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PPOs – What's the market doing?

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Note

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These slides were presented at TIGI 2019. They represent views from the perspective of insurers and reinsurers.

If you have any questions, please contact Sharon Cumberbatch at the IFoA who will be able to put you in touch with the IFoA PPO Working Party members. Alternatively get in touch directly, our details are given at the end of the presentation.



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2018 PPO Working Party Qualitative Survey

- Conducted telephone interviews with senior actuaries and claims staff from various insurers and reinsurers regarding their exposure and approach to PPOs
 - Recent view – interview conducted in early 2019
 - All analysis presented relates to these interviews unless otherwise stated
 - 13 insurers and 5 reinsurers.



Agenda

- Actuarial methodology
 - Level of concern
 - Reserving methodology (excluding Ogden discount rate)
- Ogden discount rate
- Reinsurance and alternative risk transfer
- Investment
- Conclusions





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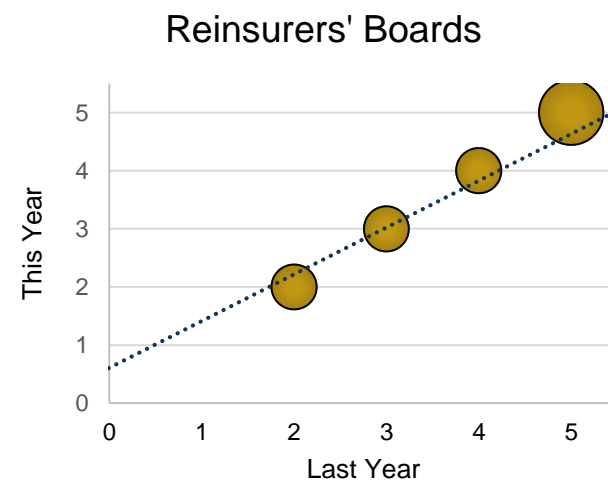
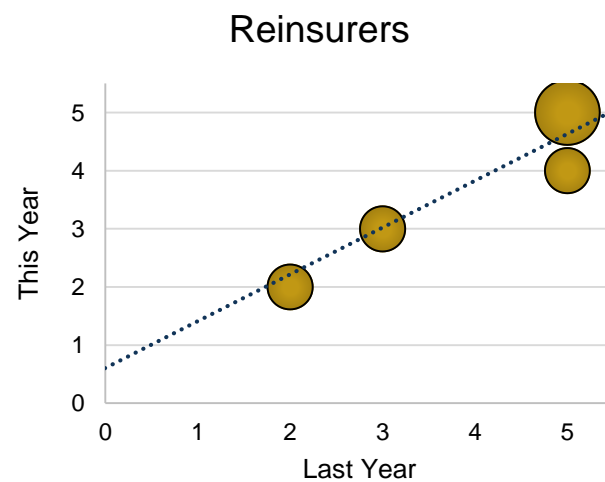
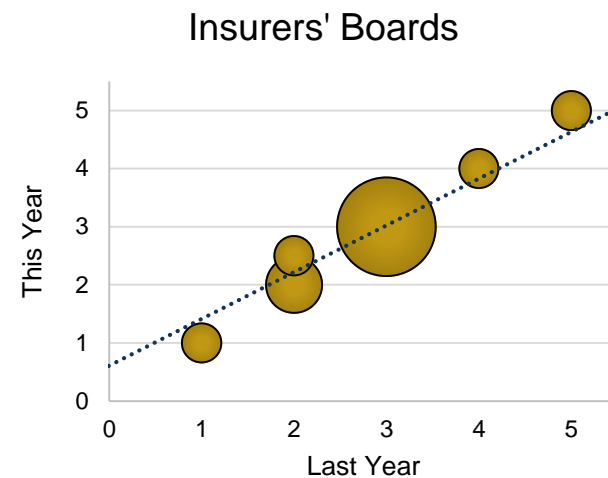
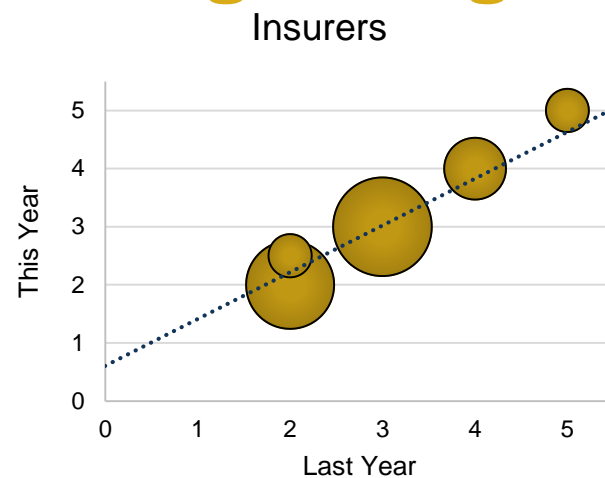
Actuarial methodology

Level of concern

26 April 2019

Level of concern regarding PPOs

- Chart showing concern levels between years
- Scale of 1 to 5, with 5 representing most concerned
- The average score for insurers was 3.0 and 2.8 for their Boards
- The average score for reinsurers was 3.8 and 3.8 for their Boards.



Reasons behind insurer / reinsurer concern

- Why no change (16):
 - Uncertainty with regard to the Ogden discount rate
 - Market propensity continues to fall
 - Concerns around investment and return on assets, but happy with methodology.
- Why increase (1):
 - PPO propensity may increase depending on the decided Ogden discount rate.
- Why decrease (1):
 - Ogden discount rate change reducing PPO propensity.



Reasons behind Board concern

- Why no change (16):
 - Uncertainty around Ogden discount rate has reduced PPO propensity
 - The number of PPOs within the book is small and therefore less of a concern than other issues
 - Growing focus on Solvency II measures; the volatility that PPOs cause in the balance sheet is an issue.
- Increase (1):
 - PPO propensity may increase depending on the decided Ogden discount rate.
- Why decrease (1):
 - PPO propensity fallen due to Ogden discount rate change.



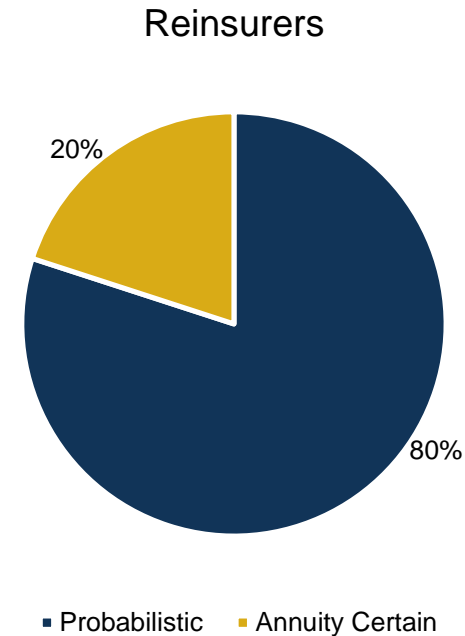
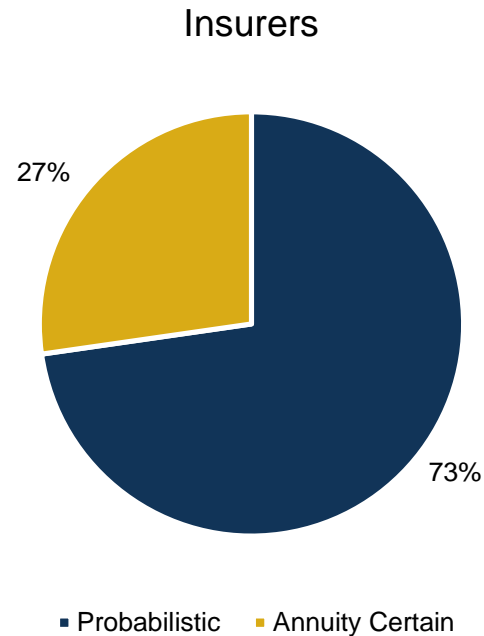


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Actuarial methodology

Reserving methodology

How do you reserve for settled PPOs?

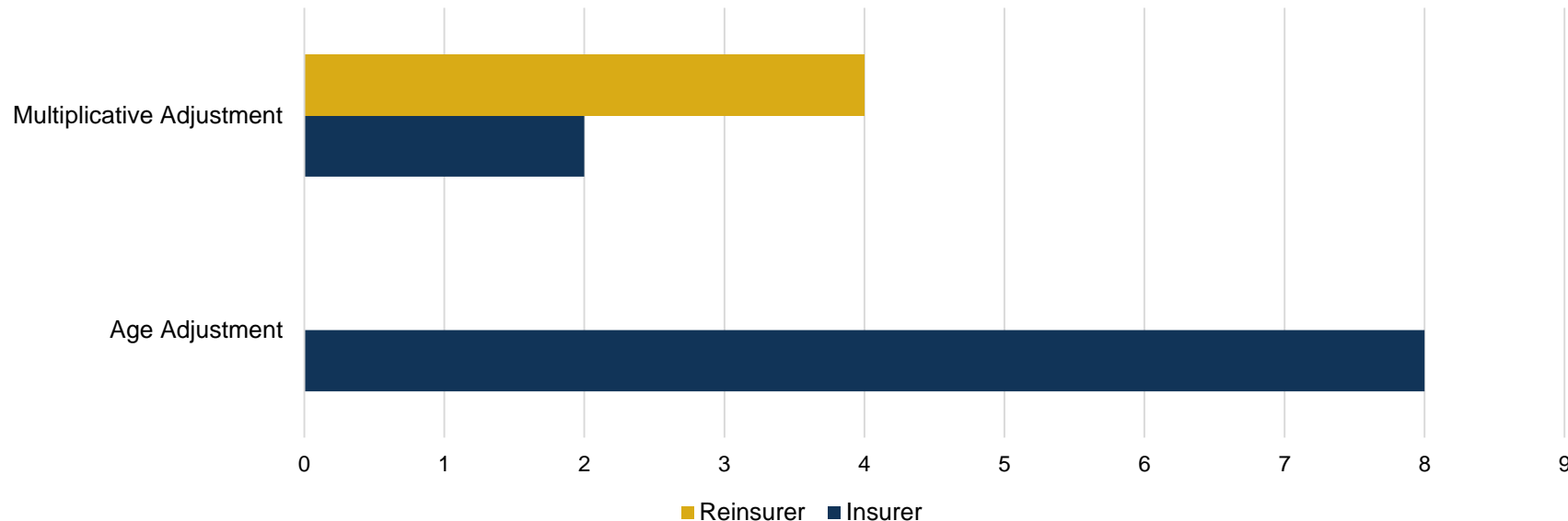


- The majority of those asked based their life expectancy on an average between their own medical expert's view and the view from the claimant's team.
- Almost all those asked had not changed their reserving methodology in the last year.



How do you reserve for settled PPOs?

- How do you scale your life table?
 - Multiplicative adjustment: assumed that the claimant had a mortality experience “z” times more than the life tables suggest
 - Ageing adjustment: considered the claimant had the mortality experience of someone “y”-years older than their actual age.



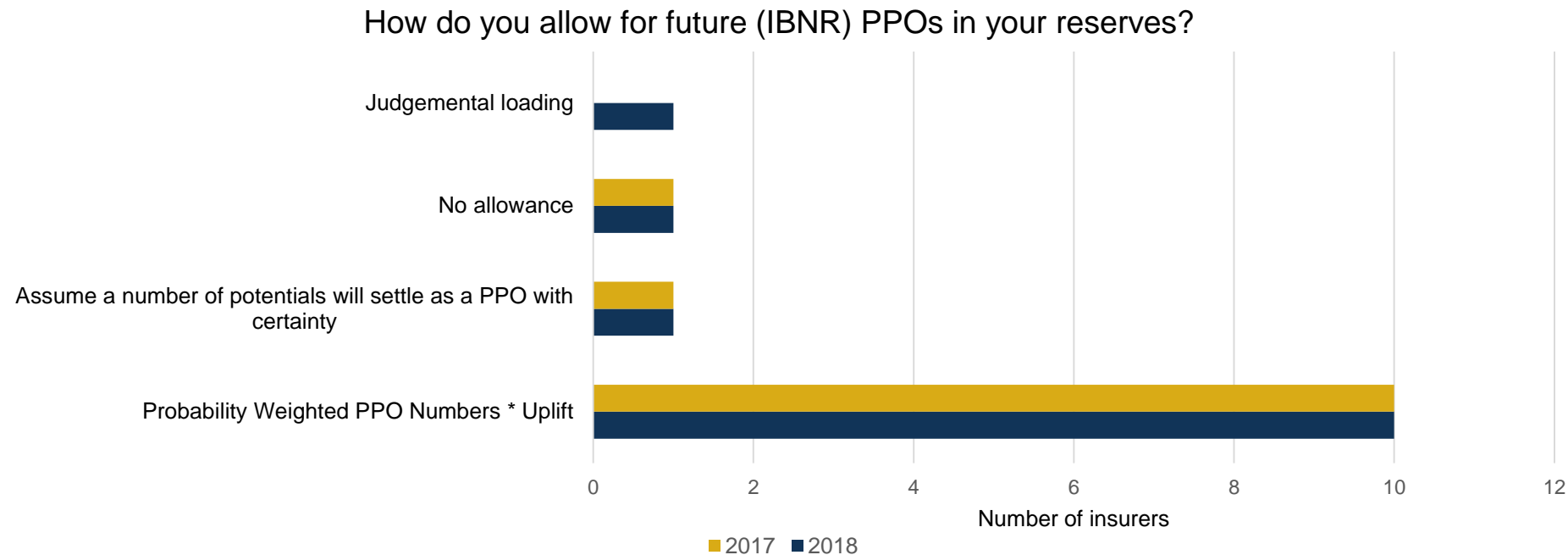
IBNR PPOs – identification

- All insurers and reinsurers said that they monitored their open claims and assessed the probability of them becoming PPOs.
- Not all claims were monitored by all participants:
 - Some only looked at a certain number by injury outstanding estimate
 - Some only looked at open large claims > £1 million
 - Some did look at every injury claim individually.
- Indicators used included injury type (particularly mental capacity), age, annual care cost.
- Insurers reviewed potential PPOs quarterly, half-yearly and some annually.
- A combination of historical propensity data and IFoA PPO Working Party propensities applied to claims split by large claim threshold was perhaps the most common approach.
- The majority of insurers and reinsurers monitored the accuracy of their predictions.
- All reinsurers noted that their notification rules for PPOs did not differ by cedant.



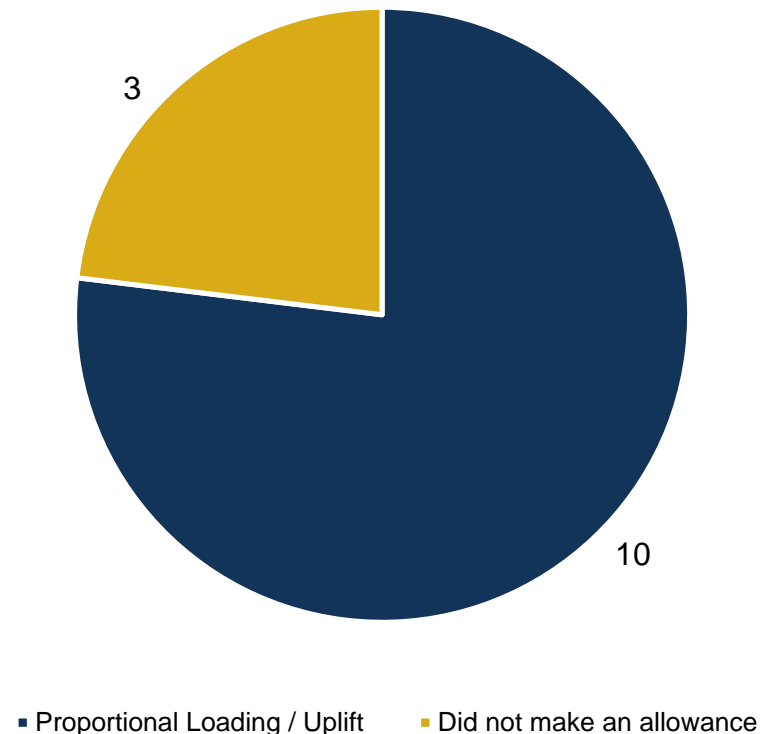
IBNR PPOs – reserving

- The chart below shows the approaches taken by insurers in relation to claims already identified as large claims. All reinsurers used a “Probability Weighted PPO Numbers * Uplift” approach.



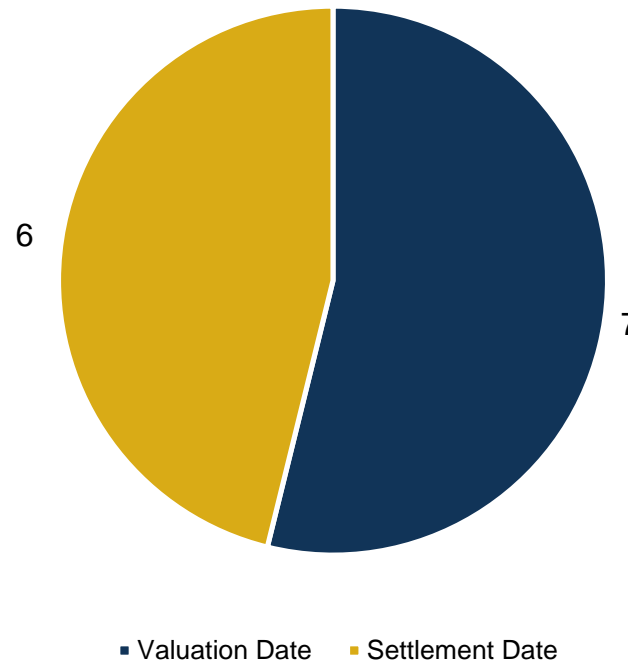
Pure IBNR PPOs – reserving

- The majority of those Insurers asked considered pure IBNR PPOs (in relation to claims not yet reported) and added a proportional loading to the PPO reserves.



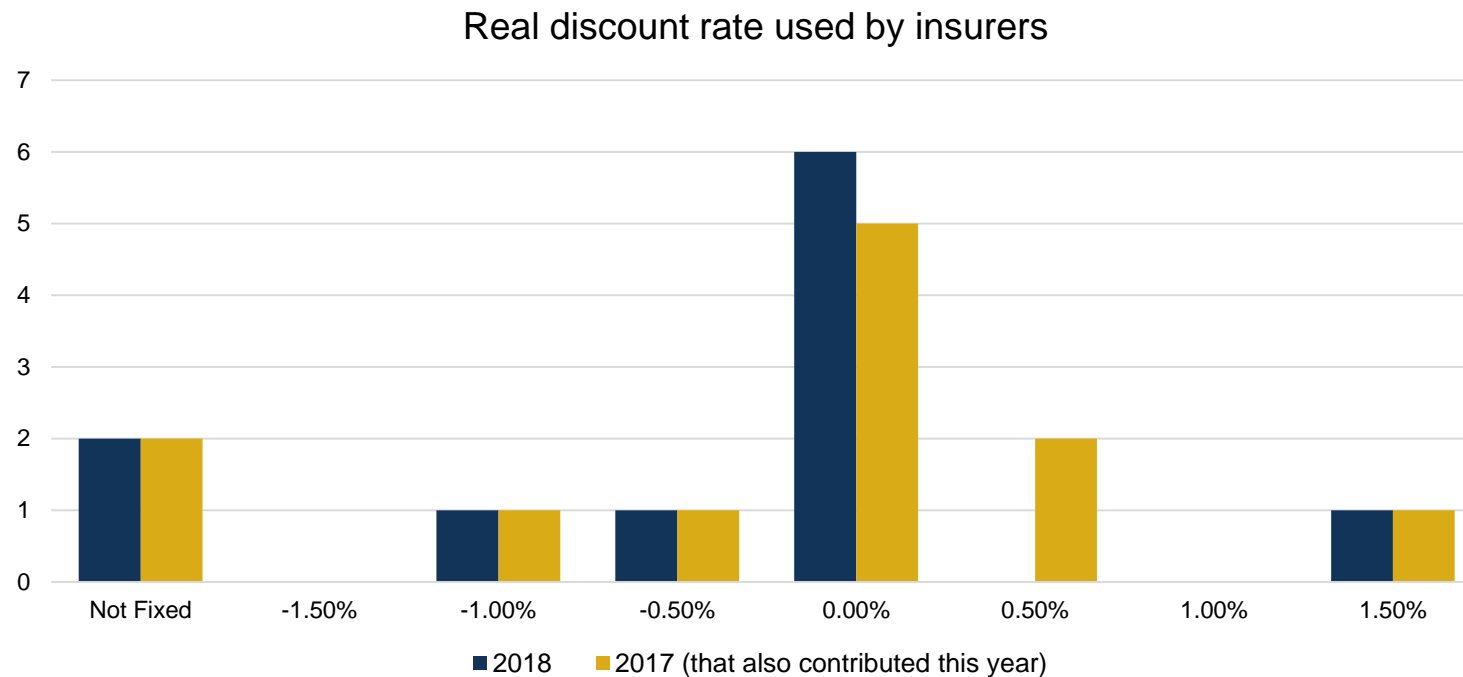
IBNR PPOs – discount to what date?

- 7 Insurers discounted to valuation date and 6 to expected settlement date under UK GAAP or IFRS.
- All those asked said their reserving methodology for IBNR PPOs had not changed in the last year.



Discounting – real discount rate (GAAP or IFRS)

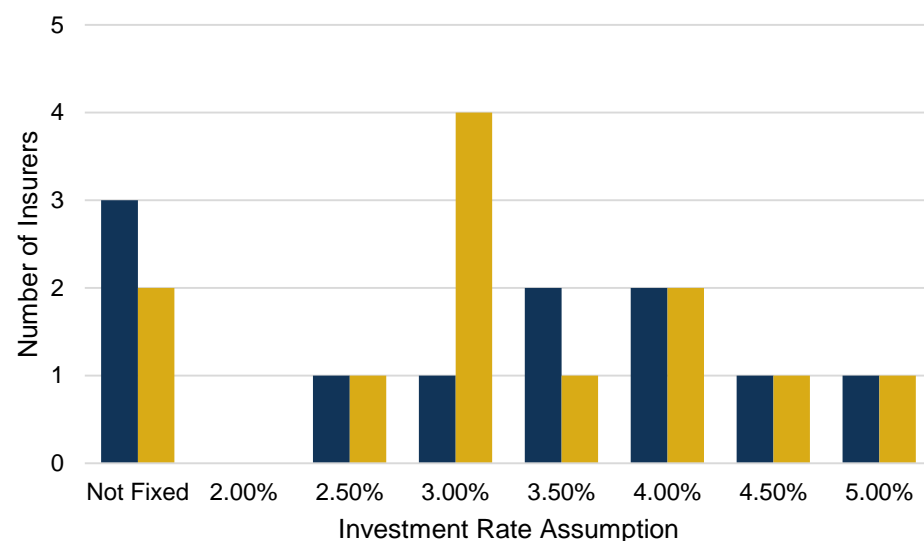
- For insurers, the most popular real discount rate remained at 0% per annum.
- There has been no significant shift in real discount rates when compared to last year.



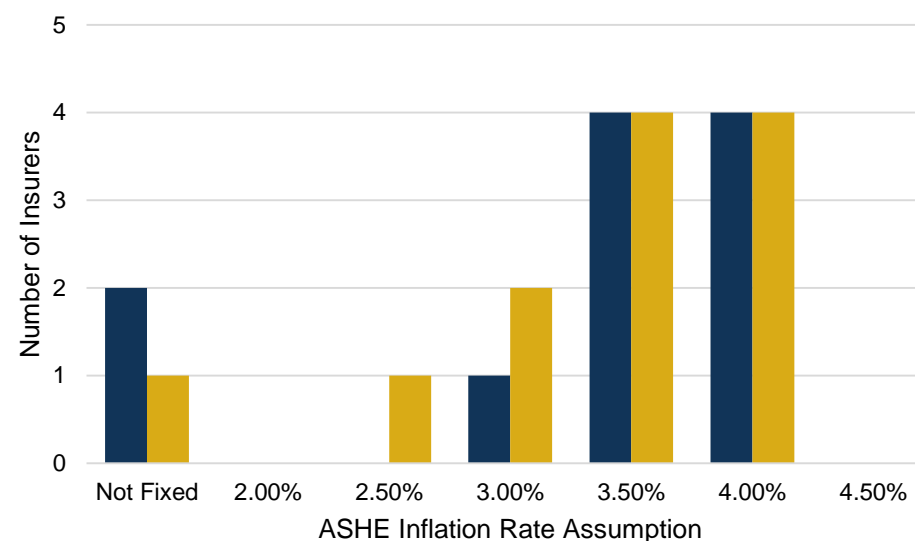
Discounting – components of real discount

Investment return and ASHE inflation assumptions (GAAP or IFRS)

- Rates which weren't fixed tended to follow risk free yield curves or were based on risk free yield curves with an adjustment.
- Long term yields were generally based on the current assets held by the insurers
- Future ASHE was derived using historical ASHE and RPI mostly.
- The majority of insurers now feel that ASHE 80 is now the default ASHE percentile.



■ 2018 ■ 2017 (that also contributed this year)



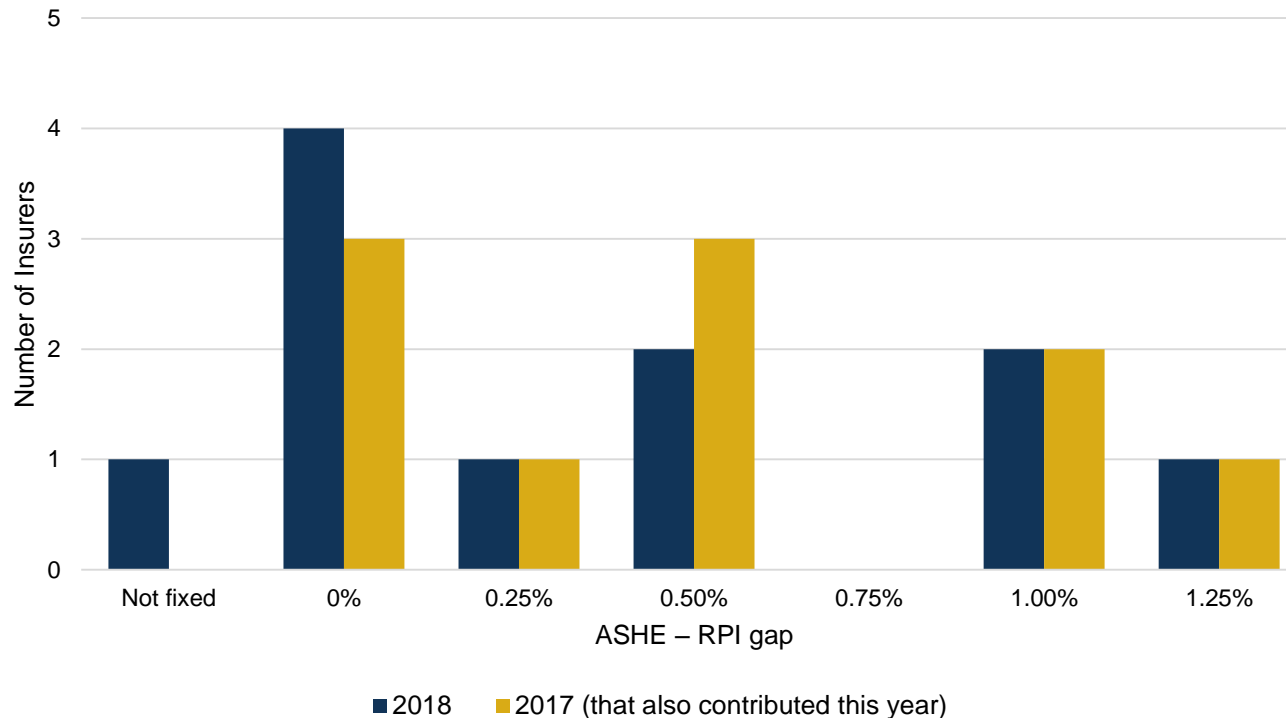
■ 2018 ■ 2017 (that also contributed this year)



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What gap is assumed between RPI and ASHE

- We asked what the gap was between the Insurers' RPI and ASHE inflation long term assumptions
 - Contributors assumed a range of gaps, with the majority between 0% and 0.5%.
 - In all cases ASHE inflation was assumed to be higher than RPI.
- All insurers now regard the 80th percentile as the default ASHE percentile.



Discounting – reinsurers (GAAP or IFRS)

- All but one of the reinsurers did not discount due to US GAAP reporting requirements.
- The one that did discount had a real discount rate of 0% per annum.
- ESG projections taking into account historic ASHE and CPI fed their inflation assumptions.
- All of the reinsurers ASHE inflation was assumed to be higher than RPI, and the ASHE 80th percentile was regarded as the default ASHE percentile.



Variation orders and bad debt

- Although there were a significant number of PPOs with variation orders, and some with indemnity / reverse indemnity guarantees, only four insurers said they allowed explicitly for these when valuing their PPOs.

	Variation Orders	Indemnity Guarantees	Reverse Indemnity Guarantees
Total for Insurers	84	0	14

- Reinsurers that provided this information had 111 variation orders in total and 44 reverse indemnity guarantees, and none of them allowed explicitly for these when valuing their PPOs.
 - N.B. some of the variation orders and guarantees may be in both the insurer and reinsurer totals.
- Two insurers and one reinsurer allowed for bad debt under UK GAAP / IFRS / other, but all must under Solvency II.
 - Those that did allow for bad debt did so using a probability of default * loss given default method



Uncertainty in reserving

- All insurers quantified the reserve uncertainty in PPOs, about half stochastically and the other half using scenario tests.
- Four out of five reinsurers explicitly quantified PPO reserve uncertainty, three using scenario tests and one using a stochastic method.
- A variety of correlations were assumed with other large losses, varying from no explicit correlation to 100% correlation.
- The CVs for the gross PPO uncertainty ranged from 12% to 100%. The CVs for the net PPO uncertainty ranged from 15% to 85%. There was, however, inconsistency between responses in terms of whether it was settled, potential or pure IBNR PPOs being considered, which gives rise to the wide ranges quoted.
- The majority of settled PPO gross / net CVs were between 20% and 35%.



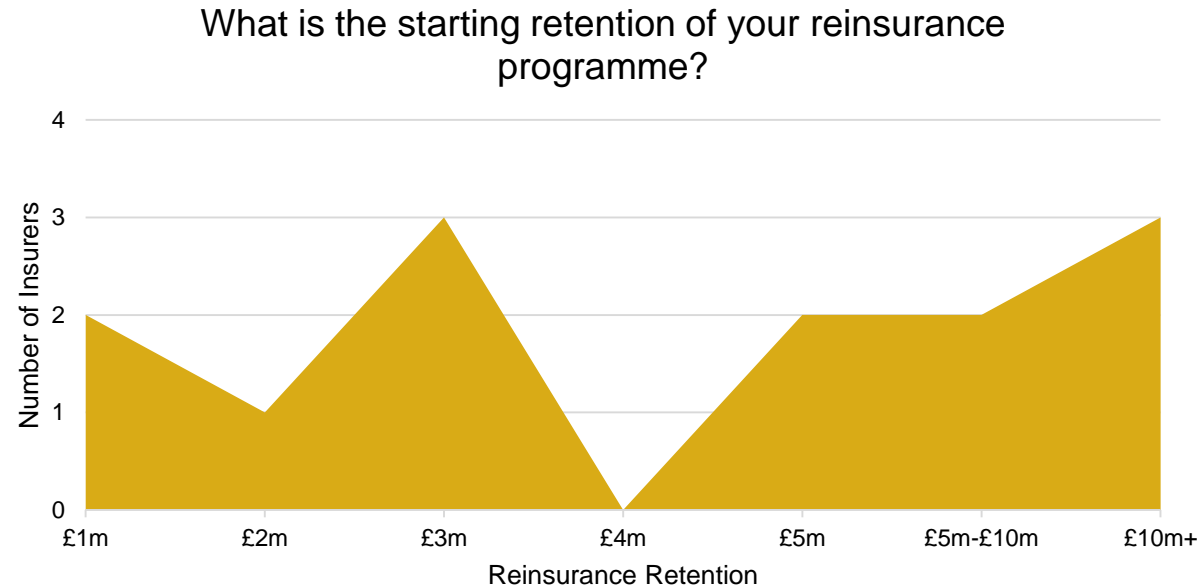


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Reinsurance and alternative risk transfer

26 April 2019

Reinsurance in the market



- Only one of the 13 insurers said that their reinsurance programme had changed as a result of PPOs.
- We also asked insurers whether they took the impact of the cost of capital into account when buying reinsurance – 11 insurers said they did.



Reinsurance availability

- All of the reinsurers asked stated that their reinsurance offerings had changed due to PPOs:
 - They also noted that their reinsurance offering had not changed as a result of the recent Ogden discount rate change.



Capitalisation clauses

Capitalisation clause: allows (or even compels) the reinsurer to settle an individual PPO liability as a lump sum with the insurer, on a pre-agreed bases, once such an award has been made / agreed.

Three main contract types offered are:

- **Uncapitalised:** Traditional "Pay as Paid" basis with inflation-linked deductible, recoveries made throughout the lifetime of the claimant.
- **IUA Capitalisation:** Lump sum capitalisation at time of settlement, allows for life impairment typically by way of medical expert opinion. Full and final settlement.
- **Delayed 20 Capitalisation:** "Follow the fortunes" for 20 years then lump sum capitalisation 20 years after expiry of reinsurance treaty. Typically assume unimpaired mortality for lump sum.



Reinsurers' view on capitalisation clauses

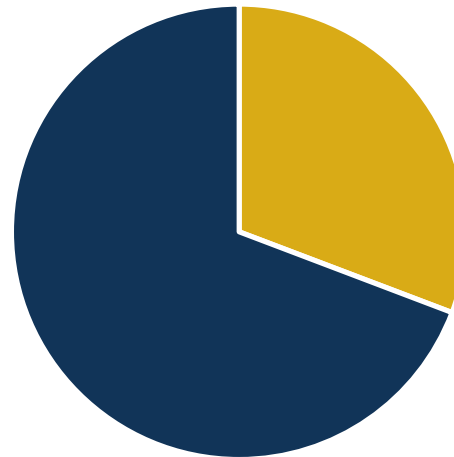
- Two reinsurers insisted on capitalisation clauses while one used them on a case by case basis.
- Reinsurers stated that capitalisation clauses are to improve their profit and loss account.
- Reinsurers stated a few PPOs had been capitalised already.



Insurers' view on capitalisation clauses

- Four of the insurers surveyed said that they had a capitalisation clause on their reinsurance contracts.

Do you have a capitalisation clause in your reinsurance contract?



■ Yes ■ No

- Of those that did not have a capitalisation clause, the clear majority stated that they were keen to avoid them.



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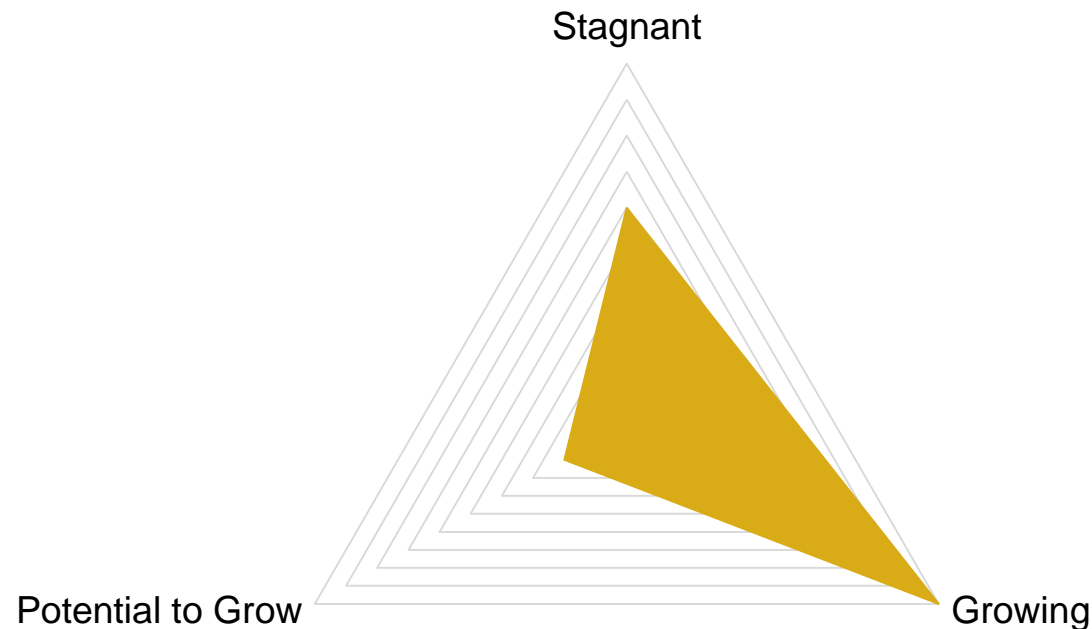
Risk transfer – hurdles

- All insurers would consider transferring the risk associated with PPOs if the right option arose
 - Some insurers already had arrangements in place to transfer the risk of PPOs other than reinsurance.
- The most significant hurdles mentioned were cost of any options and the lack of solutions on the market.
- We asked respondents, if concerns around anti-selection could be mitigated, would they consider pooling settled PPO cases with other firms. All but one said that they would.



Risk transfer – growing or changing

- A higher proportion of Insurers stated that they felt the risk transfer market was growing than in previous years.





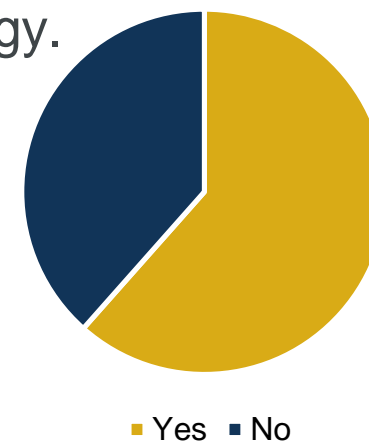
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Actuarial methodology

Investment

Investment strategy

- Eight of the thirteen insurers said that they have changed their investment strategy as a result of PPOs, however only four of these had changed their investment strategy in the past year. None of the reinsurers said that they had changed their investment strategy.



- Of these, two insurers said that they have ring-fenced assets specific to PPO liabilities, although others have long duration assets to cover all longer term liabilities.
- Insurers held a variety of assets to back PPO liabilities such as long-dated gilts, corporate bonds, equities, hedge funds and property.



Investment issues



- The two biggest issues relating to PPOs that both insurers and reinsurers said they faced when asked were:
 - The exceedingly long duration associated with PPO liabilities
 - The inability to find assets that track a similar index to ASHE.





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Ogden discount rate

26 April 2019

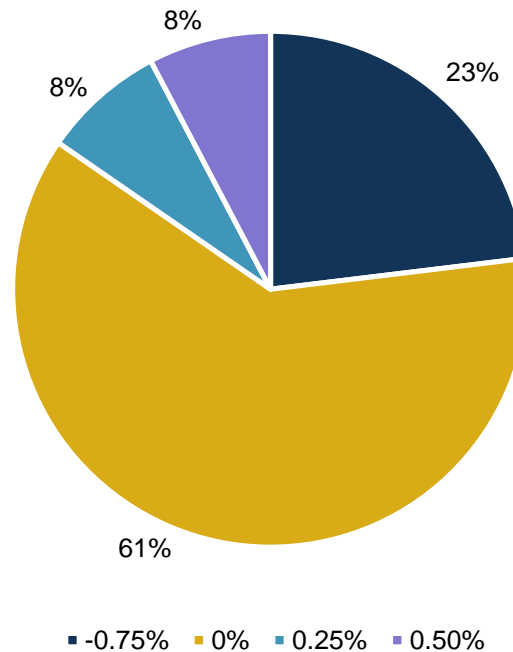
Ogden discount rate update

- The Civil Liability Bill gained Royal Ascent on 20 December 2018
- The Lord Chancellor has confirmed that he has started to review the personal injury discount rate. He will make a determination about the rate on or before the 5 August 2019.
- Consultation between the Government Actuary and the Treasury is currently underway. For which there should be a response by the end of June
- On 7 September 2017, the then Lord Chancellor David Lidington indicated that the discount rate would be between 0% and 1%
- However there have been announcements of a dual discount rate in Jersey and a forecast rate of -0.25% in Scotland since that statement was made



Actuarial best estimate – discount rate

- Following the change in discount rate a variety of rates are now assumed within Insurers' actuarial best estimates for the non-PPO reserves.

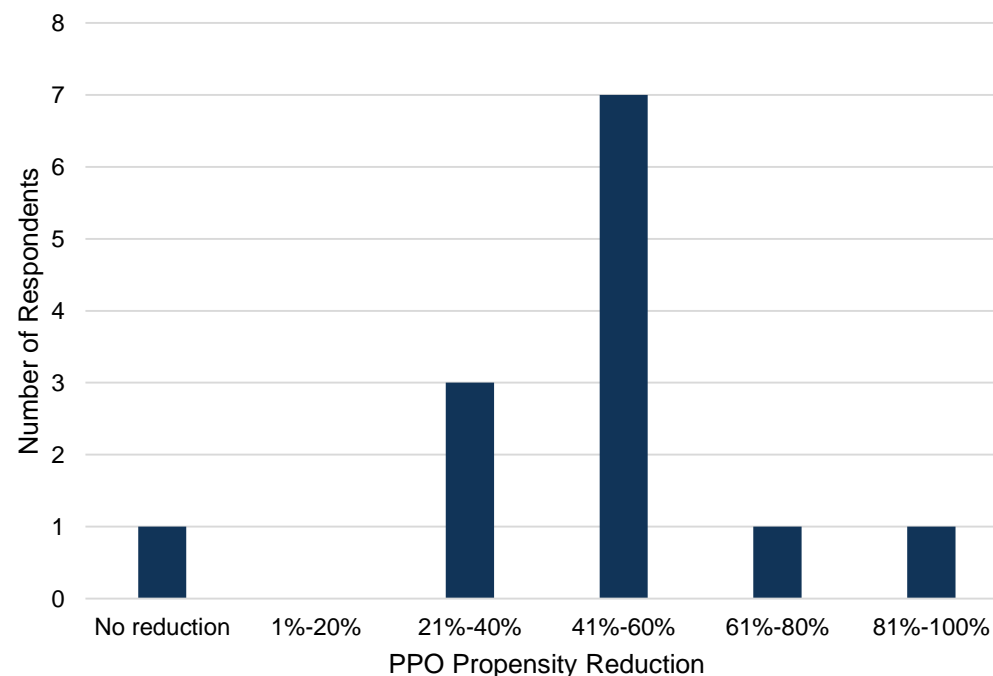


- A few insurers held a margin within booked reserves in respect of a -0.75% discount rate.



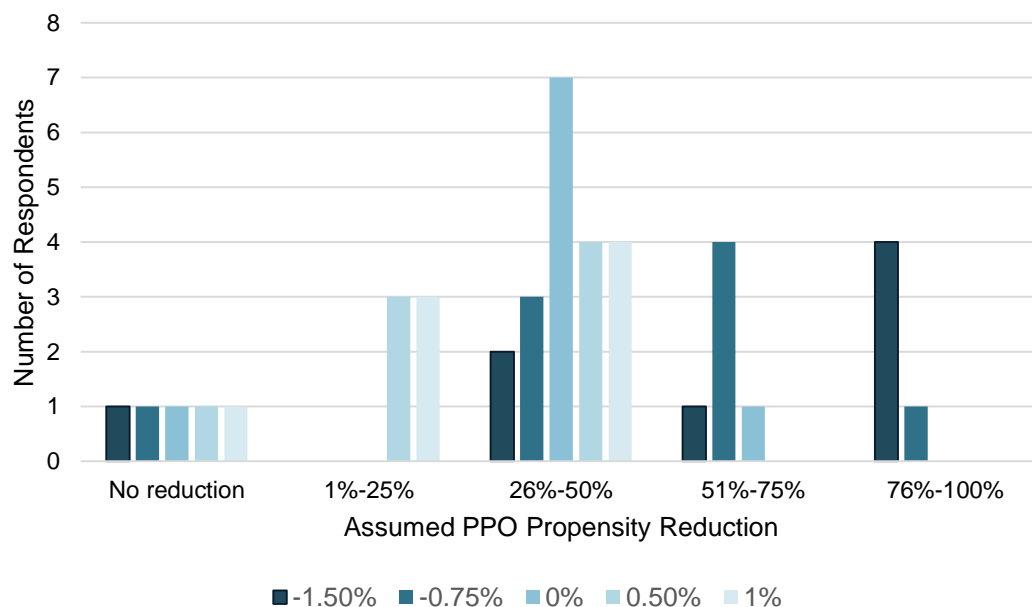
Actuarial best estimate – PPO propensity

- Participants were asked what percentage change in PPO propensity they had assumed as part of their actuarial best estimate calculations, following the Ogden discount rate change
 - One insurer said they had allowed for no change whilst the others all anticipated changes ranging from 30% to 100% reduction in PPO propensity.



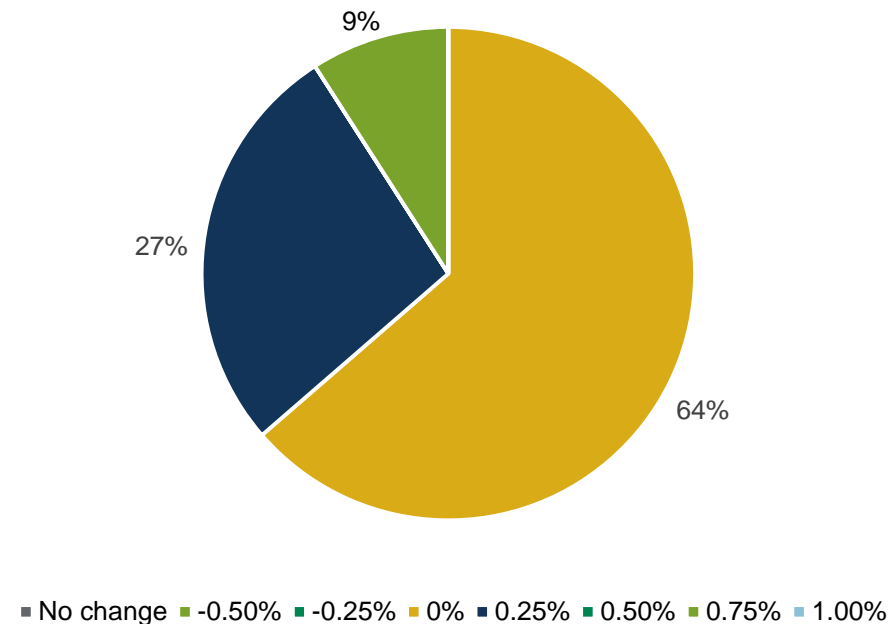
Assumed PPO propensity for different Ogden rates

- Insurers were asked what their assumed reductions in PPO propensity would be, from scenario analyses, had the Ogden discount rate changed from 2.5% to 1%, 0.5%, 0%, -0.75% or -1.5% per annum.
- Generally, the lower the discount rate, the larger the percentage decrease in PPO propensity insurers expected.
- However, some insurers expected the same reduction in propensity in all three scenarios and others expected no change at all.



Future Ogden discount rate

- Insurers were asked what they expected the Ogden discount rate to change to (if any change) following the Royal Ascent of the Civil Liability Bill.
- All insurers expected a change following Royal Ascent, with the majority expecting the Ogden rate to be between 0% and 0.5%.



Claim settlement speed

- The majority of insurers said that they had noticed a slowing down of claim settlements, particularly in the period running up to the rate change announcement on 27 February 2017
 - Although some insurers did say they had seen no difference.
- The expectation of a beneficial Ogden discount rate change for claimants seems to have been driving these delays.
- Insurers also noted that claim settlement speed has started to pick up as those who were delaying are now settling. The majority of insurers noted that they did not have a material backlog of open claims.



Claimant and claimant lawyer behaviour

- Insurers anecdotally noted the following:
 - Some claimant lawyers delayed claims anticipating a favourable movement in Ogden discount rate
 - Some claimant lawyers have been unwilling to settle at an Ogden discount rate other than -0.75%
 - Since the announcement that the rate may change again, and likely in a positive direction, lawyers have been willing to settle on a basis higher than -0.75%.
- Some insurers again said they had seen no change.



Nature of settlements (lump sums vs PPOs)

- Although many insurers said they felt there should now be a shift towards more lump sums being awarded due to their relative attractiveness increasing, the majority of these said there had not been overwhelming evidence in favour of this theory yet due to too few settlements.
- One insurer had seen a reduction in the number of PPO settlements and approaches for PPOs from claimant lawyers



Discount rate large claims are typically settling at

- The majority of insurers said anecdotally that large claims have been settling using a discount rate of between 0% and 1%
 - Although some insurers noted that many of the cases that have progressed to settlement are the ones where settlement was likely to be achieved at higher than -0.75%.





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Conclusions



Conclusions

- **There has not been a significant shift in the inflation and discount rates assumed by contributors**
 - The majority still assume a 0% real discount rate on a GAAP / IFRS basis.
- **Most insurers are assuming a reduction in PPO Propensity following the change in Ogden discount rate when calculating their actuarial best estimates**
 - However there is a wide range of assumptions from a 30% reduction to 100%.
- **Most insurers have seen a slowing in claim settlements in the period that led up to the change in Ogden discount rate.**
- **All insurers surveyed expected the new Ogden Discount Rate to be between 0% and 0.5%. A slightly lower forecast than last year.**



Questions

Comments

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Questions

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