

INSTITUTE AND FACULTY OF ACTUARIES

EXAMINATION

26 April 2022 (am)

Subject CP1 - Actuarial Practice Core Practices

Paper Two

Time allowed: Three hours and twenty minutes

In addition to this paper you should have available the 2002 edition of the
Formulae and Tables and your own electronic calculator.

If you encounter any issues during the examination please contact the Assessment Team on
T. 0044 (0) 1865 268 873.

1 Background

TT Insurance is an insurance company, owned and established by four individuals, and based solely in Country A. TT Insurance specialises in travel insurance and sells no other types of insurance. TT Insurance heavily markets its products via social media. TT Insurance currently only sells a simple travel insurance product.

TT Insurance's marketing strategy focuses on the simple product and it aims to make it as easy as possible for customers to buy this product.

TT's travel insurance product only provides the following cover:

- medical expenses if the policyholder becomes ill when abroad
- repatriation expenses for medical reasons.

TT's travel insurance is only available to customers aged under 65, with no pre-existing medical conditions.

The government of Country A is planning to introduce legislation making it illegal to ask potential customers for information relating to pre-existing medical conditions when applying for insurance products. Certain strictly defined forms of insurance will be exempt but travel insurance is not expected to be among them.

There are no regulations or legislation relating to Environmental, Social and Governance (ESG) considerations in Country A. However, investors in Country A generally expect well-run companies to have high ESG standards and practices in place. The government of Country A is considering introducing regulation to make ESG reporting a requirement for all companies, with the possibility of stronger requirements in future if considered necessary.

Questions

- (i) Discuss why TT may have decided to only offer this single product. [10]
- (ii) Discuss how the change in legislation limiting the questions that may be asked will affect TT's business. [8]
- (iii) Suggest the data issues that may arise for TT as a result of this change in legislation. [6]
- (iv) Describe two low-likelihood high-impact risks for TT's travel insurance. [4]
- (v) Discuss how the risks outlined in part (iv) could be managed or mitigated. [5]
- (vi) Describe how ESG considerations could impact insurance companies. [7]
- (vii) Suggest how any changes to ESG regulation could impact TT's business. [5]
- (viii) Suggest how TT could raise additional capital if needed. [5]

[Total 50]

2 Background

A regulator in Country C is reviewing the regulatory reserving and capital requirements for insurance companies and the technical provisions in respect of pension schemes. The regulator has a particular concern that the allowance for credit risks being calculated is insufficient for traded and illiquid corporate bonds. This concern relates to both the bond credit ratings and valuations of the bonds.

Insurance companies and pension schemes can assess the credit rating of an asset using its internal processes and controls. This is referred to as an internal credit rating. The alternative to an internal credit rating is an external credit rating provided by an independent regulated credit rating agency.

The regulator is considering the following three options for credit ratings for corporate bonds in order to address its concerns:

- (a) A requirement will be introduced that only credit ratings provided by regulated credit rating agencies can be recognised for bonds. All other bonds will be treated as unrated.
- (b) Credit ratings used for regulatory purposes must be determined by the regulator.
- (c) The regulator will continue to allow both internal and regulated credit rating agency ratings to be used. The regulator will introduce a requirement that a firm or pension scheme can only recognise internal credit ratings for regulatory purposes if the firm or scheme can demonstrate the effectiveness of its credit rating system. To demonstrate the effectiveness of its credit rating system, it will need to demonstrate the reliability of its credit rating being within a tolerance range of credit ratings that could be obtained from regulated credit rating agencies for a sample of its bonds.

The regulator is required to assess the effectiveness, implications, relevance, importance, suitability and/or value of changes to regulations including the impact on insurance companies and pension schemes before implementing changes.

Questions

- (i) Outline why a pension scheme or insurance company invests in corporate bonds. [6]
- (ii) Write down the purpose of a regulator. [2]
- (iii) Explain why a regulator would review regulations and supervisory practices. [6]
- (iv) Outline how key stakeholders will be affected by the regulator's review of regulatory reserving and capital requirements. [5]

- (v) Describe the skills and experience of the specialists the insurance regulator will need to consult, in order to review and update its regulations for credit risk. [7]
 - (vi) Assess the three options for credit ratings for the regulator. [18]
 - (vii) Discuss, for each of the three options, the supervisory challenges for the regulator. [6]
- [Total 50]

END OF PAPER