The Actuarial Profession
making financial sense of the future

Consultation response

Ministry of Justice

Claims Management Regulation: Proposal to amend the Conduct of Authorised Persons Rules 2007 to prohibit the offering of cash payments or similar as an inducement to make a claim

February 2011

About the Actuarial Profession

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

Submission to the proposal on Claims Management Regulation **(CP19/10)**

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Purpose of this paper

This paper is a response to the consultation paper CP19/10 of December 2010 to amend the Conduct of Authorised Persons Rule 2007 to prohibit the offer of cash payments or similar as an inducement to make a claim. It sets out general comments rather than specific answers to the questionnaire, as given in page 9 of the Consultation Paper. The aim of the comments below is to establish a link between the Ministry of Justice's proposal on the prohibition of cash payments or other inducements (16 i) and the rising cost of claims insurance premiums.

Background to the Motor Insurance Industry

Motor insurance offers cover to both personal and commercial customers in the UK and is compulsory in respect of third party property damage and third party bodily injury.

FSA regulated insurers collect of the order of £10bn in motor premiums each year. The motor insurance industry lost money in 2009 (as per the FSA returns based on combined operating ratios). The combined operating ratio for the market was 118.2% in 2009, which means there was a loss of 18p for every £1 of premium sold **-** a loss of 21p for every £1 of premium for personal policies and an equivalent loss of 8p for commercial policies.

Insurance premiums are already rising as a consequence of increasing claims costs. The Confused.Com/EMB press release on January 2011 cited market increases of 38.2% for comprehensive policies over 2010 (with even greater increases for non comprehensive policies). It is highly likely that material further increases will be required before the UK insurance market moves from a position of running heavy sustained losses to one where it can be placed on a sound economic footing.

Background to the Working Party

The Institute & Faculty of Actuaries commissioned a working party to investigate third party motor insurance based on some worrying inflationary trends being reported by individual insurers. The working party reported its findings at the annual actuarial general insurance conference (GIRO) in October 2010. These findings were based on data it collected from 89% of the UK regulated motor market up to and including the year 2009. In addition, the working party also carried out research on international trends and the link between the legal framework and claim inflation.

We believe that the findings of the working party provide important input to the consultation around the regulation of claims management companies and the wider context addressed by the recommendations of Lord Justice Jackson. This paper focuses on the increasing number of third party claims and how this might have been affected by the actions of claims management companies. The paper summarising the results from the working party analysis is publically available.

Key findings

The key findings from our working party that are relevant for this paper are:

1. The number of third party bodily injury claims has been increasing at 10% per annum for the period 2007 to 2009 while the number of third party damage claims has been falling over this period (see Exhibit 1).
2. The average cost of settled third party injury claims has been increasing at 20% per annum over the period 2007 to 2009 (see Exhibit 2), some of which results from an increase in the average number of claimants per claim.
3. There has been a large increase in the number of claims management companies over recent years. From 2008 to 2009 there was a 60% increase in the number of regulated PI firms and a 25% increase in the revenue of these firms.
4. There is a strong correlation between the growth of claims management companies from 2008 to 2009 and the increase in bodily injury claims frequency over the same period. Exhibit 3 shows that the areas that have experienced the greatest increase in the number of bodily injury claims have tended to be the areas with the highest growth in claims management companies.
5. The proportion of third party injury claims relative to the number of third party property claims has increased over time and is typically highest in areas where there are a large number of claims management companies (see Exhibit 4).

Conclusion

From our work we draw two main conclusions which are relevant to this paper.

a. There is a link between the existence of claim management companies and the increase in third party injury claims.
b. The increase in costs insurers have faced over recent years is primarily driven by the increase in both the number and average cost of third party injury claims, rather than from damage claims.

We have not attempted to ascertain whether the rise in claims management companies has caused the increase in third party injury claims or whether the rise in third party injury claims has caused the increase in claims management companies.

However, we do believe that **the Ministry of Justice's proposal on the prohibition of cash payments or other inducements (16 i) is likely to lead to a reduction in the cost of Third party injury claims which, over time, should lead to lower insurance premiums.**

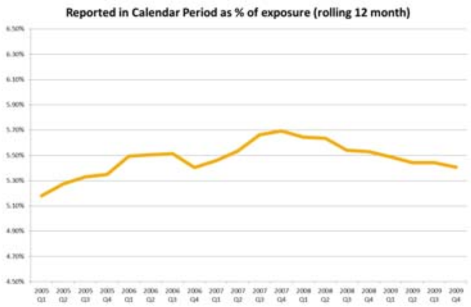
The increase in the number of third party injury claims has arisen despite the known improvements in road safety and car technology that have occurred during the past few years.

Notably in Scotland where there are no claims management companies the experience differs and the ratio of third party injury claims to Third party damage claims is lower than for any other region.

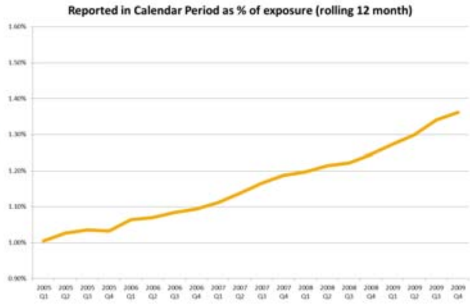
Exhibit 1 – Trends in Reported Number of Claims (TPD and TPI)

Preliminary Results
Reported Numbers of Claims (TPD and TPI)

Third Party Property Damage



Third Party Bodily Injury

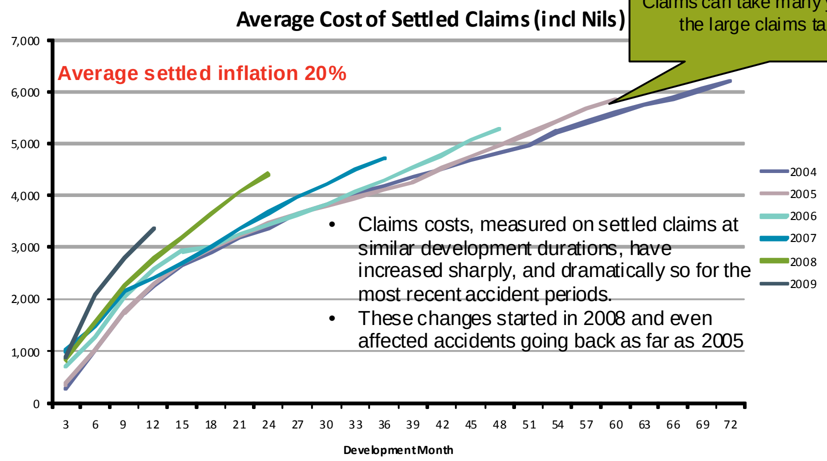


From the working party data the number of accidents reported to insurers has been decreasing in recent years, but the number of bodily injury claims has been increasing. This has at least partially been recognised in insurers' results

Exhibit 2 – Trends in Average Cost of Settled Claims (TPI)

Private Car Comprehensive
Third Party Capped Injury

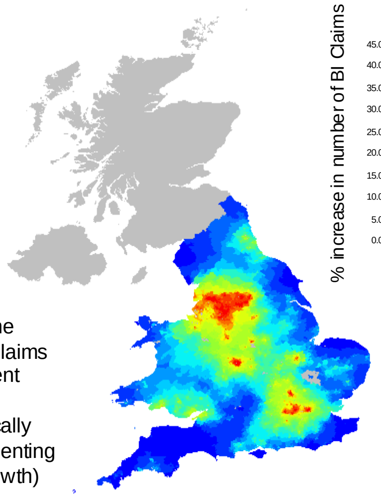
Each line shows the average cost of bodily injury claims settling for individual (accident) years. The lines show how these average costs have developed over time – over the 12 months of the calendar year in which the accident took place – and beyond. Claims can take many years to settle – the large claims taking longer



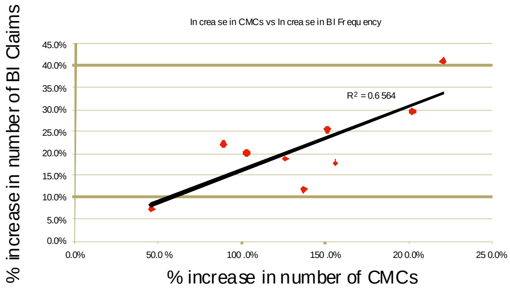
Inflation Rate: 08-09: 20.2% 07-08: 20.3% 06-07: 9.6% 05-06: 6.2% 04-05: 4.5%

Exhibit 3

The Growth of Bodily Injury Correlates with the Growth in Claims Management Companies



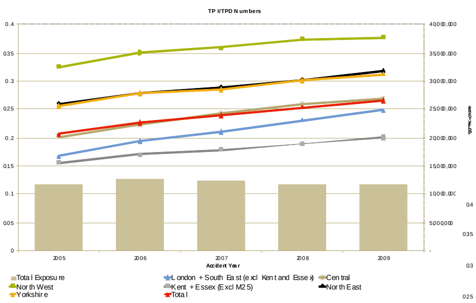
The map indicates the growth of claims management companies geographically (red representing highest growth)



The graph shows the relationship (in different geographical regions) between the growth of claims management companies over time and the increase in bodily injury claims frequency. Each data point corresponds to a different TV region.

Exhibit 4

TPI / TPD numbers (% of insured accident involving bodily injury) by TV region (Private Car Comprehensive)



- North West the biggest problem
- All TV regions are showing increases in frequency over time
- But London the greatest growth
- Later years are undeveloped

- Notably Scottish TV regions show flatter trends probably linked to different legal systems