Up Close and Personal

Issues affecting the Personal Lines General Insurance Market:

- Rainfall
- Update on Ogden and Courts Acts
- Mortgage indemnity and bursting the bubble
- Other emerging issues

Up Close and Personal

Rainfall
Rainfall

- What caused the floods
- Historical data and trends
- Impacts
- Historical perspective
- Dry years

What caused the floods?

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- What is an El Niño?
  - El Niño is an oscillation of the ocean-atmosphere system in the tropical Pacific having important consequences for weather around the globe.
  - El Niño is characterized by unusually warm ocean temperatures in the Equatorial Pacific

- What is a La Niña?
  - La Niña is characterized by unusually cold ocean temperatures in the Equatorial Pacific

Historical data and trends
Wet year (October 2000)
Historical data and trends
Dry year (June 2003)

Historical data and trends
Dry year (June 2006)

Ocean temperature over different periods

- October 2000
- June 2003
- June 2007
- June 2006
Historical data and trends

- In **winter**, there has been a statistically significant shift towards heavier rainfall. This trend is most apparent over central and eastern parts of Britain.
- In **summer**, at most locations, there has been a shift towards lighter rainfall. This pattern is strongest in south-central and northern England and in eastern Scotland.
- In **spring and autumn** picture is less clear.

Source: Parliament Study
Historical data and trends: wet years
- June and July 2007 wettest since 1914? Almost wettest? Or nowhere close?
- Rainfall in 2007 was 27.3cm, previous record was 22.8cm in 1931
- Chart of rainfall in June and July

Historical data and trends: dry years
- How dry was 1996 and 2003?
- In 1996 and 2003 total UK rainfall was 91.6cm and 90.2cm
- Over the past 94 years only 9 years had annual rainfall levels at or below this amount (6 years if we consider England only).
- Of the above 9 years only 3 were preceded by a year of below average rainfall, one of which was 2003.

Impacts
June & July 2007
- insured losses at around £2.5bn to £3bn
  - add 28% to the industry’s gross property loss ratio (source S&P)
  - repair cost strain / demand surge will push up costs
    - Jan 2005 Carlisle floods building costs rose 50%. (source ABI)
March 1947
- insured losses of £4.5bn to £6bn if it occurred today
  (source Risk Management Solutions, catastrophe modellers)
- Conclusion…sorry no Crystal ball
Up Close and Personal

OGDEN
&
COURTS ACT

Ogden

- GAD published 6th version on 3 May 2007
- Mortality
  - allows for improved & improving mortality
  - includes Scotland & Northern Ireland
- Contingencies other than mortality
  - disabled spend more time out of employment
  - future employment status determined by
    - gender
    - current employment status
    - whether disabled, or not
    - educational attainment (replace occupation, industrial sector, geographic location & level of economic activity)

Ogden how will the Courts deal with proposed methodology?

- Full loss of earnings
  \[ \text{loss} \times \text{annuity} \times \text{adj} \]
- Partial loss of earnings
  \[ (\text{loss} - \text{earnings}) \times \text{annuity} \times \text{adj} \]
  vs
  \[ \text{loss} \times \text{annuity} \times \text{adj} \]
  less
  \[ \text{earnings} \times \text{annuity} \times \text{adj}^* \]

- “Smith vs Manchester”
  \[ \text{earnings} \times \text{annuity} \times (\text{adj} - \text{adj}^*) \]
Ogden discount rate

Courts Act
- Periodic Payments
  - take-up rate still low, especially for direct insurers
  - legal decision to use healthcare workers earnings index
- Effect on lump sum awards
  - opinion divided on whether this will affect the Ogden discount rate
  - critical issue: number of periodic payment settlements (using earnings index)
  - considerable downside for insurers!

Up Close and Personal

MORTGAGE INDEMNITY and bursting of the property bubble
MIG

- UK
- UK vs US
- Affordability
- US problems and UK comparators

UK Housing

UK housing valuation metrics

Source: Nationwide, ONS, ABS, HMRC, Nationwide
US and UK household debt

Housing Data & Trends

Germany not in sync with other housing markets

Note: Statistically significant positive correlations (95% confidence level) are bold.

Source: Citi Research
US - Sub-prime

• General term that refers to the practice of making loans to borrowers who do not qualify for the best market interest rate because of their deficient credit history.

• Sub-prime lending is risky for both lenders and borrowers due to the combination of high interest rates, poor credit history, and murky financial situations.

• Sub-prime lending encompasses a variety of credit instruments, including sub-prime mortgages, sub-prime car loans, and sub-prime credit cards.

• Over the past two decades, computerised databases and scoring methods have enabled lenders to classify loan applicants with greater accuracy. There has been a corresponding increase in the number of ‘mainstream’ lenders willing to extend credit to sub-prime applicants and even to the highest ranked sub-prime applicants. (FSA consumer research article)

• Sub-prime loans made up 20% of all new housing loans in the past two years, according to Professor Nouriel Roubini of New York University

UK – Sub prime

• High profile lenders including Kensington Mortgages, which was recently bought by fund manager Investec, and Amber, owned by Skipton Building Society, have recently stopped selling higher-risk products.

• The possibility of bankruptcies in the sector was heightened when sub-prime lender Victoria Mortgages went into administration. Victoria sold £500m worth of mortgages last year, accounting for about 3% of the overall UK sub-prime market. At roughly £17bn this would equate to 15% of the total amount lent in 2006.

• A recent article in the Times noted that 9% of the UK mortgage market is accounted for by sub-prime with “Heavy adverse” estimated to account for a quarter of this amount. Their lending rate is linked to movements in the inter-bank lending rate.

• According to the Council of Mortgage Lenders, lenders foreclosed on 14,000 properties in the first six months of the year, 30 percent more than in the year-earlier period.

UK – Self certification

• A self-certification mortgage is a mortgage offered on the basis of you stating what your likely income will be, rather than providing documentary evidence. But you may have to ask an accountant to back up your statement.

• You are asked to pay a higher rate because statistics show most businesses fail within the first two years of trading. And if you are left with heavy debt there is a possibility you could lose your home. (Guardian article)

• And we specialise in providing self certification remortgages and secured loans, even if you’ve got CCJs, arrears, repossession orders, a past bankruptcy, etc. We can help with fast, friendly specialist assistance. – Fast Money

• One finding of recent FSA study: 42% of files reviewed were for employed customers and in 83% of these cases there was either no reason, or it was unclear if there was a reason, why the customer could not verify their income.
What’s next?

• Government figures show the number of households in England is expected to increase by 223,000 per annum (excluding immigration). House prices in Germany fell this year — see increase chart.

• Credit Crunch affecting businesses even where they are solvent and sound – liquidity issues.

• Bank of England guaranteeing bank accounts and lowering interest rates – solving the underlying problem or delaying the problem for another day?

• In a bleak warning, the IMF found that homes in Britain were overpriced by up to 40 per cent — far more than the overpricing in the US before the current property slump began there.

OTHER

Proposition: a case study

At fault Insurer 1

3rd party Insurer 2

conventional

£X

£X

emerging 1

£X+A

£X+A

–> –> £B Intermediary

emerging 2

£X+A

£X+A

←– £B Insurer 2
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THANK YOU