INSTITUTE OF ACTUARIES OF INDIA

CP3 - Communication Practice

November 2025 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:

Paper: "Impact on BEL and SCR from Post-Sale Changes"
Date:
To: Risk and Capital Committee (RCC), H&B Life Insurance Company
From: Chief Actuary
For: Discussion

Executive Summary

Our partner "H" is increasing its stake in "H&B" from 74% to 100% taking full control of "H&B" and approvals are expected soon from the regulator and court. Post-sale, "H" plans to implement several changes to align with its parent group. These changes are to revise mortality, expense and lapse assumptions, integrate systems and processes with the parent company and stop selling loss-making group products. These changes have an adverse impact on BEL and SCR of the company. This paper discusses the standalone and aggregate impact of these changes and suggests mitigating actions.

Background

1. Increase in Foreign Direct Investment (FDI) in Insurance & change of ownership

    - The Government in its last budget increased FDI limit in insurance from 74% to 100% due to which our foreign partner "H" plans to raise its ownership from 74% to 100% .
    - The sale is expected to be complete soon as only final approval from the regulator and court are pending. Experts say that obtaining these final approvals should not be a challenge.
    - So, once the sale is approved, "H" will have complete ownership of H&B life insurance company.

2. Post-sale changes

    - "H" wants to make the following changes once the sale receives final approval. It aims to make these changes to align with its global parent:
        - Revising assumptions: "H" wants to revise and increase its assumptions for expenses, mortality and lapses for most of the products to align with the basis and judgements of its global parent.
        - Integrating systems and processes: "H" wants to integrate its systems and processes to have it consistent with its global parent. This is expected to lead to short-term disruptions and incurring of restructuring costs.
        - Stopping the sale of Group products: "H" wants to stop selling loss-making group products even though we have a sizeable market share. This is to align with its overall global parent policy of only selling products which are profitable.

Impact of post-sale changes:

- Company at the moment, before any post-sale changes has a solvency ratio of 172% with 3,620 million of Capital Available or Own Funds and 2,110 million of Solvency Capital Requirement (SCR).
- Regulatory minimum solvency ratio is 150%

Impact of revising assumptions:

- The table below shows the standalone impacts on BEL, SCR and solvency ratio due to increasing expense, mortality and lapse assumptions:

Standalone Impacts of revising assumptions	Impact on BEL (in m)	Impact on Capital Available/Own Funds (in m)	Impact on SCR (in m)	Revised Capital Available/Own funds (in m)	Revised SCR (in m)	Revised Solvency ratio	Impact on solvency ratio
Higher expenses	88	-88	35	3,532	2,145	165%	-7%
Higher mortality rates	20	-20	7	3,600	2,117	170%	-2%

Higher lapse rates	118	-118	78	3,502	2,188	160%	-12%

- On a standalone basis, higher lapse rates have the maximum impact on both BEL and SCR and decreases solvency ratio by 12% from 172% to 160% but still leaves the Company above the regulatory minimum of 150%.
- While higher expenses and higher mortality rates leads to a fall in solvency ratio of 7% and 2% respectively on a standalone basis.
- The table below shows the aggregate impact of revising/ increasing all the three (expenses, mortality and lapse) assumptions:

Aggregate Impact of revising assumptions	Impact on BEL (in m)	Impact on Capital Available/Own Funds (in m)	Impact on SCR (in m)	Revised Capital Available/Own funds (in m)	Revised SCR (in m)	Revised Solvency ratio	Impact on solvency ratio
Aggregate Impact	184	-184	98	3,436	2,208	156%	-16%

- The aggregate impact of revising/increasing assumptions is less than the sum of all three standalone impacts because of 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. BEL decreases by 184 million while SCR increases by 98 million leading to a fall in solvency ratio of 16% from 172% to 156%. This is still above the regulatory minimum of 150%.

Impact of integrating systems and processes:

- The table below shows the impact of integration of systems and processes with the parent group company:

Impact of Integration of systems and processes	Impact on BEL (in m)	Impact on Capital Available/Own Funds (in m)	Impact on SCR (in m)	Revised Capital Available/Own funds (in m)	Revised SCR (in m)	Revised Solvency ratio	Impact on solvency ratio
Impact	0	-78	0	3,542	2,110	168%	-4%

- Integration of systems and processes is expected to incur a one-time cost of 78 million. This will reduce the capital Available/Own funds by the same amount but does not have any impact on BEL or SCR. This is expected to reduce the solvency ratio by 4% to 168%, still above the regulatory minimum of 150%.

Impact of stopping sale of Group Products:

- The table below shows the impact of stopping the sale of Group products:

Impact of stopping sales of Group Products	Impact on BEL (in m)	Impact on Capital Available/Own Funds (in m)	Impact on SCR (in m)	Revised Capital Available/Own funds (in m)	Revised SCR (in m)	Revised Solvency ratio	Impact on solvency ratio
Impact	0	-120	0	3,500	2,110	166%	6%

- Stopping the sale of group products is expected to increase unit costs in future as there would be lesser number of policies to spread fixed expenses. To cover this, an expense overrun provision of 120 million has been created. This reduces the Capital Available/Own Funds by the same amount but has no impact on BEL and SCR at the moment. This leads to a reduction in solvency ratio by 6% to 166%, still above the regulatory minimum of 150%.
- In future, this expense over-run is expected to run-off and as group policies run-off, BEL and SCR are expected to decrease, increasing the solvency ratio.

Aggregate Impact of all the three post-sale changes:

- The table below shows the aggregate impact of all the changes:

Aggregate Impact of all the changes	Impact on BEL (in m)	Impact on Capital Available/Own Funds (in m)	Impact on SCR (in m)	Revised Capital Available/Own funds (in m)	Revised SCR (in m)	Revised Solvency ratio	Impact on solvency ratio
Impact	184	-382	98	3,238	2,208	147%	25%

- Implementing all the three proposed changes post-sale is expected to increase BEL by 184 million, decrease own funds by 382 million and increase SCR by 98 million. This results in fall in solvency ratio by 25% from 172% to 147% which is **3% below the regulatory minimum of 150%**.

Management Actions

- Parent company of "H" plans to infuse 200 million immediately to bring the ratio well above the regulatory minimum and allow significant buffer. This is expected to increase the ratio from 147% (post all impacts) to 156% with Capital Available/Own funds of 3,438 million and SCR of 2,208 million.
- This would be still below "H"s parent company's internal limit of 160%.
- "H" expects this to meet naturally as expense overrun provision runs-off and solvency ratio increases as a result of run-off of loss-making group business.
- Solvency ratio can also be improved by optimising capital requirement in the following ways:
    - Reducing interest rate risk SCR by reducing ALM gap
    - Reducing mortality risk SCR by increasing reinsurance of certain products
    - Reducing Default/Credit risk SCR by proactive collection of debt that is due but not received.

(90 Marks)

Solution 2:

i) Depth of the explanation:

- The depth of the explanation has been chosen keeping in the mind the technical expertise of the audience which comprises senior employees of the company like CFO, CRO etc. They are expected to have a sound knowledge and understanding of basic insurance terminologies like BEL, SCR, ALM etc but terms like diversification benefit have been explained.
- Depth of the explanation has also been chosen to keep the focus on the real point of the paper that is Impact on BEL and SCR from the proposed changes post-sale.
- Actuarial Technical terms and explanation was made simpler.
- Impact on solvency and profitability presented in tabular form for ease of understanding
- Giving too much information about the sale and how the sale has been made possible because of increase in FDI has been avoided as it is expected that the committee members would already have such knowledge.
- Recommendation of management actions has been given in simple plain language with necessary explanation.

(3)

ii) Filtering Information:

- There is quite detailed information about why the government has increased FDI from 74% to 100%. This has been omitted as it is not strictly relevant and it is expected that the board members would already have prior knowledge about this.
- Status of pending approvals needed to complete the sale have been briefly mentioned and not in detail as it is expected that the board members would already have prior knowledge about this.
- Focus was on key impact areas – solvency and profitability as asked in the question
- Product features were not needed to be discussed, so skipped that

(3)

iii) Structure of response:

- The structure of the response follows the format of a paper submitted to board/similar committee like the RCC having:
- Executive summary for clarity
- Background about the whole situation – Increase in FDI in Insurance, change of ownership and post sale changes
- Impact of post sale changes – Assumptions, system integration and stopping sale of group products at both individual and aggregate basis
- Management actions to have the solvency ratio above the regulatory minimum of 150%
- This structure supports natural and logical order and helps readers' understanding.

(4)

(10 Marks)

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