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Current Issues Committee

Newsletter November 2006

Editor's Note: It has been a relatively quiet summer for large catastrophes and FSA publications. As a result, this issue of the current issues newsletter focuses on its International section by looking at events and changes in legislation around the world.

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

Travel insurance

American Express has undertaken research which reveals that medical claims from European holiday makers account for a total of nearly a third of all holiday insurance claims. They have urged holiday makers to take out adequate insurance cover to protect against huge medical fees that can be incurred when out of the UK. According to the research that incorporated the views of 10,000 American Express insurance customers, the average holiday insurance claim was £291.

Germany

In July, Germany's governing coalition reached a deal on overhauling both its health-insurance system and the corporate-tax system aimed at reducing companies' tax burdens. The health-insurance overhaul will mean that children's medical care (currently covered by premiums that workers and employers pay to health insurers) will be financed with tax money starting in 2008.

The Netherlands

The Dutch National Bank (DNB) has issued a discussion paper relating to the annual information provided to them by various institutions in the Netherlands. The discussion paper is intended to address the issues of a changing environment, particularly around IFRS and Solvency 2. The insurance supervisory authority wants to improve its annual and quarterly information it publishes. This change affects all of the industries, including non-life insurers, authorised by the DNB.

In September, the Dutch Association of Insurers published statistics of the Dutch motor insurance market. This showed that the rates for private motor business are decreasing rapidly and insurers face yet another period of declining results. Premium decreases have been of the order of 3% in the fourth quarter of 2005, 10% in the first quarter of 2006 and another 4% in the second quarter of 2006.

Irish Issues

Uninsured drivers

A spokesman for the Allianz insurance firm reported to the Oireachtas Committee on Enterprise and Small Businesses recently that around 100,000 motorists (approximately 6% of all motorists) were driving uninsured.

Opportunities from Reinsurance Directive

Ireland's rapid implementation of the reinsurance directive has been reported to be an added boost in maintaining the Irish economy as an attractive destination for foreign direct investment. Strong evidence has just confirmed the fact that Ireland's decision to implement the reinsurance directive before its counterparts in the EU has been prudent. Experts claim that XL Capital's decision to establish a new European reinsurance holding company in Dublin was primarily because of Ireland's decision and ability to implement the reinsurance directive before other EU countries.

Drop in motor insurance claims costs

The second report on Private Motor Insurance Statistics was published recently. The report shows that claims costs per motor insurance policy in 2003 showed a significant decrease. This has been the largest decrease in average claims costs per vehicle compared to previous development years.

High PIAB Awards

The Personal Injuries Assessment Board (PIAB) is awarding far too much to claimants with "less severe injuries", the Irish Business and Employers Confederation (IBEC) complained at an Oireachtas committee recent hearing. Tony Briscoe, IBEC's assistant director, told the Oireachtas Committee on Enterprise and Small Business that the employers' body supported a review of the level of damages awarded by the PIAB. The PIAB was set up by the Government by the PIAB Act 2003 to handle road accident and work injury claims where liability is not contested.

Central and Eastern Europe and CIS

Slovakia

The new Health Minister of Slovakia intends to change the legal status of the two largest state-owned health insurers from joint stock companies to public institutions. The change should only concern the legal status of the insurance providers Vseobecna Zdravotna Poistovna (VZP) and Spolocna Zdravotna Poistovna (SZP).

Russia

Russia is currently in bilateral talks with the US with the hope that this will help in its accession to the World Trade Organisation. However, the House Financial Services Committee believes that Russia have offered unacceptable banking and insurance provisions. The key concerns seem to relate, firstly, to the Russian proposal to permanently cap penetration by foreign banks and insurers at no more than 50% market share, and secondly not to allow firms the choice of judicial form, where US firms could branch into the region.

US and Canada

Risk focussed surveillance

The Risk Assessment Working Group (RAWG) of the National Association of Insurance Commissioners (NAIC) released a white paper proposing a "risk focused surveillance" to monitor better the solvency of property and casualty (P&C) insurers. The key purposes, among others, include:

- Better formalise and document the risk assessment process via the use of the Risk Assessment Matrix

- Expand risk assessment to provide a more comprehensive and prospective look at an insurer's risks and identification of the insurer's current and/or prospective high-risk areas.

- Co-ordinate the results of the examination risk assessment process with other financial solvency surveillance functions (i.e. establishing and updating the priority rating (CARRMEL) and supervisory plan).

Greater involvement for actuaries

On 10 June 2006 the American Academy of Actuaries (AAA) sent a letter to John Purple, Chair of the Casualty Actuarial Task Force, National Association of Insurance Commissioners campaigning for a greater involvement of actuaries at much earlier points in the regulation of solvency. Amongst other things, the AAA recommended using a greater amount of actuarial expertise in quantifying the assessment and prioritisation of risk factors and analysis of the inter-relationships among risk factors. A greater role for the appointed actuary would strengthen his/her authority, but would possibly require further training.

Changes in the requirements for the upcoming statements of opinion for 2006.

There are a number of proposed changes to the actuarial statements of opinion for 2006. The opinion now requires a discussion of risk factors even if there is no risk of material adverse development. More importantly, there is now an AOS (Actuarial Opinion Summary) that is issued separately from the opinion. It requires information as to the actuary's own range or best estimate, as opposed to just a statement that the reserves are reasonable. It also requires that, if reserves deteriorate by more than 5% in three of the last five years then the key contributors or management actions for the deterioration need to be cited.

NAIC proposal over reinsurance collateral

A task force of the NAIC agreed to draft by the year-end a proposal that would put all reinsurers (US and foreign) under a system based on financial strength ratings. Such a scheme would allow an easing of the requirement for non-admitted reinsurers to post 100% collateral for reinsurance business written in the United States. There is also some support for having a single US regulator supervising alien reinsurers and many are pushing to adopt the National Insurance Act of 2006, which would allow insurers the option of chartering federally and would create a federal-level insurance regulation.

RoyalSun & Alliance de-lists from the NYSE

The UK insurer, RoyalSun & Alliance (RSA) has de-listed from the New York Stock Exchange (NYSE).

California auto insurance rules to be pushed elsewhere

In July, California's insurance commissioner ordered auto insurers to reduce the weight they give to the home address of a driver when setting rates. This followed a study of insurance rates in the state. Activists involved say they will push for similar changes in other states, but insurers are still questioning the validity of the study that triggered the commissioner's decision.

The study by Consumers Union, a non-profit consumer advocacy group, concluded that ZIP code-based pricing resulted in disparities that had drivers living across the street from each other, but in different ZIP codes, paying dramatically different rates for auto insurance. The investigators have countered the statistical arguments given by insurers by saying that there is also a marketing component to address-based rates. Customers in upscale suburban areas get a better deal because insurers hope to sell them multiple policies, and poorer urban renters pay a higher price to cover it.

Other states' insurance officials are likely to be paying attention to the debate.

Emergency rule for commercial property insurance

In response to a number of complaints from businesses, the Florida cabinet approved an emergency rule in August designed to provide insurance coverage for Florida business owners who are unable to insure their commercial properties. A 1986 statute allows the Office of Insurance Regulation to create an association to facilitate commercial property insurance coverage if enough businesses appeal to the state for help.

The rule will create a commercial property insurance pool if at least 100 commercial properties within a three-month period request coverage, or if at least 200 properties seek coverage within one year. Private insurance companies will write the policies and a state-run reinsurance pool will be taken from those premiums. Although the program will make policies more available, it may do little to make insurance more affordable for businesses faced with up to 1,000 percent increases in premiums.

Hurricanes

The annual Casualty Loss Reserve Seminar, co-sponsored by the Casualty Actuarial Society and American Academy of Actuaries, discussed unique loss reserving challenges facing actuaries after the unprecedented strong storms that have struck the US during 2004 and 2005. Many companies insuring Florida homeowners had to increase their reserves during 2005 for 2004 claims, and so technical methods were presented at the seminar to help insurance companies and their actuaries more effectively assess reserve needs on hurricane claims.

Bermuda

The Bermudan Monetary Authority (BMA) is in the process of planning for the introduction of a risk-based capital regime. This would result in the further enhancement of the capital adequacy framework.

Australia and New Zealand

New General Insurance standards

The Australian Prudential Regulation Authority (APRA) has issued new standards relating to the capital requirements for general insurers that bring the country's systems in line with international financial reporting standards. The new standards are intended to follow IFRS to a large extent. The standards include a new definition of Tier 1 capital instruments and new limits on Tier 1 capital (which needs to make up at least 50% of the capital an insurer holds). The new standards are set to take effect from 1 January 2007, while new standards relating to risk and reinsurance management take effect from 1 October 2006.

Increased personal liability exposures

Amended provisions of the New South Wales Protection of the Environment Operations Act have removed the defence of "no knowledge" for directors and managers who now face new personal liability for environmental pollution caused by a company. Even non-executive employees are now liable for the corporation's offence, since the Act applies to all those who are "concerned in the management of the corporation".

APRA and MAIC

APRA has formalised an information sharing agreement with the Motor Accident Insurance Commission of Queensland (MAIC). The MAIC oversees compulsory third party motor insurance and is effectively an insurer of last resort should an insurer become insolvent. The agreement formalises the working relationship between APRA and MAIC. APRA has also entered similar agreements with other agencies in the past.

This is of particular interest to the UK because of the gender rules and the consequential need for market data to be maintained which demonstrates the validity of differential rates.

Vision 2020 task force

While of particular interest to Australian actuaries, this paper also contains some useful information on the actuarial industry in Australia which may be interesting for those not necessarily working in the region.

The Vision 2020 Task Force was established by the Institute of Actuaries in Australia (IAA) to consider and generate discussion within the membership of the IAA relating to the principles on which it should base its strategy, what high level directional changes in strategy these imply and what key issues its members need to consider over the coming years.

The key conclusions of relevance to General Insurance (GI) actuaries were as follows:

- GI and health actuaries may see continued growth in the employment demand over the medium term in Australia and New Zealand. There is strong and growing demand for all actuaries in Asia (Indonesia to India and up to China).
- Communication skills and leadership qualities will be important for substantial success.
- There are a number of important questions around what level of qualification should be titled "Actuary". It has been proposed that the current "senior associate" level might be changed to "Actuary".
- The education syllabus needs improvement, including possibly separating the current Part I from that of the UK Institute of Actuaries' syllabus and review, restructure and modernise it. Also, more material is required around communication and business skills. Finally, a complete overhaul of the Part III and CPD parts of the syllabus is proposed.
- The IAA should be more proactive in domain development for the profession. Also there has been discussion of "co-branding" risk management actuaries with other qualifications.
- It is important that the work being done in research and development is maintained or increased.
- Marketing and public relations of the profession should be improved both for those joining the profession and for employers and the community in general.
- A standing review of the IAA governance and quality assurance every few years is suggested.
- It will be important for the IAA to offer more support to members outside of Sydney and Melbourne. Discussion is also encouraged around the support for those in New Zealand and Asia – and possibly the education syllabus could be less Australian centric.

The discussion paper is available off the IAA website at www.actuaries.asn.au.

Asia-Pacific

China

New regulations and rules on insurance

The China Securities Regulatory Commission (CSRC) has approved a series of regulations and rules on insurance. These include the Administration Rules on Health Insurance, the Administration Regulations on Qualification of Members of Board of Directors and Senior Management Personnel of Insurance Companies (draft), and the Administration Rules on

Representative Offices Launched by Foreign Insurance Institutions in China (draft for amendment).

The Administration Rules on Health Insurance are likely to be published first and will standardise health insurance and the operation of health insurance in China. The rules will cover operation conditions, products, sales, actuarial evaluation and reinsurance.

Mandatory motor insurance

Effective from 1 July 2006, owners of China's 130 million cars, motorcycles and tractors are required to buy insurance under a rule issued by the China Insurance Regulatory Commission (CIRC). The city of Shanghai will use floating premium rates rather than the nationwide practice of flat rates, in line with procedures introduced in May 2004. This means that drivers with bad records will need to pay up to 70% more for their coverage while good drivers will get a 30% discount.

Local mandatory policies bought before 1 July will remain effective until the policy's expiration, when they will transfer to the national plan. Drivers can also buy commercial vehicle insurance to supplement their mandatory coverage.

The law requires that when an accident occurs between a motor vehicle and a pedestrian or cyclist, the driver must compensate for deaths, injuries and other damage, unless there is evidence to prove the other party deliberately caused the accident.

Hong Kong insurers urge government action on health insurance

In Hong Kong, insurers have warned that consumers will continue to pay hefty premiums if the government keeps delaying its medical financing plan to cope with the ageing population. Suggestions have been made that the government should explore compulsory universal insurance schemes and give tax incentives to those who can afford to buy top-up insurance. According to the Hong Kong Federation of Insurers, only about 2 million of Hong Kong's 6.9 million people have medical insurance. The insurance sector legislator said that packages offered by medical insurers were unattractive because premiums were high and there were many exclusions and stringent age limits.

2 Claims and Legal

UK Asbestos

The Treasury is considering changes to the Financial Services Compensation Scheme (FSCS) to broaden the circumstances in which insurers can claim a contribution directly from the FSCS in mesothelioma cases.

The changes are required because of the Compensation Act 2006, which enabled mesothelioma claimants to claim full compensation from any liable person. The person who has paid the compensation was then required to seek a contribution from other negligent parties. The change in the law was to reverse a recent House of Lords decision, on the grounds that requiring a claimant to trace all relevant defendants was too onerous, or in any case increase the time needed to get compensation.

Because the FSCS is a fund of last resort, it would not have any involvement in a claim that has already been settled in full by a solvent insurer. The Treasury and the FSA are therefore proposing to amend the FSCS to enable an insurer who has settled a claim to recover a contribution from the FSCS where the exposed person has developed mesothelioma and could recover compensation from the FSCS, but has chose to pursue their claim against an employer with a solvent insurer.

On a different matter, the Treasury announced at the end of October 2006 that the government would bring forward legislation to ensure that Turner and Newell workers would be exempt from a scheme that requires compensators to return DWP compensation payments. This compensation recovery scheme was designed to ensure that tax payers did not subsidise compensators. The step taken by the government reflects the fact that in the case of Turner and Newell, a trust fund has been set up to meet the liabilities and the parent, Federal Mogul, is insolvent.

A little piece of England in Nebraska

Underwriters have been reminded the contract clauses requiring that English law and jurisdiction may not always be enforceable. A Catlin policy specified that the contract was under English law. However, the contract also referred to Amended Lloyd's Restricted Perils form NMA 2072. A court in Nebraska ruled this allowed the jurisdiction to be changed. Having won their case in the English courts, Catlin now face an away match in the US courts.

NHS Recovery Charges

The NHS injury costs recovery scheme will be implemented in January 2007 and applied to accidents after this date. Details of this scheme were included in the recent Health Bill. The scheme allows for NHS hospital treatment to be recovered from a liable party under a published tariff. This scheme will also allow other charges to be recovered including ambulance fees, and the effects of contributory negligence.

3 Market News

Names' action doomed

In November 2006, more than 1,000 Lloyd's Names failed in their attempt to win compensation against the Treasury in the High Court. The Names were claiming that successive UK governments breached their responsibility under a European Insurance Directive for more than two decades, leading to significant losses. The trial lasted four months and the outcome was expected to determine whether the individuals would be allowed to bring actions and, if so, whether the claims are time-barred. The Names lawyers have said that they may appeal against this High Court decision. The Treasury have strongly refuted the allegations that it "failed to properly regulate the Lloyd's market" and have welcomed the High Court ruling.

Motor rates must rise

The AA has called on motor insurers to increase premiums to combat continued rising claims costs. The AA's latest Insurance Premium Index shows that comprehensive premiums rose by less than 0.5% in the second quarter of 2006. According to the same index, premiums fell by 0.5% during the previous quarter. The motor market has failed to make a profit since 1994, producing a combined operating ratio of 102.2% in 2005. Experts are predicting that 2006 will produce an even worse result unless rates increase significantly – with predictions that the combined operating ratio could slump to as much as 110% for this year.

. . . and they are

Norwich Union has announced that it is going to increase its motor rates by an average of 16%, with higher risk groups such as young drivers facing even larger increases. The insurer reported a £33 million underwriting loss on its private motor book for the first six months of this year – more than double the loss reported for the first half of 2005. Fortis have also indicated that they will increases motor rates in order to head-off a predicted underwriting loss for 2006.

While other rates fall

Solicitors' professional indemnity rates have been driven down by up to 25% because of high levels of competition, according to experts. This compares with predictions before the 1 October renewal date which estimated decreases in the order of 10% - 20%.

Lloyd's plan for levy cut

Lloyd's has announced its intention to cut the Central Fund levy to below 1% of capacity in 2008, one year earlier than previously planned, in an apparent move to increase the attractiveness of the market to capital providers. The levy was doubled last year from 0.5%, to the current level of 1%, owing to the fall in funds caused by the dispute between Lloyd's and the six reinsurers of the Central Fund. However, experts have warned that Lloyd's plan to cut the levy earlier than planned could be foiled by another damaging hurricane season.

Independent news

The run-off of collapsed insurer Independent Insurance is expected to be finalised by 2009. PricewaterhouseCoopers, the insurer's liquidator, is gearing up to ask permission from Independent's creditors to set up an "estimation scheme of arrangement". This is a compromise agreement that will enable the distribution of assets to Independent's creditors. It will mean that Independent's liabilities will be ring fenced and claims against Independent will have their value frozen.

Meanwhile Michael Bright and two other top executives of Independent Insurance have pleaded not guilty to the charge of conspiracy to defraud in relation to the insurer's collapse in June 2001. A trial is expected early next year.

Hiscox favouring Bermuda

Hiscox is abandoning London in favour of Bermuda, in order to take advantage of a more favourable tax and regulatory regime. The Lloyd's insurer will re-domicile to Bermuda by the end of the year, subject to a number of regulatory approvals. Hiscox concluded that there were "significant advantages" in moving the group's domicile to Bermuda and will become the second Lloyd's insurer to leave London in favour of Bermuda, after Catlin in 2002. Omega Underwriting Holdings has also announced plans to move its headquarters from London to Bermuda.

Meanwhile, Atrium has ruled itself out of becoming the next Lloyd's insurer to abandon the London market in favour of Bermuda. The company has said that it has no intention of re-domiciling to the offshore market or establishing a subsidiary on the island.

D&O boost

The high-profile case of the three former NatWest bankers, accused of fraud, is expect to boost sales of D&O policies. Insurers are understood to have been inundated with D&O policy queries from company executives, concerned by the recent extradition of the so called NatWest Three. However, experts do not expect D&O premiums to rise.

4 Solvency 2

CEIOPS Consultation Papers 13 and 14

In July CEIOPS published two consultation papers containing draft advice from CEIOPS to the EU Commission. These papers were published for consultation and feedback ahead of submission to the EU Commission.

Paper 13 discussed internal capital requirements. CEIOPS' draft advice included rules on the Pillar II requirements for an insurer to provide the result of the SCR calculation along with analyses of how much capital an insurer actually needs (Internal Risk and Capital Assessment – IRCA) and the interaction of this SCR and its business plans. CEIOPS advises that these analyses should include stress tests and be forward looking.

Paper 14 discussed diversification effects and the treatment of the MCR and SCR for group insurers. A group's diversification benefit is defined as difference between the sum of the individual SCR amounts and the group SCR as calculated by a group internal model (using consolidated data if necessary). CEIOPS advises that group specific risks should be allowed for in the diversification effect and that the capital benefits of diversification should act to increase the capital of solo entities rather than reduce the capital requirements. CEIOPS also concludes in Paper 14 that group MCR amounts are not necessary.

Paper 14 also discusses the treatment of insurers whose head offices are outside the EU and the governance of such insurers. For those insurers where the head office is within the EEA, CEIOPS does not see problems where such regimes have equal standards but where those standards are below the EU regime, capital charges may apply to the EU operations of such insurers. In particular, CEIOPS will want to ensure that risks from such insurers are properly addressed. For insurers where the head office is outside the EEA, CEIOPS recommends a process of ring-fencing assets if needed.

New Solvency 2 Website

The International Underwriting Association recently announced the launch of a new website (www.solvencyii.co.uk) providing information and issues for non-life insurers. The website provides a background to Solvency 2 with a history of the EU directives going back to the 1970s. The website also gives the latest timetable and a list of topical issues.

The website has some useful diagrams and an overview of the differences between Solvency 1 and Solvency 2. It defines a lot of the terms commonly used in Solvency 2 gives a high level view of the new approach to estimating liabilities: best estimate plus risk margin.

The timetable outlined by the IUA has 2010 as the year for which this new regime will come into force.

Quantitative Impact Studies

Insurers submitted data for QIS2 at the end of July 2006 and the results are expected to be available shortly on the CEIOPS website. We hope to discuss further in our next current issues newsletter. The aim of QIS2 is to assess the effect of the new solvency system on insurers' balance sheets and in particular new capital requirements under various proposed approaches.

The Institute of Actuaries submitted a response in July to CEIOPS on QIS2. The UK actuarial profession made specific comments on the SCR and MCR formulae. The response can be viewed on the Institute of Actuaries website.

A further study, QIS3, is expected to take place in the second quarter of 2007 with a focus on calibration and group issues.

5 Government and Regulatory Issues

EU gender directive

The UK government looks set to endorse a controversial gender directive from the European Commission that will make it illegal for insurance companies to take into account differences in sex when setting insurance premiums. This European gender directive needs to be incorporated into UK law by December 2007. The Directive provides two options, either:

- member states must ban all differential treatment based on gender in the provision of insurance products; or

- member states can allow gender-based treatment subject to conditions about the relevance and accuracy of the data on which the differences are based, and about the publication of gender-related data (the 'opt-out' option).

The UK government has chosen the opt-out option, which should apply to all classes of insurance. The details of the implementation of this directive remain to be decided and the UK government will be conducting two consultations – the first in the autumn of 2006.

The implications of insurers having to use published gender-related data could include: the restriction of new entrants into the market and the competitive environment; the ability of multivariate analyses; and the ability to anticipate trends.

FSA Consultation Paper 2006 / 16

Individual Capital Adequacy Standards (ICAS)

The FSA proposes to introduce sub-principles and further guidance to help insurance firms understand the FSA's expectations when completing their Individual Capital Assessments. The guidance takes into account developments in Solvency 2 based on discussions with CEIOPS and other EU institutions.

The Association of British Insurers (ABI) has issued a draft industry guide, prepared by the ABI, Lloyd's, the LMA and the IUA, complementing the FSA's proposal in CP 06/16.

Financial Reinsurance

The FSA intends to amend the Interim Prudential Sourcebook (IPRU(INS)) and the Lloyd's sourcebook to require insurers to disclose certain information about financial reinsurance. These changes are based on CP 05/14 with some modifications. These changes will come into effect on 6 October 2006.

Reinsurance Directive

The FSA intends to carry out proposals regarding the Reinsurance Directive covered in the July edition of the Current Issues Newsletter. Further details are provided in CP 06/12.

Improving the Safety of Young Drivers

The ABI has launched a campaign to reduce the number of young drivers (ages 16-19) killed or seriously injured on British Roads. This campaign results from the fatalities involving young drivers increasing from 10% in 2000 to 12% in 2005. The proposal involves building on the foundations of the Pass Plus scheme for new drivers.

Insurers Call for More Spending on Floods

The ABI has warned that Government spending on flood defences needs to increase by 10% a year to £750 million by 2011 to deal with the growth in flood risk. Over half a million homes (570,000) are at high flood risk, compared to the estimate of 220,000 when current flood spending levels were set in 2002.