

CASE STUDY L1 – INTERNAL RELATIONSHIPS AND PRESSURES

Guided by – Bharat Venkataramani

Presented by –
Pradeep Kumar Anand
Ramakant Malpani
Saddam Hossain

Agenda

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- Scope
- Case study
- Three Tasks and Responses
 - Task 1- Revision of Surrender Values
 - Task 2- Reduction in Yield and Product Redesigning
 - Task 3- Bonus Recommendation Report

Scope

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- The case study should be approached principally from consideration of the internal relationships involved and how to deal with the pressures involved from a professional point of view.
- Other professional matters and technical considerations should be identified but not dealt with in more detail than required in dealing with these issues.
- For the Indian market we consider the role of 'With Profits Actuary' is similar to the 'Appointed Actuary' (AA) for the case study purpose.

Case study

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- An actuary employed by a Life Office

- Responsible for carrying out financial calculations under direction from various members of the senior executive

- Three separate tasks assigned to the Actuary
 - where the technical considerations are straightforward
 - ..but how the results may be perceived on presentation to other members of the Executive or alternatively utilized in the pursuit of new business and the equitable treatment of existing policyholders are the concerns

Task 1- Revision of Surrender Values

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- The AA instructed to prepare revised Surrender Values (SVs) for conventional endowment and whole life assurance
- AA prescribed the basis
- Revised SVs – unjustifiably low – pointed by the Actuary but...
- ...instructed not to question as no guarantee of SVs are given

Task 1- Revision of Surrender Value (contd...)

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- Questions to consider:
 - Is the Actuary correct to query the instruction?
 - Should the Actuary prepare the revised figures?
 - What actions to be taken before and after preparing figures?
 - What if the surrender values are stated in policy literature?
 - On receipt of complaints, the AA and the CEO instructed to draft letter to policyholder- should the Actuary draft the letter?

- What would be the Actuary's reaction if he/she is the AA?

Task 1- Preparing the Revised SVs

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- Calculate revised SVs

- Section 8 (Actuarial Investigation) of APS 1

- Section 2.4 of PCS

- “Advice given to the actuary’s firm or to a colleague within the same firm, whether or not the colleague is an actuary, should normally meet the same standards as for external advice.”*

- Perform reasonability check by comparing

- Recent Surrender Value

- Product brochure, policy contract and illustration provided at the time of sale

- SVs offered by the competitors for the similar products

Task 1- Preparing the Revised SVs

(contd...)

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- Compare with Policyholder Reasonable Expectations (PRE) already set
 - Section 2.2 of APS 1

“An Appointed Actuary should ensure, so far as is within his/her authority, that the life insurance business of the company is conducted on sound financial lines and that he/she has regard to Policyholders’ Reasonable Expectations (PRE).”

Task 1- Preparing the Revised SVs

(contd...)

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- Compare with Policyholder Reasonable Expectations (PRE) already set

- Section 4.2 of APS 1

“The Appointed Actuary has a continuing responsibility to look after the reasonable expectations of the company’s policyholders, having regard to;

i) The broad nature of the company, and

ii) Its approach to the treatment of policyholders both individual and as a group vis-à-vis shareholders.

If a significant change is likely, the Appointed Actuary must make sure that the company appreciates the implications of this on its policyholders reasonable expectations.”

Task 1- Preparing the Revised SVs

(contd...)

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- Insurance Act, 1938
 - Sec 113 -Acquisition of surrender value by policy
 - Requires surrender values at least equal to Guaranteed Surrender Values
 - Breach would invite legal action against Company
- Prepare the report
 - Highlighting the concerns regarding lower SVs
 - Explaining the future implications for company
 - May propose any alternative solution if that achieves more reasonable SVs

Task 1- Illustrated SVs in the literature

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- Perform consistency check by referring to
 - Statement in the policy literature
 - Scale of the surrender values provided in the illustration at the inception (taking change in the assumption in consideration)
- Check PRE – Section 4.2 & 4.3 of APS 1
- How does new SVs compare with GSVs prescribed by Sec 113 of Insurance Act, 1938 ?

Task 1- Illustrated SVs in the literature (contd...)

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- Prepare the report to the AA – following Section 3 (Standards for Advice) of PCS
 - Highlighting the concerns regarding lower SVs
 - If the SVs are not consistent with illustration
 - it will be a regulatory breach
 - will bring it to the attention of the AA considering profession responsibility under Section 4.3.1 of PCS.

"On becoming aware of any event which appears to be a material breach by another member of any professional guidance or other guidance, a member must take appropriate action at the earliest opportunity."

Task 1- Illustrated SVs in the literature (contd...)

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- Will seek justification or clarification on the proposed action from the AA - following Section 8 (Relations with other members) of PCS
- If the AA is not willing to take corrective actions then
 - Will discuss this with other actuarial colleagues in the team and would ascertain correctness of Actuary's views.
 - After discussion if Actuary's contention still holds ground then he/she should refer to the institute as required under Section 4.3.5 of PCS.

“If the member does not consider a discussion to be appropriate, or if the matter is not resolved as a result of such discussions, then, subject to paragraph 4.3.2, the member must refer the matter to the professional body.”

Task 1- SVs- Illustrated in the literature (contd...)

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- May propose any alternative solution if that achieves more reasonable SVs
- Rewording of current illustration to make it comparable with current assumptions
 - Section C 10 b of APS 5 -Illustrative surrender values
 - Distinguish between guaranteed and non guaranteed SV
 - Modified illustration to be filed with Regulator for approval

Task 1- Letter to Policyholders

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- Case 1 - Lower Surrender Values:
 - Prepare a draft letter
 - Inform policyholder about the low levels and non guaranteed SV and considerations behind the same as per Section C10-b of APS 5
 - Explain reasons that could have led to change in SV basis
 - Consider any PRE already set (Section 4.2 of APS 1) and address the same in the current situation

Task 1- Letter to Policyholders

(contd...)

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□ Case 2- Illustrated Surrender Values:

In addition to the above

- need to explain the rationale behind low SVs in terms of various expenses, mortality experience and general market conditions
- deviations of actual from assumptions made at pricing stage with justifications
- of course, any communication to the policyholder will be the joint decision of the senior executive group

Task 1- In capacity of the AA

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- Consider all the points the actuary has made in the above report
- Check if the approach meets PRE requirements and whether policyholders are treated fairly
- Check if the methodology, assumptions used are reasonable
- Check if the alternative approach proposed is viable
- In case all factors have been taken into account and AA feels there is no change required - explain the rationale and justification to the Actuary
- In case there was some aspect that was not considered then AA may agree to a change and ask the actuary to recalculate the SVs on the changed basis

Task 1- In capacity of the AA (contd...)

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- If the AA feels that the alternative approach suggested by the Actuary is reasonable the AA may agree to implement those changes
- The AA may seek a Peer Review (APS 4) of the work before arriving at a final decision
- Final decision to be taken considering:
 - Section 4.2 of APS 1
 - Section 4.3 of APS 1
 - Section B (Role of Appointed Actuary) of APS 5

Task 2 -Reduction in Yield (RIY) and Change in product design

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- The Actuary calculates RIY for ULIP new business
- The AA instructs to ignore hidden mortality and morbidity expense margins....
- ...as the margins are only a contingency against adverse claims experience...
- ... thereby significantly improving the RIYs
- In addition, Marketing manager wishes -
 - Competitive position through product redesign ...
 - ...which increases the RIY but does not affect profitably

Task 2 - Reduction in Yield (RIY) and Change in product design (contd...)

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- Redesign involves
 - Introduction of Index Linked Policy Fee
 - Impose early SV penalty and utilize additional profit for increasing maturity benefit
 - Loyalty bonus of 1% of maturity value payable on survival only
- What considerations should affect the Actuary's action?
- What would be the Actuary's reaction if he/she is the AA?

Task 2 - Treatment of mortality and morbidity in RIY calculation

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- The IRDA (Linked Insurance Products) Regulations, 2013 exclude mortality and morbidity from the RIY consideration and hence ignoring these margins should not impact the RIY.
- Regulation 39 - (a) - *“Mortality and Morbidity charges may be excluded in the calculation of the net yield.”*

Task 2 - Treatment of mortality and morbidity in RIY calculation (contd...)

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- Fat margin in morbidity and mortality prohibited by IRDA (Linked Insurance Products) Regulations, 2013
 - Regulation 8 – (iii) – *“The mortality / morbidity charge for the mortality / morbidity risk covered shall:*
 1. *only reflect the pure risk charges for the cover offered and shall not include any allowances for expenses or any other parameters.*
 2. *be reasonable and consistent with the prescribed mortality tables or morbidity tables, if any.*
 3. *be demonstrated with support of insurer’s own experience , wherever applicable.*
 4. *be expressed as per Rs. 1000 sum at risk for each age.”*

Task 2- Product Redesign

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- If the Marketing Manager is an Actuary:
 - Bring to his/her notice the regulation and guidelines governing the aspects being considered.
 - Prohibition of Indexed linked policy fees as per the regulation 35 D (iii) of the IRDA (Linked Insurance Products) Regulations, 2013.

Regulation 35 D (iii) – “This charge should be flat throughout the policy term or vary at a pre-determined rate, subject to an upper limit. The pre-determined rate shall preferably be say x% per annum, where x shall not exceed 5.”

Task 2- Product Redesign (contd...)

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- ❑ The possibility of making profit on early surrenders
 - Needs to be examined in the light of the regulation 13 a (vi) of the IRDA (Linked Insurance Products) Regulations, 2013.
 - Need to consider the situation of lower surrenders than expected

- ❑ Appropriateness of any subsidy
 - Maturing policyholder gaining from surrendering policyholder

Task 2- Product Redesign (contd...)

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- Need to treat policyholders fairly
 - IRDA (Protection of Policyholder's Interests) Regulations, 2002
 - Section 3 (Point of Sale)
 - Section 6 (Matters to be stated in Life Insurance Policy) - relating to Guaranteed SVs
 - Providing clear information to policyholder at all points of relationship
 - Giving suitable advice to policyholder
 - Providing products that perform as Insurer have led policyholder to expect

Task 2- Product Redesign (contd...)

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- Need to follow principles of life insurance policy illustration
 - Section 4 (Illustrations) of SCSP
 - Section B of APS 5 : Role of Appointed Actuary
 - *“The illustration, which is prepared by the insurer as required under the Standard of Conduct and Sound Practice (SCSP), doesn’t create unreasonable expectations and that such illustration are not prepared in any other way.”*

Task 2- Product Redesign (contd...)

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- Section C of APS 5: Guiding principles
 - *“The illustration should not be used as a tool to achieve a competitive edge in the market place.”*
 - *“The illustration for a product should be consistent with the terms and conditions of the product as filed with the IRDA”*
- Modifications to be cleared explained in prospectus and sales illustrations
- Policy document should state all the provisions

Task 2- Product Redesign (contd...)

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- Breach of standards set by the regulator and the profession should not be recommended
 - Advice given should comply with Section 3.1 of PCS

“An actuary is expected to use best judgment in formulating advice, while paying proper regard to any relevant professional guidance or other guidance. He must keep himself abreast with updated professional guidance and adhere to that.”
 - Any modification needs regulator’s approval and which depends on compliance with the extant regulations

Task 2- Product Redesign (contd...)

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- If the Marketing Manager is NOT an Actuary:
 - Need to discuss the matter in confidence with AA
 - Ascertain correctness of Actuary's view
 - Decide on how best to proceed in consultation with AA
 - Any modification needs regulator's approval- which depends on compliance with the extant regulations
 - Follow Section 3 (Standard of Advice) of PCS

Task 2- In capacity of the AA

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- Consider all the points made by the Actuary
- Check if the approach meets PRE requirements and policyholders are treated fairly
- Comply with Section 8 f of IRDA (Appointed Actuary) Regulations, 2000
 - *“ Comply with Authorities directions from time to time”*
- Comply with Section 4.3 of APS 1 -
 - *“The Appointed Actuary must take all reasonable steps to ensure that new policyholders are not misled with regard to their expectations, e.g. in connection with illustrations at the point of sales.”*

Task 2- In capacity of the AA (contd...)

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- Comply with Section B - 3 of APS 5

“As the file and use compliance is the responsibility of the Appointed Actuary of the Insurer, the Appointed Actuary must ensure that the illustrations issued by the Management of the Company have been prepared taking into account his/her advice and that the advice renders is within the framework of this Actuarial Practice Standard.”

Task 3- Bonus Recommendation Report

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- The Actuary prepared the Bonus Recommendation Report
- The AA fundamentally disagreed with the approach
- The Actuary told to rework it in a manner which caused the Actuary distress but is acceptable to the AA
- Report presented for approval to executives before Board approval
- The AA is being strongly criticized by all including other actuaries present
- Criticism is in line with concerns of the Actuary

Task 3- Bonus Recommendation Report (contd...)

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- Questions to consider:
 - How should the Actuary react?
 - What should the Actuary do?
- What would be the Actuary's reaction if he/she is the AA?

Task 3- Bonus Recommendation Report (contd...)

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- Consider internal relationship carefully
- Section 8 (Relations with other members) of PCS
 - *“Members must avoid any action that would unfairly injure the professional reputation of any other member. Criticism of one member’s work by another member is acceptable, provided that the criticism is properly reasoned and believed to be justified.”*

Task 3- Bonus Recommendation Report (contd...)

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- Adhere to Section B (Guidance to Actuaries who are Directors and Employees of a Life Insurance Company) of APS 1
 - *“3. Any other actuary who is on the Boards of Directors owes a special responsibility to the Appointed Actuary and should take care to respect the status of the Appointed Actuary.”*
 - *“4. The requirement of the paragraph (3) above also applies to any other actuary holding a managerial or other position of authority in the company.”*

Task 3- Bonus Recommendation Report (contd...)

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- The AA should not be criticized in the meeting since this may harm the reputation of the AA and the Profession.
- An adjournment may be suggested where the Actuary can discuss the approach again with the AA in private.
- The Actuary may comment that there are other professional opinions and elaborate on the original approach if asked to do so.
- The AA may be suggested that since this is a draft report changes could be considered in the final report.

Task 3- Bonus Recommendation Report (contd...)

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- Consider the Technical issues and ascertain the breach
 - Section A -9 (Allocation of Surplus) of APS 1
 - IRDA (Distribution of Surplus) Regulations, 2002
 - GN 6 – Management of participating life insurance business with reference to distribution of surplus
 - PRE influence by sales material, benefit illustration, any other document shared with the policyholder that relates to the management of participating business and the company's past practice
 - Profitability and the capital requirement of the company

Task 3- Bonus Recommendation Report (contd...)

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- The Actuary should seek clarifications rather than challenge.
- The Actuary should check the understanding of the matter with colleagues and peers to confirm the thinking behind it.
- Since the report is not final, there is an opportunity to review
- there is no immediate need to bring any breach to the notice of higher authority or the profession.

Task 3 – In capacity of the AA

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- Consider all the points made by the Actuary
- Can seek an independent view from another actuary or seek a peer review of the work done under Section 1.1 of APS 4
 - *“The objective of the peer review is to lead an opinion by the reviewing actuary (the peer reviewer) that the work of the AA is in conformity with generally accepted actuarial practice.”*

Questions??..

Thank You!!