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Ogden – and the end of PPOs?

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Presentation to Reserving Seminar 2017
20 June 2017

Note

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These slides were presented at the Reserving Seminar 2017.

If you have any questions, please contact Sharon Cumberbatch at the IFoA who will be able to put you in touch with the IFoA PPO Working Party members. Alternatively get in touch directly, our details are given at the end of the presentation.

Agenda

- WP Update
- Discount Rate changes
- Consultations
- Working party response

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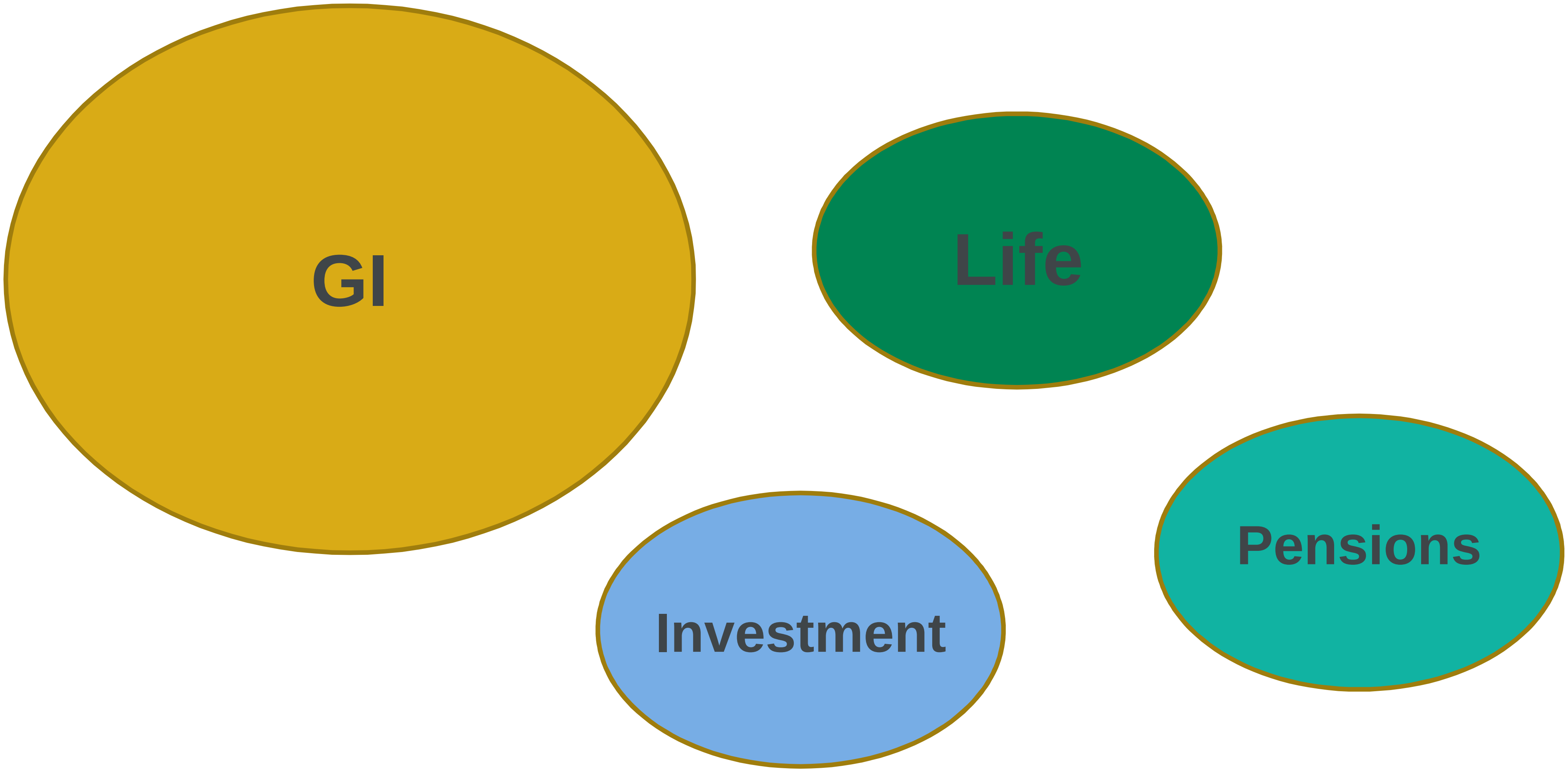
WP Update

20 June 2017

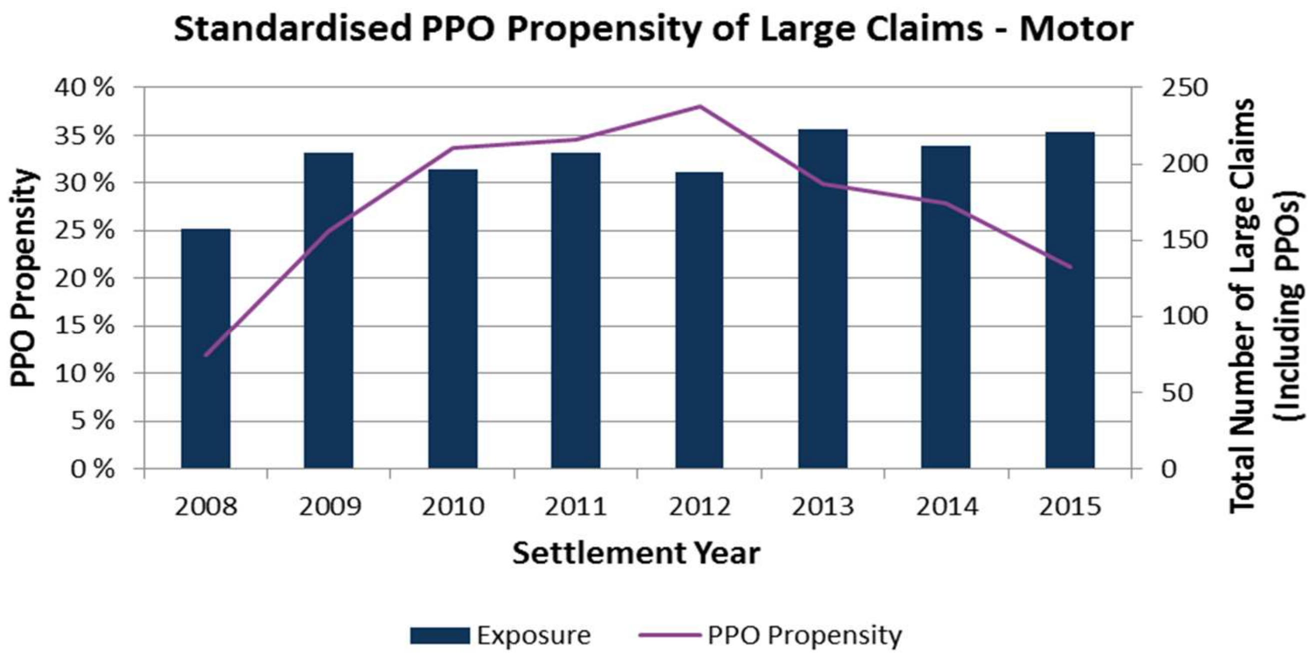
Working Party Make up



Thank you

- Thank you to all our contributors!
- By a larger proportion of you using our injury and care regime categorisations we intend to produce more in-depth results
- Thank you to all WP members

PPO Propensity



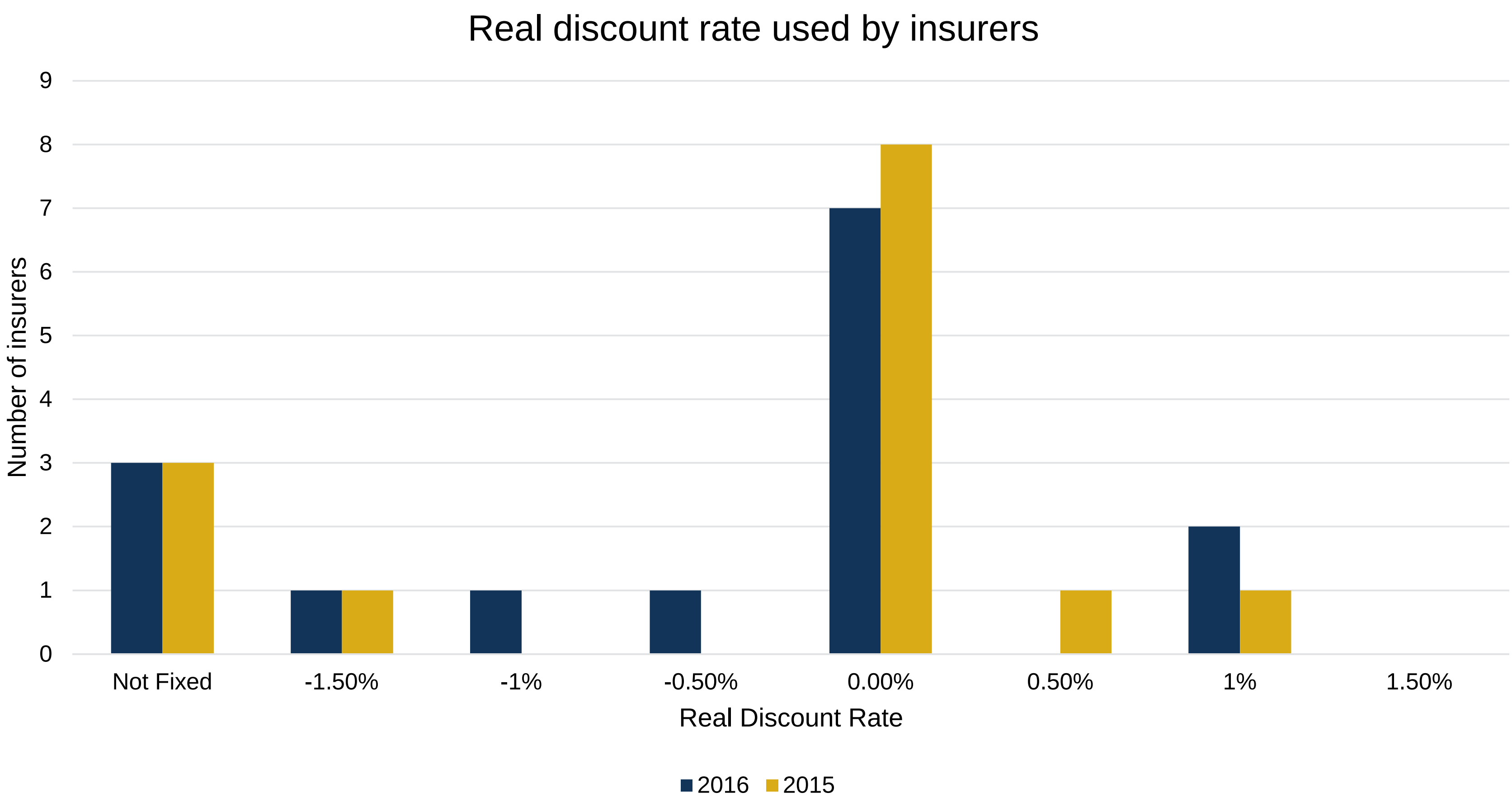
- PPO propensity reduced from 2014 to 2015
- The PPO propensity for the settlement year 2015 is 21%
- This standardised propensity is calculated using a standard mix of claim amounts
  - This is explained in the CIGI slides

2016 PPO Working Party Qualitative Survey

- Conducted telephone interviews with senior actuaries from various insurers and reinsurers regarding their exposure and approach to PPOs
  - Recent view – interview conducted in winter 2016-2017 (and spring 2017)
  - 14 insurers and 5 reinsurers
- Second round of questions asked in spring 2017 in relation to the change in the Ogden discount rate
  - 11 contributors (mix of insurers and reinsurers)

Discounting – real discount rate (GAAP)

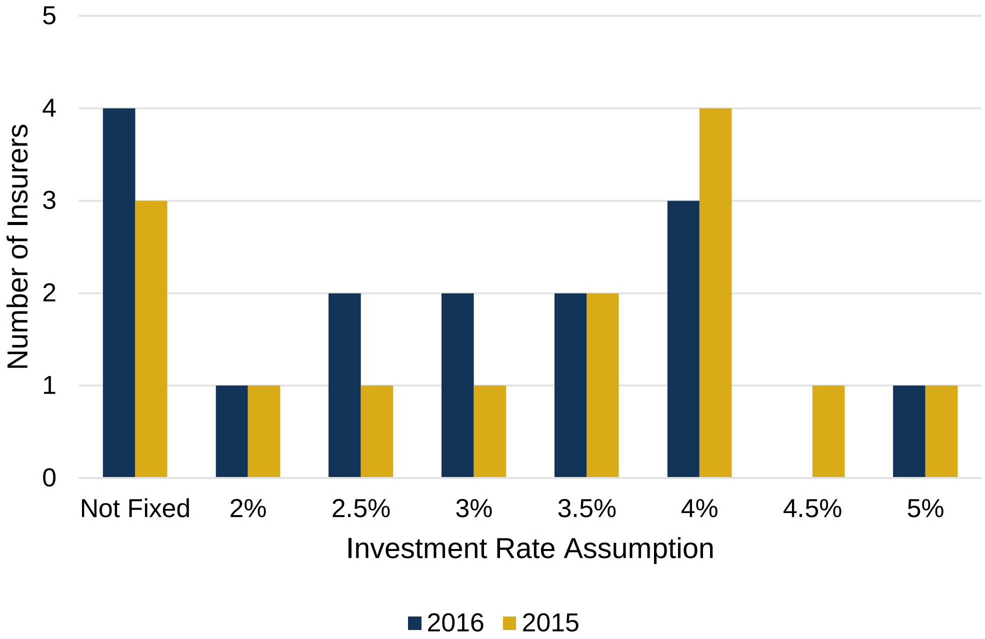
- For insurers, the most popular real discount rate remained at 0% per annum, although the distribution of real discount rates has shifted to more negative rates.

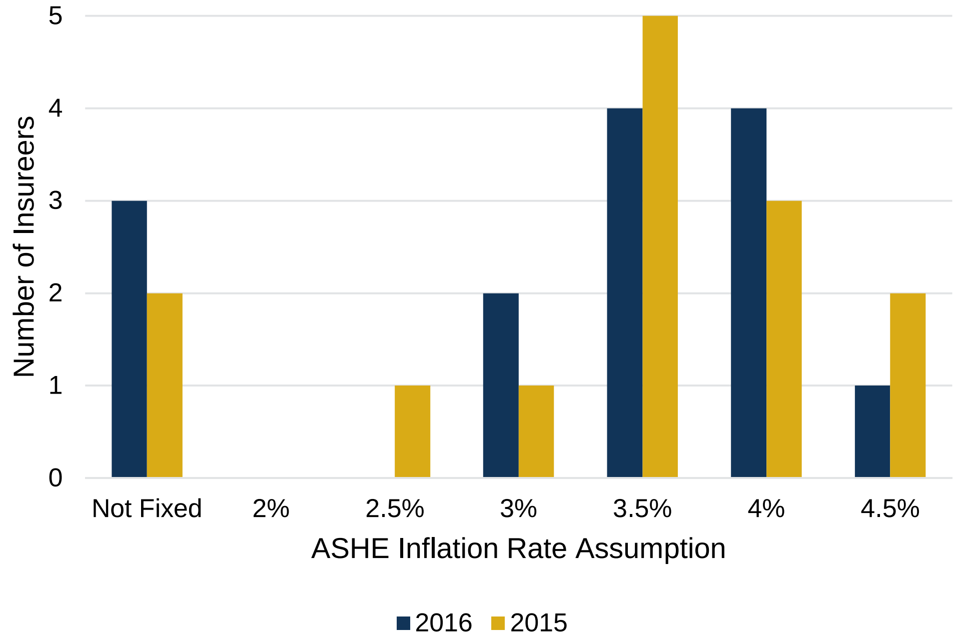


Discounting – components of real discount

Investment return and ASHE inflation assumptions (GAAP)

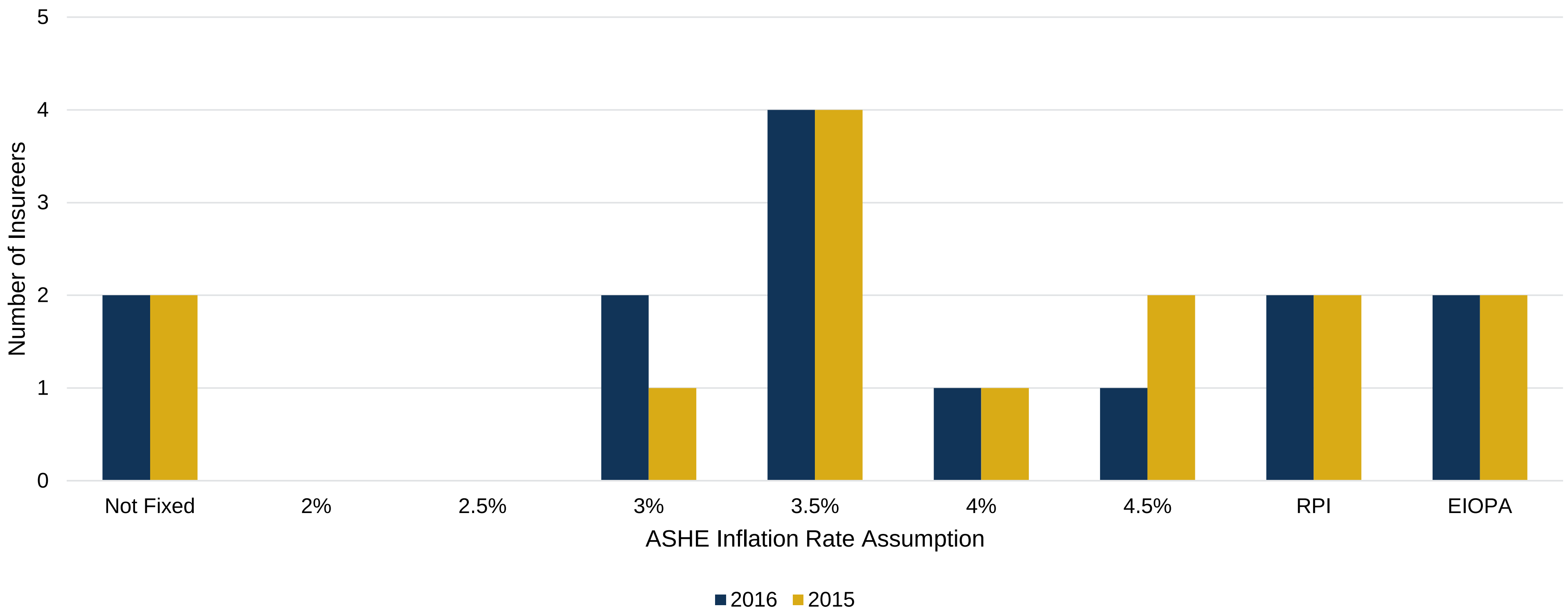
- Rates which weren't fixed tended to follow risk free yield curves or were based on risk free yield curves with an adjustment.
- Long term yields were generally based on the current assets held by the insurers.
- Future ASHE was derived using historical ASHE and RPI mostly.





Discounting – Solvency II

- As the EIOPA curve is prescribed, the main question revolves around the inflation rate used. For insurers:



- All reinsurers used the same ASHE rate for all valuations.

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Discount Rate

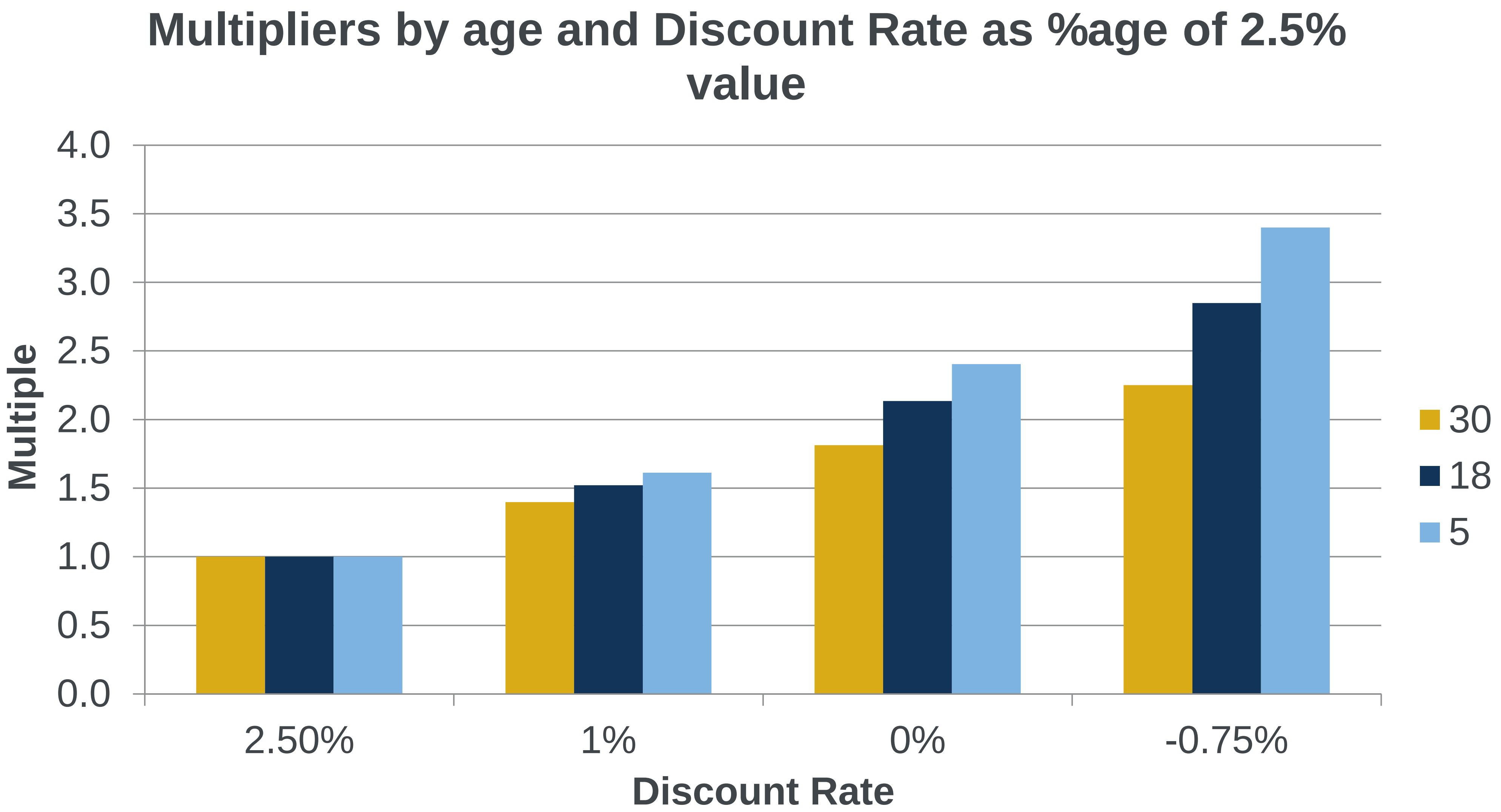
2 May 2017

Ogden discount rate – timeline

1999	Wells v Wells, Discount rate 3%, Risk free investor, ILGS yield, 100% compensation
2001	Lord Chancellor reviews – keeps methodology - Discount Rate 2.5%
2012	First consultation
2013	Second consultation
2014/5	Panel of experts report
2017	Lord Chancellor sets the Discount rate - -0.75%, announces consultation. Response 3/8/17
20??	Results of consultation

Multipliers

Multipliers



Claim examples

- Claim example 1

Lump sum - non futures	1,000,000	1,000,000	1,000,000
earnings	20,000	20,000	20,000
Cost of care	75,000	75,000	75,000
Age	5	18	30
Lump Sum 2.5%	£4m	£4m	£4m
Lump sum -0.75%	£11m	£9m	£7m

- Claim example 2

Lump sum - non futures	3,000,000	3,000,000	3,000,000
earnings	20,000	20,000	20,000
Cost of care	200,000	200,000	200,000
Age	5	18	30
Lump Sum 2.5%	£10m	£10m	£9m
Lump sum -0.75%	£28m	£23m	£18m

Caveat – calculations not 100% perfect – intended to be indicative – claim is fabricated

Claim examples

- Claim example 1

Lump sum - non futures	1,000,000	1,000,000	1,000,000
earnings	20,000	20,000	20,000
Cost of care	75,000	75,000	75,000
Age	5	18	30

DON'T FORGET – REINSURER IMPACT IS GREATER IN RELATIVE TERMS

- Claim example 2

Lump sum - non futures	3,000,000	3,000,000	3,000,000
earnings	20,000	20,000	20,000
Cost of care	200,000	200,000	200,000
Age	5	18	30
Lump Sum 2.5%	£10m	£10m	£9m
Lump sum -0.75%	£28m	£23m	£18m

Caveat – calculations not 100% perfect – intended to be indicative – claim is fabricated

Financial impact

Sabre
£2.2m

Aviva
£385m

Hastings
£20m

RSA
£85m

Direct Line
£175m

Acromas
£4m

Admiral
£105m

Consultations

What did the consultation say?

- Asked a number of questions with four main themes
  - How should the rate be set
  - How often should it be reviewed
  - Who should make the decision
  - What about PPOs?
- Short timeline of only 6 weeks
- Proposed a first response date of 5th August
  - "A response to this consultation exercise is due to be published by 03/08/17 at: http://www.justice.gov.uk and http://www.scotland.gov.uk"

Consultations

- IFoA response
  - Rate should be based on the market consistent valuation
    - (ILGS real yield)
  - Frequency of review should be driven by changes in the market yield
  - Formulaic approach requires no decision
  - PPOs should not affect the choice of discount rate

Consultations

- APIL response
  - Approach to setting the rate is appropriate
  - It should be reviewed every five years
  - Panel of experts – non political
  - PPO availability should not affect the discount rate

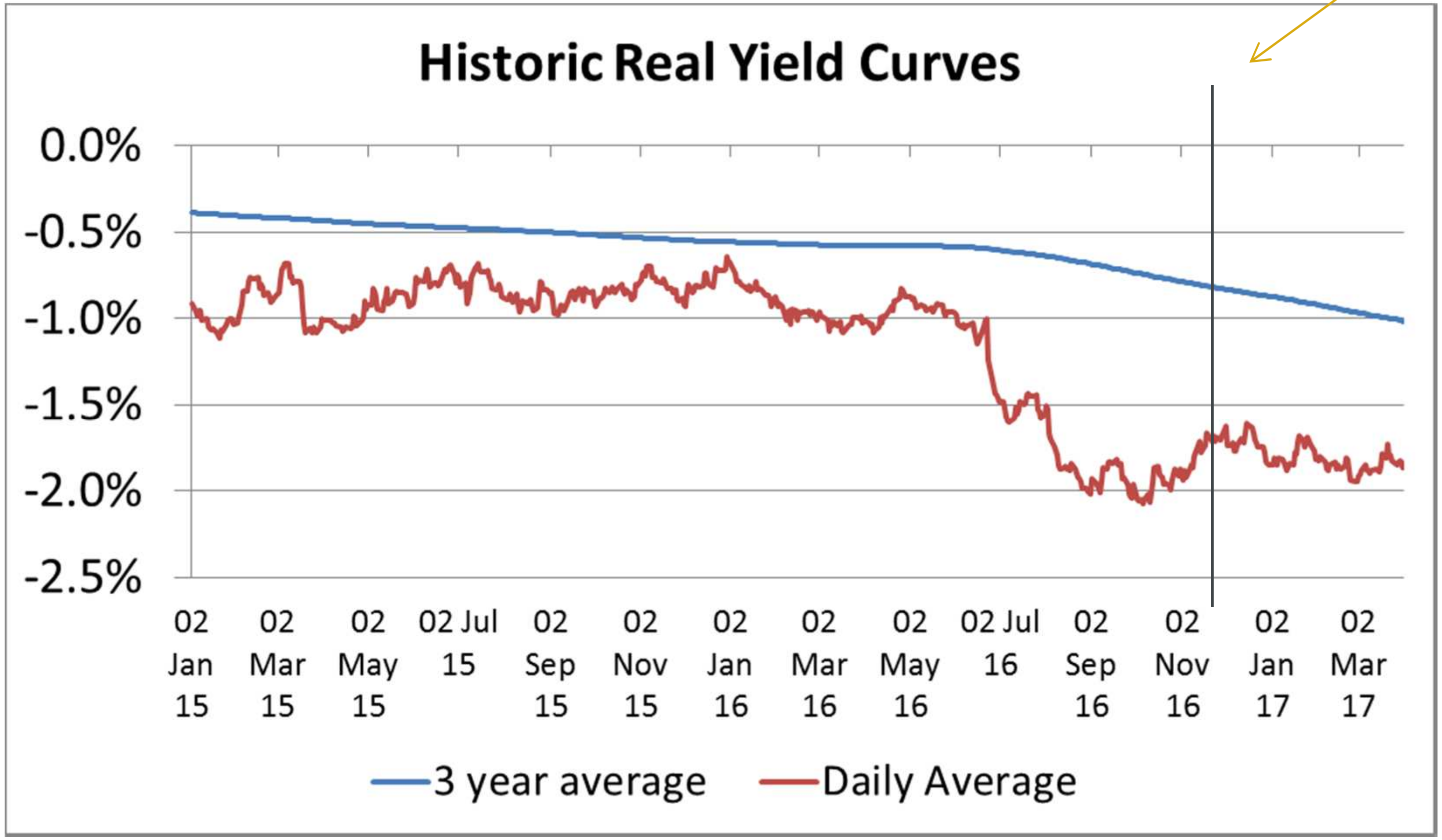
Consultations

- ABI response
  - The principle of 100% compensation for claimants
  - The preservation of claimant choice on the taking up of PPOs
  - The breaking of the link between the setting of the rate and ILGS
  - No tie to any particular investment model in the future
  - A reflection of the reality that claimants invest lump sums in low risk, mixed portfolios of assets

What might that mean – Discount Rate

- Historic yield curve information

31/12/16



What that might mean - timing

- Expect a more frequent review
- Could be monthly if IFoA adopted
- Claims environment expected to be more volatile
- APIL – 5 Years – less than average settlement time of a large claim

What that might mean – PPO propensity

- Universal desire for continued availability without changes to increase PPO use
- IFoA highlighted PPOs are better method of compensation for some types of loss
- Relative attractiveness affected
  - APIL/IFoA – PPOs become less economically attractive compared to now.
  - ABI – PPOs might become more economically attractive
- Government might still push for greater PPO use due to NHSLA situation
- Some claimants likely to always want a PPO

What that might mean – Election

- Hung parliament may delay the action taken
- Lizz Truss replaced by David Lidington
- Impact of decision on job security?
- More difficult to get legislation through?
- How high up the agenda will it be?
- Had thought Autumn 2018 – will this be possible?

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WP Response

What the working party is doing

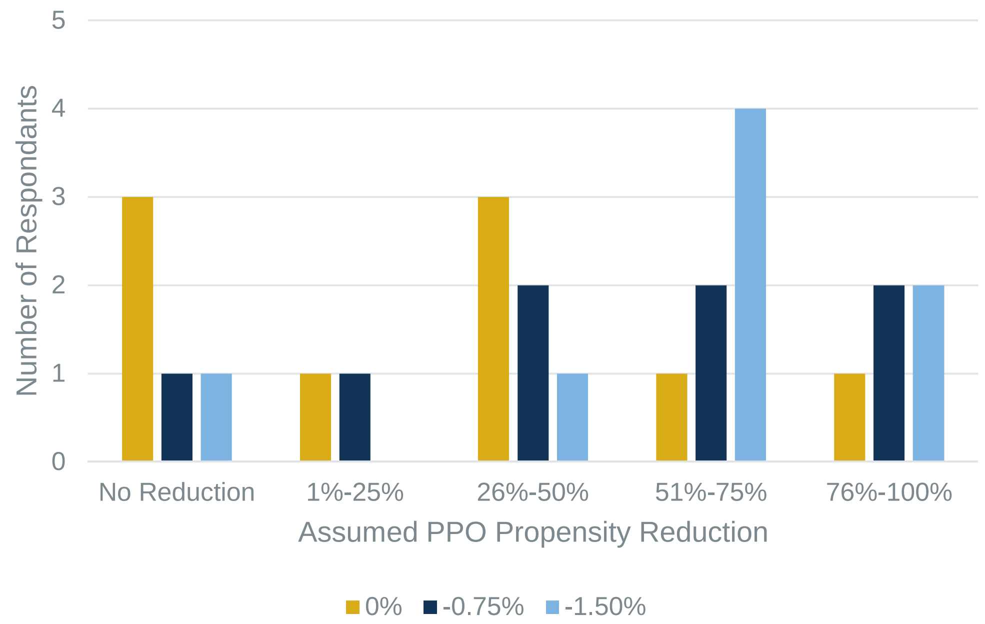
- Additional qualitative survey questions
- Collecting YE 2016 data
  - Interesting, yes, how relevant?
- Requesting End June information
  - High level
  - Number and settlement date of lump sums and PPO
  - New threshold? Discount rate impact?

Qualitative survey – additional questions 2016 year-end position

- All but two insurers valued non-PPOs within the actuarial best estimate (ABE) on an Ogden 2.5% per annum basis, i.e. the prevailing discount rate.
  - The two insurers that valued ABE reserves on a different basis did so at a rate of 1.5% per annum.
- While the majority of insurers held a margin for a reduction in the Ogden discount rate, this was often as part of a general margin as opposed to a specific margin.
  - There was no consensus in terms of allowance, with various insurers including an allowance for the Ogden discount rate dropping to 2.0%, 1.5%, 1.0% and 0% per annum.
- Of the reinsurers asked, three valued non-PPOs on an Ogden 2.5% per annum basis and one at a 2.0% per annum basis. All four of the responding reinsurers held a margin for a reduction in the Ogden discount rate as part of a general margin.

Post the announcement

- Of those insurers and reinsurers for which a response was received:
  - All apart from one are now or will be assuming a -0.75% per annum discount rate for valuing non-PPOs within the actuarial best estimate (ABE). (One reinsurer was waiting for updates from cedants on case estimates, but was setting IBNR at -0.75% per annum.)
  - As part of the revised valuation, two respondents made no explicit allowance for a change in PPO propensity, while others assumed a reduction in the PPO propensity.
- Insurers and reinsurers were asked what their previous assumed reductions in PPO propensity would have been, from scenario analysis, had the Ogden rate fallen to 0%, -0.75% or -1.5%



Post the announcement

- In terms of additional margins for further reductions in the Ogden discount rate, this was often as part of a general margin, in some cases being sufficient to cover a reduction to -2.0% per annum.
- Some respondents said that it was too early to comment on any changes in the speed of settlement of claims or claimant / lawyer behaviour, whereas others have noted:
  - Very few (or no) claim settlements since the “announcement of an announcement” in December 2016
  - A general slowing down of settlements
  - Claimant lawyers actively sought to slow down lump sum settlements until after the discount rate announcement.

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Conclusions

Recommended Actions

- Capital/reserving/pricing affected
  - Need to re-state the triangle. (history to current, or current to history?)
  - Settlement delay will be more important than previously
  - Need to be clear to claims how to record rate
- Reinsurance purchase decisions need to be carefully considered
- Communication of uncertainty the key
  - Need to highlight to boards that the rate could go down as well as up
- Capital
  - What about ENIDs? Where does the 99.5th sit in the distribution?
- Scenario analysis of strategic analyses important

Conclusions

- **No certainty on direction of discount rate**
- **Timing of consultation response uncertain and subject to election/brexit risk**
- **Frequency of update to the rate expected to be more frequent**
- **Unlikely to be the end of PPOs**
- **PPO WP looking to provide initial findings on PPO propensity post DR change at GIRO**
  - **BUT WE NEED YOUR HELP WITH THAT!!!!!!!!!!!**

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 presenters.

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Questions

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