Solvency II and Ogden the Perfect Storm

- Presentation by Alan Chandler, Chartered Insurer

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- **I have trained more than 2,000 individuals to become ACII qualified**
- I have trained over 50% of the individuals in the last 8 years that have gone onto achieve the highest ACII pass in the whole of the UK.
- I train to a pass rate of more than 96% in all CII qualification levels. Certificate , Diploma and Advanced Diploma.
- I deliver the Allianz scholarship and academy programmes in both the UK and Ireland and I have been a Cii examiner.
- I have trained students who have won national prizes in almost all ACII subjects including Insurance Law (MO5), Liability (M96), Commercial Property and BI (M93), Personal Lines Insurance (P86), Business and Finance (M92), Underwriting Practice (M80), Advanced Underwriting (960), Claims Practice (M85), Advanced Claims (820), Marketing (945), Advanced Broking (930) and Advanced Risk Management (992).

Learning Objectives

- Understand Insurers Solvency margins
- Obtain an overview of Solvency II
- Understand the current position of the Ogden table changes
- Understand and be able to explain to your clients how Solvency II and Ogden is affecting the cover and premium being offered by the market.

Solvency II and Ogden

What are Solvency Margins

- In The UK and indeed right across Europe there has been a history of Insurance companies going bankrupt during the years.
- One of the main reasons for this is the business model and accounting of insurance companies.
- Most businesses cite their greatest challenge as cash flow not so insurance companies.

Having lots of upfront cash can mean big dividends are often paid

Then reality catches up! Lack of claims reserves, lack of unearned premium, lack of IBNR, lack of IBNER and lack of unearned risk provision – insurance accounting is complicated!

List of recent bankrupt insurance companies

Company	Date
AA Mutual International Insurance Services Ltd	01/05/2007
Andrew Weir Insurance Company Ltd	12/11/1992
Anglo American Insurance Company Ltd	10/03/1997
BAI Ltd (Builders Accident)	30/07/1998
Balva AAS Insurance	04/07/2014
Bermuda Fire and Marine Insurance Company Ltd	16/12/1994
Black Sea and Baltic General Insurance Company Ltd	24/08/1998
Bryanston Insurance Company Ltd	23/03/1992
Chester Street Insurance Holdings Ltd	09/01/2001
Continental Assurance Company of London plc	27/03/1992

And here is some more

Drake Insurance plc	11/05/2000
English and American Insurance Company Ltd	19/03/1993
Eurolife Assurance (International)Ltd	24/04/2009
European Risk Insurance Company hf.	28/04/2014
Highlands Insurance Company (UK) Ltd	01/11/2007
HIH Casualty and General Insurance Company Ltd	16/03/2001
Independent Insurance Company Ltd	18/06/2001
KWELM Group of Companies	17/11/1993
Lemma Europe Insurance Company Limited	05/10/2012
Marina Mutual Insurance Association Ltd	14/11/1997

And some more!

Millburn Insurance Company Ltd	11/12/2013
Municipal General Insurance Ltd	09/03/1994
North Atlantic Insurance Company Ltd	06/03/1997
OIC Run Off Ltd / London and Overseas	21/10/1994
Pacific and General Insurance Company Ltd	15/11/1985
Paramount Insurance Company Ltd	24/06/1996
Scan Re Insurance Company Ltd	10/03/1994

And some more again! Remember this list does not include many foreign insurers who pass ported in like Quinn and this was why Solvency II was introduced

Sovereign Marine and General Insurance Company Ltd	11/07/1997
The Aldgate Insurance Company Ltd	12/11/2009
The Exchange Insurance Company Ltd	06/10/2010
Trinity Insurance Company Ltd	23/03/1992
UIC Insurance Company Ltd	12/08/1996

What are solvency margins

- A solvency margin is the amount of surplus assets insurance companies have to hold over and above their liabilities.
- Solvency margins are set by regulators and stipulate the minimum surplus assets the insurer has to hold over and above their liabilities.
- Example if an Insurer has to hold a solvency margin of at least £500M and their liabilities are £400m, they will need to make sure they hold assets of at least £900m

Solvency I

- The EU have stipulated some form of solvency requirements since 1973 and the principles of Solvency I still remain today.
- The Minimum Capital Requirement (MCR) known as solvency one has been with us for some time
- This has both a premium and claims calculation and the insurer takes the highest of the two.
- The MCR has been calculated at a 85% confidence level
- Broadly speaking the MCR comes to around 20 to 25% of annual GWP

Solvency I

- The FSA as was never felt Solvency I was enough and the previous list of bust insurance companies certainly testified this fact, so they introduced their own solvency requirements.
- They introduced their own requirements of Enhanced Capital Requirement and Individual Capital Assessment but these only applied to the UK - hence many insurers who were struggling for capital headed for the offshore havens

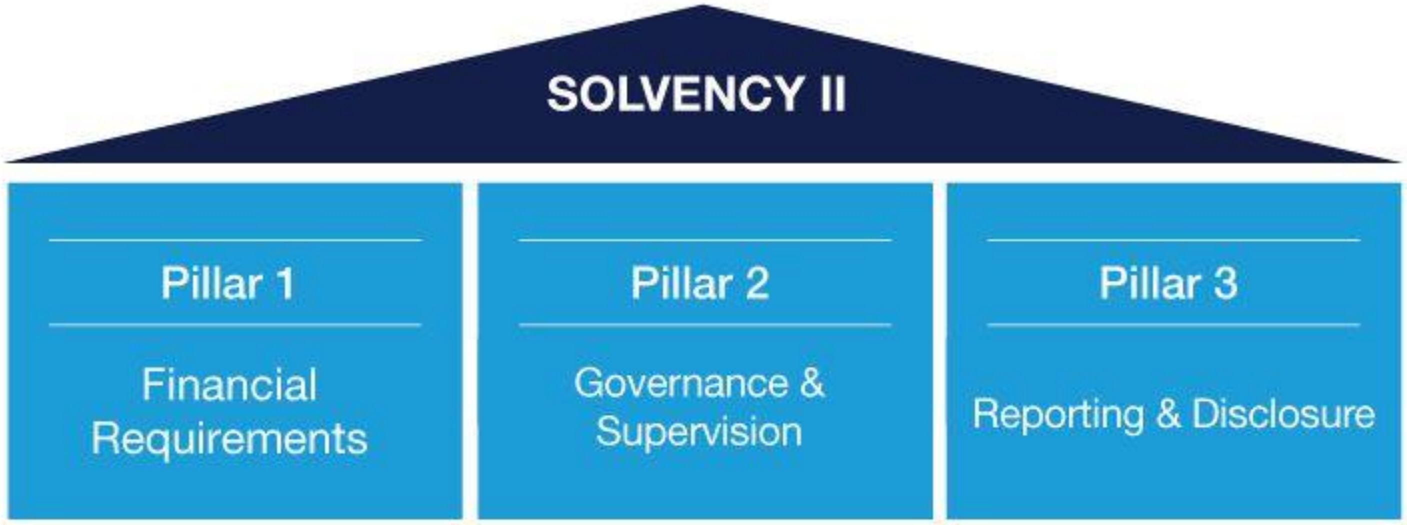
Solvency II

- The EU had originally planned to roll out new solvency requirements in 2005 but due to a combination of politics and the financial crash Solvency II never saw the light of day until the beginning of 2016.

- From January 2016 Solvency II applies to all EU insurers and there is no longer hiding places in the EU to obtain soft touches

- It is estimated that it cost the UK insurance industry £3 Billion to implement !

The Three Pillars of Solvency II



Solvency II

- The new capital requirement under Solvency II is known as the Solvency Capital Requirement (SCR)
- This has to be at a confidence level of at least 99.5%
- Insurers can use the EU generic formula or use their own formula which has to be signed off by the PRA
- It is also compulsory that insurers have an actuarial function, believe it or not certain EU insurers existed without one until Solvency II.

Solvency I (Red card) and Solvency II (Yellow card)

Solvency II was a massive challenge for almost everyone – some have got to the top of the solvency mountain ,some are working with their regulator and some have given up!

So having used up most of their spare capital to become compliant the last thing the insurance industry needed was a large claim hike!

Ogden Table change

- In 2017 Liz Truss made a decision to move the Ogden table rate from 2.5% to -0.75%
- This meant most motor and EL books had to be increased by a rate increase of between 9 and 15%
- When premiums go up so does an insurers capital requirement - fine if you had spare capital not if you used it all up being compliant with Solvency II

Example of an Ogden settlement

Serious Brain injury to a person of 21 years of age at date of settlement.

At 2.5% rate

Claim would settle at £9,072,028 with a future loss element of £8,242,086.

At – 0.75% rate

Claim would settle at £20,020,103 with a future loss element of £19,193,161

This is an increase of 121%

Think about policy limits – EL, PL, Products are probably now all too low!

What’s next for Ogden

- David Gauke was made the new Lord Chancellor on 8/1/18 - he does have a law degree unlike his last two predecessors!!!
- MOJ proposed on 7/9/17 that new rate will be between 0 to 1% and a three year review date set by an independent committee.
- This will have to go through parliament will take many months and around 12 stages including votes so the future is by no means certain.
- It looked like parliament would push through a change to the Ogden rate urgently but since September 2017 it has moved at the speed of a tortoise.

The Perfect Storm

- So with the combination of Solvency II and Ogden we have the perfect storm
- Those with large spare capital will be king.
- We now have a significant barrier to entry and MGA’s may well become more popular than setting up a new insurer.
- Lets have a look at some of the effects of the perfect storm

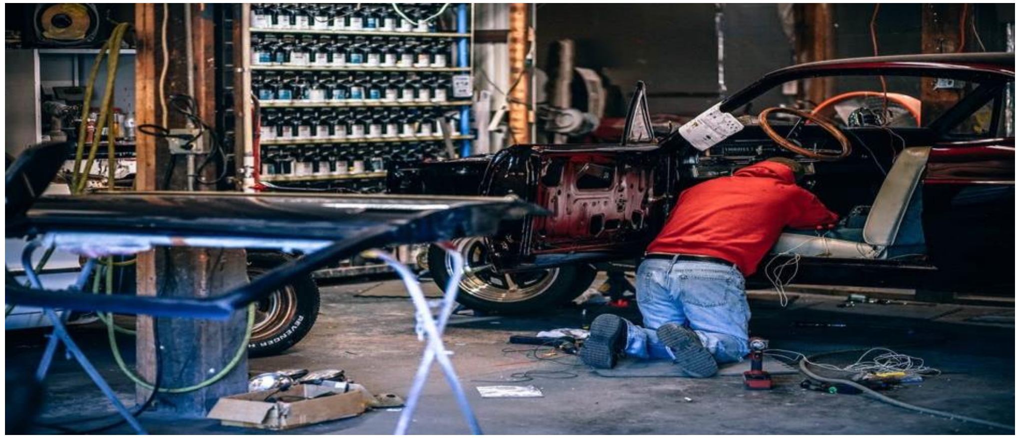
The Perfect Storm

- LV seek out Allianz’s massive cash pile despite its operation running well
- Marker study are turning to the vast wealth of Qatar Re to keep them going
- ERS pull of haulage fleet despite 12 months ago being one of the ‘go to’ markets
- Gable insurance disappear completely
- Enterprise insurance go bankrupt
- CBL insurance go bankrupt

The Perfect Storm

- There is a rush to the exit door for motor trade and construction business for many insurers and minimum premiums are increasing massively.
- Many insurers will want to write more of the ‘new covers’ like Cyber and D&O – these covers are very capital hungry, so to capitalise these new covers insurers will have to start writing less of the traditional covers.
- If you have to reduce your writing of traditional covers what will you write less of ???

Covers under threat



How can brokers deal with the perfect storm

1. Educate clients about the affect of Solvency II and Ogden
2. Get clients to invest in risk management – if insurers are going to write high risk business they are going to be more far more ‘picky’ going forward. Give underwriters a reason to quote on your clients business.
3. Be aware of using offshore solutions – they never had ECR/ICA requirements so the gap they have to get to solvency II has been far greater than UK FCA/PRA regulated insurers and they are far more vulnerable to the perfect storm.
4. Look to proactively work with insurers who are in a great capital position – they are in a strong place and will get more and more of market share

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