

## Special news – the Turner report

The Second Report of the Pensions Commission, very much associated with chairman Lord Turner of Ecchinswell, appeared on 30 November 2005. Seamus Creedon reports.

### Government response

The appearance of the report coincided with apparent tensions within government as to how to respond to the issues raised. It appeared that the Treasury wanted to attack the proposals on affordability grounds, based in turn on the assumption that it was not necessarily committed to raising the level of means-tested pensions credit in line with earnings. 10 Downing Street was apparently more sympathetic to the broad thrust of the proposals and to the need for a fairly stable framework, although it too appeared to reserve its position on affordability.

It is envisaged that government will respond in general terms early in 2006 but it remains to be seen how long the timetable will be for any implementing action.

### Other responses

The actuarial profession responded rather grudgingly to Turner's analysis, suggesting that his envisaged change in the retirement age for state pension purposes to 67 or 68 failed to take improving longevity sufficiently into account. Faculty President Harvie Brown criticised a 'lack of new thinking' although it was not clear what he would have expected in this regard.

The Association of Consulting Actuaries was critical of the lack of support for employer provision and not at all a fan of the 'Britsave' proposal. It was reluctant to accept Lord Turner's suggestion that defined benefit (DB) schemes were an anachronism, although the Turner analysis was quickly supported by Rentokil's decision to close its DB scheme to active members (see p17 opposite).

Attitudes on the part of financial services providers seemed to vary, with some insurers with relatively well-developed administration were hostile to Britsave, while fund managers

seemed disposed to welcome the new scheme or at least the probable opportunity to manage some extra assets.

Business attitudes also seemed likely to be diverse, with larger firms with occupational arrangements broadly welcoming the report, while smaller firms focused on the impact on their costs of the 3% minimum employer contribution to Britsave. Some were concerned that firms with existing occupational arrangements might not be unhappy to see the cheaper Britsave substituted for these.

Meanwhile the trade unions were inclined to cherry-pick from the report – welcoming the elimination of means-testing in relation to the pensions credit while expressing themselves concerned about the implications for poorer workers of any increase in state retirement age. There was perhaps a sense that trade unions' real concern is protecting the generous retirement provisions of public sector schemes – an issue beyond the scope of Turner.

### Comment

The Turner report is a thorough analysis of a most difficult subject which at root reflects tension between generations warring for national resources. These tensions are not at all unique to the UK, and no country has achieved a solution which obviously should be emulated.

It will, however, require exceptional and sustained political leadership to implement a stable framework which is appealing in concept but with details which in different ways grate with different stakeholders. Indeed, given future economic and demographic uncertainty and the short political cycle, it can be understood why most democracies fail to achieve stability in pensions frameworks. More on this in next month's issue!

### Key recommendations

- The establishment of a National Pensions Saving Scheme (colloquially 'Britsave') into which all employees without good existing provision would be automatically enrolled but with the right to opt out. Minimum default employee contribution rates would be 5% of gross pay above £5,000, of which 1% is effectively paid by tax relief: employers would be required to make matching contributions of 3%. Both employers and employees would be able to make additional voluntary contributions, and the self-employed would be able to join on a voluntary basis. The design of the scheme should aim for low costs, eg 0.3% per year, thus boosting the value of pension saving by up to 30%. The scheme aims to encourage people to save for a pension and to enable them to do so at low cost.

- Reforms to the state system to ensure a sound foundation on which pension saving can build. These involve a gradual move towards a more generous state pension with the state pension age also increasing over the long term. In essence a higher pension at a later age.

- Measures to improve the position of people with interrupted work records and caring responsibilities, who are disadvantaged by the existing contributory system.

- Measures to facilitate later working and flexible retirement for those who want it.



The Actuary will carry an interview with Adair Turner (left) in its March issue.

## From the world of pensions

### Exterminating defined benefit pensions?

Rentokil Initial – which has as one of its core businesses rodent extermination – attracted fierce criticism on announcing just before Christmas its intention to consult on ceasing future defined benefit accrual for members of its pension scheme. Commentators noted that Rentokil was the first FTSE-100 company to take such action and began to speculate on which would be next.

The strongest reflex criticism came from trade unions, who could presumably see the likely power of the Rentokil example. Many actuaries also commented, although they seemed curiously reluctant to express an opinion on the specifics of the Rentokil action. Instead it was described as another nail in the coffin of defined benefit pensions, which had already been very firmly nailed down by misguided government action.

Other commentators saw Rentokil's action as an entirely reasonable response to changing demographic and economic circumstances which have made intolerable the risks for employers in running a traditional occupational scheme. Others are widely expected to follow, although several commentators made the point that often the drafting of scheme rules may greatly complicate negotiations between sponsors and trustees.

Interestingly, Rentokil's announcement referred to its scheme's position as 96th out of 100 in a Lane, Clark & Peacock league table of FTSE companies ordered on the strength of their funding position (see [www.lcp.uk.com/news/news.asp?ID=108](http://www.lcp.uk.com/news/news.asp?ID=108)).

### PPF levy changes mostly welcomed

A relatively brighter response, reflecting at least doom postponed, greeted the appearance of the final consultation from the Pension Protection Fund, also shortly before Christmas. Key changes included a much lower cap for the levy in relation to liabilities at even the weakest of schemes, more sensitivity to credit status (with 100 bands replacing the ten originally proposed), and willingness to recognise special and some forms of contingent contributions (see below). This consultation also included the 'scaling factor' which will be the principal driver of the amount to be collected and which is expected to give rise to total contributions of approximately £575m.

Actuaries and their clients universally welcomed the detail of these changes and congratulated the PPF on the quality of its consultation. Actuaries and other commentators however acknowledged the optimism explicit in the scaling factor, which means that the PPF is expecting to collect not much more than

half of what might be regarded as a 'normalised' actuarial cost. There remains the potential for unexpected adverse developments in longevity or financial markets to destroy the financing of the scheme. Several actuaries renewed calls for the level of benefits 'insured' by the PPF to be reduced closer to a 'safety net' level.

### Voluntary forms on PPF website

A series of voluntary electronic forms have been launched on the Pension Protection Fund website to enable schemes to provide information in addition to that in the Pensions Regulator's scheme return. These forms will enable the most accurate information to be used in the risk based levy calculation. Completing the forms electronically will ensure that data is accurate and this, in turn, will result in a fair risk-based levy calculation.

The forms currently available are:

- ◆ the Declaration of Scheme Structure and Participating Employer Forms for multi employer schemes (to assess insolvency risk interactions),
- ◆ the Section 179 Valuation Certificate (to support up-to-date assessment of underfunding) and
- ◆ the Actuarial Certificate for Deficit Reduction Contributions (to capture special contributions since the last formal valuation).

These certificates should be down-

loaded from the forms section of the PPF website and submitted electronically. The website can be found at [www.pensionprotectionfund.org.uk](http://www.pensionprotectionfund.org.uk).

### Light at the end of the tunnel?

Deloitte actuaries estimate that the total deficit for the final salary pension plans of FTSE 100 companies stands at £75bn at year-end 2005. The total deficit has grown from around £65bn at the start of the year, despite improved investment markets and a threefold increase in contributions in recent years.

David Robbins, consulting partner at Deloitte, commented: 'Falling interest rates have increased the value of pension deficits. While the market value of pension scheme assets has increased over the year by around 15%, this has not been enough. We estimate that the stock market would need to rise immediately by a further 30% to eliminate the UK's pension deficits.'

Mr Robbins went on to say: '2005 is the year in which the UK's finance directors have finally accepted that pension deficits are company debt. Companies are now starting to use new and innovative ways to manage this debt. These include using escrow accounts, guarantees from parent companies or banks, and liability hedging using derivatives. We predict the FTSE 100 deficit will fall back to below £65bn by the end of 2006.'

## Swiss Re estimates 'worst-ever' 2005 for insurance industry

The usual sobering estimates from Swiss Re's *sigma* team interrupted the Christmas festivities. Although the Boxing Day 2004 tsunami meant that the human toll from catastrophes in calendar year 2005 was down, this was still a bad year.

Swiss Re said: 'According to preliminary estimates, more than 112,000 people died worldwide in natural and man-made catastrophes in 2005. These catastrophes triggered total

financial losses of around \$225bn, an estimated \$80bn of which were insured. This made 2005 the costliest year ever for insurers.'

### Liability insurance growth prospects

The *sigma* team at Swiss Re has also been researching insurance market development: 'In an environment of strong insurance growth in the emerging markets, liability insurance outperformed overall non-life business: while

overall non-life insurance premiums grew by 5% per year between 1999 and 2003, liability premiums increased at an annual average of 13%. Swiss Re's new *sigma* report analyses the recent trend and the opportunities and threats it poses for insurers, particularly in Asia, Latin America, and Eastern Europe.'

Visit [www.swissre.com](http://www.swissre.com) to catch up with *sigma* research.

## From the world of general insurance

### Asbestos and pollution developments

Equitas has settled North American asbestos and pollution-related claims with General Motors Corporation. The amount of the settlement is not currently to hand.

### Terrorism

The Port Authority of New York and New Jersey (PA) has been found 68% negligent in respect of the terrorist bombing which killed six people and caused extensive damage in an underground car park at the World Trade Center in New York in February 1993. As a result, assuming the verdict is not successfully appealed, businesses affected by the attack can sue PA for damages, and insurers can subrogate against PA for claims they have already paid to their insureds. It could also lead to a surge in claims for bodily and emotional injury against PA.

In mid-November, the US Senate passed a two-year extension to the Terrorism Risk Insurance Act 2002 (TRIA), which was due to expire at the end of 2005. A fairly similar extension was passed by the House of Representatives in early December, as a result of which a joint committee was formed to create a final version. This committee produced a version similar to that passed by the Senate, which includes reducing back-stop coverage for terrorist events, with deductibles of \$50m in 2006 and \$100m in 2007, compared with deductibles under the original TRIA which could be as low as \$5m. This was passed before Christmas, and was expected to be signed into law by President Bush early in the new year.

### American International Group (AIG)

In November, AIG filed restated third-quarter figures and disclosed that some of its employees have received 'Wells notices' warning that officials from the Securities and

Exchange Commission (SEC) are recommending that the SEC should take action against them for violation of federal securities laws, and giving them the opportunity to respond.

### Finite risk reinsurances (FRR)

Following the 'Wells notice' filed against RenaissanceRe, as reported in the previous issue of *The Actuary*, the company's chairman and CEO, James N Stanard, resigned his positions. It is not yet known whether the SEC will bring actions against the company, Mr Stanard, and other executives, or whether the changes in management within the company will result in a resolution of the issues without further action. The company has stated that it continues to co-operate with the investigators. Various credit rating agencies downgraded the company after the announcement of the departure of Mr Stanard and the disclosure of poor third-quarter results showing a nine-month loss of over \$100m.

MBIA Inc announced in November that it has earmarked \$75m to settle investigations into its treatment of FRR transactions. The company also announced that it would restate its results from 1998 onwards to reverse certain reinsurance credits taken in the original figures. This is the second such reinstatement by MBIA in 2005.

Converium Holding Ltd has joined the list of companies to restate their earnings on account of the treatment of FRR. It announced in early November that it was delaying until mid-December publication of its third-quarter figures and restating its previous figures, although it indicated that it did not anticipate that any reinstatement would be very material.

In the UK, the Financial Services Authority has taken its first regulatory action against individual brokers, having taken over supervision of intermediaries early in 2005. The

brokers involved were Robert Phillips and Isabel Rawlence, of Benfield Group, who were involved in the using of loans disguised as reinsurance in assisting their client Chiyoda Fire and Marine Europe (Chiyoda) to distort the financial results of its company. Six directors of Chiyoda have already been found guilty of related charges. The two brokers have been banned from taking part in regulated activities for two years.

### Goshawk Syndicate Management Limited (Goshawk)

In the wake of the fine on Goshawk reported in the previous issue of *The Actuary*, the group's board has been replaced and an equity issue is being considered. This would be written by Phoenix Asset Management (Phoenix), the largest shareholder of Goshawk – Phoenix was also responsible for the board changes. The new chairman, Rory Macnamara, and chief executive, Michael Dawson, are now expected to develop the run-off strategy for the business.

### Alea

In early November Alea (a Bermudian reinsurance group) announced a doubling of its estimated hurricane Katrina losses from \$30m to the \$55m–70m range, plus additional hits from Rita and Wilma and the European floods, and stated that, as a consequence, it was seeking a buyer for all or part of the company. This followed a downgrading of its credit rating by Standard & Poor's (S&P) in September. A couple of weeks later it disclosed that it was selling renewal rights on its US excess and surplus lines business to AmTrust for 3% of the gross premiums written. Then, in early December, the company was further downgraded by S&P, Alea London ceased writing business and was selling renewal rights on part of the business to the Canopus agency at Lloyd's. As part of this latter transaction, a number of the Alea team

were being transferred to Canopus. Almost immediately after this, Alea Europe sold the renewal rights on most of its business to SCOR for 9.5% of the gross premiums generated by SCOR from the business in 2006, thus putting the final entity in the group into run-off.

### Swiss Re acquires GE Insurance Solutions (GEIS)

Swiss Re announced in mid-November that it was buying GEIS, the commercial and reinsurance business of GE, for around \$7bn, made up of cash and shares. As a result of the deal, Swiss Re expects to gain access to new markets, especially in the US, and to overtake Munich Re as the world's largest reinsurer. GE will, at least for the time being, become the largest shareholder in Swiss Re, and will have the right to nominate a director to the Swiss Re board. The credit rating agencies all took a negative view of the proposed acquisition, saying that they were likely to downgrade Swiss Re by one notch if it went ahead, mainly on account of the risks associated with executing such a large acquisition and fears that GEIS reserving was not as strong as that of Swiss Re.

### Problems at XL

In November, XL lost its long-running dispute with Credit Suisse (CS) over the reserving levels at Winterthur Swiss Insurance Company, which it acquired from CS in 2001. The companies had failed to agree over the amount of the payment due to XL, under the terms of the acquisition, to bolster the reserves, the difference between the parties being over \$1bn. As a result, a binding independent actuarial review was carried out, and this resulted in an estimate much nearer to that of CS. As a consequence, XL needs to increase reserves by \$830m and is planning to raise additional capital of around \$650m to avoid (or ➤)

## From the world of general insurance

► reverse) a downgrading by the credit rating agencies. This latest problem at XL follows second-quarter catastrophe losses nearing \$1.5bn and correction of estimated reserving shortfalls of over \$180m arising on NacRe business acquired in another major deal in 1999.

### KWELM

Creditors of the KWELM group of companies received their final dividend in December. The average total payout for the companies – Kingscroft Insurance Co Ltd, Walbrook Insurance Co Ltd, El Paso Insurance Co Ltd, Lime Street Insurance Co Ltd, and Mutual Reinsurance Co Ltd – was said to be increased by these payments to an average of 88.7% of liabilities. The companies entered a scheme of arrangement in 1993.

### Compensation Bill

The UK government published its new Compensation Bill at the end of October. This would restrict the activities of claims management service companies, and give courts more leeway to reject personal injury and other claims. The claims management service companies would need to be authorised by a regulatory authority and comply with a code of conduct especially in relation to their advertising and selling. The courts would be allowed to consider whether their decisions might discourage the provision of a socially desirable activity and, hopefully, lead to a reduction in frivolous claims.

### Solvent schemes of arrangement

British Aviation Insurance Company Ltd (BAIC) has withdrawn its appeal against the High Court decision to refuse to sanction the proposed solvent scheme of arrangement, as reported in earlier issues of *The Actuary*. At much the same time, a judge did sanction solvent schemes for Scottish Eagle and La Mutuelle du

Mans, for both of which a single meeting of creditors was considered acceptable unlike the decision in the BAIC case. It is clearly necessary to take account of the details of particular companies and their proposed schemes before deciding whether they are worth pursuing.

### Deep-vein thrombosis (DVT)

The House of Lords has ruled that the development of DVT by airline passengers is not an 'accident' under the terms of the Warsaw Convention. It is not therefore compensable by the airlines or their insurers. This decision is thought likely to put an end to the issue in the UK, and to have a positive impact for insurers in relation to similar claims in other jurisdictions.

### Large losses

There has been a relative lull in claims activity since the last report – not before time, insurers and reinsurers would feel. Loss updates and related issues include:

■ **Hurricane Wilma (17–24 October 2005)** There has been a general tendency to increase estimates of the cost of claims arising from this event, with Risk Management Solutions increasing its estimate of insured losses in Florida to \$8–12bn, significantly above previous estimates, as a result of the particularly high wind-speeds in the Miami area. This is in addition to an estimated \$3bn incurred in the Yucatan Peninsula area of Mexico.

■ **Hurricane Beta (30 October 2005)** This was the 23rd named storm and the 13th hurricane of this year's North Atlantic season, breaking both previous records. It caused significant mudslides and floods in Nicaragua and Honduras, although insured losses are likely to be modest in view of the relatively low insurance penetration.

■ **Indiana Tornado (5–6 November 2005)** This event, which also had some impact on northern Ken-

tucky, caused at least 23 deaths and significant damage over a limited area – insured losses are not expected to be very material, but could be concentrated in a relatively small number of local insurers.

■ **French riots (late October/early November 2005)** These occurred in a range of suburbs of 15 or so French cities over a period of two weeks or so, resulting in significant property damage and the burning of a large number (possibly 7,000) of vehicles. The overall insured cost is estimated to be of the order of €200m.

■ **Tropical Storm Gamma (20–21 November 2005)** This struck the coasts of Belize and Honduras, causing flooding and at least 14 deaths. Insured losses are expected to be modest.

■ **Flooding in Sri Lanka (22 November 2005)** This resulted from exceptionally heavy rainfall (7 inches in 20 hours in some places), and caused the evacuation of 20,000 people from their homes, including many tsunami survivors. Insured costs are not likely to be material.

■ **Explosions and fire at oil storage depot at Buncefield, near Hemel Hempstead, England (11 December 2005)** This started with an explosion at 6am on Sunday morning, which was fortuitous from a human perspective, in that there were no fatalities and only limited injuries, none of them life-threatening. The fire continued for several days, and consumed many of the tanks of oil, containing oil estimated to be of value of up to £200m. In addition, large parts of the adjacent business park were destroyed and many surrounding homes and other buildings were seriously damaged. Significant business interruption occurred, especially to businesses with an involvement in the business park. The site was run by a consortium of oil-related companies, and it is understood that a significant part of the cost is likely to be covered by their captive insurers – however, it is early yet to be sure of the impact on

the commercial insurance market.

The US government flood insurance programme has been significantly extended as a result of the impact of hurricanes Katrina and Rita, with the maximum amount payable being increased from \$3.5bn to \$18.5bn.

The amount of capital raised by the global reinsurance industry since hurricane Katrina in August 2005 has increased to \$11.2bn, of which \$4.2bn relates to new start-ups. It has been estimated by Munich Re that premium rates for natural catastrophe insurance and reinsurance will increase by between 50% and 70% as a result of the adverse experience in 2004 and 2005.

Lloyd's has announced updated estimates of its hurricane losses. These are now said to be £1.9bn for Katrina (up from the original estimate of £1.4bn), £535m for Rita, and £483m for Wilma. It now believes that an overall profit for 2005 year is unlikely. As a consequence of increased premium rates for catastrophe business, the Lloyd's market capacity for 2006 is now estimated to be £14.7bn, an increase of 7% over 2005.

Meteorologists at Tropical Storm Risks have predicted a 'highly active' hurricane season in 2006, with activity being in the top one-third of those seen historically – so it's a happy new year to all of you!

### 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](http://www.actuaries.org.uk/Display_Page.cgi?url=/general_insurance/gen_ins-curr-issues.html)

The latest issue is dated December 2005 and covers government and regulatory issues, Solvency II, international news, claims and legal issues, and market news.

 DAVID HART

## From Court 76

Financial Times, 3 December 2005

(extract)

'The long-running and highly controversial litigation brought by Equitable Life against its former directors and auditors finally shuddered to a halt yesterday as the society agreed to pay legal costs incurred by nine of its former board members.

'Equitable first filed the multi-billion pound claims against Ernst & Young, its former auditors, and 15 former directors, in April 2002. Last night, it had nothing to show for its efforts but a bill for legal costs totalling £45m.

'The last two to settle were Jennie Page, ... a former non-executive director who is probably best known as ex-chief of the Millennium Dome, and Chris Headdon, the society's former chief executive and appointed actuary.

'Even so, Ms Page was clear that, given how far matters had progressed, she would have preferred to have seen a final judgment in the case and even in the final stages tried to negotiate for a statement in court at the very least. "I'd have preferred that policyholders had had the opportunity of Mr Justice Langley saying something to mark the end of these proceedings, but the society refused to allow a hearing," she said.

'Those views were generally echoed by Mr Headdon, who still faces the prospect of pro-

fessional disciplinary proceedings. He, too, says he would have welcomed a final judgment, objectively weighing up the evidence. "It is regrettable that policyholders have not had the benefit of hearing Mr Justice Langley's views," he commented. Having acted as a litigant-in-person for much of the proceedings, and been obliged produce copious submissions and even prepare to cross-examine some witnesses, he will be paid £450,000 by the society to cover legal and other costs.

'Of the society's final bill of £45m, about £35m represents its own costs. Add the legal expenses shouldered by other parties and the entire litigation has cost more than £70m; all to no avail, beyond grief on all sides.

'Had the parties not settled, they were due to go back to court on December 12 to make final submissions to the judge. Although negotiations had been under way for weeks, this meant that Equitable had to deliver its closing submission in early December, and the defendants a few weeks later. All that work was duly done before the final deals were struck and the entire effort made largely redundant. "Ever since the Ernst & Young settlement, this has been dragged out and dragged out", said one lawyer. And that, he pointed out, simply added to the costs bill which policyholders have ultimately had to shoulder.'

Equitable Life letter to policyholders, 2 December 2005 (extract)

'In his report into the near collapse of Equitable Life, Lord Penrose said that the Society was "the author of its own misfortune". His Lordship concluded that decisions were made by the previous Board which resulted in dire financial consequences for policyholders and for the Society as a whole; decisions that nearly put your society out of business.

'Lord Penrose reached clear and forceful conclusions as to the downfall of the Society. However, we must accept that it is a different matter to satisfy a Court that the role of the former directors constitutes a responsibility that leads in law to culpability and redress.'

## New longevity index

Credit Suisse First Boston has launched a new index of longevity for the US population apparently intended to facilitate the trading and hedging of longevity risk. The index is published annually. Actuarial consulting firm Milliman is acting as calculation agent for Credit Suisse in the creation and development of this index. More at: [www.csfb.com/institutional/fixd\\_income/longevity\\_index.shtml](http://www.csfb.com/institutional/fixd_income/longevity_index.shtml)

## Reach for the top – bag a Munro!

For details, see p44



Climbing Ben Lomond, 8 January 2006

