

Advanced Risk Financing and Transfer

27th March 2021

Instructions to candidates

Read the instructions below before answering any questions

Three hours are allowed for this paper which carries a total of 160 marks, as follows:

Part I

1 compulsory question (case study) 80 marks

Part II

2 questions selected from 3 (scenarios) 40 marks each for a total of 80marks

- You should answer the question in Part I, and two out of the three questions in Part II.
- You are advised to spend no more than 90 minutes on Part I and 45 minutes on each question selected in Part II.
- It is recommended that you spend 15 minutes reading and planning your answer to the case study and 75 minutes answering it, and that you spend 10 minutes reading and planning your answer to each scenario and 35 minutes answering it.
- A case study tests extensively across syllabus learning outcomes, whilst a scenario will be more focused on specific learning outcomes.
- Read carefully all questions and information provided before starting to answer. Your answer will be marked strictly in accordance with the question set.
- You may find it helpful in some places to make rough notes in the answer booklet. If you do this, you should cross through these notes before you hand in the booklet.
- Answer each question on a new page. If a question has more than one part, leave six lines blank after each part.

PART I

Case study

This question is worth 80 marks

You should include relevant examples and further reading in your answer where applicable

QUESTION 1

CASE STUDY

Your organisation has carried out a risk identification and risk evaluation exercise and the results were plotted on a risk matrix as follows:

	Negligible	Minor	Moderate	Major	Catastrophic
Highly likely	<i>Risk D</i>				<i>Risk A</i>
Likely				<i>Risk B</i>	
Possible			<i>Risk G</i>		
Unlikely					
Rare	<i>Risks C, E and F</i>			<i>Risk H</i>	

QUESTION

You are appointed to design the risk control measures using a variety of risk financing and risk transfer methods for the indicated risks A to H. Your report should detail the type of tool/s or method/s suggested, the reasons and advantages for your selection and the corresponding expected outcome and effect.

Present your report.

(80 marks)

PART II
Scenarios
Answer TWO of the following THREE questions.
Each question is worth 40 marks

QUESTION 2

SCENARIO

You receive a claim pertaining to a multiple vehicle collision involving your insured who is fully to blame for the accident caused.

Your insured has caused damage to six vehicles and injuries to ten occupants on a motorway in the UK. The nationalities of the persons injured are various and include UK, European and American. These third parties sustained injuries that will entail long recovery consequences.

Your office is in Ghana and the policy has been issued to provide worldwide cover and foreign jurisdiction. The claim is fully covered by the policy and a reserve of 50 million USD has been allocated.

QUESTION

Assuming that the reserve is a very accurate one reflecting the expenses to expect with respect to liability.

If the liability award remaining constant and in line with the reserve, what other risks could result in the company paying more than expected? Discuss the available tools and options available to ensure that this will not happen and that no more than the reserve is eventually paid.

You should present your discussions from the risk financing and risk transfer point of view, given the long time it would take to settle all the liability claims in the potentially different jurisdictions.

(40 marks)

QUESTION 3

SCENARIO

QDA company ltd is a very large corporate consisting of a large number of oil rig offshore companies all over the world with assets of over a trillion USD. A variety of risk management techniques apply and the complexity of the risks involved entail different use of different risk control measures.

One of the methods used is the funded risk financing mechanism which is typically used by firms to retain financial impacts of their losses should they occur, thus cushioning the impacts of the losses. The mechanism involves the reserving of cash funds to help cover the cost of risk events. The company is looking at stepping up this mechanism and change it into a full-fledged captive company which, albeit is still a form of self-funding, the captive company benefits from many other market and financial advantages.

QUESTION

In the light of setting up a captive insurance company to write the risks of QDA company ltd, explain the type of captive you would suggest giving reasons for your answer and the potential advantages and disadvantages of having such a funded risk financing mechanism.

(40 marks)

QUESTION 4

SCENARIO

Risk financing is a planning process to arrange for funds that are reliable and sufficient to provide for losses that might occur. The main objective of risk financing is to maximise the value of the organisation, playing a major role in removing or minimising uncertainty by arranging funds for this purpose.

Any decision to risk finance involves a number of considerations.

QUESTION

In the light of the above, discuss the factors and the corresponding mechanisms that need to be considered prior to deciding to risk finance.

(40 marks)

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PART I
Case study

This question is worth 80 marks

**You should include relevant examples and further reading in
your answer where applicable**

QUESTION 1

CASE STUDY

Insurance companies have accelerated their withdrawal from insuring coal, making it costlier to secure insurance for new projects. The insurance industry is still underwriting oil and gas companies and momentum is growing behind calls for the financial sector to withdraw from fossil fuels.

On the other hand, a rise in global crude oil supply could put the brakes on surging gasoline prices that have hit record levels in parts of the United States and Europe.

Despite high prices, gasoline demand in Europe also remained at elevated levels, while consumption in China and India was running more than 10% above 2019 levels, notwithstanding that record levels of electric vehicle sales were registered worldwide in 2021.

QUESTION

You are the risk management consultant of a private energy supplier that provides energy-generating resources to giant conglomerates and public energy houses.

In the light of the current global energy infrastructure, draw up a report that seeks to protect the risks of various energy sources produced by your company that are facing fluctuating costs and new emergent energy sources.

The report must detail the steps to guard unexpected risk events and the strategy to ensure shareholder value in line with corporate culture and risk appetite of the firm. Also, the report must highlight the benefits derived from your risk control and risk financing suggestions.

(80 marks)

PART II
Scenarios
Answer TWO of the following THREE questions.
Each question is worth 40 marks

QUESTION 2

SCENARIO

AB-FIN is a top tier financial services multinational group that has subsidiaries in many countries. The group has potentially significant Professional Indemnity (PI) exposure. Additionally, the group has contractual obligations to provide evidence of insurance cover for PI risks to its customers and to the local regulators.

The premium paid for insurance does not come cheap and during an AGM, the board of directors of the group, appointed a sub committee to look at alternative financing of these PI risks.

QUESTION

If you were part of the newly appointed sub committee to look at non-conventional pre loss risk transfer options, what types of options (other than the conventional insurance) would you suggest? Give reasons for your suggestions.

(40 marks)

QUESTION 3

SCENARIO

Reinsurance redistributes risk across a wide range of insurance companies. It accomplishes this by enabling an insurance company known as the cedent to purchase insurance from one or more insurance companies known as reinsurance companies. By redistributing this risk among many companies, the cedent diversifies its risk in exchange for a premium paid to the reinsurance company.

There are limits to the insurability of risk events, meaning that not all risks can be cost-effectively reinsured and these create a number of legal and fiscal implications associated with the use of reinsurance.

QUESTION

Given the comments in the scenario above, discuss the value of reinsurance and explain two main types. Also discuss the limits of insurability and their respective legal implications.

(40 marks)

QUESTION 4

SCENARIO

Rose Cipollone began smoking in 1942, when she was 16 years old. Shortly before she died of lung cancer in 1984 at the age of 58, her husband sued the company that manufactured the cigarettes she smoked.

In 1988, a jury in New Jersey awarded Cipollone's husband \$400,000. The jurors found that, before 1966, the company had failed to warn of the health risks of smoking its products.

(After 1966, cigarette packages included a federally required health warning that smoking cigarettes may be hazardous to health).

QUESTION

If you were the risk manager of the tobacco company aware of the lawsuit and the exposure to a repeat, what post event loss risk transfer mechanisms would you propose to counteract any similar consequence faced by your firm.

Explain two relevant post loss risk transfer methods.

(40 marks)
