

EXAMINERS' REPORT

June 2012 examinations

Subject F102 — *Life Insurance* Fellowship Principles

INTRODUCTION

The attached report has been prepared by the subject's Principle Examiner. General comments are provided on the performance of candidates on each question. The solutions provided are an indication of the points sought by the examiners, and should not be taken as model solutions.

QUESTION 1

i. Uses:

- To update assumptions for product pricing, needed to ensure premiums/charges are robust to changes in withdrawal rates.
- As surrender values will be available, the rates can be used when setting surrender penalties.
(Note: not in setting surrender values as the product is unit-linked)
- To detect (and understand) any trends.
- Make projections for the future.
- Set assumptions for reserving basis.
- Set assumptions for embedded value calculations.
- Analysis of surplus.
- Compare with industry experience and investigate any significant differences.
- Would allow the identification of any problematic products or distribution channels.
- The persistency of various distribution channels (or individual sales staff) can be incorporated in remuneration.
- Production of management information reports.
- May be required by legislation.

ii. Reasons:

- There may have been a change in the mix of business by a factor not identified as impacting withdrawals (e.g. sex, if sex was not one of the factors analysed).
- Withdrawal rates can be particularly affected by economic conditions:
 - Increased unemployment leading to higher withdrawals.
 - Lower rates following when economy improves.
- Withdrawals may increase if the fund is perceived to be producing relatively low returns relative to competitors.
- Withdrawals may also increase after period of very good fund performance, as policyholders may feel they have made a sufficient return.
- Economic conditions can also impact on the type of person effecting a policy, and hence their future propensity to withdraw.
- Extrapolation of past data may not be all that relevant over a long period of time as so much may have changed.
- The sales process, distribution channel or target market may change.
- New product launches by the company, or by competitors, can impact withdrawal rates.
- Legal/tax changes may make it less attractive to retain the policy.

On the whole the question was answered reasonably. Many candidates, however, gave too few distinct points to score well in part (ii).

QUESTION 2

Implications:

- Policyholders will have developed expectations with respect to the:
 - level; and
 - volatility of the bonuses.
- PRE will have arisen from:
 - past practice of company;
 - marketing material, point of sale disclosure;
 - communication accompanying previous bonus declarations;
 - market practice.
- The practice of limiting smoothing will result in increased volatility, violating PRE.
- This increase in volatility also makes managing policyholder's expectations of a (relatively) smooth bonus rate going forward, more difficult.
- If policyholders wanted to share fully in the investment experience without smoothing, they would have taken out a unit-linked policy.
- In particular, if competitor's products provide a smoothed return, following a different strategy may be risky.
- However, some policyholders would prefer that surplus is distributed relatively earlier through higher reversionary bonus rates, which could have a positive impact on new business volumes.
- If the insurer were to adopt a lower volatility investment strategy, expected returns will be lower than before, which also violates PRE.
- A violation of PRE may have reputational and legal consequences for the insurer.
- The proposal means that terminal bonuses become the primary means of:
 - smoothing benefit payouts, and
 - allowing policyholders to share in mortality and expense experience.
- But policyholders will have also developed expectations as to the size of the terminal bonus relative to the reversionary bonuses.
- Any change in bonus distribution strategy would require careful communication.
- The change will create inequity between different generations of policyholders,
 - e.g., if free assets have built up in recent years, it would be penal to policyholders not to distribute this in part through smoothing.
(A different example could have been given.)
 - This could be dealt with via terminal bonuses although this could create an expectation that is not sustainable.
(Or any similar point about distribution of the estate)
- This bonus strategy would limit the deferral of surplus distribution which raises capital requirements.
 - This may require an increase in product charges to meet the increased cost of capital, making the product relatively less competitive.
 - And would constrain the amount of new business the insurer could write.

- Particularly as this is a mutual insurer and new business financing arises from the bonus distribution mechanism.
- Lower volumes would impact fixed expense recovery.
 - Especially as only the terminal bonus can be used to pass the expense risk on to policyholders.
 - And if charges on the unit-linked products are fixed.
 - Although the practice (of passing all the expense risk) onto unit-linked products could be inequitable and/or uncompetitive.

Some candidates did not read the question and suggested that smoothing will be removed when the question stated that it would be reduced (i.e. some level of smoothing still takes place). These candidates therefore did not consider the impact of the proposal on terminal bonus rates.

Stronger candidates were able to use the information supplied in the question to tailor their answers, e.g. for a mutual life office, the with-profit product range provides a source of capital and this proposal would have a negative impact on the available capital.

Some candidates suggested that any existing surplus that has not been distributed yet would be released if this proposal is implemented. These candidates therefore suggested an increase in the solvency position of the company. However, this ignores the claim of the existing generation of policyholders on this surplus.

QUESTION 3

i. It is likely that the distribution manager will want to reward brokers that:

- write high volumes of business for the insurer
- have access to particular target markets that are seen as key for future sales
- write more business with higher premiums / sums assured for insurer
- write business that has good persistency (including during the cooling-off period)
- write business that has good mortality experience
- perform some of the administrative tasks
- meet a certain standard of training/qualification which demonstrates their ability to sell in a knowledgeable way

ii. Advantages:

- The company will hope to attract more profitable business.
- Achieved through selling more business / business with better persistency / mortality / lower expenses.
- Could incentivise brokers to sell the desired types of business.
- Brokers will be sharing in the increased profits.
- May produce brokers who have an affinity to sell the company's products over those of other companies.

- May be an incentive for other brokers who currently don't work much with the company to become "key brokers".

iii. If the additional commission is not loaded for the insurer faces the risk of not making sufficient additional profit to cover the additional commission.

Manage by:

- Loading for the additional commission.
- Only pay the extra commission if there is an improvement in experience.
- Could be justified as a (short term) marketing expense until the fruits of the exercise come through.

There may not be the expected improvement in experience (mortality / persistency / expenses).

Manage by:

- Monitoring experience by broker.
- The commission could be earned only when improved experience has been demonstrated.
- Commission clawback can be implemented if business does not meet required standards.
- Renewal commission could be included to reward brokers for good persistency of business.

Premiums may become uncompetitive if additional commission has to be loaded for.

Manage by:

- Monitor competitive position (premiums & commissions).

Brokers may become unhappy, and stop selling your business, if they feel they have been put on the wrong (standard) commission scale.

Manage by:

- Monitor broker performance to ensure that "key" brokers aren't being overlooked.
- Provide clear guidelines to brokers as to how they could qualify for the "key" status.

It could result in brokers "mis-selling" policies just to ensure they get more commission or meet the "key broker" criteria.

Manage by:

- Monitoring the broker performance especially lapses.
- Ensure commission 'claw-back' is done and/or move to renewal commission.

New business strain could increase if sales increase as a result of the new commission structure. This could result in the company's capital being put under strain.

Manage by:

- Reinsuring – financial reinsurance or quota share with nil premium payment period or high initial reinsurance commission.
- Asking shareholders for more capital to ensure that the growth is supported.

It could start a commission “war” in the market as competitors match or better the commission you are paying. There is really nothing you can do to manage competitor's behaviour/response.

Part (i) was well answered

Part (ii) was reasonably well answered by most candidates.

Part (iii) was generally poorly answered. Most candidates did not even mention the key point that if the additional commission was not loaded for it would result in lower profits. Many candidates only gave the risk but did not indicate how to mitigate the risk as asked.

QUESTION 4

i. Data checks:

- Reconcile policy data between the beginning and end of the experience period.
- Check policy movements (including alterations).
 - By number, sum assured and premium.
- Carry out consistency checks with the recent data:
 - Compare data to previous years.
 - Compare with relevant data such as internal accounts.
 - Check for consistency of term with premium, etc.
- Look for any unusual values.
- Carry out spot checks.

ii. Choose a period of investigation long enough to give credible results.

But not too long so as to mask the impact of the recent experiences.

Subdivide the data by:

- Product type (e.g. for level and decreasing sum assured products)
- Age
- Sex
- Duration

- Location
- Lending institution
- Initial mortgage value
- Sum assured
- Dwelling type
- Occupation
- Income or marital status or socio-economic status

For each homogeneous group, consider the contracts issued in the last financial year.

The number of altered policies out of this cohort is divided by the exposure.

Carry out a similar process for 2nd and subsequent years.

Also check the average length of the extension for each homogenous group.

iii. A cash flow model can be used to project both assets and liabilities into the future,

The main steps to be taken are:

- Make a suitable assumption about amount and type of initial assets e.g. in relation to reserves plus assumptions about free capital.
- Estimate the liability experience for the next time period using expected future experience.
- Use a stochastic model for capital value changes and investment income on the various asset types over the same time period.
- Asset return assumptions should be consistent with the inflation assumptions used in the liability modelling.
- Determine statutory capital adequacy requirements and supervisory reserves at the end of the period having regard to the projected asset distribution.
- Repeat for as many future periods as required, and with lots of simulations of the investment returns.
- The statistical distribution of assets available to meet the liabilities each year can be determined.
- This can then be used to find the probability of insolvency given the strategy.

iv. Implications for investment strategy:

- Term:
 - Longer term, so asset term may need to increase.
 - A longer asset term suggests greater asset volatility.
 - So may need to increase proportion of conservative assets.
- May wish to make a tactical switch to safer assets in any event, given current climate.
- Need to ensure the company is not over-exposed to property as an asset class.
- Or structured products involving mortgages.

- If free assets are sufficient, the company might be able to do nothing and accept the higher mismatching and reinvestment risk, especially if suitable longer dated assets are not available.
- If suitable longer dated assets are not available (e.g. government bonds) the company might be able to use derivatives to increase the duration of the assets.
- Longer liability term increases expense inflation risk, which may require increasing both term and weighting of index-linked bonds.

This question should have been a reasonably straightforward application of bookwork, but was answered poorly.

In part (i) a number of candidates provided lists of checks that were completely irrelevant to the question, e.g. “check staff” or “is the loan still being paid off?” A surprising number of candidates provided no detail to demonstrate understanding e.g. “check that the data is accurate and free of errors” or “do recon check” without then providing further clarification and got no credit.

In part (ii) a number of candidates suggested investigating the trend of average outstanding loan term, but without adding that the data need to be grouped into cohorts by year of issue and the trend is investigated for each cohort separately. Of the candidates that suggested calculating alteration rates, many suggested splitting the data into homogeneous groups, but then offered no/few possible risk factors. A large proportion of candidates made senseless comments about the length of the investigation period, many suggesting a specific period e.g. “2 years” or “3 years” without any basis – very few candidates made intelligent and useful comments about the appropriate period for the investigation. Some candidates got confused about what was being asked, and explained how to perform mortality, withdrawal and expense investigations.

In part (iii) a number of candidates suggested using a deterministic model (some suggesting with sensitivity testing) for the assets and liabilities, however the output from such a model will not enable one to derive a probability of insolvency. A surprisingly large proportion of candidates that suggested using a stochastic model for the assets also suggested using “stochastic models for inflation”, implying that an independent model should be used for inflation. However, one stochastic model would be used, and inflation projections should be consistent with the asset return projections to ensure consistency between asset and liability projections.

In part (iv) many candidates made the comment that asset term needs to increase, but then were not able to make any further valid comments. To fill time candidates resorted to repeating themselves, commenting on expenses, valuation assumptions, regulatory requirements and other irrelevant matters. A number of candidates thought that a longer liability term meant that the company could now invest in equities and property (without any reference to free assets) – such an aggressive strategy is unlikely for term assurance type products. Some candidates thought that if assets of sufficient long term do not exist to match the liabilities, the company could use immunisation to protect itself, and then proceeded to list the advantages and disadvantages of immunisation.

QUESTION 5

i. An Internal unit linked fund:

- Consists of a clearly identifiable set of assets, e.g. equities.
- Is divided into a number of equal units consisting of identical sub-sets of the fund's assets and liabilities.

This division is notional.

ii. Principal risks:

- Unit prices are generally set at discrete points in time, whereas the underlying asset values effectively change continuously.
- This is a particular risk if:
 - The underlying asset values are volatile, or
 - If there is a sudden large movement in market values. A company's liabilities, dependent on the unit price, are therefore not exactly matched to the underlying assets. This timing delay introduces a pricing risk for the company, that needs to be managed.
- The unit price calculation would include some approximations, including:
 - An allowance for tax on unrealised capital gains.
 - An allowance for accrued asset and liabilities e.g. accrued interest not yet received.
 - Estimates of the market value of assets, where the market value is not immediately observable e.g. property, as there is a risk that the actual values are very different to the estimates.
- There could be errors in the actual unit price calculations:
 - Unit prices are based on the appropriation / expropriation prices of the underlying assets, depending on whether the company is creating additional (net) units or cancelling (net) units.
There is a risk that the company uses the wrong basis when calculating the unit prices.
 - There unit prices could be based on the incorrect data (e.g. the asset managers provided the incorrect market values of assets).
 - There could be an error in the calculation routine.
- Although regulations generally do not specify how units are to be priced, regulations may restrict what policy charges, for example, may be included in the unit price. Any changes to regulation could be a risk to the company.
- The basic equity principle states that the act of creating/cancelling units should not affect the unit price. Any error could therefore violate this principle and lead to a negative market perception.
- In addition, approximations / errors may:
 - Have a negative impact on company's profits / income because charges are often based on the value of units. The company would be responsible for making up any shortfall in policyholder benefits as the result of a pricing error.

- Could negatively affect the company's reputation which in turn may negatively affect new business volumes / increase withdrawals.
- Allow policyholders to select against the company by disinvesting if they become aware that the unit price overstates the value of assets.

iii. Criteria:

- There must be a unit-related charge on the unit fund.
 - This allows the company to hold less than the fully funded value of units in early years.
 - Additional units can be purchased over the lifetime of the contract using unit-related charges.
 - Because the charge is unit-related, the portion of the unit charge that has been used for funding will be exactly sufficient to purchase the outstanding number of units, irrespective of any price movement of the underlying units.
- The charges that are not used for actuarially funding (including a portion of the unit charge and/or policy fees) should be sufficient to cover the renewal expenses on the contract.
 - We would not want to be in a position where future (prudently predicted) cashflows are negative on a contract.
 - Any shortfall between the ongoing charges and renewal expenses will be capitalised in the non-unit reserve.
- The face value of units should only be available on contingent events like death or survival.
 - A unit-related surrender penalty is needed to reduce the unfunded value of the units to the funded value of the units.
 - The unfunded value of units is mostly available on death, which still exposes the life company to some risk.
- Actuarial funding must be permitted by legislation.

Most candidates struggled with this question with answers to part (ii), in particular, being very poor. The question referred to risks in determining the unit price (i.e. the actual calculation of the unit price). This should have been the focus of a candidate's answer. Some candidates only described the risks as a consequence of an incorrect unit price and therefore did not answer the question.

QUESTION 6

i. Cross-subsidies

- Within an age band.
 - Younger lives are relatively less likely to claim and therefore cross-subsidise the older lives within the age band.

- Premium rates do not differentiate by other known risk factors, for example:
 - Smokers vs non-smoker. Smokers are more likely to be hospitalised and are therefore subsidised by the non-smokers
 - Males vs females.
- Between healthy and ill on entry.
 - Given that the initial underwriting is limited, there is significant scope for anti-selection.
 - The relatively healthy, cross-subsidise the less healthy.
- Between policies with benefits of different sizes.
 - Depending on the methodology followed in loading for expenses, there is likely to be a cross-subsidy between small premium and large premium policies.
- There is also cross-subsidy between early and late withdrawals.
 - Early withdrawals will not have repaid initial expenses and are therefore cross-subsidised by later withdrawals.
 - A different premium structure e.g. annual premiums, could possibly reduce this cross-subsidy to some extent.

ii. Factors:

- Risk Characteristics:
 - Any cross-subsidy in a product design increases risk because actual experience may be different to the assumption on the extent of cross-subsidy, e.g. we may get more smokers buying the product than assumed when we priced the product.
 - The shareholders appetite for this additional risk should be considered.
 - Some additional risk management measures may have to be introduced, e.g. limiting the maximum sum assured per policyholder.
 - The company may want to consider a quota share reinsurance arrangement to share the business mix risk.
- Marketability:
 - Potential policyholders may not like the idea that they may be cross-subsidising others in terms of health.
 - However:
 - Simplifying the design (e.g. the age bands) means that the product is more marketable.
 - A simplified underwriting process, may also reduce new business administration.
 - The product designer needs to weigh-up the benefit of simplicity against the additional risk due to the cross-subsidy.
- Competitiveness:
 - There may be existing products in the market.
If our company's design is different to the market:
 - We may expose ourselves to being selected against, e.g. if competitors' do not cross-subsidise between ages, we may end up with the older policyholders.
 - The product may also be less marketable, e.g. if it is more complicated because we try to limit the cross-subsidies in the product.

- Profitability:
 - The premium should cover benefit payments, expenses and a profit margin.
 - If there are cross-subsidies, the additional risk may mean that the product needs to be priced with a bigger profit margin requirement to compensate for the additional risk.
 - The sensitivity of profits to changes in business mix may inform the decision on the size of the required margin.
- Guarantees:
 - As premiums are guaranteed risk is increased, because the company will not be able to take corrective action of actual experience wrt cross-subsidies is different to expected.
- Financing Requirements:
 - Cross-subsidies introduce additional risk, which may affect the solvency reserves required on the product, increasing capital required.
 - This in turn affects the profit margin requirements for this product.
- Consistency with other products the company is already writing:
 - If the company is selling a fully-underwritten version of this product, it may expose itself to selection risk if the healthier lives choose the alternative product.
- Regulatory requirements /professional guidance:
 - May prevent a company from differentiating by some risk factor, e.g. gender.
 - Forcing the life assurance company to accept the cross-subsidy risk.

Other design factors not applicable to the question:

- *Sensitivity of profit*
- *Administration systems, as this should not affect the extent of cross-subsidies*

Answers to this question were reasonable over all.

Most candidates were able to identify a range of cross-subsidies in this product design, as required by part (i).

The quality of answers to part ii varied. The weaker answers only described the design factors in general, whereas the stronger candidates described the impact of the cross-subsidies on these design factors.

QUESTION 7

i. Advantages:

- May improve business volumes of initial policy.
- If priced correctly, should improve profitability.
- Greater volumes may reduce expense recoupment / claims volatility.
- Reduced underwriting costs at exercise date.

Disadvantages:

- Anti-selection risk.
- Lives in poor health at the end of the term will want to exercise the option.
- There may be increased capital requirements resulting from higher reserves.

ii. Ways of reducing the risk:

- limit the total amount of sum assured available under the options
- restrict the choice of contract available under the options
- restrict the term of the carrier contracts
- limit the time available during which each option needs to be exercised
- ensure that any exclusions on the carrier contract also apply to all option contracts
- encourage all policyholders to take up the option, e.g. through reminder notices / automatic take-up
- keep the additional premiums required in respect of the option contracts low (to help achieve the last objective), although normal minimum premiums should still apply
- do not guarantee the premiums that will be offered on the option contracts
- underwrite initially as though option will be exercised
- price conservatively initially
- arrange for a suitable reinsurance treaty
- use lower retention limits than normal

Note: “Extra Premiums” does not gain credit unless candidates indicated that any such extra premiums are levied on the carrier contract rather than on the option contract.

iii. Mortality rate

- This is the key assumption as you need to know how many additional deaths will be expected due to offering this option. In addition, the mortality rate up to the end of the term determines how many policies will still be in force.
- In order to determine who will survive to the end of the term, the mortality rate of the term assurance product can be used.
- To set the mortality rate post exercising the option, you could use the experience from other products though it is likely that this isn't going to be available as this is a new option being offered by the company.
- The mortality rate can be set by using the mortality rate for the term assurance pricing and making an assumption about worsening mortality due to anti-selective lapsation and take up.
- You could also ask a reinsurer for pricing assistance with the option as they are likely to have experience from other clients/markets.

Lapse / Withdrawal

- This is needed to know how many policies will be left at the end of the term.

- Use the historical experience on the term assurance product.
- May decide on slightly lower lapses at the durations near the end of the term as some people who lapsed previously may now be incentivised to remain due to the option.

Take up rate at end of term

- This is needed to know how many people will exercise the option .
- As we will have no experience on this, getting advice from a reinsurer or a consultant is probably the best way to set this assumption.

Investment return

- The option premiums will need to be accumulated until the end of the policy term to pay for the additional death claims that will be incurred due to the extension being allowed without further medical evidence.
- If the company has a whole of life product it could use the same investment return as it uses in that pricing.
- Alternatively, the yield on gilts of a term equal to the average term policy issued would be appropriate.
- The yield should be lowered for reinvestment risk and taxation.

Profit / Safety margin

- This would be required in order to ensure the option is profitable.
- The safety margin would be included as there will be significant uncertainty around some of the assumptions including the take up rate.
- As the option is more risky, you should use the profit margin for the term product plus an additional margin for the extra riskiness.

Expenses

- While not one of the most important assumptions, the office will need to build in expense loading sufficient for it to recoup its development and other expenses over the expected volume of business (which is uncertain).

On the whole this question was not particularly well answered, considering it was essentially bookwork.

Part (i) was answered well.

In part (ii) most candidates simply didn't put enough points down, and so very few candidates got more than 4 out of 6.

In part (iii) many candidates only listed two or three of the assumptions, so they could not score really well. Several candidates spent a lot of time describing the method of calculation (e.g. North American method), which was not what was asked.

QUESTION 8

i. Advantages for the policyholder:

- Favourable overall morbidity or expense experience will be reflected in lower charges / premiums at policy reviews.
- Premium rates should be more competitive as there will be fewer margins built in.
- Surrender values, maturity values and death values are available.
- There should be some flexibility to vary benefit levels under in-force policies due to the risk premium approach to costing.
- The product could be packaged with other elements to meet overall needs, for example an increased death benefit.

Disadvantages for the policyholder:

- If experience is poor the mortality or expense charges may be increased, resulting in lower unit-related benefits (i.e. death, surrender and maturity benefits) and pressure on premiums.
- Poor experience and increased charges may result in premiums being increased following the 5-yearly premium review, i.e. much of the risk is passed to the policyholder.
- The contract may be difficult to understand, e.g. the variability of charges, or why certain benefits are unit-linked and not others.

ii. The major features on which such contracts are sold are:

- the definition of sickness
- policy conditions, e.g. waiting period, deferred period, exclusions, rehabilitation clause, etc.
- level of cover available, including replacement ration and benefit escalations
- the level of charges / price
- the insurers willingness to pay claims / level of claims underwriting

iii. Expense risk:

- the risk is that the expense charges will not meet the expenses actually incurred
- can be significant owing to the long term nature of these contracts and the uncertainty regarding expense inflation
- the timing mismatch between initial expenses and the regular expense charges can pose a risk, particularly in respect of early withdrawals
- claims underwriting is an important (and expensive) aspect of this business, and can be difficult to estimate at outset
- the expense risk is exacerbated as this is a new type of business for the recently-established insurer, making expenses difficult to estimate
- the variable expense charges reduce the risk, but this may lead to other problems (see above)

- the extent to which charges can be varied may be limited by market pressure, PRE and regulation
- changes in the mix of new business from that anticipated is a risk as there are likely to be cross-subsidies involved in the expense recoupment
- lower than expected new business volumes is a risk as fixed expenses may not be adequately recouped
- too much new business may pressurise capital, and administration systems/procedures may need updating

iv. Risk Premium:

- Likely to have low retention limits initially.
- Will assist in reducing claim fluctuations, which is likely to be a problem for a recently established company entering a new market.
- May provide financing commission which would assist with new business strain.
- If written on a treaty, it could assist the insurer to accept large applications without excessive delays.
- The cost of the cover may be relatively low owing to the reinsurer's large risk pools and low margins (or other reasons, e.g. taxation).
(Could be used as a reason with any form of reinsurance)
- To benefit from the reinsurer's technical assistance, which is of particular benefit here as the company is new to the market, and could include:
 - access to rating data and advice
 - advice on initial and claims underwriting
 - product and system design suggestions
 (Could be used as a reason with any form of reinsurance)

Individual Risk XL:

- Could be used to protect against individual claims of long duration.
(It is not sufficient to say "protect against large claims", as the sizes of the claims are known at outset.)

Aggregate (or Catastrophe) XL:

- Can reduce aggregations of claims caused by non-independence of risks.
- Could be used to cover injuries arising from a workplace accident. Unlikely to be available to cover diseases.

Stop Loss

- Can protect against overall experience on the business being poor.
- A potential problem as the insurer is new to the market and will thus not have much experience or data for pricing.
- Such cover, however, may not be available.

The question was poorly answered on the whole.

In part (i) any candidates focused on the savings element of the contract which, as stated in the question, was relatively insignificant. There was no suggestion in the question of there being a range of unit funds to choose from, and the income benefit is not unit-linked. Many candidates listed generic advantages of unit-linked products, such as transparency and flexibility without explaining why they believed these to be relevant to protection policies.

Many candidates made no valid attempt at answering part (ii), choosing instead to simply describe the contract and its benefits.

In part (iii) many candidates, incorrectly, assumed that the expense charges were unit-linked (which was not stated in the question). Some candidates also claimed that expense charges were only variable every 5 years, and that it was the premium review that would mitigate expense overruns (when in fact it is the reviewability of expense charges that is the key). A few candidates wrote that large expenses are a risk – it is not the size of the expenses that poses the risk, but the difficulty in predicting them.

In part (iv) candidates were penalised for suggesting types of reinsurance which are inappropriate, such as Original Terms (Quota Share or Individual Surplus) – unless a deposit-back arrangement was included. No credit was awarded for Financial Reinsurance as this is not risk reinsurance.

END OF EXAMINERS' REPORT