could include efficient application / sales / underwriting process [1/2]

Competition:

Conduct market exercises to win business from its competitors, such as: [1/2]
 Free gifts / financial incentives to new customers [1/2]
 Conduct market research on customer preferences [1/2]
 Making use of more distribution channels / sell through new or different distribution channels [1/2]

Distribution:

Improve remuneration / commission level to distributors to encourage sales [1/2]
 Expand the distribution channels, either through the existing channels (i.e. engaging with more brokers, employing more sales staff etc) [1/2]
 or new distribution channels such as online / internet sales etc [1/2]

Socio / economic trends:

Offer budget product or products with a lower level of premiums in the initial period to deal with the reduced demand during an economic downturn [1/2]

Regulations / Other:

Change the benefit design so that it fits with any changes in state provisions [1/2]

(b)

Reduce the future level of lapses on in-force business

Product reviews:

For CI product with reviewable premiums, consider limiting any significant increase in premiums [1/2]

or if experience has been favourable, consider offering a reasonable level of reduction in premiums [1/2]

Customer services:

Maintain regular contact with existing customers [1/2]

Offer ongoing rewards to existing policyholders to encourage better persistency [1/2]

Conduct ongoing satisfaction survey to identify existing and potential issues [1/2]

Contact customers who have requested a surrender to outline their options and encourage them not to lapse [1/2]

Distribution:

Stop selling through distributors that have particularly high / poor lapse experience	[½]
Only sell through reputable financial advisers	[½]
Ensuring appropriate commission and clawback arrangements are in place with distributors	[½]
Set up a retention team whose job involves improving retention / persistency	[½]
Spot check new business to assess whether it has been sold appropriately	[½]

Socio / economic trends:

Offer financial support such as premium holiday to those existing policyholders who are suffering financial hardship during an economic downturn	[½]
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Regulations / Other:

Introduce automated premium collection / direct debit facility if it is not already in place	[½]
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[Marks available 17½ , Maximum 8]

[Total 20]

Part (i) - This was generally well answered by most candidates. In general, candidates were able to structure well and generate enough marks, particularly in part (a). It is worth noting that the question was split into two parts, (a) and (b) to enable specific idea generation. Candidates who simply repeated the same points for a reduction in business volumes and lapses did not score well.

Part (ii) - This question was mainly well answered, with many candidates scoring highly. The stronger candidates were able to structure their answers with clear headings and covered a wide range of topics. Similar to part (i), candidates who provided conflicting answers on why new business volumes might increase and not giving enough depth and considerations to lapses did not score well.

Q2

(i)

Because the product covers “Accident Only” claims, the premium rates are likely to be lower than a product that covers sickness claims as well, which makes the “Accident Only” product more and affordable [½]

In particular that the neighbouring country’s population may generally be on lower incomes, so need a cheaper product [½]

It may meet the need more closely for some customers, if a significant proportion of the neighbouring country’s population are in very good health, and/or: exposed to higher risk physical exercises / sporting activities / occupation [½]

Accident rates are generally high in the neighbouring country and hence customers really see the value for money [½]

There may have been successful marketing and advertisement campaign conducted by the insurers in the neighbouring country [½]

The neighbouring country’s government may have provided support for the product which has increased awareness by citizens about the benefits of the product as a

means to reduce burden on the state	[1/2]
There could be regulatory requirements on employers to provide the group accident cover to their employees	[1/2]
There could be requirements on individuals to take out individual accident cover on their loans / mortgages	[1/2]
The product may be simple and clear to understand for customers	[1/2]
There could be less underwriting involved and hence simpler sales process	[1/2]
There may be state-provided IP benefits for illnesses but not accidents	[1/2]
There may have been some high-profile accidents in the press that highlight the benefits of such a product	[1/2]
This may be the only IP-type product available in the neighbouring country	[1/2]
	[Marks available 6½, maximum 3]

(ii)

Advantages:

It may meet the exact need of the customers	[1/2]
In particular those who are more exposed to the risk accident than sickness	[1/2]
This will help keep the premium rates affordable for these customers, and provide a cheaper alternative for customers who could not afford a more comprehensive IP Product	[1/2]
Sickness provisions may have already been covered by the state / employer, so this product will help bridge the customers' benefit gap	[1/2]
The product could be easier to understand as it does not involve the definition of Sickness	[1/2]
It may provide the customers with peace of mind to pursuit their sporting activities and/or higher-risk occupation	[1/2]

Disadvantages:

Customer is still exposed to incapacitation from other non-accidental illnesses, which could lead to financial hardship if they fall ill	[1/2]
while still need to continue paying the premiums for the "Accident Only" policy	[1/2]
They may regret not taking out the sickness cover when they fall ill, which could lead to further psychological stress	[1/2]
The saving in premiums for not having the sickness cover may not be justifiable by the increased level of risk	[1/2]
The claimants may still not be paid a claim after the accident if the incapacitation definition is not met	[1/2]
It might also be difficult to prove that incapacitation was caused by an accident, e.g. someone with long-term back problems might claim that a car accident caused a current bout of incapacitation, although the car accident may not have been the main underlying cause	[1/2]
The customer may not fully understand the cover and be disappointed at the point of claim if their claim is declined by not meeting the incapacitation criteria	[1/2]
There could be exclusions in the policy terms relating to certain types of high-risk activities	[1/2]
Policies could be mis-sold to customers due to unclear exclusions	[1/2]
	[Marks available 7½, maximum 3]

(iii)

Neighbouring country's "Accident Only" product features:

Company A should consider its neighbouring country's "Accident Only" product features	[½]
Consider what factors contributed to the neighbouring country's product's success	[½]
Company A should consider the similarities and differences between Country X and its neighbouring country, in terms of:	[½]
<i>(½ mark for any two examples, 1 mark for any four examples below)</i>	[1]
Size of population	
Demographics	
Maturity of economy	
Main industries	
Size of work force	
Social and cultural factors	
Wealth distribution	
Customer Needs in Country X:	
The product design should meet customer needs in Country X	[½]
The premium frequency should be designed to fit the income pattern of customers	[½]
For example, consider weekly premiums if a significant proportion of customers are receiving their wages on a weekly basis	[½]
Consider conducting market research or customer survey so as to gain a firm understanding of the needs / reasonable expectations of customers in the country	[½]
Consider conducting research including discussion with employers in the country on whether accident only product would reasonably meet their employee benefit needs	[½]
This may be dependent on the proportion of manual / office staff employed by the employers	[½]
Employers would want to cover their employees by providing replacement income when the employee is incapacitated to do work in general, not necessarily for accidental causes only	[½]
Consider whether most of the demand for "Accident Only" IP cover will come from individual or group arrangements, so as to decide whether it is worth launching both individual and group "Accident Only" products	[½]
Consider the design that would be most suitable and how the following features might need to be amended / incorporated':	[½]
<i>(½ mark for any two examples, 1 mark for any four examples below)</i>	[1]
Waiting period	
Deferred period	
Replacement ratio	
Benefit payment term	
Indexation / benefit escalation	
Consider whether the insurer can get sufficient demand for the product in order to realise relevant economies of scale	[½]
Consider conducting market research to determine the target market, such as its potential size	[½]
and the premium size that potential customers would reasonably expect	[½]
Company A should also take into consideration the level of financial sophistication of customers in Country X	[½]
Consider whether to add onerous benefit features such as guarantees	[½]
Consider whether to offer both guaranteed and reviewable premium features to cater	

for different policyholder needs	[1/2]
Consider whether to offer to cover all accidents, or a limited list of work-related or sport-related accidents	[1/2]
The product should tie in with state benefits provided in Country X	[1/2]
Consider the design of the rehabilitation benefits, in particular the differences between those required under sicknesses as opposed to injuries sustained from an accident	[1/2]
Product-Fit:	
Company A may want to consider how the product features of the “Accident Only” product may fit in with its existing products	[1/2]
company culture and risk policy / appetite	[1/2]
Distribution / Intermediaries:	
Consider whether distributors would be willing to sell the product, or see any potential problems / barriers in selling it	[1/2]
Consider whether distributors will understand the product or whether additional training would be needed	[1/2]
Consider whether distributors are likely to require a certain level of remuneration to sell the product and whether this would be acceptable	[1/2]
Consider which distribution channels are likely to be appropriate, e.g. as a simpler product, this might open up options such as the internet	[1/2]
Operational / Practical Issues:	
The IT and administration system are also key considerations	[1/2]
Consider whether the system used for the comprehensive IP products would still be compatible with the “Accident Only” product	[1/2]
Underwriting and claims management procedures would need to be modified to reflect the accidental nature of the product, e.g. people who have had major injuries in the past may be more susceptible to incapacitation in the case of an accident (this would need to be identified from underwriting)	[1/2]
Claims assessment protocol for accidental causes may also need to be reviewed and tightened compared to the one on the comprehensive product	[1/2]
Consider what evidence of the accident may be needed, e.g. proof that the policyholder was not acting unlawfully (e.g. speeding)	[1/2]
The product should be designed to be tax efficient for the company and the policyholders	[1/2]
Reinsurance:	
Consider whether reinsurance would be available for the new product features, such as level of cover, premium reviewability etc	[1/2]
Consider the potential costs of reinsurance cover	[1/2]
Consider whether any reinsurers may be able to provide expertise on the product especially if they also have exposure in the neighbouring country	[1/2]
Regulations and Other Considerations:	
Consider whether there are any regulatory restrictions	[1/2]
e.g. product design / pricing, underwriting / claims management (1/2 mark for any two examples)	[1/2]

Consider if there is any product approval process	[1/2]
Implications of the product features on reserving and capital requirements would need to be considered	[1/2]
Professional / Industry guidelines applicable to product design / benefit features should also be considered	[1/2]
Product design should aim to minimise financing requirements	[1/2]
so there may be caps on benefit levels, and guarantees offered may be kept to a minimum	[1/2]
Consider moral hazard as the risk characteristics of this product might include moral hazard risk.	[1/2]
Product design should be considered in conjunction with pricing / profitability criteria, for example:	[1/2]
premiums should be sufficient to cover expected claims, plus expenses, with a margin for contingencies and a margin for profit	[1/2]
Consider environmental, social and governance (ESG) sustainability relating to the design of the product, including:	[1/2]
<i>(1/2 mark for any two examples below)</i>	[1/2]
Being green / low carbon emission (e.g. a paperless product / admin and claims process etc)	
Having a socially responsible investment strategy	
Not covering accidents caused by unethical / un environmental actions	
[Marks available 26, maximum 10]	
(iv)	
Data Availability / Morbidity Assumptions	
The insurer has to consider the availability of data to use in pricing the product	[1/2]
Sources of data could include:	[1/2]
<i>(1/2 mark for any two examples below)</i>	
Own data	
Population data	
Reinsurers' data	
Industry data	
Actuarial consultancies	
The above data sources from the neighbouring country may also be considered	
The various external data sources would need to be adjusted to reflect the new product including adjustments for the following:	[1/2]
<i>(1/2 mark for any two examples below)</i>	[1/2]
Demographics of the target market	
Differences in underwriting and claims management	
Differences in product features between Company A's product and the other country's product	
The product is new hence the company is unlikely to have data specific to "Accident Only" claims data	[1/2]
However, the insurer is likely to have data from the comprehensive IP product.	
Company A could consider using the comprehensive product data and split it into accidental causes claims data and non-accidental claims data	[1/2]

The accidental causes claims data could then be used for conducting an experience investigation for the derivation of claim inception, recover and mortality rates	[½]
One key advantage of this approach is that the data would be relevant to the target market	[½]
In particular that Company A specialises in IP business in Country X, which means It is likely to have sufficient and credible past data	[½]
Although credibility of the data would depend on the proportion of all claims which are due to accidental causes only	[½]
If the proportion of claims due to accidental claims is small, there are chances that data in some of the homogeneous risk groups would not be credible	[½]
The lack of credible data in any of the homogeneous groups could be supplemented by any of the external data sources	[½]
The insurer could consider consulting the reinsurers especially those that have exposure to the neighbouring country and get the experience from the neighbouring country	[½]
Population statistics in the Country X on injuries and disabilities may be available from government departments	[½]
 Other Assumptions	
Expenses:	
Consider using Company A's own expense experience	[½]
Consider the appropriate allowance for (one-off) development / project costs	[½]
Need to consider expected volume of new business to derive a suitable per policy expense	[½]
Consider how to make suitable allowance for expenses (e.g. initial expenses, claims management expenses and expense inflation)	[½]
 Commission:	
Consider appropriate allowance for commission level based on types of Intermediaries and suitable commission structure. e.g. indemnity or regular commission payment	[½]
 Reserving and Capital Requirements:	
Consider appropriate allowance for reserving and capital requirements	[½]
These could be based on regulatory requirements	[½]
or internal economic capital / risk capital requirements if higher	[½]
 Lapse / Persistency	
Consider appropriate allowance for lapses	[½]
The starting point could be based on the lapse experience of its own comprehensive IP products, and adjust appropriately for any known / expected customer behaviour for the "Accident Only" product	[½]
any further considerations on future trends / changes in socio / economic conditions	[½]
 Tax:	
Consider appropriate allowance for company taxation on IP business	[½]
Consider whether Company A may be able to utilise any unused tax relief if applicable	[½]
 Investment returns on assets:	

Consider appropriate allowance for expected investment returns on assets backing liabilities	[1/2]
Take into consideration of the nature, term and currency of the assets	[1/2]
Risk Discount Rate / Required Rate of Return:	
The Risk Discount Rate / Required Rate of Return should be based on Company A's risk policy / appetite	[1/2]
and returns / profit margins expected by its key stakeholders. e.g. shareholders, parent company, members etc	[1/2]
Pricing Margins :	
All the assumptions should be best estimate	[1/2]
Consider whether additional margins may be added to reflect that the product is New and that Company A does not have experience in the "Accident Only" product	[1/2]
The margin could be allowed for within each assumption individually where appropriate	[1/2]
or within the Risk Discount Rate / Required Rate of Return	[1/2]
However, higher levels of margins may make the product not affordable	[1/2]
Consider the costs / benefits of reinsurance	[1/2]
Pricing approach:	
Consider what is the most suitable approach for pricing the product	[1/2]
Two approaches could be considered, namely the equation of value / formula approach or cash flow techniques	[1/2]
Equation of value approach would be simple to apply and save costs and time	[1/2]
However, it is likely to be too simplistic for the purpose of pricing IP products	[1/2]
The cashflow approach would be more suitable to deal with the complex product features of an IP product,	[1/2]
and the functionality to perform sensitivity analysis of premium rates to varying assumptions	[1/2]
Expected value of future premiums should equate to present value of claims, expenses and profit	[1/2]
Consider what level of profit would be required	[1/2]
Regulation should be considered in terms of its impact on pricing, for example:	
<i>(1/2 mark for any two examples below)</i>	[1/2]
Minimum / maximum prices that can be charged	
Reserving / capital requirements and how they affect premiums	
Rating factors that can be used for pricing	
Other information (e.g. the results of genetic tests) that may not be allowed to be used for pricing purposes	
Consider the extent of cross-subsidies that Company A is able to include and is likely to be acceptable by the market	[1/2]
Competition / Marketability / Customer Expectations / Other considerations:	
As Country X does not currently have any "Accident Only" IP product, there is no direct comparison locally	[1/2]
Consider comparison against the "Accident Only" IP products in its neighbouring country, noting any economic and demographic differences between the two	

Countries	[1/2]
Consider comparison of the “Accident Only” IP premiums with the premiums of its comprehensive IP products	[1/2]
which could help assessing whether the differences in premium rates are sufficient to make the “Accident Only” product financially more attractive to potential policyholders	[1/2]
The insurer should also consider the amount of premiums that customers may reasonably be willing to pay	[1/2]
Consider comparison against the premium rate derived from the pricing exercise / projections	[1/2]
Consider commercial adjustments that may need to be made to make the standard premium rates (i.e. the rates directly produced by the pricing model based on the chosen pricing methodology and assumptions) of the “Accident Only” product to cater for different types of policyholder. For example:	[1/2]
For group IP, the potential to provide large volume discount to large corporations	[1/2]
For individual IP, the potential to offer lower premium rates to policies with higher benefit amounts	[1/2]
Consider whether other insurers are likely to follow suit, in which case there will be a number of competitors	[1/2]
Consider the general level of the IP market (in terms of the underwriting cycle) to determine what the scope is for including margins in premium rates	[1/2]
	[Marks available 30, maximum 12]
	[Total 28]

Part (i) - This is a knowledge based question and was well answered by most candidates. However, some candidates failed to understand the concept of an "Accident only Income Protection" product which is still a Health & Care product rather than a General Insurance product.

Part (ii) - This question was generally well answered by most candidates. The stronger candidates managed to articulate their answers clearly between advantages and disadvantages and provide specific considerations relating to the “Accident only Income Protection” product. The less prepared candidates tended to provide generic answers which did not hit the marking schedule.

Part (iii) - This question was reasonably well answered by most candidates. Well prepared candidates had clearly understood the requirements under similar style questions and were therefore able to provide the level of breadth required to score highly. Candidates who did not score well tended to focus and go into detail mainly on product features but forgot to cover wider considerations such as IT, reinsurance and regulations etc.

Part (iv) - This question was not very well answered by most candidates. Many candidates failed to read the question properly, and instead answered a more familiar question focussing on a small number of factors such as data. Although some marks could be achieved from these factors, a broader answer was required to score highly. For those who managed to cover a broader range of factors, many simply listing items without providing further detail and missed the opportunity to gain further marks. Only

the strongest candidates were able to provide a well-structured answer, covering a broad range of relevant factors and went into detail on each of these factors.

Part (iv) of this question differentiated the stronger candidates from the less prepared candidates.

Q3

(i)

Differences between CI and PMI

Policy / Premium term:

PMI is generally a short-term product, the premiums on PMI are generally renewable annually [1/2]

CI is generally a long-term product, the premiums on CI can be guaranteed or reviewable periodically throughout the policy term. e.g. after every 5 years [1/2]

Benefit cover:

PMI normally pays out to cover the expenses incurred during medical treatments typically for acute illnesses (and may generally exclude chronic and terminal illnesses) [1/2]

CI is normally paid upon the diagnosis of a critical illness as set out in the policy terms [1/2]

and the conditions are generally lifestyle threatening [1/2]

PMI may cover an individual risk (policyholder) or a family [1/2]

CI usually covers individual risks (policyholders) [1/2]

although children's benefits might also be provided [1/2]

Claims:

PMI indemnifies the policyholder [1/2]

and payments are normally paid directly to the healthcare providers [1/2]

CI normally pays a lump sum which is determined by the policyholders at outset [1/2]

and is payable directly to the policyholders [1/2]

PMI allows for multiple claims during the policy term (usually a year) [1/2]

Under CI, usually only a single claim is possible [1/2]

unless the CI lump sum is in the form of tiered benefits, i.e. a set proportion of the total sum assured will be payable based on the severity of the critical illness [1/2]

PMI cover may be subject to limits [1/2]

For CI, claims terminate the policy (unless it is tiered) [1/2]

[Marks available 9, maximum 4]

(ii)

The main reason is to increase new business volumes [1/2]

and to increase profits [1/2]

which could increase shareholder dividends and improve company share price [1/2]

The CI product sales may have been lower than expected in recent times [1/2]

The market may be saturated due to a lot of insurers competing in the CI product

line	[1/2]
The CI products may not have been performing well, due to adverse experience in:	[1/2]
<i>(1/2 mark for any two examples below)</i>	[1/2]
Claims	
Lapses	
Expenses	
Investment return	
Reserving and capital requirements may be also more onerous for the CI products	[1/2]
The insurer may generally be looking for growth opportunity	[1/2]
and the PMI market could be underserved	[1/2]
and there may be high competition in the other product types. e.g. Income Protection,	
Long Term Care	[1/2]
The PMI market seems like a profitable opportunity, as PMI products are	
demonstrably profitable based on the financial performance of existing PMI insurers	[1/2]
A wider product range could enhance the company's reputation / brand image	[1/2]
The company may have spare capital that it wants to use profitably	[1/2]
The distribution channels including financial intermediaries have expressed a	
preference to include PMI products in Company A's product range	[1/2]
This may be because higher commissions are generally paid on PMI product line	[1/2]
On the other hand, it is also possible that PMI commission is typically lower,	
making it easier to keep the product affordable (and so more popular)	[1/2]
The capital required to write PMI could be much lower than that for CI	[1/2]
It may offer Company A diversification benefits, in terms of risk exposure / capital	
requirement	[1/2]
Market research / Customer survey may have indicated strong demand for PMI	
products, this could be the result of:	[1/2]
PMI has recently been made compulsory (for employers to provide)	[1/2]
PMI becomes more attractive (for individuals / employers), e.g. through tax	
Incentives	[1/2]
Adding a new product may also help Company A to cross-sell or bundling its	
products to customers	[1/2]
The expense base to administer PMI products could be much lower than that for CI	
products	[1/2]
Company A may have the opportunity to negotiate a favourable arrangement with a	
large hospital network, enabling it to offer competitive premium rates to potential	
policyholders	[1/2]
There could have been changes in state provisions, leads to new business	
opportunities in the PMI market	[1/2]
Regulations may have changed that provide incentives for insurers to provide PMI	
cover so as to reduce burden on state health services	[1/2]
Company A's competitors may have started to provide PMI, and the Director does	
not want Company A to fall behind competitions	[1/2]
The Director could have joined Company A from another PMI provider, with	
significant experience / knowledge in the PMI business	[1/2]
This could be the strategic direction from Company A's parent company	[1/2]
There may be synergies in selling the two products, including:	[1/2]
<i>(1/2 mark for any two examples below)</i>	[1/2]
Economies of scale that might be achieved by selling more business	

The spreading of (fixed) overhead costs over a larger number of policies
 The potential to use the same admin system for the two different products
 The potential to more fully utilise sales / underwriting / claims teams (for example, if
 There is spare capacity and/or expertise within them)

It might be a good time in the underwriting cycle to start selling PMI [½]

It could be that the Director has specific objectives, e.g. corporate objective to
 increase the share price, or personal objective to meet remuneration target [½]

[Marks available 17, maximum 6]

(iii)

Advantages:

This could accelerate Company A's penetration of the PMI market [½]

as building a customer base from scratch could take considerably longer time,
 substantial resources and high costs [½]

There could be some good deals of in-force PMI business in the market [½]

Cross-selling opportunity as the new clients coming from the block of PMI business
 may immediately be offered other CI products [½]

Company A may be able to take over the systems and staff that were managing the
 block, which would enable an efficient business integration [½]

There will be savings on development / project costs, such as: [½]

(½ mark for any two examples below) [½]

Product design

Pricing

Marketing

Establishing distribution network

It could have come with existing arrangements with hospital network [½]

There will be immediate access to relevant PMI data / experience [½]

Company A will immediately benefit from a level of diversification (which would take
 time to build up if it started from scratch). [½]

Disadvantages

Company A may not have adequate expertise to assess and value the block of in-force
 PMI being purchased accurately, or identify legacy issues with the block [½]

with the risk that the purchased book may not be as profitable as initially expected [½]

It may be difficult to find a suitable block of PMI business, due to existing PMI
 providers are not selling their business, or those that have been put up for sale are too
 expensive [½]

The takeover process could be very onerous [½]

which typically involves multiple stakeholders including actuaries, accountants,
 lawyers and regulators [½]

The transaction costs involved could therefore be substantial [½]

There is always the risk that the takeover may not be approved by the regulator [½]

As PMI are generally annual renewable policies, the risk of non-renewal could be
 High [½]

Some of the existing customers under the PMI block business may not like

Company A's brand name and will not renew their policies [½]

This will reduce the number of policies to distribute fixed expenses hence the expense

per policy will increase more than expected	[1/2]
The premium rates set by the vendor / seller of the PMI block may not be appropriate for Company A	[1/2]
if Company A does not change the premium rates, it could end up making a loss	[1/2]
if Company A changes the premium rates, it could lead to high non-renewal if the revised premium rate ended up being much higher the previous premium rates	[1/2]
The same risks apply to any potential changes to the terms and conditions of the PMI business, more specifically:	[1/2]
if Company A does not change the terms and conditions, it might end up with inconsistencies between the business it is selling going forwards and the portfolio it has purchased	[1/2]
on the other hand, if Company A does change the terms and conditions, it could lead to high non-renewal rates	[1/2]
High non-renewal rates immediately after a takeover could damage Company A's reputation / brand image, which could have further adverse effects on attracting new PMI customers	[1/2]
Reputational damage could also affect the persistency of Company A's CI business adversely, as well as adverse effect on new CI business sales	[1/2]
There could be legacy issues on the block of PMI business. e.g. mis-selling, claims disputes, and there is therefore a risk that Company A is potentially inheriting reputational issues from the existing insurer	[1/2]
Systems and processes will need to be able to support PMI business and may turn out to be more expensive than initially planned	[1/2]
Company A may not have adequate experience in managing the PMI business, which could lead to customer complaints and reputational risk	[1/2]
Staff of the target company may be given the option to transfer across to Company A but these staff may not want to	[1/2]
Company A may have difficulties in recruiting staff who have experience in PMI	[1/2]
There is the risk of diverting excessive resources on integrating the new PMI business, at the expense of managing the CI business	[1/2]
There may be regulatory constraints and restrictions with regards to purchasing in-force insurance business in the country	[1/2]
Although there are cost savings on pricing the PMI product initially, as it is an annually renewable product, Company A will still need models for pricing and reserving / capital purposes	[1/2]
Any assets transferred from the selling company to company A in lieu of the liabilities being taken on by company A may be of poor quality	[1/2]
	[Marks available 18½, maximum 7]

(iv)

Pricing Considerations - methodology / approach

PMI products are generally annually renewable, the main value of purchasing an in-force block of PMI therefore relies on existing policyholders continue to renew their policies	[1/2]
A projected cashflow approach should therefore be adopted	[1/2]
Projected cashflows would be discounted back by the Risk Discount Rate to arrive at an initial value	[1/2]
which would then be adjusted to allow for commercial and strategic considerations	[1/2]

Pricing Considerations - risk / rating factors

Projection time horizon:

- Consider a suitable time horizon for projections [½]
- As PMI products are annually renewable, the time horizon for projections will determine how much profits that Company A is willing to pass over to Company B [½]
- To compensate Company B for introducing future renewals / new business [½]
- By passing over the existing customers base to Company A [½]
- As such, the time horizon should be long enough to make the offer price competitive, but not too long such that Company A is unable to recognise future profits on the PMI block within a reasonable timeframe [½]

Renewal rates:

- Allow appropriately for renewal rates [½]
- This should be based on Company B's experience [½]
- It should then be adjusted for expected impact of the change in ownership, taking into consideration the relative reputations and brand images between Company A and Company B [½]
- and the impact on renewal rates on similar market transactions in the past [½]
- Future renewal will also depend on the new business premium rates, and there should be interactions between the setting of these two assumptions [½]

New Business Premium Rates:

- New business premium rates is an important pricing assumption [½]
- It will have a direct impact over future renewal rates, as well as the profitability of future PMI business [½]
- The starting point is likely to be Company B's existing premium rates, to avoid any adverse impact on renewal rates in the initial years of business acquisition.
- These may then be revised to align with Company A's own pricing strategy after Company B's PMI customers have settled in with Company A [½]

Expenses:

- This should be based on Company A's own expense experience [½]
- Allow appropriately for transaction costs, and costs of integrating Company B's PMI business into Company A's systems [½]
- Need to consider expected volume of renewals / new business to derive a suitable per policy expense [½]
- Make suitable allowance for initial expenses and claims handling expenses [½]
- Allow appropriately for expense inflation [½]

Commission:

- As it is an existing block of business, the starting point is likely to be based on Company B's existing commission structure [½]
- These may then be revised to align with Company A's own preferred commission structure and distribution channels after Company B's PMI customers have settled in with Company A [½]

Reserving and Capital Requirements:

- Consider the existing outstanding claims and IBNR and IBNER allowances for the company [½]
- Reserving and capital requirement are unlikely to be significant assumptions due to the short-term nature of PMI products, in particular that claims are typically

short-tail, and premiums are payable in advance at renewal	[1/2]
Consider any potential diversification benefits between the CI and PMI business	[1/2]
Tax:	
Allow appropriately for Company A's own tax position on PMI business	[1/2]
Company A may be able to utilise any unused tax relief on its CI business to improve the competitiveness of its offer price	[1/2]
Interest returns on assets:	
Allow appropriately for expected investment returns on assets backing liabilities although it is unlikely to be a significant assumption due to the short-term nature of PMI products	[1/2]
Risk Discount Rate / Required Rate of Return:	
The Risk Discount Rate / Required Rate of Return should be based on Company A's expected return on taking on this business, taking into consideration its internal risk policy / appetite	[1/2]
and inherent risks associate with Company B's PMI business	[1/2]
Consider whether the company has a required hurdle rate that needs to be achieved for this type of transaction	[1/2]
Overall consideration:	
All the assumptions should be best estimate	[1/2]
Additional margins may be added to reflect any uncertainties in the pricing assumptions	[1/2]
This will depend on the level of information that Company B is willing to make available to the bidders	[1/2]
Commercial Considerations:	
Consider Company B's market share and ranking in the PMI business	[1/2]
Consider the actual size of Company B's PMI block, relative to Company A's overall business profile	[1/2]
Consider Company B's brand image / goodwill / reputation in the market, and the implications of the takeover on business renewals.	[1/2]
This will depend on the brand loyalty of Company B's PMI customers	[1/2]
Consider why company B is selling - e.g. Company B may be willing to accept a lower price if they are trying to exit the PMI market	[1/2]
Consider any potential advantages of this deal on attracting brand new PMI customers post takeover	[1/2]
as opposed to starting from scratch through expensive market campaign	[1/2]
and the expected business growth rates	[1/2]
Consider the likely level of competitions from the other bidders although any information relating to other bidders is necessarily limited, where the only information available is likely to be how many other bidders are participating in the bidding	[1/2]
Consider how keen Company A's management are in terms of acquiring Company B's business	[1/2]
Consider other opportunities in the market	[1/2]
and alternative use of capital instead of investing in PMI purchase	[1/2]
The Quality of Company B's workforce may not be relevant unless it is part of the deal to transfer existing PMI specialist staff from Company B	[1/2]

to the successful bidder	[½]
If the deal is such that Company A could keep all staff including some management / directors, this would lead to considerations of factors such as office location, likely motivation of the staff, quality of the systems used etc.	[½]
Consider any potential legacy issues including: (½ mark for any two examples below)	[½] [½]
Past customer complaints	
Mis-selling issues	
Adverse media coverage	
Regulatory intervention / penalties	
Data protection breaches / loss of customer data	
Consider the types and quality of distribution channels that are used by company B	[½]
Consider Company B's underwriting philosophy	[½]
Consider the demographics of Company B's PMI policyholders	[½]
Consider the potential cultural fit of Company B's PMI business with company A	[½]
Consider any lessons learned from previous business acquisitions	[½]
Consider the potential payment method, whether it will involve asset transfer or cash payment only	[½]
Consider the general economic outlook and its implications on PMI business	[½]
Any specific regulatory constraints relating to business transaction / acquisition	[½]
Consider any existing reinsurance arrangements currently in place on Company B's PMI business, including the costs of these reinsurance arrangements and the potential cost of terminating these arrangements	[½]
Consider cross selling opportunities	[½]
Consider any technical expertise that Company B can provide	[½]
Consider engaging external actuarial / professional consultants on the pricing and due diligence processes	[½]

[Marks available 33½, maximum 10]

[Total 27]

Part (i) - This is a very basic knowledge based question and was well answered by most candidates.

Part (ii) - This question was generally well answered by most candidates. Most candidates were able to come up with a wide range of points as well as good insight into what the director may want to achieve with this proposal. e.g., diversification etc.

Part (iii) - This question was generally not well answered by most candidates. Many candidates provided a repetition of points and some also appeared to mix up between advantages and disadvantages. In general, candidates tended to be able to generate more ideas on why this would be a bad idea and neglecting the marks available for advantages. The stronger candidates were able to address the specifics of PMI and thought widely about the practical implications of such a change.

Part (iv) - This question was not very well answered by most candidates. Many candidates failed to recognise that this is PMI. i.e. a short-term product rather than a long-term product, where the value of in-force component of the appraisal value is

relatively less significant than that for long-term products. In addition, many candidates also failed to address the question by considering how they would come up with a purchase price in addition to focus mainly on commercial considerations. Only the strongest candidates were able to cover both the technical and commercial aspects sufficiently and provide an answer that is also specific to a short-term health and care product such as PMI, where the core component of the appraisal value mainly relates to renewals of existing business and future new business potentials.

Parts (iii) and (iv) of this question differentiated the stronger candidates from less prepared candidates.

Q4

(i)

Insurance intermediaries

Suitable because:

Brokers aim to find the contract that best meets the specific needs of customers, and they are well placed to provide specific advice to individual customer in addition to just explaining the product features [1/2]

For example, advice on 'tiered benefits' regarding individual policyholder's needs and how these might be catered for under a tiered benefit product [1/2]

Such services are likely to be expected by the brokers' client base [1/2]

Brokers are likely to sell to financially sophisticated customers [1/2]

and so are able to sell complex products such as the tiered standalone CI product [1/2]

Brokers are also likely to sell to more affluent customers [1/2]

and who are likely to take out policies with reasonably high CI benefits [1/2]

who are less likely to be overly concerned about the level of commissions payable to the brokers as long as it is not excessive and in line with market practice [1/2]

Customers would want to be provided with options, and an independent broker would be able to provide options from various insurers [1/2]

For group products, the employer purchases group covers on behalf of the employees, so the direct customer is the employer [1/2]

and the employers, in particular the large corporations, are likely to appoint a broker to help purchase their insurance cover [1/2]

as the employers would prefer having insurance advisory from another established institution such as an insurance broker [1/2]

As GIP is a relatively complex product, the insurance brokers would be well placed:

To provide explanation to the employers [1/2]

which may help Company A to tailor its GIP product features to suit specific needs of each individual employer [1/2]

The broker is likely to have experience dealing with companies and selling these products [1/2]

and it might use this experience to provide a number of important services to the insurer, such as: [1/2]

(1/2 mark for any two examples below) [1/2]

Communication with the employers

Data gathering for pricing and underwriting

Premiums collection and claims payment

Any other services that may help reduce administrative work for the insurer

May not be suitable because:

There is a risk that the brokers may recommend the insurer who provides the highest commission, which may not be Company A's product [1/2]

The commission may be too high for the smaller companies (for group business) or individual policyholders (for individual business) seeking low benefit cover [1/2]

So the brokers are unlikely to have the smaller companies or individual policyholders seeking low benefit cover on their book [1/2]

Company A may therefore need to use other sales methods to target the smaller companies and individual policyholder seeking low benefit cover [1/2]

Tied agents

Suitable because:

Tied agents are likely to be financial professionals who should have good understanding of the product and be able to explain the complex product features to potential policyholders [1/2]

They may typically be the employees of a bank or other similar financial institution and CI products are suitable to provide protection to cover loans / mortgages [1/2]

so there is good opportunity to sell a CI policy at the same time when the tied agent's [1/2]

potential customers make of a loan / mortgage application [1/2]

For group business, tied agents may already have established relationships with certain employers [1/2]

where some employers may be existing customers of the financial institutions to which tied agents belong [1/2]

In particular if the employers concerned are the smaller companies or individual PMI customers who may find the cost of services provided by a specialist group insurance broker too expensive [1/2]

May not be suitable because:

The terms or commission required by tied agents could be relatively high as they are "tied" to one, or sometimes several insurance companies. i.e. exclusive [1/2]

agreement normally comes with a cost [1/2]

For group business, the larger employers would prefer the services and options of insurance quotes provided by the specialist group insurance brokers [1/2]

It is therefore unlikely to be suitable for targeting the large corporations [1/2]

Own salesforce

Suitable because:

Members of an own salesforce are usually employees of the insurance company, they should therefore have been trained to have detailed knowledge of the product [1/2]

They are therefore well placed to explain the complex CI product features to potential policyholders [1/2]

For group business, Company A's own salesforce agents may already have an established client base [1/2]

who are likely to be the smaller companies and individual customers [1/2]

who may find the cost of services provided by a specialist group insurance broker too expensive [1/2]

May not be suitable because:

The salesforce may be remunerated by commission or salary or a mixture of both [½]
 If the fixed salary component of the remuneration is high, there could be less
 incentive to try and sell a complex product [½]
 It is unlikely to be suitable for targeting the large corporations [½]

Direct marketing

Suitable because:

Mailshots, Telephone selling and Press / Internet advertising may be used to initiate
 the initial sale process [½]

For standalone CI, comparison website may be used if the CI product features are
 relatively standard in the market [½]

For budget Individual PMI, direct marketing will be cost efficient and [½]

Potential customers should be able to get all the product features for simple
 Individual PMI product [½]

It might be suitable for a fairly standard (i.e. consistent with other products available
 in the market) individual PMI [½]

May not be suitable because:

If product is complex, direct marketing may not provide all the salient details for the
 customer to fully understand [½]

The tiered standalone CI product could be too complex for direct marketing [½]

The underwriting process for CI product is likely to be too complex for the
 end-to-end sales process to be completed solely using direct marketing [½]

In particular for applicants with specific needs, such as health issues / high sum
 assured [½]

It is unlikely to be suitable for targeting employers who are the direct customers
 (so may not be suitable for group business) [½]

For comprehensive Individual PMI, the product is complex and direct marketing may
 not provide all the salient details for the customer to fully understand [½]

The detailed level of claims processing required by the product is difficult on direct
 marketing [½]

Worksite marketing

Suitable because:

This may be suitable if the workforce of the employers to which Company A is
 given the permission to target are sophisticated [½]

The working population might be an appropriate target market for individual
 products such as individual CI and individual PMI [½]

For budget Individual PMI, direct marketing will be cost efficient and,
 potential customers should be able to get all the product features for simple
 Individual PMI product [½]

May not be suitable because:

This method may only be suitable for certain employers with sophisticated
 workforce, or the sophisticated section of the workforce within the employers [½]

Some products would be too complex to explain to the entire workforce of an
 employer [½]

and it would be challenging to ensure that they all understand the product features
 adequately for them to fully understand and make the appropriate decision.

Such products may include tiered benefits standalone CI [½]
 and a comprehensive Individual PMI product [½]
 It will not be suitable to try to sell individual PMI products to a workforce that is
 already covered by a group PMI policy [½]
 It is unlikely to be suitable for targeting employers who are the direct customer
 (i.e. for group business) [½]

[Marks available 30½, maximum 11]

(ii)

Reasons for the deterioration in persistency experience [½]
 Company A should investigate the reasons for the deterioration in persistency
 Experience [½]
 The adverse persistence experience in the early durations may be more influenced
 by sales practices such as commission structure [½]
 Sales practices may not have such implications on persistency experience in later
 durations, which are more likely to be influenced by unsatisfactory service standards [½]
 or external factors such as economic downturn, regulatory changes etc [½]
 Reputation may have also been affected by deteriorating capital position or credit
 ratings [½]
 For CI with reviewable premiums, there could have been significant increase in
 premium rates following the recent premium reviews [½]
 The trend of poor persistency could also be a market-wide problem, where CI
 products may be perceived as no longer meeting the customer need as a result of
 mis-selling scandal / adverse press and media coverage [½]

Advantages of the level commission system:

Company A's indemnity commission structure may not have the clawback system
 in place to provide intermediaries with the incentives to keep lapse experience
 down [½]
 Even if there is clawback system in place, it may not be effective to incentivise
 intermediaries to improve the persistency experience [½]
 The renewal commissions may not be sufficient to provide the intermediaries with
 the financial incentives to maintain their policies on the book after the commission
 clawback period [½]
 The regular commission system could therefore be able to address the problem if
 the deterioration in persistency experience was mainly within the commission
 clawback period [½]
 The change is likely to promote a migration from hunters to farmers in terms of
 distributor behaviour [½]

Disadvantages of the level commission system:

Level commission is likely to be less popular with distributors as it does not meet
 their expenditure as well as indemnity commission [½]

Market standards:

Consider the standard commission structure in the market, and whether competitors
 generally using level commission or indemnity commission [½]
 Investigate whether insurers using the level commission system have better
 persistency experience than insurers using the indemnity commission system [½]

Consider what the distribution channels' reaction would be with a level commission system, in particular that the general market standard is to use the indemnity commission system	[1/2]
Distributors may prefer the existing system as the proposed level commission system may be perceived to increase uncertainty in terms of commission paid	[1/2]
Approval from regulator may be required	[1/2]
Pricing and Systems:	
Premiums may need to be adjusted to reflect the level commission accordingly	[1/2]
This may also mean that marketing literature has to be revised at a cost	[1/2]
Systems will need to be updated to reflect the new commission system, and there may also be implications on maintenance expenses due to the additional process of paying regular commission	[1/2]
Removal of indemnity commission will reduce the level of new business strain	[1/2]
Level commission would match commission outgo to premium contribution and to timing of profitability more appropriately	[1/2]
Need to think about whether this change will impact the business mix	[1/2]
New business volumes / Profit:	
Consider the likely effect on new business volumes (if the change is unpopular, new business volumes might fall)	[1/2]
Consider the likely effect on profits as a result of the different commission system and/or selling a different volume of business	
Consider the number of sellers to whom this applies, e.g. if most sales are through direct marketing, then the effect of changing commission structure might be small	[1/2]
Consider any tax implications caused by the different commission structures as the timing of the tax relief on level commissions would be different from that on indemnity / upfront commissions	[1/2]
	[Marks available 14, maximum 5]
	[Total 16]

Part (i) - This question was generally not well answered, even though it is a knowledge based question. Many candidates did not appear to consider the command verb of the question being "Discuss" and their answers are more like a list of points which did not give sufficient information nor explanation and hence less marks were awarded. The stronger candidates were able to structure their answers with clear sub-headings and provide reasons on both why a channel may be suitable and why it may not be suitable. It also appears that some candidates were not aware of the bookwork behind workplace marketing.

Part (ii) - A substantial number of candidates were unable to articulate a good response to this question. Candidates generally seemed to find this part of the question challenging and failed to consider investigation as to why the persistency experience may have deteriorated and instead focused on sales channels, which had already been covered in the previous part. Only the strongest candidates were able to address this question directly, took into considerations the likely reasons for the poor persistency experience and provided a logical assessment of the advantages and disadvantages of such a change.

Parts (i) and (ii) of this question differentiated the stronger candidates from the less candidates.

Q5

(i)

Advantages:

- There is the potential of increase in sales for smaller sum assured size policies,
Because of the simpler sales process [½]
- If competitors are not currently offering this, it could be a unique selling
point / product feature [½]
- There could be significant savings in underwriting costs [½]
- A more efficient sales process is likely to be welcomed by the intermediaries and
policyholders [½]
- The potential increase in sales could also improve economies of scales, as there
would be larger volume of business to spread overhead costs [½]
- This may in turn improve the profitability of the company [½]
- As an alternative to increased profits, lower expenses could result in lower premiums,
which might further increase new business volumes and hence profits [½]
- Improved customer experience may help improve persistency experience [½]
- The innovation may also enhance the company's reputation / brand image in the
market, which may help the sales of the company's other products [½]
- If the level of "Free Cover Limit" has been chosen appropriately, the additional
underwriting risk could be minimal [½]
- It might be possible for the insurer to choose "Free Cover Limits" that are
appropriate because it has experience from its group business, and it may be
straightforward to apply the changes on systems and literature because of this [½]
- There could be faster processing of claims for smaller benefit policies [½]

Disadvantages:

- There could be anti-selection risk [½]
- in particular that the level of "Free Cover Limit" is set too high, or if other insurers
are not offering this
- If the company tries to allow for anti-selection risk in pricing, this could push the
premium rates upwards [½]
- leading to healthier lives seeking their cover with other insurers and further
exacerbates the anti-selection risk [½]
- The lack of underwriting could lead to inadequate premium rates being charged [½]

The deterioration in morbidity experience could lead to increased reserving and capital
requirements, leading to: [½]

(½ mark for any two examples below) [½]

Reduction in profit

Intervention from regulators

Damage to the company's reputation / brand image

which could cause further adverse effects on future sales

On the other hand, if the level of "Free Cover Limit" is set too low it may not
have the desired impact on increasing new business sales [½]

Policyholders might deliberately 'play the system' and select benefits just below the "Free Cover Limit"	[½]
The business profile may change as a result as this could lead to higher proportion of smaller size policies	[½]
But the overhead expenses remain the same, which means more policies would need to be written to cover the relatively lower contributions towards fixed expenses by the smaller size policies	[½]
There could be issues in finding suitable reinsurance cover	[½]
Renegotiate with reinsurer for revised terms may result in more expensive reinsurance premium rates	[½]
There could be increased new business strain if the new product is popular	[½]
If the new feature does not increase sales sufficiently, development / project costs may not be recouped	[½]
If group "Free Cover Limits" are not appropriate for individual business (or if the group "Free Cover Limits" are inappropriate), then the insurer is unlikely to achieve a satisfactory result	[½]
Depending on the needs of customers, this approach might bring the insurer in-line with competitors which could lead to it losing its unique selling point (USP), or out-of-line with competitions which could lead to it losing sales because the concept of "Free Cover Limits" is not accepted by the market	[½]
[Marks available 14, maximum 5]	

Possible actions to address the disadvantages:

Inappropriate level of "Free Cover Limit"	
One key action is to ensure that the chosen "Free Cover Limit" is at the appropriate level	[½]
It should be at a level that will attract more new business, but also serves the purpose of mitigating the risk of the company being selected against	[½]
Perform analysis of the average size of policies typically written by the company and compare that with the rest of the market	[½]
The company may also consider offering different levels of "Free Cover Limit" to different risk groups, such as age bands and occupational classes	[½]
The company may consider a more tiered system, where there is a "Free Cover Limit" below which no underwriting is done, followed by another (higher) "Free Cover Limit" below which a small amount is done; this would:	[½]
reduce the impact of setting the (single) "Free Cover Limit" at the wrong level or having an 'all-or-nothing' system	

The company may improve the product features to address potential selection risks, such as:	[½]
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<i>(½ mark for any two examples below)</i>	[½]
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- longer waiting period,
- longer deferred period,
- extend the list of exclusions for pre-existing conditions,
- reduce the level of replacement ratio,
- remove other options to reduce risk generally.

Consider applying indexation to the "Free Cover Limit" to ensure it remain appropriate over time	[½]
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Pricing and Underwriting risks:

Consider the potential impact on morbidity experience and update the pricing assumptions according	[½]
Factor any saving on underwriting costs in pricing	[½]
Consider the potential implications on business profile, in particular the split between smaller size policies and larger policies	[½]
and derivation of the per policy maintenance expenses	[½]
Consider whether guaranteed premium period should be reduced to allow the company to review premiums earlier	[½]
Re-design the proposal form to capture additional information	[½]
Target marketing to insure good risks	[½]

Reinsurance:

Seek reinsurance assistance in setting the appropriate level of “Free Cover Limit” and managing pricing / underwriting risks	[½]
Negotiate with reinsurer to incorporate the changes in reinsurance treaties / arrangements	[½]

Other:

Ensure that sales literature is clear, particularly around the customer needs being met by the cover, so ensuring that customers choose their benefit level based on need, rather than the “Free Cover Limit”	[½]
The company could enhance risk management, specifically for risks with benefits below the “Free Cover Limit”, e.g. by increasing claims underwriting, and/or generally (e.g. through good management control systems) for all risks in order to reduce reserving and capital requirements	[½]

[Marks available 10½, maximum 4]

[Total 9]

Part (i) - This question was mainly well answered, with many candidates scoring highly. The stronger candidates were able to give more of a balance between advantages and disadvantages.

Part (ii) - This question was not well answered by many candidates. Most of the answers were too generic in nature with only brief comments on reinsurance and underwriting. It also appears that some candidates had simply ran out of time, which resulted in offering little elaboration or breath of points. The strongest candidates were able to provide clear rationale on analysing the Free Cover Limit and clearly linking back to the answers they provided in part (i).

Part (ii) of this question differentiated the stronger candidates from the less prepared candidates.

[Paper Total 100]

END OF EXAMINERS' REPORT



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