

From the world of general insurance

UK floods

The total insurance claims from the floods that ravaged the UK in June and July could top £5bn, industry experts have predicted. While official estimates have been more conservative at between £2bn and £3bn, industry sources have put the figure at potentially double that. The floods affected Yorkshire in June, with the latest floods affecting areas in the south – most notably Gloucestershire. Despite the magnitude of the losses, they are not expected to impair insurers' capital strength and are likely only to have an impact on earnings. Demand surge is expected to occur in the wake of the floods, where the sudden surge in demand for contractors leads to an escalation in costs for labour and materials.

The impact of the floods is being compared to the 1947 floods, when the large amount of snow and ice from the harsh 1946–47 winter melted during the spring of 1947 leading to widespread flooding when the country's river system failed to cope. Catastrophe experts claim that if the 1947 floods occurred today the resulting insured loss would be between £4.5bn and £6bn.

Reinsurance companies are expected to escape any major losses from the floods, owing to high retentions of primary insurers and the '168-hour rule' included in many reinsurance programmes. This rule means that insurers cannot make a joint reinsurance claim for the floods in Yorkshire and the southern regions since they occurred more than one week – or 168 hours – apart.

Insurers are already predicting that insurance premiums (for both residential and commercial property) could rise by between 5% and 10% at the end of 2007 as a result of the

increased claims in 2007, from both the flooding in June and July, and the storms in January.

In addition, the floods could trigger rate increases in the private motor market, with motor claims from the flooding possibly reaching as much as £25m, after an estimated 4,500 vehicles were damaged. This follows a 4.6% drop in the average car insurance premium during the second quarter of 2007, according to *insurancewide.com's* own car insurance comparison tool. This drop, though, conflicts with the AA's latest premium index, which showed a 2.5% increase.

Other large losses

■ **Earthquake and typhoon in Japan (July)** During July, Japan was hit by both a major earthquake and its first typhoon of the season, with the earthquake expected to be the more costly for insurers. Catastrophe modelling company Eqecat has claimed that the insured losses from the 6.8 magnitude earthquake, which struck on 16 July, will not exceed \$830m.

■ **Bridge collapse, Minneapolis, US (1 August)** The interstate 35W bridge in Minneapolis collapsed and seven people died when the bridge fell into the river. The Minnesota State Department of Transportation designed the bridge and has primary responsibility for its inspection and maintenance.

Travel insurance

Following a review by the Treasury of the sales practices of travel agents and tour operators, amid concerns of mis-selling, the Treasury has stated that the Financial Services Authority (FSA) will become responsible for regulating the sale of travel

insurance sold alongside a holiday. Travel agents selling insurance alongside holidays are currently exempt from FSA regulation. The new regulations are expected to come into effect in January 2009 after a further consultation period.

In connection with these new regulations, the British Insurance Brokers' Association (BIBA) is to lobby the government to bring the level of insurance premium tax (IPT) on travel policies in line with that on other insurance products. IPT on travel insurance is currently 17.5% compared with 5% on other insurance products, the higher rate being introduced in 1997 as a 'tax avoidance measure'. BIBA's view is that following the government's decision to regulate travel agents who sell travel insurance it was 'unsustainable' to have a differential level of tax for travel products.

Pleural plaque battle taken to Lords

Norwich Union and Zurich appeared in the House of Lords at the end of June to argue that sufferers of pleural plaques should not be entitled to compensation, following a long-running dispute. Pleural plaques attach themselves to the lungs and are believed to be caused by exposure to asbestos. They are symptomless and have no adverse effect on any bodily function. Claimants have argued that there is a higher incidence of mesothelioma in individuals with pleural plaques and compensation stems from the stress of knowing this. However, insurers argue that the development of mesothelioma is not connected to the existence of pleural plaques but to the original exposure to asbestos. A decision is not expected until October at the earliest.

Solvency II

The European Commission unveiled its draft proposal for Solvency II on 10 July, which should result in creating common capital standards across Europe, although the deadline for implementation of Solvency II has now been delayed for two years until 2012.

The draft directive lays out a new framework of capital requirements for insurance companies, as well as stipulating higher standards of risk management and improved disclosures. The framework gives companies a choice to either adopt a standard formulaic approach for assessing capital or to opt for internal modelling, which is more challenging in the short run but should provide a much better understanding of the risk inherent in an insurance business. In some circumstances regulators can insist that an entity develops an internal model if it feels that the standard formulaic approach doesn't accurately capture the firm's risk profile.

Other areas covered by the framework directive are that applications for internal models must be approved or rejected by regulators within six months of receipt, and that internal models must meet five tests: use test, statistical quality standards, calibration standards, validation standards, and documentation standards. The key of these is probably the use test, which links with the management of the business and is likely to be the test that most internal models would currently fail. The formulaic approach will be clarified after the results of QIS3 are available.

Following the publishing of the draft directive, there were warnings that the rules could lead to sharp premium increases for high-risk

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products, with covers such as long-tail liability becoming more expensive. However, other products such as motor and household may well get cheaper. There are also predictions that Solvency II could trigger a wave of consolidations and encourage insurers to move away from certain product lines. The regulations could also encourage insurers to increase the diversification of their books of business.

New Lloyd's syndicates

Some market participants are raising concerns about the number of new Lloyd's syndicates being approved at a time when rates are softening. Since the beginning of 2007 new start-ups in Lloyd's include Pembroke Casualty Insurance Syndicate, Ark Syndicate Management, Montpelier Syndicate 5151, and Mitsui Sumitomo Insurance – together bringing about £400m of fresh capacity to the market.

In the last month, a new Lloyd's syndicate has also been established by CMGL Syndicate Management, a Capita Group subsidiary company. The new syndicate will write the reinsurance to close of Syndicate 55, providing finality for the names of the syndicate. Capita CMGL will provide run-off and administrative services to the new syndicate.

Meanwhile, another new potential syndicate, Leinster Syndicate 4882, has failed in its bid to gain the necessary Lloyd's approval. Leinster is expected to try again to gain the necessary approval from 1 January, with a revised business plan.

Exit from Lloyd's

Highway Insurance Holdings has obtained court approval for the

transfer of the business of Lloyd's Syndicates 37 and 2037 to Highway Insurance Company.

Reduction in capacity predicted

Meanwhile, analysts have predicted that a number of existing Lloyd's insurers will cut capacity in 2008 in the wake of worsening market conditions. Widespread reductions are expected across all lines of business. Syndicates that have less catastrophe exposure are more likely to reduce capacity because rates are most robust in areas that have the most exposure to catastrophes. Kiln, Hiscox, and Canopus have already announced that they intend to cut syndicate capacity for next year.

Risk-based central fund contributions

Under proposals being considered by Lloyd's, individual central fund contributions may be based on the risk profile of each syndicate. Syndicates currently pay a central fund contribution of 1% of the amount of premiums they write, although it has been recommended that this be dropped to 0.5%. The new risk-based contribution proposal is contentious with some sources who claim it will result in double counting – since syndicates are already required to allocate capital to the market dependent on their risk profile.

Atrium acquisition

Ariel Re became the latest major Bermudian reinsurer to take a stake in Lloyd's when it bought Lloyd's managing agent Atrium Underwriting in a deal worth £193m. It is the second recent takeover by a Bermudian company, after Validus Re

bought Talbot Underwriting for £200m. Montpelier Re and Bermudian life insurer Sagicor has also recently established a presence in the Lloyd's market, with speculation that Canopus, the Lloyd's insurer, is another potential takeover target for a Bermudian operation.

Brit enters cat swap

Brit Insurance Holdings plc has agreed a three-year \$200m catastrophe swap with Cayman Islands-based cat swap specialist Fremantle Limited. Under the terms of the deal, Brit will receive up to \$200m in coverage if between four and nine specific natural catastrophes occur during the three years.

Berkshire Hathaway results

Second-quarter profit for Berkshire Hathaway rose by 33%, mainly from its insurance units and higher gains on investments. Net income increased to \$3.12bn from \$2.35bn a year earlier.

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

 KATE ANGELL,
RACHEL JACKSON

HENRY STEWART
CONFERENCE STUDIES

Friday, 28th September 2007
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Risk management has a new face

This is the slogan with which the Society of Actuaries has launched its new designation of Chartered Enterprise Risk Analyst (CERA). The society continues to explore with other actuarial associations the potential for a globally recognised designation. More on CERA at www.ceranalyst.org.

PPF levy consultation

The Pension Protection Fund board is proposing to maintain a stable levy estimate (allowing for indexation) for the next three years, subject to there being no significant change in long-term risk exposure. The board is proposing a number of actions that should lead to a reduction in the volatility of individual bills in the short term, including:

- ◆ setting a stable levy estimate for the next three levy years;
- ◆ collecting an amount each year that is closer to the levy estimate; and
- ◆ changing the levy distribution parameters to manage the level of cross-subsidy between stronger schemes and weaker schemes.

The consultation, in response to stakeholder concerns about levy volatility, may be found at www.pensionprotectionfund.org.uk. Responses are sought by 3 October.

The PPF also published in early August a description of its long-term risk model, which it has created with support from Barrie and Hibbert. This description also is available from the website.

Accounting for pensions

Lane Clark & Peacock (LCP) has revealed in its 14th annual *Accounting for Pensions* report that UK pension schemes of FTSE 100 companies had a net surplus of £12bn as at mid-July 2007. This is a dramatic improvement from a £36bn deficit

in 2006 and is the first time since 2002 that LCP's survey has shown the FTSE 100 pension schemes with a net surplus.

Key findings of LCP's 2007 survey include:

- The £12bn net surplus as at mid-July 2007 for UK pension schemes of FTSE 100 companies includes surpluses of £20bn against deficits of £8bn.
- Favourable investment returns are the main factor behind the record improvement contributing around £30bn. Higher real bond yields contributed £10bn.
- Company contributions hit a new record of £13.4bn in 2006, up 19% from 2005.
- 57% of total assets of FTSE 100 UK pension schemes are invested in equities.
- Many companies have updated their assumptions for mortality, reflecting growing evidence that life expectancy continues to increase rapidly.
- However, even the updated allowances made for future improvements in life expectancy may not be sufficient.
- Each additional year of life expectancy adds around £12bn to pension liabilities.
- Aggregate buyout deficit for UK pension schemes of FTSE 100 companies is estimated at £90bn at mid-July 2007, down from £175bn last year.
- 80 of the world's largest companies from Europe, the US, and Japan have a pension scheme deficit of £21bn at mid-July 2007, down from £88bn last year.

Art of pensions 2007

Actuary Lynda Whitney of Hewitt picked up the

prize for the most thought-provoking entry in this year's competition organised by Pendragon. Her entry, posing the question of whether better smoking habits have damaged the health of pensioners provision, is reproduced below.

Full details of all the 2007 winners, and indeed of some of the winners from preceding years, may be found at the Art of Pensions website www.artofpensions.com.

New research finds patients live longer under hospice care

From the US we hear of a study of the benefits of hospice care. The study was conducted by researchers for the National Hospice and Palliative Care Organization, and the consulting and actuarial firm, Milliman Inc. The researchers evaluated 4,493 patients with various forms of cancer and congestive heart failure. They analysed the differences between those who received hospice care and those who did not. Data came from the Centers for Medicare and Medicaid Services and represented a statistically valid sampling. The finding was that the hospice patients in this group lived an average of 29 days longer than the non-hospice patients.

What accounts for the increased longevity? According to the study, patients entering hospice in a weakened condition may avoid the risks of being over-treated for their illness. Secondly, hospice patients may receive better monitoring, treatment, medications, and therapies. Further, the physical, emotional, and spiritual support provided by hospice may also be a factor in extending life, as this kind of care alleviates anxiety and fear. The study also suggests that the use of sedatives and opioids does not negatively affect the patient's longevity, as some healthcare providers have believed.

