



Institute
and Faculty
of Actuaries

GIRO40

8 – 11 October, Edinburgh



Institute
and Faculty
of Actuaries

Hot Topic – PPOs

Insurer, reinsurer opinions
Capitalisation clauses

Antony Cloughton, DirectLine Group
Peter Saunders, Swiss Re
Members of the PPO Working Party

ertise
ponsorship
Thought leadership
Progress
Community
Sessional Meetings
Education
Working parties
Volunteering
Research
Shaping the future
Networking
Professional support
Enterprise and risk
Learned society
Opportunity
International profile
Journals
Support

14 October 2013

Welcome!

- Individuals survey information
- Capitalisation clauses
 - How do they work?
 - Company survey
 - Key decision areas
 - Potential impacts

14 October 2013

3

2013 contributors include



4

Individuals survey

14 October 2013

5

Survey response

- 159 Respondents
- 139 had heard of and were aware of PPOs!
- 95 either work for either an General Insurance direct insurer or reinsurer

	General	Life	Other	Pensions	Total
No	0	12	1	6	19
Yes	114	20	1	4	139
Blank	1	0	0	0	1
Total	115	32	2	10	159

- Today will generally focus on the 95 respondents views

14 October 2013

6

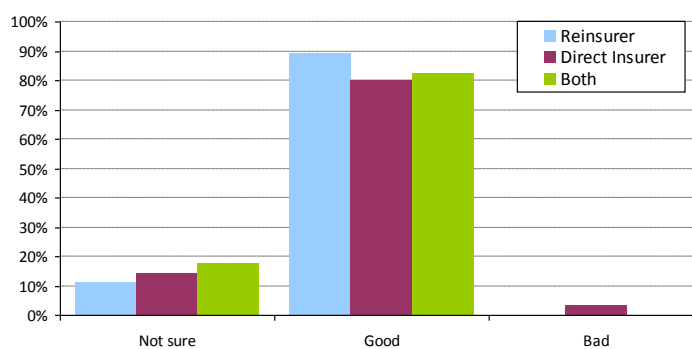
Are PPO's good for society?

What is your opinion?

14 October 2013

7

Are PPO's good for society?



- People not working for GI insurers/reinsurers had 89% “Good”, and 0% “Bad”
- 38% of those working in Life Insurance were “Not sure”

14 October 2013

8

How important are PPOs?

Do PPOs rank in the top three concerns within your own role?

14 October 2013

9

How important are PPOs?

Do you think they will rank in the top 3 for your role in 20 years time?

14 October 2013

10

Do PPOs rank in the top three concerns within your own role?

- 71% said ...

14 October 2013

11

Do PPOs rank in the top three concerns within your own role?

- 71% said ... **NO!**

14 October 2013

12

Do PPOs rank in the top three concerns within your own role?

- 71% said ... **NO!**
 - Similar across insurers and reinsurers
 - 66% deal with PPOs in their role

14 October 2013

13

Do PPOs rank in the top three concerns within your own role?

- 71% said ... **NO!**
 - Similar across insurers and reinsurers
 - 66% deal with PPOs in their role

- But in 20 years time

14 October 2013

14

Do PPOs rank in the top three concerns within your own role?

- 71% said ... **NO!**
 - Similar across insurers and reinsurers
 - 66% deal with PPOs in their role

- But in 20 years time still 57% said no ☹️

14 October 2013

15

Do PPOs rank in the top three concerns within your own role?

- **BUT**
73% said they should be in the current top three concerns for the insurers writing UK motor and UK liability business!
😊

14 October 2013

16

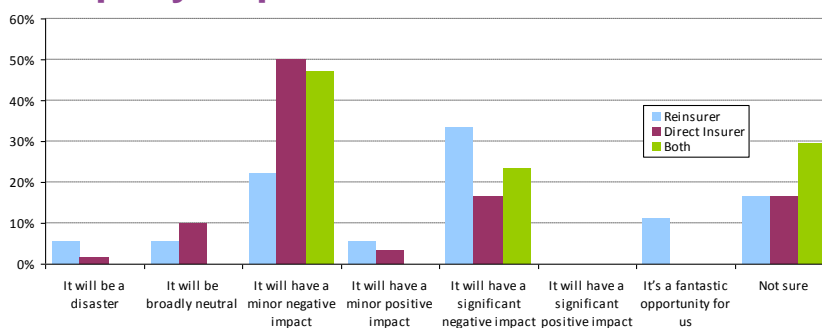
How important are PPOs?

What do you think causes the mismatch between role and company on importance?

14 October 2013

17

Company Impact

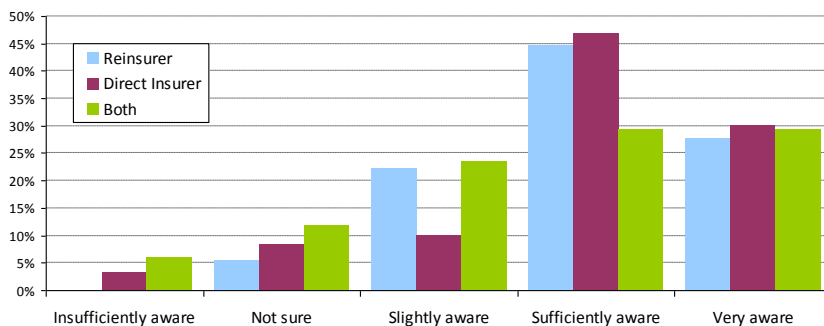


- Most respondents when asked about impact on the company fell into one of three camps
 - Not sure, and either a minor or significant negative impact
- However, over 50% in all three groups think PPOs will only have a small impact on day to day prices

14 October 2013

18

Management awareness of PPOs?

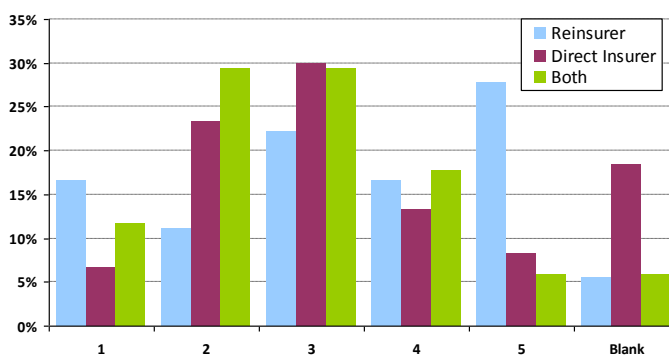


- Similar pattern for insurers and reinsurers
- Most commonly believe very or sufficiently aware

14 October 2013

19

Solvency II LTG awareness

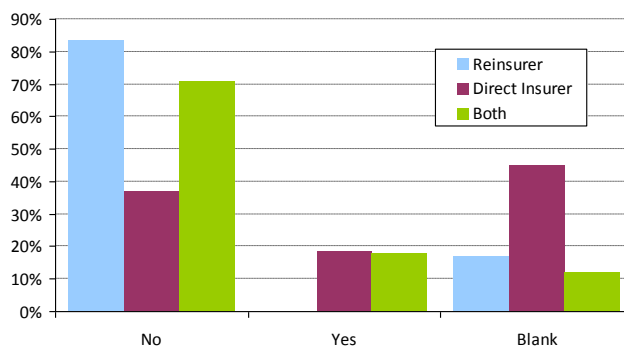


- Spread of views on the awareness of senior management about the LTG issues in Solvency II (1 = low awareness)
- Reinsurers have much fatter tails!

14 October 2013

20

Is your company planning to lobby around the LTG?



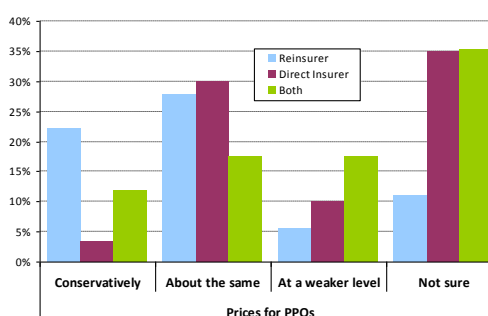
- Direct insurers more likely to lobby around the matching adjustment, no reinsurers lobbying
- But reinsurer proportion of PPO's is greater

14 October 2013

21

Respondent's think their company...

- Even less data than the total pool – 73 people responded
- Mistype with “about the same”. Hope still answered correctly
- But with all that – aren't the results interesting? Many simply aren't sure if they're pricing correctly, but 20% of reinsurer respondents thought they are pricing conservatively
- It should be noted – respondents may not be involved in Pricing functions!



14 October 2013

22

Pricing strength

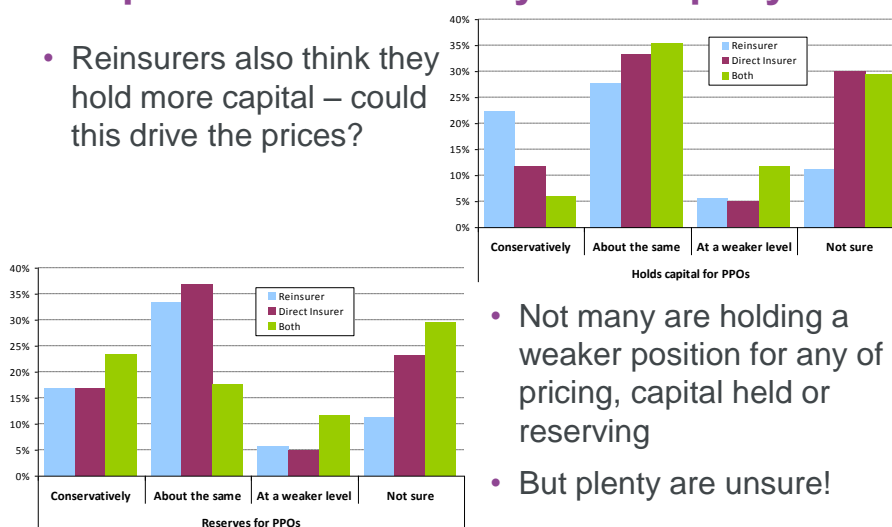
Your views on what might drive that?

14 October 2013

23

Respondent's think they're company...

- Reinsurers also think they hold more capital – could this drive the prices?



- Not many are holding a weaker position for any of pricing, capital held or reserving
- But plenty are unsure!

14 October 2013

24

Capitalisation Clauses

14 October 2013

25

What are the facts?

- Someone will carry the capital cost for PPO reserves
- The capital load will be smaller for those who can benefit from diversification and/or pool the risks
 - This is the classic reason for insurance
 - HOWEVER: PPO's are far more correlated across claims than typical policies or claims
- There is a significant amount of uncertainty around the assumptions underpinning the reserves
- If the reserves and capital calculations are uncertain, then the pricing is uncertain
 - Someone is going to **LOSE** and someone is going to **WIN**

14 October 2013

26

Capitalisation Clauses – are they common?

How many insurers do you think have them?

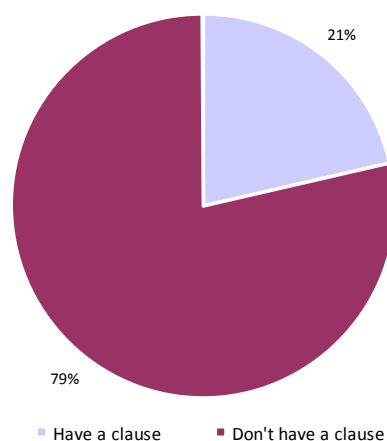
<25%
25% → 75%
>75%

14 October 2013

27

Capitalisation Clauses – are they common?

- Uncommon with the direct insurers interviewed
- However, survey biased towards larger companies
- All but one reinsurer interviewed did offer them – 43% prefer to write with a capitalisation clause
- Some reinsurers writing significant share of business with them

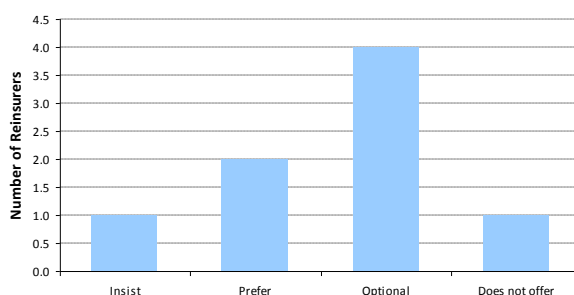


14 October 2013

28

What are Reinsurer views?

- Reinsurer opinion on the desirability of the capitalisation clause is split:



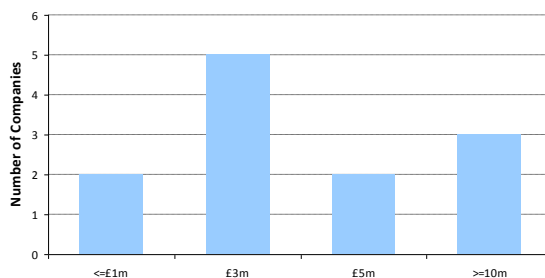
- A lot may depend on price

14 October 2013

29

How much reinsurance is taken?

- 12 of the direct insurers responded on what their motor retention level is:



- A significant variety with some direct insurers retaining the vast bulk of the costs – and some retaining very little

14 October 2013

30

Capitalisation Clauses

How many in the room have read or know what is in one of the IUA capitalisation clauses?

14 October 2013

31

Capitalisation Clauses

For those who haven't

<http://www.iuaclasses.co.uk>

Press the link for

Per Claimant Capitalisation
Calculator (Closed Version)

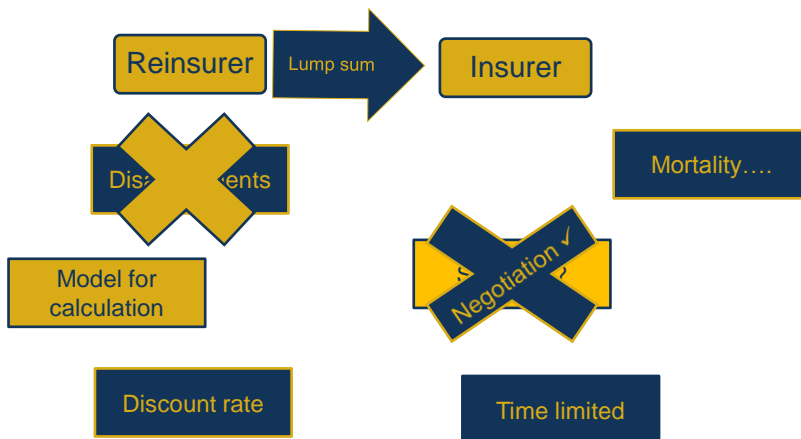
Then the link for the clause

[IUA02-017 Per Claimant Capitalisation Clause \(2\)](#)
[IUA02-016 Per Claimant Capitalisation Clause \(1\)](#)

14 October 2013

32

IUA Clause(s) – how do they work?



14 October 2013

33

IUA Clause(s) – how do they work?

- Other considerations at drafting of the capitalisation clause template were
 - Mandatory or optional capitalisation
 - Standard wording or customised
 - Timing of capitalisation
 - Variability orders
 - Statutory funding

14 October 2013

34

IUA Clause(s) – how do they work?

- Other considerations at drafting of the capitalisation clause template were
 - Mandatory or optional capitalisation - **Mandatory**
 - Standard wording or customised - **Customised**
 - Timing of capitalisation – **At settlement**
 - Variability orders – **Not compensated for**
 - Statutory funding – **Adjusted for, negotiate on time insurer in receipt of it for**

14 October 2013

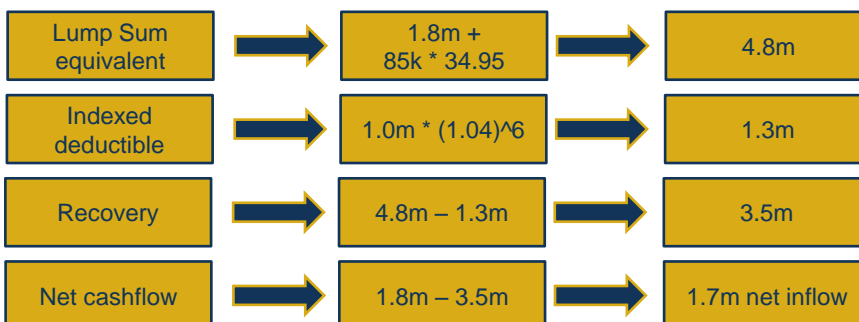
35

IUA Clause(s) – how do they work? An example

- One simplified claim scenario £'s

Ogden Multiplier
age 29+6 @ 1.5% $\xrightarrow{\text{Male}}$ 34.95

Assumption	Value
Age @ settlement	29
Lump sum	1,815,276
PPO	85,000
Settlement delay	6
Wages	4%
PPO index increase	4%
Impairment at settlement (years)	10
Investment income	6.5%
Ogden equivalent rate	1.5%
r/l attachment	1,000,000

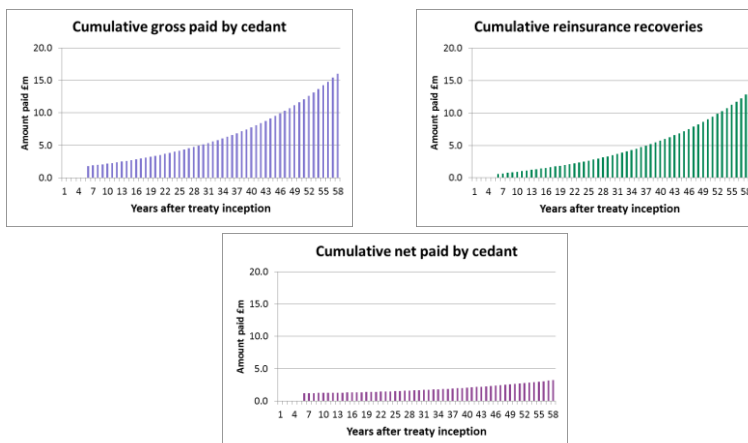


14 October 2013

36

IUA Clause(s) – how do they work? An example

- One claim scenario – Traditional Protection

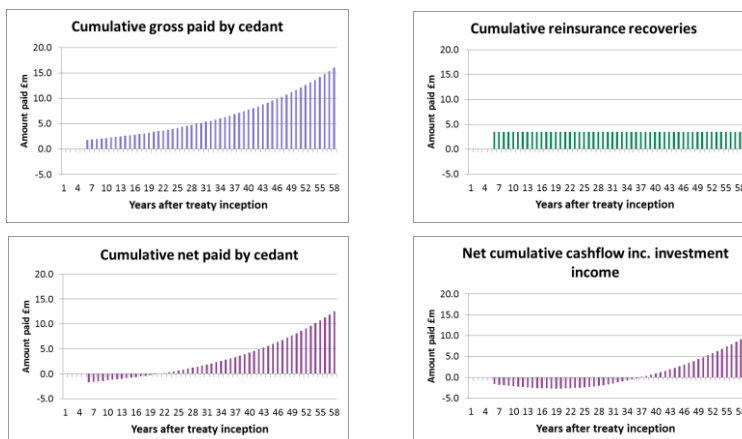


14 October 2013

37

IUA Clause(s) – how do they work? An example

- One claim scenario – Capitalised at Settlement



14 October 2013

38

Assumptions

- Defining a fair price depends on the assumptions
- Key ones are:
 - Real Discount Rate (Ogden equivalent)
 - Life expectancy
- Additional assumptions
 - Statutory funding

Insurer Considerations

- Before deciding to buy a capitalised product the insurer will need to consider
 - Cost benefit of taking on extra risks (future inflation, investment return, longevity, number of PPOs, legislative changes, assumptions varying from reality)
 - Capital impact
 - Reinsurer security
 - Impact on liquidity
 - Administrative burden of reinsurance recoveries

Reinsurer Considerations

- Before deciding to sell a capitalised product the reinsurer will need to consider
 - Cost benefit of taking on extra risks (Future inflation, investment return, longevity, number of PPOs, legislative changes, assumptions varying from reality)
 - Capital impact
 - Administrative burden of multiple versions
 - Any impact on cedant settlement behaviour (encourage to pay-off for lump sums)
 - Miss-selling?

Assumptions – The Discount Rate

- Possibly the most important assumption in the final cost of a PPO
- So how do you decide what it is for pricing purposes?
 - Very much depends on price
- Two clauses exist – one for floating rate, one for fixed

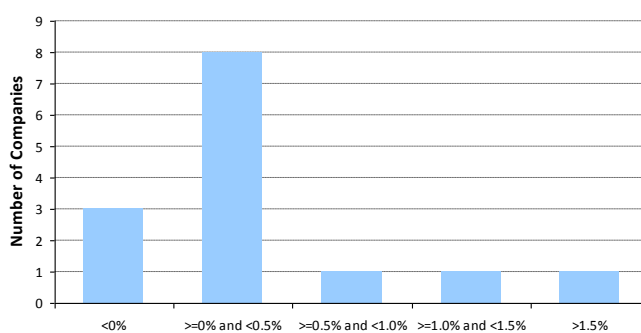
Assumptions – The Discount Rate

- We asked the companies what their real interest rate for reserving was.

14 October 2013

43

Direct Insurers' Real Discount Rate



- 14 responses, most below 0.5%
- We also asked the reinsurers

14 October 2013

44

Reinsurers' Discount Rate

Do you think it was higher or lower than the direct insurers?

14 October 2013

45

Reinsurers' Real Discount Rate

- No real consistency
- Two reinsurers don't discount
- Significant variation amongst the others



Both higher and lower than insurers

14 October 2013

46

Assumptions – Life Expectancy

- Usually at least two independent medical experts form an opinion
 - But the claim actually settles as a PPO
 - Which opinion should be used?
 - Are they all biased?
 - Include enough/too much mortality improvements? Cautious in front of a judge? Underestimate complications? Not allow for suicides?
 - Why are claimant's experts' views usually higher than insurer views?
 - Are there lessons from our life insurance colleagues?
-

14 October 2013

47

Life Expectancy

Views on life expectancy?

14 October 2013

48

Life Expectancy

- How are PPOs performing so far?
- Session E10 has some information!

14 October 2013

49

Capitalisation Clauses – Good or Bad ideas?

Do you think Capitalisation Clauses are a good idea

– for Direct Insurers?

– for Reinsurers?

14 October 2013

50

To close ...

- Please still fill out the survey!
 - Results will be published in the PPO Working Party paper
 - It can be found here:
<http://www.actuaries.org.uk/news/articles/periodic-payment-orders-working-party-survey-members-views>
 - and a link is on the front page of the Institute and Faculty of Actuaries website
- Session D9 will have far more details of the results of the qualitative survey of companies plus the quantitative survey results
- Lets grab the popcorn and watch the reinsurance renewal season play out!

14 October 2013

51



Questions



Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.

14 October 2013

52