1994 General
Insurance Convention

REPORT OF THE PECUNIARY LOSS WORKING PARTY 1994

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1 EXECUTIVE SUMMARY

1.1 This paper describes the recent work of the Pecuniary Loss Working Party (PLWP).

1.2 Section 2 provides the context for the recent work and describes the reasons for examining creditor covers at this time.

1.3 Section 3 contains the results of our recent market survey into Mortgage Indemnity Guarantee ("MIG") issues. This survey is based on responses not just from MIG insurers, but also from intermediaries and mortgage lenders.

1.4 An overview of the recent history of creditor covers is provided in Section 4. This is an important element of background to the next section.

1.5 Section 5 covers the possible provision of some unemployment benefit by private sector insurance arrangements. This note is structured to set out the main issues and so encourage discussion at the 1994 GIRO conference.

2 INTRODUCTION

2.1 Background

The discussion at the 1993 GIRO conference on MIG confirmed that interest remains strong on this topic. The PLWP has therefore continued to monitor developments in this area and this year presents the results of a survey into future MIG intentions. This survey is unusual in that it covers not only insurers (suppliers) but also brokers (intermediaries) and lenders (purchasers).

2.2 Creditor

Discussion of the possibility of providing some element of unemployment benefit by means of a private sector insurance arrangement was emerging around the time of the 1993 GIRO conference. The PLWP decided to monitor this development carefully and at the time of writing (late July 1994) it is clear that the subject remains a live issue. It is hoped that the combination of the review of the recent history of creditor contained in Section 4 and the overview of private provision issues contained in Section 5 will stimulate a lively discussion at the 1994 GIRO conference.

2.3 PLWP Membership

The 1994 PLWP has again benefited from a broad composition as follows:

P Akers (Chairman):	Consultant
M Cross:	Insurer
D Davies:	Lender
J Leigh:	Consultant
N Shuker:	Insurer

2.4 Methodology

Standard working party methodology has been used throughout, with interested individual members progressing particular elements and submitting their work to group review.

2.5 Acknowledgements

The PLWP chairman places on record his thanks:

- to PLWP members for their efforts and enthusiasm
- to all support staff at the Institute of Actuaries
- to Liza Groves for ongoing secretarial support

3 MIG MARKET SURVEY

3.1 Introduction

In recent years Mortgage Indemnity Guarantee (MIG) has taken a significant position in the presentations of the Pecuniary Loss Working Party (PLWP) at GIRO conferences and we thought it was time to take a step back and assess the views of the players in the marketplace.

It was decided to send a questionnaire to a selection of insurers, lenders, brokers and reinsurers to obtain their views concerning MIG. The questions were divided into five areas namely product, price, reserving, claims and future market developments.

The PLWP would like to thank all those who gave of their time to fill in the questionnaire, and those organisations who felt able to contribute. A more comprehensive set of results has been supplied to those who took part.

The number and quality of responses was encouraging, of fifty five questionnaires sent out twenty five were returned. Of these twenty five, three felt unable to contribute and three were not involved with MIG in any way.

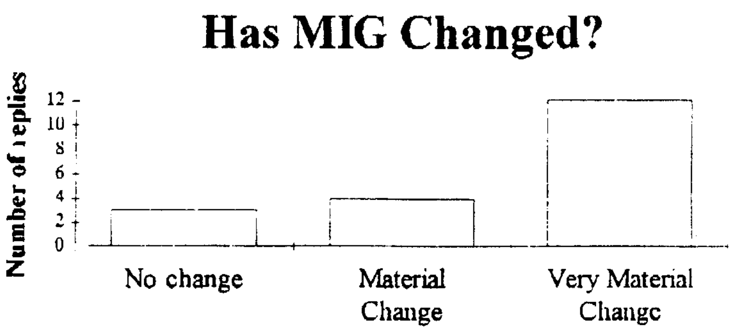
Of the remaining nineteen, ten were from lenders (banks and building societies), seven from insurers, one from a broker and one from a reinsurer. In the analysis the one broker and the one reinsurer have both been classified as insurers. This reflects their position in the marketplace, and was confirmed by the fact that overall their answers resembled more closely those given by insurers than those given by lenders.

This left us with two groups to compare the results across, the lenders (10) and the insurers (9). If there is a difference in response between lenders and insurers, this difference is highlighted.

We hope that the results of this survey, produced in this paper, will lead to a healthy debate at GISG surrounding the issues related.

3.2 Product

The first question concerned any recent changes in MIG cover and whether the organisation considered them material or not. As can be seen from the chart below most organisations felt that recent changes had been very material. One participant felt that the changes were "Very, very material". What is perhaps more surprising is the fact that three of the nineteen organisations have not seen any changes to MIG cover. All three were insurers, one had only been writing for a short period, which may explain their lack of change, but the other two seem to have been immune to the upheaval in the rest of the market.



The next question concerning possible future changes to the MIG product produced some of the following responses.

- Greater risk retention by lenders, mainly through captive insurers.

- Use of Excess of Loss cover.

- Various comments concerning the likely direction of price movements over the next few years.

- The introduction of annual premiums for MIG cover.

- Rates that vary by geographic region.

The next question was about the introduction of more restrictive cover. This restrictive cover could include any or all of sharing of losses, limits to cover, upper limits to claim amount and introduction or extension of exclusion. Of those sixteen organisations that had seen either material or very material change to their cover, the majority (10) had seen all four changes listed. Most of the changes were very similar in effect.

The fourth question concerned the organisation's view of MIG cover, whether it was individual insurance or corporate insurance. All 10 lenders considered that it was a corporate insurance, but only two thirds of the insurers considered it such.

The final question on the topic of product concerned the possibility of an underwritten MIG. This would entail the involvement of the insurer in underwriting the insurance risk of the individual. If the individual was turned down for insurance, then the lender would either bear the risk himself or decline to lend to the individual. Most schemes are currently on a block basis, and the insurer does not know individual details. The risk is however financially underwritten since the lender will take up financial information before issuing any loan. This led to some confusion but the result was that roughly half did not consider an underwritten MIG attractive, mostly because of the administrative burden.

3.3 Price

The first question was about which direction organisations felt the next price move would be. As can be seen from the table below insurers believe that rates are currently adequate and if there is any movement in rates it might be marginally up. On the other side lenders believe quite strongly that prices will increase, the most often mentioned figures were 20% and 30% price increases.

	Insurer	Lender
Up	3	7
Stable	5	2
Down	1	0
No Comment	0	1
Balance	2	7

The next question was about the fairness of the rating structure. Almost universally the Loan to Value (LTV) method is used in rating and then in a very crude manner, with large discontinuities in premium as a borrower moves from a lower LTV band to a higher LTV band. The responses were evenly spread with seven thinking yes, eight thinking no, three thinking yes and no with one organisation not replying to the question. On balance more lenders thought that the rating structure was fair while more insurers thought the system unfair. This may well reflect the different organisations' attitude towards pricing for risk and cross subsidisation.

As to the likelihood of the introduction of further rating factors support was again almost evenly split, eight thinking yes, eight thinking no and three thinking yes over the longer term. The relative position of lenders and insurers were reversed compared to the previous question. So that although insurers think that the rating structure is currently unfair a majority do not see further rating factors being introduced in the near future. Lenders on the other hand see the current rating structure as fair but expect the introduction of further rating factors.

3.4 Reserving

The first question asked concerned the number of years over which the premium was earned. These were as listed below.

Number of years	Number of organisations
5 years	1
7 years	5
8 years	1
10 years	1

The most important point to note is that most insurers seem to have settled on seven years as the correct period over which to earn premiums.

The second question asked if the company would be willing to provide an earnings profile. Encouragingly all of the companies were willing to do this and a graph of the results is shown on the following page.

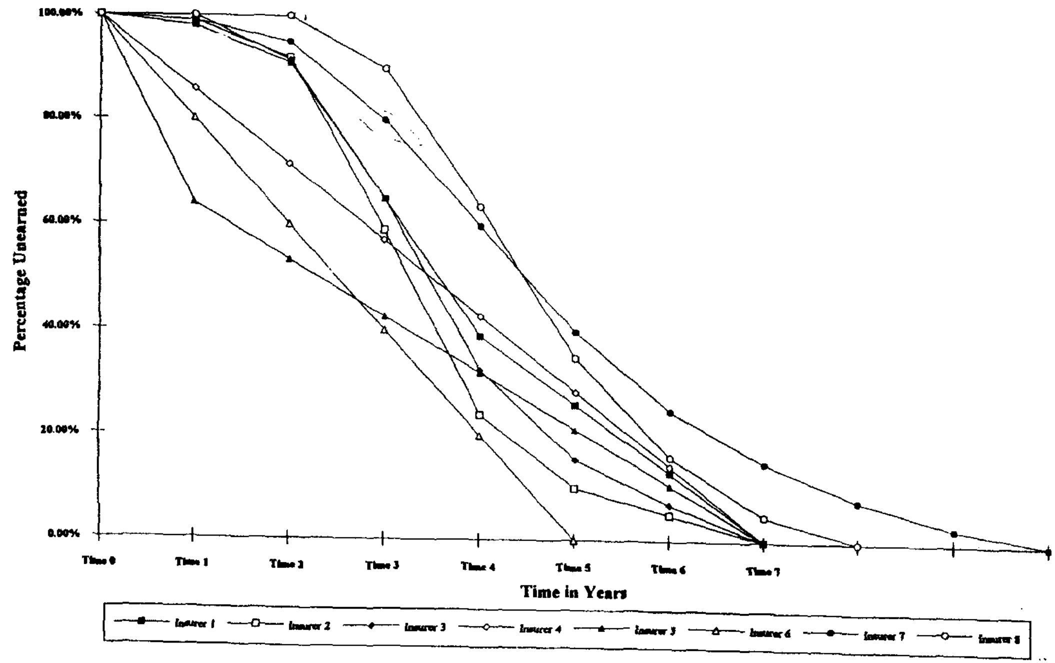
The rate at which the premiums are earned has to be considered in conjunction with the claims reserving policy. If claims are reserved for only when a claim amount has been agreed between the lender and the insurer then the earning pattern needs to be a lot more conservative than if the claims reserve includes amounts for mortgages currently 6 months in arrears. This having been stated the difference in earnings patterns is still stark. Three of the eight insurers (insurers 3, 5, 6, 7) have (almost) level earnings profiles.

The other five insurers have all earned less than 10% of the premium within the first two years. Without industry wide claims data it is very difficult to judge the appropriateness of the competing profiles, but one would expect a certain amount of prudence from the actuarial profession.

One insurer was more sophisticated and used an earnings profile dependent on years of inception of the mortgage plus their view of interest rates, the housing market and unemployment. This should alleviate the problem of using an average earnings profile, but as one organisation pointed out will make claim ratio comparison across year of inception a little more complicated.

When asked if they had made any changes over the last few years to the earnings profile they used, three of the eight stated that the profile had lengthened as a result of their experiences during the recession.

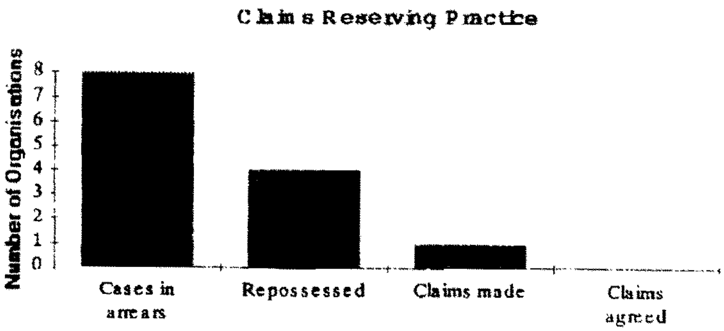
Unearned Premium Run Off



3.5 Claims

The greatest length of time between inception of a mortgage and paying of a claim recorded by an insurer was 19 years. Two others recorded 10 years and another 9 years. Most organisations did not seem to keep records of this sort.

The second question concerned reserving practice for claims. It asked reserved claims were reserved for when agreed, when made, for repossessed properties or for mortgages in arrears. As can be seen from the chart below the majority of companies reserve for mortgages that are in arrears. This has to be considered the most sensible way to proceed as the financial impact of economic difficulties can be seen a lot earlier and will give the insurer a greater chance of managing the risk appropriately.



The third question was concerning the accuracy of the claims reserving process in the organisation. This would not only apply to insurers but also to lenders who have to estimate the amount of the loss that they will be left with. Of the twelve organisations that replied to this question, eight thought that their claims reserving was either accurate or very accurate. Three organisations thought that their claims reserving process was fair and only one thought that it was inaccurate. This question is open to abuse, with the possibility of presenting the organisation in the best light by stating that claims reserving was very accurate. On the other hand organisations have probably spent a lot of time and effort in recent years ensuring that their estimates of MIG claims are as informed as possible and the answers probably reflect this.

The final claims question concerned the accuracy of MIG claims reserves compared to other classes of business that the organisation was involved with. Here two of the respondents felt that their MIG claims reserves were more accurate than other classes of business, four felt them to be the same and seven felt them to be worse.

3.6 Developments

The questions on future market developments were of a Yes/No nature, and produced the following results.

The first question concerned the possibility of selling a MIG type cover directly to the borrower. Five organisations thought that this was a possibility, but fourteen thought it was not. Although a majority of lenders were not interested in such a cover, a far higher proportion said yes compared to the insurers.

The second question asked if the organisation thought MIG would exist in its current from at the end of the decade. A more than 2:1 majority thought not. The insurers were more positive than the lenders that MIG in its current form would continue to exist.

As far as the reinsurance of MIG is concerned, four organisations have some cover, eleven had no cover and four did not answer the question. A further question was asked about whether the availability of MIG reinsurance would increase. Ten organisation thought it would, six thought it possibly would and three thought that reinsurance capacity would remain the same. The lenders were a little more hopeful on the future availability of reinsurance capacity than the insurers.

The final question asked for any further comments that the company wanted to make on likely market developments. A sample of the responses is given below.

- Increased underwriting of risks by lender
- Improved management information on mortgage lending (2)
- Improved mathematical modelling integrating bad debt and insurance experience to the benefit of pricing and reserving
- Full retention by the lender
- The contract is not truly insurable
- Contained risk within excess of loss programmes or time limits on current indemnity products
- Tighter control
- Partnership with the lender
- Pricing geographically structured
- Lenders taking an increasing share of the MIG risk
- More competing market available for MIG (2)
- Development of reinsurance market (4)

- More flexible approach reflecting the merits of each lender

- Buyer - Reversion to the policy terms and conditions and premium rates that prevailed prior to 1992

- Back to block arrangements to lessen administrative burden and reporting requirements

- Increased certainty of claim payment

- A break in the link with building societies/contents business written for customers

- Accurate lending pricing for risk, removing necessity to maintain MIG to keep headline rates competitive (2)

- Greater acknowledgement of individual lender experience

- Move away from single premium being only payment method

- More progressive thinking on future development of product, learning lessons from the past but not being totally inhibited by those losses.

3.7 Conclusion

The MIG market has undergone some dramatic change over the last couple of years, not least because of the enormous losses that insurers, and lenders, have sustained on mortgage lending. From this survey it would appear that great changes have been made to the product offered and the price charged for this product. These changes have occurred across the industry, apart from a couple of exceptions who appear to have escaped unscathed.

The methodology for claims reserving used by most institutions seems to have become a lot more sophisticated and hopefully a lot more accurate as a result.

However there still appears to be some lethargy in the market; i.e. a lack of sophistication in rating, with many institutions not even considering any changes; a lack of management information that could allow for risk assessment and risk management; no use of the wealth of information gathered at the mortgage interview or that is held by lenders on historical mortgage payment; only a few contributors even mentioning the credit scoring that is now being carried out by an increasing number of lenders.

The industry, and profession, having dealt with the problem of estimating claims, now needs to turn their attention to the problem of premium rating. The lesson in other markets is that good risk individuals quickly switch their purchases to an organisation that charges the appropriate premium.

The lessons of that past must be fully understood, and not be used to impede the development of the product in the future. The comparison between questions 2 and 3 in the price section of the questionnaire showed that although insurers think that the rating structure is currently unfair a majority do not see further rating factors being introduced in the near future. Lenders on the other hand see the current rating structure as fair but expect the introduction of further rating factors. This sort of woolly contradictory thinking can only impede the development of the MIG product.

Otherwise the future looks bleak for MIG. Some form of cover will always be sought by a lender wishing to protect its balance sheet, but the form of this cover could change dramatically; excess of loss reinsurance; use of captive insurers; claims equalisation reserves; coupled with a lack of flexibility in the current MIG product could mean that the next few years may see as many changes as the last few. The old Chinese curse "May you live in interesting times" seems appropriate.

4 CREDITOR INSURANCE UPDATE

4.1 Creditor - The Last Few Years

Since the last report, this Line of Business has undergone a harrowing experience - the UK recession.

As creditor covers, amongst other things, people becoming unemployed, it has reacted sharply to the increase in unemployment that started in the middle of 1990.

That this happened is not unusual. However, the sheer scale and speed of this drop caught many people by surprise. If we examine the graph of unemployment since 1984, and the flows into and out unemployment (i.e. people becoming unemployed and unemployed leaving the register) we can see how the situation changed dramatically in a short space of time.

Examination of the data shows that there was an increase in the annualised unemployment frequency trend (twelve times the ratio of monthly inflow into unemployment to the numbers employed) - the measure best used to track the likely level of unemployment claimants on a creditor account - from a low of 13.7% in mid 1989 to 15% p.a. in the middle of 1990, to 20.1% one year later.

Another point to draw out is that this increase in unemployment was not, initially, a nationwide phenomenon. Regional data shows us that the earliest increase came from the south of the country, with the northern parts following several months later.

What effect did this have on the creditor business?

To examine this, let us look at what creditor insurance covers and how it differs from national unemployment.

As you may recall from our previous paper, creditor insurance broadly covers the repayments due under specific financial agreement, whether these are mortgages, personal loans, credit cards, HP agreements or other forms of finance, should the insured be unable to work due to accident or sickness, or if the person is made unemployed or redundant, the latter being a stricter definition.

No underwriting of individual lives take place with the exception of any financial underwriting that may take place when the financial instrument is first negotiated. To prevent widescale selection, the underwriting companies impose restrictions, examples of which include being actually at work when the insurance was taken out, exclusion for part or all of the period of cover for conditions that were pre-existing when the insurance was taken out, exclusion for unemployment that was known or pending at that date or as a result of normal seasonal activity and the exclusion of disability or unemployment resulting from anything self-inflicted (e.g. drug abuse, alcohol etc).

These exclusions together with the financial underwriting before the loan/credit has been offered - creditor insurance is usually only offered at the point in time at which the loan/credit is arranged - conspire to exclude a lot of people who regularly contribute to the inflow of people onto the unemployment register, for example students, seasonally employed people, people resigning from work (if cover is redundancy only) and so on. This has the effect of gearing the reaction of creditor frequencies to the economy, so that if unemployment or frequency move up 10%, the corresponding increase in creditor frequencies will be much higher. It is anticipated that the same will happen in reverse as the economy improves.

Needless to say, this had a marked effect on the underwriting losses of the major carriers, though it is difficult to quantify this for all but the few companies transacting only creditor business. Suffice it to say that relatively large losses were made. In a lot of cases, the companies were powerless to react - insurance effected by payment of a single premium, as is the bulk of personal lending, cannot be amended part way through its term and the inadequate rates could therefore not be revised for anything except new business.

Monthly premium business rates can be revised at relatively short notice, but protracted negotiations with clients often meant delays of many months in getting the changes implemented.

As the scale and depth of the recession became apparent, the trend of rate increases required to restore profitability immediately became substantial. Lending Institutions, particularly the building societies, balked at the thought of imposing big changes on their customers. At the same time, insurers suspected that the sheer scale of change could be counter-productive, taking the view that as rate increases bite the good customers start dropping out (- remember that this insurance is voluntary) i.e. the level of selection which negates the rate increase results in a much higher frequency which negates the rate change. It became apparent that simply imposing rate increases was not sufficient and other action was required. The most obvious of these was to reduce benefits in some way. A variety of changes were implemented, including:

- reducing the scope of unemployment cover to redundancy only

- further restriction to the maximum number of payments

- extending the exclusion period that had to elapse before a claim accrues benefits

- strengthening the clauses excluding pre-existing conditions for disability cover.

An interesting but unwelcome side effect of implementing rate or benefit changes occurred in 1991/92 in that claim frequencies increased again a few months after notifying customers of these changes. It is believed that this was as a direct result of reminding customers that they have cover who then put in claims that they would probably not otherwise have submitted - this reinforced a belief that has always existed that the insureds do tend to forget that they have cover, particularly those that have had cover for a while, such as those with long (three to five year) loans or credit cards -

it was this last sector that gave most of the problems mentioned above.

Due to the high levels of profit commission and the ability to carry forward past losses to offset against future profits, losses that arise now in this type of business can give rise to extra profits in later years if the scheme is retained.

However, between the point at which a scheme stops making losses in a policy period and that at which accumulated losses have been erased by future profits is when the business is most vulnerable to being poached by another insurer, who can offer cheaper rates with the ability to pay profit commission immediately without the necessity to offset built up losses. Insurers attempted to limit or reduce the chance of a scheme moving away by implementing what has become known as a long term agreement. This has taken several forms from preventing the cancellation of the scheme until accumulated losses have been completely mitigated, to simple two or three year 'no-move' agreements. In this way the level of rate increase could be reduced and a more measured approach taken to resolving the situation rather than the knee-jerk reaction prevalent in a lot of situations.

Having coped with the unemployment backlash the insurers have braced themselves for a phenomena that has been observed in the past and which did indeed happen again, though no-one is entirely certain as to why it occurs. I am referring to the disability/sickness backlash that nearly always seems to follow a deterioration in the employment situation. Several reasons have been put forward for the increased claims activity on this part of the cover, namely

- unemployed claimants reach the end of their maximum cover period and 'move' onto disability cover in some way

- GP's become more sympathetic to their unemployed patients, particularly those approaching retirement and might be more inclined to sign claim forms for creditor cover

- Increased levels of stress when the economic environment worsens (maybe people worry about job security!)

and so on. The extent of this backlash is never as great as that affecting unemployment cover but is still sufficient to be noticed. This is part of the reason why it is not only the unemployment benefits that were reduced or restricted as mentioned above.

Another way in which insurers attempted to reduce the scale of losses was to take a harsher line in the way that claims were handled i.e. to apply the policy conditions more strictly than perhaps they had been applied in the past, or to investigate more claims, perhaps using external investigators who would try and catch out claimants.

This last method did in fact catch out many fraudulent claims, but all of these measures attracted a great deal of criticism, increasing the number of complaints to the Ombudsman and producing several mentions on so called consumer programs such as Watchdog or in other consumer publications such as Which? magazine. Some of these complaints could well be termed justified, such as the rejection of a claim from someone who had been hospitalised for over half a year because they did not submit their claim within six months of the loss date. But on the whole it was the way in which the insurance was sold that attracted most criticism, for although most of the complaints could not be upheld as the insurer was simply applying policy conditions at the point of sale of the insurance.

All this publicity had a detrimental effect on the claims experience for, as mentioned earlier, it reminded people that they had creditor cover and produced further claims.

4.2 The Future For Creditor Insurance - Problems Or Opportunities?

There are several things happening within this type of insurance that pose some interesting problems for insurers.

The Office of Fair Trading have long been concerned with the use of 'Negative Option' as a means of selling creditor insurance. For those unsure as to what this means, this is where insurance is put into effect unless the person physically opts out of it, usually by putting a cross in the box somewhere within the credit agreement. In this way the penetration (percentage of people with credit who have creditor cover) is usually kept high, a crucial factor in determining scheme performance, and provided it is properly explained by the person arranging cover there should be no problem. However, applications for credit cards are invariably done at arms length and there is usually little or no human contact at which this point can be explained. Also, most Finance House credit is arranged via third parties, for example salesmen in carpet stores etc, who may not be fully conversant with the forms and whose ability to properly explain the insurance is sometimes restricted.

This led to many complaints arising from people misunderstanding the cover they have and/or being ineligible, a point they often do not find out until they attempt to submit a claim, The OFT therefore decided to ban the use of negative option as a selling tool with effect from 31 March 1994.

The implications for the industry are that, for a variety of reasons performance can be expected to deteriorate as the level of selection increases from the people who have to now positively opt for the cover. This will produce many challenges to prevent this - penetration will need to be increased by the use of better selling methods, benefits may need refining to prevent selection and so on. This is an area where the profession can put its skills to good use.

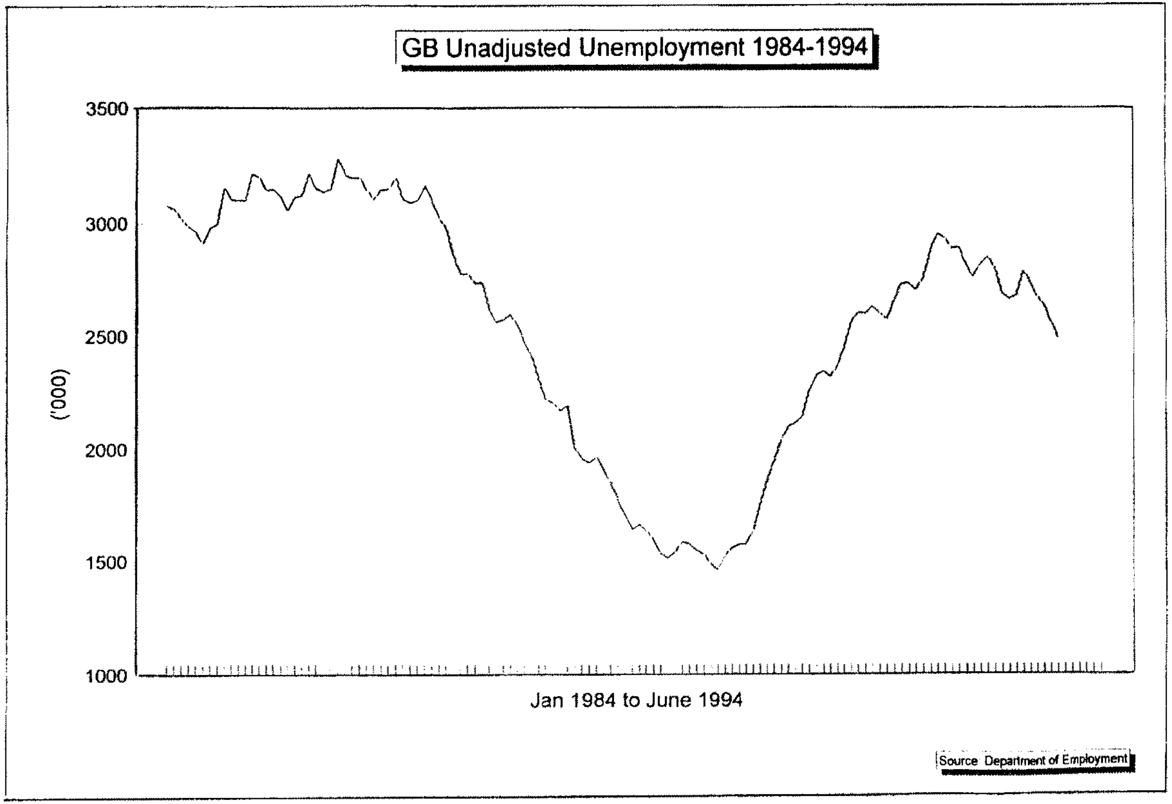
As creditor insurance is very much aligned with the Finance industry, it is very much at threat from the move into Bancassurance by Banks and Buildings Societies, both of whom are the prime source of most creditor business. We can perhaps see the long term elements of creditor being underwritten directly by the new Life offshoots (as it already is in some cases), with a possible movement into General Insurance Companies in the near future giving the ability to write all the business in-house, either by direct writing or co/re-insuring. This is a very real threat and the insurance companies must work even harder to give these institutions added value to try and prevent this wholesale move away from them. Again, this is an area where the profession can help in evolving the analytical and monitoring tools required to maximise the benefits to the institutions.

I should perhaps also mention the forthcoming imposition of the Insurance Premium Tax. Firstly, as commission levels on this type of business tend to be quite high, often 30% or more of premium, the reduction in the rate of IPT from 3% of Net premium to 2.5% of gross actually meant an increase in most cases of some 20% or more in the amount of tax collected.

Secondly, as we will now need to inform clients that they are paying tax we will again be reminding them that they have cover - perhaps we should send out a claim form at the same time to save on postage!

Lastly, the increased activity of the recent years through rate and benefit changes has led to increased requirements from the lending institutions for more information regarding their schemes, and better more pro-active methods of monitoring performance of the schemes and/or crucial economic indicators, an area in which the profession is well equipped to help.

The future for creditor insurance remains very interesting, with many opportunities for the profession to exploit our skills to the full to satisfy the ever-changing demands that will be forthcoming.


GB Unadjusted Unemployment 1984-1994
3500
3000
2500
2000
1500
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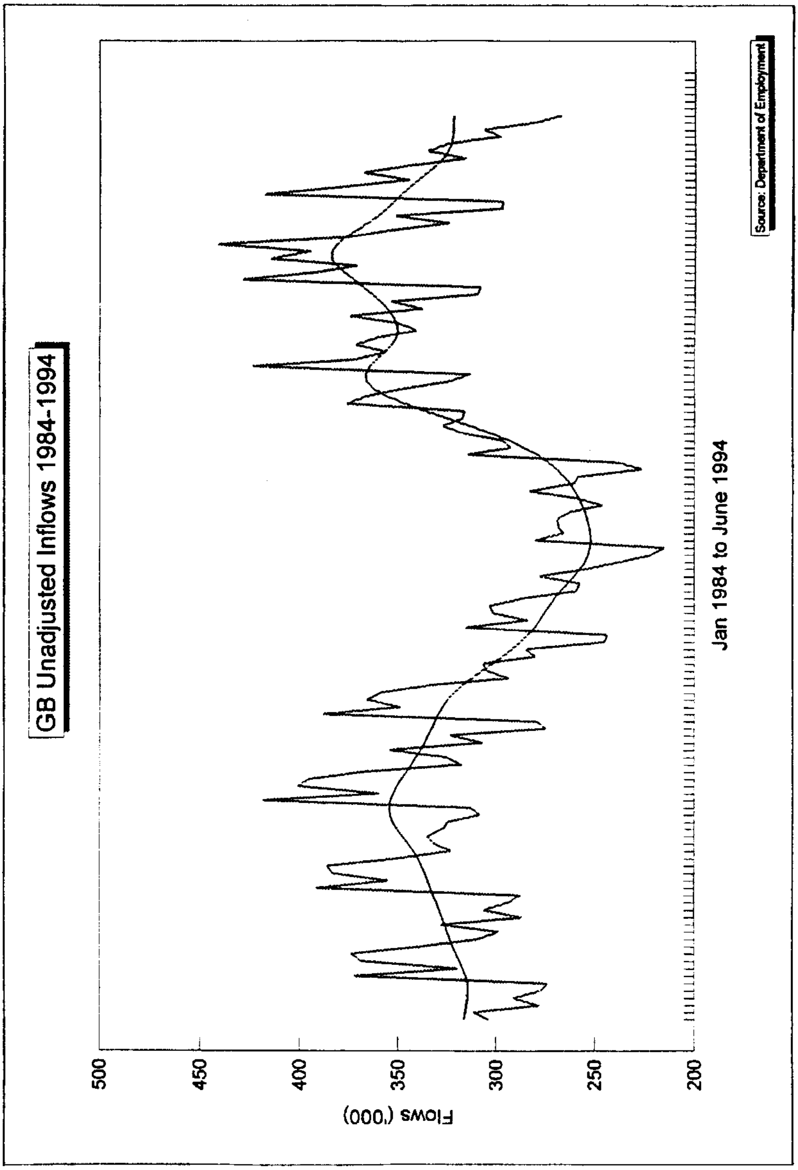
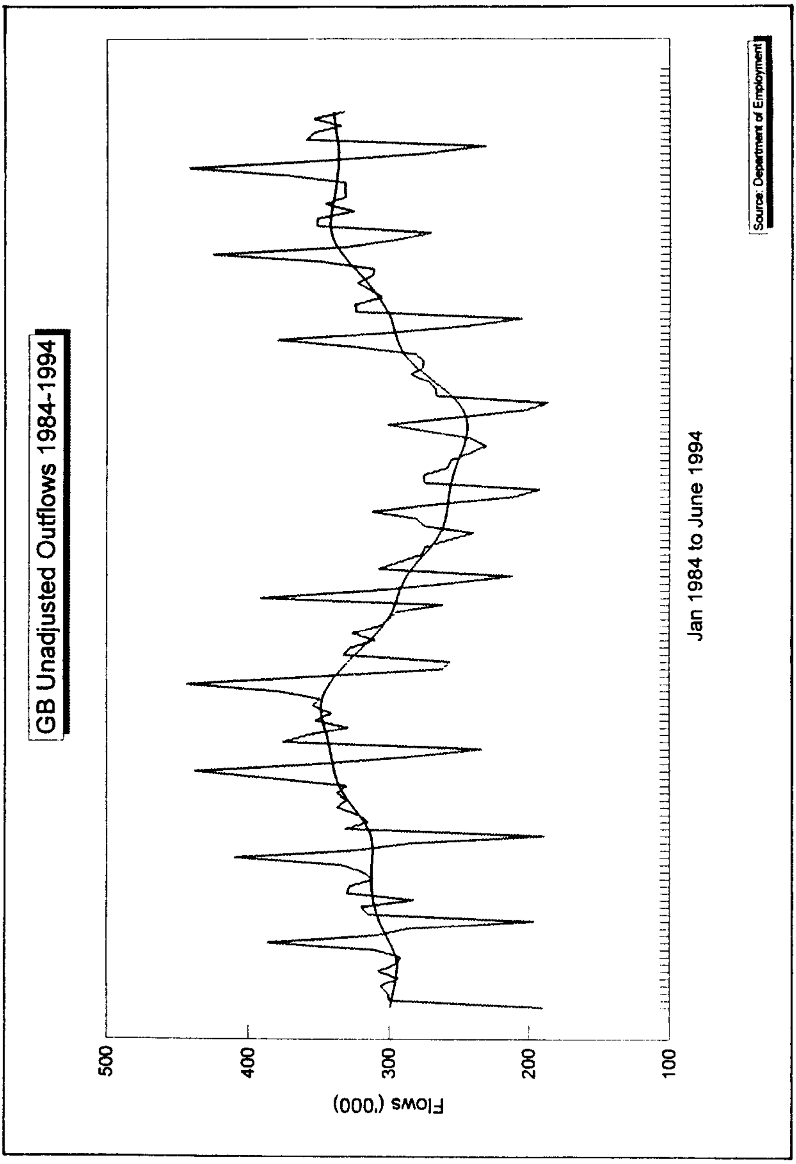
(000.)
Jan 1984 to June 1994
Source Department of Employment


GB Unadjusted Inflows 1984-1994
Flows ('000)
500
450
400
350
300
250
200
Jan 1984 to June 1994
Source: Department of Employment


GB Unadjusted Outflows 1984-1994
Flows ('000)
500
400
300
200
100
Jan 1984 to June 1994
Source: Department of Employment

5 UNEMPLOYMENT BENEFIT : A SUITABLE CASE FOR PRIVATISATION?

5.1 Introduction

Unemployment is not commonly regarded as an insurable risk in the United Kingdom. The most important exception to this is in the field of creditor insurance, where the insurer makes loan repayments on behalf of a borrower who becomes unemployed. This was covered in the report of the Pecuniary Loss Working Party to the Llandrindod Wells GIRO in 1991, and recent developments in this field have been covered in other parts of this report.

Some trades unions have also provided unemployment benefits in the past, and a few continue to do so. These were often organised on very unsound principles, and the benefits were guaranteed only as long as the funds were sufficient to pay them. Therefore they often ceased in times of high unemployment, when they were most needed.

In the United Kingdom today, apart from accumulated savings and informal help from friends and family, by far the most important source of relief for unemployment is National Insurance. This provides benefits for those registered as unemployed and eligible for benefit. The scheme is financed by contributions (NICs) paid by employers and employees and levied on wages. When contributions are insufficient to fund the payment of benefits, the balance is made up through general taxation.

In recent years, some suggestions have been made, generally by free market oriented "think tanks" that provision for unemployment relief should be transferred to the private sector. This seems to fit with the philosophy of the Government since 1979 of privatisation of state enterprises and contracting out to the private sector of the functions of government departments. The purpose of this paper is to consider whether or not this is feasible, and how the insurance industry might deal with such a challenge. It does not consider any specific proposal, such as government green or white paper, since none has been issued, and suggestions have generally been a matter of proposing a principle as a basis for further discussion, rather than a concrete proposal. Rather, we look simply at the basic principles which would be involved.

5.2 Basic Principles

The first argument in favour of a move towards private sector provision of unemployment benefits is the same as for any privatisation. This is economic efficiency. The private sector, being responsive to the demands of shareholders and customers, should be able to provide an efficient allocation of resources and the matching of costs to risks. On the other hand, the state being currently a monopoly supplier of unemployment insurance, is likely to be an inefficient supplier for the reason that all monopolies are, and government enterprises in particular tend to be. In addition, if unemployment relief were available through private insurance rather than public provision, individuals would be able to choose how much provision they made, taking into account their own preferences for security of income, their other resources and the premium rate which will be applied to them. This is a very different situation from the present one, where the same benefits are paid to all (subject to some rules on other resources), irrespective of such preferences.

The main argument against this is the fundamental argument for the existence of a welfare state - that in a modern economy it is the duty of society, through the government, to ensure that its citizens do not fall into destitution because of economic failure. This fundamental proposal has been accepted for a long time, quite explicitly since National Insurance was introduced in 1911. However, a welfare system of sorts has existed for much longer. From 1601, the Poor Law required each parish to provide for its own destitute parishioners, usually by providing work, often in the confines of the parish workhouse. Many parishes also "gave out relief" - in effect paid social welfare benefits. The system was much reformed in the nineteenth century, and was finally superseded by National Insurance in 1911.

5.3 Current Private Arrangements

As mentioned above, creditor insurance is the class which accounts for the majority of private unemployment insurance in the United Kingdom. We will cover typical arrangements briefly.

Creditor insurance is made available to those taking out loans, and sometimes also other long term commitments to make regular financial payments. The purpose of the insurance is to make the repayments if the borrower may be unable to when one of the number of insured events occurs. The most common of these events are death and disability, but cover for unemployment is also widely available.

The cover has several elements. First there is the actual event covered. Many policies cover only unemployment arising from redundancy within the meaning of the Employment Protection Act. Some policies also cover dismissal arising from causes such as the general inadequacy of the insured, or in circumstances akin to redundancy but not actually within the legal definition of redundancy. Very few policies cover all unemployment, including that arising from the voluntary resignation of the insured, or his dismissal for misconduct.

The second element is the waiting period for benefit. It is usual for insureds who become unemployed to have to wait thirty days before they become eligible for any payments from the insurance. Many policies specify a longer period than this, although shorter periods are not common. After that, the insured may be eligible for a month's benefit for every month he remains unemployed, or a day's benefit for every day he remains unemployed, and some policies will give benefit in respect of the waiting period once it has ended.

The third element is the limit of the number of payments which may be made on a single claim. In a short term personal loan of up to five years, or a credit card account, there is a natural maximum period, which is until the debt is cleared. However, in order to keep premium rates affordable, payments are often limited to a shorter period than this - six or twelve months being the most common. When the loan is very long term, such as a mortgage, or the payments are an indefinite stream, such as a direct debit for electricity payments, a limit must be imposed on the number of payments, and this limit is usually six or twelve months.

Creditor policies are normally subject to a number of exclusions from cover. In respect of unemployment the most common are unemployment resulting from strikes or lock-outs, unemployment which is a normal seasonal occurrence in the industry concerned, unemployment following the end of a fixed term contract and unemployment about which the insured knew, or ought to have known, at the time the policy commenced.

It is unusual for creditor insurance policies to be underwritten individually. Insurers usually rely on the exclusions to be able to deny cover to those who would be unsuitable risks, and expect those who would not be able to claim not to effect the cover when taking out the loan. They also rely on the financial underwriting of the lender when granting the loan to exclude thoroughly unsuitable cases. It is expected that the existence of creditor insurance will not influence the lender's decision on whether or not to grant the loan.

An important principle of creditor insurance is its short term nature. Policies are insured for the term of a loan, which generally means a maximum of five years, and in the vast majority of cases three years or less. Rate guarantees are generally short term - policies already on the books cannot have their terms varied, but the terms for issuing new policies are usually not guaranteed beyond the next annual renewal date of the arrangement, and sometimes not for that long. Creditor insurance on ongoing arrangements, such as credit cards and mortgages, is usually issued as a series of one month policies, in which the next policy renewal is not guaranteed from month to month, or possibly only until the next annual renewal.

5.4 Issues For Resolution

If private insurance arrangements are to succeed in providing unemployment benefits the following areas will need to be addressed:

- supervision,
- solvency,
- capacity,
- reinsurance,
- taxation - insurer and policyholder,
- selective underwriting,
- red lining - will all occupations be insurable?
- pricing,
- reserving - including claims equalisation reserves,
- nature of purchase: voluntary or compulsory,
- investment policy,
- claims handling.

It is hoped that consideration of these and other issues will stimulate a lively and productive debate at the 1994 GIRO conference.

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