INSTITUTE AND FACULTY OF ACTUARIES

EXAMINERS' REPORTS

September 2020

Subject CP1 - Actuarial Practice

Paper One

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.

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.

Mike Hammer
Chair of the Board of Examiners
December 2020

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

1. The aim of the Actuarial Practice subject is that upon successful completion, the candidate should understand strategic concepts in the management of the business activities of financial institutions and programmes, including the processes for management of the various types of risk faced, and be able to analyse the issues and formulate, justify and present plausible and appropriate solutions to business problems.

2. This subject examines applications in practical situations of the core actuarial techniques and concepts. To perform well in this subject requires good general business awareness and the ability to use common sense in the situations posed, as much as learning the content of the core reading. The candidates who perform best learn, understand and apply the principles rather than memorising the core reading.

3. The examiners set questions that look for candidates to apply the principles specific to the situation set out in the questions, having read the question carefully. Many candidates gain few marks by writing around the subject matter of the question in a more general fashion. Detailed specialist knowledge is not required and nor is very detailed development of particular points.

4. Good candidates demonstrate that they have used the planning time well to understand the breadth of the question and to structure their answer - this is a big advantage in making points clearly and without repetition. This also enables candidates to use the later parts of questions to generate ideas for answers to the earlier parts.

5. Time management is important so that candidates give answers to all questions that are roughly proportionate to the number of marks available.

6. The comments that follow the questions concentrate on areas where candidates could have improved their performance. Candidates approaching the subject for the first time are advised to use these points to aid their revision.

7. Candidates who give well-reasoned points, not in the marking schedule, are awarded marks for doing so.

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

Paper 1 scored considerably higher than Paper 2 with the average scores being circa 14% different between the papers. Paper 1 was generally answered well but candidates continuing to struggle with higher order skills questions with stronger candidates clearly structuring their answers in a coherent way giving evidence that they planned their answers.

C. Pass Mark

The pass mark for this exam was 55.
878 candidates presented themselves and 364 passed.

Solutions

Q1

(i)

The main reason will be around having liquidity to pay out any claims [1]
The company will also need to have liquidity to pay out expenses as well – which are all generally immediately available [½]
Cash would be available to pay immediately – and therefore any immediate needs for claims for policyholders could be paid out [½]
– e.g. paying the costs for suitable accommodation in the event of a fire OR to pay for courtesy car. [½]
Short term loans are equally liquid but these could be used to pay for slightly longer claims being made [½]
e.g. repairs for housing could be paid over time, non-essential replacement of products stolen, ongoing medical repairs etc…. [½]
Both assets are relatively low risk (other than inflation) therefore should be easy to value [½]
The actual amount available should it be needed for claims/expenses etc [½]
Both assets are short term in nature [½]
To match assets and liabilities [½]

[Marks available 5½, maximum 2]

(ii)

The important point is that the company could have access to the investments if needed quickly.

(a)

Liquid domestic government bonds [½]
even if these are longer dated and therefore potentially having a higher yield than other assets, they should still be suitably liquid if they are needed to trade [½]

Short term money instruments others than loans [½]
– again may give higher yields than cash but would remain liquid [½]

Liquid high rated corporate bonds [½]
– e.g. European investment bank, or other suitable high level corporate bonds (AAA) – ideally this will be monitored regularly to ensure sufficiently liquid [½]

Credit was given to other suitable assets which gave good reasoned explanations linked to liquidity and higher yield.

(b)

Property [½]

– this tends to be illiquid investment and they are unlikely to be able to get access to funds when needed. [½]

Equity [½]
this could be highly volatile and whilst it may be liquid (if the name is good), investment could be worth significantly less than what was invested [½]

Credit was given to other suitable assets which gave good reasoned explanations linked to liquidity and volatility.

[Marks available 6, maximum 4]
[Total marks available 12½, maximum 6]

(i)	*This part was well answered with most candidates receiving full marks. Some candidates talked about regulation and wider current status of the economy but didn't link back to the general insurance product and therefore scored no marks for this.*
(ii)	*This part was not answered as well, with many candidates ignoring the answer given to (i) where liquidity was important to the product and indeed suggested high risk/low liquid as suitable which scored no marks.*

Q2
Specify problem

- The initial problem is to design and price the new term assurance contract [1]
- All the stakeholders will have to be identified, [½]
- for example regulator, customers, reinsurers, Agricultural Bank etc. [1]

- For each of the stakeholders the risks contributed needs to be identified [½]
- and analysed. [½]
- The risks for term assurance include: mortality, expenses, lapse rates, business volumes, underwriting, legislation/regulation etc [2]
- Does it have sufficient experience to price the product [½]
- Does it have measurable targets [½]

Develop solution

- This stage of the control cycle considers the strategic course of action that could be used to handle the particular risks in question. [½]
- It gives an assessment of the risks faced and how they can be managed, mitigated or transferred. [1]

- This stage also provides an analysis of the options for the design of the new term assurance contract that **transfer risks from one set of stakeholders to another** [1]
- The company will need a model to price the term assurance product [½]
- and sufficient detail to consider different types of policyholders [½]
- Need to set the relevant assumptions [½]
- With the mortality assumption being the most important [½]

Monitor experience

- For example, in a developing country there may be significant uncertainty on future mortality [½]
- and lapse rates. [½]
- Review actual experience vs assumptions [½]
- Long-term contracts with fixed premiums would have more risk, however, the extent that this risk can be transferred to policyholders has to be balanced [½]
- against customer demand [½]
- and competitor products. [½]
- Assess the value of selling via tied agents rather than other sales channels [1]

Consideration of the commercial and economic environment [½]
Eg regulation [½]
Eg competitive position [½]
Professionalism – need to consider this at all times [½]

[Marks available 17, maximum 8]

This question was generally well answered by most candidates with candidates able to apply their knowledge of the ACC to the specific situation being asked.

Q3

Initially, there will be start-up costs that will be incurred by the subsidiary [½]

- Investigatory costs: research the potential need for the business [1]
  - Market research, analysis of proposal, consultancy fees etc [1]
- Pre-launch costs [1]
  - Advertising, office equipment, staff training, systems set-up etc [1]

Some of these start-up costs are likely to roll into when the business is up and running. [1]

On-going expenses can be divided between fixed and variable expenses. [1]

Fixed costs relate to outgoing that must be paid regardless of whether the business turns over a profit. [1]

Variable expenses change in line with sales – as sales increases, so do variable expenses. [1]

Some expenses may remain broadly fixed in real terms, [½]

whereas others will vary directly according to the level of business being handled at that time. [½]

There are also a third category of expenses that is essentially fixed, but that can vary in large amounts from time to time. [½]

Examples of fixed expenses are:

- Rent [½]
- Office Insurance [½]
- e.g. fire cover, employers' liability [½]
- Management Salaries [½]
- Contributions to a benefit scheme [½]
- Utilities [½]
- Regulatory approval/compliance [½]
- Maintenance of building [½]
- Professional fees e.g. lawyers, consultants [½]
- Sales and marketing [½]
- Equipment and supplies e.g. computers, desks [½]
- Finance repayments [½]
- Technology expenses [½]

Examples of variable expenses are:

- Staff remuneration e.g. bonuses / commission [½]
- Material costs [½]
- Investment expenses [½]
- Termination expenses [½]
- Per policy administration costs [½]

[Marks available 19, maximum 8]

This question was generally well answered. Those candidates that broke down their answer and explained sub headings did very well. A few candidates didn't answer the specific question being asked and focused on an expense analysis in detail which didn't score as well.

Q4

(i)

High level preliminary risk analysis [½]
to confirm so high risk that it should not proceed. [½]
Hold a brainstorming session. [½]
With internal and external experts in the subject matter [1]

Carry out a desktop analysis. [½]

To supplement the brainstorming session identifying further risks and mitigations [½]
Construct risk register. [½]
Including cross reference to interdependencies [½]

[Marks available 4½, maximum 4]

(ii)

- Insufficient funds being set aside [½]
- Insolvency of the provider [½]
  - Due to investment underperformance [½]
  - Or other reasonable example [½]
- Partial withdrawal by policyholder [½]
- Investment mismatch [½]
  - Meaning full payment cannot be made – agreed with beneficiary [½]
- Illiquidity of assets [½]
- Fraudulent claim [½]
- Death of beneficiary in the period [½]
- Unexpected tax bill [½]

[Marks available 5½, maximum 2]

(iii)

Benefits lower than expected. [1]
Cost of purchasing the intended item (eg annuity) has risen over the course of the period [1]
Inflation has eroded real return [½]
Leading to lower standard of living than expected [1]

[Marks available 3½, maximum 2]
[Total marks available 13 ½, maximum 8]

(i)	*This part was well answered, with most candidates getting nearly full marks. Some candidates discussed how to analyse risks in general as opposed to the steps needed and scored less well*
(ii)	*This part was less will answered*
(iii)	*Again this part was less well answered with some repetition between (ii) and (iii).*

Q5

(i)

Reduce probability of risk event occurring [½]

By amending shipping routes [½]
Only insuring well run vessels [½]
Diversifying to other geographical areas [½]
Cease insuring the highest risk cases [½]
Or get experts to help build an understanding of the scenario [½]

Limiting the severity/consequences of a risk that does occur [½]

Insure only up to a certain limit [½]

Or only lower value ships	[½]
Use of experts to minimise costs	[½]
eg hostage negotiators following piracy kidnappings.	[½]
Reinsurance	[½]
Protection of reputation by swift payment and assistance to ships in difficulty.	[1]
Stop offering the product	[½]
Price very expensively	[½]
ie ensure premium correctly reflects risk taken on (i.e. better underwriting)	[1]
Claims control	[½]

[Marks available 9½, maximum 4]

(ii)

Scenario analysis deterministic method of assessing risk.	[1]
In this instance it is very difficult to apply a full probability distribution	[½]
, as there are relatively few data points	[½]
(eg number of ships insured compared to number of lives a life insurer might cover)	[1]
Develop scenario for each region in which company operates –	[½]
what issues might cause an increase in tension (eg new governments, oil price spike)	[½]
Taking expert advice in each area	[½]
Test those scenarios (how likely, how long will they last)	[1]
Review assumptions underlying each scenario	[½]
How does the scenario impact claims?	[½]
Eg hull losses from military action, or increase ransom claims from piracy	[½]
Cost each scenario	[1]
Looking at cost of each element of the scenario	[½]
Scenario analysis tells you the impact	[½]
but not likelihood of the event	[½]
Stress testing might be an alternative to explore extreme events (eg a world war in this context)	[1]

[Marks available 10½, maximum 4]

[Total marks available 20, maximum 8]

(i)	*This part was answered OK when candidates focused on a wide variety of control measures, candidates that focused on one or two measures in detail scored less well.*
(ii)	*Candidates grasped most of the fundamental process but didn't go into enough detail to score full marks.*

Q6

(i)

Provisions are the calculated amounts that need to be set aside to meet a provider's future liabilities. [1]

Reasons include:

a. To determine the liabilities to be shown in the provider's published accounts and reports; [½]
b. To determine the liabilities for regulatory purposes; [½]
c. To determine the liabilities to be shown in internal management accounts and reports of the provider; [½]
d. To value the provider for merger or acquisition; [½]
e. To determine the excess of assets over liabilities and whether any discretionary benefits can be awarded; [½]
f. To set future contributions to a benefit scheme that the insurer sponsors for its employees [½]
g. To value benefit improvements for a benefits scheme that the insurer sponsors for its employees ; [½]
h. To calculate discontinuance/surrender benefits; [½]
i. To influence investment strategy; and [½]
j. To provide disclosure information to beneficiaries. [½]

[Marks available 6, maximum 3]

(ii)

- Private equity investor. Preferable for values that represent an actuary's 'best estimate' of the future experience [½]
  - but on aggressive end of the spectrum. [½]
  - Assumptions that are more likely to overstate/understate the liabilities or assets may lead to wrong decisions being made. [1]
  - But also have an interest in the price being as low as possible [½]

- Management/Board of Directors. Will want the full picture to decide whether or not to proceed with the sale. [1]
  - Therefore, they will want to see a range of figures on different assumptions. [½]
  - A stochastic approach could add value in this situation. [½]

- Regulators (note two involved). May wish to see a realistic picture of the provider's finances or figures that intentionally understate the financial strength, [1]
  - to ensure current policyholders continue to be protected. [½]
  - May also consider provisions on a discontinuance basis. [½]

- Current shareholders. They will want to make their own assessment of the sale so will request to see an actuary's 'best estimate' value [½]
  - but on the more prudent end of the spectrum [½]

- But also want price as high as possible [½]

- Policyholders. Will want to ensure security of benefits is not worsened post-transaction if provisions are undervalued [1]

- DB scheme members. Similarly, will want to ensure security of their benefits is not worsened post-transaction [1]

- Government/State. As it is a well-known company, the government may come under pressure to ensure that the company is not sold 'too cheap', leading to a loss of value, redundancies etc [1]

Give credit for an reasonable example with explanation [1]

[Marks available 12, maximum 6]

[Total marks available 18, maximum 9]

(i)	*This was very well answered with most candidates scoring full marks.*
(ii)	*This was less well answered. There was clear evidence that those candidates that had spent time planning and thinking about lower/higher sale prices and the impact on each of the stakeholders then went on to structure their answer well, picking up most points. Some candidates focused on all possible stakeholders rather than focusing on the main ones and the impact on them.*

Q7

(i)

Liquidity facilities [1]

Contingent capital, ie capital available in the event of further poor experience. [1]

Senior unsecured finance, if used to allow the parent company to provide capital to the overseas subsidiary. [1]

Be a broker for reinsurance products where available [1]

Use experts to advise on other expense management activities [½]

Could use its experience to sell in the most profitable areas, reducing the capital strain for new business [½]

Advice around issuing debt or other restructuring [½]

Advice and practical assistance on using securitisation [½]

[Marks available 6, maximum 3]

(ii)

Depends on the regulatory approach taken used (formulaic or risk based). [1]

Contingent capital arrangements may lack visibility [1]

and require the regulator also to assess the health of the bank granting the capital, which may not work under a formulaic model [1]
Liquidity facilities should help assuming terms are appropriate, simple to assess [1]
Senior unsecured financing - is the regulator looking at the subsidiary in isolation? [1]
Or at the group? [½]
This may not have helped at group level, [½]
but will make the subsidiary look stronger. [1]
Reinsurance would need to meet the capital requirements/rules for the company [1]
Expense analysis should assist [½]
but any changes to longer term assumptions would need to be justified to the regulator [½]
Advice of debt and securitisation depends on transparency of the arrangements [1]

[Marks available 10, maximum 5]

(iii)

<u>Advantages</u>

- Could model the risks of the company better than using a standard formula approach laid down by the regulator. [½]
- ….because the internal model would reflect the risks that were specific to the company rather than the industry wide. [½]
- ….Indeed it could include risks that are not covered in the standard formula [½]
- This would mean that the company was holding the capital specific to these risks which could be lower than the standard formula approach [½]
- The company may have assumptions built of more appropriate experience which can help assess both the assumptions and the relative stresses for its capital model. An internal model could take this approach into account. [½]
- Using an internal model could also remove any approximations that a standard formula approach may have taken into account. [½]
- The internal model could be used for other purposes e.g. Economic Capital modelling [½]
- Better modelling of diversification benefits [½]
- Internal model can have better understanding of risks [½]
- Internal model could be stochastic, standard model might be deterministic [½]

<u>Disadvantages</u>

- Significant amount of cost could be required to build and maintain the internal model [½]
- Company already fits standard model [½]
- Specialist skills will be required to develop and maintain the model [½]
- Hence likely to be a feasible undertaking only if the company is large [½]
- The approval process with the regulator could be onerous and time consuming… [½]
- …..particularly with respect to the company needing to justify why the capital requirements are lower than standard formula approach….. [½]
- and therefore the company will probably need to run both models [½]

- Depending on discussions with regulator it is possible any reductions in capital requirements may not materialise [½]

[Marks available 9, maximum 3]

(iv)
The issues the regulator is likely to consider are:

- Will the internal model allow for the risks in the company better than the standard formula approach? [½]
- Will the company's internal model indicate a level of capital that the regulator is comfortable with? [½]
- Would the company's internal model indicate a level of capital below any regulatory minimum level of capital? [½]
- Are the assumptions underlying the company's internal model justifiable? [½]
- Does the company have sufficient technical expertise to model its risks accurately? [½]
- Is the regulator happy that some of the implicit margins for prudence in the standard formula could be removed under an internal model approach. [½]
- Does the regulator have sufficient technical expertise to review and approve the company's internal model? [½]
- Could the company be trying to show an overly optimistic position? [½]
- Is the data being used credible [½]
- How comparable will the results of the model be with other equivalent companies in the market? [½]

[Marks available 5, maximum 3]

[Total marks available 30, maximum 14]

(i)	*This part was answered reasonably well*
(ii)	*This part was answered less well with candidates tending in general terms rather than referencing to regulatory capital.*
(iii)	*This part was answered well, with stronger candidates structuring their answer into advantages/disadvantages.*
(iv)	*This part was poorly answered, with most focusing on one or two ideas rather than considering how a regulator would look at the situation.*

Q8

(i)

- Purpose of the investigation [½]
  - Eg a valuation of existing business should allow for actual policies written, and using model points might degrade accuracy [½]
  - a valuation of potential new business is probably accurate enough using model points; [½]

  actual policies that might get written would be spurious accuracy [½]

- in general, what is being asked for – indicative results (model points probably OK) [½]
- or something to be published (model points probably not OK) [½]
- if a new product no model points available [½]
- size and importance of the line of business [½]

Regulatory/professional (and TAS) requirements [½]

- some investigations must be performed using actual policy records eg supervisory valuation [1]

- Speed of results [1]
  - using model points will speed things up [½]
  - a large portfolio may take too long to run; a small portfolio might not need to bother with model points [1]
  - how much computing power is available [½]

- Accuracy level required [1]
  - model points will always degrade accuracy – decision needed on trade off between this and other issues [1]

- Availability of actual policy records [1]
  – and in the correct format for the model [½]
  - data feeds may not have been built to drive model using actual policies [½]

- Difficulty of determining model points [1]
- The underlying business being modelled will typically comprise a very wide range of different policies, [½]
- and these will need to be brought together into a manageable number of relatively homogeneous groups. [½]
- The groupings need to be made in a way that each policy in a group is expected to produce similar results when the model is run. [1]
  - some judgment can be required as to how to average out actual policies into model points eg
    - what points to average over can affect the final result eg can age be averaged, how about sum assured [1]
  - may need to spend money on new systems/ testing time/delays to implementation [½]

[Marks available 17, maximum 7]

(ii)

The potential reasons for valuing liabilities using a stochastic model include:

- The stochastic model can successfully mimic the most important characteristics of the insurer's liabilities. [1]
- A stochastic model is potentially more objective in incorporating allowance for uncertainty in key risks than a deterministic model. [1]
- For example in allowing for
  - …. e,g. volatility in asset values [½]

- …. or uncertainty in claims experience [½]

- A stochastic approach can provide management with more insights into the variability of the company's liabilities, and the potential risks the business is subject to as it can provide a distribution of results. [1]
  - This can help management understand the impact the liabilities of extreme events [½]
  - Or allow management to understand the implication of certain decisions e,g. the impact of investment mismatching on liabilities. [½]

- A stochastic model can allow for various factors which could impact liabilities in different circumstances, which cannot be accurately modelled using a deterministic model. For example: [1]
  - The impact on liabilities of lapse rates varying dependent on economic circumstances. [½]
  - Allowing for the impact of management actions on liabilities [½]
  - Better understanding of tail risks [½]

- A stochastic model will be needed to model the impact on the insurer's liabilities in the event that economic circumstances are volatile. [1]
- Stochastic models are particularly useful in assessing the value on insurance policies where insurance liabilities vary in a non-linear way. [1]
  - …..e.g. where the insurer's liabilities have maturity guarantees or guaranteed annuity options. [1]
  - And better modelling of correlations [½]

- Stochastic model likely to be required where accuracy of the results is more important than the time taken to produce the results. [½]
- A regulatory requirement to value liabilities using a stochastic model may have recently been reduced. [½]
- The model has been thoroughly tested and audited and the insurer is confident that it working correctly. [1]

[Marks available 12, maximum 8]

(iii)
We are left to work out whether the values produced by the stochastic model agree with the formulae specified. [½]

We will need to check both the mean output value and a range of other point values in the distribution of results. [1]

Possible ways are:

- pick a single simulation output result and try to reproduce eg spreadsheet, simplified deterministic model [1]
  - do this for some assumptions near the mean, as well as for more outlying outcomes [1]

- sensitivity test the results [1]
- reconcile with last time's result (assuming accurate!) [1]
  - a step through analysis of each data/assumption/method change could be used (effectively analysis of surplus/change) [½]
    - would make sure each step change result appears reasonable [½]

back of the envelope ballpark estimates although stochastic results are often counter intuitive [1]

- ask for peer review [½]
- ask qns of modelling experts/review documentation of model [½]
- Check against experience once there is some [½]

In all of the above need to allow for:

- how much margin of accuracy is required [½]
  - can be difficult to get similar models producing the same results to low % points of accuracy [½]
  - how material is the line of business [½]

[Marks available 11½, maximum 4]

[Total marks available 43½, maximum 19]

(i)	*This part was answered OK, although a number of candidates focused on one issue rather thinking more widely*
(ii)	*This part was answered poorly with most candidates again not answering the question in enough breadth to score well.*
(iii)	*This part was also answered poorly with simple checks discussed but other ideas were rarely discussed and most answered lack depth to explain the points that were being made.*

Q9

(i)

Correct perceived market inefficiencies and promote efficient and orderly markets [½]
Protect consumers of financial products [½]
Maintain confidence in the financial system [½]
Help reduce financial crime [½]

[Marks available 2, maximum 2]

(ii)

Unregulated markets – i.e. not regulated by any party [1]
Voluntary codes of conduct, so companies choose to join or not [1]
Self-regulation – that is policed and regulated by the companies in the industry, maybe with an oversight group made up of the companies' governance teams. Organised by market participants. [2]
Statutory regulation – government or equivalent set down the rules [1]

and police accordingly to ensure the rules are being followed. [1]
Mixed. Combination of some of the above. [1]

[Marks available 6, maximum 3]

(iii)
Unregulated

Advantages
- Lower costs [½]
- Potentially increased innovation in the industry [½]

Disadvantages
- Lost confidence in the market [½]
- Relies on everyone "playing by the rules" [½]
- Risk of mis-selling and suboptimal outcomes (for retail in particular) [½]

Voluntary code

Advantages
- Effective for some markets [½]
- Cost effective [½]

Disadvantages
- Open to rogue traders who do not comply [½]

Self Regulated

Advantages
- Lower costs than regulation [½]
- Self policing, gives responsibility to the experts rather than a regulator who may not know all the details of the products [½]
- Potentially increased innovation in the industry, but regulated by other experts to ensure meets needs etc [½]
- As they have the most knowledge, they should in theory optimise cost versus effectiveness. [½]
- However, regulator will be very close to its market, may be weaker than it should be (or seen to be so). [½]

Disadvantages
- Lost confidence in the market compared to regulatory but better than non regulated [½]
- Relies on whistleblowers [½]

Statutory Regulated

Advantages
- Generates confidence in the market [½]

- Ensures everyone is playing by the same rules and protects consumers [1]
- Should be less open to abuse or influence, and this protect fair markets. [1]

Disadvantages
- More costly [½]
- and could stifle innovation [½]

Mixed

Advantages
Means different sectors get the most appropriate level of supervision [½]

Disadvantages
Does require co-operation and openness however. [½]

[Marks available 12, maximum 3]

(iv)
Cost of changes. [½]
Loss of expertise and capital if new regime less attractive to business. [1]
Large market participants – in the new smaller standalone country one or two firms may be overly dominant [1]
so need to avoid monopolies and anti-competitive practices. [½]
Also these firms could absorb most of the regulator's time, to the detriment of consumers. [½]
Country F's firms are no longer able to trade on preferential terms with Bloc E. [1]
Loss of access to customers to firms which remain in Bloc E. [½]
Also increased cost of business to business transactions. [½]
Loss of competitive pressure if Country F citizens can no longer access firms based in Bloc E as easily – less innovation, higher prices for consumers. [1]
Volatility in currency and financial markets caused by the change making planning difficult. [1]
Loss of confidence from the public leading to reduced participation in the industry potentially with an impact on the wider economy [1]
Unless rules are not followed with a transition period it could be an uncertain time on what the processes actually are. [1]
Lack of investment from some companies until rules understood [½]
May not have the resources to do immediately, both in the companies affected and the regulator to enact the new rules [1]
Possible lower regulation being a positive for the sector [½]

[Marks available 11½, maximum 4]

(v)
If Country F moves to a less regulated regime, its firms may undercut Bloc E firms. [1]
Negative impact on Bloc E firms if they cannot compete due to higher level of regulation or reserving [1]
And risk to its consumers if Country F companies become less secure [½]
due to relaxed regulation. [½]
Will they need to bail out residents who have less safe investments in Country F? [½]
If Country F does well, will others want to leave? [1]

Impact on companies in Bloc E that supply Country F, eg outsourced services such as IT. [½]
General concerns could include:
Exchange rate fluctuations – could be positive or negative [1]
Higher inflation leading to higher wage and input costs [1]
Cost of complying with two sets of regulations (could be contradictory) [½]
Supply chain disruption in particular if use "just in time" techniques [½]

[Marks available 8, maximum 4]

(vi)
Could work together to understand where areas of the different regulatory environments could be harmonised. With the effect of only changing areas that both parties were comfortable with on day 1 of the new arrangement. [2]
Could impose restrictions on Country F companies selling to Bloc E. [½]
Or insist that they abide by Bloc E rules if they wish to trade. [½]
And vice versa [1]
Change its own regulatory regime to remain competitive – consider what other countries are doing worldwide. May be politically impossible [1]
Any wider ranging changes could come in over a transition period of a number of years, enabling countries and companies to adapt and put things in place to minimise the changes in regulation. [1]
This could include buying/selling companies and working to be in the jurisdiction where the majority of the business is written for the companies. [1]
Could introduce tariffs or rules for working across the 2 regimes – this would involve a large amount of negotiation. [1]
Could consider different trades off for specific areas [½]
Give credit for any reasonable arguments [1]

[Marks available 9½, maximum 4]

(i)	*This part was answered exceptionally well with most candidates scoring full marks*
(ii)	*This part was answered very well, with candidates scoring high marks. Some candidates did go into more detail on the regimes which was not needed for this part. Some candidates wrote solutions to (ii) and (iii) at the same time and these generally were well thought and structured well and therefore scored the marks in the relevant parts.*
(iii)	*This part was also answered very well*
(iv)	*This was answered less well compared to the first 3 parts with a number of candidates focusing on F in isolation and not considering the wider issues.*
(v)	*Stronger candidates did see the question from both sides and therefore scored well.*
(vi)	*This was answered less well with only 1 or 2 ideas being given, therefore not going into enough breadth to score all the marks available.*

[Total marks available 53, maximum 20]

END OF EXAMINERS' REPORT