

FROM THE WORLD OF GENERAL INSURANCE

Asbestos developments

In light of the recent introduction of the Control of Asbestos at Work Regulations (see the July issue of *The Actuary*), a major UK insurance broker has raised the spectre of companies becoming uninsurable if they complied with these new regulations. Jardine Lloyd Thompson has warned that insurers will restrict coverage, or even refuse to provide coverage at all, if compliance is not forthcoming. Apart from the legal obligation to compile a register of asbestos included in their buildings, employers are required to manage that asbestos to ensure that it is not a hazard to the staff and third parties. Failure to comply would increase the risk of claims under employers' liability and general liability policies.

Meanwhile, in the US, concerns are increasing that exposure to silica will be 'the next asbestos' to plague insurance carriers. As a consequence,

some companies are now starting to exclude silica coverage from their liability policies.

Smoking

The UK government is understood to be considering the introduction of a complete ban on smoking in workplaces. This follows representations from the British Medical Association (at their recent conference) and others. If carried through this could be expected to have a beneficial effect on the claims activity under employers' liability policies, especially for bars and restaurants. A similar regulation was recently introduced in the Republic of Ireland.

Low loss activity in 2nd Quarter 2004

Following on from last month's relatively good news for the US non-life insurance industry in the

first three months of 2004, the second quarter catastrophe claims are also below normal, totalling only \$1.65bn, only about a third of the amount experienced in the equivalent period last year. The total for the six-month period is the lowest in the past ten years.

In addition, a survey by the Confederation of British Industry and PricewaterhouseCoopers has highlighted increased business activity and fewer claims as being responsible for increased profitability in the UK general insurance market. Nevertheless, like the earlier American analysis, there was a degree of pessimism regarding future prospects, as competition was expected to increase on top of staff numbers (and hence costs) having already done so.

 DAVID HART

Danger – unexploded tax bombshell

Unfunded public sector pension liabilities are approximately £580bn, according to consultants Watson Wyatt. This is over 50% higher than the most recently published official estimate.

Stephen Yeo of Watson Wyatt said: 'The pressure that has forced the private sector to account for pension costs in a transparent way is only slowly having an effect in the public sector. Given the enormous size of the liabilities involved, it is vital that the true cost of all pensions is recognised.'

The most recent official estimate put the present value of the liabilities in all the

unfunded public sector pension schemes at £380bn at 31 March 2002, based on a 3.5% real discount rate. However, changes in the way liabilities are calculated – bringing them more in line with the private sector – further accrual of benefits and improvements in mortality have significantly increased the present value of unfunded pension liabilities in the public sector over the past two years.

From 2005–06 the liabilities in the Whole of Government Accounts will be calculated using a discount rate of 2.8% real. This is similar to the rate used in the private sector under accounting standard FRS17. Watson Wyatt estimates that this

will add approximately £60bn to the present value of the liabilities. If, however, the discount rate was reduced to the same rate that will be used to discount nuclear decommissioning liabilities (which the government actuary notes have a potential duration not dissimilar to that of pension liabilities) of 2.2% real, the value of the liability would increase from £440bn to approximately £550bn. None of these figures takes account of the latest figures for the expected improvements in mortality which could add around 5% to all the above figures. If a 5% adjustment was appropriate, the total liability, using a discount rate of 2.2%, would be approximately £580bn.

Watson Wyatt has also been to the fore, together with the Pensions Policy Institute and the consultant Ros Altmann, in calling for a royal commission to be established with cross-party support to report on the future of retirement income in the United Kingdom.

Gene databases corrupted by Excel

Apparently some longstanding problems with Excel are wreaking havoc in the world of bioinformatics. Well, causing a few problems, anyway.

As many Excel users know to their cost, it tries to be very clever when importing data by recognising dates and converting them to date values. So if the string '1 Dec 2004' is encountered, it is converted into a date serial number (in this case 38322) and formatted as a date (for example, as 01-Dec-04, or 1/12/2004). This conversion is irreversible: the original string is completely replaced by the new date.

There are about 30 standard gene names that Excel interprets as dates. If data sets that include these names are loaded into Excel, the names are garbled and the data sets corrupted.

Excel also automatically converts strings that it believes are floating point numbers. For example, the string '2310009E13' is converted to the number 2.31E+13. Again, the conversion is irreversible. There are approximately 2,000 commonly used identifiers that fit this pattern.

(from Louise Pryor's monthly newsletter at www.louisepryor.com)

Danger – private sector black hole

Lane, Clark & Peacock (LCP) launched last month its 11th annual Accounting for Pensions Survey together with a first annual survey of European pension schemes.

FRS17 pension scheme deficits of FTSE 100 companies have dropped from £55bn to £42bn in the year to July 2004 as a

result of higher equity returns and a surge in company contributions. Despite this overall improvement, the FTSE 100 index would still have to climb above 5900 to eliminate the combined FRS17 deficit.

Many companies may not be reflecting the latest life expectancy findings in their accounts. If the most recent figures were used, this could increase deficits by a further £20bn.

Many companies have reversed the trend to underfund their schemes, significantly boosting their contributions. Pension contributions over the year (£10bn) exceeded the cost of benefits (£6.6bn) by £3.4bn (last year, there was an FRS17 contribution shortfall of £0.6bn).

The top 50 European blue-chip companies have deficits totalling €116bn, according to analysis of the Dow Jones STOXXSM 50 index, included in the survey for the first time. Germany reports the highest average pension fund deficit in Europe at €4.3bn per company in the index, followed by Spain with €4.0bn. The UK was third highest at €2.8bn per company, which is surprising given the level of funded provision in the UK compared to the rest of Europe.

On average the share prices of the seven companies highlighted in last year's survey with the biggest exposure to equities in their pension funds, including Rolls-Royce, ICI, and British Airways, performed well this year with an average return of over 20%, compared to the FTSE 100 which returned 10%.

The LCP survey acquired a certain notoriety when used to suggest that Banco Santander – which is bidding for Abbey National – had an unfunded pension deficit of almost €10bn measured according to international accounting standards.

Resolution wins the day

Resolution Life, the specialist closed life fund acquirer, won over two other bidders for the life business of Royal & Sun-Alliance. The consideration for the business was £850m. Immediately following this substantial deal, sources for Resolution were quoted as having up to £2bn of capital for such transactions, and were known to have been in discussion with HHG plc, Abbey National, and Britannic, all of which operate substantial closed life with-profits funds.

Resolution, led by Clive Cowdery and

chaired by Sir Brian Williamson, is backed by institutional and private equity investors and insurers including FF&P Asset Management, Prudential, Royal London, Standard Life, Foreign & Colonial, Murray International, Nikko, OZ Investment, and Perry Capital.

'Resolution Life Group is an innovative private sector response to an acknowledged failure of the market to deal with vast overcapacity in long-term savings. Its success will be determined by its ability to create a policyholder-friendly environment by matching the aspirations of closed life fund sellers and long-term investors', according to a submission made by the group to the Treasury Select Committee investigation into restoring confidence in long-term savings (see p16).

Pensions Bill and unintended consequences

The National Association of Pension Funds (NAPF) has written to the main political parties and the Pensions Com-

mission chairman, warning them that changes to the regulatory framework are likely to kill off future forms of defined benefit workplace pensions including all types of schemes where risks are shared between employer and employee.

In the open letter, NAPF chief executive Christine Farnish said the current changes to the regime were well intended but risked 'the perverse consequence of discouraging and disincentivising any form of future defined benefit provision and reducing innovation in the workplace pensions market'.

Farnish concluded the letter by saying: 'We would urge policy makers, and all those with an interest in finding sustainable solutions to the UK's pensions challenges, to carefully consider the likely overall impact and unintended consequences of current changes to the regulatory regime before bringing the new measures into force. Unless this is done, more modern forms of risk-sharing in the delivery of retirement savings to millions of citizens are likely to be stillborn.'

Follow up this story at www.napf.co.uk.

Tillinghast vs Treasury

According to Tillinghast analysis, the persistency, penetration, and volume assumptions used by the Treasury (as advised by Deloitte) to illustrate potential profitability margins for providers from the new stakeholder products are optimistic and unrealistic. Tillinghast estimates that the anticipated minimum premiums needed for financial services companies to break even will need to be significantly higher than those implied by the Treasury's analysis – in some cases double in size. For example, using the Treasury's assumptions – and allowing for the increased charge cap of 1.5% for ten years – Tillinghast estimates that retail bank providers would need customers to make monthly contributions to the stakeholder savings products of around £48. But Tillinghast believes that a more realistic figure would be £94. A realistic minimum lump sum contribution through the same channel would be over £3,000.

Tillinghast also estimates that on more realistic assumptions, the returns to shareholders are likely to be too low, in contrast to the published estimates.

Given these observations, Tillinghast says

that many financial services companies will decide against selling stakeholder products. And those companies deciding to market them will do little to target people on low to middle incomes, the main target of these products, because of the need for high break even case sizes. As a consequence, these proposals will represent little progress towards closing the savings gap.

Tillinghast principal Andy Cherkas said: 'We believe that some of the Treasury's conclusions concerning the economics of stakeholder products for providers are derived from a string of assumptions, each one of which may be achievable on its own for some providers, but taken together appear to us to be too optimistic. For example, estimated lapse rates of 1.3% for pensions and 3% for savings appear to us to be low when considering the target market and the portability of the underlying contracts.'

'Providers are only really likely to be able to make an acceptable return on stakeholder products if self-directed, higher income customers seek out and buy these products in volume.'

Trials and tribulations section

Equitable and professional discipline

Both the actuarial (as reported in our last issue) and accountancy professions appear to be envisaging disciplinary action arising out of the Equitable controversy. The Institute of Actuaries proceedings vis-à-vis several former directors were picked up by most of the national press from the pages of our August issue, with comment generally reflecting a somewhat grudging endorsement.

Meanwhile, the press speculated that the accountants Ernst & Young also would face disciplinary proceedings in addition to the substantial civil litigation claim being pursued by the current board of the Equitable.

Exciting accountancy

Controversies reported last month continued with a generally unenthusiastic life office reaction to FRED34, the Accounting

Standards Board (ASB) proposals to incorporate realistic liabilities into general purpose reporting. Meanwhile, the European Commission pressed ahead with its intention, encouraged by the perfidious French (!), only partially to endorse the new IAS39 dealing with valuation of financial instruments. This caused outrage in the UK, with the chartered accountants questioning whether the Commission had the power to endorse a standard only in part.

MPs not confident in actuaries

Last month saw the publication of the report of the Treasury Select Committee (TSC) on restoring confidence in long-term savings (see www.publications.parliament.uk/pa/cm200304/cmselect/cmtreasy/71/7102.htm) which roundly allocated blame for the present state of affairs on a wide range of parties, including to a degree the actuarial profession. At

the heart of the TSC's recommended changes was a simpler approach to making customers aware of the degree of risk associated with particular types of product.

Pensions woes

Restoring or creating confidence in occupational pensions seems likely to become the next major controversy, as attention this month focused particularly on the former Turner & Newall pension plan, where dramatic benefit reductions for members imminently to retire are threatened. This seemed likely to put further pressure on government to make rescue funds available ahead of the introduction of the Pensions Protection Fund. The case gained significant press and radio coverage, and it seems at least possible that the parlous state of the UK's formerly very successful pensions industry will become an important political issue.