



Institute
and Faculty
of Actuaries

EXAMINERS' REPORT

SA2 - Life Insurance
Specialist Advanced

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*

On completion of the Life Insurance Specialist Advanced (SA2) subject, candidates should be able to demonstrate a detailed understanding of:

- the life insurance market (as described in the core reading). This includes a detailed understanding of the current products sold, the underlying market demand and methods of distribution, as well as the regulatory and fiscal regime.
- the principles and techniques of actuarial management and control, that are used in practice within the life insurance market (as described in the core reading).
- the commercial issues, economic uncertainty and associated risks that underlie the life insurance market (as described in the core reading).

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. Whilst candidates are expected to show knowledge of the relevant content of the Core Reading, it is much more important in this exam to tailor answers and apply that knowledge to the specifics of the question than it is in earlier exams.

Candidates who make well-reasoned points, which are not in the marking schedule will receive credit where appropriate and relevant to the question asked.

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

Overall, this exam had a normal level of difficulty, and this was reflected in the pass mark for this exam.

Questions 1, 2 and 4 were fairly standard questions and candidates performed in line with the expectations of the Examiners. Question 3 was a non-typical, though topical, question. Candidates did not seem to take sufficient time to consider the *differences* between the assets described and more conventional assets. For example, cocoa and coffee farmers may be more susceptible to climate risk due to their geographical location; offshore wind-turbines may be more susceptible to climate risk through increased ferocity of storms. It is this kind of tailored answer that will score well.

The better prepared candidates were those who read the questions carefully, tailored their answers to the questions and thought about what was being asked, rather than just writing about what they know on a particular subject.

It is important to focus on the detail in the question, for example, the products involved. Then tailoring the answer to those details. For example, describing lapse risk for immediate annuities is careless. Similarly, careful consideration of the impact of a particular mortality variance on the products and its materiality for that product. By taking a methodical approach to answers, step by step, however, there are opportunities to score well. It is important that candidates make sure they provide a full answer to all questions.

When considering proposals, consideration should be given to the potential stakeholders involved. This would generally always include policyholders and the company, but in this exam also considered wider stakeholders such as the government and regulators. It can also be relevant to consider different groups of policyholders such as with-profits policyholders and non-profit policyholders.

Time management is required to make sure there is enough time to answer all the questions.

Breaking the question down into smaller parts helps to make sure that a suitable breadth of answer is supplied. It is critical that candidates check that their answers specifically refer to the details of the question, using all of the information in the question pre-amble. It is not the intention of the examiners to include information in the questions that is not relevant to the answers.

Questions 1 and 2 required a methodical approach to standard actuarial situations presented and so the focus on the question on detail described above was key.

Question 3, whilst topical, introduced a scenario that was quite different to past exams. It built on standard work, but required careful consideration of what is different and may lead, for example, to additional risk to both the company and policyholder.

Question 4 was answered well by those that considered the stakeholders as described above.

C. Pass Mark

The Pass Mark for this exam was 60
534 presented themselves and 195 passed.

Solutions for Subject SA2 - April 2023

Q1

(i)

Mortality experience	[½]
There have been more deaths than expected.	[1]
For example due to a bad winter/hot summer/data cleanse/poor underwriting (any sensible example)	[½]
This would lead to a positive non-economic experience variance for the annuity book as reserves	[1] [½]
and regulatory capital held for annuitants who have died are released to surplus.	[½]
More deaths on the term assurance book would lead to negative non-economic experience variance	[½]
but the term assurance book is small relative to the annuity book	[1]
Alternatively, mortality experience for the term assurance book may have been favourable.	[½]
The impact of mortality on the pension book would depend on the death benefit provided	[½] [½]
the usual death benefit would be return of fund	[½]
so the impact of higher mortality would be the loss of future profits on those extra deaths	[½]
which is not likely to be material relative to the annuity impact.	[½]
so, overall, there would be a positive variance from higher mortality.	[½]
Lapses	[½]
Lower lapses due to retention policy or economic conditions	[½]
Lower levels of lapses in the pension book will increase in force at the end of the year.	[1]
The reserves are likely to be the value of expenses less charges	[½]
which are likely to be negative for a profitable product	[½]
thus reserves will be lower at the end of the year.	[½]
The required capital for the pension book is likely to be higher as the volume of business is higher	[½]
but this is not likely to be sufficient to offset the reduction in reserves...	[½]
leading to a positive variance.	[½]
Assuming that the newly written term assurance product is assumed to be profitable and have -ve BEL	[½]
in which case, lower lapses would lead to a positive variance in the same was as pensions.	[½]
Alternatively, if the BEL is positive	[½]
then higher lapses would lead to a positive variance	[½]
that is small relative to the pension positive variance.	[½]
Annuities are not subject to withdrawal and so lapses have no impact.	[½]
Expenses	[½]
Actual expenses incurred are lower than expected	[1]
due to efficiency programmes delivery lower per policy costs	[½]
or outsourcing arrangement implemented (any sensible eg)	[½]
that have not yet been recognised in the assumptions.	[½]
Error (e.g. assumption setting, model - any sensible example)	[½]
Favourable reinsurance terms	[½]

There may be additional movements in the Risk Margin (any valid example)	[½]
there may be additional movements in the SCR (any valid example)	[½]
May have included margins for uncertainty on some assumptions which have been released	[½]
[Marks available 22, maximum 12]	

(ii)	
General Measurement Model (“GMM”) or Building Block Approach (“BBA”)	[½]
will be used for the immediate annuities	[½]
and the term assurance product.	[½]
The pensions policies will follow the Variable Fee Approach (“VFA”).	[½]
as cashflows vary in line with a clearly defined pool of assets	[½]
The annuities and term assurance will use market observable discount rates	[½]
whereas the pensions policies will use the discount rate by reference to the pool of assets.	[½]
All approaches will have a CSM or Loss Component	[½]
and a risk adjustment	[½]
There may be a difference between the treatment of the annuities and the term assurance policies	[½]
as the term assurance policies may have been sold as loss leaders and so they may be loss making	[½]
If this is the case the CSM will be replaced with a “loss component”	[½]
[Marks available 6, maximum 4]	

[Total 16]

*Part (i) The question related to an analysis of surplus and, specifically, a positive non-economic variance. As such, candidates got no marks for discussing economic variances and assumption changes. The best approach to answering this question was to consider the main sources of variance and apply those to each product. For example, most candidates correctly identified that more deaths in the annuity book would be a possible source of **significant** surplus. So, for example, marks were awarded to candidates who argued that heavier mortality would most likely lead to a negative variance for the pension and term assurance product, but that this was likely to be small relative to the annuity positive variance. Equally, candidates could argue that the pension and term assurance products had lighter mortality as they are typically different age groups to the annuitants.*

Part (ii) This was well answered by most candidates who applied the core reading to the products in the question.

Q2

(i)	
Risk Capital/Internal economic capital	[½]
The Life insurance company is exposed to risks.	[1]
Risk capital provides a day-to-day buffer to protect against adverse movements in assets and/or liabilities.	[1]
The regulator may require liabilities to be determined on a prudent basis	[½]

which would be higher than best estimate liabilities.	[½]
Regulatory capital will include capital requirements beyond the value of the liabilities e.g. SCR	[½]
Hold more capital to avoid any regulatory capital add-on being required	[½]
If the available capital falls below the regulatory capital, then the regulator is likely to impose sanctions on the life insurance company.	[½]
The company will want to hold a buffer above the regulatory capital to reduce the risk of sanction.	[½]
The company has set the bottom of its preferred range to be above the regulatory capital level so that, if the level of capital fall below the preferred range, the company has time to take action before failing to meet the regulatory capital.	[½]
May be expecting a regulatory change	[½]
The size of the gap between the regulatory capital and the bottom of the preferred capital range will depend on the company's risk appetite.	[½]
Working capital	[1]
The company will want to hold capital in order support the business:	[½]
To support the writing of new business	[½]
To carry out developments	[½]
To provide investment freedom to achieve higher expected returns	[½]
The company may be targeting a particular credit rating with rating agencies	[1]
Good credit rating will allow insurer to borrow at a cheaper rate if required.	[½]
and so will set its target capital range for that purpose.	[½]
Being considered financially strong may be a key marketing tool and so having a capital level well above the regulatory capital may aid new business sales.	[1]
or to be comparable to competitors	[½]
The company may be active in acquiring companies or blocks of business and so may need higher levels of capital to achieve that.	[½]

[Marks available 14, maximum 8]

(ii)

The company might take no action	[½]
investigations might show that the position is likely to be temporary	[½]
the company will check for errors	[½]
and so taking action to reduce the available capital would not be appropriate.	[½]
or may know what it intends to use the excess for already	[½]
The company might choose to reduce the level or debt it holds.	[½]
The company might seek to reduce the available capital by returning it to its shareholders	[½]
through increased dividends	[½]
or share buy back.	[½]
If the company has a with-profits fund and the with-profits fund has a significant estate, then it will be necessary to consider whether this is excessive	[½]
if so, the company will want to treat its with-profits customers fairly	[½]
by distributing the estate/changing guarantee charges	[½]
via higher bonuses.	[½]
The company might wish to recapture reinsured business	[½]
the additional risk is likely to increase the required capital	[½]
by more than the reduced counterparty risk	[½]

with the aim that the available capital will now fall within the increased preferred range	[½]
but the company would expect increased future profits as a result increasing available capital as well.	[½]
The company might decide to take more investment risk for example, by reducing the amount of hedging	[½]
or by taking a mismatched position (or any suitable example)	[½]
The company could invest in its infrastructure to reduce costs in the future	[½]
and increase future profits.	[½]
Write more new business	[½]
Revise premiums	[½]
Look to acquire another company/fund/block of business	[½]
	[Marks available 14, maximum 8]

(iii)	
The stochastic model provides important insight into how solvency will be affected across a range of scenarios	[1]
and testing how the model reacts under certain scenarios to test management actions enables firms to model interactions/dynamic assumptions	[½]
and so helps the company prepare plans for changing circumstances.	[½]
Models guarantees/options more appropriately	[½]
However, they are complex models	[½]
care needs to be taken in calibrating the model	[½]
in setting the assumptions and interpreting the output.	[½]
Time zero stress testing is a simpler way of assessing the current risk position	[½]
but these would need to be repeated over time as the company's position changes.	[½]
Stress tests are easier to explain to non-technical decision makers (e.g. Board)	[1]
"reverse stress testing" can be used to identify "killer scenarios"	[½]
those scenarios that could make the company insolvent	[½]
thus focussing management actions to mitigate the likelihood of such scenarios.	[½]
Takes time/cost and experience to develop stochastic model	[½]
	[Marks available 9, maximum 4]
	[Total 20]

Part (i) Candidates that stepped through the main types of capital (economic, regulatory, working and rating agency) and discussed the rationale for each scored well.

Part (ii) The question sets out a scenario of a company that is over capitalised relative to its target. Candidates who considered how this capital could be used in terms of developing the company, providing shareholder value and improving outcomes for customers scored well.

Part (iii) This question required a discussion of the pros and cons of stochastic models relative to scenario testing. Candidates familiar with the core reading scored well. In this question, the advantage of one method tends to be the

disadvantage of the other. Candidates that argued in the opposite way to that set out above received the appropriate marks.

Q3

(i)

Company reputation

It is particularly important that the assets invested in comply with the relevant ESG principles. [½]

For example, if green energy companies were utilising significant fossil fuels in the development of equipment, then this could harm the company's reputation. [1]

The company itself should also be careful to integrate ESG into its business [½]

Risk of increased lapses if reputation falls or fund not ESG compliant [½]

Given the target market are socially responsible, the company must also show itself to be responsible in other areas [½]

Such as diversity of staff (*any reasonable example*) [½]

Overall, given the target market, the company will need to take extra measures to ensure compliance with ESG principles. [½]

Need to monitor assets to ensure remain ESG compliant. [½]

May make co open to more complaints [½]

Any reasonable example for a complaint [½]

Could be overall good for reputation [½]

If it fails/low returns bad for reputation [½]

which is a large risk due to new start-ups [½]

which could impact new business sales [½]

AMC may be higher/may need to change in the future [½]

Company is inexperienced so risk of mistakes [½]

Not able to meet liquidity requirements [½]

[Marks available 9, maximum 3]

(ii)

The company is exposed to credit risk [1]

in respect of the loans issued [½]

if the counterparty failed to meet its obligations [½]

or the underlying asset became worthless [½]

as these are new ventures, there may be little data on which to measure this risk [1]

meaning that the risk could be perceived as high. [½]

much of this risk is passed on to policyholders [½]

but AMCs will be impacted [½]

as well as loans that the company is holding and not backing unit funds (where customers have lapsed) [½]

The company would not be exposed to additional market risk [½]

since the assets are loans [½]

unless the company defined the credit risk which impacts the value of the asset as a market risk [½]

but given these are all held to maturity this is unlikely [½]

There is no interest rate risk except in the unlikely event that they can find a buyer for the asset. [½]

The company is exposed to some further liquidity risk	[1]
as the underlying assets are illiquid	[½]
before the maturity date of the assets	[½]
If the company cannot sell all of the loans it has invested in to policyholders via the fund.	[½]
There may be additional operational risk	[1]
In respect of mis-selling	[½]
if the customer did not realise the potential penalties of surrendering before the term	[½]
and the use of inadequate models/judgement when valuing the assets	[½]
It is unlikely that the asset creates any additional conduct risk	[½]
There may be additional model risk	[½]
In relation to modelling the risks involved	[½]
The assets are new and as such new models will have to be built	[½]
for example, expert judgement could be inappropriately applied	[1]
any relevant example	[½]
There may be some additional unit pricing risk	[1]
due to the asset being hard to value	[½]
If the company allows surrenders to occur at a preceding price, anti-selective surrenders may occur	[½]
systems may carry out of date values of the assets	[½]
any relevant example	[½]
The company is exposed to additional insurance risk	[½]
In relation to persistency	[1]
If a policyholder surrenders early, the company may not have had a chance to recover its expenses	[1]
The company is also left with an illiquid asset on its balance sheet which it cannot sell	[½]
causing additional liquidity risk	[½]
and credit risk	[½]
and reputational risk if penalties are deemed unfair	[½]
possibly causing regulatory fines	[½]
Climate risk may increase	[½]
physical risks from climate change would adversely impact return on assets	[½]
Hydro power will by their nature be situated close to waters such as rivers	[½]
Increasing flood risk to any buildings/equipment	[½]
Leading to a reduction in the assets	[½]
Fair trade coffee/cocoa will have activities in hot countries	[½]
Potentially prone to fires	[½]
<i>(Any reasonable examples up to 3 marks total)</i>	
)	
Transition risk from climate risk.	[½]
It is unlikely to increase the level of any group risk	[½]
There may be expense risk	[½]
from fund related charges being higher than expected, mispricing due to inexperience, sales lower than expected <i>(any reasonable example)</i>	[½]
Regulatory or tax changes related to fund	[½]
Currency risk if loans are overseas	[½]

[Marks available 31, maximum 18]

(iii)

Profitability	
The company is likely to have a specified target profit criterion	[1]
This could be in net present value terms, internal rate of return, discounted payback period or any combination of these.	[½]
AMC should cover expected expenses	[½]
and decide if contribute to overheads	[½]
Shareholders may be willing to accept lower or different target for ESG	[1]
or different	[½]
due to nature of ESG	[½]
Policyholders may be willing to pay higher charges for investing in ESG	[½]
Because they value the contribution they make to the environment	[½]
even so they would not expect this to pay for higher profits	[½]
Consider basis for reporting profits	[½]
if different then ensure business decisions understand the impact on timing of profits	
for example	[½]

Marketability

The company should perform market research to assess the size of the potential market	[½]
This is a niche product and customers may be wary of the expected returns and the risks involved.	[½]
However ESG is an important current issue and as such there may be a large potential market	[1]
It may depend on what similar funds are being sold,	[1]
and competitors charges	[½]
Is the AMC reviewable?	[½]

[Marks available 11½, maximum 6]

(iv)

The contents of sales literature may need to be updated	[1]
as this is a different type of investment fund risks	[½]
and it may need to refer to liquidity risks.	[½]
advertisements may need to be considered	[½]
need to ensure that the sustainability claims are correct and accurate,	[½]
and that there is no chance of misleading the customer into thinking other investment	
are also sustainable investments	[½]
policy projections need to take account of the type of risks and likely returns	[½]
if the projections are stipulated by the regulator, some wording may be required to	
ensure policyholders understand that there may be different risks.	[½]
Policy documents will need to clearly show how asset values are determined.	[½]
Whether the charges related to these contracts are reasonable	[1]
compared to other contracts and their competitors,	[½]
and previous AMCs if the charge is variable	[½]
and reflects a fair assessment of the extra costs and risks they cover	[½]
and are clearly disclosed and understood	[½]
There is some discretion with regards to the approach to setting early surrender	
values, and this needs to be considered.	[½]
any reasonable example as long as additional to what is already there	[½]
Correct any errors if they arise in a fair manner	[½]

Have appropriate complaints processes/service standards in place	[½]
Special consideration for vulnerable customers	[½]
Adhere to any local regulation on TCF or similar	[½]
Due diligence on loans	[½]
Special consideration on unit pricing given illiquid nature of loans	[½]

[Marks available 12, maximum 4]

[Total 31]

*Part (i) This question asked about **reputational risks** of offering an environmentally sustainable investment fund. A discussion on **all** risks was not, therefore required. It was necessary to consider the target market and how potential customers, for whom such a fund would be attractive, might view the company's operations.*

*Part (ii) This question focussed on the main risks for a life company, as set out in the core reading, and how the new fund may add **additional risk**. As for part (i), a discussion of all risk was not required. Key aspects were that the assets were unusually illiquid and were different to the kind of assets were new to the company. So additional risk arises from company inexperience, the fact that most of the assets were start up, and valuation issues.*

Part (iii) As well as standard points for this kind of question, consideration was given to the fact that the company may accept a lower level of profitability to establish itself as an ESG champion. Equally, potential policyholders may be prepared to pay a bit more for this kind of fund (so long as it was justified).

Part (iv) This focussed mainly on communication of the additional risks associated with the fund.

Q4

(i)

Tax is applied to 'I - E' calculation [½]

I is typically made up of total investment earnings [½]
 although this may exclude dividend income from equities [½]
 and may exclude unrealised gains on equities and property. [½]

E is typically made up of Acquisition expenses, possibly spread over several years [½]
 It may also include the income component of general annuities [½]
 .might also include a carried forward amount of excess expenses from the previous tax year (referred to as Excess Expenses or XSE). [½]
 The effective tax rate to apply is determined by splitting the I-E into corporate and policyholder profit [½]
 and applying the appropriate tax rate to each portion. [½]
 A minimum profits test may apply for a proprietary company [½]

to ensure that the company pays at least the same amount of corporation tax that would otherwise be expected. [½]
 Excess E would arise if the minimum profit is higher than I minus E [½]
 Whether policyholders have to pay additional taxes will depend on the regime [½]
 higher rate policyholders may attract additional marginal taxation. [½]
 [Marks available 7, maximum 5]

(ii)

The current tax basis may be too complicated, [1]
 e.g. difficulties in determining effective tax rate (split between policyholder and shareholder) (*or any sensible example*) [½]
 Creates a level playing field for new entrants [½]
 Or may be out of line with other countries [½]
 which could cause issues with financial equivalence between territories. [½]
 It may be too penal and disincentivise taking out protection products. [½]
 Alternatively, it may be too generous and be disincentivising taking out other products. [½]
 It may not be providing the expected tax revenue [1]
 as companies may have built up substantial XSI through writing savings business. [½]
 and the protection business typically has a high E and low I, and can offset the XSI [½]
 There may be loopholes in the current tax approach that are being utilised. [½]
 New products may have been designed which are not well catered for under the current tax regime. [½]
 i.e. the definition of which products are I-E may be unclear. [½]
 [Marks available 7½, maximum 5]

(iii)

The level of impact depends on whether the change is applied retrospectively [1]
 if it is then this could materially impact the company's profits [½]
 Will depend on whether company was XSI or XSE prior to change [½]
 Will depend on whether firm is a proprietary or mutual [½]
 Without XSE it is less clear whether the tax bill will increase or decrease. [½]
 Tax is applied to profits on the business rather than I-E [½]
 and so will factor in the value of income/outgo from premiums and claims. [½]
 In addition, the tax rate may differ, as the corporation tax rate is used [½]
 whilst I-E will use a combination of policyholder and corporation tax rates [½]
 The impact depends on the overall mix of business and the volume of protection business. [½]
 If the change only applies to new business, then the effect may be more limited. [½]
 The company may be able to alter its new business product offering to make it more tax-efficient under the new regime [1]
 which may involve passing some of the cost onto the policyholder [½]
 although it will have to consider competitive pressure in doing so, [½]
 and whether the new product design meets policyholder needs. [½]
 Any changes to the product may alter policyholder volumes. [½]
 There will be an additional cost to the insurer in adopting to the new regime [1]
 e.g. systems updates [½]
 e.g. assumption changes [½]
 e.g. training [½]

There may also be higher ongoing costs	[½]
e.g. due to the need to provide additional details / calculate additional information under the new regime.	[½]
e.g. due to the need to maintain an additional tax calculation if this only applies to new business.	[½]
Reinsurance deals may need to be revisited	[½]
if they are no longer tax efficient, or would be more beneficial.	[½]
Other strategies to reduce the tax bill may be investigated.	[½]
May need to hire consultants to understand implications	[½]
Some firms may exit the protection market	[½]
and possible impact on savings market	[½]
May attract new entrants to the market	[½]
which may result in price competition, reducing prices	[½]
	[Marks available 17, maximum 7]

(iv)

Taxation on surrender can be viewed as a penalty in that the tax occurs earlier in the life of the policy	[½]
rather than at maturity, accelerating the tax paid by the policyholder	[½]
So, in some ways this could be seen as unfair to policyholders who feel they need to surrender.	[½]
It is also possible it is beneficial as the policyholder may become a higher rate tax policyholder in future, so the total tax bill over the policyholder's life could be reduced	[½]
although this is less likely.	[½]
However, if tax is not paid on surrender, this effectively lowers the total tax bill for the policyholder	[½]
and so will not be consistent with the tax paid by those who remain in force.	[½]
This can be seen as unfair to those who remain in force/have no choice (e.g. death) and it is possible to exploit by savvy policyholders as policyholders can decide to surrender to benefit from reduced tax	[1]
which may be very valuable close to maturity	[½]
depending on surrender values (and penalties) versus maturity values.	[½]
This may discourage policyholder behaviour that the government is trying to achieve namely ensuring policyholders build up adequate pension savings.	[1]
Companies may also structure policies in a way such that surrender close to maturity is the preference	[½]
thereby avoiding the tax bill for policyholders altogether,	[½]
although it will be possible to legislate to avoid this.	[½]
Partial surrenders, paid up policies, and alterations may become less viable if only surrenders attract zero taxation rather than other options.	[½]
The level of policies surrendering will increase	[½]
and there may be a large wave of surrenders if this is introduced	[½]
Insurance companies will bear the surrender costs and lower levels of business such costs may be passed onto the policyholders that remain in force.	[½]
but company profits may fall	[½]
Excess of benefit received over premium paid reflects the 'profit' to the p/h and should be taxed	[½]

and the amount of tax payable on surrender would be expected to be lower than the maturity value	[½]
Current approach consistent with how gains on other investments are taxed if sold before maturity	[½]
Surrender value quotations/illustrations will need be amended	[½]
System changes may be required (e.g. for some jurisdictions company pays tax on behalf of policyholder)	[½]
Lower tax paid to govt, therefore might need to raise tax rates	[½]
	[Marks available 16, maximum 8]

(v)

Advantages

There will be economies of scale from such an approach	[1]
reducing the overheads associated with regulation	[½]
and potentially reducing the cost to insurers/customers.	[½]
The central bank will be better informed in situations where it may need to act as lender of last resort	[½]
Simplicity - Insurers will have a single clear point of contact	[½]
It will remove the possibility of conflicting regulation from the two regulatory bodies.	[½]
It will remove duplication of regulation where the regulators cover the same area	[½]
May improve consistency between regulation of insurers and other financial industries.	[½]
May be better suited to deal with large financial group companies that offer both insurance and other financial instruments.	[1]
Improved accountability and transparency - it is clear which regulator is responsible for an issue.	[½]

Disadvantages

There will be a cost in making the changes	[1]
and resource implications (short-term)	[½]
and redundancies (long term)	[½]
The changes may take a long time to fully implement	[½]
It is possible expertise will be lost in making the transition	[½]
There will be a period of disruption for both regulators and insurers	[½]
The focus given by having more than one regulator may be lost	[½]
(e.g.) loss of focus on customer outcomes	[½]
or loss of focus on insurer specific regulation, which could harm the insurance industry.	[½]
Possible conflict of interests between being the central bank and the regulator	[½]
(e.g) may be less willing to let companies fail as it's seen as the bank's fault	[½]
(e.g) may be more willing to loosen financial regulation in troubled times and this may not be beneficial to the economy.	[½]
May be a significant change in the new regulator's "high risk areas" of focus causing further disruption for companies	[½]

[Marks available 13, maximum 8]

[Total 33]

Parts (i) and (ii) Candidates who understood how the I-E taxation basis works and its shortcomings were able to answer these parts well.

Part (iii) The question did not say whether the change in the taxation basis was to only apply to new business or to all business going forward. Separate consideration of those two scenarios was necessary.

Part (iv) Candidates who considered the impact of the proposal on the different types of policyholder (surrendering v remaining), the company and the government scored well.

Part (v) The main themes for the question were weighing up the efficiencies of one regulator compared with the protection provided by different regulators with different focus.

[Paper Total 100]

END OF EXAMINERS' REPORT



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