Examiners Report: F203 General Insurance

Introduction

This main aim of this report is to assist candidates preparing for the F203 examination. The Examiners scrutinise the official syllabus, refer to the Core Reading, which elucidates the syllabus, for crafting questions. However, they are not strictly bound to limit questions to the Core Reading material exclusively.

For essay-type and open-ended questions, especially in advanced subjects, the report might include more discussion points than what would be expected for a top-scoring answer.

Using past exam papers and examiner reports as study tools requires careful consideration, as each exam question is distinct. Professional exams aim to evaluate advanced cognitive skills like the application of knowledge, synthesis, and analysis, and presenting informed conclusions or advice.

Successful candidates focus on responding to the given questions rather than merely reciting their knowledge.

Finally, this report is based on the legislative and regulatory framework relevant at the time of the exam's creation. Candidates using these reports for revision should be aware that circumstances might have changed since then.

General comments on the aims of this subject

F203 aims to equip candidates with the capability to apply their knowledge of the general insurance sector and actuarial practices in real-world settings. A candidate who passes this stage is expected to understand not just the technicalities of general insurance actuarial work, but also have a firm grasp of product knowledge, competitive market dynamics, regulatory frameworks, and operational aspects of an insurance company. They should be adept at integrating these various areas to provide comprehensive advice.

We offer two essential pieces of advice to candidates: (i) read each question thoroughly and (ii) organize your thoughts before writing. It's important to note that achieving a passing mark doesn't require addressing all the points mentioned in this report. The focus should be on accurately responding to the question rather than attempting to cover as many points as possible.

The phrasing of each question is deliberate, and candidates should pay close attention to it. Common errors due to misreading questions are highlighted in the question commentaries. Writing about unasked topics wastes time and won't earn marks, though these broader responses might be relevant in a professional setting. An exam, with its limited marks, requires focusing on the specific scope of each question.

If a question explicitly mentions a particular aspect, it's safe to assume that there are marks allocated for that component. During the exam creation, any unnecessary content is removed, indicating that (for example) included numbers or data points are relevant for analysis and commentary.

Candidates should also consider the placement of each question section within the overall context. New information provided in between sections is pertinent to the subsequent sections. Avoid using information from later sections when answering earlier ones.

Regarding the second piece of advice, F203 is the critical paper where we assess deeper thinking skills. Successful candidates display independent and broad thinking. When reviewing past papers, remember that generic points typically score lower than insights showing professional acumen.

We recommend candidates take a step back and thoroughly consider the question's context, rather than just analysing numbers with standard techniques. This approach involves thinking about the practicalities of the business, stakeholder perspectives, wider impacts, regulatory or ethical considerations, the suitability of actuarial methods for the situation, and current economic factors. Such a comprehensive approach leads to a more nuanced understanding of the risks and dynamics, valuable in professional practice. Commentary on the current paper points out instances where this broader perspective was lacking.

More broadly, we advise employing basic exam techniques like structured responses and effective time management. The online exam format should aid in organising answers. Using bullet points can clarify answers, but ensure each point is distinct and avoid repetition. Tailor your answers according to the command words used in the questions.

Candidates providing well-reasoned, question-specific points, even if not in the marking scheme, will be awarded marks.

QUESTION 1

i. Define and describe the reinsurance cycle.

[3]

Recurring fluctuations in the supply and demand for reinsurance, typically influenced by market conditions, the level of risk, and profitability.

During a hard market, there is limited availability of reinsurance capacity, and reinsurers are more selective about the risks they cover.

This often occurs after significant losses (e.g., from natural disasters or large claims) that deplete reinsurer capital.

To compensate for higher risks, reinsurers raise prices (premium rates) and impose stricter terms and conditions on coverage.

In a soft market, reinsurance capacity becomes more abundant and competitively priced.

Premium rates decrease, and reinsurers offer more favorable terms and conditions to attract business.

Comments:

Reasonably well answered, although many candidates spoke about reinsurers entering and exiting the market rather than talking about reinsurance capacity and capital position.

Reinsurers do not typically exit and enter the market as do insurers.

You are a consulting Actuary newly engaged at Escape Re, a medium sized reinsurance company operating in South Africa, writing a large variety of property and casualty proportional and non-proportional contracts in South Africa and across other geographies.

The company has been operating for 10 years, and the reinsurance market has just reached the peak of the hard cycle. The CEO informed you that he does not expect the market to soften significantly in future, due to climate change considerations.

You are currently advising them on their reserving methodology and IFRS 17 implementation.

ii. Discuss whether you agree with the CEO's statement, paying particular attention to reinsurance pricing.

[5]

If rates have increased because of the near term impacts of climate change then it isn't really a hard market, it's necessary price increases to keep pace with increased losses and there aren't the excess profits of a hard market.

If there are excess profits at the moment but rates are likely to be appropriate for the medium / long term as climate change increases the risk then there's time for rates to soften again first.

The reinsurance market is indeed facing significant challenges due to the increased frequency and severity of climate-related events.

As a result, reinsurers are more cautious, leading to higher prices (a hard market).

However, it is important to note that while climate change can sustain high levels of risk and high premiums, it does not inherently prevent the market from softening in the long run.

High reinsurance pricing might initially deter some buyers, leading to reduced demand in certain areas, particularly in the most affected regions.

If demand decreases for specific risks, reinsurers may reduce prices to retain market share, especially in areas where the risk is better understood or more manageable.

Historical trends suggest that hard markets do not persist indefinitely. Even with climate change, reinsurers may eventually adjust, and market dynamics could lead to softening once again, especially if capital inflows or new pricing methodologies emerge.

Regulators and governments are increasingly incorporating climate risk considerations into insurance and reinsurance frameworks.

Over time, regulatory changes could push for clearer guidelines around climate risk pricing, which could either stabilize or help soften market conditions depending on how they are implemented.

Impact of reinsurance negotiations on the insurer's practice – if it leads to better risk selection and pricing at the direct insurer, it may mitigate the premium increases the reinsurer wants to / are able to put through

Conclusions & justification which is reasonable.

Comments:

Many marks are available for a robust discussion here. Very poorly answered question.

Generally little understanding exhibited of the main drivers of the market and in particular the difference between risk costs vs profit margins on reinsurance premiums.

iii. Outline specific considerations that need to be made when reserving for inwards reinsurance.

[8]

Grouping of contracts is unlikely to be as relevant along Line of Business, at least at first.

Need to consider proportional vs non-proportional contracts.

Higher excess layers vs lower excess layers.

Treaty vs Facultative, in combination with prop/non-prop.

Local/Foreign or by currency/geography.

Large individual cedants can be reserved for separately.

Typically much more sparse on the data front, need to be careful especially with non-prop sparseness

Development lag is longer than primary insurer of course.

For higher layers need to try get losses below layer as development time also includes time for losses to develop into layers.

Complications in terms of obtaining and combining data, often in excel bordereaux from cedants.

Paid development more reliable than incurred since case reserving methodology could differ by cedant.

Basis of cover is important, often proportional contracts on a risk-attaching basis implying UW Year reserving is required

Reserving for ultimate premiums and ultimate commissions is also important in reinsurance

Consideration of underwriters view of loss ratios is important as well as moderating chain ladder results, use lots of credibility

Similarly benchmarks and standard development can be useful, don't split triangles too far assuming homogeneity is more important than stability.

Scaling down to earned basis to get an IBNR which is required for financials should also be considered

Different case reserving and reinsurer notification philosophies across multiple cedants

Lack of access to granular underlying data.

Weighting of non-prop to a small number of individual claims or events where individual claims views are important

Aggregate & risk non prop will behave differently.

Comments:

Generally a very limited description of the types of issues affecting reinsurance reserving.

Extremely generic responses given without really explaining how issues would affect reserving approaches. The number of marks available for generic points is limited and it is expected that ideas put down are relevant to the question at hand

You are analysing the claims and premium triangles for a single large cedant in the Proportional USD Treaty segment in preparation for the upcoming reserving exercise. These are prepared by underwriting (UW) year.

iv. Outline the questions you would ask based on your analysis, detailing how you would use the information that you receive.

[5]

Are there any significant changes in the terms or conditions of the treaty during the period being analyzed (e.g., premium rates, deductibles, coverage limits, or commission structures)?

Understanding any modifications will allow you to adjust your reserving methodology to account for variations in the premium volumes, claims handling, and profitability. It will also help identify whether a split of the data is necessary to reflect changes in treaty structure over time.

What is the current claims development pattern, and have there been any material deviations from historical patterns that we should be aware of?

This information will allow you to adjust your loss development factors (LDFs) or use different development patterns for different periods or segments, ensuring that your reserves reflect the most up-to-date claims experience.

What types of claims are being reported under this treaty (e.g., property, casualty, catastrophe)?

Knowing the types of claims allows for more accurate reserving, as you can apply appropriate loss development factors and consider any specific reserving techniques for large losses, catastrophic claims, or certain lines of business.

Are there any large or unusual claims that have been reported that could significantly impact the reserve estimates?

If such claims are identified, it is important to isolate them from the rest of the claims experience in the triangle.

What is the underwriting strategy for this segment, particularly regarding pricing and risk appetite in light of market conditions?

Understanding the underwriting strategy provides context for interpreting the premium triangle and allows you to account for any shifts in pricing or risk appetite.

Is this just US domiciled or international business with contracts denominated in USD?

Details of Commission sliding scales / over-riders / profit commissions.

Comments:

Generally reasonably well answered but spread of number of ideas generated was low.

You receive the following cumulative written premium and paid claims for the last four underwriting years for this cedant:

Cumulative Written Premium			
	Reporting Year		
UW Year	0	1	2
2021	100	150	160
2022	110	170	160
2023	120	180	
2024	100		

Cumulative Paid Claims			
	Reporting Year		
UW Year	0	1	2
2021	20	60	100
2022	20	70	80
2023	30	120	
2024	50		

The outstanding claims per underwriting year are summarised in the table below.

OS Claims 31 December 2024	
UW Year	OCR
2021	0
2022	5
2023	10
2024	10

Sliding scale profit commission is paid based on the minimum rate, until the end of Reporting Year 2, when the final commission is calculated and due. The commission per loss ratio (LR) band is provided in the table below.

Sliding Scale Commission	
Loss Ratio	Commission
< 55%	30%
55% < LR < 80%	85% minus LR
> 80%	5%

In addition, the following information is relevant:

- ***The underwriting department indicates that in 2023 a new commercial policy was written by the cedant with a premium of 20 which is currently at a loss ratio of 100%, that was not renewed in 2024.***
- ***Notwithstanding the above, 2024 business written and rates are consistent with 2023.***
- ***A large loss of 30 has been paid with respect to the 2024 UW Year.***

v. Calculate the Ultimate Premiums, Claims, Commissions and IBNR at 31 December 2024 for Escape Re's Proportional USD Treaty Segment for this cedant. Show all calculations and state any assumptions that you make.

[11]

Ultimate Premiums

	Reporting Year		
UW Year	0	1	2
2021	100	150	160
2022	110	170	160
2023	120	180	180
2024	100	160	160

Average development for period 1 to 2 = (160 + 160) / (150 + 170) = 1

2023 Ultimate Premium is then 180 * 1 = 180

2024 Ultimate Premium is 180 – 20 as given in the question.

Partial marks given for straight chain ladder calculation on 2024 UW Year.

Ultimate Claims

	Reporting Year		
UW Year	0	1	2
2021	20	60	100
2022	20	70	80
2023	30	120	135
2024	20	80	115

2023 Claims after Reporting Year 1 are very developed, hence applied chain ladder to this is likely to be volatile.

Can apply (100 + 80)/(20 + 20) to get to 4.5 as Development Factor from 0 – 2.

4.5 * 30 = 135 Ultimate for 2023.

Marks given for straight chain ladder.

2024 Ultimate should be derived using the information in the question.

First adjust for the large loss (remove paid of 30 from triangle).

= Ultimate claims in 2023 minus 20 (as LR 100% policy is not renewed) = 115 (which is the attritional ultimate ignoring the large claim)

Partial marks given for straight chain ladder calculation on both UW Years.

Ignoring possibility of tail factor here (technically 2022 is not fully run off since there is an OCR).

IBNR and Commissions

UW Year	%Earned	Earned Ultimate Premium	Earned Ulltimate Claims	Paid	OCR	IBNR
2021	100%	160	100	100	0	0
2022	100%	160	85	80	5	0
2023	100%	180	135	120	10	5
2024	50%	80	57.5	20	10	27.5

Earned Ultimate Premium = % Earned (assumption) * Ultimate Premium

Earned Ultimate Claims = % Earned * Ultimate Claims

IBNR = Earned Ultimate Claims – Paid – OCR

(Earned assumption of 100% (or more specifically left out) was also given marks)

UW Year	Ultimate Premium	Ultimate Claims	Ultimate Loss Ratio	Ultimate Commission Ratio	Ultimate Commissions
2021	160	100	62.5%	22.5%	36
2022	160	80	50%	30%	48
2023	180	135	75%	10%	18
2024	160	145	90.625%	5%	8

The paid Large Claim of 30 was added back to ultimate claims on 2024 here.

Comments:

This was not a well answered question.

Candidates rushed to apply the chain ladder directly without looking at the information given.

Very few calculated the IBNR in a correct manner or stated assumptions made.

Credit was given for any reasonable assumptions and carrying errors through where genuine attempts were made.

vi. Describe the accounting policy and methodology decisions that need to be made in applying IFRS17 for the first time, with specific focus on Escape Re's business.

[8]

Escape Re will need to decide which measurement model to apply to its reinsurance contracts.

General Measurement Model (GMM): Default model, which is used for most contracts.

Premium Allocation Approach (PAA): Simplified approach, often used for short-duration contracts or contracts with a duration of less than one year.

Escape Re will need to evaluate its portfolio of reinsurance treaties and contracts based on contract boundary.

In particular, risk attaching proportional contracts may need to be measured under GMM.

Contracts which are managed together and not issued more than one year apart, as well as split by onerousity.

In Escape Re's case also need to consider currency/geography, as well as things like prop/non-prop, treaty/fac.

Whether any portfolios are known to be onerous and need to be split out (not just historically loss making).

Whether profit commissions need to be handled as an investment component.

Consider the RoNP for retrocession contracts in place.

Methodology choice for the RA, whether this will be based on CoC or VaR type approach. If VaR the level at which this will be done (aggregation of reserving classes)

How to derive discount rates and where to source base data per currency.

Derivation of payment patterns for LIC in order to discount, whether discounting will be applied (probably has to be).

Split of attributable non-attributable expenses for LC, GMM and Insurance Service result, as well as split down to LOB.

Adjustment for illiquidity premium based on nature of liabilities.

Comments:

This was poorly answered, considering the number of points which could have been made. Very generic description of IFRS17 which shows a lack of interest and understanding in how this works in practice.

Escape Re is looking to expand their business and has identified a potential acquisition opportunity, a small reinsurer currently licensed to operate in Mauritius, Target Re. Target Re has relationships with several insurance companies and deals directly with insurers, without reinsurance brokers. Mauritius is not an equivalent jurisdiction to the Solvency Assessment and Management (SAM) regime.

vii. List the advantages and disadvantages of Target Re's operating model.

[4]

Advantages

Target Re deals directly with insurance companies, bypassing brokers. This can lead to lower costs due to the absence of broker fees, improving profitability and efficiency.

By bypassing brokers, Target Re can negotiate more favorable terms directly with insurance companies, potentially leading to better pricing and contract terms.

Without intermediaries (like brokers), Target Re can make quicker decisions, improving responsiveness and flexibility in negotiating terms and settling claims.

Target Re might be more adept at providing customized reinsurance solutions as it is directly involved with the insurers, leading to more unique offerings tailored to the specific needs of the market.

Disadvantages

By not utilizing brokers, Target Re might have a narrower reach, as brokers often have broader access to a larger network of clients and markets. This could limit growth potential.

Reinsurance brokers bring specialized knowledge and can help navigate complex reinsurance deals. Without brokers, Target Re might miss out on expert advice and market insights.

Target Re's business is heavily reliant on maintaining strong direct relationships with insurers. Losing any of these clients could significantly impact revenue and stability.

Managing all relationships and negotiations directly increases the operational burden on the reinsurer, requiring strong internal systems and expertise to handle claims, underwriting, and risk management effectively.

If only licensed in Mauritius direct approach may not work in other jurisdictions depending on current coverage.

Comments:

Reasonably well answered, although many candidates answered the wrong question. This specifically dealt with the direct nature of Target's operating model.

Management would like to acquire and capitalise Target Re, growing their direct reinsurance business and in particular retroceding significant amounts of business written by Escape Re to Target Re to benefit from the attractive Mauritian tax regime.

viii. Discuss potential challenges that you see with this proposed business model.

[6]

Eligibility under SAM is non-existent for Mauritius. This means that credit cannot be taken under the SCR for this retrocession and capital will have to be held in South Africa for this risk.

It is possible that RI deposits in South Africa can be used to net off liabilities and so credit can still be obtained in this way.

However, not being in SA or an equivalent to SAM regime means a higher level of due diligence is necessary to be done and evidenced to the PA.

Maximum fronting rules under SAM need to be considered and this is limited to 75% by a single counterparty beyond which can't recognise the reinsurance benefit or potentially may not be allowed at all.

Cross-border transactions involving retrocession can attract regulatory attention from both the acquiring company's home jurisdiction and Mauritian regulators.

Regulators might scrutinize the arrangements to ensure that they are not being structured solely for tax avoidance or arbitrage, which could lead to regulatory challenges or the need for extensive disclosures.

The tax benefits derived from retrocession could be questioned by tax authorities in both SA and in other jurisdictions where the business operates.

Transfer pricing rules could come into play, and tax authorities might require justification that the retrocession arrangement has a legitimate business purpose beyond tax savings.

The model depends heavily on the stability of the Mauritian tax regime, but any significant changes to tax policy or the country's economic conditions could affect the business model's viability.

Political instability, changes in tax treaties, or regulatory modifications could lead to unforeseen operational risks, making the business model vulnerable to external factors.

Comments:

Poorly answered. There are specific items which should have been considered, understanding of the capital regime, fronting, equivalence was very weak.

[Q1 Total 50]

QUESTION 2

A key principle of the Treating Customers Fairly (TCF) Framework is that insurers must design products ensuring that they meet the needs of customers with extra consideration for vulnerable customers.

i. Identify five different types of insurance buyers and comment on how the framework impacts interactions with each type of buyer.

[5]

Reinsurers /Insurer/managing agent / mutual
Likely to be the most sophisticated policyholders with most data & knowledge with complex modelling capability and legal teams to test product is suitable.

As professionals in the insurance area likely to have knowledge to assess products

Multi-national corporation

Likely to have significant resources to hire in-house insurance specialists or external legal/consultancy advice so likely to be a sophisticated consumer.

Large company
Likely to have resources to seek independent advice, e.g. corporate broker.

Small business/micro enterprise
Likely to need more protection to ensure products are suitable as will lack resources to carry out independent investigation

Government / local authority
Likely to be similar to a large company

Charity / affinity group
Likely to be less sophisticated for same size than a commercial entity

Individual advised by broker
If the consumer receives independent third party advise it will lower the conduct risk. Would not necessarily apply if the broker was tied so acting as agent of the insurer

Individual
Unlikely to have insurance expertise so extra care in ensuring products are appropriate

Vulnerable individuals
Likely to need the most extensive support from conduct risk regulations examples may include the elderly or those with learning disabilities.

Comments:
This question was reasonably well answered, although in many cases distinct buyers were not identified, or how TCF would apply to them.

ii. State three key interactions that insurers have with policyholders, giving an example for each interaction of why fair treatment is critical.

[3]

Claims Handling
A policyholder who has suffered a vehicle accident expects a fair and timely claims settlement. Delayed or unfairly denied claims can lead to financial distress and reputational damage for the insurer.

Policy Wording and Disclosures
Customers must clearly understand policy terms, exclusions, and conditions. For example, a homeowner purchasing insurance should not discover hidden exclusions only after making a claim.

Premium Adjustments and Renewals
If an insurer increases premiums at renewal, the decision must be transparent and justifiable. Arbitrary or excessive hikes without proper communication can lead to customer dissatisfaction and regulatory scrutiny.

Comments:
This question was well answered.

A major insurer has flagged personal lines property insurance as a product carrying high conduct risk.

iii. Comment on why the conduct risk would be elevated following catastrophic events affecting this line of business.

[3]

Claims Handling Pressure
After a catastrophic event, insurers face a surge in claims, leading to potential delays, errors, or inconsistent claim settlements, which may result in unfair treatment of policyholders.

Underinsurance Concerns
Many policyholders may discover they are underinsured due to outdated valuations or unclear policy wording, leading to disputes and dissatisfaction with claim payouts.

Premium Increases and Policy Adjustments
Post-catastrophe, insurers may raise premiums, impose stricter terms, or withdraw coverage in high-risk areas, which can be perceived as unfair or opportunistic, increasing regulatory and reputational risk.

Demand surge may mean that actual repair quotes exceed claims handler assumptions and / or sums insured creating additional settlement uncertainty for policyholders

Comments:
This question was reasonably well answered, although the number of ideas was fairly low with most candidates understanding that more claims would be involved but not going further.

iv. Identify and describe five areas of possible improvements in relation to the TCF Framework for the insurer.

[5]

Clear and Transparent Communication

Ensure policy documents, exclusions, and terms are written in plain language, and proactively educate customers about their coverage and potential risks.

Fair and Efficient Claims Processing
Establish a responsive claims handling process, with clear timelines, empathetic customer support, and independent review mechanisms to ensure fairness in settlements.

Product Design and Suitability Assessments
Regularly review and update insurance products to ensure they meet customers' evolving needs and provide adequate coverage, particularly in high-risk areas.

Customer-Centric Pricing and Renewals
Use fair and justifiable risk-based pricing models, avoiding excessive premium increases or policy restrictions that disproportionately impact loyal customers.

Robust Complaints and Feedback Mechanism
Implement accessible, transparent, and well-documented complaint resolution processes to identify and address customer concerns promptly, feeding insights into product and process improvements.

Comments:
The question was not well answered, answers given were generic and not specifically addressing TCF issues.

v. Describe key reports and data points an insurer should monitor to ensure compliance with conduct risk standards.

[5]

Some sort of information dashboard or summary that is prepared on a monthly basis and covers key numerical data

Particular metrics can include:

- Claims data such as time taken to settle a claim, number of re-opened claims, number of rejected claims.
- Number of complaints by product line segmented by the type of complaint (e.g. claims settlement, misleading wordings)
- Any complaints referred to regulator and their outcomes.
- Information on policy cancellations or non-renewals.
- Outcomes of new product reviews.
- Low loss ratio products
- High commission products
- Overall portfolio commission
- Fines / sanctions

- Mystery shopping outcomes
- Re-opened / renewed cases

Comments:
This question was fairly well answered with most candidates getting the core points.

During a regulatory review of household insurance sales, third-party brokers and intermediaries were found to be more compliant with the requirements of the TCF framework compared to direct sales practices.

vi. Suggest potential concerns regulators may have regarding policies sold through direct distribution channels.

[4]

Lack of Personalised Advice:
Unlike brokers who assess customer needs, direct sales channels may offer standardized products without ensuring suitability, leading to potential mis-selling.

Inadequate Disclosure and Transparency:
Customers may not fully understand policy terms, exclusions, and coverage limits due to insufficient explanations or reliance on complex online documentation.

Aggressive Sales Tactics:
Direct sales teams may be incentivised to prioritise sales volume over customer needs, leading to pressure selling or misleading representations.

Higher Risk of Underinsurance:
Without professional guidance, customers may underestimate the value of their assets or select inadequate coverage, leading to disputes at the claims stage.

Limited Support in Claims and Policy Servicing:
Customers purchasing policies directly may struggle to navigate claims or policy changes without dedicated assistance, increasing dissatisfaction and potential regulatory scrutiny.

Comments:

This question was not well answered, there was little comparison against the broker channel and points were weak as a result.

[Q2 Total 25]

QUESTION 3

In South Africa, the Compensation Fund, administered under the Compensation for Occupational Injuries and Diseases Act (COIDA), provides Workers' Compensation insurance for employees who suffer workplace injuries or diseases.

The scheme is financed through employer premiums, which are set based on the employer's industry classification and past claims experience. The government is considering reforms to improve the financial sustainability of the Compensation Fund and to incentivise workplace safety.

i. State the objectives the government fund may have in designing an employer contribution methodology, commenting on how using employer's industry classification and past claims experience supports these objectives.

[5]

Risk-Based Pricing for Fairness

Different industries have varying levels of occupational risk. A mining company faces higher workplace hazards than an office-based business. Industry classification ensures that high-risk employers contribute proportionally more to reflect their greater likelihood of claims.

Encouraging Workplace Safety

Experience rating, which adjusts premiums based on an employer's past claims history, incentivizes companies to improve safety measures. Employers with fewer workplace injuries benefit from lower premiums, promoting proactive risk management.

Ensuring Fund Sustainability

By aligning contributions with risk levels, the Compensation Fund can remain financially stable. High-risk employers contribute more, preventing cross-subsidization where low-risk businesses would otherwise bear the cost of high claims sectors.

Reflecting Claims Costs More Accurately

Employers with a history of frequent or severe claims indicate a higher cost burden on the fund. Adjusting contributions based on past claims ensures that those who drive higher payouts contribute more fairly.

International Best Practice

Many global Workers' Compensation schemes use industry classification and claims experience to set premiums, as it balances financial viability, fairness, and safety incentives within the system.

Comments:
This question was fairly easy and candidates did not identify the key issues nor did they structure their questions well, but overall well enough answered.

The government is proposing a new premium calculation methodology based on adjusting the individual employer risk experience. The new method will be as follows:

- ***Initially premiums will be set at a flat rate of 1.5% of wage costs, charged uniformly across all employers from all industry classifications.***
- ***The claim ratio for each employer will be calculated as the ratio of claims incurred to premiums collected for that employer within the year.***
- ***The national average claim ratio will be determined based on total claims incurred and total premiums collected by the government insurer across all employers.***
- ***Individual premiums will be adjusted as follows:***
    - ***For every 5% where an employer's claim ratio is below 75% of the national average, their premium rate will decrease by 0.1%.***
    - ***For every 10% where an employer's claim ratio is above 150% of the national average, their premium rate will increase by 0.2%.***
- ***Premium adjustments are made at the end of each year of review and based on the claim ratio for that year. Premium rates are subject to a minimum of 1.0% and maximum of 4.0%.***

The following table shows the national average claim ratio and the experience of three companies:

1	***55%***	***480%***	***85%***	***10%***
2	***55%***	***10%***	***75%***	***50%***
3	***55%***	***15%***	***70%***	***95%***

The standard premium rate of 1.5% of wage costs applies in Year 1. Adjustments begin in Year 2 based on Year 1 claim ratios. For instance, in Year 2, Company A will pay the maximum amount of 4.0% of wage costs.

ii. Comment on the experience of the three companies and what it may indicate about their size and nature.

[4]

A must have had a major event in year 1, either in absolute terms or relative to size of company (e.g. .a single large injury for a small company).

Presence of some claims even in more benign years suggests a large event in absolute terms as otherwise would expect clean years for a small company.

Although may have some residual level of minor loss activity, e.g. slip & trip.

B is showing very stable experience after allowing for rate changes.

Suggests that may be a large company with no particularly unusual events.

Overall levels are consistently higher than average suggesting company is higher risk (e.g. heavy industry).

C has one clean year and generally volatile experience suggesting it may be a small company

Could be new start up

Particularly as paid data so might not have paid on any claims incurred in year 1.

Comments:

This question was fairly well answered, with most candidates given plausible explanations.

iii. Discuss whether the new premium calculation method is likely to align premiums more closely with expected claim costs.

[6]

Compared to the current arrangements, the new method is likely to result in premiums that mismatch industry ~ if there are significant differences between industries being covered.

This is because the current system does better reflect differences in claim cost at an industry level

The calculations have a number of limitations:

Premium adjustments reflect employer claim ratio relative to average claim ratio.

So it is possible that an employer with a claim ratio above 100% could get a premium reduction, if 100% was below the average

Premium basis does not reflect systemic drivers of claim costs, for example, an increase in claims inflation impacting all employers' costs.

Ratio of claims paid to premiums received in a single year may be a poor indicator of expected claim costs.

In part this depends on the nature of workers compensation benefits provided in this country.

Need to consider the distribution of claim costs, which will depend in part of the benefits covered

If the benefits are primarily short term in duration, for example, short term medical and loss of wages, paid claims may be a reasonable proxy for benefits incurred.

However it may be that a significant proportion of the premium is required to cover long term compensation for catastrophic injuries, in which case paid claims in a single year is a poor benchmark of expected costs.

For example, an accident may result in limited payments in the year in which the accident occurs, but require significant payments for many future years.

An exceptional event could therefore result in above industry average paid claim ratio for many years. However, this exceptional claim may not be indicative of future expected claim costs.

It may be that most employers have below average claim ratios in any given year, and so quality for premium reductions.

In particular, even employers with high expected claim costs may have claim ratios below the average in most years. The most serious claims will occur infrequently, even at high risk employers.

A small number who have had serious injury claims may have claim ratios significantly above average, and so pay higher premiums.

Payments in a single year will not be a good proxy for latent claim risk, as these are characterised by a long delay between accident date and claim notification / payment.

Injured employees may be able to choose whether to take a lump sum settlement, or ongoing payments over multiple years.

Payment preferences (rather than expected claim costs) could impact premium.

Employers may pressure employees to delay reporting claims under the following year, in order to obtain a premium reduction in the current year, or otherwise impact timing of payments.

If an employer already expects claim ratio to be above average, it may be able to delay paying premiums until the next year. This would increase the likelihood of below average claim ratio the following year.

The nature of an employer’s operations may change from year to year.

For example, an employer may increase the number of workers employed in low risk activities, and reduce the number employed in high risk activities, with no change in payroll.

It would take many years for premium rates to adjust to reflect change in expected claim costs.

Comments:

Candidates really struggled on this question.

More thought needed to go into the comparison and maybe a function of time but it seems like the question was not read properly.

Many marks were available for a well-structured and thoughtful answer.

In some countries, private insurers are permitted to compete with government-run Workers' Compensation schemes.

iv. Identify and describe five potential benefits of introducing private insurers into the South African system.

[5]

Increased Financial Efficiency:

Private insurers operate under competitive market pressures, which can drive cost efficiencies, reduce administrative expenses, and optimise premium structures. This could lead to more sustainable pricing and lower costs for employers.

Improved Claims Management:

Private insurers typically have advanced claims processing systems, leading to faster claims resolution, reduced fraud, and improved customer service. This could enhance the experience for injured workers and ensure timely compensation.

"managed care" - private companies would have the incentive to do more to rehabilitate injured workers so that they can return to work

Risk-Based Pricing Incentives:

Private insurers can implement more refined underwriting models, pricing policies based on specific employer risk factors rather than a flat rate. This could further encourage workplace safety improvements.

Better Service and Innovation:

Competition may lead to better policy offerings, improved rehabilitation programs, and innovative claims management solutions, benefiting both employers and employees.

Reduced Government Burden:

By shifting some financial and operational responsibilities to private insurers, the government could focus on oversight and regulation rather than direct fund administration.

Comments:

This question was reasonably well answered, although more distinct points relevant to the question could have been made.

v. Identify and describe five potential risks of introducing private insurers into the South African system, paying particular attention to regulatory considerations

[5]

Adverse Selection Risk

High-risk employers may remain with the government-run fund, while low-risk employers move to private insurers for lower premiums. This could lead to financial strain on the Compensation Fund, requiring government intervention or higher levies.

Market Stability Concerns

Private insurers may exit the market if claims become unprofitable, leaving some employers without coverage. The government may need to act as a reinsurer or provide a last-resort option.

Ensuring Fair Access

Private insurers may prioritize low-risk industries, leading to disparities in coverage availability and pricing. Regulatory oversight would be needed to prevent discrimination against high-risk sectors.

Profit vs. Social Welfare Balance

Unlike a state fund, private insurers are profit-driven, which may lead to cost-cutting measures that impact injured workers' benefits or delay payments. Minimum benefit standards must be enforced through regulation.

Regulatory and Compliance Challenges

A dual-system involving both private insurers and the government would require robust oversight to ensure compliance with COIDA, prevent fraud, and maintain fairness in claims management.

Would also need to be rules around joining and leaving the government insurer

For example, if a large claim occurs which will require payments for many years, the new insurer would need to cover all payments arising before rejoining government insurer.

Need to ensure a high degree of confidence that injured employees receive compensation.

Comments:

This question was not well answered, candidates needed to go further in their answers but the fact that this was the last question did not help time management.

[Q3Total 25]

[Grand Total 100]