

## Beware of surpluses

Just as the long winter suddenly metamorphosed into summer, so an enterprising pension consultant found something other than deficits and black holes for employers to worry about. In May, speaking at a pension fund strategies conference in London, Ian McKinlay, Aon's investment consulting head, warned delegates that companies are being forced to plough money into pension funds at a time when interest rates are low and liabilities are inflated.

May's issue of Aon's *Intouch Opinion* newsletter focuses on the potential risks of pension surplus. It advises its clients that with a more prudent funding regime now in place, the risk of creating future surplus is now very real and because pension funds are ring-fenced it means that surplus funds are essentially trapped cash. Aon Consulting is calling for employers to act now and adopt contingent funding and investment strategies that will allow them to invest the money in their businesses.

## Irish NPSS on its way?

The Irish minister for social affairs, Seamus

Brennan, wants a decision to be made over the issue of implementing some form of mandatory pension savings scheme by autumn this year. In an interview with *Global Pensions*, Mr Brennan said he wanted parliament to be able to make a decision 'by around September' over whether people should be compelled to save through an occupational pension.

In January, Mr Brennan charged the Irish Pensions Board with the task of compiling a report on mandatory pensions, but recently put the deadline forward to June, giving the board a tighter schedule in which to work. The board has been considering other systems worldwide where mandatory systems have been implemented, including Sweden and Australia.

The autumn deadline contrasts dramatically with the 12 years the Swedish government took to decide to implement a mandatory system, but Mr Brennan claimed the Irish government didn't have this kind of luxury.

## VAT harmonisation

Last month's judgment in the Abbey National case at the European Court of Justice (ECJ) will

result in a more level playing field for private investors across the EU by making VAT treatment consistent for unit trusts and open-ended investment companies (OEICs), says business and financial advisers Grant Thornton.

The case considered the scope of the VAT definition for the 'management of special investment funds'. Previously, OEICs were charged VAT at standard rate by managers while unit trusts were not. The court rejected this distinction and expanded the class of management activities that will now have to be exempt from VAT in the UK. The UK argued that only investment management services could qualify for VAT exemption.

The court held that most administration services that are essential to fund management will qualify. Mere support services such as IT will not be exempt.

Paddy Behan, VAT director at Grant Thornton, commented: 'The UK will benefit from playing on a level field with other attractive investment centres, such as Luxembourg and Ireland.'

**Welcome for Solvency II** *see p17* ➔

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## From the world of general insurance

### Asbestos developments

A federal judge in New York has dismissed appeals by certain claimants and insurers against a \$500m settlement in 2004 of Johns Manville asbestos claims by St Paul Travelers Cos Inc. The decision was based on the fact that acceptance of the appeals would have been contrary to an earlier bankruptcy court order relating to Johns Manville claims.

CSR, an Australian manufacturing company, has settled a long-running dispute regarding asbestos claims with a further raft of insurers for A\$103m. This brings the number of insurers with whom the company has settled its dispute, which commenced in 1995, to 55. There remains a number of insurers with whom the company has not yet achieved a settlement.

### American International Group (AIG)

Subject to market conditions, AIG is planning to sell by public offering its entire holding in IPC Holdings, the Bermudian reinsurer, which will result in the latter's total independence. AIG was a sponsoring shareholder when IPC was founded in 1993. AIG's move is said to be part of its business portfolio management and strategic redeployment of capital.

### Finite risk reinsurance

In early April, Odyssey Re Holdings Corp issued restated 2005 earnings figures to allow for the required change in accounting treatment of certain finite risk reinsurance contracts. This resulted in a \$35m reduction in shareholder equity, a significant proportion of which will be reversed in the first quarter of 2006.

### Lloyd's

Lloyd's has reported a loss of £103m for the 2005 year, with the net

underwriting loss being £1.4bn, a relatively good result given the £3.31bn net cost of hurricane claims in the year. This latter figure included £2.21bn from Katrina, £602m from Rita, and £498m from Wilma, all showing small increases from the previous estimates. The run-off of the market's prior-year reserves was neutral, with some syndicates having run-off deficiencies, totalling £300m, but others exhibiting compensating surpluses. The central fund assets increased to £670m, up from £607m at the end of 2004; this resulted in a 26% increase in the market's solvency margin.

### Goshawk Insurance Holdings

Goshawk has stated that it is suspending trading in its shares for a period from 2 May, while it completes analyses of the losses on its troubled Rosemont Re subsidiary. This is in view of its failure to meet the stock exchange reporting requirements for the 2005 financial year. It was anticipated that trading would recommence in mid-May when the company anticipated being able to finalise its catastrophe-hit results.

### PX Re

Rating agencies downgraded PX Re companies again in early April, and the company requested that the agencies withdraw their financial strength and claims-paying ability ratings, not being prepared to pay for the level of ratings which the agencies would be prepared to award. The latest downgrades are understood to reflect the agencies' concern that reinsurance clients of PX Re were selecting adversely against the company, leaving the reinsurer with very concentrated exposures in certain high-risk areas; apparently a third of clients with 1 January renewals had cancelled their contracts.

Subsequently, Guy Hengesbaugh,

PX Re's chief operating officer, resigned his post, and will be leaving the company in July.

### UK personal lines premium rates

The latest quarterly index published by the Automobile Association indicates that competition in the private motor market has depressed premium rates for comprehensive business, where the index has reduced by 0.5% in the last quarter, following two years of virtually static rates. On the contrary, non-comprehensive rates increased by 1.7% in the quarter. The indices for household buildings and contents both showed an increase between 0.5% and 1% for the quarter.

### Large losses

Loss updates and related issues include:

■ **Cyclone Larry, northern Queensland, Australia (20–21 March)** Estimated insured losses have reduced significantly, and are now thought likely to be no more than A\$600m, reflecting the high level of uninsured losses, particularly in the agricultural community.

■ **Storm in Texas (21 March)** This is estimated to involve insurance losses, from wind and thunderstorms, of \$50m.

■ **Tornadoes in American Midwest (2–3 April)** These have been declared to be a catastrophe, meaning that they are estimated to have cost at least \$25m. The worst-hit area appears to be western Tennessee, where the death toll has increased to 24 and thousands of buildings were destroyed or seriously damaged.

■ **Floods in Czech Republic and surrounding countries (early April)** These are expected to have lower impact on the local insurance market than those in 1997 or 2002, being less severe, although a wider area was affected. Estimated insured losses are €70m. The flooding

subsequently affected the lower Danube valley in Hungary and Romania, where significant numbers of inhabitants were evacuated from their homes. In spite of this later development insured loss estimates remain relatively low.

■ **Tornadoes in Tennessee and adjacent states (6–8 April)** This second storm in a week caused a further 12 deaths, and cut electric supply to 30,000 homes. No insured loss estimate is to hand.

■ **Riots in France (early April)** These were in protest at the proposal to introduce new labour laws which would have made it easier to hire and fire employees. Although the cost is expected to be covered by insurance policies, it is not anticipated to be very material, as losses mainly comprised broken windows and damaged cars.

Researchers at Colorado State University have forecast another above-average hurricane season in 2006, with 17 named storms, nine of them of hurricane intensity. They produced estimates of a 64% chance of a hurricane of category 3 or higher striking Florida and the east coast, with a 47% chance of one having landfall on the Gulf of Mexico coast.

As predicted in the last issue of *The Actuary*, there has proved to be a severe shortage of capacity for 1 April energy renewals, as a result of which there have been rating increases of the order of 750% for certain classes of business.

### 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

## Welcome for Solvency II

The majority of European insurers believe that Solvency II will improve their companies' risk and capital management functions, and half have already enacted formal programmes to address the proposed European Union (EU) directive, according to results of a survey released in May by Accenture.

According to the survey, 78% of European insurers believe that Solvency II will improve trans-

parency and controls in managing risk and capital, and 62% anticipate improvements in their organisations' allocation of regulatory capital.

The survey also revealed that a large number of insurers are moving swiftly in preparation for Solvency II. Although the final text of the directive is not expected until 2007 and implementation is not likely until 2010, 49% of the insurers surveyed had already enacted formal programmes to plan and mobilise for Solvency II, and 24% said they were

planning to enact such programmes.

'The Solvency II directive has clearly captured the focus and attention of the European insurance industry', said an Accenture spokesperson. 'Our research suggests that European insurers may be warming to the directive as they identify potentially significant strategic benefits beyond pure compliance.'

41% of respondents expect to realise competitive advantages as a result of Solvency II, and 24% anticipate receiving improved credit ratings as a result of the directive, according to the survey.

porate governance (84%), strategy and planning (79%), and asset management (76%). Most anticipate 'significant' impacts on their risk (57%) and capital management (54%) organisations, and roughly one-third expect significant impacts on their asset management (35%) and finance (30%) functions.

■ Many insurers believe Solvency II will improve the integration and performance of vital organisational functions. 41% believe it will bring a 'significant increase' in the level of integration between their actuarial, operational risk and finance functions. 30% said they anticipate significant increases in process efficiency between these functions and their business lines.

■ Solvency II programmes are being sponsored at the highest levels of many organisations. 32% identify members of their executive committee or board of directors as primary Solvency II programme sponsors.

## ACA elects new chairman

The Association of Consulting Actuaries (ACA) has elected Ian Farr as its new chairman. He is one of Watson Wyatt's most experienced and senior actuaries and is scheme actuary to a number of pension plans including some of the largest in the UK. He takes office on 1 June 2006 and succeeds Adrian Waddingham.

Commenting on his election, Ian Farr said:

'For employers and pension scheme trustees, the period ahead looks to be extremely testing in terms of pension challenges, not least with the latest government-led reforms following on from the Pensions Commission report, which we expect to see later this month.

'The ACA has been seriously concerned at the public policy decisions made over the last two decades that have so undermined workplace provision – which is now in serious decline. This is deeply troubling in terms of the fragile pension outcomes for millions of our citizens in the years ahead. My and the ACA's challenge will be to do as much as we can to ensure the next set of reforms encourage the promotion of workplace plans that are better than minimum default standards. In particular, we will be

looking for legal changes and for simplifications, as well as incentives, that will allow employers to think positively about offering risk-sharing schemes and good workplace schemes generally.

'Prior to publishing the Pension Commission report, Lord Turner had challenged actuaries to bring forward risk-sharing designs for pension schemes, as money purchase arrangements leave their members shouldering 100% of the investment and longevity risk – which is not suitable for those on lower incomes. ACA feels that it has risen to this challenge through its representations to government, despite a deafening silence from the Pensions Commission. We look to government for legislative changes to remove restrictions so as to allow employers to transform an existing money purchase arrangement into a risk-sharing scheme. In this way, the employer can have much more control of the cost than with a traditional final salary plan and the employee is less exposed to the vagaries of financial markets.'

(See also p19.)

*The July issue will include an interview with Ian Farr.*

### Additional key findings:

■ Most respondents foresee a 'moderate' or 'significant' impact from Solvency II across most major organisational functions. An overwhelming majority anticipates 'moderate' or 'significant' impacts on risk (92%), capital management (89%), finance (89%), reserving (84%), product pricing (84%), cor-



## Louise Pryor

### No More Black Box Models

The FSA wants actuarial departments to demonstrate why others should have confidence in their models. They should also have good systems and controls, including documentation, for their financial models and spreadsheets.

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#### Spreadsheet reviews

I audit spreadsheets for correctness and risk factors, providing recommendations for future practice.

#### Experience

I'm an actuary with a PhD in Computer Science and extensive practical, hands-on experience of software development and financial modelling.

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