

## Underwriting Hot Topics



### Non-Disclosure

The non-disclosure of material facts at application or renewal costs the industry an estimated £250m in lost premiums each year. The main causes are unapplied ratings and wrongly identified smoker status. What's more, the figure quoted above relates purely to term business. We can only guess at the total cost including critical illness and income protection.

Non-disclosure also has a significant impact on claims. Around 18% of critical illness claims are currently declined – just under half

of these on the basis of non-disclosure. Refinements to the application process have improved the situation, but many consumers still lack a clear understanding of what disclosure entails. Overly long application forms, confusing medical questions, and the incorrect assumption that insurers will always obtain information from a GP all contribute to the problem.

Negative media coverage generated by what is perceived as a high level of declined critical illness claims is eroding consumer confidence and generating a growing number of

complaints to the Financial Ombudsman Service (FOS). Figures recorded by the FOS suggest that – pound for premium pound – critical illness generates 300 times as many non-disclosure-related claims complaints as home contents insurance.

Clearly then non-disclosure remains a key issue. But in our opinion the problem is decreasing. Better application forms are improving the information gathering process at point of sale, and the case for tele-underwriting new applications has been well and truly made.

A recent study of 'clean' applications by MorganAsh showed that, when applicants were talked through the questions by a trained nurse half of them made additional disclosures, half of these being material i.e. affecting the underwriting decision. An increasing number of organisations are now either piloting tele-underwriting or implementing it as part of their new business processes. This seems certain to improve both the quality and quantity of disclosure – leading to a reduction in problems further down the line.

#### Ongoing duty of disclosure

One of the most contentious and least well understood aspects of the application process is the onus on the applicant to disclose any change in their health between completion of the application form and the offer of acceptance terms and indeed right through until the policy commences. Having conducted our own study into this longstanding consumer confidence and clarity issue, we are convinced that – in some circumstances at least – it can be resolved.

Reviewing our own claims portfolio we found that issues very rarely arise over the ongoing duty of disclosure in the absence of other more obvious non-disclosures. We found also that when such cases come before the FOS the ruling usually goes in the complainant's favour. The FOS' main concern and the factor on which it places most emphasis is the prominence and frequency of warnings to the applicant that ongoing disclosure is expected. Simply quoting the paragraph at the end of the application is likely to be seen as insufficient.

Our belief at Hannover Life Re (UK) is that a duty imposed on the applicant to continue disclosure post acceptance is hard either to defend or to enforce. Given this, once the policy has commenced, we tend to treat the time between acceptance and issue as a grace period along the lines of the free cover provided on many mortgage-related policies – provided, of course, no other non-disclosure issue arises.

#### Law Commission

The Law Commission is the independent body set up by Parliament to review and recommend reform of the law in England and Wales. It is currently looking at the issues of non-disclosure and misrepresentation as part of a wider review of insurance contract law.

Our view is that whilst both initiatives – should they find their way into the Law Commission's Final Report and Draft Bill (target date 2010) and eventually become incorporated into the relevant legislation – will obviously help to clarify the situation for consumers, they will actually make very little difference to operating practices.

However we do feel strongly that where negligent non-disclosure is concerned a clear distinction should be made between instances that are related to and those that are unrelated to the cause of claim – as is the current FOS practice.

A summary of the Consultation Paper published in July 2007 highlights two main recommendations:

- Slight changes to the existing degree of fault definitions so that 'innocent, inadvertent and reckless' become 'innocent, negligent and deliberate'. The suggestion is that a 'with the benefit of hindsight' remedy should always be sought in cases of negligent non-disclosure, i.e. decline, exclude or make a proportionate payment based on what would have happened had the correct information been disclosed. No mention is made of the possible link between non-disclosure and the eventual cause of claim, the inference being that it should no longer form part of the decision-making process.
- The introduction of a cut-off or non-contestability period for declination of life assurance claims due to non-disclosure. In other words: a set period of time (five years is the suggestion) after which insurers would not be able to refuse claims on the basis of negligent non-disclosure.

Non-contestability periods operate successfully in other parts of the world, for instance the United States, Australia and New Zealand. Although unnecessary in our view, we would not anticipate implementation of the Law Commission's recommendation having any major impact – provided the scope of any UK version is limited to a five-year period for death claims only. Even allowing for the fact that deliberate non-disclosure would still result in a claim being denied, an analysis of our own portfolio has shown that very few death claims on policies over five years old are declined for any reason.

The Law Commission is seeking responses to its Consultation Paper by 16 November 2007. Hannover Life Re (UK)'s response is likely to suggest that, rather than recommending these subtle but unnecessary changes, any existing agreed FOS approach is built into their eventual case for reform.



**Tim Bowns**  
Manager – Underwriting & Claims

# Reinsurance in the New Capital World

## How will we and our clients prosper in the future?

2006 saw a significant relaxation in the statutory valuation requirements for life insurers and reinsurers writing non profit protection business in the UK. This coincided with the enactment here of the EU Reinsurance Directive. Many commentators expected these developments would significantly alter insurers' appetite for reinsurance and also the structure of the reinsurance arrangements used. In the following article we examine why things haven't quite turned out that way and offer our own interpretation of how insurer–reinsurer relationships may pan out in future.

Since the late 90s protection reinsurance structures have tended to evolve into large quota share based treaties. Insurers have used such arrangements to offset the significant capital requirements of writing, for example, level term assurance in the UK by reinsuring to a global reinsurance group. By leveraging their global networks to reduce capital requirements, reinsurers have been able to pass a lower cost of capital back to insurers in the form of highly competitive reinsurance rates – with consumers ultimately benefiting from ever-more competitive term assurance premiums.

If capital was the initial driver for large quota share reinsurance structures, the reduction in capital requirements should in theory have prompted life insurers to switch back to much higher retentions. But our clients' appetite for large quota share reinsurance arrangements seems undiminished.

To find the reasons for this we need to go back to basics. Over the past few years insurers have indeed benefited from the type of statutory arbitrage described above, but an ancillary effect of large-scale risk transfer has been to stabilise insurers' mortality fluctuations and hence their profits. Within their Individual Capital Assessment (ICA) calculations for insurance risk capital, there has been a significant offset for reinsurance, albeit somewhat reduced by the need to set aside capital to cover the credit risk of reinsurance. Retaining more insurance risk would significantly affect insurers' ICA capital. Indeed it is a moot point whether insurers actually want to take insurance risk these days. It is certainly a risk that most insurers are no longer used to running.

Another interesting consideration is the nature of today's highly competitive reinsurance market. It seems many more reinsurers have decided that the UK life market is the place to be, and – for now at least – the laws of supply and demand have naturally driven reinsurance prices down.

The potential for statutory arbitrage, though reduced, still exists. The required solvency margin capital for

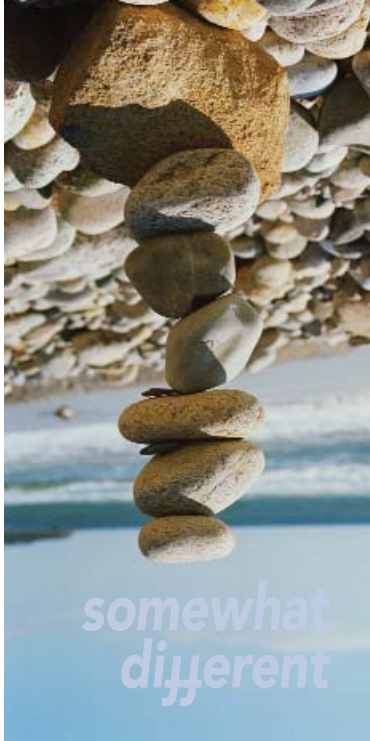


reinsurers remains significantly lower than those for cedants and has indeed been reduced further by the EU Directive. Reinsurers also continue to benefit from their presence in offshore locations, further reducing their capital requirements.

Many life insurers no longer retain the research expertise to justify offering rates as competitive as reinsurers' rates and prefer to draw on the latter's research and development resources. So from an insurer's point of view it may perhaps seem that little has changed and continuation of current reinsurance strategy is the way to proceed.

But how does the view look from a reinsurer's point of view? We can't, of course, speak for our competitors, but from Hannover Life Re (UK)'s perspective the market does seem to have changed somewhat.

We have always taken the view that our long-term prosperity depends on establishing mutually profitable partnerships with our clients based on a true alignment of interests. The term assurance market hasn't always been the easiest place in which to achieve this over recent years. Imperfectly aligned interests across the market have tended to undermine the concept of reinsurers 'following the fortunes' of their clients, which some would certainly see as an unwelcome backward step.



somewhat different

We continue to compete in the reinsurance term market and aim to support our clients in their endeavours. We recognise that our clients too must ensure their products, processes and prices remain highly competitive. But it is logically impossible for us to support all of our clients to be within the top three of the market on price! So where do we go from here?

A key part of Hannover Life Re (UK)'s philosophy of long-term partnership is sharing our expertise and ideas with our clients. We have plenty of innovative ideas to bring to the table, particularly in the area of critical illness (see Issue 30 of In Focus for a flavour of our latest thinking in this area). The Hannover Life Re group also has a history of specialisation in the field of enhanced annuities.

To survive and prosper together with our clients, we must continually find new ways of writing mutually profitable business. As a reinsurer we must always maintain our clients' confidence in the commitment we can bring and value we can add to their business. This can be difficult in a price-driven market like term assurance. We also look for a reciprocal commitment from our clients. In these days of tight governance, it is perhaps no longer realistic to expect an insurer to commit long term to a sole reinsurer. But, equally, if partnership is to be more than just a word we would expect commitment on both sides.

Competition amongst reinsurers in the term market has never been higher. Although this may be a good thing for life insurers in the short term, it is difficult to see how it can continue indefinitely. There are lessons to be learned from reinsurers' experience across the Atlantic where a commoditised market was quicker to develop than here. The difficulties faced in the US market by reinsurers who competed too fiercely for

volume on price – some of them no longer with us – are well documented. Cession rates have since fallen sharply as reinsurers tightened their terms and conditions and clients increased their retentions. In the longer term we may well see a shift to more limited quota share reinsurance here in the UK. A 50/50 quota share would also help to restore some alignment of interest.

Hannover Life Re (UK) has long championed innovation and growth in the protection market. Ever-cheaper premium rates for UK consumers, fuelled by high levels of quota share reinsurance in a competitive reinsurance market, have yet to close the so-called protection gap. As an industry we all want to find ways of serving the public well by providing valuable and attractive protection products. But, however low premiums fall; cheap term assurance may not be the answer. What is needed is innovation. The perfect solution may not present itself immediately, but we remain committed to working in a close progressive partnership with our clients, continually providing them with support and ideas. We believe we're in this together, and together we aim to prosper.



David Brand  
Managing Director


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](mailto:uk.marketing@hannover-re.com).

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CONTACT

## The Critical Path



Our annual Underwriting Seminar will be covering a variety of topics taking the audience through the life cycle of a protection product, from sale to underwriting through to claim. We are pleased to have a variety of excellent industry guest speakers who will provide an insight into their specialist areas, in addition to our own expert speakers.

The seminar is targeted at Underwriters and Claims Assessors with up to two years experience. Our aim is to raise awareness of the major issues faced by specialists in today's Underwriting and Claims environments.

**Thursday 11th October 2007**  
**Royal College of Physicians**  
**London**

Book now to guarantee a place by contacting Pat O'Hara on 01 344 846809 or [uk.marketing@hannover-re.com](mailto:uk.marketing@hannover-re.com).