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making financial sense of the future

## **Current Issues Committee**

Newsletter June 2007

*The content of this newsletter is a summary of some of the current issues that might be of interest to UK General Insurance actuaries and that have come to the attention of the Current Issues Committee. As such it is not a complete list. Anyone who feels that relevant issues have been omitted or that the above summaries are in anyway misleading is invited to contact the Chairman of the Committee, Laurence Townley.*

*The information provided has been derived from a variety of sources. The Committee has not been able to check independently the veracity of all of the facts stated. Any opinions expressed are those of the Committee members, and do not necessarily reflect the position of the Institute or Faculty of Actuaries.*

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# 1 International

## **Continental Europe**

### *EU boat insurance plans*

MEPs voted in April against European Commission proposals to close the gap between minimum compulsory insurance rates for ocean-going ships and inland vessels such as ferries and barges. It was argued that such proposals on insurance plans for passenger boats could threaten boating holidays and put some small operators out of business.

The aim of the proposals was to oblige small boat owners to provide minimum legal liability cover for each passenger at the same rate as boats carrying hundreds or thousands of people. The British Marine Federation said the move could lead to significant increases in premiums for companies running boats whose rates are currently pegged at a lower average.

## **Central and Eastern Europe and CIS**

### *Hungary*

Government commissioner in charge of reform, Tibor Draskovics, has said that when the political and professional debates are done, Hungary's health insurance system is expected to be opened to for-profit market-oriented companies.

### *Moldova*

The Republic of Moldova has introduced a law on compulsory motor third-party liability insurance. The law will come into effect in early September 2007.

The law on compulsory MTPL insurance establishes rules for concluding insurance contracts, sets the maximum amounts for insurance claims, specifies the liability of companies when examining insured losses and indicates the recipients of insurance compensation. Maximum insurance compensation for material damage caused to a car in an accident will total MDL500,000 irrespective of the number of victims. Maximum insurance indemnity to a victim of bodily injury or, in case of death, to his\her relatives may come to MDL350,000. Meanwhile, maximum insurance compensation to all crash victims will amount to no more than MDL700,000, irrespective of the number of victims.

## **US and Canada**

### *A new effort to regulate Californian medical insurance rates*

Some lawmakers and consumer groups are backing a new effort to regulate medical insurance rates in California the same way the state controls auto coverage costs. Governor Arnold Schwarzenegger first proposed that insurers be required to spend at least 85% of premiums on

actual medical care. But a new proposal would also require insurers to obtain state approval for annual premium increases above 7%.

Healthcare premiums have grown at four times the rate of wages and inflation this decade, and many advocates complain the free market has failed to rein in profits taken by private insurers.

Many experts say rising costs are primarily due to new medical technologies as well as an older and more obese population requiring greater care. But some insurers are taking profits of as much as 10% of premiums.

#### *Florida lawmakers seek long-term insurance fixes*

Following the legislature in January to reduce insurance premiums, lawmakers are now turning to longer-term fixes. These include helping homeowners pay for storm-proofing homes and better equipping the state-run Citizens Property Insurance to handle its increasing load of policies.

By storm-proofing their homes, many homeowners could lower their premiums through the mitigation credits that insurers must offer. A committee has been studying how to best improve mitigation inspections and funding, tell policyholders about mitigation credits, and streamline regulation to make the strengthening of homes against hurricanes easier.

#### *Insurance modelling in Florida*

There is currently much debate in Florida over the validity of new risk modelling software assumptions that predict property insurance losses 40% greater than past estimates. These assumptions are based in part on predictions of how many hurricanes are likely to hit the state by 2011. If the Risk Management Solutions model is approved by the Florida Commission on Hurricane Loss Projection Methodology and the Florida Office of Insurance Regulation, it may be used to justify rate increases for homeowners insurance.

State officials will also review a new public model they hope will provide a benchmark for the field. Considering the impact that insurers' use of new risk models will have on consumers, one expert suggests creating a national, impartial panel to examine risk models in greater detail.

### **Australia and New Zealand**

#### *Private health insurance cover changes*

The biggest overhaul of private health insurance in almost a decade has passed federal parliament, allowing patients with hospital cover to receive rebates for medical procedures conducted outside hospitals. The reforms, dubbed "Broader Health Cover", will allow health

funds to pay out private patients for out-of-hospital treatments such as chemotherapy, dialysis, treatment for asthma and diabetes. The laws are effective as from 1 April 2007.

Under previous law, patients had to go to hospital to receive rebates on their treatment, making some procedures unnecessarily expensive. The new laws have been developed in consultation with the health insurance industry and expand the range of services available to consumers. The changes are aimed partly at getting more Australians to buy private health insurance, as the take-up rate has stalled in the past few years.

The laws also remove penalties for people who joined a fund after the age of 30 but have remained members for more than ten years.

#### *Insurance Council Releases Tips on General Insurance*

The Insurance Council of Australia has released tips on general insurance for consumers to consider when purchasing, updating or registering an insurance policy claim.

The tips are aimed at improving the Australian community's understanding of the value of insurance. The "Tips on General Insurance: Preparedness and Recovery" is available at [www.insurancecouncil.com.au](http://www.insurancecouncil.com.au).

The detailed document can be found at the following link:

[www.insurancecouncil.com.au/ArticleDocuments/55/Insurance%20Council%20Media%20Release%20-%20Insurance%20Council%20Releas....pdf.aspx](http://www.insurancecouncil.com.au/ArticleDocuments/55/Insurance%20Council%20Media%20Release%20-%20Insurance%20Council%20Releas....pdf.aspx)

#### *Taxation Burden on Insurance Products*

The Australian Bureau of Statistics has released statistics highlighting that general insurance taxes are unfair and not equally distributed in the community. This has supported a call for the removal or reduction of taxation on insurance policies.

The figures show that State taxes on insurance now amount to AU\$3.56 billion or 8% of all State taxes. Australia has an extremely high level of taxation on insurance in comparison to other countries.

#### *AUSTRAC and APRA sign Memorandum of Understanding*

The Australian Prudential Regulation Authority (APRA) and the Australian Transaction Reports and Analysis Centre (AUSTRAC) have signed a Memorandum of Understanding (MoU) to facilitate cooperation and the exchange of information between the two regulators.

AUSTRAC is Australia's anti-money laundering and counter-terrorism regulator, and specialist financial intelligence unit. APRA is the prudential regulator of the financial services industry overseeing banks, credit unions, building societies, general insurance and life insurance companies, friendly societies and most members of the superannuation industry.

The two agencies have agreed to provide each other with assistance in relation to the exchange of information, appropriate referral of matters and cooperation in regulation, compliance and enforcement, consistent with relevant laws.

The MoU is available at [www.apra.gov.au/AboutAPRA/upload/APRA-OSFI-MoU-March-2007.pdf](http://www.apra.gov.au/AboutAPRA/upload/APRA-OSFI-MoU-March-2007.pdf)

## **Africa**

### *South African private healthcare industry*

Private health care and the medical-scheme environment in South Africa are changing because of a myriad of regulatory changes, medical advances and inflationary challenges. There have been recent calls from the Competition Tribunal and the Board of Healthcare Funders for improvements within the industry.

The Competition Tribunal has recently requested an industry-wide investigation into relationships between private hospitals and doctors in a step against rising private health costs.

Also, the Board of Healthcare Funders has called for the prescribed minimum benefits (PMBs) to be revised.

PMBs are a basket of hospital-based and chronic conditions that every medical scheme is required by law to cover in full, regardless of the cost charged by the health-care provider. There is no legislation governing the tariffs for these benefits. Coupled with a lack of competition among health-service providers, the mandatory provision and lack of tariff control for these benefits have had an adverse effect on the cost of private health care.

An environment of supplier-induced demand has ensued. Statistics show that the percentages of medical-scheme members in South Africa undergoing certain specialist medical procedures (for example, back surgery or Caesarean section) are generally higher than carried out in other countries.

Some suggestions to improving the situation have included reinforcing the role of the general practitioner as the gatekeeper, a revision of the current reimbursement system, the initiating of industry guidelines on the appropriate use and funding of new technology, and regulated charges for a set of regulated benefits.

# 2 Claims and Legal

## **The Cost of Insurance Fraud**

A report from the ABI has recently been published estimating that the cost of insurance fraud to UK insurers is estimated to be £1.6bn per year. This amount has the effect of increasing the average premium paid by policyholders by £40.

In the report the ABI gave common examples of insurance fraud claims including deliberate spills and cigarette burns on furniture and carpets. 10% of respondents to the ABI survey admitted to cheating their insurer with a large proportion of dishonest claims falling under householder policies.

Dishonest claims also included exaggerating or overestimating the value of the claim. For example, overplaying an injury following trips and slips or overstating personal contents lost on holiday.

The ABI have called for greater deterrents including prosecutions to discourage these fraudulent activities.

## **DCA: The Law on Damages**

The Department for Constitutional Affairs (DCA) has published a consultation paper CP9/07 requesting views on liability issues including wrongful death in fatal accidents, psychiatric illnesses and damages for personal injury. The aim of these proposals is to provide a clearer and fairer justice system when victims are seeking damages. The DCA has asked for views on their proposals in order to consider next steps and to carry out a cost benefit analysis on potentially affected industries such as the insurance industry.

There are several proposals in the paper:

- Wrongful death and bereavement damages: extension of the statutory list of claimants able to claim as dependants; extension of claimants able to claim for bereavement; and fixed lump sum amounts for bereavement damages for minors.
- Psychiatric Illnesses: allowing courts to develop the law rather than imposing statutory solutions.
- Collateral Benefits: fair treatment so claimants are compensated in full.
- Gratuitous Care.
- Cost of Private Care: Considering the withdrawal of the ability of a claimant to use private care rather than the NHS.
- Accommodation expenses: Find new options to award extra capital costs
- Aggravated, Exemplary and Restitutionary Damages:

The ABI have welcomed the government's recognition that reform of the system for personal injury compensation is needed.

### **PPI Premiums**

The FSA have banned nil-refund terms in single premium payment protection insurance contracts. New policies are to include a table illustrating how a refund will be calculated if the policy is cancelled.

### **More Equitas Legal Hurdles Cleared**

Equitas has announced that it has completed its reinsurance with National Indemnity Company, having cleared various legal, regulatory and procedural hurdles with the FSA, the New York Insurance Department and the Corporation of Lloyds. The FSA have also approved the payment of a £50 million return premium to the reinsured names. Legal issues that remain include those relating to High Court approval for a full transfer from Names to entirely remove liability.

### **Enron Class Action Blocked**

The federal appeals court ruled that Enron shareholders cannot proceed with a class action against banks and securities firms. Financial institutions are alleged to have been complicit in the fraud that led to the collapse of Enron. However, there remain other class action claims pending against other banks, including those involved in underwriting various security issues. The lead plaintiff solicitor has previously settled with a number of banks, but is now pursuing a litigation strategy against the remaining defendants. The judge ruled that settlements agreed pre-trial will stand.

The reason for the decision is that only institutions that had major roles in structuring deals and advising companies can be sued for securities-law violations by shareholders.

London market insurers provided significant amounts of insurance cover to the financial institutions.

# 3 Market News

## **Court victory for insurers – No. 1**

A recent court victory could save insurers millions of pounds in personal injury and clinical negligence claims. In *Andre Crofton v The National Health Service Litigation Authority* the Court of Appeal ruled that if a person obtains payments from his local authority to pay for care needs, those payments must be taken into account in the assessment of damages. Crofton's lawyers had lodged an appeal to argue that the reduction he was set to receive in his compensation was unfair but the Court dismissed his appeal in a unanimous judgment.

## **Court victory for insurers – No. 2**

In another court victory for insurers the High Court threw out seven industrial deafness test cases, brought against Zurich, QBE, Norwich Union and a self-insured company. The claims had been brought by former factory workers who argued that they had become deaf due to potentially unacceptable levels of noise in textile, weaving and steel factories and that their employers should have taken steps earlier to reduce the risk of damage to the workers' hearing. However, the judge refused to accept their arguments. If successful, thousands of claimants were expected to come forward with retrospective claims each worth up to £63,000.

## **Good year for Lloyd's**

A big drop in catastrophe related losses led to a profitable year for Lloyd's in 2006, which also enjoyed a 10% rise in premium income. The market recorded pretax profits of £3.7 billion for 2006 (compared with a loss of £103 million for 2005), and gross written premiums were £16.4 billion (compared with £15 billion in 2005). Lloyd's combined ratio for 2006 was 83.1% (compared with 111.8% for 2005). However, Lloyd's warned that it is unrealistic to expect similarly favourable claims experience in 2007, and that there are signs of softening in most lines of business.

## **More good news for Lloyd's**

Standard & Poor's have upgraded Lloyd's financial strength rating to 'A+' from 'A', as a result of "the successful completion of Phase 1 of the Equitas transaction, progress with regards to Phase 2 and the unstoppable momentum behind improving London market business processes".

## **Reinsurance rates softening**

The reinsurance market is facing a possible slide in rates according to two recent reports. The report produced by Willis stated that April renewals have continued on from where January's left off, with pricing either remaining flat or falling. Willis said that barring a major catastrophe loss, it expects this trend to accelerate with the July renewals across all lines of business. According to the second report, produced by Aon, reinsurance rates for personal lines, standard commercial lines and complex commercial lines are likely to be flat to lower during the mid-

year renewals of property catastrophe reinsurance programs. Some of the key factors driving this trend were noted as the lack of major catastrophes in 2006 and the level of new capital which has been attracted to the industry, with eight new reinsurers emerging in Bermuda along with four new Lloyd's syndicates.

Elsewhere, rates for private motor have been predicted to fall in real terms in 2007 – putting the recovery of the private motor market under threat. The emergence of price comparator 'aggregator' websites has been highlighted as a factor in suppressing rate increases. During 2006 motor premiums had increased by 4.35% as motor insurers attempted to increase rates to keep up with claims inflation, and return the private motor market to profit. The motor market has not made a profit since 1994.

### **Latest hurricane predictions**

Forecasters at Colorado State University's Tropical Meteorology Project have increased their projection for the 2007 Atlantic Basin season to nine hurricanes and 17 named storms, with landfall probabilities standing higher than average. Of the nine hurricanes predicted, three are expected to be intense or major. The team's original forecast was for 14 names storms, with seven of those becoming hurricanes.

Tropical Storm Risk has also updated its forecast for Atlantic hurricane activity in 2007 and are now also predicting nine hurricanes and 17 named storms. However, they are expecting four of the predicted hurricanes to be intense.

### **New mutual for London boroughs**

A new mutual was launched on 1 April to offer local councils access to insurance. It will initially only deal with the London boroughs of Brent and Harrow, but another eight councils will be able to place business with it in a matter of months. Eventually it will be open to all 32 London boroughs, the Corporation of London and the Greater London Authority. The new mutual has been named London Authorities Mutual Ltd and was created due to concerns about the limited number of local government insurance providers and the alleged difficulties local authorities face in getting best value for their insurance premiums. Insurers are expected to lose £6 million in premiums a year if a majority of London boroughs decide to join the mutual.

### **Kiln next for Bermuda**

Kiln is set to become the fourth Lloyd's insurer to leave London in favour of Bermuda after it announced plans to redomicile. Kiln will introduce a new Bermuda domiciled holding company for the group in 2007, in addition to establishing a Bermuda reinsurer, Kiln Re, which is expected to write £160 million of business including property reinsurance. The company has stated that they expect the new Bermudian operations to be complementary to Kiln's existing Lloyd's business.

The flow of companies leaving London for Bermuda is not expected to be affected by the reduction in the rate of corporation tax in the Budget. The rate has been reduced from 30% to 28%, but this does still not compare favourably enough with the corporation tax rate in Bermuda of 0%. Stephen Catlin, chief executive of Catlin has said that he would only consider moving the Lloyd's insurer back to the UK if the tax rate fell to 20%.

### **Names appeal**

A group of Lloyd's Names have secured a Court of Appeal hearing on 6 June to apply for a retrial, in a bid to get their money back. The Names failed in a legal bid in 2002 but claim to have new evidence. Many of the Names were left bankrupt after massive losses and allege inadequate accounting systems at Lloyd's.

# 4 Solvency 2

## **Quantitative Impact Studies**

The QIS3 study is upon us. This latest quantitative impact study on Solvency II will be looking at several topics - eligible capital, technical provisions and both the Minimum and Solvency Capital Requirements (MCR and SCR). QIS3 will aim to test the impact of companies having to hold capital at the SCR and MCR levels compared to their currently available eligible capital. QIS3 will also test whether the calculations of the SCR are able to be carried out by insurers without any major practical implications.

Templates and calibration papers have been received by insurers and are currently being completed in time for the 29 June 2007 QIS3 deadline. Insurers have been asked to participate either by their national supervisors or by CEIOPS directly. CEIOPS aims to publish the results of QIS3 in July 2007.

One of the results of the QIS2 was that small firms might be disproportionately impacted by the proposed changes. As a result of this, for QIS3, more input from small firms is being encouraged. To facilitate this, difficult areas such as the estimation of risk margins for the technical provisions specification would contain options for proxy methods.

The question of whether the existing FSA statutory returns would be discontinued following Solvency II implementation was discussed at the CEIOPS Pillar 3 working group meeting in February 2007. This issue has been put on the agenda to be discussed further with no clear proposal at this stage.

## **Solvency 2 Directive**

Due to be published in July 2007, the draft directive is in the process of being completed. However, draft texts have already been circulated to certain groups and Group Consultatif, the European Actuarial group working on Solvency 2, have been invited to submit comments on aspects of the draft. Group Consultatif have commented separately on Pillar 1 and Pillar 2 issues.

## **CEIOPS CP20**

In the previous edition of the current newsletter, we reported that CP20 had contained proposals to select the highest of all the reliable and relevant actuarial methods used to calculate the best estimate of the liabilities. This issue has now gone away and the proposal has been removed.

## **ABI**

The ABI has published 'Five Key Tests for Solvency II' which sets out five 'key tests' that it believes Solvency II must pass to deliver on the promise of supporting a globally competitive insurance industry to provide a diverse range of high quality, good value protection and investment products. The five key tests are:

- Will Solvency II use modern, market-based methods for the valuation of liabilities? The ABI argues that Solvency II should be more transparent and more sophisticated with clear links to market-based approaches to calculating estimates.
- Will Solvency II set insurers' capital requirements appropriately? The ABI argues that there must be a much greater role for insurers' own capital models. The ABI expects UK insurers to focus resources on building internal models.
- Will Solvency II properly recognise the organisations and structure of groups? The ABI argues that a new approach should recognise that firms are global, have cross border operations and can be fairly complex in structure. This could mean giving credit to firms that economically coherent and for supervisors across the EU to work together.
- Will Solvency II provide incentives for effective risk management?
- Will Solvency II be principles-based? The ABI argues against detailed rules that could be too prescriptive and towards principles that reflect market reality.

# 5 Government and Regulatory Issues

## **Treating Customers Fairly (TCF)**

In July 2006 the FSA set a deadline that all firms had to have reached the implementation stage of their TCF programs by March 2007. The FSA have published a report detailing the progress to implementation. This report can be found at:

[www.fsa.gov.uk/pubs/other/tcf\\_implementation.pdf](http://www.fsa.gov.uk/pubs/other/tcf_implementation.pdf)

The assessment of progress with TCF showed that a number of firms had met the March 2007 implementation deadline. The estimated proportions meeting the implementation deadline were 87% of medium sized firms and 41% of small firms. The FSA commented that this showed that senior management teams in these firms remain committed both to making progress with TCF and to rising to the challenge presented by this principles-based regulation.

However, the FSA were also disappointed that a significant number of firms had failed to meet the March deadline, particularly as TCF had been a relatively long standing priority. The FSA state that they will intensify their supervisory focus accordingly, including through use of enforcement.

The FSA further commented in the report about the need for firms to focus on TCF issues and the potential rewards for firms who demonstrate their own good performance in the form of either less scrutiny.

## **Consumer experiences and outcomes in general insurance markets**

An interim report on this subject has been published by the FSA in March 2007. The main finding is that consumer risk of detriment varies substantially across the various general insurance products. The FSA define the types of consumer detriment to be unsuitable purchases, expensive purchases and the failure to purchase general insurance products.

The FSA are planning to group general insurance products into two broad groups depending on the level of consumer detriment:

- Greater risks of consumer detriment: those buying personal protection products such as payment protection and critical illness; and
- Less risk of consumer detriment: commodity-type general insurance products such as household or motor policies.

The differences could warrant a rebalancing of the Insurance Conduct of Business (ICOB) rules for general insurance. The FSA's ideas for rebalancing its general insurance regime will be published via a Consultation Paper in June 2007. Any rule changes are likely to be made in December 2007.

## **Projecting Future Capital Positions**

In the recent FSA General Insurance Newsletter, it was noted that firms must have a good understanding of the possible development of their capital position over the business planning period as well as assessing capital requirements through ICAS. Alongside the most recent changes in INSPRU 7.1 which introduced the Principles and Guidance for ICAs, changes have also been made to GENPRU 1.2 to require all firms to project their Capital Resource Requirement (CRR) into the future alongside the future capital resources available to meet the CRR.

The revised rules require a firm to provide a projection of their capital strength over the term of their business planning period. Firms should continue to submit an ICA consistent with INSPRU 7.1, but this extra information will be requested as part of future ICA/ARROW reviews.

More information is available in GENPRU1.2 and the FSA General Insurance Newsletter, which can be found at: [www.fsa.gov.uk/pubs/newsletters/gi\\_newsletter12.pdf](http://www.fsa.gov.uk/pubs/newsletters/gi_newsletter12.pdf).

## **Lloyd's ICA Guidance for the 2008 YOA**

Produced by Lloyd's, this guidance paper contains the minimum required standards for Lloyd's syndicates in the 2008 ICA submissions and more detailed technical guidance for those preparing the ICA. It relates to both active syndicates and those syndicates in run-off with material active member participations. There are four main sections:

- Introduction: sets out the required basis and scope for 2008 syndicate ICAs as well as Lloyd's overall approach to its review work.
- Minimum Standards Section: briefly sets out the main issues and minimum required standards.
- Detailed technical section: guidance split out by risk group.
- Appendices: formats for the ICA document, minimum standards mapping, additional pro-forma information required.

## **'Principles-based Regulation - Focusing on the Outcomes that Matter'**

The FSA have published a paper setting out its current thinking on its move towards a more-principles-based regulatory regime. The FSA will continue to move to more principles-based regulation, supplementing the risk-based and evidence-based approach. The paper argues that principles-based regulation will achieve benefits for consumers by fostering a more innovative and competitive financial services industry.

The FSA aim to provide, either directly or through confirmation of industry guidance, a greater range of helpful and clearly sign-posted hints to help firms plan their business processes and controls.

The FSA say that it will measure its own performance against clearly articulated regulatory outcomes, using a wide range of metrics. Using the new Outcome Performance Report, this process will be integrated into the FSA's operations and governance.

### **Key Rules for Smaller General Insurance brokers**

The FSA have published Key Rules designed for smaller general insurance brokers whose operations and customers are all based in the UK. The Key Rules are drawn from the FSA Handbook of rules and guidance, supplemented with some explanatory material and are one of a number of measures the FSA are pursuing to make the Handbook more accessible. The FSA have identified the rules that are most relevant to general insurance brokers in their day-to-day customer-facing work. These include certain aspects of the conduct of business rules, client money rules, complaints handling and electronic commerce rules. The main systems and controls rules are also included to give users an overview of the kinds of systems and controls the firms should have in place.

### **General Insurance Telephone Sales**

The FSA have published results of general insurance telephone sales review, providing examples of good and poor practice in industry. The FSA want firms to improve general insurance sales standards when cold calling following a thematic review of a sample of firms looking at their sales process, systems and controls and whether they were treating customers fairly when selling general insurance over the telephone.

The review found that:

- The standard of sales where the customer called the firm was generally acceptable, however, the disclosure of significant exclusions and limitations could be improved;
- The standard of sales of insurance policies, such as personal accident insurance, health cash plans and accident and sickness insurance, through out-bound calls or cold calling to customers was unacceptably low.

Firms of all sizes and in all sectors were still confusing customer satisfaction and treating customers fairly (TCF) in their general insurance telephone sales business with some senior management in call centres focused exclusively on customer satisfaction data rather than any wider TCF management information.