Actuarial Society of South Africa

EXAMINATION

13 May 2013

Subject A302 — Communications

EXAMINERS' REPORT

General Examiner's comments

For both questions, most candidates demonstrated a good understanding of the underlying technical issues. There were some critical points that were either poorly explained or completely missed out.

Question 1

- Not many candidates gave an examples showing the mechanics of a medical aid scheme, with those that did using confusing numbers, which meant the example did not aid the explanation.
- Many candidates suggested the savings account was equal to a year's worth of premiums, when in fact it was a year's worth of the savings component of the premiums.
- A disappointing number of candidates did not explain the per visit maximum well. They did not make it clear that the member would be required to pay for claims in excess of this amount.
- Whilst the Gap in cover maximum was generally addressed by most candidates, not many went on to explain that it was agreed upfront, with some candidates even suggesting that it was negotiable.
- A disappointing number of candidates failed to highlight that the hospital plan did not limit the number of hospital visits. In some cases, candidates implied that only one visit was covered.

Question 2

- A number of candidates did not get the mortgage repayments calculations correct, either due to use of an incorrect effective interest rate (9% versus 9.4%) or just using an incorrect equation of value. A significant number also disappointingly gave R2.5m or R2,67m as the required drawdown on the pension in order to get the R2m required to purchase the house. Rounding (other than to the nearest rand) in this instance is not appropriate.
- A scenario of this nature require precise calculations to be provided – it is not appropriate to give numbers that were "around R18 000".
- Despite the question explicitly requesting that "Mrs Mabena would prefer the explanation to demonstrate the impact of the two options on her household expenditure on a monthly basis.", only a small proportion of candidates actually answered this question.
- A number of candidates converted the 9% prime (and the 12% savings rate) to monthly rates, which the client was unlikely to be able to relate to. Monthly rates are not colloquial and do not give the customer a feel of whether the rates are reasonable on not and are out of kilter with what she would have encountered in reading the press.
- Some candidates failed to clarify that the prime rate was an estimate and could change quarterly and therefore not guaranteed.

- A number of candidates also failed to state that 12% investment return was an estimate that could not be guaranteed.
- Although most candidates correctly attributed the drawdown option being more expensive to the impact of tax, only a handful also explained the difference between the borrowing rate (prime) and the savings rate (12%).
- Almost all the candidates correctly recommended the mortgage option.

Question 1

Brochure

Format: This is the content for a brochure, and no marks are available for creating a format that looks like a brochure, as this was specifically excluded from the question. Marks are available for appropriate use of paragraphing, and creating a document that can be input directly into a brochure format, without requiring intervention from the marketing team. Next steps (or similar) are important in the brochure format, as the potential client must be led to action in some way.

Language and tone: This section includes choice of words, register/level of language, avoidance of jargon, style and tone etc. It is important that the brochure is written in an accessible tone to appeal to a potential new customer, who would be the man in the street. The language use should be jargon-free and yet explain clearly and simply what the concepts are. A tone that is promotional in nature is required, so more than just a technical explanation. The tone must convey that Agreeable Health understands the client's needs and the product is designed to meet these needs. It does not need to be a hard sales pitch. An appropriate tone would be one that explains the product features clearly, in a way that highlights the benefits of the product to the client. The client's interests must be represented as central to the product.
Using terms such as 'we' and 'you' in the brochure is appropriate, and suggested by the opening paragraphs given.
A professional approach is still required, which is not familiar or colloquial as still strangers and this is a professional exchange, so no silly or unnecessary examples.

Planning and structure:
This includes the logical, coherent arrangement of information. The use of headings should be appropriate. How the brochure progresses through the different concepts must aid the explanation of the product in a step by step fashion. It is important to deal with the features related to out-of-hospital expenses clearly and completely, including the Gap-In-Cover and the Per Visit Maximums, and then separately the in-hospital benefits, in an order that makes sense and 'hangs together' well. The explanation should not jump around between the concepts, in a manner that causes confusion. Any diagrams should aid the verbal explanation, and make sense in the context of the rest of the brochure.

Overall impression and objectives: How does the brochure 'hang' together in terms of unity, coherence and emphasis, logical development, and structure of message? Do all the elements above work together to create a good impression of the product? Would the reader of the brochure understand the out-of-hospital benefit features? Would the reader understand the in-hospital benefit features? Should the reader be comfortable that he or she understands the entire product sufficiently assess if it is worth to possibly find out more about MedPlan?

Content

1. The member pays monthly premiums in respect of the product.
2. Out-of-hospital benefits
    - An explanation of what an out-of-hospital benefit is – visit with medical practitioner – eg doctor or dentist
    - MedPlan provides for this through a savings plan
    - Explanation of savings plan
        - Upfront balance
        - The year’s full savings premium allocated at the start of the year
        - Full balance can be used from day 1, even if you have only paid a small amount in premiums
    - An explanation of the Per Visit Maximum
        - Can only claim per visit up to this maximum
        - Any fee above this maximum is for the member’s own account
        - Applies for both the out-of-hospital and in-hospital benefits
    - An explanation of the Gap in Cover Period
        - Starts when savings account exhausted
        - Member responsible for benefits after this point
        - Member pays only up to Gap In Cover Maximum
        - Gap In Cover Maximum explanation - a fixed amount, set at the start of the policy year (not correct if the script says the member chooses this level or that it is negotiated)
        - Member needs to submit the claims paid during this period.
        - Once member has paid the Gap In Cover Maximum, Agreeable Health starts paying for out-of-hospital claims again
            - Up to Per Visit Maximum
    - Cohesion of explanation / Diagram to represent the product features
        - Marks available if the full explanation of the above concepts is summarised coherently and helpfully or represented in a diagram to clarify how they work with each other. (The diagram should not be judged on its demonstration of how to do a picture in Word, but rather if it aids the explanation – there would not have been a lot of time for

a perfect diagram.) A good numerical example could also be appropriate.

- In-hospital benefits
    - Hospital cover available for hospitalisation events – including all related surgical, hospital and specialist attendant doctor's costs (or a similar, valid explanation of what would constitute an in-hospital event)
    - Covers as many hospital visits as the member may have
    - Not covered out of savings plan – operates like insurance
- Next steps
    - Telephone number given to assist with next step

Question 1

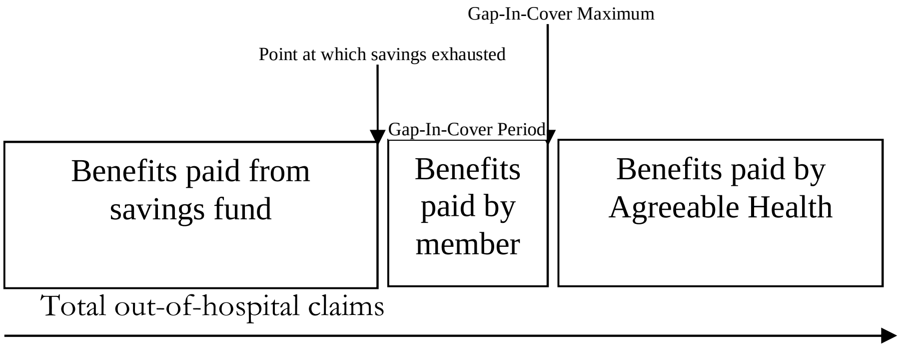
Introducing MedPlan

At Agreeable Health, we know that medical expenses are unpredictable. Unforeseen events can have a devastating effect on your family's financial wellbeing. We are committed to providing you with comprehensive and affordable benefits, giving you complete peace of mind when it comes to your medical needs.
MedPlan, our new generation medical scheme product, is designed to do just that. It not only helps you manage your out-of-hospital medical expenses but also provides comprehensive in-hospital cover.

Out of hospital benefits
A consultation with a medical practitioner, for example a doctor or dentist, would constitute an out-of-hospital event. MedPlan helps you provide for these expenses through a savings fund. At the start of every year, Agreeable Health will grant an upfront balance into your savings fund. In other words, the *total* of a year's savings premiums are allocated to you at the start of the year. This upfront balance means that even if you need out-of-hospital treatment at the beginning of the year, there would be funds available for this.
The savings fund will cover out-of-hospital medical expenses subject to a Per Visit Maximum.

Per Visit Maximum
The Per Visit Maximum is the maximum amount that you can claim for each out-of-hospital event. If the medical practitioner charges more than this maximum, you would be responsible for the amount of the medical bill above this maximum. The Per Visit Maximum applies for both the expenses claimed from your savings account, as well as your out-of-hospital visits after the Gap-In-Cover Period.

Gap-In-Cover Period
Should you use your entire savings fund amount during a particular year, you will enter into a Gap-In-Cover period. During this period, you will be responsible for the payment of your out-of-hospital expenses. It is important that you let us know about medical expenses you are incurring during this period because you only need to pay a total of the Gap-In-Cover Maximum. Once you have paid this maximum amount, Agreeable Health will cover any further out-of-hospital expenses without any overall limit, and only subject to the Per Visit Maximum.
The Gap-In-Cover Maximum is set at the beginning of each year, so you know exactly what to expect. The diagram below represents this sequence.



In-hospital benefits

If you require hospitalisation, MedPlan will cover all the medical expenses associated with your hospital admission including the hospital costs, surgical costs and the costs of attending medical professionals. This cover is unlimited and is available to you for as many hospital visits as you may have.

The balance in your savings account is not affected by the claims paid by Agreeable Health for in-hospital treatment.

Next steps

MedPlan is an affordable way to make sure that you have the funds available to cover medical expenses as and when these occur. This means that you can rest assured knowing you have access to medical treatment when you need it most.

This product is designed with you in mind. Call the Agreeable Health call centre on 0860 001 002 for all the detailed information you may need and for assistance with the MedPlan application process.

Question 2

Letter

Format: The correspondence should resemble a formal letter, with the company letterhead, the client's address, date and heading. The format mark also includes a formal salutation (Dear Mrs Mabena) and close (Yours sincerely).

Language: This section includes choice of words, register/level of language, avoidance of jargon and overly numeric approach, style & tone, grammar, punctuation, spelling etc.

Planning and structure: This involves the use of headings from the subject line to headings in the body of the letter. Also includes the logical, coherent arrangement of information, good sentence and paragraph structure, good clear use of information without technical formulae etc. as well as good beginning, middle, end conventions. Opening paragraph: goodwill and topic identification; relevant body explanations and close: goodwill once again and pointing the way ahead.

Objectives: Would you be satisfied to receive this letter? Does it explain the options satisfactorily? Do you understand what has been described to you? Would the client understand the mortgage option? Would the client understand the impact if she opts to make a withdrawal from retirement savings? Is there a clear recommendation, including the monthly difference?

Content

1. Taking out another mortgage

- Purchase can be funded via a mortgage
- It would work the same way as her current mortgage
- She would borrow the full R2m
- And repay it over 20 years
- She would be able to borrow the money at the prime interest rate
- Infinity's (the advisor's) estimate of the long-term prime interest rate is 9% p.a.
- This is not guaranteed and is subject to change each quarter
- At 9% p.a. the monthly bond repayment would be R17 994.52 per month over the 20 years (credit given if R17 545.26)
- (Total repayments of R 4 318 684.80 – asked for monthly but not penalised if give total)

2. Withdrawing money from existing retirement savings

- Currently have R3million saved towards retirement
- No restrictions on how much can be withdrawn
- But have to pay tax at 25% of the amount withdrawn
- Need to withdraw R2 666 667.67 pre-tax to fund the purchase
- Have enough saved to fund the purchase of the holiday home using this savings
- Will have very little savings left in the retirement plan (can mention amount)
- Option would be to set up a new retirement savings plan to make up the R2 666 667.67
- Save a monthly amount over the next 20 years
- Assume you can earn 12% per annum
- This is not a guaranteed return
- Contributions of R29 362. 30 per month would be needed for the 20 years (if R28 229.96 partial credit given)
- (Total of R7 046 952 over 20 years)
- These contributions would be made from after tax income

3. Explanation of why the number work out the way they do:
    - Need to replace tax
    - Earning a higher interest rate on savings than have to pay on borrowings – need to make up a higher amount on savings to be in the same position

4. Recommendation

- Fund via a mortgage
- Monthly amount is R11 367.80 more if you take it out of savings

Question 2

Company letterhead
Date

Ms A Mabena
12 4th Avenue
Parktown North
Johannesburg
2193

Dear Mrs Mabena

Funding your holiday home

Buying a holiday home is a very exciting prospect *but* funding such a venture takes careful thought so I am pleased you are seeking advice on how to proceed. I have examined your current financial situation in the light of the R2 million purchase price, and have established that there are two options available to you. You can fund this purchase by taking out a mortgage against the property or you can use a portion of your retirement savings. This letter will explain these options as well as set out my recommendation for the better one.

Funding through a mortgage

It would be possible for you to take out a second mortgage to finance the purchase. This would work in exactly the same way as your current mortgage. You would borrow the R2 million from the bank and would repay the loan monthly over a 20 year period. The bank is willing to lend you the full amount at the prime interest rate.

At Infinity Incorporated we have estimated that the long-term prime interest rate will be 9% per annum. If this is the case, the monthly repayment on the bond will be R17 994.52 per month over the 20 year term of the bond. The total repayments under the bond will amount to R4 318 684.80.

This is an estimate, however, as the prime interest rate is subject to change every quarter.

Withdrawing money from your retirement savings

You currently have R3 million saved towards your retirement. There are no restrictions on how much you can withdraw from these savings. You will, however, have to pay tax on any amount you withdraw at a flat tax rate of 25%.

This means that, in order to finance your R2 million purchase, you would need to withdraw R2 666 667.67 from your retirement savings. You therefore have enough saved to pay for the full purchase price of your holiday home, but will have very little retirement savings left if you select this option.

A new savings plan would then be set up to rebuild your retirement savings. In order to make up the full amount you have taken out, you would need to save enough to cover both the R2 666 667.67 taken out, as well as the interest that would have been earned on this amount over the next 20 years.
Assume that you could earn an investment return of 12% per annum, and make monthly contributions to this new savings plan for the next 20 years. You would need to contribute R29 362.30 per month to make up the withdrawal you have made. This would mean a total amount to be paid of R7 046 952. The assumed interest rate of 12% is not a guaranteed return.

The contributions to this new savings plan would need to be made from your after-tax income as your existing retirement savings are already at the maximum tax benefit that is allowed.

Recommendation

The better option would be to take out a second mortgage to finance the purchase of your holiday home. It would mean an estimated monthly mortgage payment in the region of R17 994.52. The cost of making up savings in your retirement fund is R11 367.80 per month more than the mortgage repayment, at the assumed interest rates.

Please contact me on 011 723 1965 to discuss this further.

Yours sincerely

(signature)

Thabo Matabane
Senior Financial Advisor

(Word count: approximately 540)

END OF EXAMINERS' REPORT

