**2012 S2**

**Q1** A) *An analysis of the financial position together with commentary on the key findings.*

**The relevant issues include:**

1. Profit for 2012 was 118.4-121-5+6.1 = 3.0 million

2. Dividend is 6.1m which is a payout ratio of 203%. This seems unusual when no dividend was paid last year even though target surplus was exceeded (but only by $2m)

3. This is a return on average net assets of 2.5%

4. Business volumes have declined.

5. Policy liabilities have reduced broadly in line with reduced business volumes.

6. The net assets in excess of CAPAD – Policy Liabilities + Target Surplus were 27.8 million in 2012 and 2.1 in 2011. Financial position becomes stronger than last year as net asset remain unchanged while policy liability has decreased by 203.5m in all product lines.

7. The apparent improvement was mainly due to a reduction in the difference between CAPAD & Policy Liabilities. If the same ratio as in 2011 was applied in 2012 the CAPAD would have been 23.5 million higher i.e. the “real” improvement was only 2.2 million.

**The key conclusions are:**

1. Profitability is in adequate

2. The minimum capital amount is only just satisfied

3. The apparent improvement in capital position occurs because of a reduction in the relative level of CAPAD.

1B) *Provide a specific recommendation for a quantitative measure of target surplus, and give reasons for that recommendation.*

**The relevant considerations include:**

1. How much working capital is needed to ensure that no problems arise in respect to meeting CAPD if experience deteriorates?

2. What is a reasonable probability lower than the CAPAD rules for the company to adopt?

3. The probabilities of failure under the Solvency & CAPAD rules of 0.5% (1 in 200 years) and 0.25% (1 in 400 years)?

4. If experience worsens then the CAPAD liabilities must also become higher – how does this interact with target surplus?

5. Are there interactions between business classes which act to reinforce negative outcomes?

6. To what extent does an increase in capital provide positive impact to the company’s reputation?

1C) *Provide an estimate of the capital required under the current target surplus and the recommended target surplus.*

Capital Required = CAPAD liabilities + Target Surplus Addition – Policy Liabilities

For the current target surplus, this is 4977.8 + 11.0 – 4873.8 = 115 million

Capital required under the recommended target surplus depends on that recommendation. The estimate must be consistent with the answer to Part [B].

**Q2** A) *Carry out put an analysis of the profit of the CG business for the year ended 30 June 2012, and set out the important conclusions to be drawn.*

**The key numbers for the analysis are:**

1. Total fee income = 14.38 million (12.12 + 1.96 + 0.30)

2. Total expenses = 13.30 million

3. Profit = 1.08 million (fee less expense)

4. The profit = 0.11% of average account balances vs expected of 0.35%

5. Withdrawal rate was 17.6% of average account balances vs expected of 15%.

6. Actual investment rate was 1.66% of average account balances.

**The important conclusions are:**

1. Profit is one third of that expected.

2. Expenses are clearly higher than expected

3. Withdrawals are above expected but the difference does not make a material difference to the profit shortfall

4. Investment performance is low compared to recent crediting rates

2B) *Determine the crediting rate for the year ended 30 June 2012, and set out the reasons for that determination.*

**The relevant issues for the determination of the crediting rate include**

1. The investment performance is low compared to recent crediting rates.

2. The difference is not necessarily all driven by market investment performance

3. With the product closed to new policies it is important to release the investment reserve at a pace which ensures that no material investment reserve remains as the portfolio declines to a small remnant.

4. There is sufficient investment reserve to release up to say $30 million without problems (but justification needed).

5. Releasing nothing is a very poor response.

6. Past practice has seen material releases when investment performance has been poor

There is a range of acceptable crediting rates. The key issue is the connection between the considerations and the recommended rate.

2C) *Set out how the financial implications of this crediting rate will appear in the company’s accounts.*

**The financial implications will see the following:**

* Policy liabilities increase by the amount of investment earnings credited to policyholder accounts.
* The investment reserve will be increased/decreased by the amount transferred to / from the investment reserve. The policies could be regarded as participating or nonparticipating. If the former the investment reserve will appear as Policy Owner Retained Profits, otherwise as Policy Liabilities.