From the world of general insurance

Asbestos and pollution developments

A Michigan circuit court has dismissed a motion by General Motors against Royal & SunAlliance (RSA) which claimed for an unspecified amount (but possibly as much as $1bn) of asbestos and environmental liabilities under policies dating back up to 52 years. The judge supported the RSA contention that the policies were time-barred, which should improve the chances of RSA's obtaining regulatory approval for the acquisition of the insurer's US liabilities by a management-led consortium called Arrowpoint Capital Corp.

Terrorism

The French terrorism risk pool, GAREAT, has been renewed for a further three years, to the end of 2009. The pool provides terrorism cover for risks with a value in excess of €6m. In 2007, the state reinsurer Caisse Centrale de Réassurance will become involve for terrorist attacks costing in excess of €2.2bn. Over 70 reinsurers are participating in GAREAT in 2007. It is expected that the renewal of the pool will lower terrorism reinsurance rates.

Financial Services Authority (FSA)

The UK regulator sent out two letters to chief executives of insurance entities at the end of 2006, outlining its priorities for the next year. These dealt with the monitoring of compliance in the areas of contract certainty and disclosure of intermediary remuneration. The contract certainty developments commenced with a meeting with the Market Working Group in late January to review the extent to which FSA targets have been met. The FSA suggested that while good progress appeared to have been made in this area, they had less confidence in the approach being taken by the market in relation to intermediary remuneration, where there still appeared to be inconsistencies in the approach used to respond to requests from clients as to how much was being paid to the broker or agent. This was an important part of the FSA initiative 'Treating Customers Fairly', and it would be considering whether there was the need for mandatory disclosure rather than the current market-led 'best practice' approach.

John Tiner, the FSA chief executive, has announced that he will be leaving the regulator in July, after over four years in the role, to return to the private sector – moves are in process to identify his successor.

An FSA report has said that more than half the adverts for motor insurance and a quarter of those for household cover contain ambiguous statements about the potential savings to customers by switching to their product. Insurers have been warned that they have three months to remedy these statements – otherwise they risk fines of hundreds of thousands of pounds.

The FSA has announced its work programme for 2007 in relation to the sale of payment protection insurance (PPI). This relates to testing progress (especially by firms for which PPI sale forms a minor part of their business) on the improvement in information provision to customers at point of sale and their treatment on mid-term cancellation of the contract. As a first consequence of these investigations, at the end of January, GE Capital Bank was fined £610,000 for failures in the training of staff involved in selling storecards with PPI underwritten by a GE company. The stores involved included many household names.

Lloyd's

Lloyd's capacity for 2007 has risen by 9% to a record £16.1bn. This is in spite of a further significant reduction in the capacity provided by names on an unlimited liability basis – these now provide only 6.8% of the market's overall capacity. There is some concern that the increase may have an adverse impact on

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profitability especially in business classes where rates are already softening. Following its acquisition of Wellington, Catlin has now become the largest capital provider, and Limit and Catlin are the largest managing agents with £1.12bn and £1.09bn of capacity under management respectively.

Premium rates

UK motor premium rates continue to increase, according to the AA British Insurance Premium Index, with an increase of over 4.3% in rates for comprehensive cover (to an average of over £800 – a new high) and a 0.1% increase for third party, fire, and theft cover (now averaging nearly £1,000) in the three months to the end of 2006. On the other hand, home insurance rates remained virtually unchanged in the same period, with premiums for buildings slightly higher, but a slight reduction in those for contents.

The UK Health and Safety Commission statistics for 2005/6 show a continuing reduction in the rates of both fatal and non-fatal injuries to UK employees, and also a reduction in work-related illness – this is expected to contribute to a reduction in average premium rates for employers' liability business during 2007. In contrast, the introduction of the National Health Service (NHS) Injury Costs Reduction Scheme at the end of January will allow the NHS to reclaim treatment costs from insurers in relation to all cases where personal injury compensation has been paid, and not only in respect of road traffic accident victims as previously.

Premium rates for airlines and airports continued to reduce in the main renewal seasons at the end of 2006 and the beginning of 2007 respectively. The reductions for airlines (which were up to 30% in extreme cases, with an average of around 20%) reflected the high level of available capacity and the low level of accidents in 2006 (only 13 accidents involving fatalities, the second lowest on record). The reductions for airports averaged around 10%.

Property catastrophe reinsurance rates at 1 January 2007 for US risks have increased by 10–15% (rather more for the most exposed areas) from those being used a year earlier, but this is significantly lower than those for renewals at 1 July 2006, which had shown a 30% increase. This reflects the relatively benign hurricane season in 2006.

Commercial property rates in US have tended to continue to fall slightly at their 1 January renewals, and a similar position was encountered in marine hull and cargo business. US liability and directors and officers rates fell by up to 15%.

Auditors' liability

In January, the European Commission commenced a two-month public consultation on possible reform of the rules on auditor's liability in the European Union. The possibilities include the introduction of a fixed monetary cap across all European audits, or different caps dependent on the size of the audited company or the audit fees paid. There will also be consultation on the possible introduction of proportionate liability under which the auditor and the audited company would share loss in proportion to their degree of responsibility. The auditors have welcomed the consultation on the basis that it may reduce what is seen as a significant risk of the failure of one of the Big Four accountancy firms.

Richard Harvey retiring

Richard Harvey, chief executive of Aviva and fellow of the Institute of Actuaries, has announced that he will be retiring in July after ten years in the job. He is intending to spend the first 12 months after his retirement doing charity work in Africa. He will be replaced by Andrew Moss, currently Aviva's group finance director, and previously Lloyd's finance director.

Large losses

Loss updates and related issues include:

■ **Oil refinery explosion in Texas City (23 March 2005)** This explosion at a British Petroleum-owned refinery, which killed 15 and injured 170 and is estimated to have cost the company $2.3bn, is the subject of a recent report by an Independent Safety Review Panel. The panel found that the BP board directors either did not receive, or failed to react properly to, information on safety deficiencies at the refinery. The current BP management has promised to act on the report's findings.

■ **Hurricane Katrina (25–30 August 2005)** A jury in a US district court has found in favour of a property owner in Biloxi near New Orleans whose home was destroyed by the hurricane. The insurer (State Farm) claimed that the destruction was caused by storm surge (and hence not covered) rather than wind damage (which would be). The judge awarded punitive damages of $2.5m against State Farm in addition to the cost of reinstating the property. State Farm subsequently agreed to settle 35,000 claims affected by this decision.

■ **Fire and explosions at fireworks factory at Halland, E Sussex (3 December 2006)** It is understood that European Risk Insurance Company (the insurer of the owner (Festival Fireworks UK) of this factory) has failed to meet the solvency requirements of the Icelandic supervisors ever since they came into force at the beginning of 2004. It is further understood that the insurer is currently making arrangements to come into line with these requirements.

■ **Violent thunderstorms and tornadoes in Florida (25 December 2006)** These unseasonable events were at their worst in the Daytona Beach area, where 40 apartment blocks were extensively damaged and the Embry-Riddle Aeronautical University suffered severe damage including the loss of, or serious damage to, 50 of its 65 aircraft. No insured loss estimates are to hand.

■ **Earthquake off Taiwan (26 December 2006)** This was of magnitude 7.1 on the Richter scale, resulting in two deaths and 42 injuries, and causing significant damage to the country's undersea communications network on the bed of the South China Sea. As a consequence, there was a major breakdown in communications across south-east Asia for two days and full normality was not restored for several weeks. This breakdown had major impact on the financial markets – although no insured loss estimates are to hand, they are likely to be significantly lower because the quake occurred during the Christmas period.

■ **Bombing of four-storey car park at Madrid Barajas airport (30 December 2006)** This explosion, caused by a truck bomb believed to have been left by the Basque separatist organisation ETA, resulted in two deaths and is estimated to have cost €35m. The loss is likely to be settled by the government's terrorism compensation consortium.

■ **Boycott of Bristol International Airport (early January)** This resulted from a perceived danger involved in taking off and landing in wet conditions on a newly surfaced runway, and involved ten airlines and 365 flights. The situation was resolved by a 24-hour closure of the airport to groove a portion of the runway. The economic loss is likely to be several millions of pounds, but there may be major legal arguments as to whether insurers will have to pay.

■ **Wildfires in the Malibu area of California (8 January)** This short-lived (three-hour) blaze destroyed five mansions and significantly damaged a further four in this seaside location. One resident was taken to hospital suffering from smoke inhalation. In spite of the small number of properties affected, it is thought that insured losses could amount to $60m in view of the exclusive nature of the area.

From the world of general insurance

■ **Windstorm Franz, northern Europe (10–11 January)** This hit Ireland, the UK, northern Germany, Denmark, and Sweden with winds reaching 100mph and severe flooding in places. Power lines were brought down, trees blown over, roofs ripped off, and transport networks thrown into disarray. There were at least seven fatalities, five of them on one of the two trawlers lost in the storm. No insured loss estimates are to hand, but the overall cost is likely to be significant in view of the widespread nature of the damage.

■ **Grounding and breaking-up of bulk carrier *M/V Server* off Norway (12 January)** This occurred in heavy seas and, although the crew were all rescued and there was no cargo, the hull was declared a total loss ($9m) by the insurer (Gard), and in addition there was substantial pollution, although no clean-up cost has yet been provided.

■ **Two ice storms across USA (mid-January)** These caused damage across 13 states from California to Illinois, with the major problems being the loss of power due to the weight of ice on power lines, trees, and buildings. While no overall insured loss estimate is to hand, substantial business interruption losses across a wide area will cause the figure to be very significant. In particular, it is estimated to have cost the Californian agricultural industry nearly $1bn, largely from devastation of the state's citrus crop.

■ **Windstorm Kyrill, northern and central Europe (18 January)** This was somewhat further south than Franz, a week earlier, mainly affecting southern UK, France, Netherlands, western Germany, Belgium, Denmark, Switzerland, Poland, the Czech Republic, and Austria. Again, the main damage was to roofs and power lines, often caused by fallen trees; these also damaged a considerable number of cars. With gusts of wind reaching over 125mph, at least 47 fatalities have been attributed to the storm. Early estimates of insured losses suggest an overall figure in the region of €5bn, with up to £1bn in UK, €2bn in Germany, and smaller amounts in France, Netherlands, and the other countries. An interesting side issue from this storm was a call from various commentators for a mechanism for aggregating claims across Europe where a multitude of different countries is involved in a loss.

■ **Beaching of container ship *MSC Napoli* off coast of Devon (20 January)** This occurred intentionally while the ship was being towed after receiving damage in windstorm Kyrill (see above). The 26-man crew of the 68,000-ton vessel had been airlifted to safety in a joint operation by British and French helicopters, and the stricken vessel was on tow to Portland harbour, when it was decided to beach it before it sank. About 200 of the cargo of 2,394 containers (158 classified as hazardous) were lost overboard, and several of these were extensively looted when they were washed onto the beach at Branscombe. Salvaging of the remaining containers is still continuing at the time of writing (early February). There is, in addition, a pollution issue arising from leakage from the vessel's oil tanks. Insurances are widely placed; liability coverage is with the London Club, hull insurance is on a separate policy led by Royal & Sun Alliance, and it is likely that a multitude of different insurers will be involved in insuring the various items of cargo.

■ **Tornadoes in Florida (3 February)** These ripped through an area north of Orlando, causing at least 19 deaths and major devastation to a narrow band in a heavily populated area, with homes destroyed and power supplies badly disrupted. It is, at the time of writing, too early to estimate insured losses.

Major reform of insurance in Florida was announced in late January. The changes include an effective increase from $16bn to $34bn in the catastrophe fund, with increased access to this for insurers, thus allowing them to purchase cheaper reinsurance and reducing the extent of the private market for catastrophe insurance. The state-backed Citizens Property Insurance Corp will also now be allowed to compete with private insurers for motor and other insurances. Rates will be frozen at 2006 levels and refunds provided to consumers who have already paid increased rates in 2007. Excess insurance profits will have to be returned to policyholders, and insurers will be prohibited from 'cherry-picking' classes of business they consider to be more profitable. Needless to say, the changes were not to the liking of the American Insurance Association.

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

Better stress-testing needed, says FSA

The Financial Services Authority's (FSA) *Financial Risk Outlook (FRO) 2007*, published recently, is designed to raise awareness of the priority risks which the FSA believes it, along with providers and users of financial services, should consider.

While the FSA's overall outlook for the global economy continues to be benign, the FRO identifies an increasing risk that it will become more unsettled. Key factors include the increasing geopolitical risks, which escalate the probability of an 'event risk' materialising; increasingly complex financial markets; and the combination of low volatility of asset prices, a low market pricing of risk, and stronger correlations between the prices of different classes of asset. These trends mean that the impact of a shock to the financial system would be much greater now than two or three years ago.

Risk is our Business

A recent FSA review on stress-testing found that, while good work was being done, some firms could be underestimating the probability of severe events. Firms should not overestimate their ability to take action in an effective and timely manner.

Also examined in the FRO is the likely impact three 'plausible alternative scenarios' could have on firms, market, and consumers. They are:

- a human influenza pandemic that could cause widespread disruption to the financial system. The effect of a pandemic was explored in the recent market-wide exercise organised by the FSA, Bank of England, and HM Treasury;
- the impact of a global reappraisal of risk, which involves a widening in risk premiums among all asset classes, but particularly affecting emerging markets and high-yield assets; and
- a deterioration in consumer credit quality, which considers the impact of continued high growth in personal debt on the financial services sector in the UK.

This year, for the first time, the FRO has identified the considerable risks and challenges that climate change poses to the financial sector. These include greater costs to firms through extreme events and possible equity market volatility arising from these costs.

PPI cautiously supports Pensions Bill

The most recent briefing note (No 36) from the Pensions Policy Institute (PPI) reviews the current Pensions Bill and concludes: 'If enacted, the Bill would alleviate many of the problems with the current state pensions system, although none will be solved completely:

- Outcomes between men and women would converge, although over decades.
- The system would remain complex with two state pensions, although some aspects would be simplified.
- The system would be more sustainable. But future levels of means-testing, while uncertain, are likely to be historically high.
- Private saving would be expected to make up for the inadequacies of the state system as well as provide additional private income.'

For more information on this topic, please contact Niki Cleal (tel 020-7848 3744, email *niki@pensionspolicyinstitute.org.uk*) or visit *www.pensionspolicyinstitute.org.uk*.

Payment protection market 'uncompetitive'

The Office of Fair Trading (OFT) decided to refer the market for payment protection insurance (PPI) to the Competition Commission on the grounds that the market was not working competitively. Reasons cited by the OFT included:

- PPI is a secondary purchase, bought only as a result of taking out the primary credit.
- The point of sale (POS) advantage experienced by distributors means that there is little competitive pressure at the key point at which the consumer buys the insurance.
- The complex nature of PPI makes comparison between different policies difficult.
- Lack of product information prior to POS adversely affects competition.
- Present levels of cancellation or switching by consumers in this market do not exert any serious pressure on the prices of PPI.
- Stand-alone providers, who might otherwise be thought to offer a competitive pressure, have difficulty accessing consumers and face substantial start-up and marketing costs to attract custom.
- Vertical integration is a significant feature with around 60% of the market undertaking both the underwriting and the distribution of PPI within the same group.

Variation in actuarial assumptions criticised

There remains enormous unexplained variation in the results of actuarial valuations to determine pension scheme liabilities, says a new report from PricewaterhouseCoopers LLP, based on a recent survey of 90 UK pension schemes with almost £200bn of assets.

Life expectancy predictions differ by up to six years without any correlation to industry, pay, type or location of workforce, or actual scheme experience. Discount rates, which represent the assumed future return of a scheme's assets, bear little correlation to actual asset allocation, varying by as much as 3% per annum for schemes with similar asset allocations.

Scheme funding valuations in the annual survey have assumed pensioners will live one year longer than assumed previously. On average, trustees and their actuaries are now assuming a man retiring at age 65 will live a further 18 years, a woman, 22 years. Liabilities across all of Britain's private defined benefit pension schemes are estimated to be around £600bn and one year added to longevity assumptions adds about £40bn to the total calculated liabilities.

These results are consistent with results from another survey of investment analysts' views published by Pensions Capital Strategies (*www.pensionstrategies.co.uk*) last month.

Government decision on transfer values

The minister for pensions reform, James Purnell, has announced the government's decisions that pensions transfer values will be calculated based on the expected cost to the scheme of providing the pension.

Mr Purnell said: 'After an extensive consultation it has become clear that the great majority favour this way of calculating pensions transfer values. This approach will mean that the success or sustainability of the pension scheme is not put in jeopardy by any transfers that do take place.'

It is intended that the new arrangements will come into effect in April 2008.

The proposals aroused controversy among actuaries and firms. Head of Standard Life pensions policy, John Lawson, said: 'The response is fairly predictable – the financial security of defined benefit schemes is given preferential treatment over the right to a fair transfer value for the individual member.'

But Joanne Livingstone, principal at Punter Southall, welcomed the agreement, saying the government had listened to the views of the majority of actuaries. 'It is a straightforward and pragmatic approach that should allow schemes to continue with their existing approach of not paying out transfer values that are higher than the scheme can afford,' she commented.

Partner at Lane Clark & Peacock, Bob Scott, warned against making hasty judgements: 'With the process due to be laid down in regulations, the pensions industry faces an anxious wait before we learn what further regulatory and compliance objections and costs will be imposed on schemes as a result.'

Royal Mail closes scheme to new entrants

Royal Mail announced in early February a comprehensive scheme of financial reorganisation which included both commitment to reducing or eliminating the deficit in its defined benefit (DB) pension scheme and the closure of that scheme to new entrants.

Aon Consulting produced the table below summarising the findings from a survey of 115 UK companies operating DB schemes and illustrating the move away from a DB pension scheme over a six-year period (assuming that 50% of those considering closure go ahead with the change).

	New members (open)/ accrual (open)	New members (closed)/ accrual (open)	New members (closed)/ accrual (closed)
2003	60%	37%	3%
2006	27%	61%	12%
2009 (projected)	18%	53%	29%

As seen in the table above, almost a third (27%) of schemes surveyed remained open to new members at the present time. When probed on the reasons for remaining open to new staff hires, six in ten respondents (61%) said they believed the scheme was 'the right type of pension for my company'. A large percentage of respondents (43%) also claimed that they had left the scheme open because their DB plan was a valuable recruitment tool. However, as Aon's projected graph illustrates, even these schemes are under pressure to change and the harsh realities of DB pension costs will eventually outweigh their preferences for DB.

Paul McGlone of Aon said: 'While reflective of what is going on in the UK market, today's announcement by Royal Mail is interesting because of its quasi-public sector status. Now the government has recognised the need for limiting the pension liability going forward, as stated by Alistair Darling, it will be interesting to see if it will act on the vastly bigger problem of public sector pensions.'