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PPOs – Market update

IFoA PPO Working Party

24 May 2021

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Note

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- Although we have used our best efforts, no warranty is given about the accuracy of the information and no liability can be accepted for anybody relying on the accuracy of the information or following the recommendations in this presentation.

These slides represent views from the perspective of insurers and reinsurers.

If you have any questions, please contact Dawn McIntosh 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.

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PPOWP
2020 Survey

Contents

- This presentation combines two elements
  - 2019 YE quantitative survey results presented at GIRO 2020
  - 2020 qualitative survey results

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2020 PPO Working Party Qualitative Survey

PPOWP
2019 Survey

- Conducted telephone interviews with senior actuaries and claims staff from various insurers and reinsurers regarding their exposure and approach to PPOs
  - Recent view – interview conducted in early 2021
  - All analysis presented relates to these interviews unless otherwise stated
  - 11 insurers and 3 reinsurers.

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Agenda

- PPO propensity – 2019YE
- Actuarial methodology
  - Level of concern
  - Reserving methodology
  - Capital modelling
  - Pricing and claims management
- Reinsurance and alternative risk transfer
- Investment
- COVID-19
- Conclusions

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PPO Propensity

2019 YE Quantitative Results

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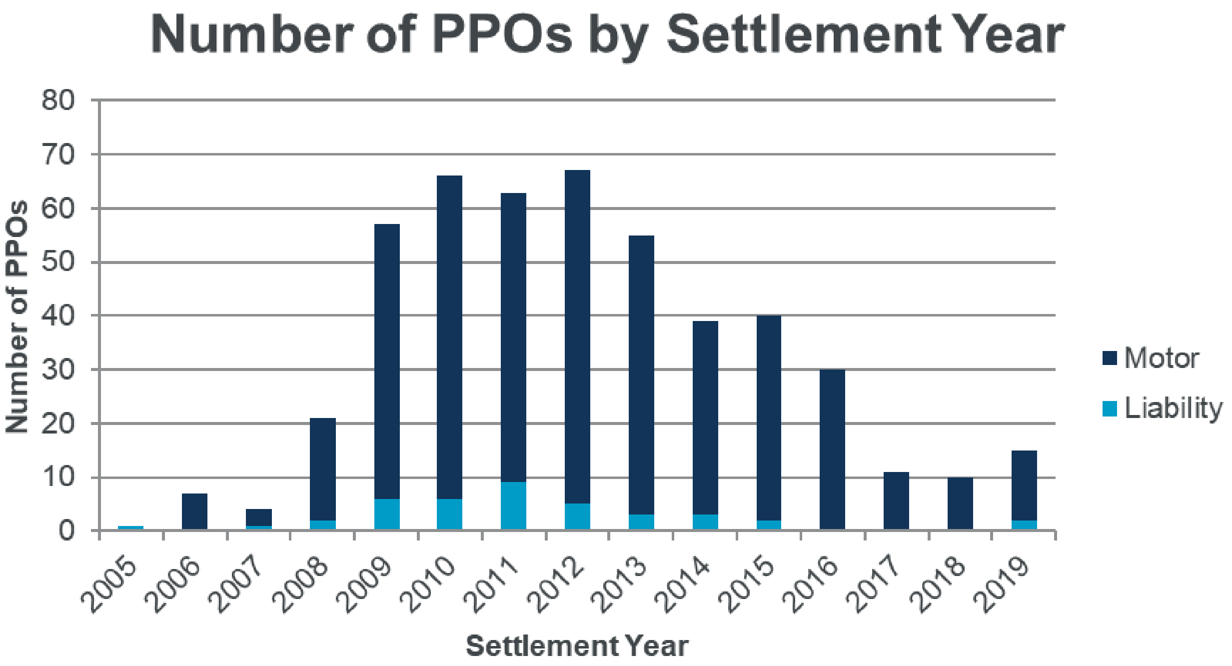
Number of PPOs



- The number of PPOs settling has increased in 2019 compared with recent years.
  - The number of PPOs settling in 2019 has reduced by 76% from levels seen in years 2009-2013.
  - The number of PPOs settling in 2019 has reduced by 59% from 2014-2016 levels.
  - The number of PPOs settling in 2019 has increased by 43% from levels seen in years 2017-2018.
  - There are still PPOs in a -0.25% Ogden Discount Rate world!
  - Two Liability PPOs for the first year since 2015.

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PPO Propensity Analysis

- Please note that all of the following propensity graphs involve Motor large claims from 2009 onwards ONLY, unless otherwise stated.
- Please also note that these results are presented as at 31 December 2019 and therefore after the Ogden discount rate change in August 2019.
- Large claims have been included in these graphs if they were > £1 million in 2011, using a 7% inflation rate.
  - For PPOs, we have used the equivalent Ogden value as if the claim had settled as a non-PPO.
- We have presented our results on various bases, as explained in the following slides.

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PPO Propensity Bases

- Akin to our more recent surveys, we present PPO propensity on a raw basis as well as a standardised basis.
- We standardise the propensity by taking into account the mix in the size of claims experience in each year.
  - This produces a PPO propensity with no bias due to the volatility in the size of large claims by year.
  - Information on how this is done can be found in the appendix of this presentation or in last year's GIRO presentation.

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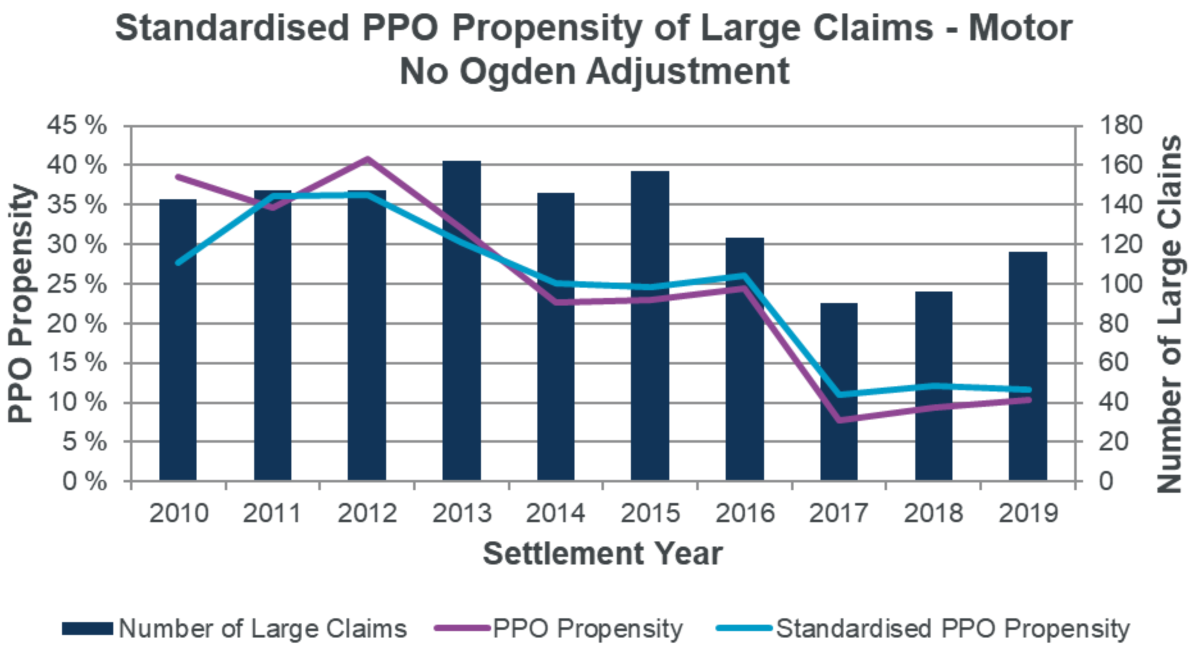
PPO Propensity – without Ogden adjustment



- Motor PPO propensity has remained broadly flat for the 2019 settlement year.
- The standardised propensity has reduced by 4% and the raw version increased by 10% from the 2018 settlement year
- An increase in the number of large claims settling above £1 million, with 2019 exhibiting a similar number of large claims to 2016 (i.e. pre Ogden change).
- Having said this, we would expect a lot more large claims to settle above £1 million now compared with 2016 and prior, so suggests a backlog.

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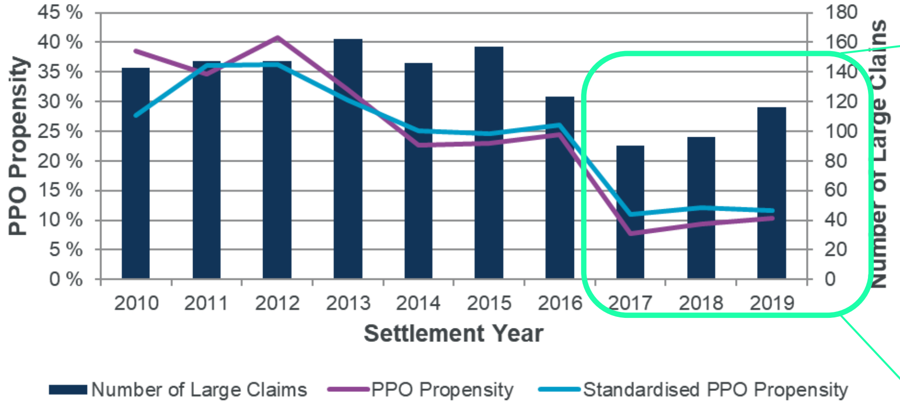
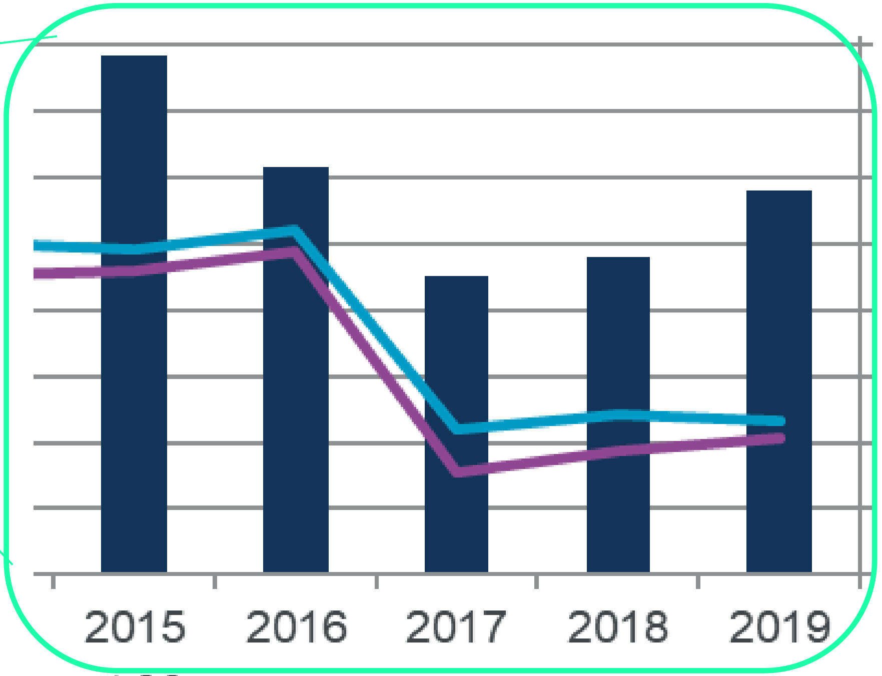
PPO Propensity – without Ogden adjustment





- Clearly there is a step in 2017 when the Ogden discount rate changed from 2.5% to -0.75%.
- The change in 2019 from -0.75% to -0.25% does not result in a step on the chart, but there are only six months of data at the most recent rate in this chart.
- The standardised line (blue), which eliminates variation owing to the mix in the size, remains flat since the Ogden discount rate change.
- However, the raw (purple) line looks to be increasing, this could be telling us that the average size of large claims is increasing, as more severe bodily injury claims, or those in relation to younger claimants are more likely to settle as a PPO. We can investigate this over the coming slides.

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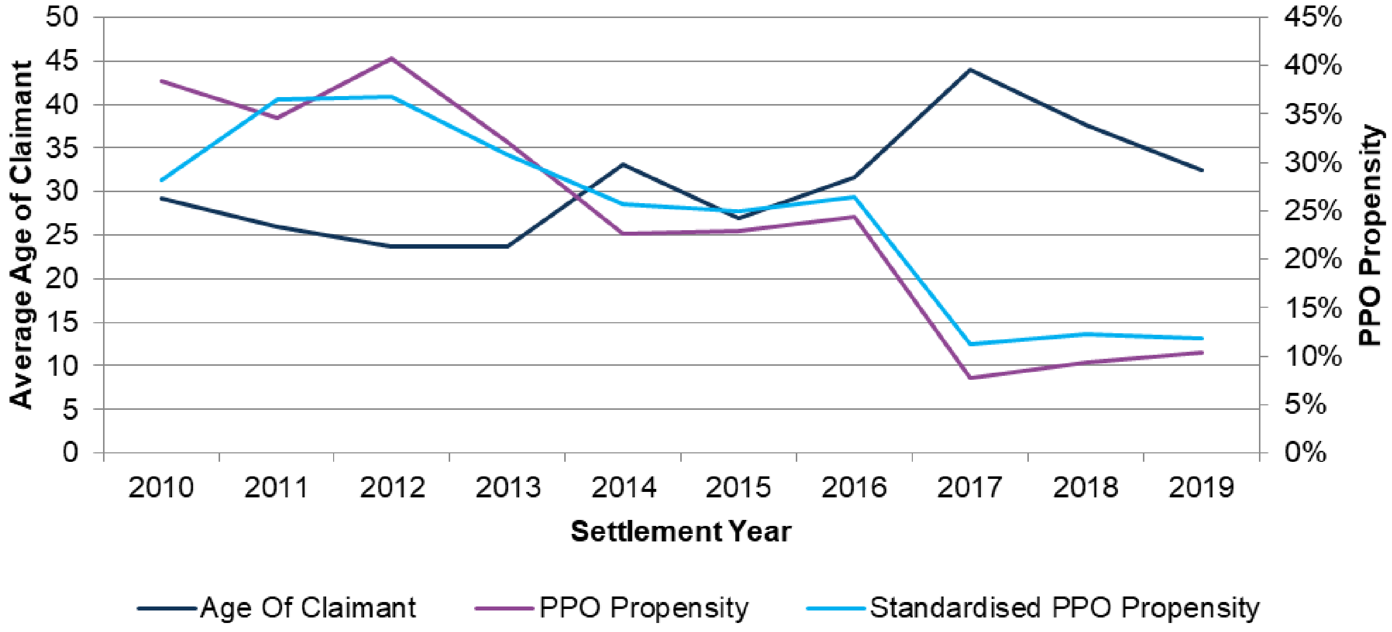
PPO Propensity – claimant age at accident



- We see that PPO propensity is roughly inversely correlated with average age of claimant at accident
- A lot of the step up in average age in 2017 will have been down to Ogden discount rate change
- The decrease in average age by settlement year since 2017 may be because those very large claims (associated with younger claimants), that were waiting for a stable Ogden rate, have begun to settle

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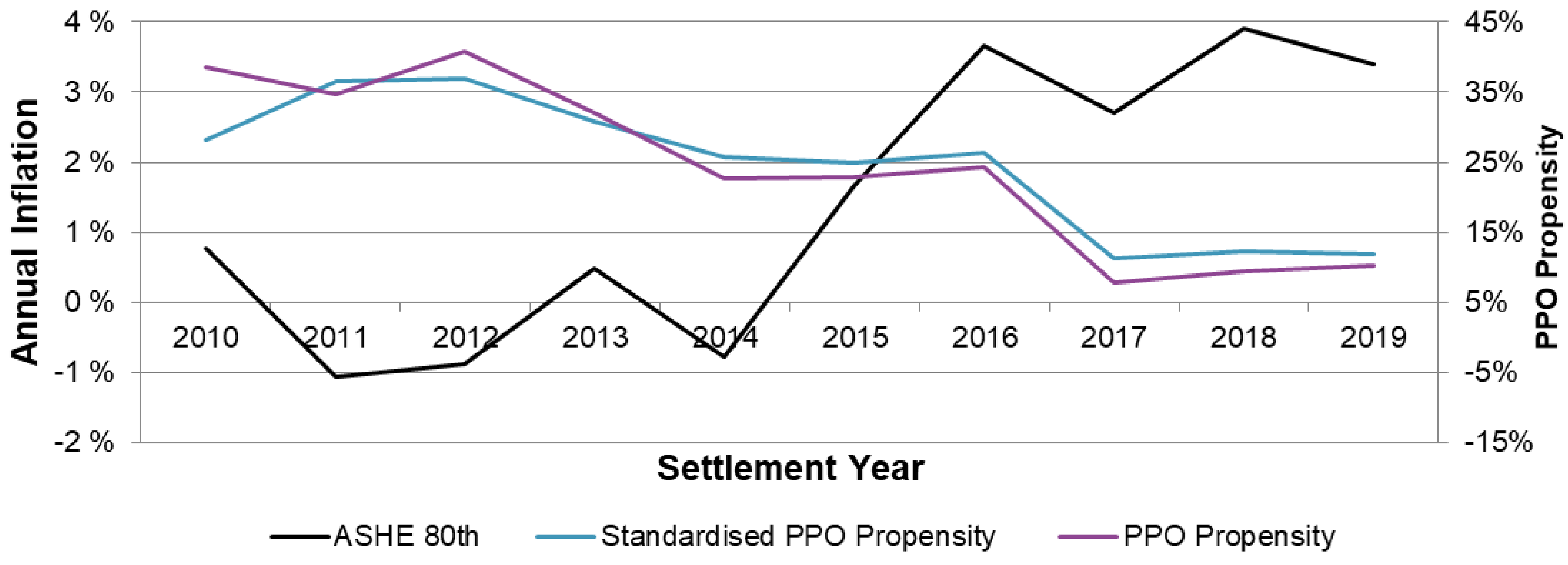
PPO Propensity – ASHE index



- Between 2010 and 2014 the 80th percentile of the Annual Survey of Hours and Earnings (ASHE) 6115 index was < 1% and negative for 3 out of 5 of those years.
- Between 2014 and 2016 the index increased to a positive rate and has been broadly flat since 2016 with some year-on-year fluctuations. The ASHE index sits at 3.4% for the 2019 year.
- The ASHE index maintaining a positive rate will make PPOs more financially attractive and could be a contributing factor to the increasing trend in PPO propensity since the 2017 settlement year.

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PPO Propensity – summary so far

In summary, there are various influences and factors to consider when explaining movements in PPO propensity. A changing Ogden discount rate means it is difficult to disentangle the strength of the effect one of these factors has. Below is potential theory for why PPO propensity has changed since 2017

- We see a large reduction in PPO propensity in the 2017 settlement year
  - The reduction in Ogden discount rate means that Non-PPO large claims become more attractive to claimants
  - Following the Ogden discount rate change there now more claims in regard of less severe bodily injuries or older claimants in our PPO propensity analysis of claims above £1 million. Therefore we are bound to see a drop. This is something we try and address in the following slides.
  - Around a similar time to the Ogden discount rate change the ASHE index increased fairly substantially, which would normally lead to more appetite for PPOs, however this effect is squashed by the two previous ones
- There has been a slight increase in PPO propensity in the 2018 and 2019 settlement years, on a raw basis, which is flattened out after standardisation
  - A possible reason for the increase on a raw basis is the fact that lower age claimants with high value claims were left open until a stable Ogden discount rate environment arose, these claims are starting to settle. The court is more likely to rule for a PPO for these sorts of claims

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PPO Propensity Bases

- We now present the analysis with and without an adjustment for the change in Ogden discount rate.
  - We have calculated the adjustments
  - We have used the insurer provided values for
    - Estimated discount rate
    - Claimant details (age, impairment, gender, etc)
    - Financial amounts (lump sum, annual cost of care, etc)
  - Thus we have extracted the relevant multipliers by discount rate, age and gender and used these to adjust the settlement amount

Time period / adjusted or not	Ogden equivalent PPO value discount rate	Large Claim discount rate
Pre March 2017	2.5%	2.5%
March 2017 – August 2019 (unadjusted)	0.5%	Rate used in settlement
Post August 2019 (unadjusted)	-0.25%	Rate used in settlement
Post March 2017 (adjusted)	2.5%	2.5%

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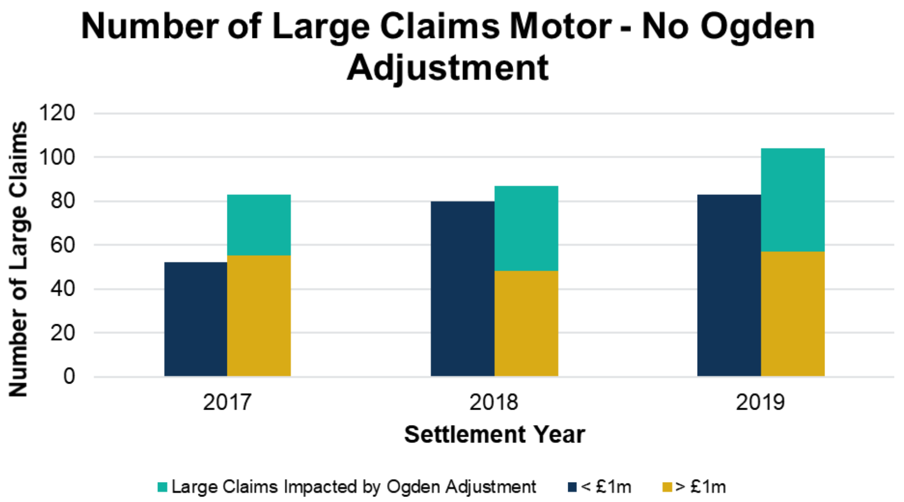
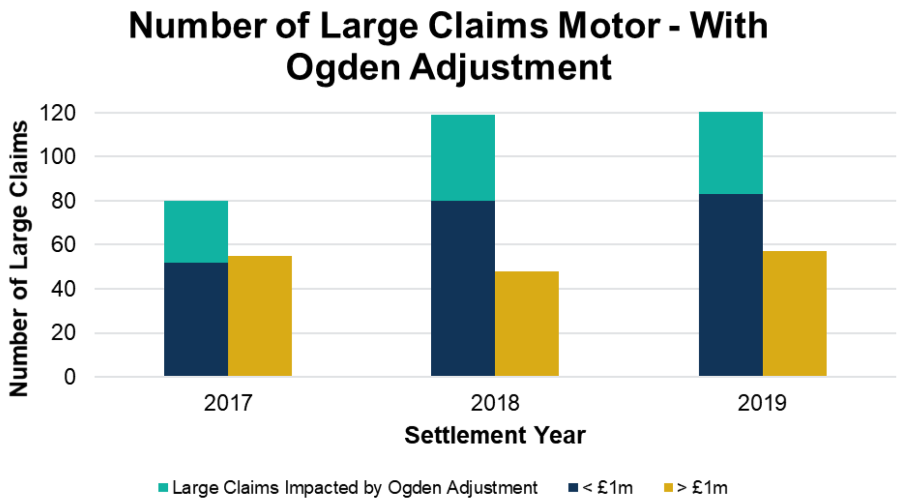
Number of Large Claims – Ogden adjustment





- Large claims have been included in our analysis if they are > £1 million in 2011 money terms.
- When adjusting the large claims to be on a consistent 2.5% basis, the number within the analysis decreases.
- This is driven by large claims of a smaller total value being included in the analysis in a - 0.25% discount world. We would expect these claims to be in respect of:
  - Less severe injuries
  - Older age of claimant

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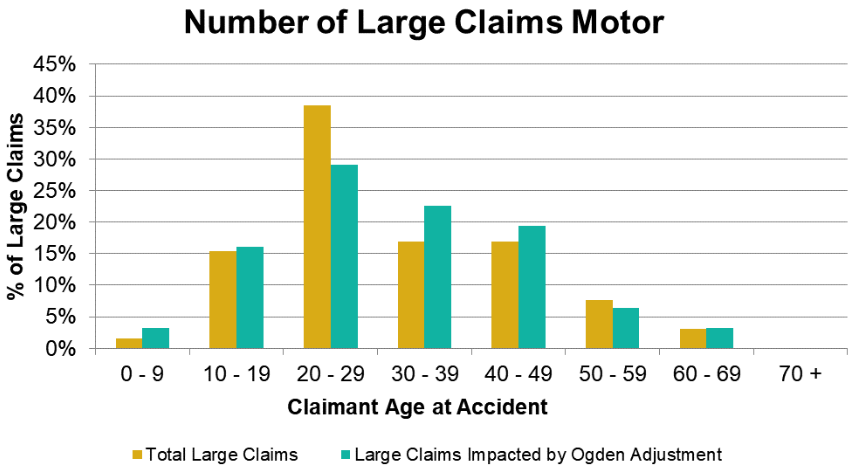
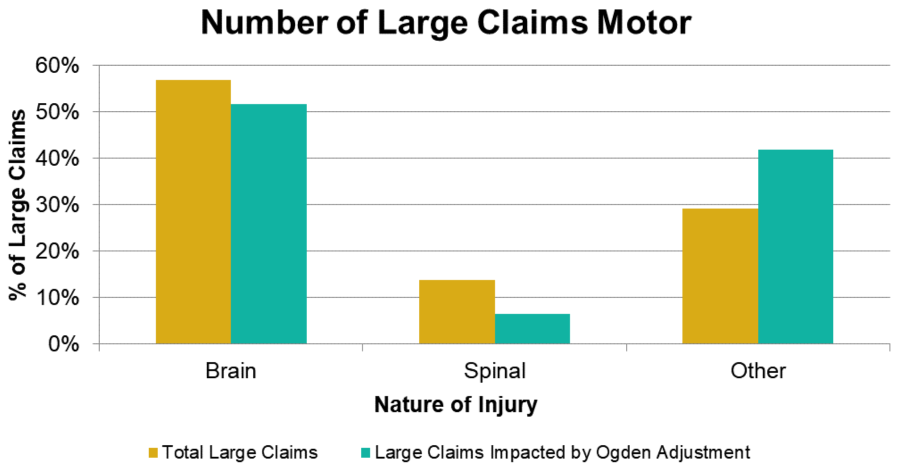
Number of Large Claims – Ogden adjustment





- The charts above illustrate the split of the total large claims for the 2017-2019 settlement year vs the large claims fell beneath the threshold after the Ogden adjustment.
- In general, these claims which became non-large after the Ogden adjustment have a higher claimant age than the total large claims.
- There is also a higher proportion of Other claims compared with Brain and Spinal injury claims, which tend to be less severe in nature.
- As these claims tend to exhibit a lower PPO propensity, we would expect the overall propensity to increase for the 2017-2019 years, when making the Ogden adjustment.
- Please note that this is a small subset of data, so subject to volatility.

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Number of Large Claims – Ogden adjustment

- What does this mean?
- We expect the Ogden adjusted propensity to be unaffected by the “mix of business” shift that occurs in our unadjusted propensity charts in the 2017-2019 years
- This means we can better compare PPO propensity to previous years

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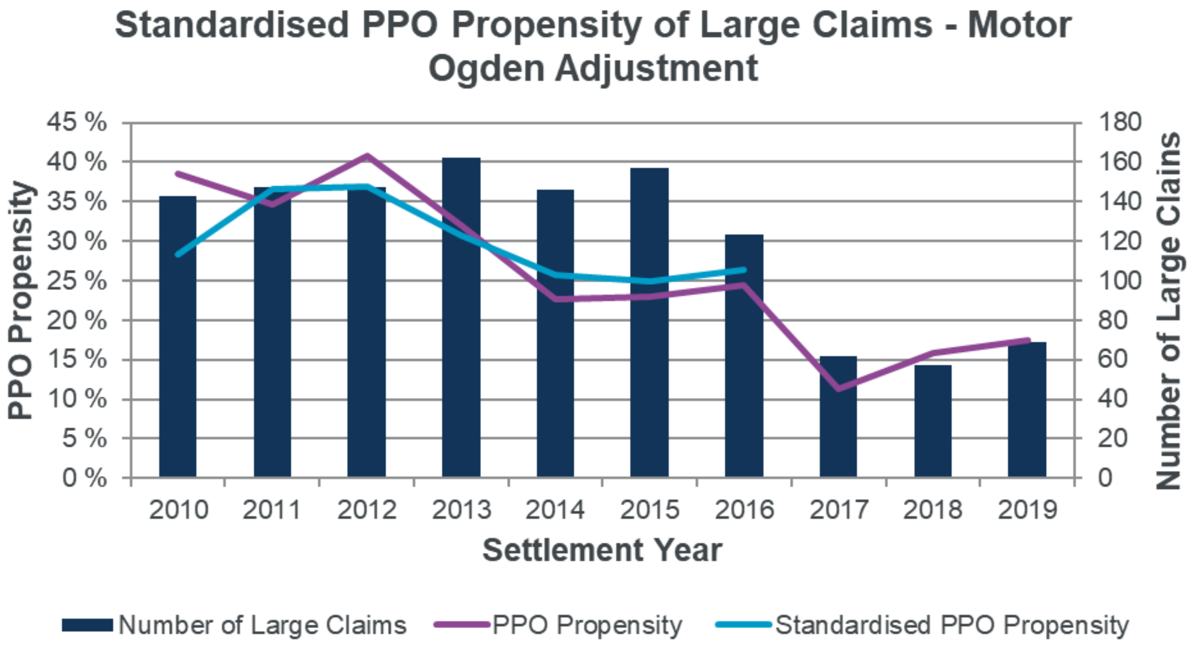
PPO Propensity – with Ogden adjustment



- This graph aims to show the propensity with the pure monetary effect of the Ogden discount rate change taken away, everything on a 2.5% Ogden rate level.
- The raw propensity has risen by 10% from the 2018 settlement year.
  - This increase on an Ogden adjusted basis represents a true increase in the PPO propensity compared with the 2018 settlement year.
- An increase in large claims settling above £1 million in 2019.

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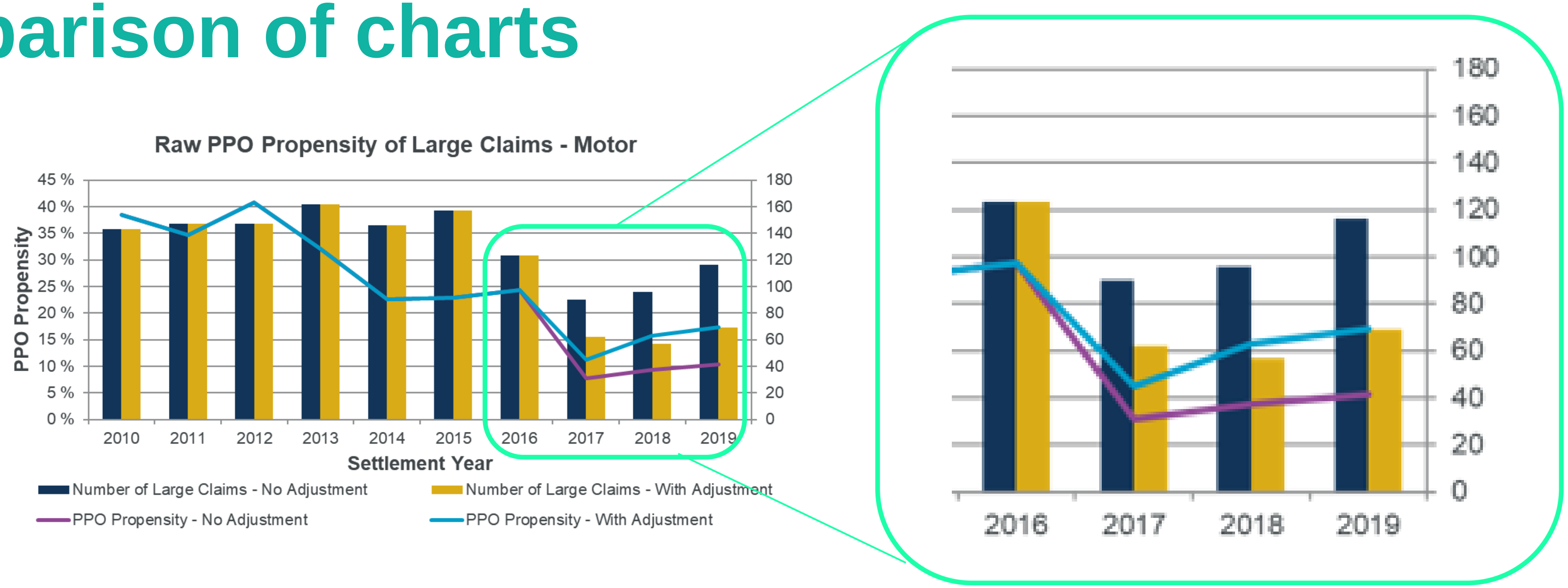
Comparison of charts



- The Ogden adjustment makes a material difference to the raw PPO propensity, with the Ogden adjusted propensity sitting around 5% points higher than unadjusted.
- Using our Ogden adjustment enables us to separate the basis effect from the behavioral effect.
- Driving factors of the increase in PPO propensity could be behavioral related.
  - Given that, prior to the Ogden discount rate change in August 2019, many large claims had been settling using a discount rate of between 0% and 1%, perhaps it was thought that the Ogden discount rate would increase by more than it did, thus PPOs were looking more financially attractive.

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Actuarial methodology

Level of concern

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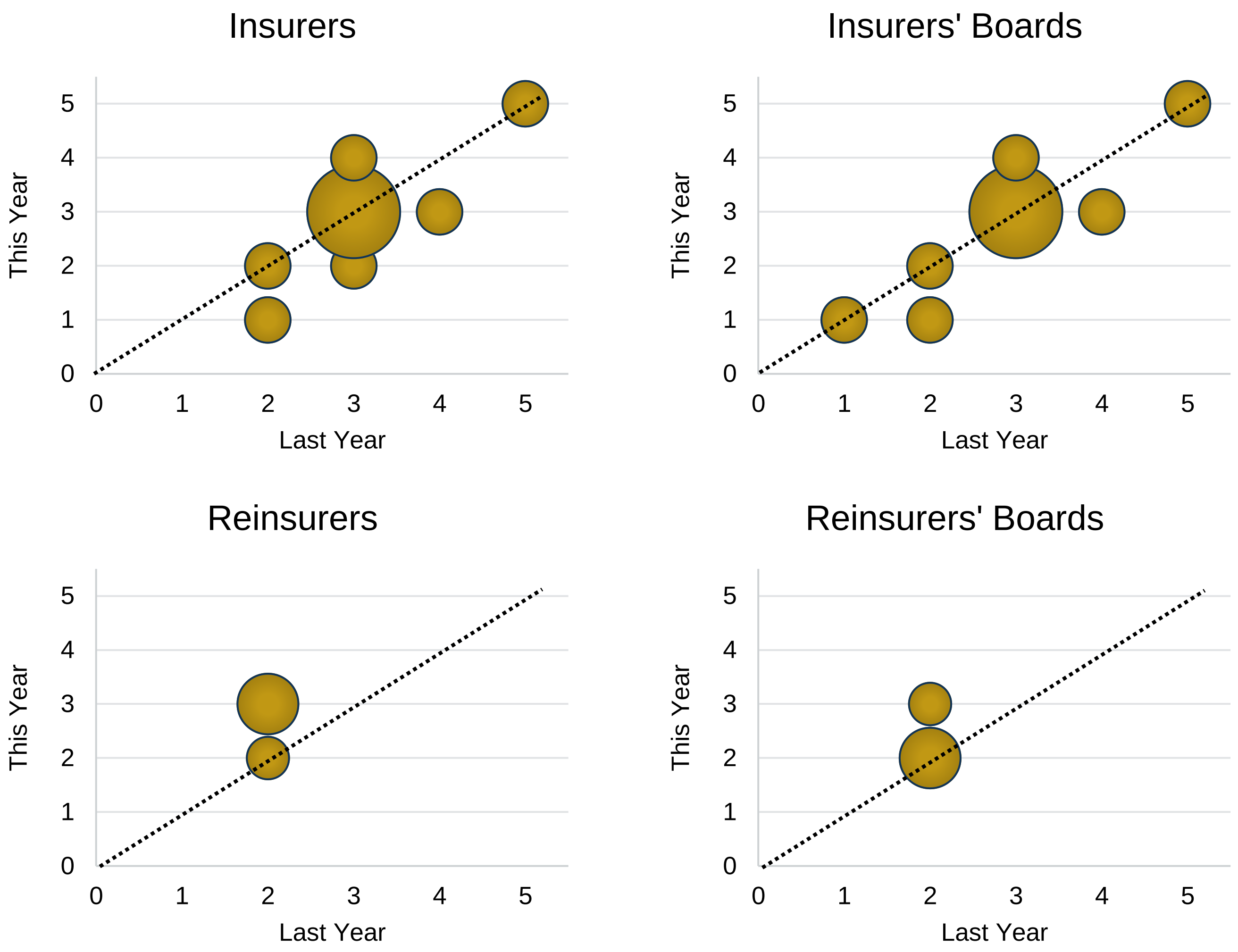
Level of concern regarding PPOs

- Chart showing concern levels between years
- Scale of 1 to 5, with 5 representing most concerned
- The average score for insurers was 2.9 and 2.7 for their Boards
- The average score for reinsurers was 2.7 and 2.3 for their Boards.



Reasons behind insurer / reinsurer concern

- Why no change (7):
  - The impact that PPOs have on reserves and capital is still high
  - Concerns around investment and return on assets, but happy with methodology
  - Still uncertainty around propensity following Ogden discount rate change
  - PPO propensity / the impact of PPOs is currently low
- Why increase (3):
  - Economic uncertainty driven by the coronavirus pandemic (COVID-19)
  - High inflation of the ASHE 6115 index in 2020
  - Basis of inclusion under IFRS 17
- Why decrease (3):
  - PPO propensity / the impact of PPOs is currently low

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Reasons behind Board concern

- Why no change (9):
  - The impact that PPOs have on reserves and capital is still high
  - The Ogden discount rate change has led to a reduction in propensity
- Why increase (2):
  - High inflation of the ASHE 6115 index in 2020
  - Concerns over investments and the long-term nature of PPOs
- Why decrease (3):
  - PPO propensity fallen due to Ogden discount rate change
  - There are larger issues than PPOs such as the impact of the coronavirus pandemic (COVID-19) on insurers' wider operations

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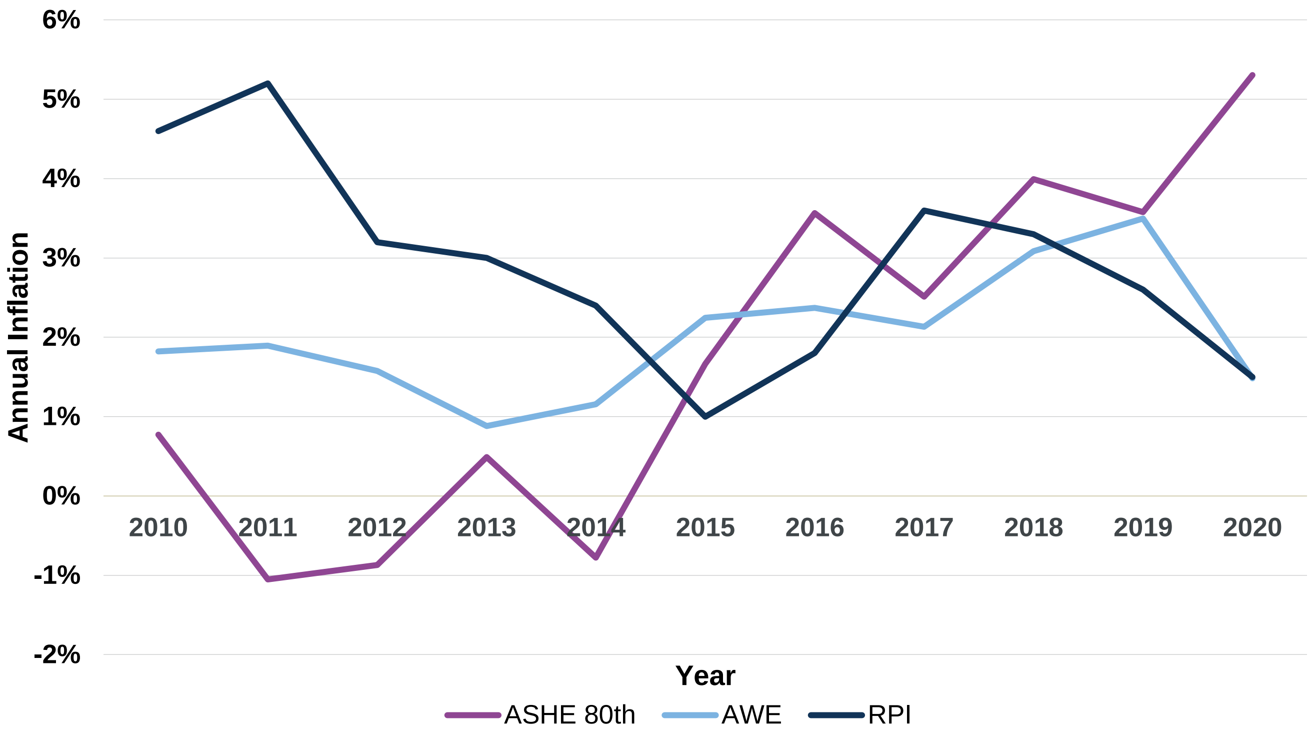
ASHE



- A common concern amongst contributors was in relation to the level of the ASHE 6115 index for 2020, representing an annual increase of 5.3% for the 80th percentile, compared with average annual increases of 3.4% across the 2016-2019 years. This compares to an annual increase of 1.5% for both the Average Weekly Earnings index and RPI.
- In light of the COVID-19 pandemic, an increased demand for public and private healthcare may be expected to lead to a short-term increase in the ASHE 6115 index. Whether, and the extent to which, this will return to pre-2020 levels is uncertain, however, the majority of insurers and reinsurers had not currently changed their view of ASHE in their reserving assumptions, as shown in the next section.

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Actuarial methodology

Reserving methodology

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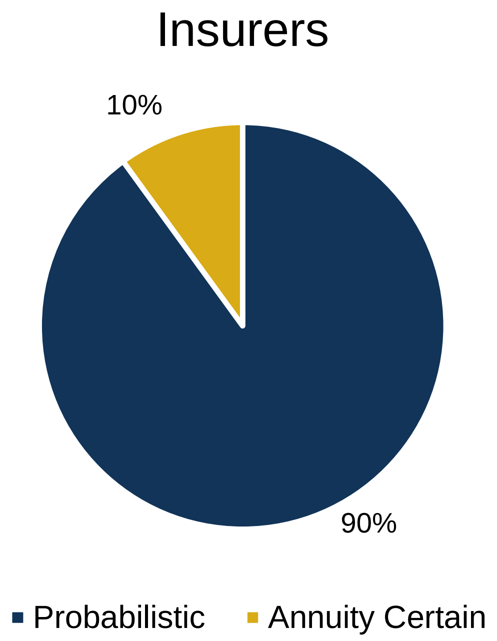
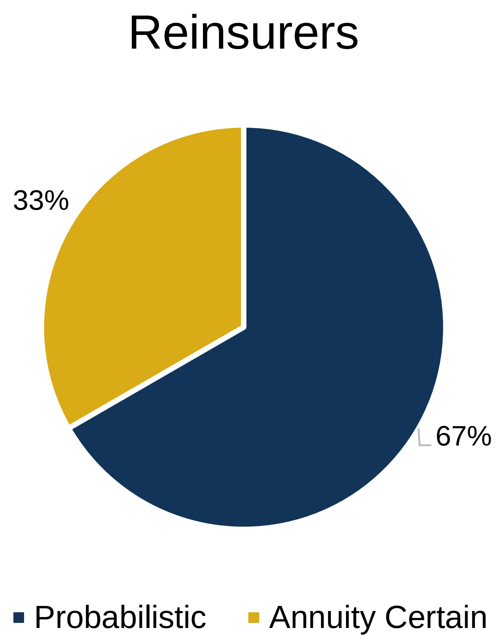
How do you reserve for settled PPOs?

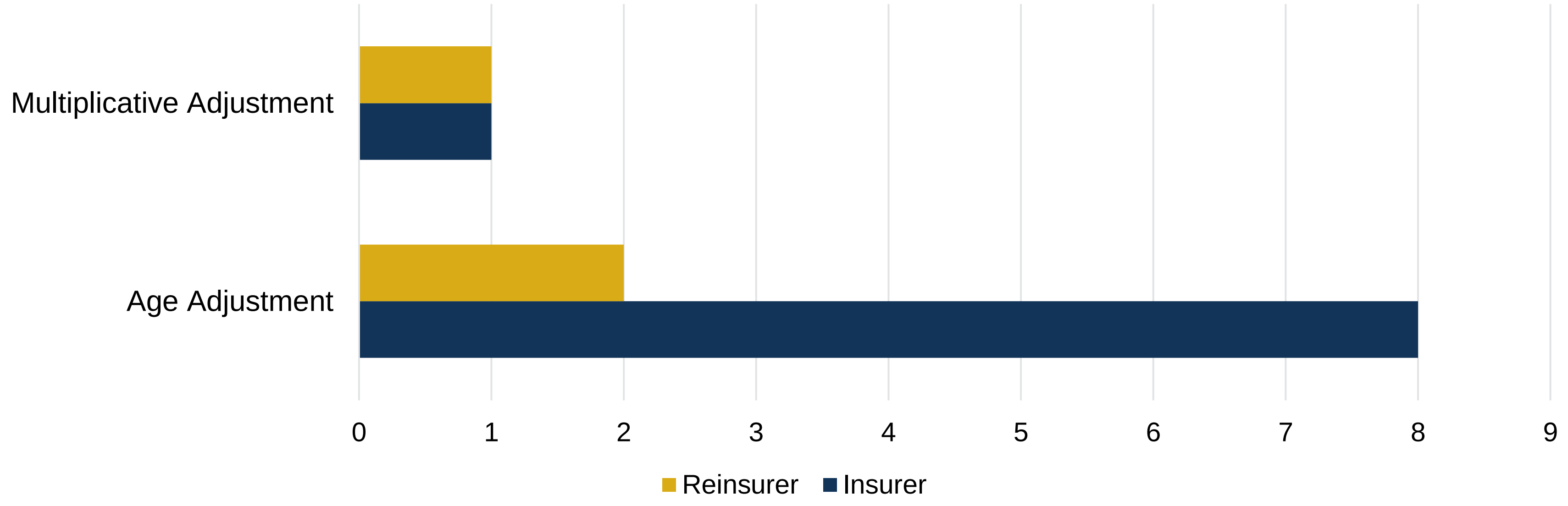




- The majority of those asked based their life expectancy on an average between their own medical expert's view and the view from the claimant's team.
- Almost all those asked had not changed their reserving methodology in the last year.

How do you reserve for settled PPOs?

- How do you scale your life table?
  - Multiplicative adjustment: assumed that the claimant had a mortality experience “z” times more than the life tables suggest
  - Ageing adjustment: considered the claimant had the mortality experience of someone “y”-years older than their actual age.



IBNR PPOs – identification

- All insurers and two out of three reinsurers said that they monitored their open claims and assessed the probability of them becoming PPOs.
- Not all claims were monitored by all participants:
  - Some only looked at a certain number by injury
  - Some only looked at open large claims > £1 million
  - Some did look at every injury claim individually.
- Indicators used included injury type (particularly mental capacity), age, annual care cost.
- Insurers reviewed potential PPOs quarterly and some annually.
- A combination of historical propensity data and IFoA PPO Working Party propensities applied to claims split by large claim threshold was perhaps the most common approach.
- The majority of insurers monitored the accuracy of their predictions.
- All reinsurers noted that their notification rules for PPOs did not differ by cedant.

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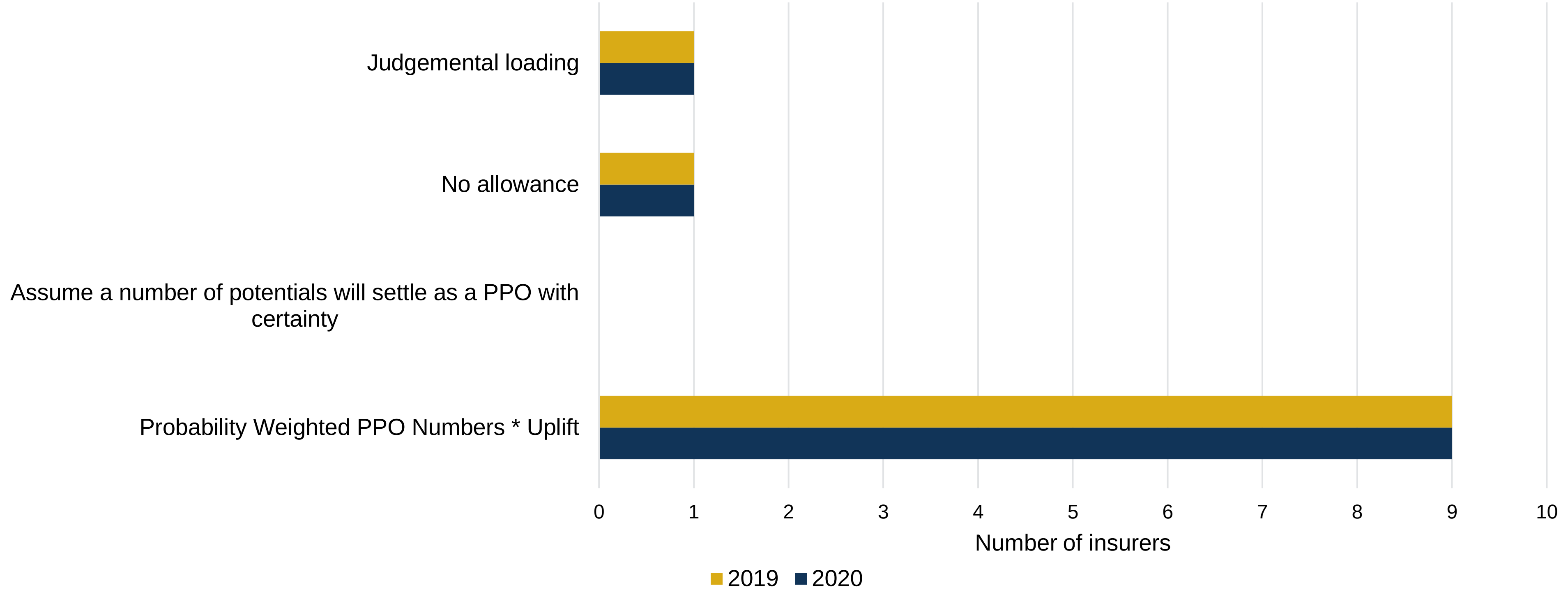
IBNR PPOs – reserving

- The chart below shows the approaches taken by insurers in relation to claims already identified as large claims. All reinsurers used a "Probability Weighted PPO Numbers * Uplift" approach.



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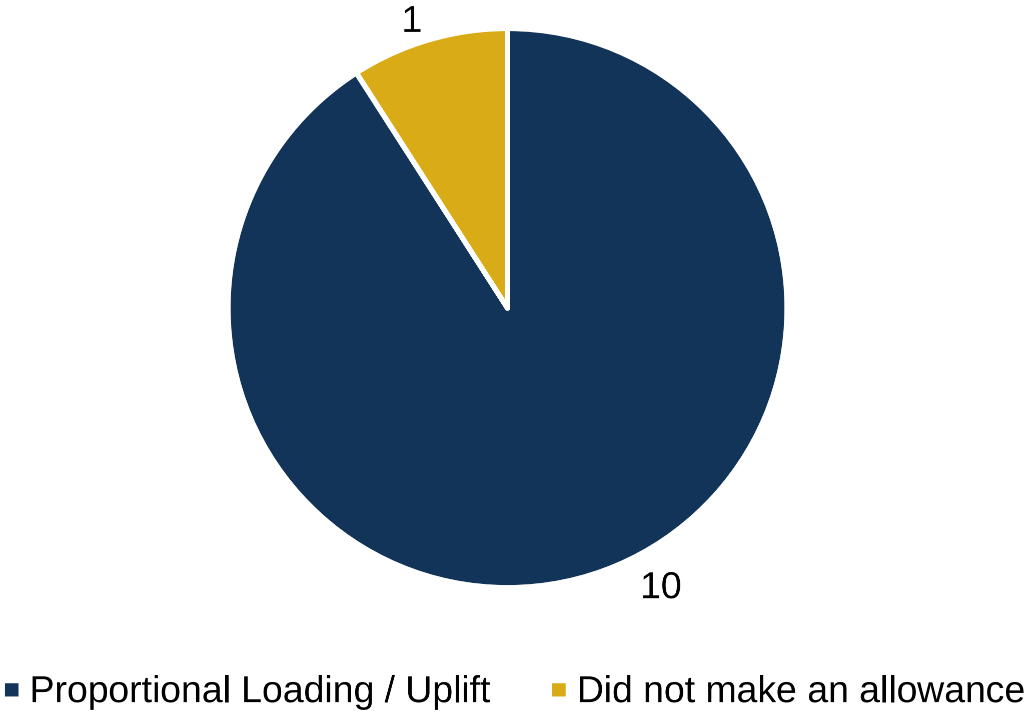
Pure IBNR PPOs – reserving

- The majority of those Insurers asked considered pure IBNR PPOs (in relation to claims not yet reported) and added a proportional loading to the PPO reserves.



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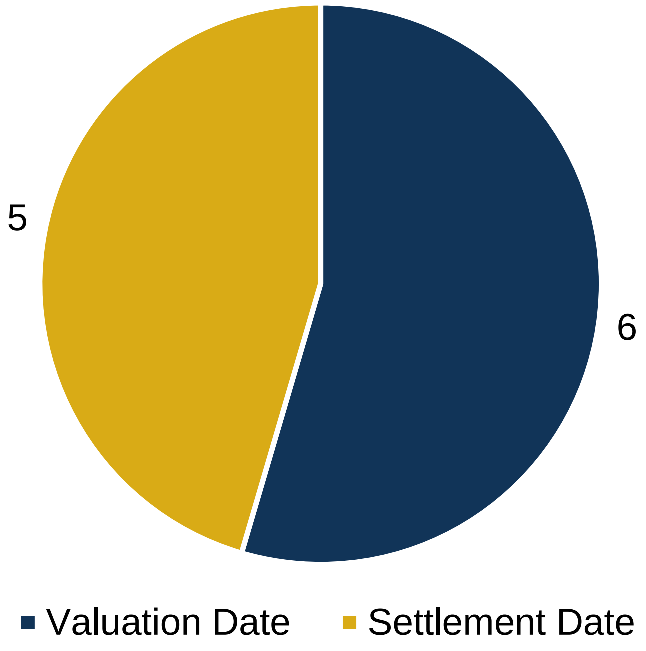
IBNR PPOs – discount to what date?

- Six Insurers discounted to valuation date and five to expected settlement date under UK GAAP or IFRS.
- All of those asked said their reserving methodology for IBNR PPOs had not changed in the last year.



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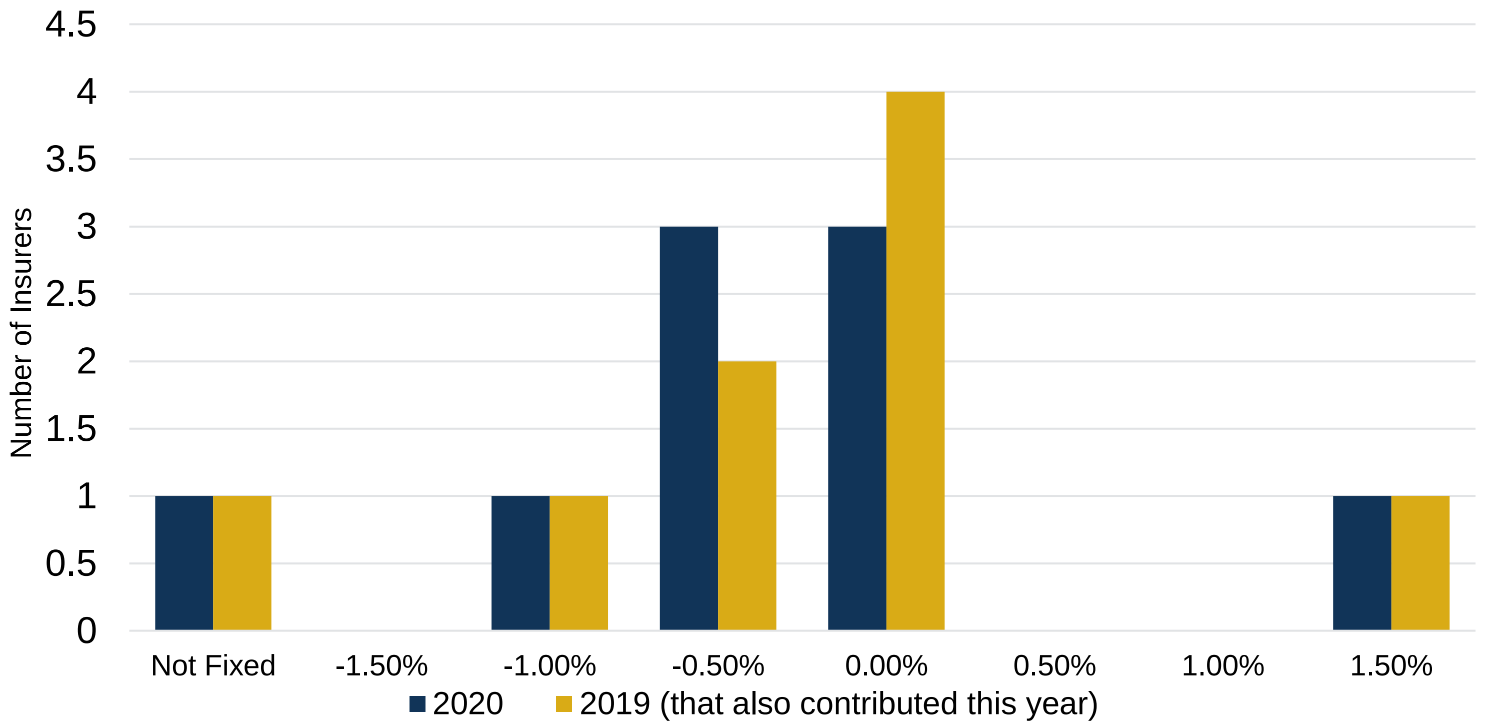
Discounting – real discount rate (GAAP or IFRS)

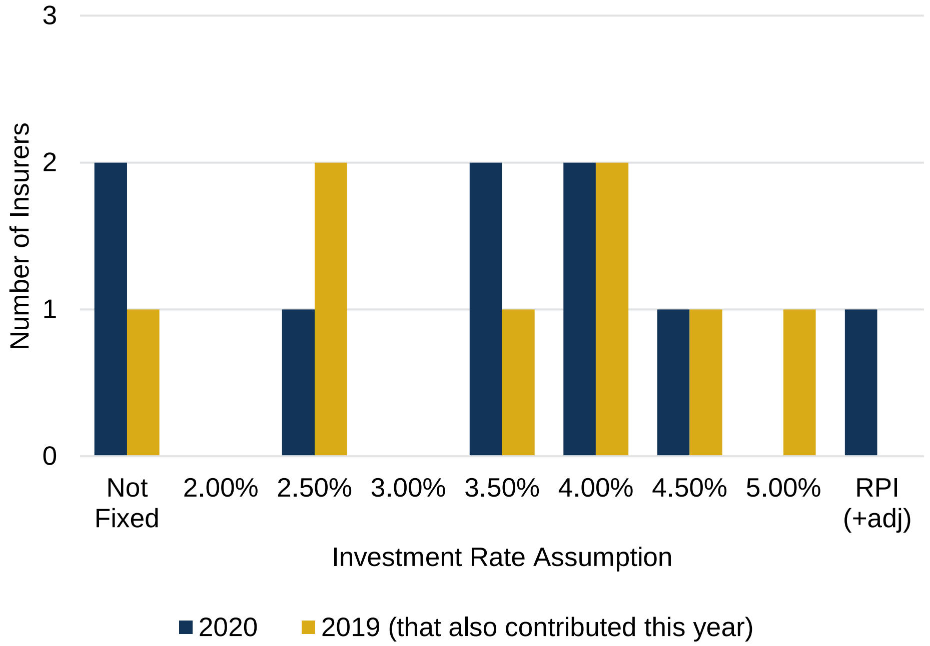
- For insurers, the most popular real discount rates used for PPO projections are 0% and -0.5% per annum.
- The distribution of real discount rates used is almost unchanged from last year.

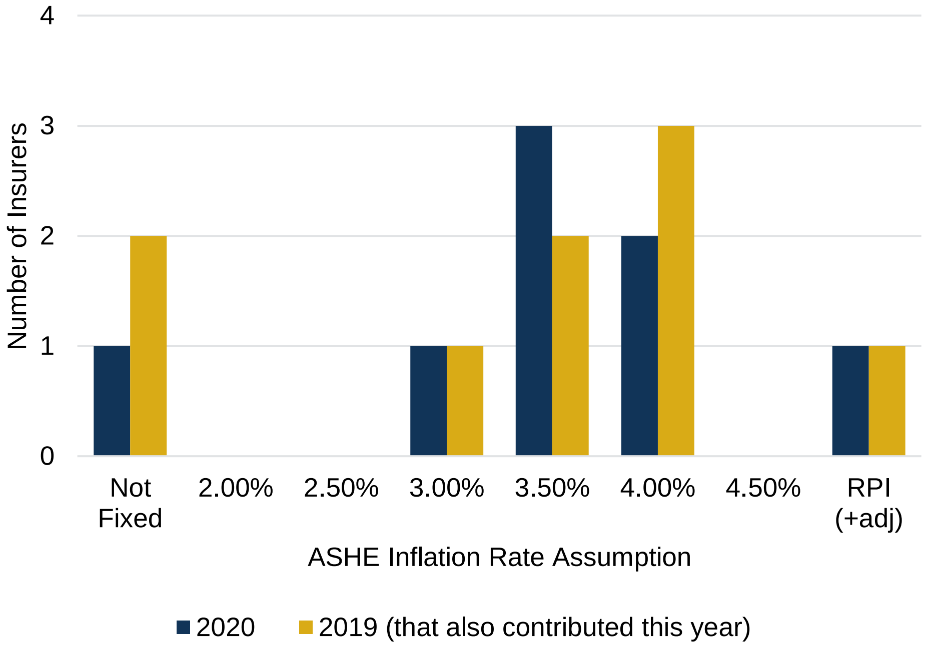


Discounting – components of real discount

Investment return and ASHE inflation assumptions (GAAP or IFRS)

- 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.





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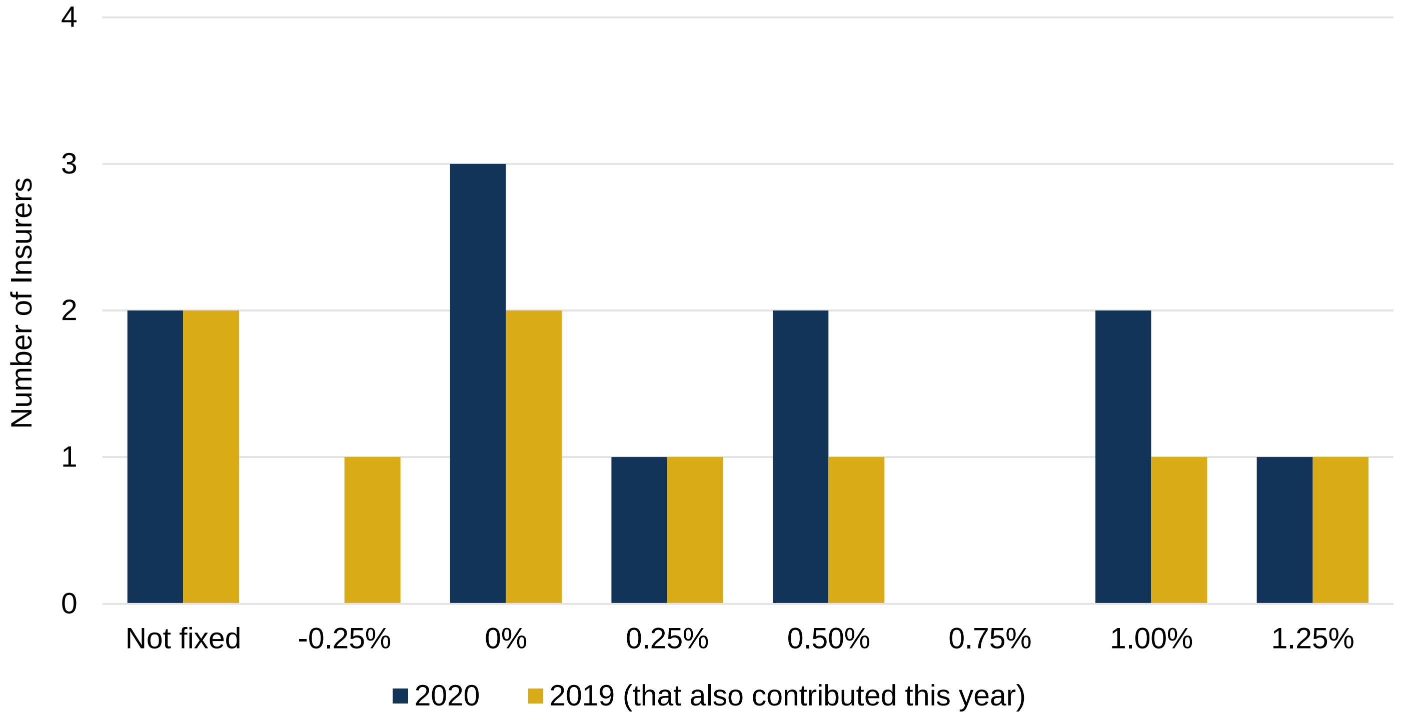
What gap is assumed between RPI and ASHE

- We asked what the gap was between the Insurers' RPI and ASHE inflation long term assumptions
  - Contributors assumed a range of gaps, with the majority between 0% and 0.5%.
  - In all 2020 responses ASHE inflation was assumed to be higher than RPI.
- All insurers regard the 80th percentile as the default ASHE percentile.



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Discounting – reinsurers (GAAP or IFRS)

- All but one of the reinsurers did not discount due to US GAAP reporting requirements. The other reinsurer used a real discount rate of -1%.
- ESG projections taking into account historic ASHE and CPI fed their inflation assumptions.
- The two reinsurers who use the ASHE index both assumed ASHE inflation to be higher than RPI, and the ASHE 80th percentile was regarded as the default ASHE percentile.

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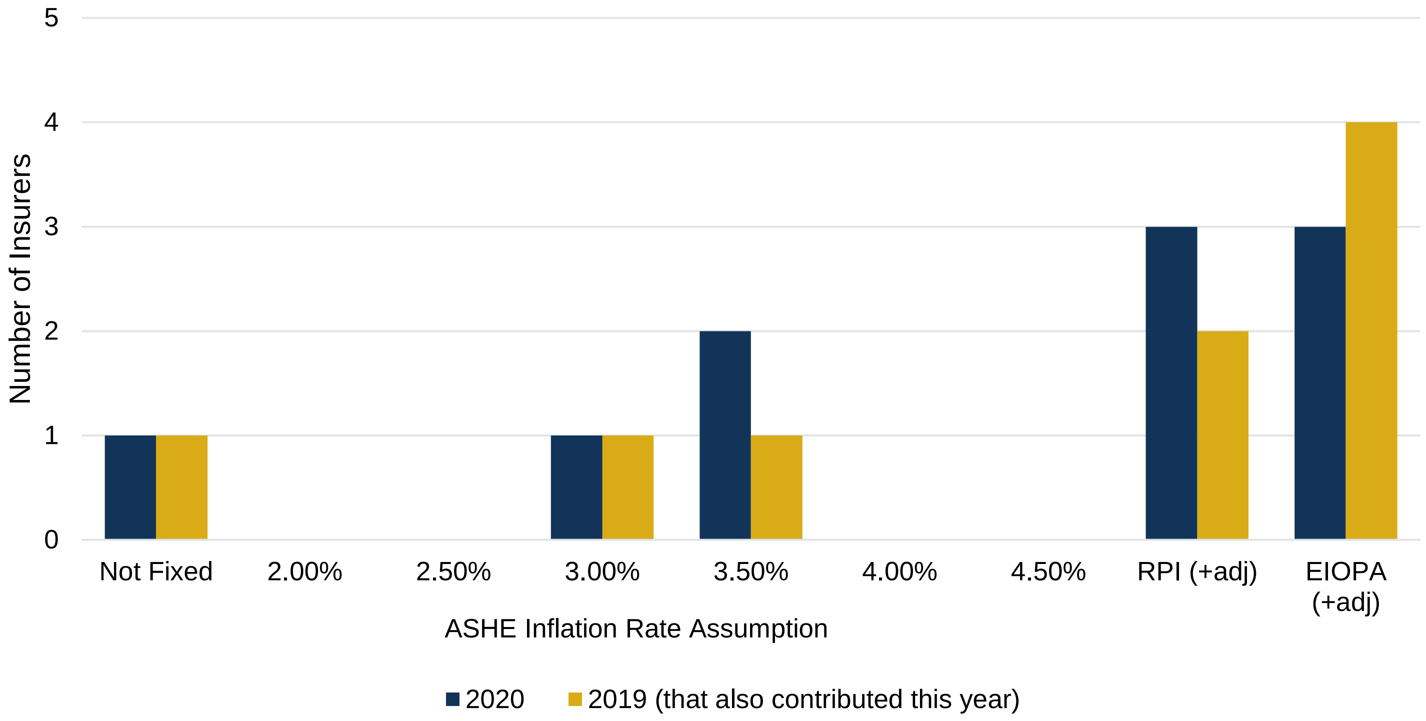
Discounting – Solvency II

- As the EIOPA curve is prescribed, the main question revolves around the inflation rate used
- **The current real discount rate over 20 to 40 years assuming an ASHE of 3% is ~ -2.7%**



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Discounting – Solvency II

- Seven of the eleven insurers asked had changed either their inflation or investment or both assumptions in the last year.
- None of the insurers or reinsurers asked had any transitional arrangements on technical provisions for the change of discount rate.
- Six out of eleven insurers said they were using a volatility adjustor but none were using a matching adjustment.
- None of the reinsurers used either the volatility adjustor of the matching adjustment.

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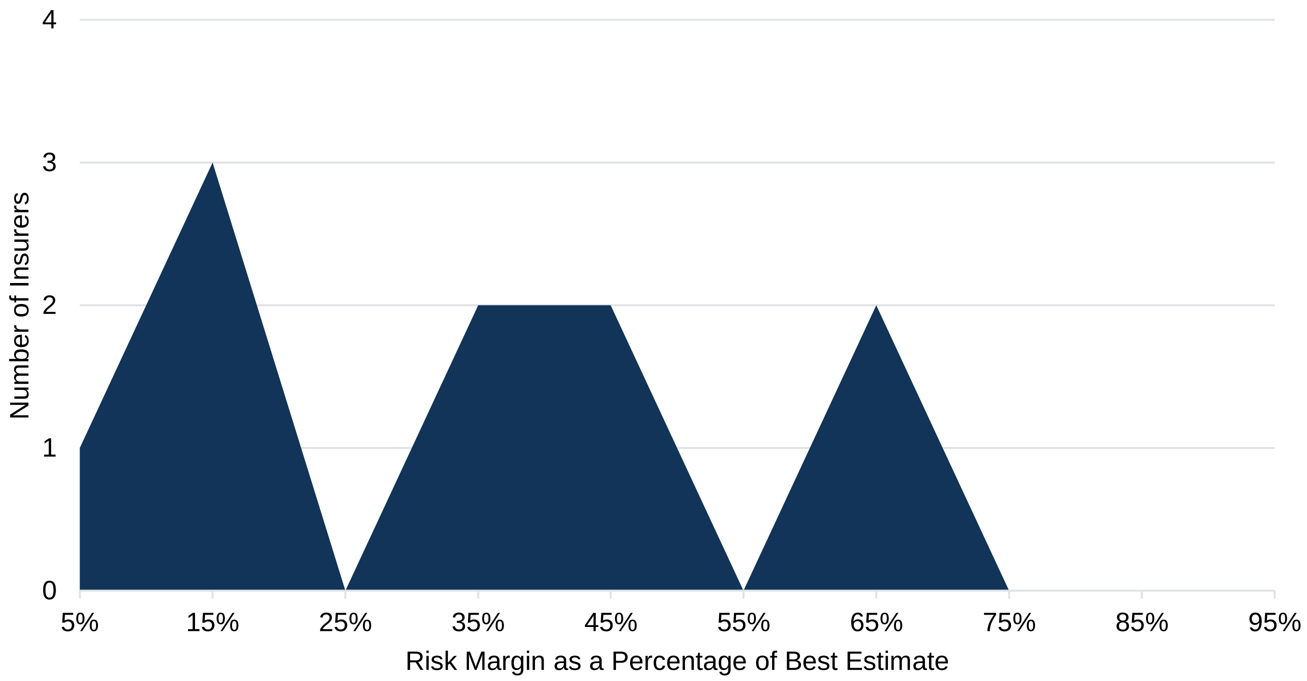
PPO risk margin

- For those who calculated (or could estimate) a PPO risk margin, the distribution of the (approximate) risk margin as a proportion of best estimate for insurers is displayed below.
- The PPO risk margin was calculated in a variety of ways, both implicitly within reserve risk as well as explicitly.



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Variation orders and bad debt

- ***Variation order:*** *An allowance for a change in the regular payment amount, usually triggered by a certain event, such as the claimant developing additional symptoms in the future, as a result of the original accident.*
- ***Indemnity guarantee:*** *A guarantee given by the insurer to pay additional costs in circumstances such as where services provided by the local council are reduced or withdrawn in the future.*
- ***Reverse indemnity guarantee:*** *A guarantee which covers the opposite situation. For example, where the insurer can reduce the size of the annual payments as public provision of care is given to the claimant.*

- Although there were a significant number of PPOs with variation orders, and some with indemnity / reverse indemnity guarantees, when valuing their PPOs only seven insurers said they explicitly considered these and only two said they explicitly allowed for these.
  - It was noted that across all respondents very few variation orders, indemnity / reverse indemnity guarantees had been triggered to date.
- Reinsurers that provided this information had 76 variation orders in total, and none of them allowed explicitly for these when valuing their PPOs.
  - N.B. some of the variation orders and guarantees may be in both the insurer and reinsurer totals.

	Variation Orders	Indemnity Guarantees	Reverse Indemnity Guarantees
Total for Insurers	87	13	36

- Two insurers and no reinsurers allowed for bad debt under UK GAAP / IFRS / other, but all must under Solvency II.
  - Those that did allow for bad debt did so using a probability of default * loss given default method

Uncertainty in reserving

- All insurers quantified the reserve uncertainty in PPOs, about half stochastically and the other half using scenario tests.
- All reinsurers explicitly quantified PPO reserve uncertainty, two using scenario tests and one using a stochastic method.
- A variety of correlations were assumed with other large losses, varying from no explicit correlation to 100% correlation.
- The CVs for the gross PPO uncertainty ranged from 13% to 100%. The CVs for the net PPO uncertainty ranged from 17% to 100%. There was, however, inconsistency between responses in terms of whether it was settled, potential or pure IBNR PPOs being considered, which gives rise to the wide ranges quoted.
- The majority of settled PPO gross / net CVs were between 15% and 45%

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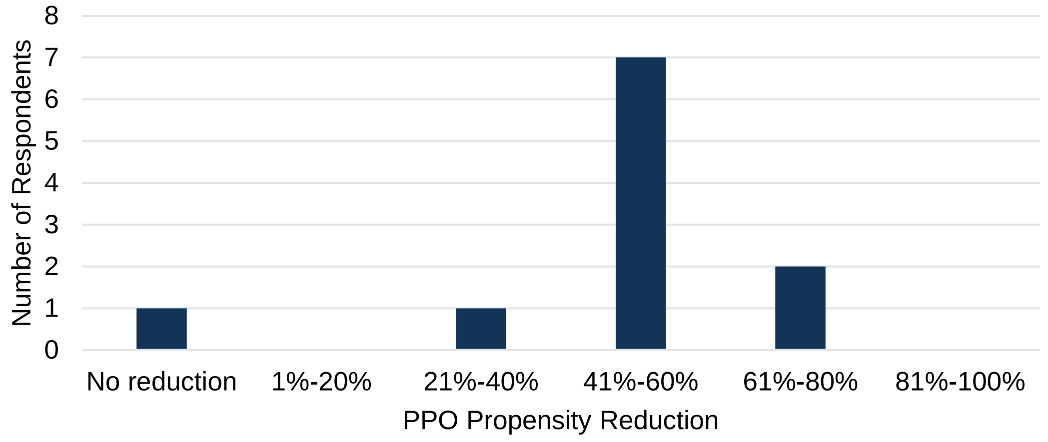
Ogden discount rate

- All insurers are now assuming a best estimate rate of -0.25% for the non-PPO reserves.
- Of the two reinsurers that responded to this question, one is assuming a -0.25% discount rate and the other a small positive discount rate.
- Participants were asked what percentage change in PPO propensity they had assumed as part of their actuarial best estimate calculations, relative to an Ogden 2.5% basis
  - One insurer said they had allowed for no change whilst the others all anticipated changes ranging from 30% to 80% reduction in PPO propensity.



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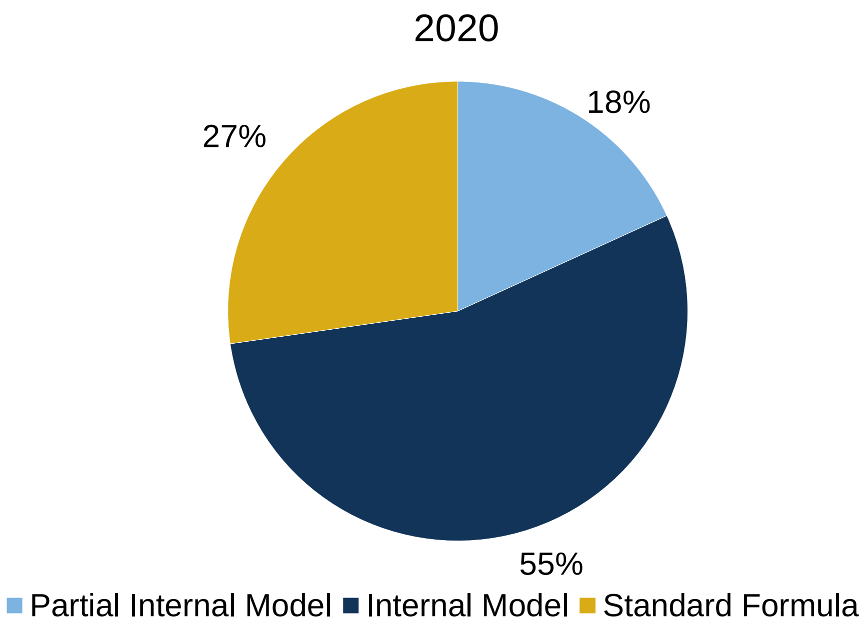
Actuarial methodology

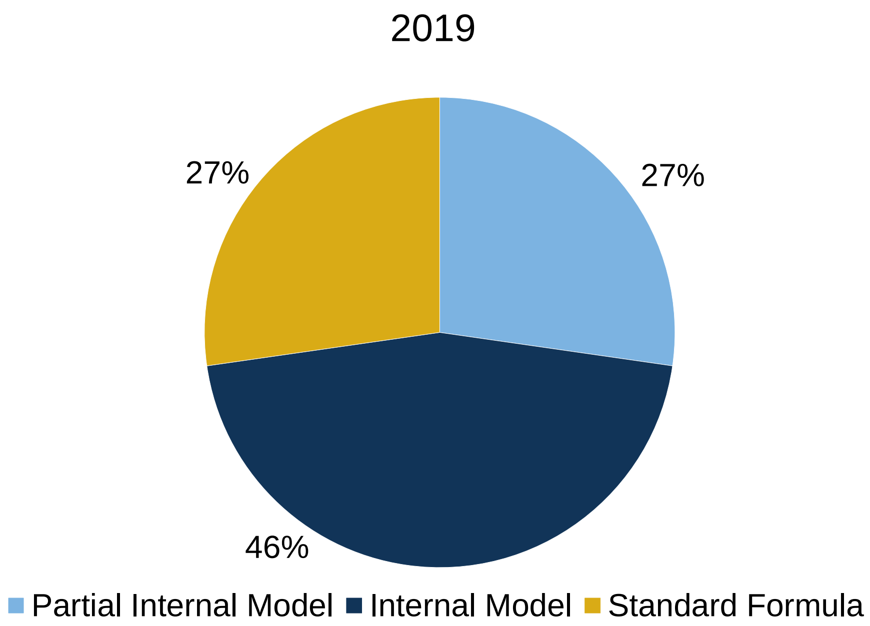
Capital modelling

24 May 2021

PPOs in SCR

- Nearly all insurers use an internal model or partial internal model when valuing PPOs in their SCR.
- The proportion of participants using a full internal model has increased from last year.
- All participating reinsurers used an internal model.





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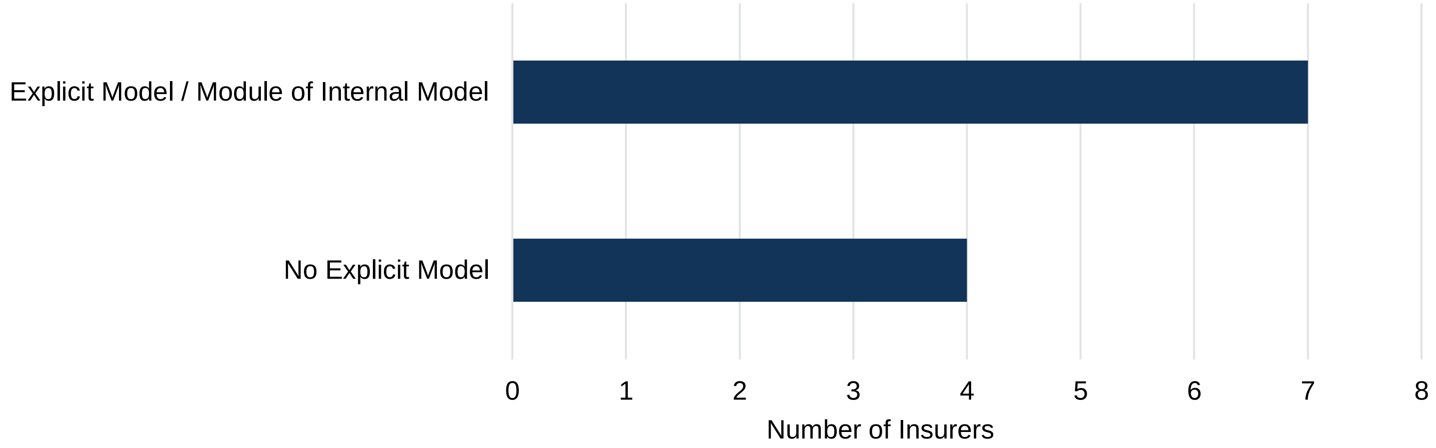
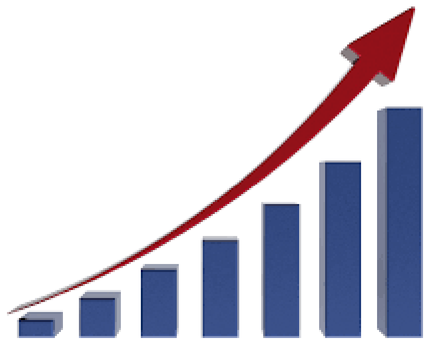
PPOs in capital models

- The majority of insurers have a separate PPO model for capital purposes as part of their internal / partial internal capital model.
- PPO models allowed for uncertainty in mortality, life expectancy, nominal discount rate, the number of large claims, reinsurance recoveries, payment escalation and the PPO propensity.
- None of the reinsurers used separate stochastic models for PPOs.





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Differences between one year and ultimate

- Most insurers / reinsurers said that there was a lower capital requirement for the one year vs ultimate view:
  - Three said that the one year measure of risk was between 25% and 50% of the ultimate measure of risk
  - Two said the one year measure of risk was between 75% and 100%
  - Two said there was no difference.
- Three insurers said they had different bases for evaluating economic and regulatory capital:
  - Two use an internal model for economic and standard formula for the SCR
  - One uses a different volatility adjustment for economic and regulatory capital.

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Actuarial methodology

Pricing and claims management

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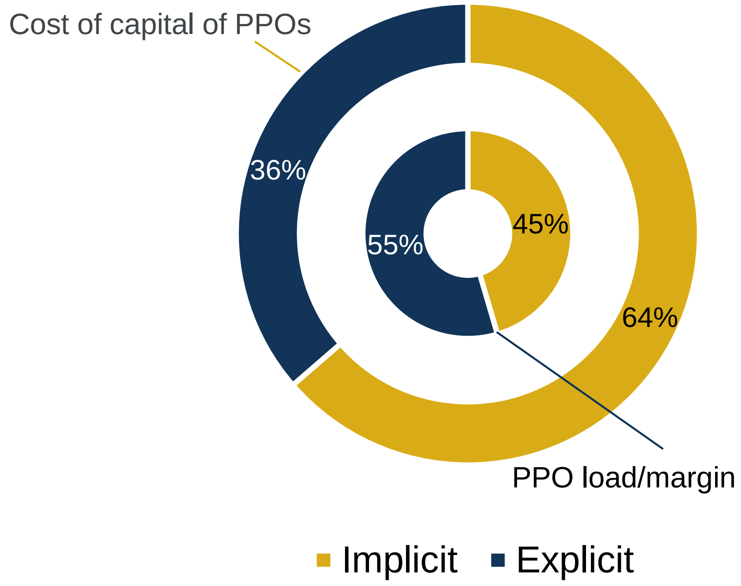
How are PPOs allowed for in pricing?



- Six insurers said that they apply an explicit load or margin to their prices to cover PPOs, with five allowing for PPOs implicitly
- Four insurers explicitly took into account the cost of capital of PPOs when pricing, with seven saying it was an implicit assumption or did not do so.

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Claim management procedures

- Most insurers said that there was no difference in their approach or claims handling procedures to settling via a PPO or lump sum and that they didn’t use measures to actively encourage / discourage PPO settlements.
- Some noted differences due to the different implications, and need for an enhanced skillset to settle claims on a PPO basis.

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Reinsurance and alternative risk transfer

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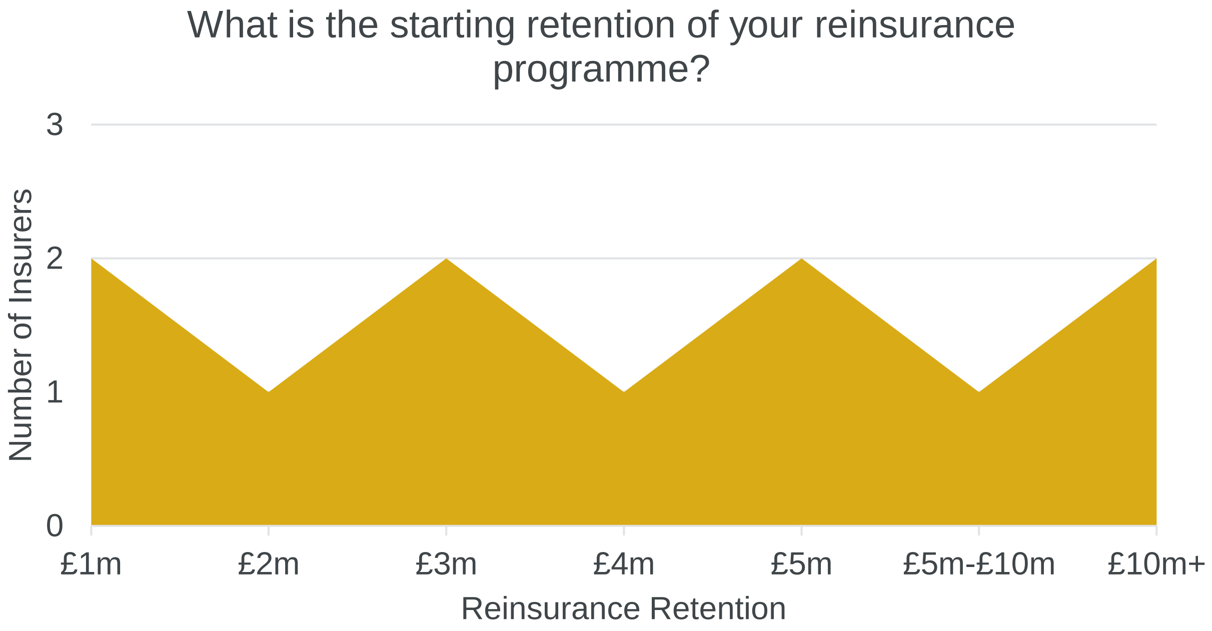
Reinsurance in the market



- Only three of the 11 insurers said that their reinsurance programme had changed as a result of PPOs.
- We also asked insurers whether they took the impact of the cost of capital into account when buying reinsurance – 10 insurers said they did.

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Reinsurance availability

- All of the reinsurers asked stated that their reinsurance offerings had changed due to PPOs:
  - They also noted that their reinsurance offering had not changed as a result of the 2017 and 2019 Ogden discount rate changes.

Capitalisation clauses

Capitalisation clause: allows (or even compels) the reinsurer to settle an individual PPO liability as a lump sum with the insurer, on a pre-agreed bases, once such an award has been made / agreed.

Three main contract types offered are:

- **Uncapitalised:** Traditional "Pay as Paid“ basis with inflation-linked deductible, recoveries made throughout the lifetime of the claimant.
- **IUA Capitalisation:** Lump sum capitalisation at time of settlement, allows for life impairment typically by way of medical expert opinion. Full and final settlement.
- **Delayed 20 Capitalisation:** “Follow the fortunes” for 20 years then lump sum capitalisation 20 years after expiry of reinsurance treaty. Typically assume unimpaired mortality for lump sum.

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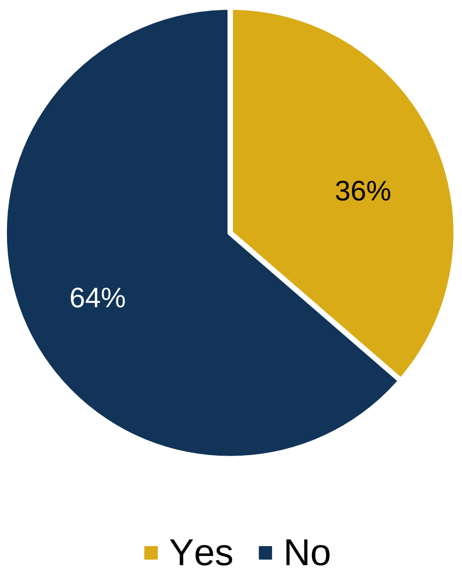
Reinsurers' view on capitalisation clauses

- Two reinsurers insisted on capitalisation clauses while one used them on a case by case basis.
- One reinsurer stated a handful of PPOs had been capitalised already.

Insurers’ view on capitalisation clauses

- Four of the insurers surveyed said that they had a capitalisation clause on their reinsurance contracts.



- Of those that did not have a capitalisation clause, the clear majority stated that they were keen to avoid them.

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Risk transfer – hurdles

- All insurers would consider transferring the risk associated with PPOs if the right option arose
  - One insurer already had arrangements in place to transfer the risk of PPOs other than reinsurance.
- The most significant hurdles mentioned were cost of any options and the lack of solutions on the market.
- All insurers said they would consider pooling settled PPO cases with other firms if concerns around anti-selection could be mitigated.

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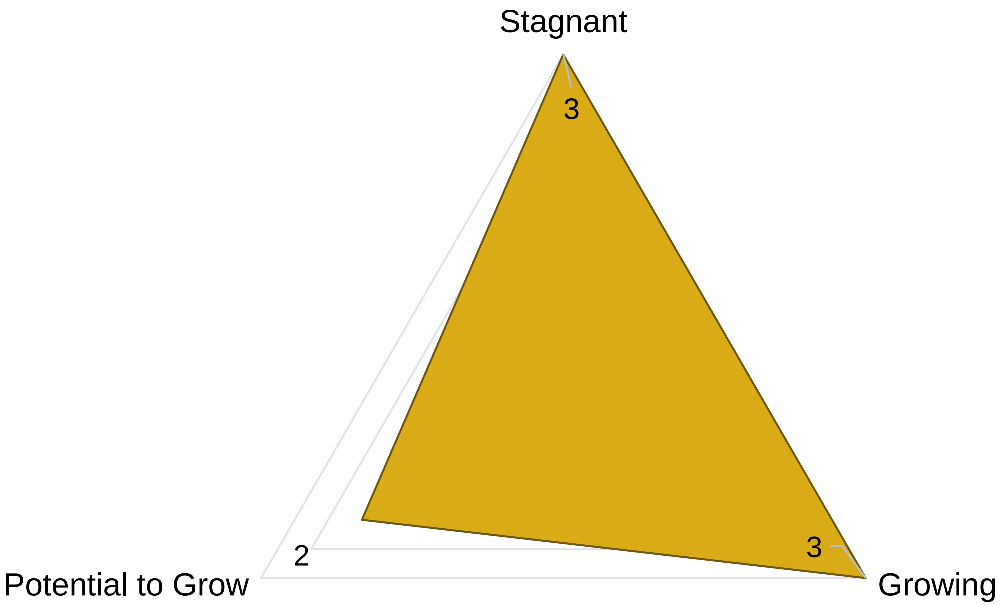
Risk transfer – growing or changing

- Opinion was split on whether the risk transfer market is stagnant or growing.
- 2 insurers feel there is potential to grow.



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Actuarial methodology

Investment

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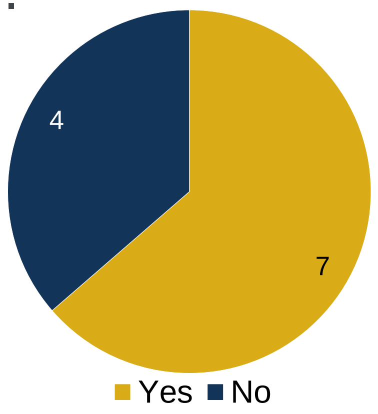
Investment strategy

- Seven of the eleven insurers said that they have changed their investment strategy as a result of PPOs, however only three of these had changed their investment strategy in the past year. Two of the reinsurers said that they had changed their investment strategy.



- Of these, three insurers said that they have ring-fenced assets specific to PPO liabilities, although others have long duration assets to cover all longer term liabilities.
- Insurers held a variety of assets to back PPO liabilities such as long-dated gilts, corporate bonds, equities, hedge funds and property.

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Investment issues

- The two biggest issues relating to PPOs that both insurers and reinsurers said they faced when asked were:
  - The exceedingly long duration associated with PPO liabilities
  - The inability to find assets that track a similar index to ASHE.

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COVID-19

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COVID-19

- The impact of the coronavirus pandemic (COVID-19) on PPOs is a current area of uncertainty.
- Potential impacts of COVID-19 on PPOs include:
  - Court closures - may lead to delays in settlements and a back-log of open large claims seen. Due to delays, claimants may be more willing to settle out of court and so a possible reduction in PPO propensity may be seen.
  - Mortality - excess deaths seen as a result of COVID-19 may lead to higher rates of mortality for claimants in the 2020+ calendar years. Given the small number of PPO claimants compared to the general population this is unlikely to be significant.
  - Care costs - increased demand for public and private healthcare may lead to increased cost of care compensation payments required in respect of PPOs.
  - Economic impacts - affecting investment returns and inflation indices used within the valuation of PPOs.

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Impact of COVID-19 on claim settlement speed

- Seven insurers said that they had noticed a slowing down of claim settlements since 23 March 2020, with the remaining four insurers saying they saw no difference.
- Operational disruption during lockdown seems to have been driving these delays, such as court closures and delayed medical reports.
- All but three insurers noted that they did not have a material backlog of open claims.
- All respondents said that they had not seen any significant change in claimant and claimant lawyer behaviour during the period of lockdown restrictions.

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Conclusions

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Conclusions

- **Despite a large increase in the ASHE index for 2020, the inflation and real discount rates assumed by contributors are largely unchanged**
  - **With the majority assuming a 0% or small negative real discount rate on a GAAP / IFRS basis.**
- **Most insurers surveyed are assuming an actuarial best estimate discount rate of -0.25%, in line with the current Ogden Discount Rate.**
  - **Compared to an Ogden 2.5% basis most insurers are assuming a reduction in PPO Propensity of 40% to 60% when calculating their actuarial best estimates**
- **Most insurers saw a slowing in claim settlements in the period that followed the initial implementation of COVID – 19 lockdown restrictions, although the majority do not currently have a backlog of open claims.**

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Questions

Comments

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Questions

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