

Equitable and Penrose From Court 76

Editor's note: Following the coverage of the ending of the Equitable Life litigation in last month's issue, we have received the following letter from one of the defendants, Chris Headdon.

'I was surprised to see that, in covering the collapse of Equitable Life's litigation against me and a number of my former co-directors, you should have chosen to accompany the independent reporting from the *FT* with a clearly partisan extract from the Equitable's own letter of "explanation" to its policyholders.

'At least two substantive points can be made about the extract from the letter you quoted. First, it is highly surprising that the Equitable should now seek to invoke Lord Penrose's report in justifying its ill-judged litigation for two reasons:

- ♦ The charges of negligence on which the litigation was based were entirely different from Lord Penrose's conclusions.
- ♦ The Equitable itself published in October 2004 a document entitled "The Penrose Report – Policy Value Reductions and Alleged Overbonusing" which rejected the principal conclusions of the Penrose report. The document is still available on the "Corporate/Lord Penrose" area of the Society's

website and it was frequently referred to in court.

'Second, the comment about "dire financial consequences for policyholders" in the letter extract is not borne out by the objective evidence. Although implementing the House of Lords' decision in *Hyman* caused a transfer of value between different policyholder groups, I produced evidence to the court, which was not challenged in any way by Equitable, which showed that, based on the 2004 FSA industry survey, Equitable policy results across a range of products were typically around the 75th percentile. That position also appears consistent with current information from policyholder message boards that, even in some cases where the FOS has judged there to be mis-selling, no compensation is being paid because policyholders have suffered no loss when their position is compared with a sample of other offices.

'More generally, if any reader has not read the article "Staying Power" by David Strachan of the FSA, published in the October 2004 issue of *Money Management*, I would recommend them to do so. The article shows, I believe, how deeply flawed was the Penrose report through its failure to put its specific findings about Equitable into an industry con-

text, despite an explicit requirement in the inquiry's terms of reference to have regard to market practice. Perhaps even at this late stage it is not too late for a proper professional debate about that and the other inadequacies of that report, given the mischief that has flowed from it.'

European Parliament investigation

The European Parliament's committee of inquiry on Equitable Life will be chaired by Mairead McGuinness (EPP-ED, Ireland) and its rapporteur will be Diana Wallis (ALDE, United Kingdom). These appointments were confirmed at the committee's inaugural meeting on 2 February in Brussels. Committee chair Mairead McGuinness announced at the outset that the committee's work is likely to take 12 months and that no conclusions will be drawn before it has completed its work. She indicated that the committee will not go beyond its mandate, though she added that it will also seek to draw conclusions useful to MEPs in their future legislative tasks. Mrs Wallis noted that the committee aims to demonstrate to citizens that laws are properly enforced at the European level and that there are avenues for redress where this is not the case.

BUPA and VHI

The actuarial and competitive economics of health insurance pricing are likely to be exposed in a court case currently going on in Ireland where BUPA is challenging the minister for health's recent decision to activate the provisions of an actuarially designed risk-equalisation scheme. The scheme was originally designed some years ago in order to sustain the community rating system traditionally operated by Ireland's Voluntary Health Insurance (VHI), which continues to account for 80% of the market.

The battle is likely to continue on several fronts, as the press reported that BUPA was encouraging its members to lobby their local politicians in opposition to the higher premiums which would be a consequence of risk equalisation.

BUPA said: "'Risk equalisation" would compel us at BUPA Ireland to pay out over twice our profits each year to subsidise our major state competitor. No company could afford to do that. It would destroy the choices that our

customers have already made. All consumers in the health insurance market would lose. We want to give you more choice.'

Meanwhile VHI told its members: 'BUPA generates a rate of profitability in Ireland, which is three, or four times the rate of profitability earned by the same company in the UK. BUPA claims to be cheaper than VHI Healthcare yet its operating expense ratio is as much as 50% higher than that of VHI Healthcare. The activation of risk equalisation will mean that these excess profits will in future have to be transferred into a risk equalisation fund and be used for the benefit of the Irish healthcare consumers. The HIA has concluded that BUPA will be in a position to make risk equalisation transfers and generate the same level of profitability in Ireland as it does in the UK.' VHI continued: 'The fact that BUPA supports community rating and risk equalisation in Australia, where it is a net recipient of transfers, totally destroys its credibility in arguing against risk equalisation in Ireland.'

Turner debate

Throughout January and February debate has continued on the analysis and recommendations of the Pensions Commission, as reported in our January/February issue (see Lord Turner's answers to questions from *The Actuary* on p36 of this issue). We were struck by the following assessment from Aon Consulting:

'We do not think the Turner recommendations are likely to be implemented, despite the fact that many of them have been welcomed by the industry.

'The proposals amount to a radical reform of the UK pensions system. No country has ever implemented radical reform of its pension system unless the reform has had the active, personal commitment of the minister responsible for finance. It is clear that Gordon Brown does not have this commitment to the Turner recommendations.

'Nevertheless, Turner's analysis and recommendations are likely to have an influence on pensions policy in the longer term, and are certain to be the subject of intense debate over the next 12 months.'

From the world of general insurance

Asbestos developments

In December, James Hardie Industries NV (JHI) signed the largest-ever Australian asbestos claim settlement, amounting to A\$3.4bn. The settlement related to claims against three former subsidiaries of JHI brought by claimants adversely affected by asbestos. The overall amount will be paid in instalments, with an initial payment of A\$115m into a special-purpose fund. Further payments capped at 35% of the company's net cashflow will be made in future years. It followed the relocation of the company to The Netherlands in 2001, leaving a fund in Australia inadequate to compensate claimants. Following this case, an Australian government committee has asked for comments on proposed changes to the Corporations Act 2001, by which it would hope to reduce the risk of similar problems in future.

The UK High Court has ruled that a Ministry of Defence (MOD) dockyard boilermaker who died from lung cancer and asbestosis after many years of exposure to asbestos fibres had contributed to his own death because he had also smoked 20 cigarettes a day for many years. As a consequence, the court reduced his award against the MOD by 20%. This is likely to become a precedent for other smokers who are also exposed to asbestos in their workplace.

Another decision in UK, this time from the Court of Appeal, has ruled that anxiety caused by the asbestos-related condition pleural plaques should not be compensable, on the grounds that pleural plaques rarely develop into asbestos-related disease. The decision, which reversed a High Court ruling from 2005, and is in direct conflict with general practice over the past 20 years or so, is likely to be appealed to the House of Lords, but if the decision is upheld, it is estimated to benefit the insurance industry by £1.4bn. As one would expect, insurers and related

parties were delighted by the decision; claimant representatives were very negative in their reactions.

There have been three recent developments in relation to reorganisations in bankruptcy of major US asbestos producers. Armstrong World Industries Inc has had its 2003 plan thrown out by a federal court on the grounds that it provided for benefits to the parent company by way of dividends prior to the liabilities to injured claimants being met in full. On the other hand, in the case of Babcock & Wilcox (B&W), a federal bankruptcy judge has recommended approval of the plan under which the parent company, McDermott International Inc (MII) would pay \$350m into an asbestos trust fund, with B&W and MII additionally providing funds totalling over \$600m unless federal asbestos reform legislation has been enacted by the end of November 2006. This recommendation is now subject to confirmation by a district court judge and by shareholder groups. On a more general basis, a Californian appeals court ruled in January that a provision in federal bankruptcy law to facilitate the payment of damages to asbestos claimants does not remove insurers' contractual rights, and the insurers therefore have a right to challenge the provisions of a trust set up by a bankrupt company to pay asbestos liabilities. This did not, however, relieve insurers of their coverage obligations. This decision came out of a dispute relating to the Fuller-Austin Asbestos Settlement Fund.

In early February, the Fairness in Asbestos Injury Resolution Act was expected to be brought before the US Senate, as one of the first pieces of legislation of the new year. However, insurers are almost unanimous in opposing it in its current form, principally on the grounds that it does not provide finality to insurers, who would be expected to contribute \$46bn towards the overall \$140bn trust fund which would be established if the act became law.

Terrorism

In mid-January, a decision was reached on some of the issues in dispute in a World Trade Center case in New York. The case had been brought by the insurers of Consolidated Edison Company of New York, who had paid claims on behalf of the utility company arising out of the collapse of 7 World Trade Center following the terrorist attacks, and were seeking to subrogate those claims against various third parties on the grounds of contributory negligence. The federal judge dismissed all such claims against the City of New York which has immunity from liability under state law. He also dismissed various other parties from the case, but left intact certain claims against the Port Authority of New York and New Jersey (owners of the property), 7 World Trade Co (manager of the property), Citigroup, and various design and construction professionals. A case conference was scheduled for 1 February to progress these outstanding issues.

The Terrorism Risk Insurance Extension Act was signed into law by President Bush, but immediately came under a degree of criticism, mainly on the grounds of potential for future problems. In particular, it was considered that the arrangements for reviewing the future of terrorism cover after 2007 were likely to be inadequate. These mirrored the Senate version of the original proposals (a presidential working party) rather than those suggested in the House of Representatives (a broadly based commission of inquiry). There was a concern that the president's wish to terminate federal involvement in terrorism cover at the earliest opportunity would unduly influence the review. The Risk & Insurance Management Society Inc has volunteered to provide a policyholder representative on the working party.

Lloyd's

Lloyd's has published a three-year plan, under which it would aim to

attract and retain corporate investment in the market by simplifying access and offering good stable returns. In particular it would attempt to develop capital requirements for syndicates which were based more on their individual performance and characteristics. It would also attempt to expand its business in the United States, possibly by gaining the status of an admitted insurer (currently it is admitted only in Illinois, Kentucky, and US Virgin Islands). Lloyd's is also anticipating expansion in India and China. Finally, it is aiming to develop improved efficiencies, for instance by establishing an improved claims-handling infrastructure.

Separately, the Lloyd's Franchise Board terminated funding to the Kinnect electronic data platform, which was described as 'not optimal' and which subsequently stopped transacting business. The cost of the project to Lloyd's has been about £70m.

American International Group (AIG)

In mid-January, Maurice Greenberg, ex-chief executive of AIG, accused Eliot Spitzer, the New York attorney general, of collusion with AIG in relation to the moves which led to his departure last year – his lawyers also sought to depose Mr Spitzer and Howard Mills, the New York State insurance superintendent, in relation to these accusations.

Meanwhile, AIG has been fined over \$500,000 by the Florida Office of Insurance Regulation for allegedly misreporting financial data and failing to provide the required information on workers compensation business, and (apparently unconnected) Donald P Kanak, the chief operating officer, has resigned for personal reasons.

Goshawk Insurance Holdings (Goshawk)

Goshawk has announced that the solvency margin of its reinsurance subsidiary Rosemont Re has ➤➤

From the world of general insurance

► dropped below the statutory minimum required by the Bermudian regulator. This results from a combination of the need to recognise additional liabilities and further reserves being set for hurricanes Katrina, Rita, and Wilma following a review by the new board and management of Goshawk. Meanwhile, efforts continue to organise the run-off of the Goshawk companies – so far the most obvious activity has been the sale of renewal rights to Ariel Re.

Financial Services Compensation Scheme (FSCS)

The FSCS has announced that general insurers will receive a refund totalling around £42m in 2006, rather than having to pay the usual annual levy. This has arisen as a result of the lower compensation payments for insurance insolvencies in 2005. In addition, there have been substantial recoveries made from the estates of insolvent insurers. It is likely that the situation will return to normal (ie a levy) in 2007.

US collateral requirements

Lord Levene, the chairman of Lloyd's, has criticised the requirements of the US 'credit for reinsurance' regime, which mean that 'alien' reinsurers must post collateral equal to 100% of their gross liabilities. He estimated that the overall

annual cost of meeting these requirements was in excess of \$500m, of which the Lloyd's contribution was over \$150m. He pointed out that Lloyd's had been required to increase its US funds to over \$10bn following the hurricanes this year, and that the United States was out of line with other reinsurance markets in this respect and, in particular, suggested that catastrophe risks should be left to free markets.

Large losses

Loss updates and related issues include:

■ **Two aircraft crashes (early December)** An Iranian military plane crashed into an apartment block in Tehran, killing 108 passengers, mainly local journalists and photographers, and a South-West Airlines Boeing 737 skidded off the runway in a snowstorm at Chicago Midway Airport onto a road junction, killing one child and injuring 11 other people. These crashes brought the overall number of aviation losses in 2005 to a level reasonably in line with long-term trends. Fatalities, at 913, from 19 fatal accidents, were higher than in any of the preceding four years (these were exceptionally low years, averaging just over 600), but closely in line with the figures for the years 1996–2000, which averaged just over 1,000, and showed some reducing trend. The total insured losses for 2005 are estimated at around \$1.3bn. There is likely, as

a consequence, to be continuing downward pressure on premium rates.

■ **Explosions and fire at oil storage depot at Buncefield, near Hemel Hempstead, England (11 December 2005)** The latest available estimate of insured losses suggest a figure of £200m, most of it to the industry mutual, OIL Insurance Ltd. Consequently the impact on the energy insurance market is likely to be modest, and certainly not of a similar order of magnitude to the impact of the Gulf of Mexico hurricanes earlier in the year.

■ **Storms in northern California (1–3 January)** More than 9 inches of rain fell in some parts, including the Napa valley wine-growing region. Floods and mudslides led to the declaration of disaster areas in 23 counties, with early estimates of loss being up to \$200m.

■ **Collapse of ice rink in Bad Reichenhall, southern Germany (2 January)** Fifteen people, several of them children, died when the building collapsed under the weight of snow. Liability insurance was placed with a local municipal insurer. No estimates of insured losses are to hand.

■ **Winter storms in north-east of United States (14/15 and 18/19 January)** These storms have both been declared as catastrophes. Insured losses are believed to be over \$50m, mainly caused by the high winds experienced.

According to Swiss Re, natural catastrophe insured property losses in 2005 amounted to about \$80bn, over half of it relating to hurricane Katrina. Thus the year was the costliest on record. Nevertheless, the insured cost was only a relatively small proportion of the total financial cost, estimated at \$225bn, with a death toll of 112,000 heavily influenced by the 87,000 killed by the Pakistan earthquake.

The impact of the adverse catastrophe loss experience on premium rates for 1 January renewals has been less marked than appeared likely earlier in the process. The rates for risks directly exposed to the hurricanes in the Gulf of Mexico, and for retrocessional cover, have increased substantially, but elsewhere the impact has been limited. It is thought that this results largely from the amount of additional capital coming into the industry during the past few months. It is, however, considered that further adjustments might arise on renewals later in the year.

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

How many centenarians?

According to figures produced by the Government Actuary's Department, the novelty of living to 100 years may disappear. Adrian Gallop, who headed the team that compiled the projections, said: 'This has to be a speculative calculation. And these are not the numbers government departments are likely to use. An epidemic like bird flu – or an obesity pandemic – could flatten it all out.' He said: 'We tend not to look at factors such as lifestyle choices, diet,

and smoking in much detail. If improvements in mortality rates continue as in recent years, we could have 1m centenarians by 2074. But if rates of improvement fall back to historic levels, the figure is likely to be around 350,000.'

Emily Grundy, professor of demographic gerontology at the Centre for Population Studies at the London School of Hygiene and Tropical Medicine, warned that government

estimations are often dubious. 'They are brave to try and calculate this', she said. 'I wouldn't. There's been a great deal of discussion about the government's methodology. The assumptions they employ seem to vary over time, and veer from being conservative to optimistic; [improvements] in mortality [rates] in countries like Denmark and The Netherlands, for example, have ceased, which likely means no extra centenarians at all.'

Contrasting views on the actuarial profession

Late January saw the near-simultaneous appearance of sharply contrasting views of the actuarial profession in the pages of the *Financial Times* and *The Economist*.

'This may sound like ranking Michael Bolton above Celine Dion in terms of musical merit, or expressing a preference between contracting bubonic plague and ebola, but, on reflection, I think I would rather be an actuary than an accountant' was the opening to an *FT* article by Sathnam Sanghera on 27 January. Sanghera apparently was very impressed by the stories told by three Mercer actuaries as to what they did and how much they were paid for it. Perhaps inevitably, this lighthearted piece provoked reactions from both professions, with Eric Anstee complaining gently about stereotyping of members of the Institute of Chartered Accountants in England and Wales as 'bean-counters' while actuary Hyman Wolanski was dismayed that Sanghera's article might lead the public to expect actuaries to display personality!

Sobriety was all too quickly restored by the following day's issue of *The Economist*, which opened a review of pensions problems with 'Among the many jokes about actuaries, one cruelly hits the mark. An actuary and a farmer are looking at two fields of sheep. The farmer asks the actuary how many sheep he thinks there are: "1,007", is the quick and confident reply. The astounded farmer asks how the

actuary reached that number. "Easy, there are seven sheep in that field and about 1,000 in the other."' From the point of view of the profession, the theme of the article was that actuaries bore most of the responsibility for historical mismanagement of pension fund finances but that it was also actuaries – led by heroes Exley, Mehta, and Smith – who had pointed up the errors of old ways and stimulated change which made Britain a leader in exploring the possibilities of liability-driven investment. *The Actuary* welcomes comments from readers on this interpretation of our history!

The Economist of 18 February carries several responses to the original article, including one from Donald Segal of the American Academy of Actuaries defending work with government to strengthen the pensions system. Others were more pessimistic or cynical:

- ◆ 'Reducing all future liabilities to net present value to compare them with current assets, and then advocating immediate corrective action, has actually promoted short-termism and risk aversion, which is a bad thing.'
- ◆ 'Workers are being led into retirement plans that will fail them. The future will be ugly.'
- ◆ '... corporate managers are also to blame for searching high and low to find actuaries who would supply such inaccurate forecasts in order to lower pension costs and improve profits.'

and their attention is firmly on the UK', explains Steve Holt of Aon. 'Smaller banks are more vulnerable to takeover as these overseas players are anxious to avoid the attention of the Monopolies and Mergers Commission.' Holt believes that there will be consolidation among Britain's smaller banks and that once one merger happens it will trigger a domino effect across the industry.

'The UK marketplace is overbanked', continues Holt. 'That means if there is not more consolidation in the sector then cost-cutting is the only alternative. There will still be a role for boutique banking for high-net-worth consumers, but the general trend is towards banking online or at the supermarket.'

Are the UK banks, many of which are also leading insurance players, set to follow the growing number of household names in other sectors which are moving into foreign ownership? Would this be good or bad news for UK consumers and corporates? *The Actuary* welcomes readers' views.

New standards for Australian insurers

Australia's financial services regulator has released new standards in the second stage of its ongoing reform of general insurance regulations. The Australian Prudential Regulation Authority (APRA) said the three standards that make up the 'stage 2' reforms address recommendations of the HIH Royal Commission that were part of the commission's 2003 report on the collapse of general insurer HIH Insurance Ltd. The three new standards, covering risk management, reinsurance, and audit and actuarial reporting, 'clarify and strengthen APRA's previous requirements in risk and reinsurance management and emphasise the importance of documenting reinsurance contracts for more certainty', APRA said.

Included in the new standards are requirements for:

- ◆ a business plan that includes the insurer's ability to meet future capital requirements;
- ◆ senior management to provide a financial information declaration annually, with documentation of reinsurance arrangements;
- ◆ prior approval of limited [finite] risk-transfer arrangements; and
- ◆ approved actuaries to prepare an annual report on the company's financial condition.

APRA-regulated general insurers must comply with the new standards beginning 1 October 2006.

GI software survey

From Louise Pryor's monthly newsletter:

'If you work in general insurance, you'll probably know about GIRO, the general insurance conference held each year by the Actuarial Profession. I'm currently chairing the GIRO working party on software use, which is looking into what software GI actuaries (and others) use, and how they use it. As our first step, finding out what software is actually used, we are conducting an online survey. So, if you work in GI, as an actuary or otherwise, we'd really appreciate if you'd help us out by completing the survey, which is at www.surveymonkey.com/s.asp?u=891841542723.

'There's a prize of a bottle of champagne for one lucky participant!'

Funding pensions deficits

As we went to press, consultation had closed on the proposals by the Pensions Regulator in relation to the pace of making good pension

fund deficits. Most of the public responses took the view that the proposals were too stringent and inflexible and would run the risk of causing serious damage to the UK economy. Fears were expressed that the estimated £27bn annual cost of the proposals (an amount coincidentally similar to the 'savings gap' identified by life insurers) would reduce business investment and cause serious misallocation of national resources.

Next steps will be for the regulator to publish a summary of responses received and to consider the scope for enhancing the flexibility of its proposals.

Banking sector for sale?

The retail banking market in Britain is set for a big shake-up, according to Aon Consulting. This will be through a mixture of domestic consolidation and further takeovers by US and European banks.

'Foreign banks are in an acquisitive mood