

From the world of general insurance

Terrorism

The US president's Working Group on Financial Markets has produced its report on the terrorism insurance market. This has indicated that the existence of subsidised federal reinsurance through the Terrorism Risk Insurance Act and its extension to the end of 2007 has retarded the emergence of commercial insurance capacity for terrorism risks. However, it does not rule out continuation of a federal involvement in the market into 2008 and beyond. It thus appears to give grounds for both relief and hope for interested parties with different viewpoints. At the same time, a lawyer working within the US administration suggested that the Senate may delay any further extension to the legislation when it comes to expiry at the end of 2007.

As a development to the item included in these columns in the October issue, there have been public protests in New York against Allianz Global Risks US Insurance Co and Royal Indemnity Co in light of their continuing refusal to pay claims relating to the terrorist attacks of 11 September 2001. These insurers contend such payments would fall outside the policy conditions if Larry Silverstein goes through with his plan to sell part of his lease back to the Port Authority of New York and New Jersey.

A US federal appeals court has upheld the 'one event' ruling in the case between Silverstein Properties and a group of insurers headed by Swiss Re, which bound the World Trade Center property coverage under the so-called Wilprop wording. The same ruling also upheld the decision that another group of insurers, headed by Allianz, who had not finalised their contracts with Silverstein at the time of the attacks, would have to pay an additional \$1.1bn.

Finite risk reinsurance

Hank Greenberg has been successful in the court case reported in the August issue of *The Actuary* under

which he sued American International Group (AIG), the company of which he was long-term chairman and chief executive. He will be able to obtain various AIG documents to assist in his dispute with the New York attorney general, Eliot Spitzer, over the settlement between Spitzer and AIG. The company was required to hand over the documents by 4 October.

Lloyd's

It has been announced that National Indemnity Company, the Berkshire Hathaway subsidiary, is to provide \$5.7bn of aggregate reinsurance cover for Equitas, the Lloyd's run-off vehicle. The premium for this will be all the assets of Equitas, except £172m, plus £72m contribution from Lloyd's and that National Indemnity will take over the staff and operations of Equitas. It is intended that this will be completed by the end of March 2007, and that it will be only the first phase of a two-phase process which would eventually result in the takeover of Equitas by National Indemnity. The second phase would require National Indemnity to seek court approval for a Part VII transfer of the liabilities of Equitas into National Indemnity or Berkshire Hathaway. It is intended that this would effectively end the exposure of Lloyd's and the names to 1992 and prior liabilities, and encourage the provision of further capital into the Lloyd's market. If the transfer can be completed by the end of 2009, National Indemnity will provide a further \$1.7bn layer of aggregate reinsurance for a premium of \$58m, of which \$40m would be paid by Equitas and \$18m by Lloyd's.

A Lloyd's market group has concluded that there is still scope for capital to be provided by both individual names and commercial sources. It also suggested that private capital could participate in the market through two alternative models, a more flexible agency agreement and special-purpose

reinsurance syndicates.

Considerable consolidation appears to be taking place in the Lloyd's market with merger talks taking place between two of the larger managing agents (Catlin and Wellington), and the acquisition of Creechurch managing agency by Canopus. It is intended that the Creechurch business will be written into an enlarged (£450m capacity) Canopus syndicate 4444 in 2007.

HIH Casualty & General Insurance Ltd (HIH)

Frederick Lo, the former company secretary of HIH, has pleaded guilty to four criminal charges (three of making false or misleading statements and one of failing to properly exercise his powers) in a Sydney court. The charges all relate to the failure of HIH in 2001. Sentencing will take place in January.

Converium Holding Ltd (Converium)

Converium, a Swiss reinsurer, has agreed to sell its North American operations (in run-off) to National Indemnity Company for a premium of \$295m. In addition, National Indemnity will assume Converium's reinsurance liabilities, amounting to \$1.06bn at the last accounting date. While it is estimated that this will reduce the Converium net asset value by \$135m, it will bring finality on the US business, and is expected to achieve the aim of improving the company's credit rating.

UK motor insurance

Motor insurance premiums continue to rise, according to the latest AA British Insurance Rating Index. In the latest quarter, average premiums for comprehensive cover increased by 1.24%, and those for third party, fire, and theft by 4.3% to almost £1,000. The increase in non-comprehensive premiums, which is largely blamed on the impact of young drivers, brings the overall

increase in this index to over 100% in the 12 years since its inception.

Large losses

Loss updates and related issues include:

■ **Typhoon Xangsane (25 September to 2 October)** Updated figures suggest that the damage in Vietnam is significantly higher than originally thought, with one report suggesting insured losses of over \$3bn. The port city of Da Nang was particularly hard hit.

■ **Storms and floods in France and Switzerland (3–5 October)** These hit eastern France, especially the Lorraine and Vosges areas, and parts of Switzerland and caused significant damage from floodwater and falling trees. They are said to be the most intense to hit the area for 50 years. In addition, winds in excess of 100mph caused damage in south-western France at much the same time. No loss estimates are to hand for either of these events.

■ **Train crash in Moselle department of France (11 October)** This was caused by a head-on collision between a Luxembourg passenger train and a French freight train, and resulted in six deaths and at least 15 injuries, some of them serious. No loss estimates are to hand.

■ **Snowstorm in New York state (12 October)** This unseasonal event, which particularly hit Buffalo, but also resulted in some snowfall in New York City, resulted in insured losses in excess of \$25m, largely through business interruption from the widespread power cuts.

■ **Earthquake in Hawaii (15 October)** Substantial damage was caused by this quake of magnitude 6.7 with its epicentre just off the north-west coast of Hawaii Island. Insured losses are initially estimated to be up to \$60m.

■ **Oil refinery fire at Jamnagar, India (25 October)** This is expected to result in insured losses from property and business interruption coverages amounting to around \$60m, but is heavily dependent on the time ➤

Annuity market change

According to *Professional Pensions*, intermediary The Annuity Bureau sees Canada Life possibly overtaking Prudential as the UK's leading annuity provider. The Bureau – a division of Alexander Forbes Financial Services – said developments such as Clerical Medical ceasing to provide annuities for new pensioners and Canada Life's 'aggressive move' into the mainstream arena were changing the landscape.

We were moved to wonder whether or why it is that an apparently more detached view of the prospects for improvements in UK annuitant mortality may be possible from Toronto or Winnipeg.

PPF in substantial deficit

Claims on the Pensions Protection Fund (PPF) are running well above the levies it is collecting, in spite of benign economic conditions, data from its annual report reveal. Mercer Human Resource Consulting believes that levy rises are inevitable as the real cost of the fund emerges. The figures show that only £324m is likely to be collected in 2006/7 – little over half of the £575m targeted. Claims for 2005/6 were £485m, of which only a quarter (£138m) was covered by levies, and there is little sign of lower claims for 2006/7.



Tim Keogh, worldwide partner at Mercer (left), said: 'There's a big undershoot here that can't go uncorrected. If there is a shortfall during times of few corporate insolvencies, the levy must be unsustainably low.'

Mercer said the final cost of the PPF, which is met by pension schemes with solvent employers, will only become known over a decade or more, with much depending on the economic cycle. But with little evidence that the risk of schemes claiming on the PPF has reduced and a deficit in the first couple of years in operation, there will be pressure for levies to be cranked up.

Mercer believes the PPF has made a reasonable

effort to set up an untested and unique system from scratch, but this system needs to become more robust and durable, ensuring that all schemes are valued consistently and all employees are assessed for risk on a basis that commands confidence. The work the PPF has already announced it is doing with its risk assessor (D&B) is particularly welcome in this respect.

Lloyds TSB implements ALM solution

Lloyds TSB Group (LTSB) has implemented the asset liability management (ALM) software for pension funds (PALM) from ORTEC. The software enables the group to conduct comprehensive risk analyses of its employee pension schemes. These risk analyses will be used for corporate pension risk assessment and to support the schemes and LTSB in formulating effective long-term investment strategies.

LTSB said it was looking for a supplier offering extensive market risk and inflation modelling expertise. ORTEC offered its solution in co-operation with Cardano Risk Management, a partner of ORTEC in the field of strategic use of liability driven derivatives solutions in ALM. Theo Kocken, managing director at Cardano, said: 'the derivative overlay features in PALM are vital in finding a solution that takes into account liabilities, assets, and various overlay products.'

Pensions adviser approved

Pension Capital Strategies Ltd (PCS), has announced that it has been successful in its application to the Financial Services Authority for the authorisation to carry out pensions and corporate strategy advisory services. The authorisation came into effect on 1 November 2006. PCS was established in 2006 to offer a new approach to managing corporate pension obligations and is a subsidiary of the Jardine Lloyd Thomson Group.

Charles Cowling, managing director of PCS

said: 'We are delighted to announce that PCS is now authorised by the Financial Services Authority. While a relatively small proportion of advice will fall under the regulated banner, the authorisation serves to demonstrate the seriousness with which PCS takes the principle of best practice and treating our clients fairly. This will provide greater certainty to our clients and enable us to offer an even broader range of pension services and advice.'

Meanwhile PCS was in the news for publication of a report, 'The FTSE100 and their pension disclosures', which suggested that FTSE100 companies are underestimating the impact of future improvements in longevity, which led PCS to conclude that the total deficit in FTSE100 pension schemes could be more than £100bn as compared with a reported £46bn.

Insurer in AIM debut

Just Retirement, a specialist UK life assurance group focusing on the provision of financial services to those at or in retirement, has announced its intention to apply for admission to AIM. Just Retirement's intention is to raise approximately £50m through a placing of new ordinary shares and there is also intended to be a placing of existing shares in the company.

Just Retirement is seeking to raise approximately £50 million through an issue of new ordinary shares to institutional investors. The proceeds will be used to provide capital to fund the future growth of the company and to expand the company's distribution capability. The company was established in April 2004 by actuary Mike Fuller, the current chief executive, and certain other members of the senior management team, with financial backing from Langholm Capital.

Just Retirement's management team also includes actuary Bernard Brown (deputy CEO of Just Retirement's life company and administration director), formerly CEO of Lincoln National. Peter Hales, recently appointed as a non-executive director of Just Retirement, was previously a ➤

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➤ taken to effect repairs. The insurance is with a consortium of Indian companies led by state-owned New India Assurance, but there is likely to be some reinsurance into the London market.

■ **Esperanza wildfire in California (26–30 October)** This was the

largest fire of the year in the western states of the US, and was centred on the San Bernardino mountains. It is believed to have been started by an arsonist, has consumed 40,000 acres, destroyed 34 homes, and resulted in the deaths of five firefighters. No insured loss estimates

are available, but fire-fighting operations cost \$10m.

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

▶ director of Norwich Union Life, CGU Life and General Accident Life. Peter has 39 years' experience in the UK life assurance industry and is a former president of the Chartered Insurance Institute.

Trading longevity risk

Cass Business School professor of pension economics and Pensions Institute director David Blake has been reported as predicting a group of investment banks was looking at starting a market in a bid to profit from the growing interest in bulk annuities 'some time early next year'. Blake declined to name any of the investment banks involved.

Mr Blake – who together with leading actuaries and others has been preparing research papers to promote the start of a traded market in longevity risk – said investment banks had seen firms such as Paternoster and Synesis Life entering the market and wanted to have part of the business, but wanted to create a market to ensure they could sell on the liabilities.

He explained: 'Investment banks are now thinking if the government does not want to kick-start this market, they will have to do it themselves. They are going to use derivatives to do that and they are going to use survival swaps, longevity swaps or mortality swaps as a way of gaining the ability to hedge longevity risk exposure.'

Mr Blake added: 'The beauty about longevity risk is that it has a very low correlation to financial risk – therefore it is a great diversifying asset and exactly what hedge funds are. This is simply a way of bringing pricing transparency to the

longevity risk market and that has got to be good news for everybody.'

New tool for pension buyouts

Early November 2006 saw the launch of a year-long co-operation between Richards Consulting and Experian plc. Using Experian's iCoder software tool, companies can now profile individual pensioners for both socio-economic group and likely marital status. This tool thus enables companies operating in the bulk buyout sphere to use more science and less guesswork in pricing the two main demographic risks in writing buyout business.

After sex, socio-economic group or lifestyle is the most important variable in determining current life expectancy, and therefore annuity cost. In the bulk buyout market, the insurer or reinsurer only has one chance to correctly assess a scheme's socio-economic make-up and price it correctly. Hitherto, this assessment has been made on the basis of pension size, or sometimes postcode. Now a software tool is available which enables the identification of actual individual households, thus offering greater accuracy in socio-economic risk-profiling.

Another key pricing assumption for bulk buyouts of defined benefit pension schemes is the proportion of annuitants actually married. Most schemes provide dependants' pensions, but few schemes actually keep or record who is actually married. As a result, pricing a bulk scheme usually involves making a guess as to the proportion of lives with a dependent spouse. This is a material assumption, as spouses' benefits add

around 12% to any annuity price, so each extra 10% in the proportion married will add 1.2% to the total price. Previously, this assumption had to be guessed by the pricing actuary. Now, however, this software tool allows you to model who is – and who is not – likely to be married and therefore carry the risk of needing spouses' benefits.

The Richards Consulting principals also are associated with new mortality modelling venture Longevitas – see www.longevitas.co.uk.

Alexander Forbes a target

A consortium of investors has made a £600m offer for Alexander Forbes. The consortium behind the bid is headed by Actis, the private equity firm, and includes two Canadian pension funds.

The offer comes after Alexander Forbes, South Africa's biggest pension consultancy firm, has been under scrutiny for its involvement in a scandal concerning the bulking of client money.

Among Alexander Forbes's business interests is a 60% stake in UK-based pension consultants Lane Clark & Peacock and a separate multi-manager business. However, a spokesperson for Actis said there were no plans to break the company up if the deal completed.

Welsh wizard software gains ground

Life insurance company Delta Lloyd Life (part of Aviva) has awarded FIS Software, a global provider of complete package-based software solutions for life and pensions organisations headquartered in Cardiff, a multi-year, multimillion pound contract for the implementation of ALIS as its new policy administration system across its portfolio of investment, risk, mortgage, and savings products.

Delta Lloyd Life will use ALIS to replace several current back office systems that are managing the Delta Lloyd business in Belgium. The new ALIS-based system provides a web-based environment, managing both back office and front office operations, and will include a data migration. This will enable Delta Lloyd Life to bring significant improvements in the administration of products and services to end-customers.

Delta Lloyd joins an FIS client group including AXA, Scottish Widows, Unum Provident, CNP Assurances, Swiss Life, Scottish Equitable, Bright Grey, The Pearl Group, Ethniki, Prefsure, Prevoir, Clal, and Eliahu, among others. More at www.fis-software.com.

News from the industry continues on p18

Think-tank supports EU solvency regulation developments

In 2003, the Centre for European Policy Studies (a well-regarded Brussels think-tank) set up a taskforce on the future of insurance regulation and supervision in Europe. The chairman of this taskforce is Johan van der Ende, director of structured investments at PGGM, a large Dutch pension fund. At the time the taskforce was set up, he was CFO of Nationale Nederlanden.

The taskforce has just published its final report. The report is jointly written by Rym Ayadi, research fellow and head of the research programme on financial institutions and prudential policy at CEPS, and Chris O'Brien, director of the Centre for Risk and Insurance Studies at Nottingham University Business School.

The report is particularly topical as it reviews

Solvency II, the new regime being proposed for EU insurers, which will bring some fundamental changes. The report's conclusions cover:

- ◆ the need for a more robust way of valuing insurers' assets and liabilities;
- ◆ the need for improved data collection, modelling, and management of risk at an individual level and for the industry as a whole;
- ◆ the need for regulators to be clearer about how to set minimum capital requirements for insurers and trigger points for intervention; and
- ◆ the need for the International Association of Insurance Supervisors (IAIS) to develop a new global regulatory framework for insurance and reinsurance.

More at www.ceps.be.

Longevity assumptions contrasted

BT's pension fund deficit could be £3bn higher than stated in the company's accounts because it is underestimating how long people will live, an independent analysis suggested recently.

If an increase in the deficit of that amount were to be fully reflected in BT's share price it would wipe around 8% from the company's stockmarket valuation, according to pensions consultant John Ralfe. In a note for RBC Capital Markets, Mr Ralfe says that if BT used the same assumptions of longevity as the Royal Mail and the Pension Protection Fund (PPF), then its deficit would rise from £2.5bn to £5.5bn.

BT and the Royal Mail have similar pension schemes with 350,000 members in the former and 400,000 in the latter. They also use the same retirement age of 60 and the same actuarial adviser, Watson Wyatt. But the Royal Mail apparently expects 60-year-old men and women to live between two and four years longer than BT. While BT assumes a 60-year-old man will live to just under 84, the Royal Mail puts life expectancy at 86. For women aged 60, BT puts life expectancy at 85.4 but the Royal Mail calculates it at 89. The deficit in the Royal Mail's pension fund is £5.6bn.

Mr Ralfe said he accepted that it might be 'politically convenient' for the Royal Mail to use more generous longevity assumptions to push

up its deficit, thereby putting pressure on the government to provide more financial help and the regulator to allow bigger price increases. But he pointed out that the assumptions of life expectancy used by the Royal Mail were the same as the mortality assumptions adopted by the PPF.

KPMG honoured at Lord Mayor's Dragon awards

KPMG has been awarded the Lord Mayor's Award at the 2006 Lord Mayor's Dragon Awards held at Mansion House. The awards celebrate exceptional examples of community work undertaken by businesses in London. Awards are given in six categories, ranging from education, through economic regeneration, community and social inclusion, to volunteer of the year.

This year professional services firm KPMG shared a joint win in the Lord Mayor's Award category with Gensler London, an architectural practice which has developed a community outreach scheme, 'Design a Future'.

KPMG was given this year's Lord Mayor's Award for an outstanding commitment to corporate social responsibility (CSR), embedded within the company over 11 years. KPMG's CSR mission is to inspire, challenge, and empower staff to positively contribute to the community and environment for a sustainable business

future. Last year (2005-06) KPMG continued to invest more than £4m in the community and over 30% of KPMG people contributed more than 30,000 hours through volunteering. Over the past two years the company has been involved in projects including the joint sponsorship of a new City Academy in Hackney with the City of London and a programme to provide pre-employment training to people who have served in the armed forces but have since experienced homelessness and are now ready to get back to work. KPMG is also committed to making its business more sustainable. Its environmental performance has been improved and is measured rigorously, with half of all financial savings made in this area given to charity.

The lord mayor, head of the City of London Corporation, alderman David Brewer, said: 'The level and duration of the CSR commitment that KPMG has made to the community is quite amazing. If every firm in London integrated this level of support within its business structure many of the problems now facing the City would be almost non-existent. Their success is testament to their aptitude and passion for the task.'

The Lord Mayor's Dragon Awards have been made by the elected lord mayor of the City for 19 years and are named after the mythical guardians of the City of London Corporation which can be seen at the gates of the Square Mile financial district.

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