

Asbestos and health hazard developments

An American appeals court has ruled that, under the terms of a workers' compensation policy, contracting an asbestos-related disease is not an accident – this decision is particularly important for policies containing some restriction on claims for bodily injury caused by disease, as there was in the specific case involved in this litigation. Where there is no such restriction, the disease element of the coverage will normally include asbestos-related claims.

A Texas state court jury has awarded over \$250m (including \$229m punitive damages) to the widow of a man who died after taking the painkiller Vioxx, against the drug's manufacturer Merck & Co Inc. This has opened up the possibility of a rash of further cases from other users of the drug, many of whom claim to have suffered serious side-effects.

World Trade Center (WTC)

A recent ruling in a US Court of Appeal has confirmed that all medical claims arising from the 11 September 2001 terrorist attacks should be channelled through the New York federal court rather than various state courts. The important distinction is that they are consequently subject to a cap under the Air Transportation Safety and System Stabilization Act 2001.

Finite risk reinsurances

ACE Ltd has announced that it will restate earnings for the years 2000 to 2004 to correct for the inappropriate accounting for eight finite risk reinsurance contracts incepting from 1997 to 2001. The financial impact on the current level of shareholders' equity is, however, quite small, at approximately \$1m. The restatement follows an internal investigation of over 100 finite risk policies, initiated following the receipt of various subpoenas from regulatory bodies.

Meanwhile, James N Stanard, chief executive, and Michael W Cash, ex-senior vice-president, of Renaissance Re, who restated their earnings earlier this year, have been advised by the Securities and Exchange Commission (SEC) of a recommendation to levy civil charges against them. The SEC has also advised of a similar recommendation involving MBIA (which has also restated its earnings).

In addition, Berkshire Hathaway Inc has dismissed Milan Vukelic, chief executive of Faraday Group, its London operation, following investigation by regulators into his role when he was head of General Re's international finite risk business. Also in London, Lloyd's is assisting the SEC by supplying information on the use of finite risk reinsurance in the market – no wrongdoing has been suggested.

Schemes of arrangement

British Aviation Insurance Company has announced that it will appeal the recent High Court decision to refuse to sanction a solvent scheme of arrangement (see September issue). If, however, the decision is confirmed on appeal, the general feeling in the market appears to be that it will be very difficult to gain approval for future solvent schemes of arrangement in cases where the liabilities are very long-tail and uncertain.

Ambassador Insurance Co

A New Jersey federal court jury has made an award of nearly \$120m against PricewaterhouseCoopers LLP (PwC) in relation to the role of its predecessor firm, Coopers & Lybrand, as auditors of Ambassador, an American insurer which was declared insolvent in 1987. PwC has said that it will challenge the decision. The extreme length of the litigation in this case has been exacerbated by arguments over the relevant forum in which the case should be decided.

Large losses

It has been a very bad month for insurers and reinsurers in relation to a multitude of large and catastrophic claims!

■ **Hurricane Dennis (10 July)** Latest estimates of the insured cost are around the lower end of the \$1bn to \$5bn range quoted in the September issue.

■ **Hurricane Emily (17–20 July)** Damage was largely restricted to Mexico, where it hit both the Yucatan and the north-east of the country, but was not as severe as originally feared, with estimated insured losses being around \$200m.

■ **Fire off the west coast of India (27 July)** The fire in the Oil & Natural Gas Corporation's platform is now estimated to cost insurers \$260m.

■ **Forest fires** have been reported in:

- central Spain, where 11 firefighters were killed at the end of July, and problems continued for at least a month;
- northern Portugal, where 15 people were killed and 134,500 hectares of land (an area over ten times the size of London) burned, with the problems continuing from late July to late August; and
- western US, with nearly 5m acres of fires this year and continuing serious problems in Alaska, California, Oregon, and Washington.

No specific insured loss estimates are to hand, but forest fires are generally not the heaviest form of catastrophe loss within the industry.

■ **Floods** have also been prevalent, starting with the events in Mumbai on 26 July, reported last month. The rainfall eventually reached 90cm (36in), and it has been confirmed that over 1,000 people lost their lives. Estimates of economic loss vary widely up to over \$2bn, but insured losses

are certain to be much lower than this (the latest available figure shows reported claims of around \$350m), owing to the relatively low insurance penetration. Further flood incidents have been reported from various parts of Belgium (30–31 July), Switzerland, Austria, and southern Germany (21–24 August). The economic losses in Switzerland alone are estimated at around \$400m.

■ **The aviation insurance** sector has not escaped – after many months of low loss activity, August has compensated with a vengeance. The losses include

- On 2 August, an Air France A340 jetliner crashed after skidding off the runway at Toronto. There were no fatalities and 43 minor injuries, but the plane, insured for \$110m, was destroyed. Total insured losses may reach \$200m, although it is understood that claims in excess of this total have already been filed.
- On 6 August, a Tunisair turboprop plane crashed into the Mediterranean near Sicily with the loss of 13 lives.
- On 14 August, a Helios Airways Boeing 737 crashed in Greece after a loss of cabin pressure. There were 121 fatalities.
- On 16 August, a Western Caribbean Airways MD-82 airliner crashed in Venezuela after double engine failure. There were 152 fatalities. Total insured losses are thought unlikely to exceed \$100m.

The impact on aviation premium rates is likely to be some alleviation of the downwards trend, rather than any significant increase.

■ **Hurricane Katrina** The most substantial event of the month was Hurricane Katrina, which devastated the Gulf coast of Mississippi, Louisiana, and Alabama, particularly the area around New Orleans. Katrina originally made landfall on 25 August just north of Miami, where damage was relatively minimal. It then moved across Florida in a south-westerly direction and west into the Gulf of Mexico. It ploughed through the oil and gas fields of the Gulf, and is estimated to have reduced the output of oil from this source by almost 90%, and of gas by over 70%. Katrina made a second landfall on 29 August on the Mississippi delta, passed to the east of New Orleans, and made a third landfall a few hours later near the Louisiana/Mississippi border. It continued to lose momentum and lost its hurricane status about 100 miles inland.

Many of the approximately 1.3m residents of greater New Orleans remained in the city, mostly on the basis that they did not have the means to leave. An estimated 5m people were left without power, and it has been said that it could take up to two months to complete restoration to all those affected. In the early morning of 30 August, the storm surge caused by the hurricane caused three breaches in the levees to the north of New Orleans, resulting in virtually the entire city being

UK is late with pensions directive

Just nine of the 25 EU members will have introduced the Pensions Directive into law before the 23 September deadline, leaving many facing legal action by the European Commission. The UK is among those that will not meet the deadline. A spokesman for EU internal market commissioner Charlie McCreevy (responsible for pensions) said that infringement procedures would be lodged with non-compliant countries after 23 September.

Member states have had two years to implement the directive, which harmonises investment rules for pension funds and permits pan-European pension funds. In the UK the EU-compliant regulations, which include the replacement for the MFR, have been delayed until an expected date of 31 October.

No new GN11 in 2005

The Pensions Board of the UK actuarial profession indicated on 13 September that the volume of comment received on

EXD54 on transfer values was such that no new guidance would be forthcoming in 2005. The board was silent as to whether or when any guidance might be forthcoming in 2006.

It remains to be seen whether this marks the end of one of the most controversial drafts issued by the actuarial profession. Most respondents expressed themselves opposed to the draft guidance, which reflected the profession's intention of achieving a better balance of fairness as between members who transfer and those who continue with the scheme. Clive Fortes of Hymans Robertson commented on news of postponement of guidance: 'While we are generally supportive of the intellectual arguments supporting the proposed changes, we do not believe that setting transfer values is a matter for the actuarial profession alone. We hope that the profession will use the opportunity to consult much more widely – or better still hand the issue to the new Board for Actuarial Standards to be set up by the FRC following the Morris review.' He added: 'There is no prescription of surrender

terms for insurance companies and there ought not to be any prescription of surrender terms for pension schemes. We would favour a system whereby trustees have wider discretion in setting transfer terms but with clear disclosure.'

(See also professional news, p8.)

Mercer and Watsons carve up their world

In the Asia-Pacific, Mercer Human Resource Consulting has acquired rival Watson Wyatt's New Zealand operation. The deal follows Mercer's acquisition of the Australian operations of Mellon Human Resources & Investor Solutions, part of a Pittsburgh-based bank, in April this year. In New Zealand, Mercer will merge Watson Wyatt's actuarial consulting, superannuation administration, investment consulting, and human capital consulting activities with its own. As part of the deal, 60 associates will transfer from Watson Wyatt to Mercer.

In a statement, Watson Wyatt said: 'This decision is aligned with our strategy to >>>

THE WORLD OF GI (continued)

flooded, 80% of the area being below sea-level. There followed a breakdown in law and order, and a ponderous response by the authorities who seemed completely overwhelmed by the magnitude of the disaster.

By the time of writing (14 September), matters on the ground were improving quite significantly, with substantial police and military presence on the streets, emergency rations being ferried in by a huge fleet of helicopters, refugees being moved to other parts of the US, and repairs being made to the first of the three breaches in the levees, allowing the pumping of flood water to commence. Nevertheless, a great deal remains to be done before any real start can be made on rebuilding the damaged parts of the city and the devastated towns and villages in the surrounding area, and in rebuilding the lives of those who have lost everything (or nearly everything) they ever owned. There is also a serious risk of disease with the flood water being polluted with sewage and a significant number of rats roaming the city. The latest available estimate is that the death toll could reach 10,000. In contrast with the improving physical situation, estimates of potential insured losses were escalating and insurer and reinsurer ratings were on watch for likely downgrading. For example, Swiss Re more than doubled its original loss estimate and aggregate loss estimates approached \$60bn. Updates will be provided in future issues of *The Actuary*.

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

I should like to express my gratitude to Kate Angell and Rachel Jackson, who wrote last month's news from the industry while I was on holiday.

 DAVID HART



The advertisement features three Volvo cars: a silver S80 sedan at the top, a silver Volvo V40 station wagon on the left, and a silver Volvo S40 sedan on the right. The Volvo logo and 'for life' slogan are in the top right corner.

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► focus on our target market areas and will allow us to redirect our resources into other Asia-Pacific markets, including Australia, which we see as highly robust from both a growth and business scope standpoint.'

Meanwhile in Europe, Watson Wyatt and Mercer Management Consulting have signed a letter of interest relating to the potential transfer of Mercer Oliver Wyman's actuarial consulting business in the Netherlands to Watson Wyatt Insurance Consulting BV with the expectation of completion of the transfer on 1 October 2005.

The transfer gives Watson Wyatt Insurance & Financial Services Consulting, already one of the world's leading insurance and financial services consulting firms, a significant presence in the Netherlands, one of Europe's largest insurance markets, where it already has a team of 14 consultants. Mercer Oliver Wyman's actuarial consulting business in the Netherlands has a team of 22 consultants.

'Bringing in this successful actuarial consulting business positions Watson Wyatt as the leading and independent player in the Netherlands,' said Philip Brook, global head of insurance and financial services consulting at Watson Wyatt. 'This is an exciting opportunity for us as it further enhances our ability to offer seamless actuarial consulting services in the Netherlands and around the world to multinational insurance companies.'

'Broken heart' model breaks hearts again

We were intrigued to note comment in the *Wall Street Journal* which linked exceptional developments in credit markets this year to a model rooted in actuarial concepts.

The *Journal* reported widespread reliance on a copula-based model of default developed by David Li which owed its origins to the linked probability of death of couples (popularly described as the 'broken heart' syndrome). Apparently Li's model has come to be heavily relied upon by hedge funds active in the rapidly growing credit derivatives markets.

Unfortunately, exceptional developments recently, including the related downgrades of automobile maker bonds, have departed from the experience which underlay Li's model. The result has been that modelled diversification has proved not to be true in the market. This suggests

some echoes of the exceptional influences which invalidated the strategies followed by Long Term Capital Management through 1998. The *Journal* quotes Mr Li: 'it's not the perfect model.' But, he adds: 'There's not a better one yet.'

EU solvency supervision

We could not improve on the analysis of the developing solvency regime by Bob Yates of Fox-Pitt Kelton:

'In a lot of ways. I mean the thrust of the rules, which really goes under the name of Solvency II, is to introduce proper economic capital requirements for insurance companies. By that I mean basically rules that require you to hold capital commensurate with the real risk of what you're doing – whether that's insurance risk, underwriting risk, or whether it is investment risk.

'From that flows a great many developments. Number one is you are going to have to make sure that the capital that you are using is earning a proper return. There will be very little room for arbitrage, or market mispricing because the requirement for capital will be directly related to the economic risk. So you're going to have to be efficient, focused, you're going to have to design products which produce the required return on equity. You're going to have to have good asset liability management, subsequently, to make sure that the risk that you're taking, whether it is in

equities or with interest rates, is getting properly remunerated.

'You're going to have to have greater economies of scale because efficiency will be paramount. And business is going to have to be written where it can be most efficiently done. I will give you an example there.

'One of the key principles in insurance is diversification. If you put together a group of risks, then the volatility is reduced and the capital that you need is reduced. So if you take something like a big individual risk, if you carry that in a primary insurance company that doesn't have too many of those risks, they're going to have a lot of volatility. They're going to need a lot of capital. If, on the other hand, that risk is laid off to, for example, the reinsurer which may have many, many such risks, then the volatility of that risk in that portfolio will be reduced. In other words, it may well be more efficient for certain categories of big, what we call high a severity low frequency business, to be written in the reinsurance market. Or at least transferred into the reinsurance market. So a lot will change structurally potentially as a result of Solvency II.'

To keep up with EU solvency developments, visit at least the following websites:

- ◆ www.ceiops.org
- ◆ www.cea.assur.org
- ◆ http://europa.eu.int/comm/internal_market/insurance/solvency_en.htm#solvency2

Secondhand smoke costs dear

Secondhand smoke imposes significant costs on non-smokers and society, according to a recent Society of Actuaries (SOA) study that concluded the annual cost of excess medical care, mortality, and morbidity from secondhand smoke exposure in the US is approximately \$10bn. This includes approximately \$5bn in direct medical costs and approximately \$5bn in indirect costs, such as lost wages, reduced services, and costs associated with disabilities per year.

The study is one of the first to explore the economic effects of secondhand smoke exposure for a variety of medical conditions in which it has shown to increase the incidence of illness. The many conditions examined include, but are not limited to, lung cancer, asthma, and chronic pulmonary and coronary artery diseases. This research was developed by the SOA

in partnership with the Robinson College of Business at Georgia State University.

The study determined both the direct and indirect costs associated with a specific medical condition as a result of exposure to secondhand smoke per year for the US population:

- estimated total cost associated with specific medical conditions is \$4,982m;
- estimated total cost associated with lost wages, fringe benefits, and services is \$4,683m.

For more detail visit: www.soa.org/ccm/content/areas-of-practice/life-insurance/research/economic-effects-of-environmental-tobacco-smoke-SOA/

[On the topic of smoking, please see the appreciation of Sir Richard Doll, 'the man who saved a million lives', on p21.]