

The Actuarial Profession  
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# 32<sup>nd</sup> ANNUAL GIRO CONVENTION

The Imperial Hotel, Blackpool  
Periodical Payments and the Courts Act

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## Periodical Payments and the Courts Act

**We are going to talk about :**

- Reserving
- Reinsurance
- Other interesting things – take your pick



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## Reserving

- Welcome to Life Insurance
- How to value an annuity
  - Sex
  - Age
  - Mortality Table
  - Annual Payments – frequency and structure
  - Discount Rate



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## Mortality

- Sex, Age and Mortality Tables
- PA92 is probably not the most appropriate table to use
- ELT16 is based on entire English and Welsh population from 2001 census
- Ogden tables use ELT16 projected
- Lives covered are likely to be impaired
- Solutions ?

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## Discount Rate

- Courts currently use 2.5% pa
- ILGs are currently 1.5% pa
- Rate applied depends on investment portfolio

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## Investment Portfolio

- Life insurers have restrictions on the assets to back liabilities which general insurers don't
- Invest in ILGs
- Or would you invest in Equities ?
- Discuss

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## Buy Annuity or Self-fund

- Annuities are expensive
- Could self fund at a high confidence level for the cost of an annuity
- Expenses

The Act of 1996  
Modeling the Financial Impact of the Act

## Expense Burden

- Initial valuation
- Cost of paying quarterly amount
- Ongoing Valuation
- Checking claimant is still alive

The Act of 1996  
Modeling the Financial Impact of the Act

## Reserving to Reinsurance

- The gross of reinsurance calculations are relatively easy
- The net of reinsurance calculations are rather more complex

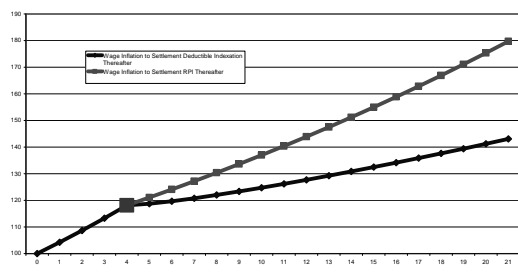
The Act of 1996  
Modeling the Financial Impact of the Act

## Reinsurance

- How indexation works
- Implications
- Issues arising

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Modeling Death and Retirement in the Future

## Reinsurance

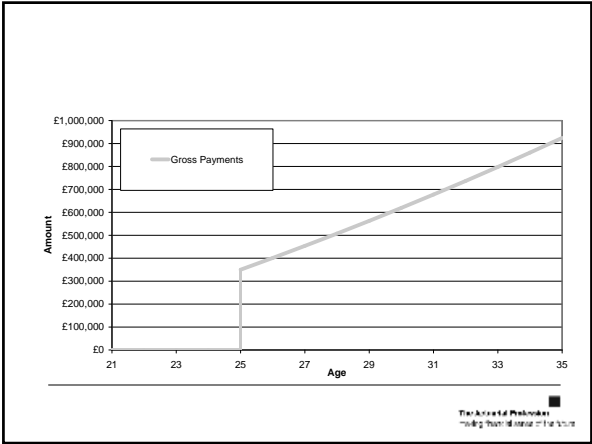


The Actuary's Handbook  
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## Example

- Deductible £500,000
- Award made to 25 year old male at date of settlement
- 4 years after attachment to reinsurance policy
- £300,000 lump sum plus
- £50,000 a year periodical payment

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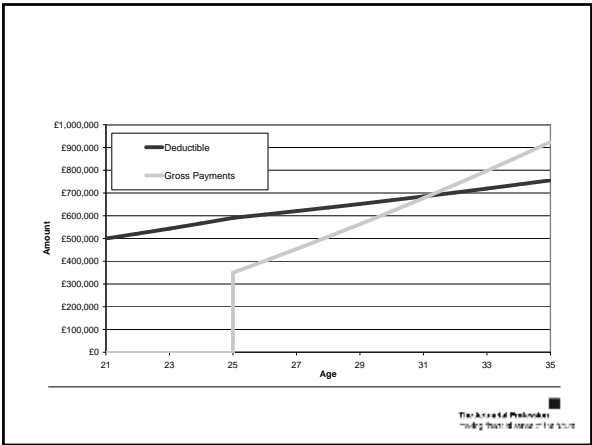
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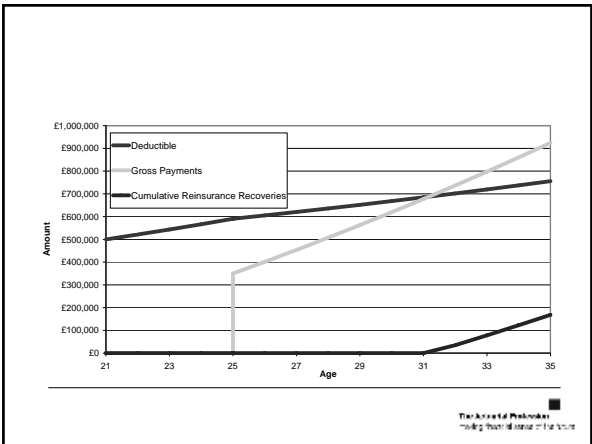
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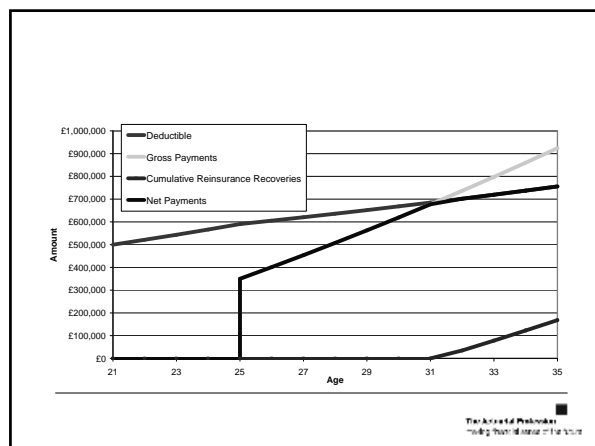
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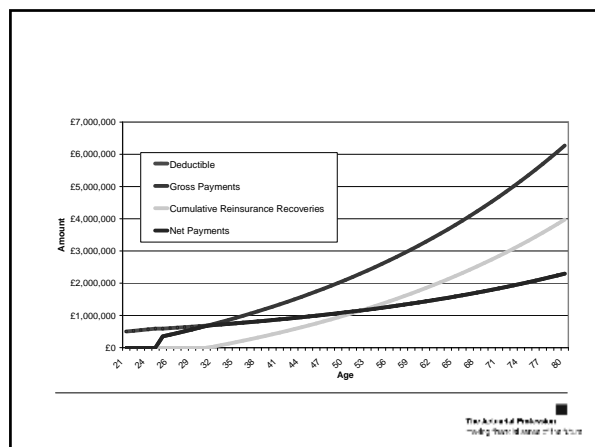
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## Implications

- Periodical Payments will be awarded in the larger claims which are those that impact the reinsurer
- Periodical Payments increase at RPI, yet indexation increases at less than RPI
- Reinsurer takes a greater proportion of claim the longer payments are made
- So reinsurer takes most of the mortality risk and investment risk

The Annual Periodicals  
Modeling Death and Disease in the Future

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## Questions

- How to capitalise between insurer and reinsurer?
- Aggregate Limits of cover - could reinsurance be exhausted?
- Additional administration costs between insurer/reinsurer
- Reinsurer security
- Investment returns for reinsurers

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## Uncertainty of Impact

- Actual impact of a PP depends on specific circumstances
  - value of lump sum award
  - value of periodical payments
  - sex and age of claimant plus any impairment
  - level of deductible
  - time to settlement
  - rate of assumed discount

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## Implications

- Pricing of Reinsurance
  - volatility loading
  - If prices get too high what will insurers do ?
- Policy wordings to apply across market ?
- Retention levels ?
- Shift in market participants ?

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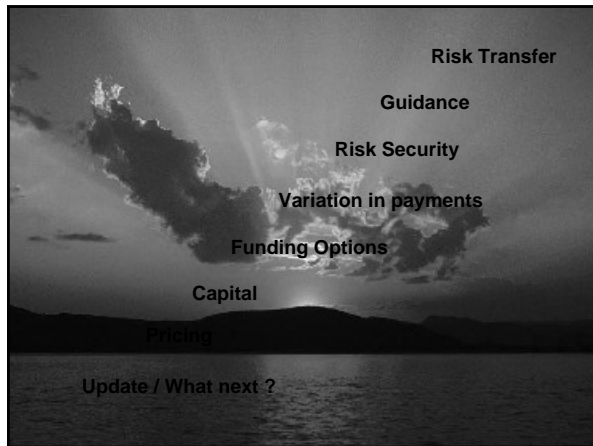
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## Risk Transfer

- Transferred to p/h
  - Care cost inflation of RPI inflation
- Transferred to insurer
  - Mortality
  - Investment / reinvestment
  - Inflation
  - Reinsurance credit risk
  - Increased admin costs
  - Mis-pricing
  - Increased reserving
  - Vested Interest / Rehab

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## Guidance on issuing PPO's

- Seems little in way of guidance.
- Evidence from IFA will potentially be expected – from claimants / defendants
- Court need to consider:
  - Claimant's needs, scale of annual payments, claimants / defendants preferences,
  - (uncertainty in life expectancy)
- Variation orders, contributory negligence, limit of indemnity, provisional damage

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## Security

- Secure
  - Government health service body / ministerial guarantee
  - FSCS protection (exc. aircraft/ship liability)
  - MIB
  - Lloyds / Lloyds syndicates?
- Not Secure
  - Equitas
  - Captives / O/S Insurance Companies
  - Medical Protection Society

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## Variation in the level of payments

- General Variations
  - RPI (other than "exceptional" circumstances)
  - Specified at time of award
    - changes in: care required; gratuitous care; education; promotions; or employment.
- Variation Order
  - Significant medical change in claimant's condition which can be foreseen
  - Flexibility around timing of the event
- Provisional Damages

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## Funding Options

- **Purchase an annuity**
  - Liability passed to life insurer
  - Current providers inc. AIG, Canada Life, Scottish Widows
  - Expensive (0% disc) ?
  - Matching of RPI for greater than 50 yrs
- **Self funding**
  - Risks are retained (mortality, investment, reinsurance credit)
  - Purchase an annuity (liability is retained)
  - Admin burden
- **Mortality Pooling / Other Pooling Scheme**

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## Capital (ICAS)

- ECR
  - Premium (unchanged)
  - Liabilities (increase)
  - Assets (increase)
- ICA / ICG
  - Risks transferred to insurer
    - Mortality / longevity
    - Investment / reinvestment
    - Inflation
    - Reinsurance credit risk
    - Mis-pricing
    - Increased reserving

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## Pricing

- Insurance pricing
  - Net retained loss (upto 24%)
  - Gross O/S claims cost (1%-7%)
  - Watson Wyatt / EMB suggest 1-2% increase
  - Approx 1% decrease in discount rate.
- Reinsurance pricing
  - Reinsurance retained loss (upto 36%)
  - Watson Wyatt suggest 25%-75% increase (based on £2.5m ret)

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## Update !!!

- Companies offering RPI annuities ?
- Number of PPO's awarded / Variation Orders ?
- Who are Reasonably Secure Bodies ?
- Funding options currently being used ?
- ICAS capital, any explicit estimates ?

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What should Counts Act Working Party focus on during the next year ?

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