

## From the world of general insurance

### Asbestos developments

A decision from the UK Court of Appeal has ruled that the public liability insurer providing coverage at the time of manifestation of a claimant's mesothelioma, rather than at the date of ingestion of the asbestos fibres, is liable to pay the claims. As a consequence, Municipal Mutual Insurance Ltd, rather than Commercial Union Assurance Company Ltd, will be required to compensate Bolton Metropolitan Borough Council, in the particular case being appealed.

The US building products manufacturer USG Corp has agreed a deal under which a trust fund of \$3.95bn will be established for the settlement of asbestos-related claims, with a view to the company emerging from bankruptcy. The fund is to be financed by \$900m of cash and the balance by means of a contingent note which will be cancelled in the event of the US Congress establishing a national compensation fund.

As indicated in the last issue of *The Actuary*, the Fairness in Asbestos Injury Resolution Act was considered again by the US Senate in early February. It voted almost unanimously to continue to debate the proposals for the creation of a \$140bn trust fund, and the president formally endorsed the bill. Strong support was given by representatives of the asbestos manufacturers, while the insurance industry remained opposed to various aspects of the proposals, particularly the lack of finality provided. Subsequently, a proposal to incorporate medical criteria for asbestos claims was rejected by the Senate. However, a major development occurred a week or so later, following the failure to pass a vote on a point of order relating to the violation of congressional rules, when the Senate voted 58-41 to block the bill, although there remains a considerable body of opinion, inside and outside the Senate, who support the idea of developing an alternative bill to reform the way in which asbestos claims are handled.

### American International Group (AIG)

At the end of January, AIG obtained a temporary restraining order against its ex-chairman and chief executive, Hank Greenberg, to stop him from poaching AIG business for his new firm CV Starr & Co, a company with which AIG has historically had a close relationship, and which is named after the founder of AIG. This order was extended a couple of weeks later, and AIG severed all links between the companies.

Charges were brought against Christian Milton, former vice-president of reinsurance at AIG, together with Ronald Ferguson, Elizabeth Monrad, and Robert Graham, all formerly senior officials of General Re, involving security frauds and the making of false statements to the Securities & Exchange Commission (SEC). The Department of Justice alleged that these individuals were involved in a scheme to make it appear that AIG had increased its loss reserves. The accused have pleaded not guilty, and the case will proceed to trial in Virginia in May.

On 9 February, AIG reached a settlement with the SEC, the New York attorney general, and the New York State Insurance Department, in relation to the investigations into allegations of irregularities in the company's accounts. It is understood that a payment of \$1.644bn (of which \$800m goes to the SEC, \$375m to policyholders harmed by the rigging of premiums, \$344m to states where the company's workers compensation practices caused harm, \$100m to the State of New York, by way of penalty, and a \$25m fine to the Department of Justice) was made by AIG, that it apologised for problems caused to policyholders and investors and that it agreed to change certain business practices; it did not, however, admit any wrongdoing. It is understood that the main credit-rating agencies do not consider that these penalties justify a reduction in the group's ratings.

Subsequent to the above settlement, the Minnesota attorney general raised fresh charges against the

company in relation to alleged misreporting of workers compensation premiums. In so doing, the state effectively rejected its share of the \$344m mentioned above.

### Finite risk reinsurance and contingent commissions

It is thought that the New York attorney general, Eliot Spitzer, will seek settlements with other insurers now that the AIG investigations have been brought to a conclusion (see above). Odyssey Re Holdings Corp is one of the potential targets; it announced in February that it was restating its financial results for the last five years to reflect a change in the treatment of a small number of ceded finite risk reinsurance contracts.

### Alea

Following its recent move into run-off, Alea warned that, after allowing for further hurricane losses, deterioration of reserves, and restructuring costs, it expects to post a loss of over \$200m in the current year. The reserve additions required amount to at least \$69m, and relate to US liability business, partly written as insurance, partly as reinsurance. The company also warned that if the loss increases much further, it will be in breach of a banking covenant in its credit agreement, which could lead the bank to foreclose. AM Best withdrew all credit ratings.

### PX Re

PX Re, the Bermudian reinsurer, has announced seriously adverse results for the fourth quarter of 2005, which have reduced the net asset value to less than half its level at 30 September. The principal factor causing the deterioration is a massive increase in the estimated cost of the recent hurricanes, with the overall cost now over \$1bn gross, and over \$800m net of retrocessions. The fourth quarter increase is \$326m gross, \$361m net, with the majority of the increase relating to Katrina. Following these results, the company has been downgraded by

the rating agencies to a level at which various of its contracts, especially its retrocessional protections, can now be cancelled by the counterparty. PX Re is said to be considering its options for the future.

### Swiss Re

Following the publication of Swiss Re's 2005 annual accounts at the beginning of March, AM Best confirmed that the company's ratings would remain under review with negative implications, as it has been since last November. The rating agency was particularly concerned by the deterioration in the company's results for liability business where there had been the need for a significant increase in reserves, resulting in an increase in combined ratio from 118.7% in 2004 to 126.4%. AM Best said it would be discussing with the company the scope for further reserve deterioration on this class of business, and also its planned acquisition of GE Insurance Solutions Corp.

### US collateral requirements

At the World Insurance Forum in Bermuda in February, European insurance industry leaders increased pressure on the US authorities to ameliorate the reinsurance collateral requirements for alien reinsurers, to which reference was made recently by Lord Levene, chairman of Lloyd's, as reported in these columns last month. They did not, however, expect quick results leading to a level playing field.

### UK motor claims

Department of Transport statistics show a steady decrease in the frequency of non-comprehensive motor claims, with an overall reduction from 360,000 in 1997 to 250,000 in 2003. Nevertheless, average costs of claims have increased to such an extent that the overall cost has risen from £753m in 1997 to nearly £900m in 2003. By comparison, both the numbers and amounts of claim under comprehensive policies have increased over

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▶ the same period. Numbers are up from under 2.5m in 1997 to over 3m in 2003, and total amounts from under £3.2bn in 1997 to £5.174bn in 2003. The statistics also show that the number of people killed or seriously injured in UK car accidents fell from over 46,500 to 37,215 in the same period.

### Large losses

Loss updates and related issues include:

■ **Winter storms in north-east of United States (14–15 and 18–19 January)** Insured losses are now believed to be over \$100m for each of these two events.

■ **Collapse of exhibition centre roof in Chorzow, Poland (29 January)** This resulted in the death of 66 people who had been attending a racing pigeon event. It is understood that this, like the collapse of the ice rink in Germany earlier in the month, was caused by the weight of snow on the roof. It is understood that Allianz, as insurers of the liability risk, has paid claims totalling Zloty5m (nearly £1m).

■ **Collision and sinking of chemical cargo ship *Ece* in the English Channel (31 January)** This occurred near Guernsey, and did not involve any loss of life. The cargo was phosphoric acid which would dissolve in the water and was unlikely to cause any pollution risk. The ship was insured by the North of England P&I club; no insured loss estimate is to hand. The other vessel involved was a bulk carrier, *General Grot-Roweck*, insured by the Gard P&I club; it was able to continue its journey.

■ **Sinking of Egyptian passenger ferry *Al Salam Boccaccio* in Red Sea (3 February)** This is understood to have been caused by a fire on the car deck, and tragically resulted in the loss of an estimated 1,000 lives. The hull was insured in the Lloyd's market and is likely to cost approximately \$50m. The ferry owners have said they will pay compensation of 150,000 Egyptian pounds (approximately £1,500) for each of the lost passengers; this is understood to be covered by Steamship Mutual

Underwriting Association, the liability insurers.

■ **Winter storms in north-east of United States (11–12 February)**

This resulted in record levels of snowfall in New York (26.9 inches in Central Park), but the cost of damage is not thought likely to reach the \$25m level at which it ranks as a catastrophe. The losses are expected to be mainly traffic-related, and are lower than they might have been if the storm had occurred during the working week.

■ **Theft of £53m in banknotes from Securitas cash depot in Kent (21 February)** This was the biggest-ever cash robbery in the UK. The primary insurance was placed with the Securitas captive, with excess coverage in the Lloyd's market.

■ **Collapse of market roof in Moscow (23 February)** This was once again caused by the weight of snow, and resulted in the loss of 56 lives. No insured loss estimates are to hand.

La Niña conditions have returned to the central Pacific for the first time since 2001. The fall in temperature in the tropical area of the central Pacific is thought potentially to give rise to increased hurricane activity during this summer and autumn.

There are concerns that the drought in many parts of UK over the past year or two could result in another surge in subsidence claims under household policies. It has been estimated that the situation is worse even than that in 1976, when the previous worst subsidence experience occurred, with some rivers and reservoirs in the south of England being at below 50% of their normal levels.

### 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)

 DAVID HART

## Windfalls or shortfalls?

An all-party Parliamentary group (APPG) examining the true cost of demutualisation among life companies and building societies has recommended that legislation be introduced requiring an independent check on 'windfalls' to ensure members' interests are being protected.

The report, 'Windfalls or shortfalls? The true cost of demutualisation', is based on the group's short inquiry, held in November. It comes shortly before Standard Life publishes the proposed payout to members in its proposed demutualisation this year. The report was launched on 7 March in Parliament.

The APPG report concluded that too many people in

previous demutualisations have not been clear on the benefits, or otherwise, of the proposals from their institutions and have not had sufficient evidence to make an informed decision. Often the only material they will have received comes from boards who are campaigning for a 'yes' vote.

Commentary on the report focused mainly on the imminent demutualisation of Standard Life and on the role of the independent actuary in relation to this.

More detail on the report can be found at: [www.accaglobal.com/pdfs/miscellaneous/appg\\_report\\_07mar06.pdf](http://www.accaglobal.com/pdfs/miscellaneous/appg_report_07mar06.pdf)

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## From the world of pensions

### Turner report

Despite initial negative reactions, the Turner analysis of UK pensions issues seems to be growing in influence.

The TUC says that it strongly backs the new pensions architecture recommended by Adair Turner's report of a National Pensions Savings Scheme (NPSS) with compulsory employer contributions unless an employee opts out, a restored link to earnings when uprating the state retirement pension, and a universal (rather than contributory) state pension which would provide particular help to women.

But the TUC remains opposed to helping pay for more generous pensions by increasing the state pension age. The submission says this would 'have little impact on the retirement age of the better-off, so it would be those on lower incomes who would be more likely to work longer to pay for better pensions... There is a four-year gap in life expectancy at age 65 between men in the highest socio-economic groups and men in the lowest socio-economic group. Among women the gap has increased over the past 20 years. Moreover, those from lower socio-economic groups are less likely to enjoy good-health in retirement.'

The TUC says that a permanent pensions commission above the day-to-day pressures of party politics could help rebuild trust in pensions. It should produce a four-yearly report including both research and recommendations to government.

TUC general-secretary Brendan Barber said: 'The Pensions Commission proposals make sense. In particular they offer a new deal to women and the increasing numbers of private sector employees who no longer have access to a decent scheme. Our one major disagreement is that we remain opposed to increasing the state pension age as it will hit the poor and those with stressful or physical jobs.'

'The future of pensions is now a big political test for this government. We do not underestimate the strength of the employer and indus-

try lobbying that is trying to get ministers to scrap compulsion or increase costs to give pensions companies a cut of a guaranteed market. But Adair Turner and his colleagues have won the intellectual argument for their proposals. The government should make clear they will implement them and then establish a broad but independent Pensions Commission that can help ensure a continuing consensus.'

Meanwhile DWP minister Stephen Timms seemed unimpressed by the alternatives to Turner's NPSS proposed by the Association of British Insurers and the National Association of Pension Funds. Perhaps he had read the post-Turner survey conducted by the Chartered Institute of Personnel and Development ([www.cipd.co.uk](http://www.cipd.co.uk)) which suggested that employers – including small employers – were much less concerned about the Turner proposals than some organisations would lead one to believe.

The actuarial profession continued to take a slightly jaundiced view of Turner's analysis pointing out that the Pensions Commission failed to address how pensioners should spend their retirement savings. The Institute of Actuaries will say Lord Turner has 'missed a trick' by presenting the savings process as a duty rather than a pleasure.

Michael Pomery, president of the Institute, says: 'We want retired people to take control of their finances. They need flexible retirement products, so they can adjust their income to meet their changing circumstances.' He cites the rising revenue take from inheritance tax as evidence that 'people are dying without having enjoyed the fruits of their lifetime savings'. In 1988, inheritance tax hit £1bn. This had risen to £2bn in 2000, and is expected to top £3bn this year.

### Valuation, funding, and asset allocation

Pensions issues continued in March to occupy a high proportion of the

financial headlines, as the implications of the gilts 'bubble' were debated. Some commentators were inclined to blame members of the actuarial profession for favouring investment in bonds at a time when these assets are unusually expensive. Others took the view that the system is at fault, and that actuaries, accountants, government, scheme sponsors, and the pensions regulator shared the blame for a drift to disaster. Meanwhile the list of firms paring back their commitment to defined benefit pensions continued to lengthen, with some exceptions (including HBOS and Aviva) taking concrete action to fund deficit positions.

It is not easy to see a way forward in this murk, and it is easy to reach the conclusion that the scheme governance model is fatally flawed. We were impressed with an impassioned plea from Sir Martin Jacomb (former chairman of Prudential) to accounting standards-setters to acknowledge that FRS17 is not necessarily 'true and fair' although the problem is that it is not at all clear what would count as true just at present.

The example of the UK was not lost on other countries, where there is growing controversy as to how to reconcile reasonable protection of members with reasonable treatment of sponsors. Moves in the Netherlands and in Belgium to tighten solvency requirements were criticised as potentially hastening the end of defined benefit provision in these jurisdictions. *The Actuary* understands that the European Commission is actively considering whether its planned Solvency 2 regime of prudential supervision should apply to pensions funds as well as insurers. Recent experience in the UK would suggest that it should proceed with extreme caution.

### Public sector liabilities

£500bn? £750bn? £1 trillion? Any advance on this as the measure of unfunded public sector pensions

obligations? Watson Wyatt was the author of the high estimate, also expressed as £40,000 for every single household in the UK. Several commentators used the figure to argue, not for the first time, that it was scandalous that the government had agreed not to raise retirement age for most public sector workers from 60 to 65.

Nevertheless the issue failed to catch fire as the Treasury pointed out that Government Actuary's Department figures showed that the burden of public sector pensions on GDP was projected to increase by only a few basis points in the foreseeable future. The implication was that the increase was of the same scale as a rounding error in the vast balancing of government revenues and expenditures. This relative unconcern with government obligations of an apparent vast scale contrasted uneasily with commentators' fears that private sector schemes were stampeding into bonds in order to bring FRS17 deficits under greater control. Of course it is true that, unlike private firms, government can always turn to taxpayers to solve its problems.

### Change at Pension Protection Fund

Myra Kinghorn, chief executive of the Pension Protection Fund (PPF) for the two years since the scheme was conceived, announced her intention to step down just as the fund approaches the collection of its first levies. Reports suggested that Ms Kinghorn planned to concentrate on non-executive roles in future, and it is understood that the PPF will announce a successor in due course.

Meanwhile comment from Hymans Robertson suggested that pension scheme sponsors were making less use of contingent assets to reduce levy burdens than many had originally expected. Martin Potter, senior consultant at Hymans Robertson, said: 'At the consultation stage there were widespread calls to allow schemes to take credit for contin-

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gent assets but less than 5% of our clients are now taking up this option. This is because there are some serious strings attached for sponsors. When push comes to shove it seems that the PPF levies are just not pushing many sponsors in this direction. Some employers may well have to go down this route in their future dealings with trustees but they are well-advised not to rush into making promises now that they may regret later.'

### Criticism of contracting-out rebate terms

A chorus of criticism greeted the announcement by the government of the outcome of its review of rebate terms. Most leading consultants pointed out that the underlying basis assumed a higher yield than the government was having to pay on its own debt in the marketplace, and that the government was therefore in effect offering 70p to be relieved of an obligation to pay £1. Commentators sought to suggest that the government had failed to take the advice of the Government Actuary, although the latter had made clear in 2005 that he proposed to assume in his calculation of rebates a yield greater than that currently obtainable in the marketplace.

It was not clear what effect the 'ungenerous' level of rebates might have on attitudes to contracting-out, as it is difficult for schemes to change their position on this very quickly. Nevertheless the general view was that individuals would be well advised in future not to contract out, and that it might be better for government to remove the option by contracting everyone back in to the state second pension.

### Our pensions have been stolen!

These were the words used in many of the complaints which Ann Abraham, the parliamentary ombudsman, considered in the report she published on 15 March.

'After everything that has happened in the past few years... we could not be proud... if we were not in the end able to say that schemes must have sufficient assets available within a certain time to keep pensions in payment and give non-pensioners the value of their accrued rights... That is the least that we should require of schemes. Without that requirement, what on earth would we say to people who ask whether their pension funds will be able to keep their pensions in payment or give them the value of their accrued rights if the scheme winds up? Without the MFR, the answer to such a question would be no. What on earth would we have achieved then? The minimum funding requirement would mean that the answer would be yes. That is all we seek with the MFR.'

This was the rhetoric used by the then government in introducing the minimum funding requirement within the Pensions Act 1995. The ombudsman concluded that the public – including the complainants – were entitled to take this rhetoric at face value: 'Having been assured by official information for many years that their pensions were safe if their scheme was funded in accordance with the MFR, they now look to those who provided this assurance – which they trusted – to honour the pensions promise that has been broken.'

Government rejected the ombudsman's recommendation that it consider compensation for maladministration broadly on the basis that the ombudsman had overstated the scope of its responsibility. The report and the government reaction will be debated in Parliament. Actuaries did not emerge entirely unscathed, as the profession had been a party to the formulation of MFR and appeared to be closer to the Department for Work and Pensions than in retrospect may have been desirable.

The report can be read at: [www.ombudsman.org.uk/pdfs/pensions\\_report\\_06.pdf](http://www.ombudsman.org.uk/pdfs/pensions_report_06.pdf).

## Causation in negligence clarified

In an important judgment for professionals in all fields and their insurers, in February the Court of Appeal ruled on losses caused by the downturn in fortunes of Equitable Life, in the case of *Andrews vs Barnett Waddingham*.

Mr Andrews had amassed a pension pot of nearly £2m and, in 1994, approached Barnett Waddingham for assistance. In the event he split his fund between two products from Equitable Life:

- ◆ an annuity linked to the retail prices index;
- ◆ a with-profits annuity.

It was the with-profits annuity about which Mr Andrews complained; he alleged that he was negligently advised by Barnett Waddingham in relation to the application of the Policyholders Protection Act 1975 to with-profits policies; he said that, if he had been properly advised, he would have taken a 5% fixed escalating

annuity instead of the with-profits annuity.

While he had not suffered any loss at the time of trial, it was accepted that, owing to the problems experienced by Equitable Life, the performance of his with-profits annuity (with the loss of terminal bonuses) would suffer, and that the 5% escalating annuity would produce a much better performance; he succeeded at trial and was awarded damages in excess of £1m, being the agreed quantum of the difference in performance for the future between the with profits and 5% fixed escalating annuities.

On appeal the Court of Appeal unanimously found in favour of Barnett Waddingham on causation grounds and set aside the judgment.

For more information see Cameron McKenna's *Law-Now* at [www.law-now.com](http://www.law-now.com).

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