

FROM THE WORLD OF GENERAL INSURANCE

**Asbestos and health hazard developments**

Equitas has completed five further settlements in relation to some of its largest direct asbestos-related liabilities. These include deals with two companies with bankruptcy proceedings pending, the asbestos producer Kaiser Aluminium Corp and floor-tile manufacturer Congoleum. Payments are being made into escrow pending the fulfilment of agreed conditions by the companies. The total settlement for all five assureds is approximately \$270m.

Following the award made against Merck, as manufacturers of Vioxx (see last month's news), more than 4,000 further lawsuits have reportedly been filed against Merck, with a potential exposure estimated at over \$18bn. It is suggested that the \$253m award in the original case is likely to be reduced to no more than \$26m on appeal, owing to the 'capping' laws on punitive damages in Texas.

**Finite risk reinsurances**

The Securities and Exchange Commission (SEC) have advised three past and present executives of General Reinsurance Corp that it is considering charges of 'violation of securities laws' against them in connection with their involvement in finite risk reinsurance transactions. The three are Joseph P Brandon, the current chief executive, Robert Graham, senior vice-president, and Christopher Garand, a recently retired senior vice-president. There is now a period for these three to respond before the SEC decides whether to pursue charges.

**US workers' compensation**

Hartford Financial Services Group Inc and St Paul Travelers Cos Inc have both received subpoenas from the New York attorney general, Eliot Spitzer, seeking information on their reporting of workers compensation premiums. Both companies have said that they are co-operating fully with the investigation.

**Swiss Reinsurance**

John Coomber, one of the British actuaries in the most senior positions in the global insurance and reinsurance markets, has announced that he will step aside as chief executive after three years in the post. His place will be taken by Swiss-born Jacques Aigrain.

**Large losses**

It has been another bad month for insurers and reinsurers, particularly in relation to those with

hurricane exposures in the US. Losses include:

■ **Hurricane Katrina (25–30 August)** Updated figures suggest that the energy losses in the Gulf of Mexico could reach \$5bn, double the previous highest (Ivan in 2004), and that the overall insured cost is likely to be of the order of \$50bn, also significantly exceeding the previous record (\$21bn at current prices) held by Andrew in 1992, and even the terrorist events of 11 September 2001. It is anticipated that there will be high levels of loss on a number of classes other than personal and commercial property, including automobile, environmental, and business interruption. Individual insurer loss estimates include Lloyd's \$2.6bn, Swiss Re \$1.2bn, XL Capital \$875m, Munich Re \$780m, Montpelier Re \$675m, Renaissance Re \$600m, Allianz \$585m, ACE \$550m, Endurance \$400m, Hannover Re \$315m, and Partner Re \$300m. It has also been disclosed that US bond insurers have exposure to debt defaults amounting to \$14bn for cities and municipal authorities in Louisiana, Mississippi, and Alabama, which were affected by Katrina. It is not yet known whether losses will arise from these exposures. In addition, it is expected that the insured costs will be high enough to trigger payments under the CAT bonds purchased by some large insurers and institutional investors. Economic losses are now estimated at up to \$125bn. As a result of the reinsured costs, Standard & Poor's has placed the entire reinsurance sector on 'negative outlook'. On the brighter side for the industry, it is expected that, taken with the impact of Hurricane Rita (see below), the property and reinsurance rates will harden significantly on renewal.

■ **Typhoon Mawar (26/27 August)** This was the first typhoon to hit Japan this season. Casualties and damage both appear to have been limited, as the wind-speeds involved were no more than equivalent to a category 1 hurricane.

■ **Air crash in Sumatra, Indonesia (5 September)** A Mandala Airlines Boeing 737 crashed on take-off onto a residential area of the city of Medan, killing about 100 of those on board, plus a further 40–50 on the ground. Insured cost estimates are not currently available, but are not likely to be very material given that the plane was over 20 years old and the compensation provided to survivors and next of kin appears to be very modest by western standards.

■ **Floods in France (around 8 September)** Further floods occurred in the Gard and Hérault area of southern France, with 10,000 people being evacuated from their homes – as a result casualties have largely been avoided. No insured loss estimate is currently available, although it is expected that the majority of the cost will be

borne by the national flood pool rather than the private insurance industry.

■ **Heavy rain and mudslides in the Bergen area of Norway (15 September)** At least one death and nine other injuries were caused, but insured losses are not expected to be very material.

■ **Hurricane Ophelia (15/16 September)** This struck the Carolinas in the US, and although only a category 1 hurricane, its slow movement meant that there was up to 15 inches of rain, which caused significant flooding, particularly in the coastal regions. It resulted in loss of power to more than 120,000 properties, but was not expected to result in insured losses greater than \$1bn.

■ **Hurricane Rita (24 September)** This hurricane (at one time the third most intense ever recorded with a barometric pressure as low as 897 millibars) had reduced to category 3 by the time it made landfall near the Texas/Louisiana border. This resulted in the main impact missing the Galveston/Houston area which had (following the disasters of Katrina) been evacuated in preparation for a direct hit. Loss of life from the hurricane was thus relatively low at around 10, which was less than the number who lost their lives in the process of the evacuation, which included the deaths of 23 elderly people when the bus on which they were being evacuated caught fire in heavy traffic. Other effects of Rita were further serious damage to the oil and gas industry in the Gulf of Mexico, and another breach in the levees causing further serious flooding in New Orleans. The early estimates of insured loss range from \$3–7bn.

■ **Typhoon Damrey (26–29 September)** This was the most vigorous typhoon to strike Vietnam in the past ten years, causing serious flooding there and in parts of China, Thailand, Laos, and the Phillipines, with a death toll of around 120, over 1,000 homes destroyed, and a further 12,000 seriously damaged. Seawater flooding extended up to 4km inland. Insured losses are not thought to be very material.

**Current issues newsletter**

Other recent developments are covered in the General Insurance Current Issues newsletter, which can be accessed via the profession's website. The September edition includes sections on government and regulatory issues, Solvency II, international news, claims and legal issues, and market news. See:

[www.actuaries.org.uk/Display\\_Page.cgi?url=/general\\_insurance/gen\\_ins-curr-issues.html](http://www.actuaries.org.uk/Display_Page.cgi?url=/general_insurance/gen_ins-curr-issues.html)

DAVID HART

## Asbestos nightmare continues

Insurance companies are becoming increasingly concerned that asbestos liabilities will continue to cause them a headache for the foreseeable future, reveals a new survey by Deloitte. The survey of over 30 leading insurance firms found that nearly 60% believe that US-sourced asbestos will continue to be a significant issue for the insurance industry for at least the next ten years. In addition, over 90% of respondents believed that the Fairness in Asbestos Injury Resolution (FAIR) Act won't be passed before the end of 2006.

Over 70% of respondents either broadly agreed with AM Best's estimate that the US insurance industry was under-reserved by approximately \$14bn in respect of its US-sourced asbestos liabilities at 31 December 2003, or thought that this was an underestimate. Almost 80% of respondents admitted to having increased their US-sourced asbestos reserves in the past three years, with almost one-third increasing them by 30% or more. Over half (53%) of the executives said they would not be surprised if their claims experience caused them to increase their ultimate claims cost for US-sourced asbestos liabilities in the next two years. In respect of UK-sourced asbestos liabilities, this figure increased to 64%.

## Offshoring

Watson Wyatt announced plans to implement a pan-European pension valuation system and is setting up a new valuation centre which will eventually handle all

pension valuations across Europe.

The firm has decided to adopt a strategy of delivering the back-office processing element of all valuations through a valuation centre. This change will take some time to implement – at present it is expected that work will start being passed to the centre in 2007, with a steady build up to full capacity by 2010. The new European valuation centre will be based in India, where Watson Wyatt has existing operations. All contact with clients will continue to be managed by teams based in Europe. At the same time, the existing actuarial software in Europe will be upgraded with a new system which has been developed and is now in use by Watson Wyatt associates in north America. This new system is currently being tailored for use across Europe and will be ready for the opening of the valuation centre in 2007.

## Milliman expands in Europe

Milliman Inc announced last month that it has opened new offices in Munich and Warsaw. This move extends the scope of resources and expertise available to clients in Europe, where Milliman is already present in Italy, Spain, and the UK. The Munich office is active in life and property & casualty insurance. The Warsaw office will initially specialise in life insurance and also act as a regional base to support clients in other central and eastern European markets such as Ukraine and Russia, where Milliman is also active. These are the two largest insurance markets in the Com-

monwealth of Independent States (CIS), which is attracting increasing activity from foreign insurers.

## Payment protection insurance practices under fire

The Office of Fair Trading (OFT) recently received a super-complaint from consumer group Citizens Advice (CAB) concerning the payment protection insurance (PPI) market. In addition, the Financial Services Authority (FSA) has recently concluded that sales practices for PPI are 'very poor' in most sectors.

The super-complaint makes numerous criticisms of the current market, including:

- **The sales process** – the 'take it or leave it' sales pitch of these products means that customers are given little opportunity to assess the comparative merits of other policies on the market and are often mis-sold policies under which they are not eligible to claim.
- **Product design** – many PPI products exclude the most common situations in which people find themselves unable to service their debt. In any event cover, when given, is often insufficient when customers encounter the most severe problems.
- **Price** – the cost of PPI often represents a large proportion of the associated credit and lenders will often charge additional interest on the premium.
- **Value for money** – many PPI products give poor value for money and could ultimately lead to increased debt.

Recommendations to tackle these problems have been put forward in the report and CAB has demanded action from FSA, OFT, and the Treasury select committee.

## Marriage going out of fashion?

The latest issue of *Population Trends*, prepared by the Government Actuary's Department and published by the Office of National Statistics, attracted considerable media interest when it appeared towards the end of September. Most of the comment, which included several references to the horrible fate awaiting the Bridget Joneses of this world and to the alleged commitment-phobia of the male of our species, related to these statistics:

### 2003-based marital status and cohabitation projections for England and Wales

- The proportion of the population who are married is expected to fall, with a corresponding increase in the proportion who had not married. Among the male adult

population, the proportion who had not married by 2031 is projected to rise to 46% (from 35% in 2003) and among female adults, to 39% (from 28%).

- The number of cohabiting couples, estimated to be 2.0m in 2003, is projected to almost double to 3.8m by 2031.
- In 2003, 21% of males and 18% of females who were cohabiting were aged over 45. By 2031, the proportions over 45 are projected to rise to 41% for males and 36% for females.

Nevertheless we were tempted to wonder if, just when commentators lose faith in the future of marriage, is the institution about to stage a comeback? Readers' views most welcome!

## PPF levy criticised

Mercer Human Resource Consulting has called for changes to the Pension Protection Fund (PPF) risk-related levy following a consultation period which ended on 4 October. It believes the financial strength of parent companies should be taken into account when setting levies for subsidiary organisations from 1 April 2006. Some companies, including major employers which present little risk to the PPF, could be required to pay over twice as much as necessary if the proposals are not amended.

The PPF's risk-based levy reflects the risk that a company will become insolvent over the next year. In some cases this risk

can be overstated because, although an employer might be at theoretical risk of failure, in practice another company in the group could step in to meet pension commitments. Mercer, which provides pensions advice and services to over 60 of the FTSE 100 companies, has called for the PPF to give credit for the financial strength of other group companies, provided they are prepared to support a scheme.

Tim Keogh, worldwide partner at Mercer, said: 'We are very concerned that some employers will face excessive levies next year because the PPF will not recognise they are part of a strong corporate group. The PPF has said it is sympathetic but will need to consult further on the issue, with a risk of delay until 2007. This is not good enough when the levy bill could easily double in the meantime.'

## ACA survey 2005

In an echo of the Pensions Institute report (see below) the latest published results of the Association of Consulting Actuaries' (ACA) 2005 pension trends survey underscore that employers' greatest concern for the future is the impact of legislation on benefits and funding costs. These worries, in the light of ongoing pension scheme deficits equating to over £130bn reported by the survey, run ahead of all others and underpin employers' pessimism about the effect of the 2004 Pensions Act measures on occupational pension provision.

Commenting on the survey findings at the ACA's annual dinner, chairman Adrian Waddingham said: 'The number of employees covered by any form of occupational pension scheme is in rapid decline – this is not disputed. The policy-mix must be wrong for this to be happening. 68% of employers say present policies to promote occupational pensions are not moving in the right direction.'

More on the results of the survey and on the ACA pension reform manifesto can be found at [www.aca.com](http://www.aca.com).

## Legislation destroying defined benefit (DB) pensions?

The government has stated in the past that it aims to shift the balance between state and private pension provision from 60:40 to 40:60 by the year 2050. The most significant unintended consequence of the Pensions Act 2004 is that measures

## From Court 76

High drama in September as Equitable Life settled its longstanding litigation against its former auditors and some former directors.

Equitable Life abandoned its £700m claim for damages against Ernst & Young yesterday in what the accountancy firm said was 'the biggest climbdown in English legal history'.

The move means there is little chance of any major compensation for policyholders, one million of whom saw their retirement savings and investments cut dramatically after the world's oldest mutual insurer came close to collapse in 2000. The insurer had claimed that Ernst & Young had been negligent when it audited the company's accounts.

The one consolation for the insurer was that, under the terms of the settlement, each side is paying its own costs – estimated at £30m so far for Equitable Life and £20m for Ernst & Young, its former auditor. However, Equitable is refunding a £795,000 payment made earlier by E&Y in respect of the insurer's legal costs.

Equitable said it was with 'great sadness and frustration' that the board had decided to withdraw the claim completely but it would have been 'foolhardy' to continue in the wake of the legal advice they had received. Vanni Treves (Equitable chairman) said the insurer had been confident it could prove Ernst & Young's audit was negligent. But it had been taken aback by the evidence given by the former Equitable directors in court. This left the board feeling there was too great a risk that the judge would rule that the former directors would not have done anything differently in terms of how they ran the company, whatever E&Y had done or said. The insurer not only had to prove there

was audit failure, it also had to show this led to a loss being suffered.

Yesterday's events deal a major blow to policyholders' hopes of recovering large sums to help offset their losses when Equitable lost a legal battle over valuable minimum income guarantees enjoyed by some pension policyholders.

Mark Hapgood QC, representing E&Y, described the decision to abandon the claim as 'the biggest climbdown in English legal history'. Ernst & Young alleged yesterday that behind the scenes, Equitable had made several proposals to settle the case in recent months, and had indicated it would accept about £10m–20m – an offer refused by E&Y.

However, the accountancy firm is not completely off the hook. It may still face an investigation by the Joint Disciplinary Scheme, the accountancy regulator.

Policyholders' only hopes for compensation now lie with the continuing action against the former directors and an inquiry by the parliamentary ombudsman, who is due to report within months. The case was adjourned until October 3.

*The Guardian, 23 September 2005*

As we went to press, Equitable continued before Mr Justice Langley only with its case against 11 former directors, having settled with four others. Expert actuary Mike Arnold of Milliman – instructed by solicitors for Equitable – was in the witness box. The settlements of the cases against the auditors and directors meant that several other expert actuaries – including your news editor (instructed by solicitors for Ernst & Young) – were never heard.

designed in theory to shore up the occupational pensions sector, in practice risk undermining it and hastening its demise. This is the overarching conclusion of a report entitled 'Pyrrhic Victory? The unintended consequences of the Pensions Act 2004' published last month by the Pensions Institute and Cass Business School.

Key findings include:

- ◆ The Act disconnects the historic alignment of the interests of trustees and the sponsoring employer.
- ◆ Company directors are likely to withdraw from trustee boards.
- ◆ The new requirements for trustee knowledge and understanding (TKU) may alienate older, highly capable

trustees.

- ◆ The business model of actuarial and investment consultants is under scrutiny and is expected to change.
- ◆ Clearance is likely to favour trustees but create problems for employers.
- ◆ There are serious doubts over the longer-term viability of the PPF.
- ◆ Employers feel they have lost control of their DB schemes and will close to future accrual.
- ◆ To proceed with confidence employers need the flexibility to design benefits that are appropriate to their size and financial strength.

More on this report can be found at [www.pensions-institute.org](http://www.pensions-institute.org).