Tutors' marking guidance notes – BP:I December 2017

General
Most well explained points are 1 mark per point. Points that are specific to the insurance industry (eg impact of a defect on reserving) are more likely to score 1.5 – 2 points. Points that could be equally valid with a non-insurance company (eg existence of foreign exchange risk) are more likely to be given 0.5 marks.

Question 1 – Mostly Chilled Insurance

Question	Max	Headroom	Mark analysis
1.1 Identify elements of IBNER and IBNR	12	15	Claims notified & IBNER: Up to 3 marks for each peril IBNR: Up to 2 marks for each peril
1.2 Reasons to be sceptical about the previous auditor's work	5	7	Up to 1 mark per well explained point. Mustn't be generic opening balances work – specific reasons why can't rely on the auditor, eg: Couldn't provide requested advice, so lacks competence? Doesn't have in house actuary Appears to have outsourced completely to external actuary Need to know much more about the work done by external actuary, assumptions made, auditor validation of actuarial data, etc No mention of auditing other insurance companies Appears to have acquired this audit of insurance company rather by accident Audits other business belonging to Hermione, so may not be adequately independent Other well explained points – give credit.
1.3 Determine an appropriate presentation of the redeemable preference shares issued to Hermione	9	10	<u>Debt/equity split</u> Definition of debt, including obligation Equity is residual Discussion of legal or constructive obligation Obligation exists, as can demand repayment Assertion of intention doesn't negate the obligation <u>Classification of debt instrument</u> Can't use amortised cost (0.5) …because don't know redemption value …because don't know redemption date Best to show as FVTPL Should be classified as current liability …because company can't enforce payment > 12 months Could decompose into liability and embedded value element
1.4 Audit procedures on premium income	9	10	Up to 1 mark per valid, clear procedure if correctly testing for stated assertion of completeness, occurrence or valuation
1.5 Five questions to support underwriters	5	6	Up to 1 mark per valid question. 1 mark for correct citation of Insurance Act 2015 0.5 for mention of CIDRA 2012
Total Marks	**40**	**48**	

Question 2 – Tremendous Insurance

Question	Max	Headroom	Mark analysis
2.1 marks	14	18	See below
2.1a Explain the risks of writing new cyber-crime insurance policies			A new type of peril for the company Little historical data exists Unknown tail of claims: IBNR: May take time to become apparent IBNER: May have unexpectedly high loss development Seemingly profitable new business often turns out unprofitable (eg recent experience of D&O policies) Difficult to price follow, as whole industry inexperienced Difficult to define scope of cover: nebulous concept Likely to result in high claims investigation costs Potential reputational damage
2.1b Limitations and mitigations to risks in 2.1a			<u>Limitations/ mitigations:</u> Policy wording with clear exclusions Reinsurance Co-insurance …ideally with more established policy lines writer Risk reduction advice for the client Recruit underwriters with experience Buy data Share data with other insurers Close monitoring of claims Adjustment premiums High premium pricing Advice from reinsurers
2.2 marks	16	18	See below
2.2a Appropriateness of continuing to use amortised cost			<u>Gilts</u> HTMFA decent definition Short dated gilts: have maturity and expect to HTM …so best classified as HTMFA Could classify as FVTPL ...if to avoid an accounting mismatch <u>New guideline 1: liquid corporate bonds</u> Has maturity value Has maturity date Intention and positive intent to hold to maturity Can categorise as HTM But would trigger tainting rules if have to sell Two year exclusion from HTM category if so A risk probably not worth taking Exceptions to tainting rules very unlikely to apply

2.2b Assessment of likely impact of IFRS 9 **2.2c** Ethical issues arising from Bill's email			<u>New guideline 2: corporate bonds and money market debt instruments</u> Intended for arbitrage opportunities Can't therefore categorise as HTM Would be classified as FVTPL Recognising FVTPL is consistent with the aims of the investment mandate <u>IFRS 9 impact</u> Gilts will still be held at amortised cost, using same logic as IAS 39 classification. So no difference there. Corporate bonds are held to collect or sell, rather than for SPPI. Would therefore be best classified as FVTOCI. FV changes in OCI until derecognised, when cumulative gain recycled through profit or loss. Money market debt instruments still held for trading, so will still be shown at FVTPL. So no difference. Overall, IFRS 9 only likely to affect the company because of no risk of tainting rules. <u>Ethical?</u> Must report truth/ substance Deliberate aim to manipulate apparent solvency Conflict of directors' duty with UKCGC Solvency II figures derived from IFRS figures Conflict of directors' duty with PRA best practice <u>Actions</u> Jane is an ICAEW member, so bound by ICAEW code Should seek proportionate, lowest level response Should be reluctant to breach duty of confidentiality to employer Should make sure she confirms facts are correct Initially raise with Bill Then elevate internally if necessary If not satisfied, rely on whistleblower protection May need legal advice Could contact ICAEW ethics helpline (give no marks if this is the only meaningful suggestion)
Total Marks	**30**	**36**	

Question 3 – Everidge Life & Pensions (ELAP)

Question	Max	Headroom	Mark analysis
3.1 Possible reasons for sales proceeds being less than previous fair value in financial statements	12	14	Auditor may simply have made a mistake The non-remote range of possible values may have been immaterial, so the auditor may have legitimately done little work on this FV excludes cost to sell So would expect sales proceeds to be less than FV Translation into GBP, ex rate changes Unique properties, so level 2 or level 3 FV Subject to high estimation uncertainty May therefore not be expected to be typical of other properties Property market might be volatile Might have been a distress sale, so not FV assumptions External auditor may have excessively relied on an expert Depreciated historical cost an allowable alternative Would still need to use fair values for solvency Sales value per square metre a non-market based valuation method Benchmarking to other similar properties better Though properties may be materially different to each other
3.2 Effect on MCEV of group policies compared with individual policies	8	10	Group policies likely to be priced more cheaply Lower pricing reflects greater buyer power Portfolio of risks may be diversified risk But can avoid acquisition costs, so net premiums might not be very different to individual policies Persistency greater risk with group policies …as employer likely to frequently shop around This will reduce the expected profit/ EV of group policies Claims are still individual …so still likely to be individual costs So claims handling costs likely to be very similar May be able to get employer do some of the admin, reducing claims handling cost (Give credit for alternative arguments, if logical and well stated).
3.3	10	12	See below
3.3a			Increasing the % of group plans would be likely to: Reduce EV of new policies per policy But volume may mean greater absolute profit …given lower premiums and higher persistency risk

			Wouldn't initially affect in-force policies Operating experiences difficult to predict …depends on how much investigation is made into the members of the group policy at policy inception It's change in operating assumptions that matters, so taking on new business unlikely to change other assumptions much. If a greater diversity of business, may be seen to reduce risk and so reduce discount rate. If loss of a group policy, likely very large assumption change expense
3.3b			IFRS initially recognises liability for mortality risk This means IFRS profit is initially depressed by sale of new long-term business MCEV recognises a day one profit (as does Solvency II) for new long-term policies So rapid expansion in long-term business likely to reduce IFRS profit …but would increase MCEV
3.3c			Group plans tend to be less profitable than individual plans So could expect MCEV to be less profitable overall
Total Marks	**30**	**36**	
Total Marks - Exam	**100**	**120**	