

From the world of general insurance

Asbestos and pollution developments

It is thought that the cost of UK mesothelioma claims could increase substantially following proposals from the government which would provide faster compensation to all people diagnosed with the disease, whatever the source of their asbestos exposure. Initially, the compensation would be paid out of government funds, but could be recovered from employers and their insurers if a civil compensation claim is successful.

The Spanish government is planning to go further than required by the European Environmental Liability Directive (see these columns last month) by introducing mandatory insurance cover for such liabilities. It is understood that the annual cost to Spanish companies will be at least €100m. Details of the required coverage are still being finalised.

Terrorism

Robert Hartwig, president of the Insurance Information Institute, announced in early March that a US bill was expected to be published in late April to extend the government insurance back-up provisions of the Terrorism Risk Insurance Act for a further 10–20 years.

There have been a number of developments in the ongoing dispute between insurers and claimants in relation to compensation for the terrorist attacks on the World Trade Center in New York on 11 September 2001. A \$12.5m settlement has been reached between Silverstein Properties Inc (Silverstein) and TIC Insurance Co (in run-off) in respect of the latter's involvement in the coverage – this is in addition to the \$9.1m already paid, and is made up of a second tranche of \$9.1m, plus interest. Also, Allianz AG and Silverstein are understood to be in mediation over whether any further payment is due from the insurer, which has already paid almost \$550m – the amount disputed is of a similar magnitude. Finally, Silverstein and the Port Authority of New

York and New Jersey are seeking over \$1bn from Royal and Sun Alliance plc (RSA) in a suit filed in late February. This sum is made up of \$250m of actual loss, plus the balance in punitive damages, interest, and fees – RSA contends that the allegations behind the claim have already been addressed, being without foundation. In relation to this last item, see also the separate item on RSA.

Finite risk reinsurance

The Australian Prudential Regulation Authority has announced that it has completed its investigations into a series of financial reinsurance contracts undertaken by Zurich Australian Insurance Ltd in 2000, and will take no further action against the company. One former Zurich employee, Alan Parsonen, has been disqualified from acting as a director or senior manager of an insurer as a result of the probe – the transactions in question resulted in an overstatement of the company's profits.

Financial Services Authority (FSA)

David Whear, a partner at the law firm of Norton Rose, and a specialist in advising the insurance industry, has stated that he believes the FSA has significantly speeded up the process of setting up new firms in the insurance sector. His perception is that the time taken has reduced from 6–12 months a couple of years ago to only 2–3 months now. He suggested that this welcome development resulted from a wish to make the UK a more attractive environment for start-ups, particularly bearing in mind the historic advantage enjoyed by Bermuda in this respect, a factor in the significant number of new companies established there following hurricane Katrina.

The FSA has launched a consultation on the idea of expanding the base for funding the Financial Services Compensation Scheme (FSCS) to include wholesale insurance firms, even though claims

largely arise from the retail sector. This would, however, reflect the benefit to wholesale firms from the increased public confidence in the financial system resulting from the operation of the FSCS. Formal proposals to this effect may appear later this year in the FSCS Funding Review Supplementary consultation paper.

Solvency II

Thomas Steffen, the German representative, was appointed chairman of the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) at its meeting in mid-March, with John Tiner of the FSA as his vice-chairman. This is an important period for CEIOPS with their launch of the third quantitative impact study (QIS3) for Solvency II on 1 April, followed by the presentation of the draft directive to the European Parliament in July. In spite of these developments, it was apparent from the Institute sessional meeting on 26 March that there are many decisions (some of them extremely fundamental) to be made if the new Solvency II regime is to be introduced by 2010 or 2011, as planned.

Marine market profitability

The frequency of total losses in the marine market has fallen significantly since the turn of the century, according to the International Union of Marine Insurance statistics. In respect of ships of more than 500 gross tons, the number of total losses has fallen from 140 in 2000 to only 67 in 2006. They claim that this is the result of improved design and better safety regulations. However, this has been offset by increasing numbers of partial losses, which have more than doubled from 318 to 685 in the same period. With the additional factor of above-inflation on the increase in levels of repair costs, this is putting significant pressure on profitability in the marine hull market.

Lloyd's

A new Lloyd's underwriting agency, Ark Syndicate Management Ltd, has been established, with funding from Aquiline Capital Partners LLC, a New York private equity firm, and others. The agency will manage a new Lloyd's syndicate with capacity of £114m, writing principally marine and energy business. The senior management team is largely derived from executives previously employed by Aspen Insurance Holdings and the Wellington agency.

Insurance reforms in Florida

The Florida insurance commissioner has estimated that the legislative changes recently introduced in the state should reduce homeowners' property insurance rates by between 24% and 52%. In addition, there is an apparent reduction in investor demand for structured risk-transfer vehicles, such as reinsurance sidecars, in the state, and AM Best has increased the credit risk factor on reinsurance recoverable from the Florida Hurricane Catastrophe Fund from 4% to 12%, as a result of the reforms.

PX Re

Following the problems at PX Re last year, which resulted in the company going into run-off, as reported in these columns over several months, a merger of the company with US-based Argonaut Group has been announced. This will result in the majority ownership of the combined group (approximately 73%), being in the hands of Argonaut shareholders, and will give Argonaut access to the Bermuda market. The deal is expected to be finalised this summer.

Royal & Sun Alliance (RSA) US operations

The sale of the US arm of RSA to Arrowpoint, to which reference has been made in the asbestos and pollution section of these columns in the past two issues of *The Actuary*, has

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▶ finally gone ahead, in spite of a late appeal by policyholder Daimler-Chrysler. As part of the deal, RSA has strengthened the reserves held against future claims, and agreed to a degree of jurisdiction from the Delaware Department of Insurance. Following the sale, credit rating agencies Fitch and Moody's upgraded the UK group from BBB+ to A- and from Baa1 to A3 respectively.

Converium

In spite of the rejection of its offer for Converium, SCOR is launching a formal tender offer for the company, equivalent to a total valuation of Sfr3.1bn. It has already secured a 32.9% holding in Converium shares. The Converium board, which had previously stated that it intended to continue on a stand-alone basis, was understood, in mid-March, to be considering the possibility of seeking a 'white knight' to fend off what it saw as a hostile bid from SCOR. SCOR's shareholders would have the opportunity to vote on the bid at the French company's AGM on 26 April. Any takeover of Converium by SCOR would require approval from the European Commission, which was said to be examining the proposals.

At the beginning of March, credit rating agency Standard & Poor's reinstated Converium's A- rating, lost as a result of the problems encountered in 2006.

Large losses

Loss updates and related issues include:

■ **Windstorm Kyrill, northern and central Europe (18 January)** The total market loss figures quoted last month as €millions should, of course, have been €billions. Please accept my apologies for this error. However, the good news is that the figures now appear to be reducing a little, with a figure of €4bn now suggested, about half of it in Germany.

■ **Cyclone Favio, Mozambique (22 February)** This made landfall just north of the tourist town of Vilankulo, with maximum wind speeds of 127mph. At least ten people were killed in the storm, which caused widespread damage, and worsened the existing flood problem in the Zambezi valley – 120,000 people have now had to leave their homes because of the flooding. No insured loss estimate is to hand.

■ **Derailment of train in Cumbria (23 February)** The crash, believed to be due to faulty points, is likely to result in a claim against Network Rail, who have public liability insurance of at least £155m (the minimum required by the Office of Rail Regulation), understood to be led by QBE Insurance (Europe). The same insurer is also believed to participate on the insurance of Virgin Trains, the owner and operator of the crashed train.

■ **Tornadoes in southern states of US (1 March)** Insured losses have been estimated at \$460m, with a significantly higher level of economic loss.

■ **Earthquake in western Sumatra, Indonesia (6 March)** This measured 6.3 on the Richter scale, and caused at least 70 deaths (mainly from collapsed buildings) and hundreds of injuries. It was centred on the area around the capital, Padang. No loss estimates are known at this time.

■ **Crash of Boeing 737 in Indonesia (7 March)** This is the fifth airline crash in Indonesia in the past 12 months – on this occasion, the plane, operated by Garuda Indonesia, overshot the runway killing 50 and injuring ten of the 140 passengers and crew on board. The initial estimate puts the loss at \$50m, and is largely reinsured into London by the local market, which retains little net liability. The poor experience in Indonesia is likely to affect the availability of coverage at the next renewal.

■ **Cyclone George – Port Hedland, Western Australia (8 March)** Although this storm made landfall in a relatively sparsely populated area nearly 1,000 miles north of Perth, it made a direct hit on a small industrialised area where fuel is received, and where there is a container port. As a result there was significant disruption to crude oil production and

the export of iron ore. The windstorm, with gusts up to 170mph, caused three deaths – no insured loss estimates are yet available.

■ **Explosion in coal mine, southern Siberia (19 March)** This was caused by a build-up of methane gas, causing at least 100 fatalities. Insurance was believed to be placed in the local market, but there may well be some reinsurance into London and other international centres.

■ **Undersea earthquake and tsunami in Solomon Islands (2 April)** The earthquake measured 8.0 on the Richter scale, and had its epicentre 25 miles off the small town of Gizo. The tsunami caused waves variously estimated at between 10 and 20 feet high. At least 28 people have been killed and many thousands made homeless, with two or three villages having been said to have been wiped out. At the time of writing (the day after the incident) it is too early to estimate insured losses.

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

FRS 17 'snapshot' not the full picture

The Association of British Insurers (ABI) has published a research paper, 'Understanding Companies' Pension Deficits'. The paper analyses existing ways of measuring the pension deficits of occupational defined benefit schemes. It concludes that FRS17 numbers alone give an incomplete view, and proposes use of other data alongside FRS17 to improve understanding.

Stephen Haddrill, the ABI's director-general, said: 'We need to understand deficits better to devise investment strategies which really deliver the best value for beneficiaries and sponsoring companies. If trustees and sponsors do not have

a complete picture, pensioners could lose out badly. This paper is a valuable contribution towards improving the clarity of information on pension deficits. We encourage international standard-setters to draw on its findings in setting a new accounting standard, and trustees to use it in assessing the health of their pension fund'.

The research paper (at www.abi.org.uk) was sparked by concern that volatile deficits reported under FRS17 could spur pension funds to adopt investment strategies that failed to maximise returns for beneficiaries.

The paper concludes that while the FRS17 accounting standard has provided a useful headline figure of a company's pension deficit, addi-

tional information, particularly relating to the timing of cashflows, is needed to build up an accurate picture of the scheme's ability to meet its pension liabilities. This will help investors to make more informed decisions, and benefit trustees and regulators by allowing them to identify schemes that are genuinely most at risk.

Robert Hunt of Xafinity commented: 'It is worth noting that the ideas raised by the ABI paper have already been partially recognised by the Accounting Standards Board, in that it issued in January a "best practice" guide on additional, voluntary, disclosures which recommends the inclusion of a sensitivity analysis in relation to the main assumptions as well as cashflow information.'

Means-testing controversy

The Actuarial Profession attracted some publicity when it took out an advertisement in Parliament's *The House* magazine warning the government that its public interest duties could drive it to campaign for change in the personal accounts scheme unless strong reservations are dealt with. The advertisement explained well the fear which the profession has that the future effect of means-testing may be that enrolment in a personal account could with hindsight prove to have been a sub-optimal decision. Similar concerns are understood to have been voiced by many other parties.

The government stance has apparently not been voiced explicitly but is understood to assume that the employer contribution to a personal account would not be available to the employee in any other form. Some press comment has attributed to the government a view that encouragement of personal saving is for the general good in any event, independent of con-

tinuation of means-testing in whatever form this may take. Critics, including the Actuarial Profession, reasonably suggest that such views are open to debate.

Readers of *The Actuary* may wish to contribute to this particular debate. Where does the 'public interest' really lie and what should be the role of the Actuarial Profession in interpreting this? The profession is surely right to suggest that individuals should be able to make financial decisions in the fullest possible understanding of their probable and possible consequences. On the other hand, there are dangers in any implicit assumption that present redistributive means-testing policies are economically or politically sustainable indefinitely. How may a reasonable balance best be achieved which balances the rights of individuals who may enrol in personal accounts and the rights and attitudes of the broader mass of voting taxpayers?

We welcome readers' views on this and all issues – what do you think the profession should (or should not) be doing or saying in support of

optimising public welfare? Or is 'optimising' a question of choice of an appropriate balance of individual and collective interests?

Queen's Award to EMB for international trade success

As we went to press, news emerged of a second Queen's Award for Enterprise to actuarial consultancy EMB Consultancy LLP. The firm won its first award for innovation in 2003 for what is understood to be the world's largest and most successful range of non-life actuarial software. This year's citation notes that 'By 2000 virtually every large and medium-sized general insurer in the UK was an EMB client. In order to grow organically, therefore, the company turned seriously to exporting in 2001 since when it has not looked back. Over the last three years the company's overseas earnings have trebled from its markets in 44 countries worldwide.'



Risk is our Business

Accelerating risk management

Consultants Deloitte (www.deloitte.com) carried out a biennial survey of leading financial services groups entitled 'Accelerating risk management practices'. Key conclusions were:

- At 70% of the institutions, oversight responsibility for risk management lies at the very top of the organisation with the board of directors – up from 59% in 2004 and from 57% in 2002.
- An indication of the accepted role of the chief risk officer (CRO) in the industry is that 84% of institutions now have a CRO in place, up slightly from 81% in 2004 and 65% in 2002, with a further 8% planning to create such a position. The CRO reports to the CEO at 42% of institutions and to the board at 37%.
- Executives were most likely to rate risk management at their institutions as extremely or very effective for traditional areas – 80% for market risk, 80% for credit risk, and 73% for liquidity risk. In contrast, only 47% considered their organisations extremely or very effective in managing risks associated with business continuity/IT security, 43% each for operational and vendor risk, and only 35% for geopolitical risk.
- Only 35% of executives reported that their organisation had already implemented an enterprise risk management (ERM) programme. However, 32% said they are in the process of establishing one and 18% said they are planning to create one.
- Where ERM programmes have been created, they have yielded benefits – roughly three-quarter

of executives from organisations with ERM initiatives said the benefits of these had exceeded the costs. However, this assessment of value is qualitative only – only 4% of executives said their organisations quantify the benefits of ERM.

- Only 42% of institutions reported using stress-testing extensively as a tool to understand their risk profile, although a further 34% used it to some extent.
- Finally, in the area of operational risk, about one-fourth of executives said their operational risk management systems were very capable in terms of reporting and data-gathering, while more than two-thirds said they were at least somewhat capable in these areas. Lagging behind were exposure calculations and scenario model building.

AIG economic capital modelling initiative

American International Group Inc (AIG) announced in March that its board of directors had approved a new dividend policy and common stock repurchase programme.

The new dividend policy provides that under ordinary circumstances AIG's plan will be to increase its common stock dividend by approximately 20% annually. The new policy will be effective with the common stock dividend declared in May of 2007. In May of 2006 AIG raised its quarterly cash dividend 10% from 15.0 cents per share to the current quarterly dividend of 16.5 cents per share. AIG's board of directors

has expanded AIG's existing share repurchase programme by authorising the repurchase of up to \$8bn in common stock.

AIG has made available an executive summary of the company's economic capital modelling initiative which aims to help improve decision-making and enhance shareholder value. The executive summary explains various topics, such as AIG's view of economic capital and the company's plans for continued implementation. It is available in the 'Investor Information' section of www.aigcorporate.com.

An economic capital model assesses how much capital a company needs to stay solvent with a specified probability given the risks to which it is exposed. The results can be different, sometimes very different, from those arrived at by regulators or rating agencies.

The process involved some outside experts. For the modelling, AIG had help from Risk Management Solutions on catastrophic losses, Milliman on general insurance, and Mercer Oliver Wyman on life and retirement services. AIG also plans to get independent validation of its model that will probably involve academic experts.

Over the next two years, finance director Steven Bensinger says AIG will be discussing its findings with the ratings agencies in the hope that their view of the company's capital needs will move closer to AIG's own. AIG will be pursuing a similar process with the regulators that are also moving towards a more 'dynamic' approach to the assessment of capital requirements. Europe is leading the way here with its Solvency II initiative and he expects the US to follow.

AIG has set a high standard which no doubt its competitors are watching carefully.