BANKING

QUESTION

Capland is a first world country with a fully developed financial market.

The banking system is dominated by three banks, who between them have a 65% market share. The remainder is spread among 10 other banks. All of the banks are listed on the stock exchange.

Greater Capland Bank ("GCB") is one of the big 3 with a market share of 22%. One year ago, on the retirement of its CEO who had served in that position for 20 years, a new CEO was hired who had previously been the CEO of a mid sized Australian bank. Her brief was to bring serious change to GCB in order to materially improve the return to shareholders.

Capland has one of the strongest anti-discrimination laws among first world countries. It provides that discrimination of any kind on the basis of any characteristic either personal or financial must be approved by the Anti Discrimination Commissioner before it can be introduced. In addition for banks, the discrimination must also be approved by the Banking regulator. The legislation requires that any applications must demonstrate that the discrimination is fully supported by reliable data and that it will generally be seen as reasonable. As a result of these requirements the Capland banks, while allowed to reject a loan application on the basis of the applicant's financial status, are not allowed any differential pricing for approved loans.

You are the senior partner of Capland Innovative Actuaries ("CIA"), a successful firm of actuaries who provide non-routine advice to a very wide range of clients across many different industries.

The GCB CEO has been in discussion with you about you providing independent advice to support an application to the Anti Discrimination Commissioner and the Banking regulator to approve GCB using differential pricing in respect to new residential housing loans based on the applicant's financial position and the size of the loan. While GCB does not currently employ any actuaries, its loans department does have data in respect to the performance of residential housing loans subdivided by financial status and loan size. This data has been peer reviewed by a well respected firm of statisticians.

The GCB CEO has had informal discussions with the Commissioner and regulator about the concept. She has told you that their initial response, while not negative, was not encouraging. The Commissioner said "you will need very good data which demonstrates that the differences are real, demonstrated over time and sustainable in future; and we will want to see the actual differentiation in price you would introduce if the application was approved". In addition, she was reminded about the requirement that the discrimination needs to be seen as reasonable.

The Banking regulator noted that this type of discrimination could have negative impacts on GCB's future profitability and hence its solvency from both the actual differential in prices versus future experience and the potential for losing business to competition at GCB's higher priced business.

© 2016 Actuaries Institute

Task

Prepare your report.

Data

Attachment A: Capland Economic Conditions Index
Attachment B: GCB Product Description
Spreadsheet: GCB Loan Experience.xlsx
Spreadsheet: Capland Investment Data Jun 16.xls

Attachment A: Capland Economic Conditions Index

This index is prepared by the Capland Economic Society. It attempts to provide a reliable index of the overall Capland economic conditions. It has been prepared for the last 25 years and is highly regarded and used by Government and businesses. Higher numbers are indicative of a better economy than lower numbers.

Year	Index
2015/16	218
2014/15	229
2013/14	242
2012/13	235
2011/12	216

Attachment B: GCB Product Description

GCB's residential housing loans have the following characteristics

25 year term
Monthly repayments of principal and interest
The interest rate is set at 300 basis points above the 10 year government bond rate at the date the loan commences and is fixed for the first five years of the loan and is then variable.
Refinancing the loan is not permitted in the first five years unless the property is sold and ceases to be the borrower's residence.
In addition to the interest rate charged each loan is charged a monthly fee of $C15

END OF QUESTION

© 2016 Actuaries Institute