

Review Of 2006

Looking back at the article I wrote this time last year, I notice a heavy reliance on analogies between the world of life assurance and the dramatic unfolding of the 2005 Ashes series. As I write this, the outcome of this winter's Ashes series is still uncertain, but it seems safe to say that matching the excitement of 2005 may prove a tall order. The pace of change in our industry, on the other hand, shows no sign of slackening, and I am pleased to say that at Hannover Life Re (UK) we continue to field a strong team who have shown themselves ready and able to cope with anything the market can throw at us!

Term Assurance - With Tax Relief!

One of the main talking points this time last year was the impending 'A Day' and the new world of pensions this would usher in from April 2006. For us as reinsurers, the introduction of pensions term (term assurance with tax relief, if you like) was obviously a key issue. Amid much publicity 'A Day' duly arrived and our clients began their entry into the world of term assurance with tax relief.

First impressions were, if anything, anti-climactic. Intermediaries, hardly surprisingly, were initially mostly concerned with clarifying their clients' pensions needs. Early feedback suggested the impact on term business would be relatively slow to take effect. Latterly, however, the pace has quickened and our clients are now reporting a significant increase in the proportion of term business sold on a pensions basis, accounting for almost 50% of new business in some cases.

Some advisers remain wary of selling the new product. There is a possibility that tax relief could be withdrawn at some point. Indeed the policyholders themselves could become ineligible for tax relief if they cease to pay tax. The lifetime limit could well affect more and more people over time as pension funds build up. Higher rate taxpayers benefit most from pensions term, and it is precisely these people



whose funds are most likely to approach the lifetime limit. Some advisers feel they could find themselves at risk should this happen and so feel obliged to spend much longer explaining the possible pitfalls in the course of the sales process.

Increasingly providers have tried to address these concerns by introducing an option that would allow clients to convert to the 'non pensions' regime at the same gross cost under certain circumstances. I believe that, after a slowish start, an increasing proportion of business will gradually migrate to the 'tax relief' camp.

This time last year I noted our concern that much of our existing portfolio could be 'churned' into the new product, causing an unexpected loss to both ourselves and our clients as initial lapses increased. With advisers initially concentrating on their

clients' underlying pensions needs, there seemed little sign of these fears being realised. But we are not out of the woods yet, and our misgivings could yet come home to roost as advisers look further into addressing their clients' protection needs in 2007. Critical illness and other riders, of course, cannot be added to pensions term, so traditional term products will continue to have a role to play, which would tend to diminish the risk of churning. It will certainly be interesting to follow developments in the pensions term market during 2007.

Critical Illness – A New World?

It would be highly unusual to read a reinsurer's annual review that made no mention of critical illness, and I would hate to break with tradition! 2006 has seen some real progress in this marketplace – and I think we would all agree that the product was in need of some development work.

The statistics now reveal that companies are declining around 20% of claims, mainly over non-disclosure or misunderstandings over what exactly TPD covers. I don't believe this state of affairs is sustainable. At Hannover Life Re (UK) we have always been keen to stress that we, and our clients, are in the business of paying customers' claims, whilst, of course, making sure it is the right claims we pay. In the new world of Treating Customers Fairly adhering to this stance has become more important than ever.

There have been a number of attempts to improve the situation on traditional critical illness products during 2006. Application forms may have become longer, but the questions they ask are hopefully now clearer and less open to misunderstanding. Warnings on non-disclosure have also been made less ambiguous, which should certainly improve matters.

The ABI also completed its work on definitions, and companies have until April 2007 to introduce these. We analysed the new definitions in detail in the August edition of 'In Focus' and I don't propose going over that ground again here. Although the debate over part of the cancer definition has been re-opened, we believe the new definitions are to be welcomed and indeed that they make the whole area of guaranteed critical illness easier to deal with. Because of this, we decided to offer guaranteed critical illness more widely during 2006, and we are happy to advise our clients on suitable product designs.

Our involvement in critical illness broadened this year when we assisted one client in developing perhaps the most innovative new critical illness product yet launched in the UK. The new plan is severity-based, with varying proportions of the full sum assured payable and a list of diseases much longer than a standard critical illness plan. A similar product design has already proved very successful in South Africa, where it has become the standard design for all critical illness plans. We believe this new product design has the potential to succeed in the same way over here.

Predictably the industry reaction has been mixed. Whilst many commentators are ready to welcome any innovation in this market, there has been some criticism of the perceived complexity of the plan and doubts raised over policyholders' ability to understand what they are buying. On the other hand research suggests that policyholders actually favour the new product design over traditional plans and feel it matches their needs more closely. Only time will tell whether the new plan will succeed here as it has in South Africa – or whether perhaps some further development on the current product will be required.

At Hannover Life Re (UK) we have always been keen to run with innovative product development ideas. We first argued in favour of tiered benefits back in 1999 – both in our newsletter and at our product development seminar. Since then we have continued to encourage this development and are now looking forward to the outcome. My team is ready and waiting to assist our clients in pushing on to the next stage in the never-ending evolution of critical illness.

Enhanced Annuities – a Growing Market?

Before moving on entirely from the subject of new product development, I would like to return briefly to another of Hannover Life Re's main fields of expertise, namely enhanced annuities. I have been surprised not to see a more rapid pace of development in the UK market. The product is now well established, with a number of specialist players active in the market, but we have yet to see any major provider enter the market in a big way. I fully expect this situation to change within the next year or so, and that the market for such products will grow considerably.

New Regulation – Good News For All!

As ever, regulatory developments have never been far from our thoughts during 2006. But this year, for a change, we have seen some welcome developments in the UK regulatory regime – both for ourselves and our clients.

The first of these – the implementation of the EU Reinsurance Directive – affects reinsurers only. Its main thrust is the introduction of a common solvency margin for reinsurers throughout the EU. Previously the FSA required UK-based life reinsurers to hold a solvency margin similar to those of our client life companies: 4% of statutory reserves, with a concession on the 'sum at risk' component of 1 per thousand of sum at risk. This contrasted with our reinsurance counterparts throughout Europe, for whom there was no formal solvency requirement whatsoever. As the EU directive is implemented throughout Europe (which will happen by December 2007 at the latest) all reinsurers will be required to put up a solvency margin – but one based on the current non-life regime, i.e. premium and claims related. For UK life reinsurers, implementation comes at year-end 2006, and in crude terms the new solvency margin is expected to be around half the current level.

In conjunction with changes relating to solvency margins, the FSA announced that it is minded to allow a change in our Pillar 1 statutory reserving requirement. The main change here would be that allowances for lapses and negative reserves would become acceptable. Again, this is due to be implemented at the end of 2006, although final rules are not yet available. Following this announcement concerning reinsurers, the publication of the Consultative Paper CP06/16 trailed a similar change for direct life companies.

Whilst in some ways I have been surprised to see the FSA relax its reserving requirements (having spent years explaining to our foreign parent why our company needs so much capital!) it is, of course, entirely consistent with the developing Pillar 2 regime and the ICA requirements now in place. Previously most, if not all, non-profit companies would have found their Pillar 1 capital requirements significantly higher than Pillar 2. This situation may well change in the future, depending on each individual company's financial position.

As we and our clients have begun analysing the effect of the changes on our capital position and future strategy, a number of interesting questions have arisen as to the future shape of reinsurance provision. Over the

last few years we have seen significant growth in large quota share reinsurance arrangements within the protection sector. Undoubtedly part of the reason for this has been capital-related, with 'regulatory arbitrage' widely used by leveraging reinsurers' global networks. Some observers have concluded that having the major part of the risk taken by reinsurers is not a healthy situation since it has given reinsurers too much influence over product design. Whilst I would obviously not agree that this has been all bad (!) I can understand where the argument is coming from. The key question now is whether our clients will begin to retain more of the risk themselves and, if so (which in many cases is by no means certain), how this will alter the future shape of reinsurance.

I will be very interested to see how our clients' strategy develops following the new legislation's introduction. Whilst opportunities for regulatory arbitrage will remain, the amount of capital required to retain business will be lower – so some companies are already considering retaining more, or indeed changing their method of reinsurance. On the face of it, you might expect reinsurers to be less than happy about this, as their volumes could decrease in future. However, I believe that we at Hannover Life Re (UK) will be well placed in the new world of reinsurance that may emerge.

I personally doubt the practise of quota share reinsurance will disappear completely, and I expect many companies to continue in this way. There will still be an initial strain in writing new business, which reinsurance helps to alleviate. Many of our clients have reduced their resources in the area of protection, relying heavily on their reinsurers to advise them, and this will naturally take time to change.

In some areas, where the alignment of interests makes good sense for both parties – critical illness in particular – our clients have always been keen on quota share reinsurance. We might expect to see them placing reduced quota shares, perhaps down from the 90% level, and this might not be such a bad thing after all. As a reinsurer, I would feel the alignment of interest is greater if my client takes more of the risk, and indeed this is more in line with the partnership approach for which Hannover Life Re (UK) is well known.

At Hannover we are confident of being better placed than our competitors as and when the world of reinsurance does change. With our team's product development expertise and experience, built up over many years, we are ready to work closely with our clients on product development in exchange for reinsuring the new product. This practice has perhaps been less prevalent in the last few years, but we are very comfortable with this way of working with clients, and indeed have continued to do this wherever we can in recent years. So we are ready to assist our clients in the new world – whatever it may entail!

The Law Commission Review – A Cloud On The Horizon?

During 2006 the Law Commission began a review of insurance contract law, with the aim of making it more up

to date, more in line with current practice, and more favourable to the consumer. A pre-consultation paper on misrepresentation and non-disclosure was issued in September. At present the status of the review is such that it is uncertain whether the Government will implement the recommendations. If so, a draft bill would still not be published until 2009/10.

The paper that has been issued is wide ranging, and we at Hannover Life Re (UK) cautiously welcome many of the proposals. I do not intend to cover this paper in any great depth here, but I think it may be worth commenting on the one issue that has so far received the most publicity. This is the suggestion that a fixed period might be set following policy issue after which we would not be able to deny a claim for non-disclosure.

It has been suggested that, except in cases of fraudulent misrepresentation, the insurer should not be entitled to deny a claim once the policy has been in force for three years. With such a short period specified, the effect on premiums would undoubtedly be significant. It could mean a wholesale revision of current underwriting practices, with significantly increased costs resulting. In our view the likely cost of these changes, taken together with the effect on claims experience, could make premiums for some covers such as critical illness and income protection unaffordable for all but the wealthier members of our society. This would significantly widen the protection gap we are currently trying to close.

Any such period mandated by law would in our view need to be considerably longer and should reflect the differing characteristics of the contracts provided. So while five years might seem reasonable for life cover, reflecting the period during which claims are commonly subject to a more detailed review, for other products such as critical illness a longer period might be necessary to avoid significantly increased premiums.

We will be watching the progress of the Law Commission's review with great interest, and will naturally be keeping our clients informed.

Thank You!

Hannover Life Re (UK) has had another excellent year in 2006. Traditionally it is time for me to thank all of our staff for their support during the year. For some companies this may be a routine message, but I want to stress that for me this really is a personal and warmly felt thank you! Our team is widely recognised as the most stable and loyal in our industry, and I strongly believe they are also the most able reinsurance team in the country. Sincere thanks to them all!

I would also like to take this opportunity to thank you, our clients, for your support. We cannot develop without you, and I look forward to many more years of growing both our businesses in partnership.

Here's wishing all our readers a very happy Christmas and a healthy and prosperous New Year!

David Brand
Managing Director

Our office hours over the Christmas holiday period

Friday 22nd December 2006	Closed from 1pm
Monday 25th December 2006	Closed
Tuesday 26th December 2006	Closed
Wednesday 27th December 2006	9am – 4pm
Thursday 28th December 2006	9am – 4pm
Friday 29th December 2006	9am – 4pm
Monday 1st January 2007	Closed
Tuesday 2nd January 2007	Normal office hours

From all at Hannover Life Re (UK) we wish you a Merry Christmas and a successful New Year.

Supporting Shelter, they believe everyone should have a home.

Shelter



Life Convention and Exhibition 2006

Scottish Exhibition & Convention Centre, Glasgow

The successful Institute of Actuaries annual Life Convention and Exhibition was held in Glasgow at the Scottish Exhibition & Convention Centre.

Hannover Life Re (UK) supported the Exhibition and presented the HLR Enhanced Annuities point of sale solution 'MERICA' with our home office colleagues. If anyone is interested in finding out more about this solution please contact our Client Relationship Management team on 01 344 846819/34.



Delegates also tried their hand at stacking cups in the Hannover Life Re (UK) Race Cups Challenge. The challenge was to stack and un-stack the 12 race cups in a 3-6-3 sequence as quickly as possible. Six finalists reached the challenge – Robin Houghton, Synesis Life won first prize of a luxury Highland Fayre Hamper and a Racing Cup game, Mike Lewry, The Actuarial Education Company came second to win a boxed set of wine and a game and third place went to Paul Collins, Aviva Plc who also took home a racing cups game.

We look forward to seeing everyone at next year's Life Convention which is being held at the Manchester International Convention Centre from 11-13 November.

We hope you enjoy **In Focus** and we welcome your feedback, please forward any comments to Kirsteen Grant. If you wish to be added to our mailing list contact Kirsteen on 01 344 846833 or email uk.marketing@hannover-re.com.

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Competition

For your chance to win an entertaining Race Cups game for Christmas please answer the following questions;

1. Who was the originator of crackers?
2. Christmas cards become popular in Britain with the introduction of the 'penny post' in what year did the penny post start?
3. What was Christmas pudding originally called?

send your answers to uk.marketing@hannover-re.com by 15th December 2006 to be entered into the prize draw.

CONTACT