INSTITUTE OF ACTUARIES OF INDIA

EXAMINATIONS

November 2025

CP3 - Communication Practice

Time allowed: 3 Hours 15 Minutes

Total Marks: 100

You are the Reporting Actuary of H&B Life Insurance Company. The government of your country recently raised the limit of Foreign Direct Investment (FDI) in Insurance from 74% to 100%. This was primarily done to encourage more players in the market, generate employment opportunities, encourage advancement of technology and increase insurance penetration. At the moment, 74% stake in H&B is with "H" – the foreign partner and 26% stake is with "B" – the domestic partner. As a result of the increase in FDI limit to 100%, "H" wants to expand its share to 100% and take full control of "H&B". The sale of B's share to "H" is under process and is awaiting final approval from regulator and court. However, it is expected that there will not be any issues with the approval and that it will be received soon.

Post the sale, "H" wants to make some changes to the overall business. They are:

1. "H" now wants to align many of the assumptions in the model with its parent company.
2. "H" wants to integrate all the systems and processes with its parent company.
3. "H" wants to stop selling Group products which have been loss making for "H&B" and focus just on Individual products.

The Chief Actuary of the company is worried about the impact on Best Estimate Liability (BEL) and Solvency Capital Requirement (SCR) because of the above changes. He anticipates that because of these changes, the company might breach the minimum solvency capital requirement of 150%.

Q.1) The Chief Actuary of your company has asked you to draft a paper (in about 900 words) for him to present in the upcoming Risk and Capital Committee (RCC) meeting (which comprises senior employees of the company like Chief Actuary, CRO, CFO etc.) where he can discuss the impacts on BEL and SCR because of changes in assumptions, integration of systems and processes and stopping the sale of Group products. The paper should cover the background to these changes, standalone impact of these changes and aggregate impact of these changes. It should also suggest any management actions to mitigate adverse impact of these changes on the solvency ratio.

[90]

Q.2) Explain how you decided on:

i) The depth of your explanation (3)

ii) Filtering information (3)

iii) Structure of your response (4)

[10]

[The information given below is fictitious and does not belong to any company. It is meant to be used only for the purpose of this examination.]

<u>Annexure:</u>

1. **<u>FDI increasing from 74% to 100%:</u>**

- Government in its last budget announcement, increased Foreign Direct Investment (FDI) in Insurance companies from 74% to 100%.
- Government said this was done to:
  - Encourage more players in the market and increase capital-infusion: Insurance is a capital-intensive industry which requires long-term funds. Government estimates billions in additional inflows over the next 3-5 years.

- Generate employment opportunities: More foreign players are expected to come into the market and open domestic subsidiaries here, especially the ones who did not do so as 100% control was not an option. This is expected to increase employment opportunities in insurance industry both directly and indirectly. Government expects an additional 10,000 jobs to be added in the next 3-5 years.
- Advancement of technology and innovation: Full foreign ownership is expected to intensify competition as there is no more protection from Government's end. This is expected to increase innovation in product design, digitalize customer experience and lead to better claims turnaround times and service quality. It is also expected that global players will bring in advanced underwriting models, automation and Insurtech, enhanced cyber and operational resilience frameworks.
- Increase Insurance Penetration: Foreign players with deeper pockets and distribution expertise along with intensified competition is expected to push growth in rural and semi-urban markets. This aligns with government's aim of greater financial inclusion.
- Government's condition to invest entire premium domestically is further expected to boost domestic growth.

2. <u>H&B's product portfolio</u>

- H&B currently sells Individual and Group products
- In Individual, its main products are Term Life, Whole Life and some health products
- In Group, it mainly has Group Term Life products

3. <u>Changes in H&B's ownership</u>

- H&B's foreign partner "H" wants to take full control of the company by expanding its share from the current 74% to 100%.
- The sale price and other considerations have been agreed between the two parties, and the news is now in the public domain.
- Regulator and court are yet to give their final approval on this.
- However, experts say that obtaining approval should not be a challenge as all the concerns have already been addressed.
- The sale has already received approval from the competition commission and has addressed all policyholders' concerns related to the sale.
- Independent expert appointed for this sale from the court has expressed favourable opinion related to the sale and its impact on policyholders.

4. <u>Changes in business as a result of the sale</u>

- As the sale is more or less final and "H" is going to take full control of H&B, it is planning to implement some changes to align with its parent company.
- Revising Assumptions: "H" wants to change many of the assumptions to align with the basis and judgements of its global parent. The change in assumptions impacts most of the products. The changes are
  - Higher expense assumptions
  - Higher mortality assumptions
  - Higher lapse assumptions
- Integration of systems and processes: "H" wants to integrate all its systems and processes with its global parent making it consistent overall. This restructuring and realignment are expected to come at a cost and some short-term disruptions in processes.
- Stopping sales of Group Products: "H" wants to stop selling Group Products after the sale is complete and wants to completely focus on Individual products. H&B currently has sizeable market share in group business, but it is loss making. The initial expenses and commissions outweigh the entire profits during the lifetime of policies. H&B was

fine with this earlier as it wanted to increase its market share and become the market leader and then change strategy to earn profits. However, this does not align with what the parent company of “H” wants. It wants to sell products or focus on Lines of Business (LoB) that are profitable.

5. **Impact on BEL and Solvency because of the changes:**
    - Solvency ratio before any impact:
        - Capital Available/Own Funds: 3,620 million
        - Capital Required/Solvency Capital Required: 2,110 million
        - Solvency Ratio: 172%
    - Standalone impact of revising Assumptions:
        - Higher expense assumptions:
            - 88 million increase in BEL
            - 35 million increase in Final SCR
            - New solvency ratio: 165%
            - Impact on solvency ratio: 7%
            - Minimum solvency ratio required: 150%
        - Higher mortality assumptions:
            - 20 million increase in BEL
            - 7 million increase in Final SCR
            - New solvency ratio: 170%
            - Impact on solvency ratio: 2%
            - Minimum solvency ratio required: 150%
        - Higher lapse assumptions:
            - 118 million increase in BEL
            - 78 million increase in Final SCR
            - New solvency ratio: 160%
            - Impact on solvency ratio: 12%
            - Minimum solvency ratio required: 150%
    - Aggregate impact of revising Assumptions:
        - Aggregate impact:
            - 184 million increase in BEL
            - 98 million increase in Final SCR
            - New solvency ratio: 156%
            - Impact on solvency ratio: 16%
            - Minimum solvency ratio required: 150%
            - Aggregate impact is less than sum of all three standalone impacts due to diversification. Diversification benefit in SCR is the reduction in total capital required because different risks are not perfectly correlated – meaning all risks will not go bad at once.
    - Integration of systems and processes:
        - Integration of systems and processes is expected to incur a one-time cost of 78 million decreasing Capital Available/Own Funds.
    - Stopping the sale of Group products: Stopping the sale of Group products which have been loss making is expected to increase solvency ratio overtime as business runs-off. Immediately after stopping the sale, there is expectation that Available capital/Own funds will fall due to expense overruns provision being created as unit costs rises.
        - Standalone Impact of stopping sale of Group Products:
            - 120 million of Expense Overrun provision
            - New solvency ratio: 166%
            - Impact on solvency ratio: 6%
            - Minimum solvency ratio required: 150%

- Aggregate Impact of all the three changes (all three assumption changes, system integration and stopping sale of Group business)
    - 382 million decrease in Capital Available/Own Funds
    - 98 million increase in Final SCR
    - New solvency ratio: 147%
    - Impact on solvency ratio: 25%
    - Minimum solvency ratio required: 150%
- Best Estimate Liability (BEL) is company's liability calculated using realistic or "best-estimate" assumptions. As it is a liability, increase in BEL leads to a fall in Capital Available/Own Funds and vice versa.

6. <u>Management Actions</u>

- Capital Infusion: Parent company plans to infuse 200 million to bring the solvency ratio above the regulatory minimum
- H wants to have a solvency ratio of 160% (10% above regulatory minimum). It aims to fulfill this by capital infusion and run-off of expense overrun and group policies.
- Some more actions suggested for improving solvency ratio are:
  i. Reducing interest rate risk by reducing ALM gap
  ii. Reducing mortality risk by increasing reinsurance of certain products
  iii. Reducing Default/Credit risk by proactive collection of debt that is due but not received.

****