



**Institute of Actuaries of India**

**Subject**  
**SP2 – Life Insurance Specialist**  
**Principles**

**For 2020 Examinations**

# SP2 – Life Insurance Principles

## Aim

The aim of the Life Insurance Principles subject is to instil in successful candidates the main principles of actuarial planning and control, and mathematical and economic techniques, relevant to life insurance companies. The student should gain the ability to apply the knowledge and understanding, in simple situations, to the operation, on sound financial lines, of life insurance companies. The life insurance products covered by this subject exclude health and care insurance products covered by the Health and Care Principles subject.

## Competences

On successful completion of this subject, a student will be able to:

- 1 understand the main principles and techniques of actuarial management and control that are relevant to life insurance.
- 2 apply these principles to simple situations within the context of life insurance.
- 3 analyse hypothetical scenarios, including using judgement to assess the implications of possible actions and to develop appropriate proposals or recommendations relating to the management of life insurance business.

## Links to other subjects

CM1 – Actuarial Mathematics 1

CP1 – Actuarial Practice

SA2 – Life Insurance Advanced

## Syllabus topics

- 1 Life insurance products and general business environment (15%)
- 2 Product design and specific features (25%)
- 3 Risks and risk management (30%)
- 4 Models and valuation (15%)
- 5 Monitoring experience and setting assumptions (15%)

These weightings are indicative of the approximate balance of the assessment of this subject between the main syllabus topics, averaged over a number of examination sessions.

The weightings also have a correspondence with the amount of learning material underlying each syllabus topic. However, this will also reflect aspects such as:

- the relative complexity of each topic, and hence the amount of explanation and support required for it.
- the need to provide thorough foundation understanding on which to build the other objectives.
- the extent of prior knowledge which is expected.
- the degree to which each topic area is more knowledge or application based.

## Skill levels

The use of a specific command verb within a syllabus objective does not indicate that this is the only form of question which can be asked on the topic covered by that objective. The Examiners may ask a question on any syllabus topic using any of the agreed command verbs, as are defined in the document "Command verbs used in the Associate and Fellowship written examinations".

Questions may be set at any skill level: Knowledge (demonstration of a detailed knowledge and understanding of the topic), Application (demonstration of an ability to apply the principles underlying the topic within a given context) and Higher Order (demonstration of an ability to perform deeper analysis and assessment of situations, including forming judgements, taking into account different points of view, comparing and contrasting situations, suggesting possible solutions and actions and making recommendations).

In the SP subjects, the approximate split of assessment across these three skill types is 25% Knowledge, 50% Application and 25% Higher Order Skills.

## Detailed syllabus objectives

### 0 Introduction

0.1 Define the principal terms used in life insurance.

### 1 Life insurance products and general business environment (15%)

1.1 Describe the main types of life insurance products.

1.1.1 Describe the main types of life insurance products that provide benefits on death, survival to a specified point in time or continued survival.

1.1.2 Describe the following life insurance product bases:

- conventional without profits
- with profits
- unit-linked
- index-linked

1.1.3 Outline typical guarantees and options that may be offered on life insurance products.

1.2 Assess the main types of life insurance products in terms of:

- the needs of consumers and key risks for the insured.
- the purpose and key risks for the insurer.

1.3 Assess the effect of the general business environment on the management of life insurance business, in terms of:

- propensity of consumers to purchase products.
- local culture.
- methods of sale.
- remuneration of sales channels.
- types of expenses and commissions, including influence of inflation.
- economic environment.
- legal environment.
- regulatory environment.
- taxation regime.
- professional guidance.

### 2 Product design and specific features (25%)

2.1 Demonstrate an understanding of life insurance product design, including:

2.1.1 Describe the factors to consider in determining a suitable design, in terms of premiums, benefits and charges, for a life insurance product.

- 2.1.2 Determine a suitable design for a product in a given situation.
- 2.1.3 Discuss the relative merits of different product designs.
- 2.2 Demonstrate an understanding of with profits business management.
  - 2.2.1 Describe methods of distributing profits to with profits policyholders.
  - 2.2.2 Explain the main uses of asset shares and how they may be built up using a recursive formula.
- 2.3 Describe the principles of unit pricing for internal unit-linked funds.
- 2.4 Determine discontinuance and alteration terms for without profits contracts.
  - 2.4.1 State the principles of setting discontinuance and alteration terms.
  - 2.4.2 Describe different methods of determination of discontinuance and alteration terms.
  - 2.4.3 Assess the extent to which these methods meet the principles in 2.4.1.
  - 2.4.4 Calculate surrender values and alteration terms for conventional without profits contracts using reserves or by equating policy values.

### **3 Risks and risk management (30%)**

- 3.1 Assess how the following can be a source of risk to a life insurance company:
  - policy and other data
  - mortality rates
  - investment performance
  - expenses, including the effect of inflation
  - persistency
  - mix of new business
  - volume of new business
  - guarantees and options
  - competition
  - actions of the board of directors
  - actions of distributors
  - failure of appropriate management systems and controls
  - counterparties
  - legal, regulatory and tax developments
  - fraud
  - aggregation and concentration of risk
- 3.2 Demonstrate the application of reinsurance as a risk management technique.
  - 3.2.1 Describe the purposes of reinsurance.

- 3.2.2 Describe the different types and structures of reinsurance.
- 3.2.3 Discuss the factors that should be considered before taking out reinsurance.
- 3.3 Demonstrate the application of underwriting as a risk management technique.
  - 3.3.1 Outline the purposes of underwriting.
  - 3.3.2 Describe the different approaches by which underwriting is applied.
  - 3.3.3 Discuss the factors that should be considered when determining the level of underwriting to use.
- 3.4 Demonstrate the application of asset-liability matching as a risk management technique.
  - 3.4.1 State the principles of investment for a life insurance company.
  - 3.4.2 Analyse life insurance liabilities into different types for asset-liability matching purposes.
  - 3.4.3 Propose an appropriate asset-liability matching strategy for different types of liability.
- 3.5 Propose further ways of managing the risks in 3.1, including:
  - policy data checks.
  - choice of with profits bonus method.
  - capital management.
  - expense control.
  - policy retention activity.
  - management of new business mix and volumes.
  - management of options.
  - systematic risk assessment and management strategies.

## **4 Models and valuation (15%)**

- 4.1 Describe the main features of a life insurance model.
  - 4.1.1 Outline the objectives and basic features of a life insurance model.
  - 4.1.2 Compare stochastic and deterministic approaches.
  - 4.1.3 Explain the use of sensitivity analysis.
- 4.2 Demonstrate the different uses of actuarial models for decision-making purposes in life insurance, including:
  - pricing products.

- developing investment strategy.
  - projecting solvency.
  - calculating embedded value.
- 4.3 Demonstrate methods of determining the cost of options and guarantees.
- 4.3.1 Describe the use of stochastic simulation and the use of option prices to determine the cost of an investment guarantee.
- 4.3.2 Describe the assessment of the cost of simple mortality options.
- 4.4 Discuss the determination of supervisory reserves and solvency capital requirements for a life insurance company.
- 4.4.1 Describe how supervisory reserves and solvency capital requirements may be determined, including:
- market consistent valuation.
  - non-unit reserves.
  - Value at Risk (VaR) capital assessment.
- 4.4.2 Discuss the interplay between the strength of the supervisory reserves and the level of solvency capital required.
- 4.4.3 Compare passive and active valuation approaches, including the valuation of assets.

## **5 Monitoring experience and setting assumptions (15%)**

- 5.1 Describe the principles of setting assumptions for life insurance business.
- 5.1.1 Describe the principles of setting assumptions for pricing life insurance contracts, including profit requirements.
- 5.1.2 Describe the principles of setting assumptions for determining liabilities.
- 5.1.3 Explain why the assumptions used for supervisory reserves may be different from those used in pricing.
- 5.1.4 Outline the principles of setting assumptions for determining embedded value.
- 5.2 Demonstrate the relevance of experience monitoring to a life insurance company.
- 5.2.1 Explain why it is important for a life insurance company to monitor its experience.

- 5.2.2 Describe how the actual mortality, persistency, expense and investment experience of a life insurance company should be monitored, including the data required.
- 5.3 Demonstrate the relevance of analysis of surplus or profit.
  - 5.3.1 Give reasons for undertaking an analysis of surplus and an analysis of embedded value profit.
  - 5.3.2 Suggest ways in which the results of such analyses can be used.

## **6 Solving problems**

- 6.1 Analyse hypothetical examples and scenarios in relation to the financial management of life insurance companies.
  - 6.1.1 Propose solutions and actions that are appropriate to the given context, with justification where required.
  - 6.1.2 Suggest possible reasons why certain actions have been chosen.
  - 6.1.3 Assess the implications of actions within a given scenario.
  - 6.1.4 Discuss the advantages and disadvantages of suggested actions, taking into account different perspectives.

## **Assessment**

Three hour fifteen minute written examination.

**END**