

Actuarial Society of South Africa

EXAMINATION

May 2021

Subject N211 — Communications

EXAMINERS' REPORT

This subject report has been written with the aim of helping candidates. This report summarises the main points that the examiners were looking for and some common problems encountered.

QUESTION 1

The examination required the candidates to draft an email response to a financial advisor in response to a complaint about investment performance. The student had to differentiate between the performance achieved by the fund and the performance for a particular investor. The key differentiator being the timing of significant withdrawal from the investment by the investor. The objective of the email was to convince the advisor and investor that their investment was in good hands even after what appears to be dismal performance and that they should remain clients of the fund manager.

Many students failed to clearly show that they understood the relationship and differences between

- *the benchmark, or longer term expected return,*
- *the actual investment return of the fund without consideration of any particular investor,*
- *the return shown in the marketing material and*
- *the actual return for the investor.*

The candidates who understood the relationship between these returns were able to explain the performance and generally did well.

The question included an instruction to illustrate performance of the fund compared to its benchmark and this presented an opportunity to include a graph which very few candidates did. A table could also have been used but is less visually appealing and a less efficient means to illustrate the performance within a word count limitation.

To achieve the objective the email needed to admit that the fund had not met its benchmark, acknowledge that the investor was disappointed, even though a large part of the poor return was due to the investor’s action, and promote how well the fund had done relative to its peers.

Students needed to be able to write this email with the correct tone. Some students were overly familiar as if they were writing to a family member. The examiners noted numerous students whose replies came across as patronising. The correct tone is a key part of these types of questions and is assessed by the examiners. It is a particularly important decision point for borderline candidates.

Students continue to make very simple mistakes which generally result in them failing. For instance, the examiners saw numerous candidates who misspelt the clients name or used an incorrect title for the customer.

Question 1 - Draft Solution

From: alex@investmentmentsunlimited.co.za
To: peter@wealthadvisors.co.za
Cc: justice@investmentmentsunlimited.co.za
Date: 27 February 2021 16:29
Subject: Poor investment performance – Investor number 13579

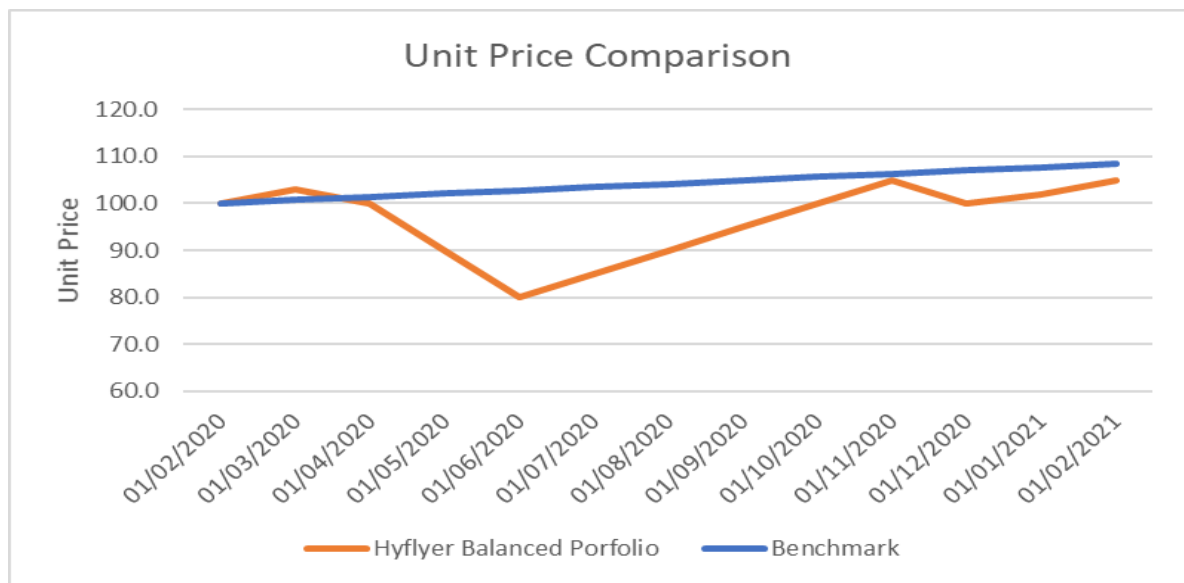
Dear Mr Jacobs

You recently sent an email to Justice Sithole about the investment performance on Ms Ryder’s investment and he has asked me to respond to your email.

Fund Performance

The performance of investment markets over the last 12 months has been volatile. Even though the portfolio holds some funds that are not invested in equity, the fall in equity prices significantly affected the performance during the year compared to its benchmark.

The benchmark for this portfolio is the consumer price index for the period plus 5%, before investment management expenses. For the purpose of comparison in the graph below, the benchmark return has been converted to a unit price that increases consistently by 0.68% per month to give a total compound return for the 12 months of 8.5%.



A key feature of the Hyflyer portfolio is the fall in the unit price to a low of R80 on the 1st June 2020 having started the 12 month period at a price of R100. Also, note that the unit price has recovered as equity markets have recovered to a unit price of R105 on 1st February 2021.

While the recovery after 1st June 2020 made some progress towards achieving the benchmark for the 12-month period, the return of the portfolio was less than the benchmark. The time horizon for the benchmark return is three years so it is expected

that some shorter periods within a three- year period will provide returns below the benchmark return and others will provide returns above the benchmark return.

Ms Ryder’s Return

The investment statement correctly shows the return of -6.4% for the year. I appreciate your concern about this return when the marketing material correctly claims a return on the portfolio of 3.4%.

The portfolio unit price increased from R100 to R105 over the 12 months which is a 5% gross return before any expenses. The difference between the portfolio return and Ms Ryder’s return can be attributed as follows:

	Actual	Benchmark
Gross Portfolio Return	5.0%	8.5%
Reduction in return due to investment management expenses	-1.6%	-1.6%
Portfolio Return net of investment management fees	3.4%	6.9%
Reduction in return due to commission	-1.9%	-1.6%
Reduction in return due to timing of Ms Ryder’s withdrawal	-7.9%	
Ms Ryder’s Return	-6.4%	5.3%

The most significant reason for the lower return is the unfortunate timing of the R1.2m withdrawal made by Ms Ryder on 1st June 2020, when the portfolio unit price was at its lowest value. The portfolio had negative returns before the withdrawal and positive returns after the withdrawal. The timing of the withdrawal has no effect on the benchmark return because the benchmark return is deemed to be earned at the same rate over the whole period.

The reduction in return due to your commission is higher than the commission you charge of 1.5% because no investment income would be earned on the commission amount after it was paid, and the positive investment return was earned after the commission was paid.

As a result of the withdrawal and commission being paid out at the time that the portfolio was at its lowest value, these funds missed out on the recovery and positive investment returns from 1st June onwards. The return achieved on Ms Ryder’s investment was therefore well below the return achieved on the portfolio for the 12-month period.

Conclusion

Our net of fees return of 3.4% compared to the average return of our peers of 2.5% for the same period for similar portfolios highlights how well we have performed over this period.

This has been an unusual year, but we already see the start of the recovery and are doing everything to ensure that the Hyflyer portfolio meets its benchmark objective. We look forward to your continued trust in Investments Unlimited to meet your clients’ investment needs and expectations.

If you have any further questions, please email me directly.

Subject N211 (Communications) – May 2021 – Examiner' Report

Yours sincerely

Alex Peters

<Company Email Signature>

[642 words]

QUESTION 2

The question required candidates to draft a Powerpoint presentation to the Board of Directors of New-Gen Insurance Co, which aimed to explain business interruption insurance (BI) to the Board members, and to explain the High Court rulings that had been made on the subject of BI cover during the Covid-19 pandemic, with specific reference to the Santam case.

This question was simple and straightforward with many easy marks on offer. The only difficulty was the amount of the reading required to answer the questions. However, candidates who managed their time appropriately should have scored reasonably well, and this was reflected in the relatively high scores for this question.

The main reason students dropped marks was leaving out important information about BI cover, and a lack of clarity about the Santam case and the key determinations made by the Court, both of which were critical to explain the situation to the Board.

The other area where students lost marks was due to a lack of a logical structure to the presentation, even though a proposed agenda was provided in the question.

Question 2 - Draft Solution

BUSINESS INTERRUPTION AND COVID-19: A LEGAL MINEFIELD

To: New-Gen Board
By: Peter Ndlovu, New-Gen Insurance
Date: 1 May 2021

Agenda

- What is Business Interruption Insurance?
- How does it work?
- Example of business interruption
- Covid-19: local state of play
- Learnings from the Santam case
- Covid-19 or the Lockdown?
- Risks and future developments

What is Business Interruption Insurance?

- Written as an add -on to policies
- Only applies to the commercial property class
- Purpose is to indemnify policyholders from losses suffered by being unable to carry on their business due to an insured event

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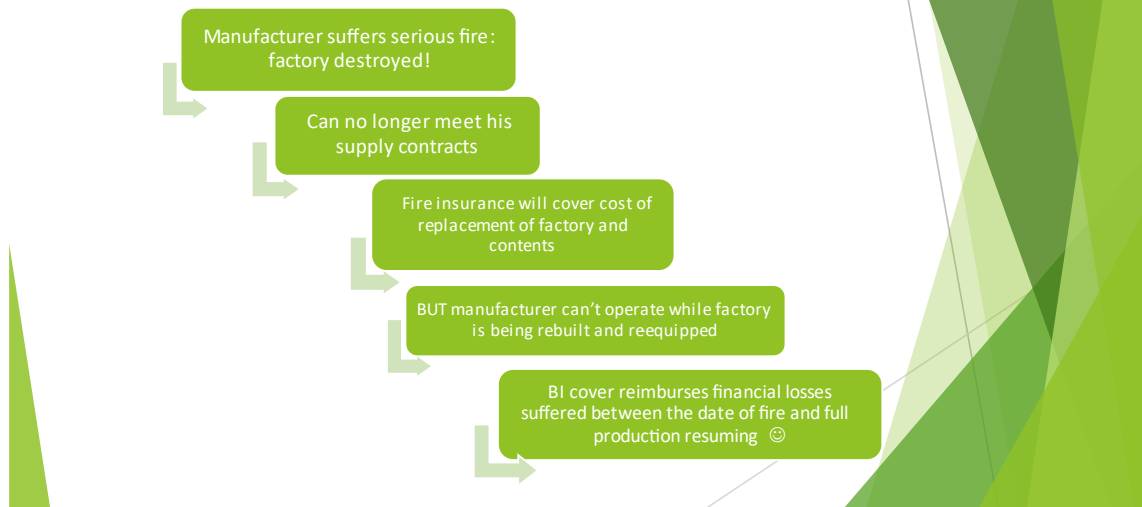
How does it work?

Three types of claims in business interruption

Major damage loss:	where an insured event at the insured’s place of business leads to the insured being unable to continue his business for a period.
Consequential loss:	where an insured event at a key partner leads to the insured being partly or wholly unable to continue his business for a period.
Non-damage loss:	where some other event, which is not otherwise insured, causes the insured to suffer a loss of profit, such as the presence of a notifiable disease in the area, resulting in a quarantine or limitation of travel to the area.

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Example of business interruption: factory fire



Covid-19: local state of play

Two categories of business interruption insurance impacted by Covid -19

Standard business interruption insurance (most SA policies)

- Requires an underlying physical damage to, or loss of, property.
- Claims under this type of insurance have been rejected by SA insurers
- **For what reason?**
 - Because Covid-19 does not cause physical damage to property.

Where a policy has an extension for infectious or contagious diseases

- SA High Court found against Santam and other insurers.
- The Covid-19 lockdown was a valid claim.
- **For how long?**
 - Losses for 18 months from start of lockdown must be covered.

Learnings from the Santam case

- The central issue was the interpretation of the policy wording.
- Was the cause of the insurance event due to Covid-19 or the lockdown?
- The court found that the outcome must be one that is fair, sensible and business -like.

Covid-19 or the Lockdown? Santam's argument rejected

- Santam agreed that Covid-19 is a notifiable disease.
- Santam accepted the initial claim as staff were quarantined for two weeks.
- Subsequent claims were submitted.....

BUT

- Santam rejected these on the basis that they were due to a national lockdown.
- A national lockdown was NOT included in their policy wording.....

BUT IS THIS fair, sensible and business-like?

WC High Court disagreed and rejected Santam's argument.

Risks and future developments

- **Risks to the insurers are based on:**
 - The quantum of claims being much higher than was expected in the pricing basis.
 - Ambiguous policy wordings that resulted in legal challenges.
- **Latest developments**
 - New policies and policies that have been renewed specifically exclude Covid-19.
 - Policy wordings will be amended to reduce interpretation issues going forward.
- **New-Gen’s response**
 - Review policy conditions to be explicit in what is covered.
 - Consider revising pricing as well.

Conclusion

For more useful information on the subject visit:
<https://www.bdo.co.za/en-za/insights/2020/covid19/covid-19-and-business-interruption-insurance>

Any Questions?



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THANK YOU

END OF EXAMINERS’ REPORT