**ASSIGNMENT COVER SHEET**

# THIS FORM MUST BE AT THE FRONT OF EACH ASSIGNMENT

**CANDIDATES MUST KEEP A COPY OF THEIR ASSIGNMENT**

**Candidate to complete the following section (and update details in header):**

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| **Candidate Number:** 192457 | **Course:** C2B Life Insurance |
| **Date Due:** Monday 19 August 2019 at 9.00am (AEST) | |

* **Please ensure that your candidate number and course name is located on the header and footers of each page of the assignment.**
* **By completing and submitting this cover sheet you are confirming that this assignment is your own work, and all material that is used is correctly referenced and cited.**

**INTERNAL USE ONLY:**

**Assignment Marker to complete and update the following section:**

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| **Comments on Questions** |
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| **Overall Comments** |
|  |

**Assignment**

(a) See spreadsheet.

(b) First of all, Green Life needs to ensure its financial strength when deciding crediting rate, especially when it wishes to credit more than what it actually earns on its investment.

Consideration also needs to be given to policy owners’ reasonable expectation which is usually based on the product disclosure documents as well as the past practice of the company.

Green Life needs to decide the strategy about the way and timing to recoup the excess of past interest credits over past investment returns. Although the common practice is crediting less than it earns on its investments, its reputation could be at stake and its future crediting rates may become uncompetitive.

The crediting philosophy should also be based on the assets backing its Investment Account business, which shall be chosen with regard to policy owner reasonable expectations.

It should aim at maintaining a consistent, competitive crediting when being compared to the interest rate offered by banks, other financial institutions and other competitors.

Green Life needs to consider how to treat policy owners fairly as policies commence at different points in time. There will be differences in historical experience for different cohorts of policies and there may also be differences in pricing assumptions.

Given the fact that investment account policies are meant to smooth crediting rates (by paying less than the actual investment return in years when investment returns are good and more than the actual investment return in years when investment returns are poor), Green Life should consider setting provisions to mitigate the anti-selection risk by policy owners. Termination charges and/or surrender penalties could be taken into consideration.

(c) See spreadsheet.

(d) Advantages:

* Having investment fluctuation reserve can smooth the investment return. This can be good for both policy owners and the company.
* For the policy owners, investment fluctuation reserve could reduce the uncertainty in the return.
* For Green Life, the investment fluctuation reserve could act as a buffer to write off any decreased value of investment. Therefore, the company is more likely to be able to meet policy owners’ expectation especially when the investment experience is poor.
* It allows the company to have some degree of discretion. Therefore, the company is able to adjust the crediting rate to serve their market strategy (e.g. credit more than competitors to attract new customers).
* The later release of the investment fluctuation reserve with surrender penalties could help Green Life retain the existing policy owners.
* It increases the liquidity of the company so that Green Life could pursue higher return by investing more money in less liquid assets.

Disadvantages:

* It exposes the company to anti-selection risk when the credit rate is higher than market by taking money from investment fluctuation reserve. Policy owners may tend to surrender their policies after a higher-than-expectation return.
* Investment fluctuation reserve increases policy liability. As a result, Green Life may be required to hold more capital in this regard.
* Extra cost (more staffs, more complex system etc.) may arise from managing the investment fluctuation reserve.
* Equity also needs to be balanced among different generation of policy owners. Otherwise, company will suffer reputation damage.

(e)

i.

Due to the existence of investment fluctuation reserve, it might not affect P&L statement unless the loss amount is higher than investment fluctuation reserve. If that is the case, a loss should be recorded Green Life P&L statement.

ii. Less PL as money will be transferred out of the investment fluctuation reserve.

iii. No impact. Capital

iv. Future crediting rate will reduce to reflect the fall in investment. It might reduce more than the actual loss so that the company is able to recoup the investment loss.

less will be paid, to recover from the previous investment loss.

(f)

(g)

**A change to the crediting rate does not affect profit, unless the business is in loss recognition.**

[P76] For non-participating business with entitlement to discretionary additions (e.g. non- participating investment account policies), the adjusted policy liabilities are determined by taking the greater of the RFBEL and the sum of the investment fluctuation reserve (if it is greater than zero) and the termination values. This adjustment prevents the investment fluctuation reserve from being included in the capital base. Note that the investment fluctuation reserve is included in the RFBEL, but it is not part of the termination value.

When long-term interest rates are very low, there can be a significant risk that actual investment returns will be less than the minimum guaranteed rate. Shareholders” capital will be required to support this guarantee, but the expected return on capital will be unduly low (and if interest rates are extremely low losses might be expected). In contrast, when long-term interest rates are high, the risk of inadequate investment returns and the capital required will be much smaller and the expected return on shareholder capital will be unduly high.

**Declaration**:

*I declare that all work in this assignment is my own work except where there is clear acknowledgement or reference to the work or assistance of others.*