EXAMINERS' REPORT

May 2020 examinations

Subject F203 — *General Insurance*
Fellowship Applications

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.

Subject F203 — *General Insurance*

Specialist Applications

May 2020

MEMORANDUM

Overall

For essay-style questions, the marking schedules contains open ended marks for other sensible comments in some sections where they are deemed necessary. Overall, there are significantly more than 100 marks available.

Performance on this paper was weak when compared to prior examination sessions.

- *Candidates continue to undermine themselves by providing generic or off-topic answers. Specific observations are provided by question throughout this report.*
- *Candidates also did not exhibit much higher order thinking and questions were generally poorly answered considering the number of marks that were available.*

Candidates should note that F203 is the key paper at which we test candidates' broader thinking. This is generally the final paper before qualifying as a professional, and we consider a capacity for broader thinking to be one of the best indicators of a candidate's suitability to act as a professional actuary. As such, we aim to design exam papers so that it is difficult to pass without displaying some capacity for independent, broad and commercial thinking.

Markers heavily reward instances where these skills are displayed. When reviewing past papers, candidates should assume that the marks available for generic points are substantially less than those awarded for the more challenging points that would be the mark of high-quality professional insight. Marks available for list items from bookwork are lower still.

As in prior sessions, candidates couldn't convince the examiners that they could apply higher order thinking to solve the problems posed. The majority of candidates answered questions with very generic answers (especially question 1). Question 1 part iii required a bit of thought and reference to the preferred method of administering the scheme – this question was especially poorly answered.

Candidates that planned their way through the exam did not appear under time pressure.

In conclusion, we would offer candidates two key pieces of advice – read the question properly and take the time to think about what is going on. Time spent making sure that you are answering the question that is asked is therefore more valuable than a panicked rush to put down as many points as possible, regardless of whether they are relevant.

QUESTION 1

This question examined candidates' ability to evaluate three options for administering a Motor Liability Fund in a fictitious country. The question considered the advantages and disadvantages of the three options as well as considering a number of aspects of product development should the insurer become involved with the product.

Candidates were also required to evaluate the impact on their management of their investments if the government prescribed how the assets backing their technical liabilities would need to be invested.

i) *This question required candidates to explain the economic benefits to motor insurance policyholders of compulsory third-party motor insurance. This question was generally satisfactorily answered but few candidates unpacked the link between comprehensive insurance and the cost reduction from having all of the vehicles on the roads insured for third party cover.*

Explain the economic benefits and benefits to motor insurance policyholders of compulsory third-party motor insurance:

- Will assist in mitigating risk and protect individuals and policyholders against the financial burden of paying for property damage or liability claims because of motor accidents.
- Mitigating this risk can have a lasting, positive impact on the economy assisting with wealth creation and financial planning. i.e. Protecting the wealth of society
    - *More jobs will be created within the insurance industry*
    - *Increased investment and trade*
    - *Acting as a credit facilitator - lenders are more assured of recoveries - more likely to provide funding for motor vehicle finance*
    - *Given that there are more resources available to fix a car after an accident, it should aid in increasing the level of road worthiness of cars*
- Widening the Risk Pool
    - Spread amongst more policyholders - hence fixed costs decrease
- Greater risk coverage - this will result in better claims recoveries
- "law of large numbers" should apply - compulsory third party would spread the expected risk premiums amongst a larger policyholder base, therefor the variability around the mean should decrease, resulting, on average in lower premiums
- Better claims recoveries will lower the overall loss ratio (Industry level)
- Lower loss ratio - means that savings can be passed onto policyholder
- A greater proportion of the population in a developing economy will be exposed to insurance which could lead to the easier sale of other insurance products

ii) *Section ii required candidates to evaluate the advantages and disadvantages of 3 potential options for administering the fund. These options were an increase in tax rate, outsourcing to the 5 largest insurers and outsourcing to all registered general insurers. The question was generally satisfactorily answered but a number of candidates exhibited a lack of knowledge for how third party property and liability insurance works.*

General Increase in Taxes:
Advantages:

- Administratively easy to implement - effected through the budget speech.
- Will probably yield the quickest results in terms of money collection

Disadvantages:

- Not all motorist are tax payers - thereby increasing the tax burden could prove detrimental. Small tax base picking up the cost of the entire nation's problem
- Increasing taxes generally reduces disposable income which could have knock on effects for the economy as a whole
- Unlikely to meet the aim of reducing policyholder cost
- Given that the MLF is already suffering from bad administration - likely that this could also result in not achieving the aims of filling the gap in the market
- Would require significant expertise to effectively manage - could argue that these skills are already available in proposals II & III.
- No payment from foreign nationals or tourists driving on our roads
- It is unclear from the question whether existing policyholders will have their premiums reduced or effectively end up paying double

Outsourcing with License Disc Fee:
Advantages:

- Compliance is still forced through the licensing department
- Outsourced to the top 5 - so likely that claims processes will be efficient. This meets the aim of protecting society at large
- Would act to reduce the cost of individual policyholders insurance cost (Because of the above reasons)
- Increases investable funds - which results in further economic growth (Good explanation)
- Could also cover vehicles coming into the country through the borders ensuring compliance

Disadvantages:

- Likely that the cost could be prohibitive - paying annually in advance for both liability and property damage
- Non-Compliance with the scheme - forging license disc plates/ still reliant on government to enforce
- Why only the 5 largest - competition commission might become involved
- What will happen if the largest 5 insurers in the market change? Could mergers and acquisition activity as well as Joint Ventures impact your inclusion in the top 5. Also competition commission outcomes could affect the make-up of the top 5.
- Proportional allocation of premium - which basis? Premiums for motor/assets/total market share?

Complete Outsourcing
Advantages:

- All short term insurers can be potentially involved… less objection from the rest of the market
- Potentially the lowest form of government intervention - which could mean that this is the most optimal
- Could drive further innovation within the market - ease of administration
- No need for costly upfront insurance premium - could be monthly payments.

Disadvantages:

- Lowest checking of compliance with the scheme - enforced through fines which is not very effective (bribery)
- Admin of how to deal with on the spot purchase of insurance
- Forcing motorist to purchase insurance on the spot - could have disgruntled customers

- Could have potential Treating Customers Fairly issues - need to check alignment with current insurance legislation
- How will proof of insurance be shown? Hard-copy or electronic. Compliance may be difficult to enforce
- There is also the possibility of fraud - produce fraudulent policy contracts

iii) *Candidates were required to draft a reply to the CEO regarding product development if a product was specified with maximum prescribed liability benefits, limited rating factors and a prescribed premium for these benefits. The candidates were asked to consider the product development from the perspective of authorisation, product features, administration, pricing, claims and other considerations. This question was very poorly answered with the majority of candidates not reading the question correctly and not exhibiting a sound understanding of how third party property and liability insurance would work and how it would need to be priced and administered.*

Authorization

- If the insurer is not already authorized to sell such business, then it must seek to gain authorization for those classes included in this type of contract in accordance with the country's regulations on the control of writing insurance.
- What will happen if the largest 5 insurers in the market change? Could mergers and acquisition activity as well as Joint Ventures impact your inclusion in the top 5. Also competition commission outcomes could affect the top 5. (No repetition)
- Does authorization extend to approval of premium rates?

Product Features

- The product is aimed at customers who do not already have motor third party insurance cover (specifically property). At launch date it needs to be determined how to add the potential liability cover to existing Motor Policyholders. If so, there will be a period during which the option must be taken up, after which non-compliance needs to be noted.
- Add-on products could be designed to create products that further allows for the principles of indemnity
- As well as selling this product to its own policyholders, it will need to be extended so that it is marketed to the customers of other insurers that do not meet the authorizing and licensing requirements to sell this product. This could create an opportunity for partnerships in the industry.
- The cover could be sold on an individual or on a group policy basis i.e. companies purchasing for fleet business. Would still require the necessary information from an AML / FAIS Act.
- If similar products are already sold by the insurer up on a stand-alone basis then the marketing of this new product will have to bear this in mind.
- Given the options that will be made available to motorist and the minimum coverage options - we will have to assume that a lot of people will choose the minimum benefits. If we are to benefit from scale - how do we ensure our marketing and advertising targets this market
- Given the likely high costs at outset (1 annual upfront premium - especially considering potential liability cover) - our product differentiation could include payment terms which could make the cover more affordable to the customers
- Need to consider whether mechanisms will be put in place to effectively cancel a customer - the options that can be implemented for very bad third party experience.

Since compulsory - how do we shape legislation to ensure we work with governments on a points-based system to ensure bad drivers are penalized.

- We need to consider benefit levels; exclusions from the policy e.g. driving under the influence of alcohol/drugs; notification times
- Cover would terminate if the vehicle is sold/terminated, or the insured got a new vehicle - likely that claw-backs could be put in place if renewal occurs with the same insurer.
- We also need to consider what, if any, endorsements would be allowed during the policy year. For example, can the level of cover be changed or VAP products added? Here we would probably just need to be aware of selection risk.

Administration

- Will the same contract and premium rating structure apply as for the insurer's own customers? Likely that the liability portion (bodily injury) is an additional product that needs to be sold. We would have to be able to sell this separately - or strip out Motor Third Party from comprehensive cover
- Premium collection would need to be very streamlined - allowing for multiple payment platforms/possibly payment plans (mitigating unaffordability) / Rating factor would be determined by location of license
- Likely that some commission incentive will need to be built into the product for the government on ensuring collection. Will need to be established at outset (Pricing consideration in the minimum)

System Issues

- Do we have the systems - to support the likely volume
- Ensuring compliance with current legislation - policy wording adhering to TCF principles
- How do we ensure mis-selling from car licensing department, i.e. The seller must explain the policy terms and conditions to the customer. In particular, the seller must explain the level and type of cover and the restrictions/exclusions the policy.
- This will require training - national campaigns educating everyone on the maximum liability benefits and the minimum levels of cover (Will need to be shared among participants who sell the product).
- Advisors will also need to be FAIS accredited
- Goal is to ensure compliance with the product - but minimize the reputational risk to insurers due to mis-selling
- Ensuring that we will be able to process refunds - policyholders that have already purchased/claw-back structure for term premium
- Consider management information that needs to be available
- Risk management expertise with regards to potential fraud - at both sale and claim stage needs to be considered. Information would then need to be shared amongst participating insurers

Pricing Issues

- This is compulsory insurance with maximum liability benefits and fixed prices to be charged for the standard Minimum coverage benefits
- We are subject to using only two rating factors - being location which is a proxy for traffic density/quality of roads etc. and use being either private or commercial. Hence all other factors would need to be captured in the above

- Likely that all participants would participate in the pricing exercise basing this off their existing information for Motor TP property and bodily injury claims. Data sharing issues would need to be investigated
- Since maximum benefits are being introduced for the liability class- this is likely to be accompanied by fixed benefit levels based on the type of injury sustained. Prescribed maximum benefits would be gazetted and increased each year with medical inflation - this would inform the minimum prices across industry

Data

- In order to derive a risk premium, any appropriate internal data will be used with the usual factors regarding past experience being considered. For example: period of data/out of date, large claims, trends, inflation.
- If little or no internal data is available on the bodily injury - a committee would be established to source the data from the MLF
- Data would need to be adjusted for prescribed minimum benefit levels; likely inflation over the period; (Both property and medical inflation)
- Would need to consider the cost of litigation in the process - especially the high costs being ceded to law firms on the MLF. The prescribed maximum benefits would curb excessive claims being introduced - but likely that a more efficient claims process would lead to lower overall cost to the industry
- After having obtained a risk premiums, allowance would then be made for commission, expenses, profit, contingencies and investment return. In order to smooth out fluctuations in premium rates over time we would need to form a view of the average likely claims cost during a full economic cycle.
- We would need to be aligned with the aims of the product - hence we would probably not be selling the "minimum" products to maximize profitability - but we would also not want to expose ourselves to underwriting losses. Hence it is essential for government & all participants to lobby effective collections, sales and claims processes.
- In determining the loadings for expenses, we need to project volumes of exposure and consider per policy and per premium loadings. At product commencement - it is likely that collaboration would be required from all participants on this point - however within this average there will be opportunities for insurers with more efficient internal processes to extract additional profits.
- Over time this could lead to discrepancies in the market - especially if one insurer has a much stronger brand - would need to decide whether correcting measures will be put in place - or will insurers with better processes enjoy the benefits. Part of the vetting process by the regulator.
- To get a view on volume we need to look at licensed vehicles with an allowance for the unlicensed ones as well? But if premiums are paid through the process of renewing the license this point may be moot as the probability of taking out license now perhaps small?

Claims Issues

- Effective administration required on the claims side - coinciding with current procurement, legal, recording and settling processes
- We need to consider what claims information should be kept to help with our future rating.
- We need to consider whether payments are made to the insured or applied directly to the claimant

- Can we collect further information at claims stage - i.e. type of vehicle; extent of damage; policyholder details;
- This could increase the information available - which we could further utilize in the industry
- A point for discussing ineffective legal processes- (if not repeated from above)
- In-sourcing / Out-sourcing of legal processes - with regards to liability settlements.

Other

- Any complaint procedures should be clearly set out in the documents.
- The insurance contract will be governed by the law of the country.
- Vetting of insurers - likely to consider admin efficiency; expertise; governance & risk; capital and risk

iv) *Section iv required candidates to consider the impact on the management of their investments if the government prescribed how the assets backing their technical liabilities would need to be invested. This question was also quite poorly answered with a number of candidates discussing disinvestment of their current assets whereas the question specifically referred to the technical liabilities of the new product.*

Investment Strategy

- The investment strategy has to consider the risk profile of the liabilities.
  Given motor property and bodily injury this is likely to be a mix of short tail and long tail liabilities.
- Short tail liabilities, property damage will need high levels of liquidity
- Long tail bodily injury could be linked to court and wage inflation and therefore real assets may be suitable to back these reserves. Index linked bonds could be used for this purpose
- Investment strategy will be dictated by the solvency margin in each approved company. Level of mismatch could be maintained in other real asset categories e.g. equities given higher levels of solvency cover
- Need to check whether the assets for this new product needs to be ring-fenced - or can the liquidity generated within cash be used to cover other immediate short tailed claims as well. This could mean that the company can theoretically now mismatch - and purchase longer dated real assets like equities to ensure sufficient return on longer tailed liabilities
- Strategy will be company specific - is the board of the entity willing to further mismatch other classes - to provide an overall better return

Proposed Allocation

- The current suggestion of 50/50 might not be appropriate - would need to determine likely levels of long tail and short tail liabilities
- Need to understand whether inflation + 1.5% will be sufficient to cover the inflation of court awards and medical inflation
- The proposed allocation would need to be tested when vetting potential insurers - it could be appropriate for insurers with significant free capital - provided that the assets do not need to be ringfenced for this product
- Need to fully cater for our costs and not rely on significant investment returns (covered in pricing above) - likely that we would be able to achieve better returns elsewhere.

Solvency Capital

- Current standard formula - there would be limited impact from a market risk perspective as Government instruments do not attract counterparty risk charges nor concentration risk charges
- Possibly the cash in bank would attract type counterparty charges
- Could argue that this needs to be adjusted given the now fairly high levels of exposure
- Government bank being supported - question states that this is new and internally we would need to do a risk assessment of the potential market risk introduced by this new entity.
- You will need to include the impact of interest rate risk on government bonds?
- The way SOE's are run perhaps not appropriate to treat govt bank as risk free, so should keep capital against default risk - if not in standard formula then in ORSA…

QUESTION 2

Question 2 examined a range of actuarial topics related to a large multi-national general insurance company that was faced with an outbreak of a flu-like virus in the territories in which they operate. The initial part of the question focussed on how to model the impact that the virus could have on its travel business and how best to provide for these expected additional claims.

The question also considered the insurer's risk appetite and whether it would be appropriate to suspend sales of travel policies. The question also required candidates to outline the factors they would take into account to determine whether the purchase of stop loss reinsurance would make sense.

Finally, candidates were informed that the territories in which they operate was going into recession and asked which personal and commercial lines products they expected to be affected by the recession. Candidates were also required to outline the impact of the recession on the company's profit and capitalisation.

i) *The first part asked candidates how they would approach building a model to predict the extent of the travels claims, their assumptions for the model and external factors that could potentially invalidate the model. In general, the question was not well answered with very few candidates suggesting that a multi-state model be used and not many candidates considering much detail regarding the demographics of the territories in which they operate.*

Discuss what your approach would be to building this model as well as the assumptions that you would be required to make.

There will be a number of different approaches to answering the question so credit will be given for other suitable approaches

A multi-state model will need to be built that allows for transitions between the following states: Healthy to sick and sick to immune to the virus or deceased. The model should project the number of sick members of the population on a time-based method and remove previously infected members of the population. There will also need to be allowance for claims frequency and severity of the sick members of the population.

The model will need to consider amongst other factors the following:

- The overall population demographics of the territories in which you operate
- Population split between urban and rural
- Potentially consider movement of population
- Allowance for variable infection rates depending on whether population is urban or rural
- Allowance for variable travel propensity depending on the per capita GDP of a population as this will in all likelihood determine whether a population can afford to travel

- A potential allowance for seasonal adjustment to infection rates

- A potential allowance for decreasing infection rates as vaccines or similar are developed
- The model will need to allow for the interaction between being ill and having to travel during the period that you are ill. The 0.005% of the population who have trips booked will not necessarily be ill over the period of their travel
- Would need assumptions around the potential cost if travel is cancelled not through the policyholder being ill, but through other mechanisms, e.g. banning of flights, cancelling of visa's, cancelling of accommodation etc…

Other assumptions:

- Average cost of future trips that have been booked.
- These can be potentially be split as follows:
    - By commercial and private travel
    - By GDP of an area
    - Classified into small, medium or large or similar

- There will need to be a classification of average time to a trip for active or future travel that has been arranged
- The likelihood that someone who has a trip booked will be ill during the time of the trip
- The duration of time that a patient is ill for
- If someone is deceased and would have been travelling in future there could be a claim from their estate
- Individual allowances for different infection rates split by the demographics discussed above
- Quantum to allow for decreased infection rates as a result of the development of a vaccine / travel ban / quarantine or similar

Other considerations:

- Will need to consider whether the model will be built on a stochastic/deterministic basis
- Appropriate governance would need to be followed for internal model approval (HAF/Risk Management & Product Committee references)
- The model probably won't have a very long time-frame but an allowance could be made for discounting
- The model is based on very uncertain assumptions so a range of potential future outcomes would be useful to get more clarity regarding the significance of assumptions made
- A percentile plot of infection rates, population proportion with trips booked and severity of claims could provide very useful insights
- Can policyholders obtain refunds if they cancel their policies
- What happens if countries ban all unnecessary travel and airlines/ travel companies cancel bookings?
- Can probably only model best and worst case scenarios. Plot these against actual development

What external factors could potentially invalidate your model?

- The development of a vaccine more quickly than expected and a vaccine that works better than what was expected

- Imposition of travel bans or quarantines by the governments involved
- Any natural immunity displayed by populations under consideration
- Development of a better treatment protocol that shortens time to recovery
- Any mutations of the infection rate or intensity of the virus
- False statistics distributed by countries - not wanting to suffer economically.
- Other actions from providers - if airlines offer reimbursements due to cancellations on their part, no need for insurance to cover that as well
- Time - each day the actions of governments and behavior of populations and data will be changing. Model needs to be dynamic

ii) *Part ii required candidates to advise the CFO how best to provide for these potential claims under IFRS. In general this question was poorly answered with candidates broadly listing all potential types of reserves rather than unpacking the suitability of a URR reserve and mentioning that an IBNR would not be suitable as the claims had not occurred yet.*

What advice would you give your CFO and how best would you allow for these potential claims under IFRS?

- Travel policies are sold on a specified term basis and thus a UPR should be held for these policies on an IFRS basis
- These potential claims have not been notified or incurred so an outstanding claims or IBNR reserve would not be appropriate for IFRS purposes
- The model being built in essence suggests that future loss ratios will be high and thus an Unexpired Risk Reserve would be the most suitable method of making allowance for the higher than expected claims on the policies that have been written
- This reserve will delay the emergence of profit so will come to the attention of your auditors and potentially the revenue authorities
- The model that you have built will need to stand up to scrutiny as depending on the size of the reserve and the timing in the financial year the auditors would probably want to interrogate the results
- The URR will also probably be noted in your financial statements as well as the range of potential outcomes that you have calculated
- You are a multinational, so a similar approach may need to be followed for all the individual firms in their local jurisdictions and there may be local variations to consider
- Allowance for any reinsurance type claims needs to be considered so as to raise the corresponding asset - terms and conditions of RI will need to be scrutinized

iii) *This section required candidates to explain what is meant by risk appetite and discussing the advantages and disadvantages of suspending the sale of travel insurance. Candidates generally answered this question satisfactorily*.

Risk Appetite

- Risk appetite can be broadly expressed as the degree of risk that a business is willing to accept in pursuit of its objectives.
- It is widely recognized that risk appetite has multiple dimensions and many metrics, rather than a single deterministic value - otherwise, stochastic dominance could be used to decide which risks are acceptable and which should be avoided.

- Appropriate examples of risk appetite statements

Advantages

- The insurer is taking no further risk on new policies
- The insurer should be able to quantify its existing exposure to the risk and try to determine its estimated maximum loss
- If the pandemic turns out worse than expected suspending sales may result in a lower level of loss compared to the rest of the industry
- It should be relatively straight forward to start selling the products again if the outlook improves

Disadvantages

- The insurer sells most of its business via an intermediated channel
- Cancellation or suspension of this product may mean that it no longer has a complete product offering in the market and may result in loyal brokers considering alternative insurers causing knock on effects in product sales. Also depends on competitor response to the pandemic
- The company will receive lower premium especially if the suspension coincides with peak travel season. Their staff costs will not change in the short term so additional loss of profit may result
- Depending on how long sales are suspended the volume of staff supporting the travel product may need to be reduced
- There will be no immediate or significant capital reduction so ROE will reduce further
- If a vaccine is developed faster than expected or the pandemic turns out less extreme than expected, revenue and profit may have been lost unnecessarily by stopping sales of the product
- Some travel contracts may be sold as an automatic add on to ticket purchases with a credit card. It may be more difficult to suspend these policies at short notice
- Having such a short notice period could have detrimental impacts on the planning and marketing strategies of your brokers.

iv) *Part iv required candidates to outline the factors they would take into account to determine whether the purchase of stop loss reinsurance for the travel portfolio would make commercial sense. Candidates generally answered this question satisfactorily but very few candidates linked the evaluation of the stop loss reinsurance back to the results of the model in part i. A number of candidates also displayed limited understanding of stop loss reinsurance.*

- The starting point would be to evaluate the terms of the Stop Loss treaty against the results of the model that you constructed
- What is the projected expected loss ratio from your modelling exercise and at what level does the stop loss treaty attach?
- Does the stop loss treaty have an upper limit?
- How does the upper limit compare to the variability exercise included in your model?
- Does a breach of this upper limit fall within your risk appetite for reinsurance purchase?
- How does the cost of the reinsurance treaty compare to your expected claims above the attachment point? Is there any potential upside for you or is it just a cash swop or expense? Reinsurers will have the same statistics and information so the cost may be much higher than in normal circumstances
- How many reinsurers are on the treaty and do the number of reinsurers and their credit rating conform to the purchase of reinsurance in your RI and alternative risk transfer policy?
- What is the impact on your capital requirements following the purchase of the reinsurance? Consideration needs to be given to both the reduction in net liabilities and potential increase in market risk from further asset concentrations
- Will the reinsurers on the panel be seen as approved reinsurers/equivalent by the local regulators in all of the territories in which you operate?
- Are there any other reinsurance treaties or co-insurance policies on this portfolio?
- What is the change in ROE before and after the purchase of the reinsurance?
- Financial strength of the reinsurers in these uncertain times

v) *The section required candidates to discuss which other lines of commercial and personal lines business would be affected by the reinsurance. This question was generally quite well answered with the majority of candidates applying the impacts of a recession to a number of products.*

<u>General</u>

- The recession will result in a decrease in disposable income and a probable increase in lapses with lower levels of new business. This will lead to a flat or decreasing level of GWP. A lot of pressure on the premium paying ability for PL and CL as people lose jobs and businesses close.
- The economic pressure could lead to an increase in fraud and moral hazard as policyholders attempt to claims that are not justified and would not be as prevalent in good economic climes. This may lead to increased loss ratios and higher costs of investigations etc.
- Investment return will be constrained in the short term - this could mean that your pricing assumptions do not hold and short term losses are made

<u>Personal Lines</u>

- Buildings - potential increase in fire claims
- Motor - increase in small single vehicle accidents of theft of motor vehicles. Decrease in frequency under lockdown
- Contents - potential increase in levels of theft
- All risks - increase in levels of theft of items with payments of cash in lieu
- Hospital cash plans could see additional claims from illness

- Any products offering unemployment or retrenchment protection on loans or mortgages will see an increase in claims

Commercial Lines

- Any products offering credit guarantee type of benefits whether for the domestic or export market will probably be under pressure as the economic environment results in companies filing for bankruptcy
- Similar fire and theft claims as outlined for personal lines classes
- Fire in commercial property classes may lead to substantial business interruption claims. These will have to be carefully investigated and in some cases could have co-insurance etc involved which could complicate matters
- Reduction in Marine and Aviation business with potential fraudulent claims
- D&O claims from any negligence on behalf of directors
- Could be an increase in levels of cyber crimes
- Fidelity Guarantee from increased fraud claims

vi) *The final question required candidates to discuss the impact of the recession on the company's profit and capitalisation. The question was generally satisfactorily answered although a number of candidates gave repetitive answers from the previous questions without considering additional impacts of lower premium and different claims behaviour on the company profits. Candidates also made the error of thinking that lower premiums will have an immediate impact on their company's required levels of capital.*

Profitability

- Gross written premium and deterioration in claims will be under pressure as discussed in v above
- Fixed costs and staff costs will become a higher proportion of GWP leading to a deterioration in overall insurance margin
- Staff redundancy exercise with associated costs may need to be conducted if recession lasts for an extended period of time
- The investment markets will in all likelihood come under pressure as a result of the recession leading to more investment in cash/equivalents and bonds with potentially lower levels of yield
- Sharp and unprotected drops in equity market could lead to substantial unrealized or realized losses
- Some classes such as motor could exhibit better performance during lockdown conditions

Capitalization

- Probable increase in levels of claims and claims reserves as discussed above
- Premium forecasts unlikely to change over the short term unless an out of cycle ORSA is performed or this occurred over a budgeting cycle. Subsequent QRTs may change premium forecasts
- Combined ratios used will likely come under pressure from a claims and cost perspective
- Potential changes to lapse risk as policyholders cannot afford to pay premiums
- Credit rating of counterparties may come under pressure as economic outlook changes
- Lower interest rates could result in higher values of discounted liabilities
- Higher levels of RI premiums and RI technical provisionswith poorer credit quality steps leading to higher counter party default risk

- Change of investment to cash and equivalents could lead to higher concentration risks
- Higher levels of premium and other debtors with outstanding term of longer than 90 days as economy slows down leading to further charges
- Diversification benefit may be less if travel class sales are still suspended and GWP volumes for travel continue to decline
- Loss absorbing capacity of deferred tax would be expected to increase slightly, if not already past its maximum.
- The Loss absorbing capacity of deferred taxes will be expected to decrease given that expected future profitability over the next 3 years will be less.
- Drops in asset markets would leave the market risk exposure and hence market risk capital charges lower. Will depend on the investment strategy. Drop in asset values will be disproportional to lower charges - hence lower coverage
- Overall profitability would be expected to decrease with a probably higher SCR and a lower SCR coverage ratio
- Reinsurance rates may increase, further decreasing net premium. The element of the SCR that is dependent on volume, may decrease (but if backward looking not immediately), and negative investment returns on shareholders capital may decrease own funds available and still lead to reduction in coverage ratio

END OF REPORT