

Institute of Actuaries of India

Subject CP3 – Communication Practice

March 2022 Examination

EXAMINERS' REPORT

Introduction

The Examiners' Report is written by the Examiners with the aim of helping candidates. The solutions given are only indicative. It is realized that there could be other points as valid answers and examiner have given credit for any alternative approach or interpretation which they consider to be reasonable.

The report is written based on the legislative and regulatory context pertaining to the date that the examination was set. Candidates should take into account the possibility that circumstances may have changed if using these reports for revision.

A. General comments on the aims of this subject and how it is marked

The general aim of the examination is to produce a piece of communication on a scenario which an actuary would face in day to day work. This is aimed at a non technical person, typically a non actuary basis the situation provided.

The communication is expected to be standard and acceptable and the expectation is that the recipient would understand the communication as well the be satisfied with the overall response.

The reflective question of 10 marks are designed to make the candidate think of the type of communication they have adopted and justify their approach

B. Pass Mark

The Pass Mark for this exam was 50.
321 candidates appeared and 61 passed.

Solution 1:

Dear Lata,

Thank you for your email. I have attempted to answer the questions you have on repricing in the following sections.

First, how do we measure product profitability. Our products are long duration contracts and profits from these products emerge over the term of the contracts. We follow a method called the Value of New Business (VNB) for measuring the profitability of the contracts. This method measures the profits over the term of the contract and discounts these profits at the risk discount rate. Shareholders put in capital and the risk discount rate is the rate at which the shareholders expect to be rewarded for the risk on the capital that they provide.

The need for capital arises on account of two factors. For each contract we must set aside monies called reserves which ensures that there is an ability to meet customer obligations under most circumstances. The initial premium that we receive may not be sufficient to meet the cost of acquisition of the customer and the reserves. Shareholders would need to pump in capital to bridge this gap. Apart from the reserves, there is additional capital that we need to hold for the business that we write.

In the past we have been pricing our products competitively and this has enabled us to garner a good market share. However, profits that have emerged from the business have not been sufficient to increase the capital to a level that would be needed for us to continue to grow at the current levels.

This has made us revisit our pricing philosophy. We have now articulated that the VNB we expect should be higher for the capital that we deploy. We also require more certainty in respect of the profits from the business that we write. If there is uncertainty, then the profitability should be improved to compensate for the higher risk the shareholders will be taking. The risk discount rate that we use for riskier products increases resulting in an increase in prices.

In the next few paragraphs, I will explain how this uncertainty has risen and how this has impacted the prices.

To measure the profitability, we need to make assumptions of mortality, persistency, and interest rates. Mortality assumption lets us establish the amounts we will be paying out in case of death during the term of the contract. Persistency assumption enables us to estimate how many customers continue with the contracts. Interest rate assumptions enable us to establish the amount of interest we earn on the reserves and the capital that we set aside. We need to note that mortality and persistency assumptions are derived based on our past book.

As we grow our business, we expect a change in customer profile and customer behaviours. Our contracts are long duration contracts and we have not been able to achieve the kind of asset liability matching as required which also results in uncertainty of profits. We therefore stress these parameters to see the possible impact on VNB and make sure that the profitability is high enough so that even if one of the parameters is different from our underlying assumption, the risk to the profitability is less.

This has resulted in an increase in premiums. You are right in that volumes could be affected. Therefore, we have tested the impact on volumes and even with lower volumes, VNB will not be affected significantly. It helps us with our capital situation as with a significantly lower capital deployment we can generate a marginally higher VNB. The repricing also enables us to recover our capital faster which is important in the current context of shortage of capital.

I hope I have been able to explain our pricing philosophy and the trigger for repricing. Please do reach out to me if you have any more questions.

Regards

Ram

[90 Marks]

Identification of key issues:

Most of the examinees scored average on this aspect as it was not answered well. Most of them stated only Current business profile, method of profitability, need of capital, assets liability mismatch and shorter payback period.

Few were able to demonstrate the need of re-pricing, nature of capital needed, required rate of return by shareholders, what assumptions needed in pricing, how uncertainty measured by stresses assumptions, , how expected fall in sales covered by higher VNB in simple words.

Very few candidates tried to discuss on the assumptions used like mortality, persistenct and interest rates

Many tried to explain using technical terms, definitions thereof and the data given in the question paper which became unnecessary and complicated for understanding from user point of view. Many examinees gave unnecessary points not relevant to the purpose.

Catering to audience:

While addressing the user of communication, many examinees used proper salutation and welcome line. However, few assured justification of re-pricing which was not at all required. Proper concluding was given by most of the examinees. However, few recommended the increase in prices in conclusion which was also not at all required given the purpose of communication. Lots of students just tried to copy paste the sensitivity tables without making any sense of the same.

Many used proper simple language; however, professional language was not used by few as was required in communicating with a Sales Head.

Few of the examinees avoided the jargons and also explained them wherever used.

Content- Concise and relevant:

Very few examinees avoided irrelevant points. Many examinees repeated the relevant as well as irrelevant points.

Most of the examinees used technical terms/data from the question paper and explained them as it is. Few also provided superfluous information related to pricing and profitability.

Few lost points due to lot of spelling, grammar and punctuation mistakes.

Few were able to meet the objectives of communication – justification of re-pricing covering expected fall in sales volume. Few prepared summary and covered relevant points therein. However, examinees who were able to state relevant points in simple tone scored well.

Solution 2:

Any technical term the candidate considers as jargon with an explanation of why they considered it as jargon.

[4 Marks]

This question was generally well answered by students with students scoring good marks

Solution 3:

Any information that the candidate filtered. There are a lot of technical details of how pricing is done and how VNB is calculated. The candidate should be able to demonstrate that they filtered this information while framing the response.

[4 Marks]

Most students answered this question poorly. Many students couldn't segregate what was asked in Q2 and Q3 and came up with relatively less points. Students need to read question carefully to understand what is actually asked

Solution 4:

Structuring can be done by giving specific headings or sign posting in the reply. This is an email reply and therefore structuring using headings maybe difficult. The candidate should be able to explain how they have done structuring in their reply.

[2 Marks]

Overall reasonably answered with students explaining their logic

Additional Comments:

The candidates should structure the responses correctly. They should also focus more on interpreting the data rather than copy pasting the same. The students are expected to produce a first draft of communication which caters to the audience. As such there should also be an element of further discussion scope in the response
