INSTITUTE OF ACTUARIES OF INDIA

Subject CP3 - Communication Practice

May 2024 Examination

INDICATIVE SOLUTION

Introduction

The indicative solution has been 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.

Solution 1 :

Dear Mr. Transaction Head,

Thank you for providing me the opportunity to conduct a high-level review on ABC Health Insurance Company's reserves and solvency position. Report below illustrates the key findings on the subject.

Current state assessment of ABC Health Insurance Company's Reserves and Solvency position

Company background

ABC Health Insurance Company has been into operation for the last 14 years with a market share of 4.7% of the total health insurance industry. Company is spearheaded by the CEO Mr. Bulgaria, who has been with the company for the last 5 years. Company's senior management saw a significant change in 2023 with some sharp hires from the financial markets:

- Mr. Austria as the Chief Financial Officer with rich industry experience of over 20 years.
- Ms. Greece as the Chief Investment Officer with experience of over 20 years in the financial markets.
- Ms. Ireland as the Appointed Actuary with over 15 years of industry experience.

Business Overview

- **Products:** Company primarily sells one year Indemnity products which constitutes 98% of the portfolio with personal accident and travel covering the remaining 2% of the product suite
- **Premium growth:** In FY 2023, the non-life industry's premium grew at 16% and stand-alone health insurers demonstrated a significant growth of 33%. ABC Health Insurance reported a premium growth of 27% higher than that of non-life players, while it remained a laggard with respect to the stand-alone health insurance players.
- **Expenses**: Company's expense ratio stood at 25% of Gross Written Premium, marginally less than other stand-alone health insurance players i.e. 26%.
- **Commission payout:** Company's commission ratio stood at 6.5% of Gross Written Premium, in line with the other stand-alone health insurance players i.e. 6%.
- **Business reinsured:** Company retained 80% of its business while ceding out 20% to reinsurers.
- **Investment Income:** Company reported an investment return of 7% which is little below the industry's average of 7.8%.

Reserves

Company maintains the following reserves to meet the policyholder liabilities:

- **Unearned Premium Reserve:** Company booked INR 1,887 crores to meet the liabilities that may arise in future as the policyholder can make claims until the end of the coverage period. The calculation methodology adopted by the company is in line with the standard Industry practice and the actuarial principles.
- **Outstanding Claims Reserve:** Company booked INR 341 crores as the outstanding claims reserves, reporting a significant drop from previous years despite growth in the premium. This is primarily on account of change in calculation methodology done in FY 2023. Previously company booked the full amount of reported claim as the reserve whereas the final settlement of claim was approximately 70% of the reported amount.

In FY 2023, company allowed this impact of final settlement in its outstanding claim reserve calculation resulting in a significant reduction from the previous year.

- **Incurred But Not Reported (IBNR) Reserve:** Company booked INR 146 crores as IBNR calculated using standard actuarial methodologies. It appears the company has been optimised its IBNR from previous years i.e. a drop from 9% to 5% as a percentage of Net Earned Premium. There is no concrete reason available for this reduction as systems and processes are similar to previous years. On an average, this ratio stands between 8% - 15% for other players across the industry.

  Claims ratio as a percentage of Net Earned Premium – As a result of reduction in reserves, company witnessed a significant reduction in its claims ratio from 66% in FY 2022 to 55% in FY 2023. This reduction provided an upside to the company's profit and loss accounting whereby company reported its first profit in FY 2023.

Solvency position

- Company's solvency ratio in FY 2023 stood at 174% which is reasonably above the regulatory requirement of 150%. However, this is at the back of capital injection of 150 crores in FY 2022 wherein the solvency ratio was marginally close to the minimum regulatory requirement. The average solvency ratio for stand alone heath insurers stood at 212% in FY 2023.
- The capital available towards solvency is impacted negatively by the increase in receivables greater than 180 days which are considered inadmissible for the purpose of solvency calculations. Hence, the company should strengthen its processes to make timely recoveries to avoid any failures on receivables.
- As the industry prepares to transition into the Risk Based capital regime, the regulator had asked companies to conduct an impact assessment study to analyse the impact on companies' current solvency capital. The result of this exercise illustrated a negative impact on the current solvency ratio across the industry. However, the capital remains above the minimum regulatory requirement of 150%.

Conclusion

- Despite being one of the oldest stand-alone insurers in the country, the company is still in the phase of developing efficiencies across various areas like expenses, claims, sales, and others to maintain its control over the market share. The competitors are performing better across some of these areas giving a strong competition to company to sustain its position. It is expected that the hiring of 3 key senior level resource will help the company to drive premium growth and profitability.
- The company needs to closely monitor its claims experience due to recent change in outstanding reserve calculation methodology. Any adverse claim experience will impact the outstanding claim reserve and thereby its profitability and solvency capital.
- The company should work on improving the recovery mechanism from external parties to improve the available solvency capital.
- The company plans to reprice its product due to improvement in claims experience and expense ratio to enhance its competitiveness in the market. However, the company should monitor the claim experience to make a reasonable assessment of its improvement in future years as any incorrect assessment could mean insufficient premiums and losses in future.
- There have been no regulatory issues against the company until present and company has a reasonable reputation in the market.

[90]

Solution 2:

Following are the jargons which are excluded out of the note in part 1:

1. Retention ratio
2. Net written premium
3. Proportional Quota share arrangement.
4. Bornhuetter Ferguson Method, Chain Ladder Method
5. Net Incurred claims

[1 mark for each point, 5]

Solution 3: Following are the points which are excluded out of the report in part 1 as the information was not relevant:

1. Extensive details about the key hiring of the 3 senior management personnel since this is a high-level report.
2. Details on granularity of the components forming the expenses.
3. Details on the product suite and the distribution channel through which each is sold.
4. Details about strength of company's relationship with its brokers and reinsurers.
5. Details of various ratios and the calculation methodology.

[1 mark for each point, 5]

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