The Actuarial Profession
making financial sense of the future

General insurance pricing seminar
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Periodic Payment Orders: impact on Pricing and Reinsurance Buying

PPOs – Impact

For pricing
- consider the cost of PPOs compared to Ogden
- more capital

For reinsurance
- a more sophisticated model to assess the value of reinsurance

Stacks more uncertainty….

PPOs – What's the "problem"?

The certainty of a lump sum replaced by the uncertainty of an income for life…

£6 million now versus £1½million now and £100k for life indexed to earnings inflation

Uncertainty around future

- earnings inflation
- investment returns
- (impaired life) mortality
- reinsurer default
- legislative uncertainty

PPOs – Pricing and Reinsurance

- Overview
  - What
  - Why
  - How Many
  - Effect on reinsurance
- Impact on pricing
- Impact on reinsurance buying
- Practical Considerations

Recap on Ogden

Awards for serious injury cases will includes heads of damage for:-

- Loss of earnings
- Costs of providing appropriate accommodation etc
- Care costs
- Etc etc

Under Ogden, future costs are converted to a lump sum using specified tables

Discount rate set by Lord Chancellor - currently 2.5%

PPOs – What are they ?

When a periodic payment order is made not all future costs are not converted to a lump sum

Typically the insurer pays the claimant an income to cover care cost (yearly,half-yearly,quarterly) for life

The income is indexed typically to ASHE 6115 – an index of care workers hourly wages

Superceded previous structured settlements

PPOs – Why?

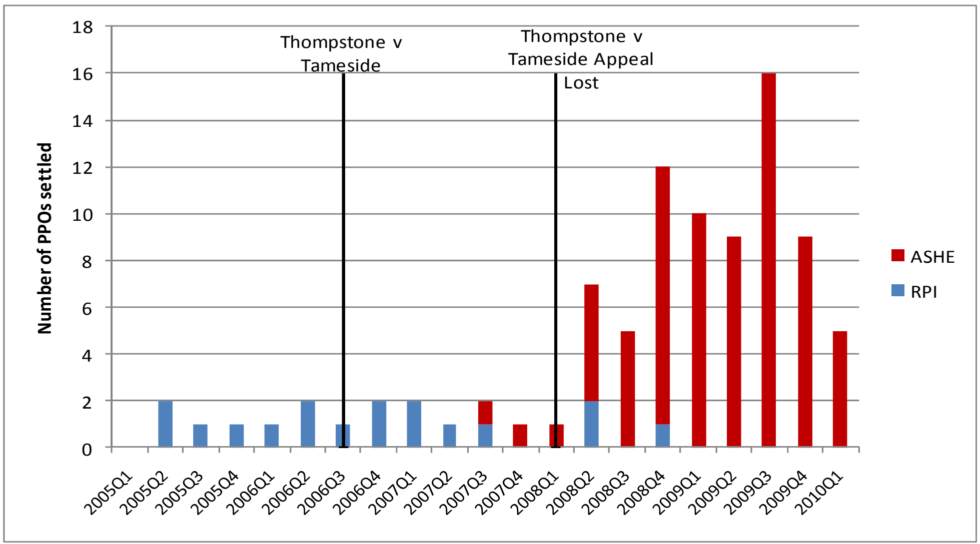
- Removes the risks that a seriously injured individual runs out of money either through poor investment, higher inflation or ‘living too long’
- Government keen because it reduces the chances that the lump sum runs out and the individual falls back on the state
- Often used when the claimant is young or incapable of decision making or where the life expectancy is highly uncertain

PPOs – How many

The number of PPOs has increased exponentially over the last 3-4 years

- Courts Act (2003) implemented in April 2005 with RPI being the accepted index
- November 2006 court judgment (Thomstone v Tameside and Glossop NHS) ruled that other (higher) indices could be used
- Upheld by Court of appeal Jan 2008
- Current poor investment conditions

PPOs – How many?



PPOs – How many

Insurance companies	circa 100
MIB	circa 45
NHS	circa 600

For insurers, mostly motor although a few liability

Already massive amounts of money (and uncertainty!)

PPOs – reinsurance issues

Excess of loss reinsurance designed for lump sum settlements not PPOs

PPOs move reinsurance recoveries far into the future

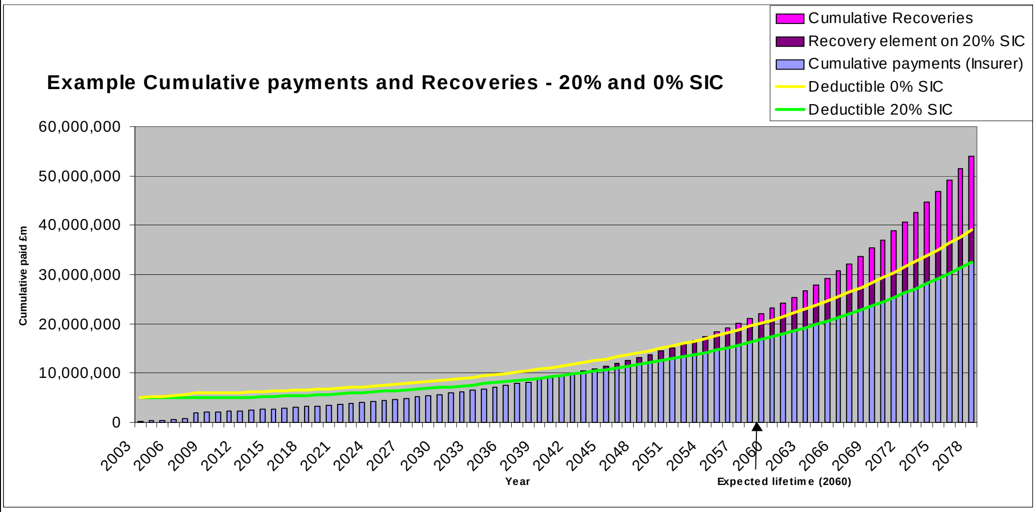
Retentions are indexed which makes situation worse

For a 20 year old claimant an insurer could be exposed to reinsurer default risk for 50 years or more

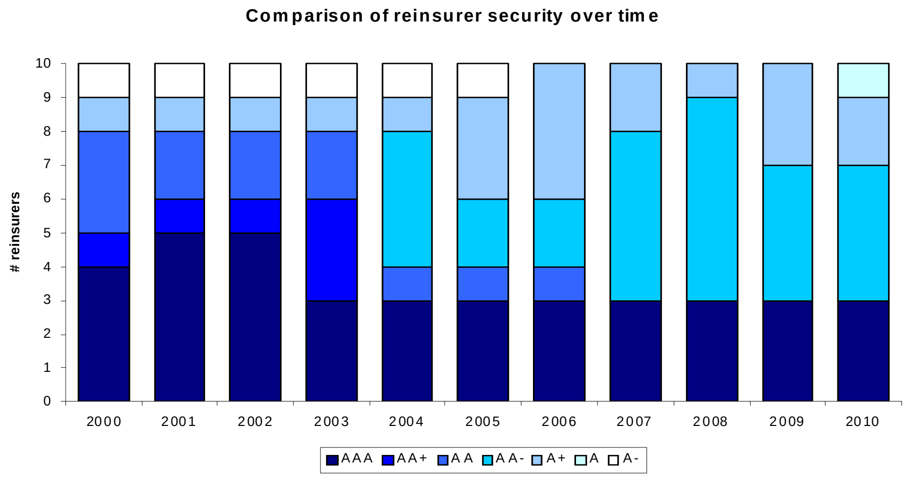
Retentions are indexed each year which

- means insurers continue to pay
- requires accurate record keeping

PPOs – reinsurance issues



PPOs – reinsurance default



Impact on Pricing

PPOs – Additional Pricing Load

Key Components

- - number of PPOs
- - cost of a PPO compared to Ogden
- - additional capital cost

PPOs – number of PPOs

- all the normal large claim assumptions plus
- proportion that will settle as a PPO
- But also need to consider:-
  - will the proportion need to vary according to economic conditions
  - more likely for minors
  - pricing now, settlement several years in the future

PPOs – assess cost

Assumptions required for ASHE index, discount rate, mortality, reinsurance default

Assume ASHE	X%
Assume Discount Rate	Y%
Net	“Y - X” %

Compare to current Ogden 2.5%

PPOs – cost compared to Ogden

Example

A young male seriously injured in a motor accident

Near normal life expectancy

Lump sum £1.5 million, Care costs £100k indexed

Ogden Lump sum	£6 million
PPO Reserve	£4-8 million dependent on assumptions

PPOs – capital

Masses of uncertainty mean extra capital
The insurer now takes the risk that the claimant used to take
On the balance sheet for decades rather than years
ASHE can't be matched
Unknown future PPO penetration

Impact on reinsurance buying

PPOs – reinsurance buying

Pre-PPO the assessment of (XOL) reinsurance buying involved

- Value = expected recoveries - reinsurance premium
- Impact on Portfolio volatility

PPOs – reinsurance buying

Post-PPO the assessment of (XOL) reinsurance buying changes to

- Value = expected recoveries + value of capital saved - reinsurance premium – cost of bad debt
- Impact on Portfolio volatility

Some practical considerations

PPOs – practical considerations

Paying them – do you have system for paying and indexing ?

Proof of life

Valuation Systems : 5 years to live v life expectancy reduced by 5 years…

Reinsurance recoveries : record keeping over 30-40 years

M&As

Accounting issues, FSA returns etc etc

PPOs – summary

It's complicated and uncertain

It changes the nature of general insurance companies

You need to think about now

- What to put in your pricing
- How you evaluate the reinsurance buying decision
- Capital modelling

GIRO working party

Questions or comments?

Expressions of individual views by members of The Actuarial Profession and its staff are encouraged.

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

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