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CURRENT ISSUES IN LIFE ASSURANCE

SEMINAR, 2 NOVEMBER 1994

Around 200 actuaries attended the Current Issues in Life Assurance seminar held on 2 November 1994 at the Ramada Hotel, Heathrow. The seminar was divided into 5 sessions, covering a variety of topical subjects. Mr C. Hairs and Mr P. Grace acted as chairmen.

Unfair Contract Terms Directive

The first session was presented by Mr M. Hoskins and Mr P. Kennedy, who summarised the current position on this Directive, gave details as to its primary effects, and finally gave information on the impact this Directive might have on the actuary.

The E.C. Council of Ministers adopted the Directive on 5 April 1993, and it is to be applied to all consumer contracts which are effected after 31 December 1994. At the date of the seminar, the DTI had still not laid the regulations before Parliament in order to implement the Directive. The reason for this delay was that the Consumer Affairs division of the DTI had not yet taken a firm view on all the points which had been raised by the consultees. However, the DTI has given an indication as to the view which may ultimately be taken on many significant issues.

Mr Hoskins gave a summary of the current position on the understanding of the Directive, and summarised 6 points where the Association of British Insurance is concentrating its attention; namely consultation, timing of implementation, definitions within the legislation, guidelines to interpret the legislation, the representative actions (where under current proposed rules the only body able to take representative action against the company for this legislation would be The Office of Fair Trading), and cost of compliance.

Mr Kennedy discussed how the Directive might work in practice. He discussed how the Directive might interact with an actuary's work, and in particular, whether the concept of actuaries' discretion would be allowable in the future.

In the ensuing discussion, a wide variety of points were made. There was some discussion on what the definition of fairness would be, and could current contracts be assumed to be fair. The point was made as to how seriously the Directive was being taken, and how this Directive might cause companies much more serious problems in the years ahead. The overall impression given by all speakers in this session was that this Directive was yet another burden on the life insurance industry when it least needed it; that the effects are, as yet, uncertain, but if we are not careful it could become a major issue.

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Disclosure and Guidance Notes

The second session was presented by Mr C. D. Pullan, and Mr D. O. Forfar, who briefly presented the Professional Guidance Notes on Disclosure, and then took questions from the floor. (For details of the proposed disclosure rules, see the report on Current Issues in Life Assurance Seminar, 26 April 1994, *J.I.A.* **121,** 597). In response to the questions, it was noted that the regulators were prepared to accept that With-Profits Guides need not be revised immediately if the only cause for the change would be to change the reduction in yield information held within them. The question of whether development expenses and unrepresentative costs can be not charged to asset shares in the current year was raised, and it was felt that this could be permitted, but that a clear record should be made so that adjustments can be made to future years' results.

There was also discussion as to whether the current classification of GN22 should be raised from advisory to best practice in the near future. There was a mixture of views on this, with many people feeling that, since this is a very new area for actuaries, it was not the right time to raise the disciplinary standing of GN22. However, it was noted that the regulator would not be willing to wait for a period of time (3 years was mentioned), in order to ensure the guidance is working acceptably; the regulator will expect effective implementation of the rules much sooner.

Dynamic Solvency Testing

The third session was presented by Mr P. J. Nowell, who updated the audience on the results of the Dynamic Solvency Testing (DST) Working Party Questionnaire sent to Appointed Actuaries in August 1994. The presentation was based on the replies to the survey which had been received at the time of the seminar (roughly half of those sent out). He pointed out that the summaries of results presented were only provisional, and there had not been an opportunity yet for them to be reviewed by the majority of the working party members.

The results to-date indicated that most offices would welcome further discussions and input on DST, and many offices have indeed plans to extend/improve the models upon which DST exercises are based. DST is most commonly performed on a non-stochastic basis, the most common period of projection for DST is 5 years, and most offices use realistically expected experience assumptions. The results of DST exercises are normally communicated to the Board by means of a presentation by the Appointed Actuary, but, it was noted, that getting the issues across in this way was not easy. There was broad support that Advisory Guidance Notes would be helpful in relation to DST, and that many offices would be ready to implement DST in respect of 1995 year-end, although some would require a longer period to prepare models, etc.

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GN1/GN8 and The Insurance Companies' Regulations

The fourth session was presented by Mr P. N. S. Clark. The current proposals for the provisions of GN1 and GN8 were presented to the seminar. Mr Clark started by setting out the main reasons for the changes now proposed. Three new statutory instruments had come into force on 1 July 1994, primarily to implement the requirements of the Third Insurance Directives, but also to tidy up existing regulations in a number of other areas. The most significant of these instruments was the Insurance Companies' Regulations 1994, and it is the changes which this required which was the main item addressed by him. The changes in GN1 were:

(1) Appointed Actuaries will need to sign a Premium Adequacy Certificate each year. GN1 makes clear that, since reserves to cover any inadequacy in the rates would have had to be established at the end of that year, the requirements given in the additional certificate should not necessitate the Appointed Actuary carrying out any further investigations.
(2) It was noted that a significantly more liberal regime with regard to the use of derivatives and the necessity of ensuring adequate control thereof was dealt with, but not fully within the revisions. This was because the Investments Committee of the Wider Fields Board was working on an entirely separate note on the use of derivatives.
(3) GN1's application is now extended to actuaries who are not Appointed Actuaries of the Boards of Holding Companies of Insurance Companies, and also to 'absence of action'.
(4) Paragraph 2.3 now makes clear that only material conflicts of interest need to be considered.
(5) The Actuary was now required to qualify his certificate if the data were thought inadequate.
(6) Paragraph 8.1 now ensures that Section 18 reports do not contain window dressing.

With regard to GN8, some of the main revisions are:

(1) the removal of the ability to satisfy the detailed regulations only in aggregate;
(2) guidance on maximum assumed non-sterling reinvestment rates;
(3) notional apportionment of assets according to Regulation 69 (12); and
(4) the Guidance Note is much stronger now in taking account of policyholders' reasonable expectations, and in the requirement to reserve for one year's future overrun acquisition expenses.

Mr Clark noted, also, that Friendly Societies would now be served by annex to GN1 and a completely separate GN8A with appropriate regulatory references. He concluded by reminding the seminar that both of these revised Guidance Notes had been prepared under the fast track process, and they would require revision within 18 months. The revision process would also consider possible amalgamation.

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In the ensuing discussion, many questions of a clarification nature were asked, and there was also some querying of the meaning of certain items. Mr Clark closed the discussion by commenting that the Supervision Committee of the Life Board would re-examine certain aspects of the draft revisions in the light of comments made. In particular, they would look again at the guidance relating to expenses in the closed fund situation, and at guidance on policyholders' reasonable expectations for unit-linked business.

Pension Transfers and Opt-Outs

The fifth and final session was presented by Mr R. Brimblecombe and Mr R. Harvey. Mr Brimblecombe commenced by giving a quick overview of how the problem had developed. It started in 1988 with the introduction of Personal Pensions and the passing of the Financial Services Act. The first voicings of regulatory concern were heard in 1992, and in 1993 the KPMG Report and the first SIB Review were published. He covered 1994 in more detail, mentioning the development of LAUTRO's Enforcement Bulletin 16 (first published in 1992) and the implementation of Transfer Value Analysis Systems. In the autumn of 1994, SIB had completed its review of past business, and settled on a basis for redress and compensation.

In the most recent SIB Review, there is a reference to something entitled 'Actuarials'. This is the technical basis for analysis and compensation. It was derived from advice given from a group of actuaries which had been assembled by the then President of the Institute of Actuaries.

Mr Harvey then sketched out some questions and issues for Appointed Actuaries and for the profession generally. The most immediate issue facing both the profession and Appointed Actuaries is "What year-end provisions should be made for compensation and associated expenses?" This would depend upon how the affected business was sold for each company, and how the costs should be met once they have been quantified. In particular, which part should be made by shareholders, and which by policyholders? Should these costs be reflected in future asset share calculations, and how will policyholders' reasonable expectations be affected? He noted that there is little experience on which to base any estimates, either for compensation or for future expenses. Finally, he raised the point as to whether any Appointed Actuary would need to take action in respect of his/her Board and the DTI because of solvency concerns.

A large part of the discussion dealt with how the Investors' Compensation Scheme (ICS) levy will be allocated between companies. Under the current method for paying a levy, companies can be expected to pay redress for this particular problem, even if they, as a company, had no experience or exposure to it whatsoever. It was noted that the profession would be holding discussions with the PIA and the DTI on this matter. It was noted that the whole of this area was new, and that estimates as to the expected cost of this

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should be made on the basis of the best one can with the information available.

The difficulty of judging the 'Advice Standards', at the time the advice was given, was raised. The SIB Report says that compensation should be judged against the rules in force at the time. It was felt that, potentially, this could cause difficulties, as there was less clarity in the past concerning best advice than there is now.

The session was concluded by Mr Grace, who said that the Institute and the Faculty would be having discussions with the DTI and GAD on this matter.

R. C. Dix

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