Subject CP1

CMP Upgrade 2024/25

CMP Upgrade

This CMP Upgrade lists the changes to the Syllabus, Core Reading and the ActEd material since last year that might realistically affect your chance of success in the exam. It is produced so that you can manually amend your 2024 CMP to make it suitable for study for the 2025 exams. It includes replacement pages and additional pages where appropriate.

Alternatively, you can buy a full set of up-to-date Course Notes / CMP at a significantly reduced price if you have previously bought the full-price Course Notes / CMP in this subject. Please see our 2025 *Student Brochure* for more details.

We only accept the current version of assignments for marking, *ie* those published for the sessions leading to the 2025 exams. If you wish to submit your scripts for marking but only have an old version, then you can order the current assignments free of charge if you have purchased the same assignments in the same subject in a previous year, and have purchased marking for the 2025 session.

This CMP Upgrade contains:

- all significant changes to the Syllabus and Core Reading
- additional changes to the ActEd Course Notes and Assignments that will make them suitable for study for the 2025 exams.

1 Changes to the Syllabus

This section contains all the ***non-trivial*** changes to the syllabus objectives.

Shorten syllabus objective 1.1.2 to:

1.1.2 The business roles that actuaries advise.

Delete syllabus objective 4.4.5.

Amend syllabus objective 5.3.3 to:

5.3.3 Issues which need to be taken into account on the insolvency or closure of a provider of financial products.

2 Changes to the Core Reading and ActEd material

This section contains all the ***non-trivial*** changes to the Core Reading and ActEd text.

Chapter 1

Section 6.2

Amend the first (ActEd text) bullet point in this section to:

- TAS 100: General Actuarial Standards – covering risk identification, judgement, data, assumptions, models, documentation and communications

Chapter 10

Section 6.2

Amend the first paragraph of this section to:

Many of the largest domestic companies have significant overseas exposure. Amongst the largest 100 companies listed in the UK, more than 75% of the revenue is earned internationally.

Chapter 20

Section 3.4

Amend the paragraph under the sub-heading 'Natural disasters' to:

Certain countries and areas are known to be susceptible to natural disasters, such as tidal waves, earthquakes, volcanic eruptions, hurricanes, floods, drought and famine. Climate change is impacting the extent and incidence of many of these types of disaster.

Chapter 21

Syllabus objectives

Amend the numbering of objective 5.3.1 to 5.3.4.

Section 2.4

Amend the final (Core Reading) paragraph of this section to:

This is discussed further in Chapter 23 on Pricing and financing strategies.

Chapter 25

Section 4.1

Amend the final bullet point of the second solution in this section to:

- An insurance company might also be exposed to the risk of brokers failing to pass on premiums.

Section 6.1

Delete the phrase '**to be successful**' from the end of the third Core Reading bullet point (starting '**a provider of finance …**').

Chapter 28

Section 1.2

Replace the first two (Core Reading) paragraphs in this section with the following:

A common step in the risk assessment process used by financial institutions is to extend the risk identification approach covered in Chapter 25, by estimating both the probability of occurrence and the cost or impact if a risk event were to occur, for each material risk identified.

Once the financial institution has both the probability of occurrence and the cost / impact for a risk event, it can look to rank risk events. One approach to doing this is risk-scoring, where the financial institution assesses the impact of the risk on a five-point scale (or a three-point scale). For the five-point scale, the potential impact could be categorised into: 5 = high, 4 = medium-high, 3 = medium, 2 = medium-low, 1 = low.

Delete the second sentence ('**This risk-scoring approach …**') from the end of the third (Core Reading) paragraph.

Section 1.4

Replace the second and third Core Reading paragraphs in this section with the following:

In banking, operational risk has typically been measured using a standardised approach. For example, this could be as a percentage of average income over the last three years, or simply as a percentage uplift to the total aggregated risks other than operational risks.

In the European Union, the Solvency II standard formula for insurers uses a factor-based approach based on premiums and provisions.

Chapter 30

Section 6

Replace the first Core Reading paragraph in this section with the following:

Where a financial institution has, in its risk assessment process, identified a range of high impact but low probability risks, it will need to consider how to manage these risks. Such risks are likely to be among the most difficult risks it has to manage. They are likely to include both risks related to normal business activities and operational risks.

Chapter 34

This chapter has been materially amended, so replacement pages 1 to 16 are included at the end of this document.

Chapter 36

Section 1.2

Delete the first three ActEd paragraphs in this section (starting ‘Solvency II succeeded …’, ‘Solvency II is much wider …’ and ‘As noted above …’).

Section 2.2

Amend the final sentence of the last (ActEd) paragraph of this section to:

Assets are also valued at market-consistent value or fair value.

Insert the following new (ActEd) paragraph at the end of this section:

Capital requirements can be determined by applying stress or scenario tests to the balance sheet values of assets and liabilities, and then by setting the required capital as the amount that would enable the provider to continue to meet its obligations under such adverse conditions. The economic capital requirement is therefore typically determined by modelling the impact of such tests on the market-consistent values of assets and liabilities. The next section covers the use of models to assess capital requirements in more detail.

Chapter 39

Delete the term ‘Continuing Care Retirement Community’ and its definition.

Amend the definition of ‘Risk factor’ to:

A factor that is expected, possibly with the support of statistical evidence, to increase risk.

3 Changes to the X Assignments

This section contains all the ***non-trivial*** changes to the X Assignments

Assignment X5

In Question X5.3, amend existing part (e) to part (f) and insert the following new part (e):

(e) transferring the liabilities to a non-insurance consolidator

The additional Solution content for this new question part is as follows:

(e) ***Transferring the liabilities to a non-insurance consolidator***

The impact on members would be largely the same as transferring the liabilities to an insurance company that will guarantee the benefits … [½]

… as the vehicle should allow the continuation of a defined benefit structure, and so the benefits remain predictable. [½]

Whether there are greater costs, or cost savings through economies of scale, depends on the size of the consolidator relative to insurance companies. [1]

Regulatory (including provisioning) requirements may not be as onerous for non-insurance consolidators as they are for insurers. [½]

Therefore, the cost of providing benefits may be lower through the non-insurance consolidator than through an insurer. [½]

However, a less stringent regulatory environment would mean that member benefits may be less secure than if the transfer were to an insurer. [½]

4 Changes to the Mock Exam

There have been no changes to Mock Exam Paper 1 and only a few minor changes to the solutions for Paper 2.

5 Other tuition services

In addition to the CMP, you might find the following services helpful with your study.

5.1 Study material

For further details on ActEd's study materials, please refer to the *Products* pages on the ActEd website at **ActEd.co.uk**.

5.2 Tutorials

We offer the following (face-to-face and/or online) tutorials in Subject CP1:

- a set of Regular Tutorials (lasting a total of five days)
- a Block (or Split Block) Tutorial (lasting five full days)
- an Online Classroom.

For further details on ActEd's tutorials, please refer to our latest *Tuition Bulletin*, which is available from the ActEd website at **ActEd.co.uk**.

5.3 Marking

You can have your attempts at any of our assignments or mock exams marked by ActEd. When marking your scripts, we aim to provide specific advice to improve your chances of success in the exam and to return your scripts as quickly as possible.

For further details on ActEd's marking services, please refer to the 2025 *Student Brochure*, which is available from the ActEd website at **ActEd.co.uk**.

5.4 Feedback on the study material

ActEd is always pleased to receive feedback from students about any aspect of our study programmes. Please let us know if you have any specific comments (*eg* about certain sections of the notes or particular questions) or general suggestions about how we can improve the study material. We will incorporate as many of your suggestions as we can when we update the course material each year.

If you have any comments on this course, please send them by email to **CP1@bpp.com**.

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Insolvency and closure

Syllabus objective

5.3 Understand how an organisation can monitor its experience and manage risk.

5.3.3 Issues which need to be taken into account on the insolvency or closure of a provider of financial products.

0 Introduction

This chapter looks at the following situations:

- an insurance company becoming insolvent
- a bank becoming insolvent
- a benefit scheme closing or 'winding-up'.

0.1 Insurance companies

An insurance company is insolvent if it is unable to meet its liabilities as they fall due or if it does not have assets in excess of the value of the liabilities.

In most territories, regulations impose on insurance companies a more stringent test of solvency than just having to demonstrate the holding of assets in excess of the value of the liabilities. That is, insurance companies are required to maintain a significant *excess* of assets over liabilities in order to demonstrate solvency. This required excess amount is referred to as the *required solvency capital*.

The amount of required solvency capital is related to the level of prudence associated with the valuation of the liabilities, with very prudent liability valuations being associated with relatively low solvency capital requirements.

0.2 Banks

The situation for banks is very similar to that for insurance companies. Given the interdependence of banks, the regulator may place particular emphasis on ensuring that any insolvency of a bank is managed in an orderly manner. This is called resolution. It is important that insolvency is managed carefully to avoid a contagion effect, *ie* the failure of one bank leading to the failure of others.

0.3 Benefit schemes

A benefit scheme sponsor may become insolvent or decide to stop financing future benefit provision for some other reason.

This may lead to closure of the scheme to new members, with or without continued contributions and benefit accrual in respect of existing members. In the latter case, where there will be no further accrual of any benefits, the scheme may remain in force to meet accrued benefits or be *wound-up*.

***Winding-up* is the process of terminating a benefits scheme, usually by applying the assets to the purchase of individual insurance contracts for the beneficiaries, or by transferring the assets and liabilities to another scheme.**

1 Insolvency of an insurance company

1.1 Regulation

Insurance companies are normally subject to some form of State regulation and they are usually required to maintain a certain level of solvency capital. There are also regular reporting requirements that enable the regulator to monitor the financial position of companies. These are designed to enable the regulator to intervene in the running of a company before it reaches the position of being unable to meet its liabilities.

The required solvency capital therefore provides extra security to an insurance company's policyholders, enabling the regulator to take action where appropriate to protect policyholders' benefits, before the company becomes unable to meet its liabilities.

1.2 Intervention

Consequently, in such environments, insurers rarely become insolvent. If the required level of solvency capital is breached, the regulator intervenes to protect the interests of existing or prospective policyholders.

Recovery plan

In most cases, the company will be required to establish a recovery plan, and this will be monitored closely by the regulator.

The recovery plan may include some or all of the following actions:

- changing the investment strategy to invest in assets that better match the liabilities
- implementing a plan to raise new capital
- increasing the amount of reinsurance the company has in place
- limiting the levels of new business sold.

Limiting the levels of new business sold may not make a significant difference in practice, as the volumes of new business for a company nearing insolvency may be very low anyway.

Question

Explain why the volumes of new business may be very low for a company nearing insolvency.

Solution

If a company has got as far as the regulator intervening (including closely monitoring the company's solvency position) then this is likely to be widely reported. Customers may consider that a company perceived as *risky* is not a wise choice when taking out a new policy. In addition, financial advisers, the financial press and possibly the regulator may warn prospective customers of the risks associated with the company. Also, the company may already have taken action to limit new business if it has identified capital shortfalls.

Closure to new business

If the insurer's financial position is serious, then the regulator may require it to close to new business completely, so that new policyholders are not entering a fund whose solvency may be in doubt.

Closure also removes the pressure of new business strain on the limited remaining available capital.

However, closure to new business is normally a last resort, because it will be difficult for the insurance company to re-open.

At the very least, a regulator is unlikely to permit re-opening to new business until the company has substantially more than the minimum capital requirements built up.

If a company maintains the infrastructure (staff, premises, systems) to enable it to re-open, these costs will be a further drain on capital while no business is being written.

If the insurer writes products where significant initial charges are taken from the policies, it may be permitted to start selling this business again in order to benefit from retaining these charges within its capital base. However, such products are often not popular with customers and it may be difficult to sell them in sufficient volumes.

If a provider closes to new business, it will still have outstanding liabilities from the business written that will need to be met. There should be capital releases from this business as it matures. However, in the longer term, a lack of economies of scale will bite and further actions will be needed.

Question

A mutual life insurance company has only ever sold with-profit business.

The company closed to new business following intervention by the regulator when it was unable to meet the solvency capital requirement. Consequently, it has suffered from a lack of economies of scale as fixed expenses have been spread over an ever reducing number of policies.

Describe the other problems that the company is likely to face in the longer term.

Solution

In the longer term, the issues for the company will include:

- the costs of closing down – *eg* moving to smaller premises, redundancies as fewer staff are required to administer the business
- restrictions on the investment policy – as the proportion of benefits that are guaranteed increases over time
- changes to the bonus philosophy – as the proportion of guaranteed benefits and investment policy change
- difficulties in meeting policyholders' reasonable expectations – *eg* if the investment policy or bonus philosophy change radically from what they were at the time at which a policyholder took out the contract. Communication with policyholders will be important.

Resolution plan

Increasingly, insurance companies are producing resolution plans as well as recovery plans. Resolution planning is used when recovery actions have not been successful and insolvency seems inevitable.

Sale or merger

The insurer may be sold to, or merge with, another provider, which takes on the liabilities.

A sale or merger would avoid the potential problems described above, by ensuring that there was always at least a *critical mass* of business in force to make the operation of the business practicable.

1.3 Modelling

In any of the above recovery scenarios, it will be important to carry out projections of the insurer's future position. Such modelling could be done on a range of deterministic scenarios or with the aid of a stochastic model.

The projections should provide information on:

- **the solvency position of the insurer**
- **shareholder profits (if any).**

The model should allow for:

- **any costs relating to staffing levels, including redundancies**
- **the amount, and timing, of any loan or debt redemption**
- **obligations relating to any staff benefit schemes, particularly if these schemes are in deficit**
- **tax.**

It will be important to make assumptions about the actions that might be taken in various scenarios, and to include these in the model.

It is critical to the validity of the model that any actions that the insurer might take in response to future developments would actually be implemented in practice. For example, a projection of the future solvency position should only reflect sharp cuts in discretionary benefits being made in response to falls in asset values *if* the company would truly make such sharp cuts *in practice*. In reality, the insurer may be reluctant to make benefit cuts for competitive reasons or for fear of not meeting policyholders' reasonable expectations. Or the insurer may decide to *defer* the benefit cuts in relation to the timing represented in the model, in the hope that the solvency problems are only temporary.

If there is an acquiring company prepared to take over the business, it will be necessary to consider:

- **the location of the operation**
- **any integration of the systems platform**
- **relocation of staff or whether there is an adequate labour force already available**
- **the effect of the takeover on unit costs.**

1.4 Compensation schemes

Where an insurer cannot meet its liabilities (as opposed to not having adequate solvency capital), and a buyer cannot be found to take them on, there may be a statutory scheme set up from which some or all of the benefit payments are paid.

Such a scheme is usually funded by a levy on all other providers.

For example, in the UK there is a Financial Services Compensation Scheme (FSCS).

Policyholders are eligible for protection under this scheme if they are insured by an authorised insurance company and that company is unable to meet its liabilities. Under the scheme, compulsory insurance claims (*eg* third party motor insurance and employer's liability) are paid in full. For other insurance claims, 90% of the benefit amount is paid.

The FSCS is funded by a levy on all authorised providers.

2 Insolvency of a bank

2.1 Regulation

As for insurance companies, banks are also normally subject to some form of State regulation and they are usually required to maintain a certain level of solvency capital.

This is covered further in a later chapter.

They are also required to report regularly to regulators, who monitor the banks' financial position.

2.2 Intervention

Again, as for insurance companies, banks are also often required to have plans in place with regard to what will happen if they get into difficulties. For example, banks in the European Union have recovery and resolution plans, hopefully enabling them to recover but, if not, enabling them to fail in an orderly manner to limit or avoid a knock-on effect on other banks (*ie* systemic risk).

The close linkages between banks heightens this systemic (or contagion) risk.

Recovery plans set out the actions a company should take in order to keep itself solvent, such as raising further capital and stopping paying dividends or coupons. Resolution plans set out the actions that should be taken if the recovery plans have been ineffective or insufficient, such as radical restructuring.

Under resolution, the regulatory authorities ensure continuity of the bank's critical functions and seek to recover parts of the bank that are viable. Parts of the bank that are not viable are allowed to go into liquidation.

It might be possible to sell parts of the operations to other banks, as was the case when Lehman Brothers filed for bankruptcy in 2008.

As is the case for insurance, customers of a failed bank may have losses at least partly protected under a compensation scheme.

3 Closure of a sponsored benefit scheme

3.1 Types of closure

There are two types of closure of a benefit scheme:

- the scheme is closed to new members, but existing active members' benefits continue to accrue
- the scheme is closed to new members and no further benefits accrue to existing members.

The type of closure will depend on the circumstances. The employer / sponsor might:

- **be insolvent**
- **choose to stop financing future benefit provision, *eg* to reduce costs or to follow market trends in benefit provision.**

Closed to new members only

Under this scenario:

- **the scheme is closed to new members**
- **existing members' benefits are unchanged: in defined benefit schemes, benefits continue to accrue with additional service and salary increases**
- **the sponsor expects to continue to pay contributions for the declining number of active members.**

There should not be significant human resource issues, as the scheme is simply not offered on joining employment and the new employee accepts the revised remuneration, *eg* salary and perhaps access to an alternative benefit scheme.

The sponsor's contribution rate as a percentage of salary is likely to increase under this type of closure (although the contribution amount will fall as the number of members declines) and also to become more volatile as the membership reduces.

Closed to new members and no accrual of any future benefits

Under this scenario:

- **the scheme is closed to new members**
- **no further benefits accrue to existing members**
- **the sponsor will not need to make any contributions to meet the cost of future accrual, but may still need to make some contributions to the scheme if it is in deficit, to make up the shortfall.**

There are likely to be human resource issues under this approach, as the existing members will no longer receive benefits in respect of future service, and they are likely to have had expectations that such benefits would continue to accrue.

3.2 Level of benefits

Consideration needs to be given to the benefits that will be payable when a scheme ceases, particularly if the sponsor is insolvent and/or the scheme is in deficit.

The benefits that will be paid to the members of the discontinued scheme will be affected by the following factors:

- **the *rights* of the beneficiaries, which will depend on the terms under which the scheme operates and any overriding legislation**
- **the *expectations* of the beneficiaries, which are likely to be the benefits that would have been available had the scheme not discontinued.**

If there are insufficient assets to meet the rights and expectations of beneficiaries, a lower benefit may be paid.

Rights will rank ahead of expectations if there aren't enough assets to meet both for all beneficiaries. Defining the terms *rights* and *expectations* is a matter of judgement.

Rights

There are many interpretations of the *rights* of beneficiaries. At one end of the scale they only have a right to the benefits that have been, or should already have been, received. At the other end of the scale beneficiaries have a right to what they would receive if they remained in the scheme until retirement and continued to accrue benefits.

Expectations

The interpretation of *expectations* (the benefits that would have been paid had the scheme not discontinued) will involve deciding whether to include:

- future accrual of benefits
- future growth (*eg* earnings link) that would apply other than on leaving
- any discretionary benefits (*eg* discretionary pension increases or enhanced early retirement terms).

The determination of the rights and expectations of the beneficiaries is only relevant if there are sufficient assets available to ensure the provision of benefits at that level. If the scheme's assets do not cover the liabilities, some or all of the benefits will have to be reduced unless the shortfall can be met, *eg* through a third party guarantee.

Level of assets – schemes in deficit

If the scheme is in deficit, then either:

- some (or all) of the members will have to accept a reduced benefit
- the sponsor will (if possible) be required to make up the deficit.

If the benefits are to be reduced, legislation or scheme rules may indicate which types of benefits are to be reduced or which types of beneficiaries are to have their benefits reduced.

The different categories of members might be listed in an order of priority that determines which benefit payments must be made first and which will have to be reduced if there is a shortfall of assets. Benefits already in payment are often deemed to have the highest priority.

The assets for these purposes may simply be those that have been funded within the scheme. Alternatively, there may be additional assets available to secure the discontinuance benefits:

- **from a solvent sponsor (perhaps as a requirement under legislation)**
- **as a debt placed on an insolvent sponsor, which may rank alongside, above or below other creditors**
- **from insurance that may have been taken out to ensure the sufficiency of assets in the event of sponsor insolvency**
- **from a State-sponsored fund that has been established to support benefits where the sponsor is insolvent, possibly paid for by a levy on solvent schemes.**

The expenses involved in determining the benefit allocations, informing the beneficiaries and securing the appropriate form of provision will further reduce the assets.

These expenses (*eg* legal fees, actuarial fees) will have to come from the scheme assets if the sponsor is insolvent. Expenses will usually be a first call on the assets because the advisers would not be willing to perform the necessary calculations *etc* for free. Therefore they will be higher in priority than even the highest-ranking type of beneficiary.

Level of assets – schemes in surplus

If, on discontinuance of the scheme, the assets are more than sufficient to meet the benefit rights of the members under the chosen method of provision, the surplus may pass back to the sponsor.

Alternatively, legislation or scheme rules may require the surplus funds to be used to increase the benefits.

Ownership of surplus and its allocation to individual beneficiaries can be a contentious issue. Allocation could be done by taking account of an indicator of the extent to which the individuals can be viewed to have contributed to the surplus, such as:

- **the length of their membership**
- the value of benefits accrued
- the level at which contributions were paid.

It can be difficult to decide the fairest way to allocate any surplus assets, due to perceived inequity across different generations or different categories of members. For example, pensioners might feel aggrieved if only the benefits of those members not yet retired are enhanced. Some members may lose out as a result of moving from one category of membership to another, *eg* retiring shortly before benefits are improved for members who are yet to reach retirement age. In practice, such an extreme distribution of surplus would be unlikely.

3.3 Provision of benefits

If a benefit scheme is being discontinued, the following options may exist for the provision of the outstanding benefit payments:

- **continuation as a closed scheme, paying the accrued benefits as they fall due from the existing fund**
- **transfer of the liabilities to another scheme with the same sponsor**
- **transfer of the funds directly to the beneficiaries**
- **transfer of the funds to a personal pension (*eg* with an insurance company) – which will be defined contribution in nature …**

  … or to a new employer's scheme – which may be defined benefit or defined contribution
- **transfer of the liabilities to an insurance company to guarantee the benefits through the purchase of immediate and deferred annuities**
- **transfer of the liabilities to a non-insurance consolidator to guarantee the benefits**
- **transfer of the liabilities to a central discontinuance fund, operated on a national or perhaps industry-wide basis.**

Pay benefits from existing (closed) fund

Under this approach, the scheme operates as a closed fund and no more benefits accrue. The existing fund is used to meet benefit outgo as it falls due (subject to having an adequate funding level).

This option is generally used as a temporary measure until one of the other methods of securing benefits becomes a more attractive or sensible option.

Transfer to another scheme with the same sponsor

Discontinuance is not always the result of financial failure of the sponsor. If the sponsor is still in existence, it may have set up a new scheme into which the benefits can be transferred.

if the sponsor has been, or is being, taken over, the liabilities might be transferred to the purchasing company's scheme.

Transfer directly to the beneficiaries

It may be that a payment can be made to each member to reflect the capital value of their benefits.

Transfer to a pension arrangement with another provider

Where the payment is to be made to beneficiaries, legislation may require that this payment remains within a pension arrangement. In that case, the individual may need to place the funds with an appropriate insurance company (or similar provider) or in the scheme of any new employer.

Funds transferred to a pension provider would be invested to provide a personal pension policy, either on a group or individual basis. This would almost certainly be 'defined contribution' in nature, without the guarantees that would have been provided in the original defined benefit scheme.

Transfer of guarantees to an insurance company

The benefit scheme liabilities could be transferred to an insurance company to *guarantee* the benefits. Immediate annuities would be purchased (normally on a group basis) to cover the liabilities in respect of pensions in payment. Similarly, deferred annuities would be purchased to cover liabilities in respect of deferred pensioners.

Transfer to a non-insurance consolidator

It may be possible to transfer the liabilities, for a premium, to a benefit scheme consolidator – sometimes referred to as a 'superfund'. These vehicles allow the continuation of a defined benefit structure, but no longer relying on the original sponsor. Through combining many schemes, a consolidator is able to achieve efficiencies in costs, service provision and investment through economies of scale.

Transfer to a central discontinuance fund

In some countries, particularly where the employer of a discontinued scheme is no longer in existence, it may be possible for the assets and liabilities of that scheme to be transferred into a central fund. This may be run by the government or an industry body. As for the consolidator option, this can be beneficial as it leads to economies of scale in investment and administration.

Considerations

A scheme sponsor may favour transferring funds / liabilities to another party if it wants to crystallise any surplus or deficit, in order to remove any uncertainty about its financial obligations to the scheme.

If benefits remain in the scheme and the employer remains solvent, the employer remains liable for any shortfall in the value of assets to meet the promised benefits. The employer may need to finance any initial deficit and any future deficits that may arise.

If benefits are transferred to a third-party arrangement that does not offer guarantees (*eg* a defined contribution scheme, or an insurance policy that is simply an investment vehicle), the ultimate benefit will then depend on the assumptions used to determine the capital value transferred and future experience, *eg* investment returns on the funds.

The benefits may be greater or smaller than the discontinuance benefit.

In other words, the risks and potential rewards are transferred from the scheme to the individual. The individual is exposed to the risks of the actual experience (in terms of investment, mortality, *etc*) differing from the assumptions used to calculate the value of the benefits to be transferred.

If the liabilities are transferred to a third party that will guarantee to pay a specified level of benefit, such as an insurance company or non-insurance consolidator, the third party will be accepting the risks of adverse future experience.

The third party will charge a premium for taking on these risks. As a result, the balance of the funds may not be sufficient to provide in full the benefits that could have been targeted using one of the other forms of provision described above. Nevertheless, this approach can give more security to the scheme member and complete severance for the employer / sponsor.

Non-insurance consolidators may not be subject to as rigorous reserving and regulatory requirements as insurers. Protection of member benefits may therefore not be as strong, but the cost of providing benefits may be lower than that of annuity purchase from an insurer.

An alternative way of guaranteeing benefits, other than with an insurer or a consolidator, is via the operation of some form of central discontinuance fund – as mentioned above. Such central funds may not guarantee to provide 100% of the benefits. The central fund might impose levies on other employers providing schemes, to meet shortfalls in the fund if experience is poor.

The chapter summary starts on the next page so that you can keep all the chapter summaries together for revision purposes.

Chapter 34 Summary

Insolvency of an insurance company

Insurance companies rarely become insolvent due to:

- the requirement to hold regulatory solvency **capital**
- ongoing **monitoring** by the regulator
- regulatory **intervention** where necessary.

If the insurer's financial position is serious, it may be required to establish a **recovery plan** and/or resolution plan.

A recovery plan may include closure to new business.

The insurer may be sold to, or merged with, another provider.

In the extreme event that an insurer cannot meet its liabilities and a buyer cannot be found, there may be a statutory compensation scheme from which some or all of the benefits are paid.

In any of these scenarios, it will be important to project the insurer's solvency position into the future using either a stochastic model or a deterministic model with scenario testing.

Insolvency of a bank

The situation for banks is very similar to that for insurers, potentially with more emphasis on **resolution plans** that aim to ensure that:

- banks that have not been able to recover are allowed to fail in an orderly manner, limiting or avoiding causing damage to other banks
- critical functions can continue.

Closure of a sponsored benefit scheme

There are two types of closure of a benefit scheme:

- no new members but benefits continue to accrue for existing members
- no new members and no further benefit accrual for existing members.

A benefit scheme may cease due to:

- the **insolvency** of the sponsor
- a **decision by the sponsor** to stop financing future benefit provision, *eg* to reduce costs or to follow market trends in benefit provision.

If a scheme ceases, the level of benefits that will be paid will be affected by the:

- **rights** of the beneficiaries
- **expectations** of the beneficiaries
- the level of **assets:**
  - if under-funded, may have to reduce benefits; need to consider the priority of different groups of members
  - if over-funded, need to consider how to use the surplus
  - in either case, follow legislation and scheme rules.

Provision of outstanding benefits under a discontinued defined benefit scheme

Option for benefit provision	Who takes the risk of adverse experience
Pay the accrued benefits from the continuing (closed) fund	Sponsor (if still solvent)
Transfer the liabilities to another scheme with the same sponsor	Sponsor (if remains defined benefit)
Transfer the funds directly to the beneficiary in cash form (if permitted by legislation)	Beneficiary
Transfer the funds to a personal pension (*eg* with an insurance company) or to the scheme of any new employer	Beneficiary – if funds are transferred to a personal pension or a defined contribution arrangement with the new employer (or risk transferred to new employer if it offers a defined benefit scheme)
Transfer the liabilities to an insurance company to guarantee the benefits	Insurance company
Transfer the liabilities to a non-insurance consolidator to guarantee the benefits	Consolidator
Transfer the liabilities to a central discontinuance fund (national or industry-wide)	Beneficiaries (ultimately) – although could also be passed to solvent sponsors through a levy to maintain the fund