Hot Topic – PPOs

Insurer, reinsurer opinions
Capitalisation clauses

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Members of the PPO Working Party
Welcome!

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

2013 contributors include

- Ageas
- Aviva
- NFU Mutual
- AXA
- MMA
- esure
- CFS
- Liverpool Victoria
- Provident
- RSA
- Saga
- Direct Line Group
- Groupama
- Allianz Insurance
- Admiral
- Zurich Insurance
- NFU Mutual
- Groupama
- Allianz Insurance
- AXA
- Liverpool Victoria
- Provident
- RSA
- Saga
- Direct Line Group
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- Allianz Insurance
- AXA
- Liverpool Victoria
- Provident
- RSA
- Saga
- Direct Line Group
- Groupama
- Allianz Insurance
- Admiral
- Zurich Insurance
14 October 2013

Individuals survey

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

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<td>32</td>
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• Today will generally focus on the 95 respondents views
Are PPO’s good for society?

What is your opinion?

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

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

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How important are PPOs?

Do you think they will rank in the top 3 for your role in 20 years time?
Do PPOs rank in the top three concerns within your own role?

• 71% said …

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

• 71% said … NO!
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 ………
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 😞

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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!
  😊
How important are PPOs?

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

• 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
Management awareness of PPOs?

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

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!
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

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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!
Pricing strength

Your views on what might drive that?

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!
Capitalisation Clauses

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**
Capitalisation Clauses – are they common?

How many insurers do you think have them?

- <25%
- 25% → 75%
- >75%

- 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
What are Reinsurer views?

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

• A lot may depend on price

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

For those who haven't

http://www.iuaclesuses.co.uk

Press the link for

Then the link for the clause

IUA02-017 For Claimant Capitalisation Clause (2)
IUA02-018 For Claimant Capitalisation Clause (1)
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
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**

IUA Clause(s) – how do they work?

**An example**

- One simplified claim scenario £’s

<table>
<thead>
<tr>
<th>Assumption</th>
<th>Value</th>
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<tr>
<td>Age @ settlement</td>
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<tr>
<td>Lump sum</td>
<td>£1,815,276</td>
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<td>PPO</td>
<td>£85,000</td>
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<td>Settlement delay</td>
<td>6</td>
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<td>Wages</td>
<td>4%</td>
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<tr>
<td>PPO index increase</td>
<td>4%</td>
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<tr>
<td>Impairment at settlement (years)</td>
<td>10</td>
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<tr>
<td>Investment income</td>
<td>6.5%</td>
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<tr>
<td>Ogden equivalent rate</td>
<td>1.5%</td>
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<tr>
<td>r/I attachment</td>
<td>£1,000,000</td>
</tr>
</tbody>
</table>

Ogden Multiplier age 29+6 @1.5% = 34.95

Lump Sum equivalent = 1.8m + 85k * 34.95 = £4.8m

Indexed deductible = 1.0m * (1.04)^6 = £1.3m

Recovery = 4.8m – 1.3m = £3.5m

Net cashflow = 1.8m – 3.5m = £1.7m net inflow
IUA Clause(s) – how do they work?
An example
• One claim scenario – Traditional Protection

IUA Clause(s) – how do they work?
An example
• One claim scenario – Capitalised at Settlement
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.

Direct Insurers’ Real Discount Rate

- 14 responses, most below 0.5%
- We also asked the reinsurers
Reinsurers’ Discount Rate

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

Reinsurers’ Real Discount Rate

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

-2.5%  
+2.5%

Both higher and lower than insurers
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?
  – Why are claimant's experts' views usually higher than insurer views?
• Are there lessons from our life insurance colleagues?

Life Expectancy

Views on life expectancy?
Life Expectancy

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

Capitalisation Clauses – Good or Bad ideas?

Do you think Capitalisation Clauses are a good idea
– for Direct Insurers?
– for Reinsurers?
To close …

• Please still fill out the survey!
  – Results will be published in the PPO Working Party paper
  – 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!

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.