

FROM THE WORLD OF PENSIONS

SPC president seeks leeway for schemes

At this month's annual dinner of the influential Society of Pension Consultants, actuary Robert Birmingham, president, expressed the hope that Alan Johnson, the new secretary of state for work and pensions, would turn his recent words of encouragement for the role employers play in pension provision into action.

Deficit management is the most pressing pensions matter facing most companies at present, said Mr Birmingham, who is managing director of Entegria, the benefits consulting division of Hogg Robinson plc. He expressed the view that employers and trustees must be allowed time and leeway to manage deficits. 'It would be catastrophic if impending legislation forced trustees to impose intolerable funding burdens on companies. Positive encouragement such as additional tax relief would be a real sign that government appreciates the role employers play in pension provision', he said.

FRS17 deficits

Punter Southall warns that the pensions industry should not rely on headline-grabbing figures that claim to reflect the true aggregate pension fund deficit of FTSE 100 companies. As pensions have risen up the scale of the mainstream agenda, the headlines have been filled with a succession of figures each claiming to represent the real situation. However, these figures can vary dramatically.

Reliance given to these figures is mistaken as they are only spot figures, dependent on the decisions made about the figures to use in calculating the aggregate deficit. These decisions include:

- Should overseas pension schemes of FTSE 100 companies be included, or just UK pension schemes?
- Should post-retirement healthcare schemes be included?
- Should the aggregate figure be based on the current composition of the FTSE 100 index, or its composition at a date in the past (eg 1 January 2004)?
- What accounting periods should be included (eg the 12 months immediately preceding the release date of the survey, or the last calendar year)?
- What assumptions should be used in rolling the figures from the company's year-end forward to the release date of the survey (if any roll-forward is used)?

Since surveys make different choices in producing aggregate figures for the FTSE 100, their results cannot be compared, and there is no single true answer to the question 'how large is the FTSE 100 FRS17 deficit?'. Punter Southall believes that it is much more meaningful to look at the results for individual FTSE 100 companies

and to examine the individual assumptions used by each company within the index.

Pensions Bill and moral hazard

There was a mixed welcome for the government's amendments to the moral hazard clauses in the Pensions Bill, announced by the Department for Work and Pensions (DWP). The amendments protect the interests of the UK's corporate transactions and restructuring markets and addresses industry concerns over the mitigation of moral hazard.

The moral hazard clauses proposed by the DWP are designed to stop parties acting to avoid funding a deficit liability by passing the liability on to the proposed Pensions Protection Fund (PPF), the result of which would be higher PPF premiums for the rest of UK businesses.

Trevor Llanwarne, PricewaterhouseCoopers chief actuary for pensions in the UK, said: 'A series of key amendments have been made by the government to clarify the moral hazard clauses and address industry concerns. Such changes include the adoption of a clearance procedure, greater protection for the position of insolvency practitioners, a list of working examples showing the intent of the clauses, and wording changes to the clauses themselves to improve clarity against which to judge potential abuse. These changes offer good news for British business – they will help legitimate business transactions proceed whilst keeping the size of levy under control.'

PPF staff get defined benefit pension

Opposition parties have tried to force the government to slash generous retirement benefits planned for staff at the Pension Protection Fund (PPF). The Liberal Democrats and the Conservatives tabled a joint amendment designed to overturn a key part of the Pensions Bill, when discussed in the House of Lords.

Lord Oakeshott of Seagrove Bay, the Liberal Democrat spokesman on pensions in the Lords, said it was hypocritical of the government to demand that PPF staff be given civil service pensions when it refused to fund the PPF. The annual cost of running the PPF, including pension payments, will be between £9m and £15m, according to government calculations.

Companies have broken pensions promise – TUC

Speaking on 'keeping the pensions promise' at the CBI pensions conference in October, Brendan Barber, TUC general-secretary, said that UK companies have broken their promise to share the burden of pensions saving with employees:

'Pensions provision in the UK has until recently been a very positive example of social partnership in practice. Employers, employees, and state all played their role. But our system was not the unmitigated success that has sometimes been claimed.

'Although the retreat from good occupational schemes has recently accelerated, the employer commitment to such schemes has been on the wane for some time. Employer pension contributions as a percentage of GDP hit a peak at the beginning of the 80s and then fell sharply. There has been an increase in contributions recently but they are still well below where they were.

'Thousands of employees are being shifted into riskier schemes which may not suit their needs, whilst at the same time employers are significantly cutting back the amount they contribute. The Pensions Commission report does not mince its words on this subject. Talking about the projected decline in future pension saving it says: "The biggest element of this decline is the reduction in the generosity of employer pension contributions."

'I hope that in this transitional phase in pension provision, companies remember that their success is a shared endeavour with their workforce, and that together we can seek to restore the pensions promise', Mr Barber concluded.

SEC investigates pensions accounting

News has emerged that the US Securities and Exchange Commission has asked a number of publicly quoted firms to explain their approach to accounting for the pensions and employee benefits liabilities. Although the assumptions actually used are generally disclosed in SEC filings, the SEC interest now appears to be in the process by which these assumptions are selected.

SEC enforcement lawyers said they identified the companies after analysing assumptions about increases in compensation and healthcare costs, rates of return on pension investments, and the 'discount rate' that companies use to determine how much to set aside today to meet obligations in future years. 'We believe it's possible that a company with large retirement plans relative to the size of the company could manipulate any of those and have a meaningful impact on earnings or the balance sheet', said an SEC enforcement attorney.

SEC lawyers plan to use the non-public information to gain an understanding of whether the actuarial firms that help companies develop assumptions or the audit firms that review the numbers could have helped companies manipulate numbers. 'We're interested in anything that bears on the purity of the process', the SEC enforcement attorney said.

FROM THE WORLD OF GENERAL INSURANCE**Asbestos developments**

While the proposed US asbestos tort reform stalled before the recent elections in spite of a degree of compromise by Senator Daschle, watchers believe that the new Congress will make asbestos reforms a priority. It was felt that Kerry and Edwards received too much support by asbestos trial lawyers so a Kerry administration would not have been receptive to asbestos reforms. Interestingly, Senator Daschle was not re-elected, so another stumbling block has been removed. The major sticking points, other than the continuing issue of the size of the fund to be established under the legislation, continue to be the treatment of existing claims and the timescale for introduction of the revised regime. The problem area seems to be whether pending claims should continue under the current tort system or fall within the scope of the trust fund to be established under the proposed legislation. Senator Frisk, on the Republican side, is determined to limit the continuation of the old 'broken' system.

World Trade Center (WTC)

The next phase of the court battle between Larry Silverstein, the main leaseholder of the WTC, and various of the property insurers who underwrote the risk prior to 11 September 2001, commenced in New York in October. This element of the litigation relates to determination of the number of losses to be paid by those insurers who have not been deemed to be bound by the so-called Wilprop policy wording. There are nine of these companies, not all of which are in the same position as each other, as they are subject to different policy wordings which may result in different findings by the court. The amounts at stake from these insurers total \$1.13bn, being their share of the sum insured. In any event, they are likely to pay this amount, but if the court finds that the terrorist attacks on WTC constitute two events under the relevant policy wording, the amount would double. It is not expected that this trial will take as long as the earlier one and may, in fact, be complete by the time this issue of *The Actuary* reaches you. The initial skirmishes in this phase were marked by complaints from the insurers' lawyers that Mr Silverstein's lawyers were using their opening statements inappropriately to present arguments, which is not permitted at this stage of the trial.

EU sex directive

The reported rejection of the European Union directive on sexual equality (see *The Actuary*, August) was, perhaps, a little too sweeping a statement. It now appears that insurance can be treated as an exception to the general rule bar-

ring sex discrimination, but each member state has the option of accepting the permitted exception, or otherwise. It now appears that while in favour of the exception for insurance in principle, the Germans may not, under their constitution, be able to implement it, and the Spanish (among others) may stick to their position in favour of the original proposal. The British, however, seem certain to take advantage of the option to exclude insurance. In any event the issue will be revisited in five years' time.

**Contingent commissions/
placement service
agreements**

Eliot Spitzer, the New York attorney general, has charged Marsh & McLennan Cos Inc (MMC) with fraudulent dealing in placing its clients' business in such a way as to distort the insurance market. The accusation is that the leading brokerage placed business with insurers offering it (MMC) the highest commissions, and also conspired with insurers to rig premium quotes on insurance programmes for some clients. It is understood that two executives of American Home Assurance Company have confirmed their role in such a scheme, and are assisting in the investigations. Following the charges, MMC has announced the resignation of its chairman and chief executive Jeff Greenberg and the appointment of Michael Cherkasky (who previously worked with Mr Spitzer) as his successor, together with a series of changes in business practice. It is understood that the attorney general may be attempting to settle with the company out of court.

Mr Spitzer has indicated that this is only the commencement of a wider-ranging investigation involving what is claimed to be fraudulent activity in the placement of insurance business. MMC's 2003 accounts show that contingent commissions comprised \$800m, or approaching 10% of its total brokerage, and over 50% of the year's profits. MMC has stated that it is co-operating fully with the investigations; meanwhile the news of the charges has had a negative impact on share prices and security ratings in the insurance broking sector. It is understood that UK regulators are watching developments in the US with interest. [See also p18.]

**US national disaster
insurance programme**

Following the spate of major natural catastrophes in the US, as reported in these columns over the past few months, and more below, there have been a number of calls for changes in the insurance arrangements. The establishment of a national insurance programme to cover such disasters has been called for by John Garamendi,

the Californian insurance commissioner, and Maurice Greenberg, chairman of American International Group has asked for government support for moves to set up catastrophe reserves. The intention of the former would be to spread the risk more widely, and limit the expected increase in homeowners' insurance rates in those areas most affected by recent catastrophes.

Climate change

A further report relevant to this topical issue has been produced by Charles Keeling, an American physicist working from an observatory at the summit of a Hawaiian volcano. Dr Keeling has been measuring the level of carbon dioxide (the principal 'greenhouse' gas) in the atmosphere for a period of nearly 50 years, and has detected not only a monotonic increase, but also an accelerating rate of increase over this period. His results published recently show that a concentration of 315 parts per million (ppm) in 1958 has increased to 376 ppm in 2003. Two features of particular note are that the rate of increase tends to be higher in 'El Niño' years, but the actual level does not fall back in consecutive years, and that 2002 and 2003 are the first two consecutive years where the increase has exceeded 2ppm. In view of the fact that other research indicates that there has been no commensurate increase in the level of terrestrial emissions of carbon dioxide over this period, scientists believe that this could be the beginning of some form of 'feedback' mechanism in the process of climate change – a worrying thought for general insurers, and indeed for mankind.

Large losses

Recent notable general insurance incidents/losses include:

- **Hurricane Charley** (13–15 August). The latest estimate of insured losses is \$6.8bn, mainly in Florida.
- **Hurricane Frances** (2–5 September). The latest estimate of insured losses is \$4.4bn, over 90% of it in Florida.
- **Hurricane Ivan** (8–17 September). Latest estimates of the insured losses in the Caribbean are now in the range \$1–2bn, mainly in the Caymans. Insured losses in the US are now estimated to be in the range \$3–6bn, of which the Property Claims Service estimates \$3.8bn to be in Florida.
- **Hurricane Jeanne** (16–27 September). On reaching the US mainland, Jeanne followed a path very similar to that taken by Frances three weeks earlier, and caused significantly greater damage than had been anticipated from its earlier 'tropical storm' status – this may be partly the result of the already weakened state of some property as a result of Frances.

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Large losses *continued from p16*

The estimates of insured losses varied quite widely, with figures of \$6–9bn being suggested by different modelling agencies.

The cumulative effect of Charley, Frances, Ivan, and Jeanne appears to have caused the demise of one company (American Superior) and the downgrading of others by the rating agencies. It is now expected to have a positive impact on the 2005 renewals. Lloyd's has stated that it expects claims of \$2.3bn.

■ **Typhoon Tokage** (20–21 October). This was the tenth typhoon to hit Japan this year and the largest for over ten years, claiming 60 lives and causing massive insured losses, with flash flooding and landslides as well as significant damage from the winds reaching over 140mph. The total typhoon damage is now estimated at well over \$5bn, causing bottom-line losses for a number of Japanese insurers.

■ **Niigata earthquakes** (23 and 27 October). As if the typhoons were not sufficient, Japan suffered a further (almost simultaneous) blow from earthquakes measuring 6.8 and 6.1 respectively on the Richter scale, causing over 30 deaths and 2,500 injuries. Although no insured loss estimates are currently to hand, damage is believed to be significantly less than that arising from the Kobe earthquake in 1995.

■ **Dubai Airport** (27 September). A wall collapsed on the site of the construction of a new terminal for Dubai International Airport, killing five workers and injuring 12 others. It is understood that the incident is likely to be covered by an airport contractors' policy placed in London.

 DAVID HART

Changes at Marsh/Mercer

Following the investigation and legal action by New York attorney general Eliot Spitzer, which may also embrace other major broking/advisory organisations, Marsh & McLennan is moving to streamline its businesses, including the giant Mercer consulting business. Marsh has announced that it will shed 280 jobs from its risk and insurance business in the UK (out of a total of 6,350 personnel at some 30 locations throughout the country). Marsh employs actuaries throughout its broking and advisory businesses, particularly in providing pensions consulting services in the global Mercer business, which has expanded considerably in recent years.

Cautionary tales

Maybe you remember all the excitement back in September about the Genesis space probe, which was going to be grabbed by stunt pilots as it parachuted to earth. Unfortunately the parachutes didn't open. We now know that the switches that were to trigger the parachute were installed upside down. It appears that the design drawings were faulty.

(www.newscientist.com/news/news.jsp?id=ns99996541)

This is a superb example that everything has to be right for things to work: in this case, the implementation was OK but the specification was wrong. This principle applies to financial models as well as spacecraft. I gave a talk at the recent GIRO Convention about how to believe your models. The slides are available from:

www.louisepryor.com/show.do?page=articles.

You may not have to be a rocket scientist to operate a fax machine, but it seems that being a lawyer isn't always good enough. A

lawyer put a 100-page document in the fax machine the wrong way up, and so faxed 100 blank pages through to the destination. The document wasn't received by a deadline, and an appeal succeeded against fines worth €100m.

(<http://news.zdnet.co.uk/business/legal/0,39020651,39170375,00.htm>)

A new version of the World Bank Technology Risk Checklist is out. From the introduction: 'The World Bank Technology Risk Checklist is designed to provide Chief Information Security Officers (CISO), Chief Technology Officers (CTO), Chief Financial Officers (CFO), Directors, Risk Managers and Systems Administrators with a way of measuring and validating the level of security within a particular organization.' It's available from:

www.infragard.net/library/pdfs/technologyrisklist.pdf

(from 'You don't have to be a rocket scientist' in Louise Pryor's latest newsletter)

Beware the liability monster!

Liability systems throughout the world are growing increasingly costly, according to Swiss Re's latest *sigma* report. The study, 'The economics of liability losses – insuring a moving target', examines the development of liability claims and its drivers.

Thomas Holzheu, senior economist at Swiss Re and co-author of the study, comments: 'Growing liability claims costs have raised concerns among companies and their insurers throughout the world. Insurers must better understand the development of liability claims costs and factor this into their pricing.'

In the world's ten largest non-life insurance markets, commercial liability claims totalled \$84bn in 2002, with \$67bn originating from the US alone. The relative size of insured commercial liability claims costs varies across countries, with the US leading at 0.64% of GDP. This is about three times the level seen in Europe's largest economies.

sigma may be downloaded from www.swissre.com. Readers can download from the same source a new study of aviation insurance which concludes that to maintain a system of sustainable insur-

ance for the aviation industry, pricing must reflect the cost of capital to insurers.

Are we saving enough?

The ABI's report 'The State of the Nation's Savings 2004' reveals public support for key reforms to state and private pensions. In particular:

■ 47% of the public believe that extra spending on state pension provision should help those who cannot afford to save and encourage people who can save to do so. Only one in four support alternative proposals for a higher basic state pension for everyone.

■ A growing percentage of the public believe that individuals must take the main responsibility for providing for their retirement income – up to 42% from 35% a year ago.

■ There is wide acceptance among the public that current demographic changes mean that people will either have to work longer (supported by 37%) or save a higher proportion of their salary (29%) than their parents to generate an acceptable standard of living in retirement.

At its Saver Summit 2004, the ABI will also publish policy proposals that build on this public support for change and

respond to the challenge for new thinking set out in the Pensions Commission's recent report. The ABI is proposing:

- State pension reform which would address the disincentives to save created by means testing by increasing the state second pension for lower earners, and provide effective incentives to save for those who can afford to do so by improving contracting out.
- Action to encourage greater pension contributions from employers through a new pension contribution tax credit.
- Greater provision of financial advice through the workplace.

'The State of the Nation's Savings 2004' also includes a detailed picture of the state of under-saving in the UK, across age groups, income bands, and sex. Under-saving is no longer a phenomenon of the traditional under-saving groups such as women and the self-employed. Levels of public confidence in pensions remain low. Just 3% of people think that state benefits will provide a comfortable income for them in retirement. Only 5% of the population say that they are 'very

confident' that they will have enough to live on in retirement.

'Life or death situation' for Deloitte

Financial reinsurance, which has been implicated in the difficulties of Independent Insurance, HHH, and Equitable Life, is the subject of a \$2bn lawsuit against auditor Deloitte in the US. In a court hearing earlier this year, Robert S Bennett, a former defence attorney for President Bill Clinton hired to defend the accounting firm, called the case 'a life and death situation' for Deloitte.

In discovery, the plaintiff Japanese insurers have found what they believe is a smoking gun – a series of emails and other memos from a Deloitte actuary who raised questions about why the liabilities related to financial reinsurance weren't being recorded. 'I have a concern over the lack of recognition' of future liabilities, the actuary, John Slusarski, wrote in one 1999 email quoted in plaintiff filings. A year later, he quantified the unbooked

liabilities at \$1.4bn, the filings say.

Despite the sabre-rattling, the case seems likely to hinge on the knowledge that would reasonably be expected of the plaintiffs, both professional insurers which reinsured aviation business to Fortress Re, which failed after the 11 September 2001 disaster.

Basel boosts IT spend

A study of 1,700+ banks from 63 countries, conducted by AIM Software, the Vienna University of Economics, and sponsored by Reuters, has revealed that improving data quality is regarded as a key issue for risk management – and that regulatory requirements including Basel II and Sarbanes-Oxley are driving substantial investments in IT.

The survey quizzed banks about 11 key topics involving reference data management and risk management and shows that financial institutions worldwide are making considerable efforts to deepen their data management and increase data quality.