

EXAMINATION

6 October 2009 (pm)

Subject SA2RSA — Life Insurance Specialist Applications

Time allowed: Three hours

INSTRUCTIONS TO THE CANDIDATE

1. *Enter all the candidate and examination details as requested on the front of your answer booklet.*
2. *You have 15 minutes at the start of the examination in which to read the questions. You are strongly encouraged to use this time for reading only, but notes may be made. You then have three hours to complete the paper.*
3. *You must not start writing your answers in the booklet until instructed to do so by the supervisor.*
4. *Mark allocations are shown in brackets.*
5. *Attempt all questions, beginning your answer to each question on a separate sheet.*
6. *Candidates should show calculations where this is appropriate.*

AT THE END OF THE EXAMINATION

Hand in BOTH your answer booklet, with any additional sheets firmly attached, and this question paper.

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

QUESTION 1

ABC is a financial services group which is listed on the Johannesburg Stock Exchange. ABC has a large number of subsidiaries (all of which operate solely in South Africa), which include:

- A large life assurer;
- A non-life insurance company;
- A large asset management company; and,
- A small life assurer (XYZ).

XYZ is a small subsidiary life assurance company which has, historically, sold low volumes of Individual regular premium funeral products by means of direct marketing. The principal source of business for XYZ has been mail shots to the database of some of ABC's subsidiaries (not the large life assurer) and a small call centre which services leads stemming from TV advertising.

Two years ago, ABC restructured much of the group. The Capital Adequacy Requirement (CAR) of XYZ was quite large and the CAR ratio (ratio of excess assets to CAR) was 1.25. After considering the options available to them with regard to XYZ at the time, the Board of ABC opted to cease writing new business through XYZ. As a consequence, XYZ has written no new business in the last two years. The CAR ratio has dropped further in the last two years, such that it recently dipped below 1.

As a consequence of the CAR ratio dropping below 1, the Financial Services Board (FSB) has met with representatives of the Board of XYZ and discussed the situation with them. During this meeting, XYZ indicated that they (in conjunction with their parent company) were considering various options for the company going forward and might even consider re-opening the company for new business.

- i. The Board of ABC has decided that it does not want to continue operating XYZ as a closed portfolio. Nor does it want to sell XYZ as the database of XYZ overlaps that of many of its other subsidiaries. As a consequence, the Board of ABC is seriously considering two options, namely :
 - a) Opening to new business and possibly expanding the product range at the same time as recapitalising XYZ with the intention of ensuring that the subsidiary meets the parent company's growth criteria (which for insurance subsidiaries is a Return on Embedded Value of CPI + 10%) over the next 5 years;

[27]

PLEASE TURN OVER

- b) Merging the business of XYZ with the larger life assurance subsidiary.

[17]

You are an Actuary on the Board of ABC and have thus been tasked with considering the above alternatives. Discuss the factors that would be taken into account in assessing each of the above actions

- ii. The FSB has requested that XYZ advise what action they will be taking in order to return to a financially sound state (in terms of section 35 of the Long Term Insurance Act). In particular, the FSB has asked XYZ to produce a 5 year business plan (in a standard form) showing the projected statutory position of XYZ at the end of each of the next 5 years. After considering the options and your report on the above, the Board has decided to re-capitalise the company and open to new business. Discuss the main figures, indicators and ratios that the FSB can be expected to be looking at when considering XYZ's application to write new business.

[11]

[Total 55]

QUESTION 2

A rapidly growing South African life insurance company, Company A sells mainly unit-linked business. Its range of unit-linked portfolios currently consists of only local equity funds. The company proposes to increase its clients' investment choice by introducing fixed interest, balanced and absolute return funds.

- i. Discuss the key considerations in assessing the proposal to introduce the new funds. [17]
- ii. Discuss the issues that should be addressed in the guidelines of the new fixed interest, balanced and absolute return funds. [17]
- iii. Company A plans to launch a new balanced fund which will make use of a performance fee to the investment manager. (None of the company's current portfolios use performance fees.) Describe the elements needed to specify comprehensively the investment management fee of the new fund. [8]
- iv. One of the company's local equity funds is very small, and the company is therefore considering merging it with one of the other funds. Describe the key factors that should be taken into account when considering whether or not to merge the unit-linked funds. [3]

Total [45]

Grand Total [100]

END OF PAPER