

FROM THE WORLD OF PENSIONS

Pension Protection Fund needs greater clarity say manufacturers

Government policy on the proposed Pension Protection Fund (PPF) is currently poorly expressed and needs greater clarity if it is to have any chance of greater employer support, according to the latest EEF/Aon Consulting survey.

This call was made following publication of results from this survey, which analysed the views on the PPF of almost 50 of the UK's largest manufacturing companies with occupational pension schemes. Despite a high level of support in principle for the idea of the PPF, the survey showed that, as it is currently designed, there is still considerable confusion and uncertainty among employers about how the PPF will operate and the costs that they will incur. Until these are resolved, it is clear that it will be very difficult for employers to give greater support to the PPF.

Key findings from this survey were:

- ◆ two-thirds of the companies supported, in principle, the idea of the PPF;
 - ◆ three-quarters of them felt that employers should be able to recover all or part of the PPF levy from pension scheme members;
 - ◆ nearly 85% of the companies who responded felt that the introduction of the PPF would have a negative or no impact on their decision to provide a defined benefit occupational pension scheme in the future.
- Manufacturers' scepticism is perhaps under-

standable given continuing controversy over the security conferred (or not conferred) by the PPF. This month saw pensions minister Malcolm Wicks and incoming chairman Lawrence Churchill promote the security message based on the power of the PPF to vary contribution rates. However, the potential for a double dose of member disappointment continued to pre-occupy the National Association of Pension Funds (NAPF) and the Association of Consulting Actuaries (ACA).

Keep it simple, citizens!

A high-level group of pensions experts has started work on the detailed practicalities of implementing a new, simplified Citizen's Pension, according to the NAPF.

Amidst growing consensus over the need to simplify the UK's complex state pension system, the idea of a universal Citizen's Pension has gathered support from a wide range of voices in the political, business, trade union, and academic communities.

The new high-level working group, set up by the NAPF, includes representatives from many of these groups, and will be chaired by former NAPF chairman and Faculty president Tom Ross. Its aim is to identify practical ways of implementing a Citizen's Pension, available to all those satisfying a simple residency test. The new pension would replace the current basic state pension, second state pension, and means-tested pension

credit – a system widely seen as overly complex and a barrier to additional pensions saving.

The project will directly address issues such as:

- ◆ how best to phase out contracting-out and merge the two state pensions;
- ◆ how to devise an effective residency test;
- ◆ the optimal level at which to set a Citizen's Pension;
- ◆ the extent to which any means-tested benefits would still be needed; and
- ◆ the development of a practical plan and timetable for change.

Members of the new Citizen's Pension working group, which expects to complete its work by the end of 2005, include:

- ◆ Tom Ross (chairman)
- ◆ Rodney Bickerstaffe – National Pensioners' Convention
- ◆ Adrian Boulding – Legal & General
- ◆ Ronnie Bowie – actuarial profession
- ◆ Christine Farnish – National Association of Pension Funds
- ◆ John Hawksworth – PricewaterhouseCoopers
- ◆ Deidre Hutton – National Consumer Council
- ◆ Professor Paul Johnson – London School of Economics
- ◆ Alison O'Connell – Pensions Policy Institute
- ◆ Stewart Ritchie – Scottish Equitable
- ◆ Rhos Roberts – Great Universal Stores plc
- ◆ Martin Taylor – Goldman Sachs

 GORDON SHARP

Myners review of mutual life offices

Paul Myners has published a consultation document (see www.hm-treasury.gov.uk/independent_reviews/myners_review/review_myners_index.cfm) seeking views about various aspects of the governance of mutual life offices. The document also explores some wider issues, arising from Lord Penrose's report into Equitable Life, about the role of non-executive directors in complex businesses.

Specific questions raised include ones about:

- ◆ the corporate governance guidance that applies to mutual life offices;
- ◆ the role of non-executive directors in complex businesses such as life insurance, including the information and

advice that they use;

- ◆ the role of policyholders in the corporate governance of mutual life offices;
- ◆ the role of regulation in the corporate governance of mutual life offices;
- ◆ the market disciplines that influence mutual life offices;
- ◆ the potential advantages of the mutual form, particularly in the financial sector;
- ◆ the structure of the UK mutual life insurance market;
- ◆ practice in other countries.

Launching the document, Paul Myners said: 'I hope this consultation process will reach as many people as possible and that everyone with an interest will respond.

Mutual life offices are a sizeable presence in the market for life insurance in the UK. They are valued by their policyholders and contribute to the diversity of the insurance sector. My challenge is to promote in this sector the very best corporate governance practice, providing a sound basis for its future health and prosperity.'

Mr Myners is understood to have encouraged mutual life office to make their customers aware of the review and to invite them to contribute. The closing date for responses to the consultation is **17 September 2004**. Paul Myners will submit the final report of the review to the government by the end of December 2004.

FROM THE WORLD OF GENERAL INSURANCE

World Trade Center

The Victim Compensation Fund in relation to the terrorist events of 11 September 2001 closed to further claims on 15 June, having agreed claims totalling nearly US\$7bn in respect of over 5,500 deaths and injuries. Those families of the dead and injured who have been compensated through this fund have agreed to sign away their rights to litigate, leaving fewer than 100 possible litigants to pursue claims against the airlines and/or the World Trade Center owners, the Port Authority of New York (PONY). These claims are likely to include most of the larger ones, as a major reason for claimants to opt for the litigation rather compensation through the fund was the fact that their claims exceeded the limit payable by the fund. Nevertheless, the relatively small number of potential litigants should provide some greater handle on the reserves required by insurers with exposure to the liability claims arising from the airlines and PONY.

In addition, Silverstein Properties has made it clear that it will await the outcome of the second phase of litigation, due to commence in September, before deciding whether to appeal against the decision on the first phase (see July general insurance news)

EU sex directive

The proposed European Union directive on sexual discrimination has been rejected, to the considerable satisfaction of the insurance industry across most of the continent. The directive, which would have barred the use of sex in underwriting life or general insurance business, would have fundamentally changed the rates in a number of major classes of personal lines business. For general insurance, a particular impact would have been expected on private motor policies where there are typically (in the UK at least) quite material differences between premium rates for male and female drivers.

Low loss activity in first quarter 2004

It has been announced that the property/casualty insurance industry in the US reported an underwriting profit in the first quarter of 2004. It is suggested that this is the first time on record that the first quarter of a calendar year has achieved better than underwriting break-even. This exceptional result appears to be the result of a combination of relatively strong premium rates and a modest level of claims activity, espe-

cially in the large loss category. Nevertheless, the Insurance Services Office and Property Casualty Insurers' Association of America, which released the information, say that the future prognosis for profitability is less favourable, as there are signs of intensifying competition in the market.

Large losses

Recent notable general insurance incidents/losses include the following:

- Serious storms in Colorado and Texas during June are estimated to involve insured damage of up to \$100m in each state. The Colorado storms actually came in two waves only hours apart and involved hailstorms with hailstones described as being 'up to the size of a baseball'.
- A court in Louisiana, US has made an award of nearly \$600m against various tobacco manufacturers to pay for various measures to assist the state's smokers to give up. The measures include the provision of nicotine patches, advertising, and the cost of telephone hotlines. The tobacco manufacturers have said that they will appeal against the verdict.

 DAVID HART

UK protection market shortfall...

The health and protection market in the UK continues to show a dangerous gap – £2 trillion – between what the public needs and the ability of the industry to get its benefits message across. Despite this the market remains optimistic for growth of more than 10% in 2004.

In its survey of the current and developing UK scene, the major protection markets of the world, and of leading opinion formers in the health and protection insurance market, the Protection Review 2004 highlights:

- ◆ problems in developing a new generation of critical illness insurance and individual private medical insurance (PMI) in the face of massive extra spending by the NHS;
- ◆ continuing frustration for IFAs in the time taken to underwrite and process protection insurance proposals;

- ◆ a need for the industry to communicate better with the government and the consumer the value of and need for protection cover.

... is the same worldwide

Millions of consumers around the world lack adequate life insurance protection, according to a Swiss Re *sigma* study released recently. *Mortality protection: the core of life* identifies significant shortfalls in the amount of mortality cover purchased when compared with consumers' real protection needs. If the protection gap were to be filled, the average amount a family spends on life insurance premiums each year would need to increase by £53 to £240, depending on the country.

Christian Stöckli, a senior actuary at Swiss Re and co-author of the study commented: 'One of the most striking findings of the *sigma* study is that each country we

examined has a substantial mortality protection gap, despite many differences in how national markets operate.'

Many families are either uninsured or inadequately insured against the death of their primary earners. A measure of this shortfall is the life assurance protection gap – the difference between the resources needed and the resources that would be available to maintain a family's current living standard after the death of its primary earner. The *sigma* study estimates the size of the mortality protection gaps of five important markets – Australia, Germany, Italy, Taiwan, and the US. Swiss Re estimates the UK gap as £2.2 trillion in its latest *Insurance Report*, published in June.

Copies of this latest *sigma* study are available from www.swissre.com/sigma. It followed closely on the heels of the usual *sigma* annual review of world insurance market developments, which also is available on the website.

Regulation and accounting developments round-up

June and July were a busy time for those concerned with supervision and accounting for insurance business.

Basel 2 agreed at last

After five years of debate, the 13 banking supervisors represented on the Basel Committee on Banking Supervision finally reached agreement on the accord to replace the current Basel accord near the end of June. Basel 2 is to be implemented in 2007. Commentators continue to debate whether and how Basel 2 will promote stability and competition in global banking. Nevertheless, it appeared that something of the order of 100 countries would want to subscribe to the new accord, even if several significant newer markets had to acknowledge that it would be several years before they were ready.

We will not try here to summarise a document of more than 250 pages, but the new accord should be of real interest to actuaries, both in its own right and because insurance solvency supervision will follow a similar framework. Many of the techniques envisaged by Basel are very recognisable, particularly to actuaries familiar with general insurance. Basel is also a significant commercial opportunity, with major banks expected to spend upwards of £25m each on development of data warehouses and risk models.

■ Find out more at: www.bis.org

FSA publishes PS04/16

Early July saw the publication by the UK Financial Services Authority (FSA) of near-final text for the Integrated Prudential Sourcebook for Insurers. Based on last year's consultative papers CP190 and CP195, a key element of the draft sourcebook is the FSA's stipulated approach to capital requirements for non-life insurance, with-profits life assurance, and reinsurance.

The industry professed itself pleased that the FSA had acted on criticism of its original proposals, particularly in relation to the 'Pillar 1' risk capital margin for life with-profits business. Based on analysis by

Watson Wyatt, the requirements are less onerous than set out in CP195. Nevertheless some concern remained that the proposals might adversely impact investment by insurers in some forms of corporate debt and in equities.

These proposals are due to be finalised for the 2004 year end for life assurance, although the corresponding non-life requirements will remain a matter for private reporting only for the time being. (See comment on changed roles for actuaries on p21).

■ More detail at: www.fsa.gov.uk

IAS 39 stirs controversy

The US and 'old Europe' appeared to be locking horns again as proposals to implement international accounting standards became mired in controversy in recent weeks. On a closer look, the governments of France, Italy, Spain, Belgium, and Slovenia were being supported by most of the larger European banks and insurers in withholding endorsement of the application of IAS39.

This standard, equivalent to US FAS133, effectively requires most assets and certain liabilities to be measured at market value.

ERM is good for shareholders

Executives at major companies and investment professionals at the world's leading investment firms hold starkly opposite views on the primary threats to companies' top revenue sources, according to the 2004 Protecting Value Study published recently.

Among the main findings:

- ◆ More than two-thirds (69%) of CFOs, treasurers, and risk managers at Global 1,000 companies in North America and Europe view property-related hazards, including fires, explosions, and supply chain disruptions, as the leading threats to top revenue sources.
- ◆ In sharp contrast, most investment professionals (79%) say non-property-related hazards, including pricing fluctuations, governmental/regulatory hazards, and management/employee malfeasance, pose the greater threat.
- ◆ Despite highly publicised cases of improper management and employee practices and acts of terrorism, very few companies view management or employee malfeasance (3%) or terrorism (1%) as serious threats.
- ◆ Most CFOs, treasurers and risk managers (80%) rate their companies' ability to protect top revenue sources as 'excellent' or 'good', while nearly one-half of investment professionals (49%) rate companies' abilities as 'fair' or 'poor'.
- ◆ The threats to companies' revenue

sources have the potential to have a significant impact on operations, with a majority of CFOs, treasurers, and risk managers (60%) reporting a major disruption caused by a top threat would 'threaten business continuity' or cause a 'sustained hit to earnings'.

- ◆ The majority of investment professionals (78%) indicate they 'frequently' analyse the potential risks to companies' revenues and more than one-half (53%) rate the quality of information on potential risks contained in financial statements as 'fair' or 'poor'. Additionally, most investment professionals (68%) rate stakeholders' level of understanding of the top threats facing companies as 'fair' or 'poor'.
- ◆ Approximately 90% of CFOs, treasurers, risk managers, and investment professionals overwhelmingly agree that enterprise risk management (ERM) should be – and is becoming – a board-level issue in both North America and Europe. European companies appear to be making more progress in this regard, with 93% reporting that risk management is already a board-level issue at their companies, compared with 65% in North America.

To download an executive summary of the 2004 Protecting Value Study containing the complete findings, please visit www.protectingvalue.com.

Resisting banks were arguing that technical factors associated with the new standard would damage confidence by introducing substantial volatility into balance sheets and movements in equity.

As we went to press it seemed likely that the European Commission would endorse IAS39 only in part, although FSA chief John Tiner and accounting commentators argued that this would be worse than postponing implementation of 'international' accounting standards. IFRS4 for insurance accounting effectively classifies much of life insurer balance sheets as being of financial instruments to which IAS39 applies, so the current uncertainty risks creating real implementation challenges for actuaries and their accounting colleagues.

See:

- www.efrag.org
- www.asb.org.uk
- www.fbe.be

ASB criticised on embedded value

The fallout from Equitable continued to be controversial as the UK Accounting Standards Board (ASB) prepared to specify changes to accounting for with-profits business for immediate implementation.

Readers will recall that financial secretary Ruth Kelly charged the ASB with remedying the apparently unsatisfactory accounting vacuum described by Lord Penrose in his report on events at Equitable.

Although detailed proposals had not yet been published as we went to press, at least one major life insurer chose to get its retaliation in first. Scottish Widows chief executive Archie Kane criticised the ASB for making changes too fast. This may have been connected with the expectation that the proposals would centre on reflecting in embedded values the true 'cost' of capital required to support with-profits business. This would in turn be likely to reduce the room for manoeuvre in capital terms enjoyed by banks owning with-profits life insurers.

- A project outline is at: www.asb.org.uk

Solvency 2 moving into higher gear

And finally, there were signs that the tortuous process for designing the new insurance supervision regime for the European Union was beginning to fall into place. This is likely to be based loosely on the three-pillar Basel framework, and ultimately will drive the evolution of local

requirements such as the FSA has proposed in PS04/16 (see above).

The actuarial profession, in the form of the Groupe Consultatif, is strongly committed to working closely with the Conference of European Insurance and Occupational Pension Supervisors (CEIOPS) to develop the technical aspects of the new regime. While some very significant differences of view remain between governments and between supervisory philosophies and procedures, the technical challenges are very much akin to those which have been faced in the UK with realistic balance sheets and individual capital assessment. It remains to be seen how much will have to change again when the new European regime is implemented after 2007.

Meanwhile controversy continued over the Commission's intention to toughen the solvency margin requirement for reinsurance business under an imminent directive. Some reinsurers warned that an inevitable consequence would be to cause reinsurers to move business outside of the EU.

See all of:

- http://europa.eu.int/comm/internal_market/insurance/solvency_en.htm
- <http://www.gcactuaries.org/solvency.htm>
- www.ceiops.org, and www.cea.assur.org



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