

From the world of general insurance

Asbestos and pollution developments

A firm of solicitors, Thompsons, has drawn attention to the anomaly between the treatment of asbestos claimants in England and Wales compared with that in Scotland. For example, it has pointed out that widows of mesothelioma victims are subject to a compensation level set at £10,000 in England and Wales, whereas widows north of the border can receive up to £30,000, in addition to which other family members can receive amounts of up to £15,000.

In June, the House of Lords is expected to rule on the test case as to whether compensation should be paid, and if so at what level, to claimants with pleural plaques, but no visible symptoms.

Terrorism

The US Coalition to Insure Against Terrorism and the American Insurance Association have presented a common set of principles to the House of Representatives Financial Services Subcommittee in relation to its consideration of the possibility of extending the Terrorism Risk Insurance Act (TRIA) for a further period. The main requirements put forward are that the new TRIA rules should be permanent, that there should no longer be a distinction between acts of terrorism within the US and elsewhere, and that the provisions should include separate coverage of chemical, nuclear, biological, and radiological attacks. The industry bodies claim that these principles would provide long-term stability to financial markets and speedier recovery in the event of another terrorist attack.

Lloyd's

Equitas has completed phase 1 of its deal with National Indemnity Co, the Berkshire Hathaway subsidiary, under which National Indemnity provides \$5.7bn of reinsurance cover to Equitas, and acquires Equi-

tas Management Services Limited. This necessitated certain approvals and amendments from a number of bodies, including the Financial Services Authority, the Equitas trustees, the New York Insurance Department, and Lloyd's members, all of which requirements were met. The completion of phase 2 depends on a change in the law on transfer of liabilities within the Financial Services and Markets Act (which it is hoped will take place during this summer) and the approval of the High Court. These steps may prove a greater obstacle to the finality sought by names.

The Lloyd's market revealed record pre-tax profits of £3.7bn for 2006, with a combined ratio of 83%. This compares with a 2005 combined ratio of 112%, the difference being largely influenced by the very low level of catastrophe claims in 2006. It was also disclosed that the market reduced its US windstorm exposure by one-third in 2006 following the major hurricane losses from Katrina, Rita, and Wilma in 2005.

The above two developments resulted in an improvement from A to A+ in the Fitch financial strength rating for Lloyd's, and a confirmation of the A rating by AM Best.

Insurance reforms in Florida

In spite of fears that catastrophe coverage would be subject to major rating changes following the recent reforms in Florida, the 1 April renewals passed without any major changes. It is, however, believed that, with the inclusion of the doubling in the size of the Florida Hurricane Catastrophe Fund, there will be more than enough reinsurance capacity for the 1 June and 1 July renewals and this could put significant downwards pressure on rating levels at that time. The Colorado State University forecasting team has predicted that hurricane activity in 2007 will be 'significantly above average' having increased the predicted number of hurricanes of

strength 3, 4, or 5 from three to five, with at least one hitting Florida. London-based Tropical Storm Risk has also increased its predicted number of hurricanes, with both teams estimating a total of 17 named storms.

Converium

During the Easter period, SCOR published its official offer prospectus for Converium, which consisted of SFr4 plus half a newly issued SCOR share for each Converium share. This was in line with its original indicated offer, and remains on the table from 23 April to 22 May. A week or so later, Converium sued SCOR in a US court for violating local securities laws by excluding Converium's US shareholders (who apparently own 22% of the company) from the tender offer, and failing to make proper disclosures concerning the offer. Converium hoped that it would be possible to obtain a hearing of this case before the 22 May deadline. SCOR, for its part, refuted the accusations.

Meanwhile, Converium has put in place significant compensation packages for members of its board and senior management in the event that contracts are terminated following a takeover by SCOR.

(See also item on next page.)

Oil Insurance Limited (OIL)

The shareholders of this major Bermuda-based energy mutual voted in late March in favour of a restructuring of the company to allocate more fairly the burden of the windstorm-risk premium. However, it is understood that those voting in favour only constituted 77% of the 74 shareholders, and subsequently some 13 of the minority shareholders (especially utility companies) left OIL. A similar proposal to that now accepted was rejected by a narrow margin towards the end of 2006, and this resulted in the departure of nine shareholders.

Standard & Poor's (S&P) placed the company's 'A' credit rating on credit watch negative, citing concerns as to

the stability of the membership base. Under S&P procedures, within three months, the rating will either be reduced to a BBB+, or the credit watch will be removed, depending on the outcome of discussions between OIL and S&P, and any further developments.

Solvency II

In early April, the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) released details of its third quantitative impact study (QIS3) for Solvency II. This concentrates on data required to calibrate the parameters used within the new solvency regime, as the standard formula is now largely defined. The fact that this exercise has only one option for carrying out the calculations should reduce the workload on insurers and, it is hoped, increase their participation in the study. The results of QIS3 are expected to be released in October or November.

Job losses

Axa has announced that it is to reduce its workforce in Germany by 1,200, following its merger with Winterthur. Those affected are understood to be largely corporate function-holders in Axa Konzern and DBV-Winterthur, and were thought unlikely to involve compulsory redundancies, the intention being to manage the reduction by job changes and attritional losses of staff.

US Federal Catastrophe Fund

The Property Casualty Insurers Association of America (PCI) has recommended to a Congressional subcommittee that a federal catastrophe fund should be established to insure against what it describes as 'mega-catastrophe risks'. It is claimed by PCI that this would protect customers from spiralling insurance premiums, avoid widespread insurer insolvencies, and maintain healthy insurance markets in the US.

Generic financial advice

Otto Thoresen, leading a taskforce reviewing the availability of financial advice, has called on the pensions and insurance industry to contribute to development of a universally available advisory process. Speaking at the ABI conference on 10 May, Thoresen appeared to be echoing evidence given by the Resolution Foundation, which said that it was essential that advice be available in conjunction with the introduction of personal accounts. Thoresen emphasised his view that this would require a significant commitment, financially and otherwise, on the part of the industry.

Readers can keep in touch with the progress of the Thoresen review at www.hm-treasury.gov.uk/independent_reviews/thoresen_review

Insurance contract law review

The Law Commission has foreshadowed that it intends to issue a consultation paper during the summer. The consultation paper will set out the views of the law commissioners on the topics discussed in their three issues papers and the responses received to them. The issues papers covered misrepresentation and non-disclosure, warranties, and intermediaries and pre-contract information.

The deadline for responses to the new consultation paper will be 16 November.

Converium succumbs

Converium, formerly the reinsurance arm of Zurich Financial Services, has at last yielded to the overtures of SCOR of France. The combined entity will be the world's fifth-largest reinsurer, measured premiums. SCOR's initially hostile advances were unusual for the insurance sector, but a sweetening of the price offered by just under 8% (making the transaction worth about £1.4bn) sufficed to change the attitude of the Converium board and shareholders. Both Converium and SCOR have had volatile experiences in the recent past, but combination will presumably offer advantages in terms of risk diversification and more. (See also item on previous page.)

Pension scheme funding

At least 30% of pension schemes are prepared to set funding targets below the 'trigger' levels set out by the Pensions Regulator under the Statutory Funding Objective (SFO) regime, according to a survey by Mercer Human Resource Consulting. Mercer's SFO valuations survey studied 230 UK pension schemes across a variety of industry sectors and analysed the policies being adopted following the introduction of the regime in December 2005, and some of the governance issues arising.

The SFO requires trustees to set scheme-specific funding targets. While no specific rules

have been set as to the appropriate level of target, the Pensions Regulator has hinted at its preferences by setting 'trigger points', below which schemes' approaches may be subject to additional investigation. According to Tim Keogh, worldwide partner at Mercer, 'the data shows that at least 30% of trustee bodies are prepared to "trigger" and take their chances with the regulatory follow-up. The actual total of triggering cases could be as high as 60% – though we don't know the exact figure as the full trigger formula has not been made public'.

Recovery plans – the name given to policies adopted to increase the assets in schemes with a deficit – are becoming shorter. 94% of schemes plan to achieve their new funding target in ten years or less, compared to only 38% two years ago. 10% plan to settle the deficits almost immediately through extra contributions.

The survey shows that schemes have increased their funding targets by 8% on average over the past two years. The change is primarily to allow for increased longevity expectations.

School for regulators

City minister Ed Balls announced the next steps in the government agenda to increase the global competitiveness of the UK's financial services industry at a City High-Level Group meeting on 9 May. *continued on p18* ➤

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Large losses

Loss updates and related issues include:

■ **Wind and thunderstorms in Mexico, Texas, and Oklahoma (23–24 March)** Two deaths have been linked with this event and an initial estimated cost of \$55m has been published by the Property Claims Service.

■ **Tornadoes in the mid-west of US (28–30 March)** There are understood to have been 65 separate tornadoes, affecting 17 states, with the worst impact being in North Dakota, South Dakota, Minnesota, Wisconsin, Nebraska, Iowa, Illinois, Kansas, Missouri, Oklahoma, and Texas. At least four fatalities have been attributed to these storms. No insured loss estimates are to hand.

■ **Storms in northern Texas (13–15 April)** High winds, heavy rain and hail, plus at least three tor-

nadoes, caused at least two deaths and tens of thousands of claims for property damage. A church and several houses were completely destroyed, and the city of Del Rio was severely damaged by one tornado which, among other things, tore the roof off a school. No insured loss estimates are to hand.

■ **Tornadoes and rainfall in eastern and southern US (13–17 April)** These affected all the eastern states from Maine to Georgia, plus Mississippi, Louisiana, and Texas. No insured loss estimate is currently available.

■ **Flooding and tornadoes in eastern US and Canada (23–24 April)** These storms claimed at least 16 lives and affected the area from Florida to Québec, plus an area around Alabama and Ohio, and Texas. Nearly 1m properties lost their electricity supply. New Jersey

has estimated significant losses from what was described by the state governor as the second worst rain-storm in the state's history. No overall insured loss estimate is available, although it appears likely to run into hundreds of millions of US dollars.

■ **Earthquake in Kent, England (28 April)** This measured 4.3 on the Richter scale, had its epicentre under the English Channel and caused (by UK earthquake standards) quite significant damage to around 1,300 homes in Folkestone and the surrounding area. Early estimates put the insured cost at 'up to £50m'.

■ **Recall of exploding toilets in health and safety alert** The Japanese-manufactured Washlet toilets are designed to warm the seat, flush automatically, and wash and blow-dry users; unfortunately a number of them have also smoked, sparked, burst into flames, and/or suffered

from an explosion of the water pressure tank, and as a result 180,000 have been recalled by the manufacturers at an estimated insurance cost of £45m. The problems, which are not believed to have resulted in any serious injuries, are understood to have been caused by substandard Chinese parts.

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

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► At the meeting, the government and industry discussed detailed plans for an International Centre for Financial Regulation (ICFR). The centre will carry out research and offer training on international regulation with a view to influencing global regulatory developments. The proposal has attracted significant financial support from industry and the City, in addition £2.5m to be provided by the government over the next three years. At the request of the chancellor, Mervyn Davies, chairman of Standard Chartered, has agreed to chair the interim executive committee, representing donor interests, that will now prepare the centre for launch.

Ed Balls said: 'Developing a new world-class centre of financial regulatory expertise will not only help to inform the UK's principles-based regulatory approach, but influence developments in regulation across the world. The centre will be the first of its kind in the world, and although based in London it will have global reach, providing research and training for financial services regulators around the world.'

Sandy Crombie of Standard Life appears to be the only actuary on the City High-Level Group, which is also reviewing the workings of the London insurance market.

Regulating pensions ALM

Allianz Global Investors, one of the world's top asset management companies, has published what it says is the first major study of investment-focused regulation and accounting rules for defined benefit (DB) pension schemes in OECD countries.

Highlights of the study include:

- The valuation and risk characteristics of DB

liabilities under national regulation varies significantly across OECD countries. This has a direct impact on the asset portfolio – for example, even for identical pension plans there is no uniform optimal 'liability-driven investment strategy' in different countries. Furthermore, the difference in the way accounting rules measure the liabilities on the balance sheet creates a potential dilemma for schemes, as they cannot 'serve two masters at once'.

- Where regulation forces schemes into sub-optimal asset portfolios the employer's funding contributions will rise in order to meet future DB obligations.

- There are marked differences in the type of regulation requirements ranging from general recommendations such as the 'prudent person principle' to mandatory and strictly enforced solvency requirements. These requirements trigger different contribution and liquidity demands and influence the choice of the funds investment policy.

- There is a direct correlation between the DB benefit structure and the cost to the employer, in terms of the level and flexibility of the corporate funding strategy. Final salary schemes with guaranteed indexation are approximately double the cost of career average schemes with conditional (discretionary) indexation.

For more, visit www.allianz.com/de/allianz_gruppe/presse/news/maerkte_und_studien/maerkte_und_studien1/news_2007-05-09.html

tPR tightens transaction guidance

The Pensions Regulator has issued a reminder to parties considering corporate transactions – the

underlying principle for considering clearance is whether the event is financially detrimental to the ability of the pension scheme to meet its pensions liabilities. The reminder comes ahead of a planned update to clearance guidance during the summer.

Published on the regulator's website the reminder states that:

- ◆ Where there is a significant weakening of employer covenant as a result of a corporate transaction, for example where a highly leveraged transaction occurs and/or the assets for which the scheme currently has recourse are being removed from the employer group, then clearance is an appropriate consideration irrespective of the funding position of the scheme involved.

- ◆ In addition trustees in these sorts of circumstances should consider whether to seek a materially enhanced level of mitigation in excess of FRS17/IAS19.

This is also true of transactions which may result in scheme abandonment. The regulator also published its final guidance on scheme abandonment following the consultation earlier this year. The guidance reinforces its message that, in cases where there is an employer of substance, abandonment is unlikely to be in the members' best interests.

Paternoster powers ahead

Specialist bulk annuity provider Paternoster has taken more than £400m of pension scheme liabilities onto its books since its launch last year, the company has announced.

Pension funds transferred £260m of assets to Paternoster during the first quarter of 2007 – an increase of 111% in business quarter on quarter. The total value of the liabilities on the firm's account stood at £411.7m at 31 March 2007, it said.

Chief executive Mark Wood said Paternoster has been approved as the annuity provider to 19 pension schemes with 8,700 members. He added: 'The total market volume of for the quarter is expected to have been in the region of £600m of liabilities, representing a 50% increase on the same quarter last year. There are currently five transactions set to take place before September which are expected to bring another £2.5bn of assets into the market. This is the equivalent to the total market for 2006 and strong evidence of a rapidly growing sector.'

A Demon of Our Own Design

This book tells the story of man's attempt to manage market risk – see review on p42.

Compensation for Equitable policyholders?

The European Parliament's (EP) committee of inquiry into Equitable Life, in adopting its final report recently, strongly backed its rapporteur's view that the UK government should set up a compensation scheme for victims of the débâcle. MEPs also agreed that EU policy and law making must be overhauled to prevent such cases in future and to foster a healthy European pensions and insurance market.

The report – drafted by UK MEP Diana Wallis and adopted by the committee by 13 votes to 0 with 4 abstentions without any major amendments – must still be approved by the parliament's Strasbourg plenary in June. However, no further amendments can be tabled: the plenary can only endorse or

reject the committee's text.

The EP inquiry was set up in January 2006 in response to two petitions received by the parliament from policyholders who were among the victims of the financial débâcle at the Equitable Life Assurance Society (ELAS) that inflicted major losses on over a million people, mainly in Britain but also in other countries, including Ireland and Germany.

The committee has been looking into the role of UK government and regulators in implementing EU insurance law and that of the European Commission in monitoring the implementation of such law. The spotlight has been on two key issues: the plight of the policyholders and the implications for the European single market in financial services.