FROM THE WORLD OF GENERAL INSURANCE

Asbestos developments

Equitas has agreed to pay the manufacturer Crane Company $33m to settle insurance claims for asbestos and other liabilities. Crane will receive $1.5m in the third quarter of 2005 with the remainder to be placed in an account to pay future asbestos claims.

American International Group (AIG)

Former AIG chief executive Maurice Greenberg is to dispute the company's restated accounts. AIG said its accounts were wrongly inflated by up to $3.9bn (£2.1bn) but Greenberg said this could be $1.5bn (£0.8bn) more than the real figure.

Finite risk reinsurances

Further companies have received subpoenas in relation to the ongoing investigations into the use of finite reinsurance products, including AXA Re, CNA Financial, and GE Insurance Solutions.

In addition, Moody's Corporation, which owns the credit rating agency, has also been subpoenaed by New York attorney-general Eliot Spitzer for information on how it establishes its ratings for reinsurers. Structured financial products, particularly the newest, such as collateralised debt obligations, can be complex and difficult to analyse, making the opinions of rating agencies particularly influential.

Schemes of arrangement

The future of solvent schemes of arrangement is likely to change dramatically, following a landmark High Court ruling, experts have warned. The judge refused to sanction a scheme proposed by the British Aviation Insurance Company in respect of long-tail products liability business written in the US and Canada between 1930 and 1991. Schemes of arrangement are essentially a compromise between a company and its creditors, allowing insurers to run off the business without placing it in liquidation. As a result of the case, policyholders with accrued claims are unlikely to be bound in future by the same rules as those with incurred but not reported claims, unlike the pattern of current schemes. The ruling is not expected to affect insolvent schemes of arrangement.

Motor market cycle

According to Standard & Poor's (S&P) 2005 *Motor Review*, motor insurers are on a downward spiral, but a severe market crash is unlikely, with the deterioration in results not expected to be as severe as in previous cycles. According to S&P, this is because of the current low interest rate environment and more active cycle management on the part of insurers.

FSA general insurance newsletter

The FSA published the latest issue of its general insurance newsletter in July. The newsletter includes an update and further assistance on individual capital assessment (ICA) submissions, stating that 75 ICAs have now been requested, with approximately 35 submissions currently being reviewed, and the number of individual capital guidance decisions now into double figures.

The newsletter also states that the FSA is undertaking two projects, the first investigating how firms are managing the underwriting cycle and the second looking into payment protection insurance (linked to mortgages, loans, credit cards, and store cards). Findings for both projects will be published towards the end of this year.

The full newsletter can be found at *www.fsa.gov.uk/pubs/other/gi_newsletter6.pdf*.

Large losses

Transport for London (TFL) faces weeks of uncertainty over whether it can reclaim potentially millions of pounds of losses arising from the terrorist attacks in London on 7 July. According to a statement, TFL will be looking to recoup the bulk of the cost of damage to stations and trains from Pool Re, although the full extent of its claim is unknown at this stage. Claims outside of the London Underground are reported to be minimal compared to terrorist attacks in the past.

Insured losses from Hurricane Dennis have been predicted to be as much as $5bn by catastrophe modelling firms. Risk Management Solutions estimated insured losses at between $1bn and $5bn, while AIR Worldwide put the figure lower at between $1bn and $2.5bn in insured property losses. Hurricane Dennis made landfall at Santa Rosa Island between Navarre Beach and Pensacola Beach, Florida on 10 July at 2.25pm local time. The National Hurricane Centre reported that Dennis was a category 3 storm when it reached the shore, with sustained winds of 120mph and hurricane force winds extending up to 40 miles from the centre. Until Dennis, the US had not been hit by a hurricane in July since 1916. Even before Dennis had dissipated a more powerful hurricane was gathering force behind it. Hurricane Emily, the strongest ever recorded in July, hit land in Mexico but weakened to a tropical depression as it moved inland through northern Mexico.

Royal & SunAlliance and Allianz Cornhill could face claims of up to £20m following the collapse of the Gerrards Cross tunnel where a Tesco store was being built. The Health & Safety Executive is investigating the collapse of the tunnel at the end of June. In addition to material damage claims, a substantial business interruption claim from Network Rail for disruption to the Chiltern Railways link is expected.

At the end of July, Mumbai (Bombay) was hit by floods for a number of days. On Tuesday 26 July, Mumbai had more than 65cm (26in) of rain, which is the heaviest rainfall in India's history. The heavy monsoon is estimated to have caused damages in excess of $690m. More than 20m people have been affected by the rains and it is thought that the number of people who have died from the floods could soon rise to over 1,000.

On Wednesday 27 July there was a fire in the Oil & Natural Gas Corporation's oldest process platform off the west coast of India. The platform is in India's most important oil field and is said to be completely destroyed. Over 350 people were rescued, but ten people were killed in the fire and a further 12 people are still missing.

On Thursday 28 July, Birmingham was hit by a tornado with winds up to 130mph. Initial estimates were that insurers could face a cost of £40m for this event, although loss adjusters are now predicting that this estimate is conservative. In addition, over 50% of the residents affected may be uninsured. Buildings which were hit by the tornado may need to be pulled down due to the amount of damage that the tornado caused. It has been suggested that the tornado may have been due to global warming. In a study, US climatologist Kerry Emanuel said that storms in the Atlantic and Pacific have increased in duration and intensity by half since the 1970s, reflecting temperature rises.

Current issues newsletter

Other recent developments are covered in the general insurance current issues newsletter, which can be accessed via the profession's website at *www.actuaries.org.uk/Display_Page.cgi?url=/general_insurance/gen_ins-curr-issues.html*

DAVID HART

PPF – the risk-based levy

News editor Seamus Creedon interviews Partha Dasgupta, finance director of the Pension Protection Fund.

➤ **Industry sources are generally pleased with the proposals. Why is it important to have a risk-based levy in place from 2006?**

➤ We are very pleased with the support that the proposals have received from industry, which reflects the views employers and the industry expressed to us while we were preparing the consultation document. We listened closely to those views, and that is why we are proposing to introduce the risk-based levy for all eligible schemes from next year. This will mean that a fair and reasonable approach to all pension schemes can be taken from next year, minimising the cross-subsidy from well-funded schemes with strong employers to poorly funded schemes with weaker employers.

There are three core principles underpinning our proposals, they are:

- **Fairness** – ensuring that schemes pay an appropriate amount towards the levy reflecting the level of risk they pose.
- **Simplicity** – applying effective and simple mechanisms and solutions for collecting the data required to set the levy.
- **Proportionality** – ensuring that the levy is fair and proportionate between schemes and in its impact on individual schemes.

➤ **You are proposing that all affected pension schemes need to have a valuation for levy purposes completed no later than 31 December 2006. Sources say this will be a further compliance burden for trustees and pension scheme sponsors, who already have to get to grips with all the changes arising from the Pensions Act and Finance Act. What is your response?**

➤ We believe that approximately two-thirds of schemes should be able to provide the Pension Protection Fund with details of a s179 valuation by 31 December 2006 without conducting an out-of-cycle valuation. On balance, the Pension Protection Fund thinks that the limited costs for schemes in bringing forward the deadline for conducting an initial s179 levy valuation are more than outweighed by the benefits of using timely, accurate data in an individual scheme's risk based levy calculation and achieving fairness across all levy payers.

➤ **Why are you keen for multi-employer schemes to submit information about their scheme structure ahead of next year's Pension Regulator's scheme return?**

➤ The risks faced by pension schemes sponsored by multi-employers are markedly different to those faced by those sponsored by a single employer. The structure and rules of different types of schemes have an impact on how risk is shared among participating employers and therefore on the calculation of levy risk factors.

In line with our principles of fairness and proportionality the Pension Protection Fund proposes to take into account the structure of multi-employer pension schemes when calculating the levy factors.

Much of the information needed to enable the Pension Protection Fund to accurately assess the risk posed by multi employer schemes is not going to be provided by this year's Pensions Regulator scheme return. Although in our consultation document we have proposed a compromise that would enable the Pension Protection Fund to calculate insolvency risk for multi employer schemes based on the insolvency risk of the biggest employer in the scheme, or section of the scheme, we believe there are real advantages for schemes volunteering scheme structure information.

To enable schemes to do this we have placed on our website a 'declaration of scheme structure form' that will enable schemes to provide the Pension Protection Fund with comprehensive scheme structure information.

The key advantages of providing this information in advance of next year's Pensions Regulator's scheme return is that first, in most cases, multi employer schemes present a lower risk to the Pension Protection Fund than single-employer schemes. Completing the 'declaration of scheme structure' form will ensure that the Pension Protection Fund is able to reflect this lower level of risk in the calculation of the levy. Second, all multi-employer schemes will be required to provide this information from next year, as part of the Pension Regulator's scheme return. Where a scheme completes the voluntary declaration of scheme structure form this year, their scheme return will be pre-populated with relevant information, so only changes to the information will need to be reported in future years.

➤ **Concern has been expressed by organisations of a charitable nature as to the effect of the proposals on them – can you comment on this?**

➤ We have listened to the concerns expressed by many small companies and charities about the financial impact of the risk based levy, and believe that our proposals respond directly to their concerns.

Clearly it is in the Pension Protection Fund's interest to ensure that funding position of schemes improves over time, and that the levy does not cause companies to collapse. With this in mind, the Pension Protection Fund has proposed two levy caps:

1. a 15% cap on the insolvency risk factor to be used as part of the levy calculation; and
2. a percentage cap on the risk-based levy as a proportion of a scheme's liabilities.

We believe these caps should ensure the vast majority of schemes are able to pay the Pension Protection Fund levies.

Where a scheme is affected by the cap, or is unable to pay the levy because of financial difficulties, the scheme will be referred to the regulator for assistance.

➤ **The Pension Protection Fund's investment mandate suggests a prudent approach which is likely to be welcomed by the actuarial profession. On the other hand it has been suggested that the Pension Protection Fund may accept equity stakes in reconstructing organisations – how are these approaches reconciled?**

➤ In terms of accepting equity stakes, the Pension Protection Fund has a clear preference for types of asset class when seeking to maximise a pension scheme's assets in any negotiations. The important point is that the Pension Protection Fund's sole objective in any negotiation is to maximise the assets of the pension scheme.

The preferential order is:

- Cash today
- Cash in instalments (with guarantees)
- Securitised or collateralised assets
- Senior secured debt
- Secured debt (fixed charge)
- Secured debt (floating charge)
- Unsecured debt
- Subordinated debt
- Preference shares
- Convertible bonds
- Equity
- Equity options/warrants

In negotiations the Pension Protection Fund will systematically try and secure assets for a pension scheme based on the preferential order above. Ultimately, where there are no other assets

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available, the scheme may consider taking an equity stake in the new company. This will be seen as insurance for the pension scheme should the new company succeed in the future as it may provide the prospect of making further recoveries. It is important to stress that in these circumstances neither the pension scheme nor the Pension Protection Fund invest any money in the equity stake.

➤ Why is the Pension Protection Fund going to use a credit rating or scoring solution and what criteria will be used in selecting the service provider?

➤ To enable the insolvency risk of sponsoring employers to be measured as a factor within the risk based levy, the Pension Protection Fund intends using a market solution provided by a leading credit specialist.

A competitive tender exercise has been undertaken to select a credit specialist to undertake the task. We are currently in the process of agreeing contracts, and will hopefully be in a position to announce the successful supplier shortly.

The successful company will be recognised as leading provider of global business information including assessment of business failure with a proven track record.

All tenders were measured against specific criteria, including:

- accepted and viewed as credible by industry;
- published and transparent methodology;
- provides broad coverage of eligible schemes;
- flexible enough to take into account scheme and corporate structure in insolvency assessment;
- a stable measurement of risk;
- the most economically advantageous tender

➤ Why have you delayed the inclusion of an asset allocation element to the levy?

➤ The Pension Protection Fund acknowledges that asset allocation is an important leading indicator of future scheme funding levels. However, it is proposed to defer the inclusion of an asset allocation factor until a later date. The Pension Protection Fund considers that to include an asset allocation factor in the 2006/7 risk-based levy calculation would place too much of an additional burden on schemes in relation to the additional benefit inclusion would bring.

We will be considering and consulting industry on an approach that is consistent with the risk framework used by banks and insurers. There are many practical issues involved and we want to make sure that we take those issues into account. The types of assets that pension funds are including in their asset allocation strategies have become much broader and we need to make sure that we accurately reflect the risk that they pose.

➤ The relatively modest level of cross-subsidy envisaged by the proposals has generally been welcomed. Is it sustainable? What if there are some early major insolvencies?

➤ Our approach to funding will be dynamic not static, matching as closely as possible our assets to our liabilities.

We will be examining closely the potential net liabilities to the Pension Protection Fund of those schemes which enter assessment periods. In setting the amount of the levy needed in future years to manage the long-term liabilities, the Pension Protection Fund will take account of the expected level of deficits. We will therefore be managing the levy to ensure that, together with the assets of the schemes taken in, the finances of the Pension Protection Fund remain sound. Any shortfall between the levy in the first year and the cost of schemes starting assessment periods and later entering the Pension Protection Fund will be met by making suitable adjustments to the levy in future.

The Pension Protection Fund has been designed to cope with around 250 schemes entering the fund each year, including a FTSE100 scheme every five years.

➤ There are several recent examples (mostly outside the UK, and mostly associated with some element of fraudulent conduct) of high-profile failures which were not anticipated by the rating agencies – what safeguards would exist against such cases hitting the Pension Protection Fund?

➤ The Pension Protection Fund will use market techniques when evaluating insolvency. Fraudulent activity is always very hard to predict in advance. There has been a greater focus on forensic accounting techniques by analysts, fund managers, rating agencies, and other market participants since many of these high-profile events occurred. The market will always learn from these events and try and to adapt. However, we have to be pragmatic and realise that no indicator is going to be right 100% of the time. I don't believe that the Pension Protection Fund has any systematic bias to this risk compared to others.

➤ Some commentators say that it will be 20 years or more before pension scheme deficits will be filled in many cases. Is the level of benefits offered by the Pension Protection Fund sustainable in that context?

➤ Yes, we believe that the levels of benefits offered by the Pension Protection Fund are sustainable and will help to promote confidence in defined benefit occupational pension schemes in the UK.

Clearly it is difficult to project 20 years forward, however, there has been a significant trend recently to increase scheme funding and reduce pension fund deficits. The evidence shows that the industry and pension schemes are taking positive steps forward to reduce risk and thereby potential calls on the Pension Protection Fund.

Editor's note *Dun and Bradstreet were announced as the selected credit assessment provider in the days following this interview*

Wesleyan bucks the trend

Wesleyan Assurance Society is to invest £10m into the back-office administration at its Birmingham headquarters after deciding it would no longer look at options for outsourcing operations. The move will preserve 200 administrative jobs at the Colmore Circus base.

The Wesleyan has been examining its outsourcing options for two years, including the possibility of moving operations to South Africa, India, or elsewhere within the UK. A spokesperson commented: 'Like every other company in the financial services industry, we have had to seriously consider the options for outsourcing our administration. We received tender proposals from several parties, some of whom had offshore capability. But we came to the view that outsourcing would be the wrong decision. Our business proposition would not stand up to scrutiny if the policies we write for customers end up being processed in the same building as policies for half a dozen other companies.'

Watson Wyatt windfall

Newspapers reported this month that actuaries Roger Urwin and Paul Thornton would each receive approximately £6m in shares and cash from the takeover of the UK partnership by its US namesake, which completed on 1 August. It was further reported that the seven members of the firm's board would share an amount approaching £35m from the total proceeds of approximately £250m. Shares worth approximately £18m were reported to be retained on behalf of the 175 non-voting partners and remaining staff but there continued to be some speculation as to unhappiness with the shape of the distribution.

Any unhappiness on the part of junior staff is unlikely to have been allayed by the appearance of an edict apparently requiring them to invest in Watson Wyatt stock as an implicit condition of career progress above a certain level.