SOCIETY OF ACTUARIES IN IRELAND

NEWSLETTER

February 1998

Editorial Notes

Welcome to the February 1998 Newsletter. There are a number of important issues engaging the minds of the Society at present. One relates to the Life Assurance Disclosure Regulations and commission disclosure in particular. I would like to draw the attention of members to the invitation by our President, Bruce Maxwell to give their views on this topic to him.

The second issue relates to Pensions Practising Certificates and the forthcoming consultation meeting on Monday 9th March next. I would encourage as full an attendance as possible from members, so that their views can be fully aired, any concerns expressed and addressed at this meeting.

On a lighter note, I would remind members of our forthcoming gala Ball on Saturday 23rd May which will round off our 25th Anniversary celebrations. It promises to be a wonderful occasion and an opportunity for any pretenders to Adrian Daly's title of "King of the Blue Suede Shoes" to put their money where their mouths are!

Paul Duffy

Actuarial Aspects of Life Assurance Disclosure

On 26th January the Society of Actuaries held a meeting to consider actuarial aspects of life assurance disclosure. The timing of the meeting proved fortuitous because the latest draft disclosure regulations had been issued by the Department of Enterprise Trade and Employment at the beginning of the month. Given the huge impact that disclosure will have on the way in which the life assurance industry operates it was hardly surprising that there was a full house to hear Bill Hannan deliver his paper!

Bill began by looking at the UK situation, describing how and why disclosure has evolved there and covering the three phases since disclosure was introduced in 1988. The current phase which has been in place since 1995 requires commission disclosure for all distribution channels and product disclosure based on the company's own charges. Bill drew attention to the rationale for the introduction of commission disclosure, pointing out that its purpose is not to assist the policyholder in understanding the policy, but rather to assist them in understanding their relationship with the intermediary.

In order to create a level playing field between distribution channels the concept of commission equivalents was introduced i.e. the full cost of benefits and services must be taken into account in arriving at a commission figure. The regulations require that account be taken of the advice of the Appointed Actuary and any guidance issued by the Institute of Actuaries and Faculty of Actuaries. GN22 gives guidance on the calculation of commission equivalents and the apportionment of expenses in projecting benefits from with-profits policies. The actuary is required to consult with the company's Compliance Officer in relation to all expenses.

Bill then turned to the situation in Ireland. Up to 1995 no disclosure was required by insurance companies. Since 1995 the requirements of the Third Life Directive have meant in practical terms the provision of projected surrender values and paid-up policy values on a generic basis. The DETE has now issued draft disclosure regulations which are expected to be signed into law some time in 1998. This draft requires product disclosure but does not provide for commissions disclosure. In the UK a comprehensive compliance regime exists and the Appointed Actuary can use the work of a compliance officer to calculate commission equivalents. This support structure does not exist in Ireland making meaningful commissions disclosure very difficult to achieve.

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With regard to product disclosure the policyholder will be given a table in a specific format showing how premiums paid relate to the policy value during the first five years and at five yearly intervals thereafter. The figures will include risk costs, expenses and investment return. The effect of charges is to be translated into a reduction in yield figure. The draft regulations require that these projections be prepared with regard to the advice of the Appointed Actuary and any guidance issued by the Society of Actuaries. This is likely to result in a GN22(ROI) and a working party is already preparing draft guidance.

At this point Bill contrasted the UK table with the proposed Irish table. Much criticism has been levelled at the UK table which is generally felt to be confusing for prospective clients and of limited added value. With regard to the proposed Irish table the prevailing view is that the regulators have taken a very sensible approach and have come up with a table that is easily understandable and which shows the client in clear terms how their money is spent.

In conclusion Bill felt that product disclosure would help to underpin GN1(ROI) and help to define PRE.

Jim Murphy

The report of the discussion has been written by the President who chaired the meeting.

The discussion which followed centred on the details of the product disclosure table and the concept of commission disclosure. The details will be covered by the working party and it will be important that guidance is sufficiently rigorous to enable the actuary to ensure that the spirit of the regulations is implemented. On commission disclosure many members felt that this should be introduced though recognising the difficulties in producing the information. It was argued that if there was no disclosure and no controls on commissions then this could not be in the public interest. It was claimed that the likely ending of the Industry voluntary agreement on maximum commissions would leave a vacuum which would have to be filled by some system of controls such as statutory agreements, commission disclosures and/or other possibilities. It was accepted that the actuarial profession will want to play its part in whatever transpires.

President's postscript.

The question of whether there should be commission disclosure, whether this would be in the public interest and whether the profession should publicly state itself to be in favour of disclosure, generated a substantial debate at the meeting which has continued informally since then. As mentioned above many members at the meeting felt that commission disclosure should be introduced in regulations and that the actuaries would be able to help sort out the difficulties involved and be prepared to take a responsibility role for it.

The latest draft regulations have no requirement for commission disclosure and the Society's response to the Department has made no reference to commissions, concentrating on issues relating to the product disclosure. The Society Working Party is busy preparing draft guidance for members on the Illustrative Table which will provide much more useful information for customers than is currently the norm. It is definitely in the public interest for the Society to ensure that the Table meets its objectives.

The recent announcement that the Industry agreement on maximum commission levels must be abandoned means that Council are reviewing the approach the Society should take on the issue. The meeting on Bill Hannan's paper was helpful in this regard. Any members who would like to input to the Council's considerations are warmly invited to write to me as soon as possible.

Bruce Maxwell

CPD Seminar - UK Pensions Act

On the 16th December 1997, Roger Key of Watson Wyatt gave us a half day seminar on the UK Pensions Act with emphasis on it's effect on the guidance notes produced by the Institute of Actuaries. Throughout his talk, Roger stressed that we should not see the guidance notes as a complete guide and that the Act and regulations should always be to hand.

He started with GN 28 which deals with benefits for contracting out after 6th April 1997. The comparison of schemes with the reference test was discussed. While in principle every individual member of a scheme needs to be tested, Roger explained that where there were many individuals with slightly different benefits, these could be grouped provided the test was carried out on the least generous benefit basis of the group. Roger drew our attention to the fact that while the test on the member's pension is relatively straightforward,spouses' benefits had to pass three different tests. Also, money purchase elements cannot be taken into account so hybrid schemes may have difficulty passing the reference scheme test. In the discussion that followed, the possibility of altering the rules to provide an underpin linked to legislation was put forward as a possible solution for schemes with problems passing.

GN 29 was next on Roger's list covering actuaries' whistleblowing duties. Roger pointed out that while OPRA is encouraging all breaches to be reported, there is in fact no protection for the actuary if a reported breach turns out to be immaterial. The question of whether the actuary advises the trustees or employer that they are reporting them was raised. As reporting of a breach is supposed to be immediate, the actuary should have no time to warn them anyway, but advising after the fact is allowable provided it does not prejudice the interest of the members.

Roger then moved on to GN 27 - the MFR. He pointed out that the structure of UK pension schemes and the large pensioner liabilities means that the MFR will tend to move in line with the gilt market. This may not, in fact, be appropriate for the actual scheme asset mix giving rise to volatility in the results. He illustrated the fact that a matched investment policy substantially increases the scheme's chances of continuing to pass the MFR, particularly for mature schemes. However, Roger feels that it is the accounting standards that will affect the way schemes are funded in the future rather than the MFR.

GN 11 and the changes to it associated with the Pensions Act were then covered. The fact that transfer values are now subject to the MFR minimum will often mean that two calculations will be required. The treatment of discretionary benefits may become an issue for some schemes as ignoring them will require a report from the actuary on the effect of doing so. Roger also mentioned the underlying asset assumption for different categories of members. If, for example, the SIP states that the deferred pensioner liability will be matched with gilt investments then gilts can be used as the underlying assets for the transfer value calculation on the MFR basis for deferred pensioners. (This would not be allowed for active members).

The talk was a very practical one. Given the quantity of literature available on the UK Pensions Act, it was useful to have such an instructive guide through the whole process for Irish actuaries to UK pension schemes.

Emer Chapman

UCD - Faculty of Commerce - Dean's List Awards

The Annual Society prize for the best performing student in the final year of the Actuarial and Financial Studies degree course in UCD was awarded to Donald Salisbury BAFS. The President presented the prize to Donald at the recent Dean's List dinner held in the college. Donald is now an actuarial trainee with Eagle Star in Blackrock, working in the product development area.

Included in the photograph are Linda Kerrigan, Actuarial & Financial Studies Level 2 and Emer Breen Actuarial & Financial Studies Level 1, both on the Dean's List Awards for academic excellence in their undergraduate degree programmes.

Photo: Left to right-Bruce Maxwell, Linda Kerrigan, Donald Salisbury

Report on Critical Illness Paper

On 2nd February, Martin Werth and Peter Mannion presented their paper on "Critical Illness Cover - A Time for Review". It is very pleasing to report that they chose to present this paper in Ireland before doing so in the UK. In fact of the three papers in the UK and Ireland on critical illness two were presented here first, so perhaps we are developing a speciality.

Martin and Peter's arguments are (very briefly) as follows:-

1. Reserves and pricing for guaranteed products have not adequately allowed for possible trends in experience. For example, surgical operations will increasingly become more available, less critical and more elective; cancers will be diagnosed at much earlier stages of development. Furthermore definitions are liberal and inflexible; arbitration is increasingly finding in favour of the policyholder.

2. In many cases the benefits payable under the policy are not meeting our customers' needs. In some cases people will get bonanza payouts when there is little threat to their life, health or wealth in the claim cause. The risk of this may increase as medical advances change the prognoses of events that are critical now but less so in the future. On the other hand many causes of incapacity are not covered. It may be that by having very long lists of claim causes we are misleading potential policyholders into thinking that virtually every possible serious ill ness is covered.

3. They then developed some ideas for products that could offer a better marketing proposition by being a better fit with customer needs. Varying the size of payment with severity of the claim was another option. Income pay ments could be introduced. This was backed up with evidence from a survey of consumer attitudes that had been carried out by Munich Re.

4. There is therefore the possibility of a win-win situation where a product could be both better value to customers by being a better fit with their needs and still offer less risks and a better return to shareholders.

Most speakers shared Martin and Peter's concerns and agreed that what they proposed made sense.
However, there was less conviction that their proposals would actually be fulfilled. It was generally agreed that one of the reasons that CI had succeeded where PHI had failed was objectivity of claim cause. The public may well not trust a policy where the definition of a claim can be varied by the insurance company. It was suggested that lump sum PHI might sell better by having a large headline sum assured. Lastly there was more difficulty with underwriting PHI than CI.

A comparision was drawn with credit insurance on mortgages which was discussed by Peter and Martin. They drew attention to low claims ratios for CI attached to mortgages. There was some sentiment that insufficient premium was being charged for the cost of the guarantee. One general insurance actuary was astonished that a CI payment could be in addition to EL, Motor and PHI without aggregating being applied.

Lastly Peter and Martin pointed out that CI should be regarded as a success since large quantities are being sold! Overall an interesting and stimulating paper which poses issues that the profession needs to respond to.

Tony Jeffery

List of Actuarial Consultancies

The Society frequently receives requests for the names of actuarial consultancies in Ireland. In order to update our listing, please contact Mary Butler at the Society's office, if you wish to be included on this listing.
Please also indicate your area of practice.

The Actuary in Injury and Fatal Compensation Cases
CPD Talk by Piers Segrave-Daly

Piers Segrave-Daly of Segrave-Daly & Lynch, assisted by his colleagues, presented an overview of the issues involved in this specialised area of actuarial advice in which he has been involved for over 30 years.

The vast majority of cases in which an actuary is involved are heard in the High Court although actuarial advice is also required at various tribunal hearings, and particularly at the Hepatitis Tribunal in recent years.

The principal function of the actuary's evidence is to enable the Judge to arrive at a reasonable accurate mathematical computation of the present value of losses which will continue in the future. These losses may be loss of earnings, loss of pension rights or the cost of future care in personal injury cases and the loss of support provided to financial dependants in fatal cases.

Left to right Members of the cast who re-enacted a court room scene John Logan,Piers Segrave-Daly, Nigel Tennant, Emer Chapman and Brendan Lynch

In essence, the actuarial calculation required is placing a present value on each £1 per week lost (the multiplier). In practice, actuaries involved in court work do considerably more than this and are often largely responsible for putting together the whole case for dependency losses, particularly in fatal cases. This is due to the actuary's numeracy skills which are widely valued by both solicitors and barristers who are often loathe to become involved in manipulating numbers. The main assumptions needed to derive the multiplier are the discount rate, the tax assumption and the mortality assumption. The discount rate used is 4% p.a. and this rate has applied for over 10 years. The principal argument behind the adoption of this rate is that yields on index-linked government stocks have consistently been around this level. In fatal cases, past losses are accumulated at 8% p.a. as this is the rate which the courts add interest to awards in cases which are referred to the Supreme Court on appeal.

No tax is payable on awards made by the courts but investment income arising on damages is subject to taxation in the normal way. The practice is to make allowance in the multiplier for the expected tax that will be payable on investment income. In calculating future losses only the net loss of income is applied to the multiplier. The mortality and marriage rates used in the calculations are derived from the latest population statistics. In cases where life expectancy is other than normal, the court accepts a doctor's evidence as to what reduction in life expectancy is appropriate.

Piers and his colleagues then re-enacted a court room scene to give flavour of how the actuary's evidence is presented to the courts which was both entertaining and informative.

The question and answer session brought several questions on the appropriateness of the discount rate and whether different rates should be used for valuing earnings losses and future care costs. It was noted that while there are logical arguments to support such theories, in practice two attempts to date to adopt a different rate have been unsuccessful in the courts, and that while the current approach may be simplistic, the courts are familiar with it and will be reluctant to approve any change.

Christine Murphy