THE INSURANCE COMPANIES AMENDMENT ACT 1973

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by

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I would like first to express my appreciation of the opportunity to speak to the British Insurance Law Association about the Insurance Companies Acts and the regulations to be made under the one passed last year. That rather sounds as if I am bringing coals to Newcastle so perhaps I should establish my own position in the matter. I must at once confess that I am neither an insurer nor a lawyer; I am however British, which is not entirely irrelevant in the context, and I have been associated for a period of rather more than ten years with the administration of insurance supervision in this country and with the preparation of the Acts of 1967 and 1973. These Acts would by now, but for the Election, have been consolidated with the 1958 Act in the Insurance Companies Bill published on 30 January 1974; as the Bill will have to make a fresh start in the new Parliament I will continue in this talk to refer to the sections of the three Acts which will, I hope, soon be superseded, rather than the unfamiliar ones in the Bill.*

I expect that you would like me to give some exposition of the thinking behind the 1973 Act and the way in which it is likely to be developed in the regulations provided for in no less than 13 of its 57 sections. But first I think that this Act needs to be put in perspective as a further development of the modifications made in the British approach to insurance supervision by Part II of the Companies Act 1967.

In that context it does three main things affecting respectively the Department's powers of intervention, the information required from insurance companies and the standards by which their solvency is to be determined. First then, it refines and to a modest degree strengthens the powers introduced in 1967 enabling the Department to intervene in the affairs of insurance companies. As you know, although naturally enough the phrase has never appeared on the statute book, the underlying principle of our insurance supervision system, going back for something like 100 years, has been summed up in the phrase freedom with publicity. This is where we in Britain differ in our general approach from the supervision philosophies of many other countries. "The gentleman in Whitehall" does not claim to know best; at the same time it has to be recognised that the general public increasingly expects that he will use the facilities available to him and apply a certain degree of expertise to the protection of the consumer, who has neither the time nor the facilities to reach informed judgment on his own account. The prospective policyholder may, of course,

choose to seek professional advice, but he has some difficulty in judging its value and the professional advisers themselves cannot be as well informed in some respects as it is possible for an authority armed with statutory powers to be.

Whilst the general principle of freedom with publicity remains the foundation of the British approach, the 1967 Act recognised that it was taking freedom to an unreasonable length to leave the insurer free to run his business into the ground at the expense of his policyholders, who could find little consolation in the supervisory authority merely having the power to step in once the fact of insolvency was clearly apparent in order to arrange the decent disposal of the remains. That was effectively the position under the 1958 Act. It was changed in 1967, the key provision in this connection being s.80 of the Companies Act of that year. This enabled the Department, if they thought a company was being so conducted as to involve the risk of insolvency developing, to require the company to act in a specified way so as to contain and if possible remove the risk. S.68 permitted the more decisive, indeed virtually lethal, action of prohibiting the issue of new policies if the Department thought that the position had already deteriorated to the point where current solvency was in doubt. It may be noted that these were powers in the main to limit freedom to act in specified ways, not powers to tell the company to take action of a positive kind.

The purpose of ss.12-21 of the 1973 Act is to reformulate and refine the powers of intervention and inquiry provided by ss.68, 80 and 109 of the 1967 Act. In part this was achieved by rearranging the 1967 provisions in such a way that the various grounds previously specified as justifying intervention of a particular form are now brought together in one section, s.12, and any one of them, generally speaking, may now be invoked as the basis for the exercise of any of the powers. In s.1(a) the principle of anticipating trouble introduced in s.80 of the 1967 Act has been re-stated so that in effect it expresses the whole purpose of supervision. It could reasonably be regarded as sufficient ground for any of the permitted forms of intervention, with the remaining provisions of s.12 serving to illustrate some, but not necessarily all, of the circumstances which might threaten the solvency of an insurance company. The principle is in fact carried a step further in that it looks beyond solvency in the sense of the ability to meet the company's contractual liabilities so as to take into account the reasonable expectations of long-term policyholders that they will receive bonuses which their premiums have been loaded to provide for.

As to the forms of intervention, most of the changes are minor but they are considered to be important in giving the Department

a greater degree of flexibility. It may not be fully appreciated that in a number of cases the changes permit the action to be less severe in character than it had to be under the corresponding 1967 section, so that the Department may be less hesitant to intervene at the earliest signs of trouble and may progressively intensify the requirements if their fears prove to be justified. A case in point is the ability under s.17 to require premium income to be limited for a specified part of the business instead of a whole class. Under s.13 a restriction, ie a prohibition on new contracts and renewals, can also be confined to a specified description of business.

Two new powers are included in this group of sections. S.18 permits a special actuarial investigation to be required otherwise than at the three year interval which is the maximum permitted and s.19 allows the Department to require the acceleration of the deposit of the normal annual returns by up to three months.

S.21 permits the imposition of requirements of kinds other than those specifically provided for in the earlier sections where the circumstances of the case appear to the Secretary of State to be such that none of those other forms of intervention is likely to be suitable or sufficient. This again is a matter of providing the flexibility which has been found to be lacking in the powers first given by the 1967 Act. It might be argued that the s.21 power, unlike those of the earlier sections, is capable of being used to impose upon a company a positive course of action instead of simply limiting its freedom in certain aspects of the conduct of its business. It is possible that in certain circumstances the power could be so used; it certainly has not been so far and I think it unlikely that it will be so used in the foreseeable future. It has, however, already been found useful in requiring companies to desist from undesirable action of a kind not hitherto controllable and not foreseen in the principal sections in this group. It should not be overlooked that any requirement imposed under this or any of the other sections in this group must be consistent with the objective expressed in s.12(1)(a), that is to say the avoidance of insolvency. This is by no means the same thing as what the gentlemen in Whitehall might consider the most satisfactory and efficient way of conducting the business.

The second main feature of the 1973 Act was the introduction of a power to require returns to be made more frequently than annually. This is consistent with the objective of intervention to prevent serious deterioration as soon as the first threat of the danger is apparent. It is intended that the regulations to be made under this power, given by s.5 of the Act, should require quarterly returns, which will, of course, not be so extensive as the audited annual ones which will continue to be required. The quarterly ones will not be audited but will have to be deposited in a matter of weeks from the end of each

quarter instead of the six months allowed for annual returns. Thus it will be possible to detect a possibly dangerous trend at an early stage and to follow its development closely, so that the more sensitive use of the powers to which I have just been referring will become feasible. Proposals as to the content of these returns have been put to the industry for comment.

The third modification concerns the calculation of solvency. In the case of general business, conformity with the EEC directive will involve an increase in the present rate from slightly over 10% to between 16% and 18% of the premium income as well as the introduction of an alternative calculation based on claim payments. This can be brought about by an order subject to affirmative resolution of both Houses of Parliament made under s.28. No less important for the determination of solvency is the new power given by s.32 to make regulations as to the manner in which the value of assets and the amount of liabilities of an insurance company are to be determined. It is likely that long-term and general insurance business will be dealt with separately in this connection. As regards long-term business actuaries have enjoyed virtually complete freedom for decades in making the various assumptions which underly the valuation of long-term insurance liabilities, although their exercise of this freedom has been exposed to the scrutiny of their fellow actuaries, not to mention that of the Government Actuary, as the DTI's adviser in this field. There were, however, some reasons for supposing that actuaries might come under greater pressure in the future to exercise this freedom in less responsible ways, especially in relation to the fulfilment of the reasonable expectations of with-profit policyholders. Actuaries have for some years been considering how such a risk might be averted without compromising unduly their freedom to take a prudent and equitable view of the liabilities. A distinguished member of the profession was responsible for the drafting of what were at one time known as the six principles whereby a satisfactory minimum degree of prudence could be defined. There have been extensive discussions about those principles and they are likely to emerge soon in a modified form as regulations under s.32.

The general business side presents a rather different set of problems. Whilst it is extremely difficult without the grossest mis-management to make a long-term insurance business hopelessly insolvent, that situation can come about very rapidly in general insurance business. One of the good things which might be thought to have come out of the report of the Vehicle & General affair was the idea expressed in paragraph 38 and the following paragraphs of the Tribunal's report that the solvency of a general insurance business should be determined not on the usual going concern basis, but as if it were about to be wound up. If such a concept is to be applied by the court when considering a winding up petition it needs to be converted into a

precise basis of calculation. It largely concerns the value of the assets in the event of sale by a liquidator and the Department have been devising ways of producing a reasonable simulation of the situation which would face a liquidator taking possession of assets of various categories with a view to their early realisation. Proposals of this kind are under discussion with the industry.

No less important and in some ways a good deal more difficult is the determination of the amount of the liabilities of general insurance business which our continental friends refer to collectively as the technical reserves. Amongst the various components of the technical reserves, the one which presents the greatest difficulty, and potentially the greatest danger to the solvency of an insurance company, is the provision made for outstanding claims. This has long been a matter of concern to the Department and it was this which led them to include in the accounts and forms regulations made in 1968 a new requirement for claim settlement analyses by year of origin. These may be described perhaps as a refined form of the more or less traditional run-off statement. These analyses first began to be provided by companies for their financial years beginning on or after the 1 January 1970 so that we now have an accumulation of three years data in this form. With this material to hand it has been possible to begin devising a method of projecting the ultimate total cost of payments in respect of claims arising in each year of origin, although for certain classes of business the claim settlement cycle may be five years or longer so that we do not yet have the complete picture. With the information so far received and with similar information available from other sources we have made a number of tests of a method of projection with which we feel reasonably confident that we are on the right track. We are aiming to have regulations based on this principle in operation by the time there are five years of data available and proposals have recently been put to the industry as to the minimum values to be attached to the outstanding claims and other general business liabilities.

I have dealt so far with those modifications and innovations made in or to be made under the 1973 Act which I regard as being in the main stream as it were of the business of insurance supervision. There were, of course, a number of others in the Act and some further refinements of existing provisions. S.2 for example provides a more precise definition of the key personnel whose fitness must be kept under scrutiny, including incidentally those who control a company in association with others with whom they have specified forms of relationship. That definition is inter alia important in connection with the new requirement in s.34 that a person, or such a group of associated persons, who propose to acquire control of an insurance company must first ascertain that the Secretary of State has no

objection to them as controllers. One of the sets of regulations yet to be made will specify the information to be provided whereby their fitness may be considered.

Another important group of sections, ss.7-10, is designed to give a more effective insulation of long-term business from any other business carried on by the company and to protect the assets representing the savings of life policyholders from improper uses. The most formidable of these sections is s.10 which occupies 2½ pages of print. I will not attempt to expound it fully; I will merely point out that its purpose is to limit the extent to which directors of insurance companies who have effective control of other companies may be exposed to a conflict of interest in that dual capacity. There are also references in s.30 to new arrangements for the winding up of an insurance company which has carried on long-term business and the arrangements for the sanction by the Court of transfers of long-term business formerly provided in ss.11 and 12 of the 1958 Act have been recast in ss.26 and 27.

S.41 provides for regulationsas to the form and content of insurance advertisements which will replace the very limited control imposed by s.25 of the 1958 Act. S.42 makes it anoffence to issue misleading statements in order to induce persons to enter into insurance contracts.

S.43 will permit the making of regulations requiring specified forms of connection between insurers and intermediaries, such as existed between V & G and Andrew & Booth, to be brought to the prospective policyholder's notice.

S.44 to 47 derive largely from the recommendations of the Hilary Scott Committee on linked long-term insurance. S.45 establishes the right to withdraw from a long-term policy transaction within a limited cooling off period in cases where the issue of a statutory notice has been prescribed under s.44. S.47 is the one which deals more particularly with the conduct of linked long-term business or more correctly provides for regulations to be made for this purpose.

To summarise the 1973 Act therefore, it builds upon the experience gained in administering the new powers established in 1967, provides the Department with better means for determining when or how those powers can best be exercised to avert irretrievable damage to the interests of policyholders, tightens up financial standards generally, insulates long-term business more effectively from any other business carried on and enters into certain areas of consumer protection not directly concerned with solvency for the first time. Much of the effectiveness of the new provisions will, of course, depend upon the regulations which we are currently engaged in preparing. Each regulation is the subject of consultation with appropriate organisations

and the process of drafting often throws up unforeseen complexities. It will, therefore, be several months before we have made all of the regulations for which the Act provides. So far only one has been made, the Insurance Companies (Identification of Long-Term Assets and Liabilities) Regulations 1973, SI No 2064. This was given priority because the relevant section allows a year for companies to make the necessary arrangements to identify and establish records for the continued identification of those assets and liabilities which are attributed to long-term business. We have under discussion with the British Insurance Association, the Life Associations and other interested bodies at the moment proposals relating to the initial share capital requirements, the solvency margin, the categories of assets to which linked policies may be related, quarterly returns, the valuation of assets in general business and the valuation of liabilities in that same business.

As I have mentioned, the principles for the valuation of long-term liabilities have also been under discussion for a considerable time. We hope to have all of these regulations in operation not later than the beginning of next year, together with a revised version of the existing accounts and forms regulations which will have to be looked at in relation to our experience in operating them to consistency with new regulations.

I hope that I have been able to give you in this brief account a fair conspectus of the purposes of the 1973 Act and of the further work which has to be done before it is fully effective. Inevitably I have left out some of the detail and it may be that amongst the omissions are matters in which some of you have a particular interest. I shall be very happy to try to answer any questions about the provisions of the Act and the philosophy underlying them and so far as may be possible at this stage what shape the regulations are likely to take. I should also be very interested to hear any constructive suggestions as regards the content of the regulations which have yet to be made and any criticism of those which we have in operation at the moment as we shall be reviewing them shortly.

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*The Insurance Companies Act 1974 is one of the Statutes held up by the HMSO strike.