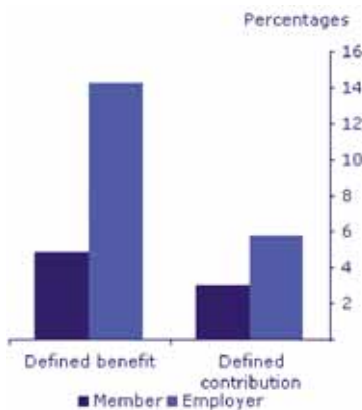


## Widening gap between DC and DB schemes

In 2006, there was a marked difference between contributions rates for defined benefit (DB) and defined contribution (DC) schemes in the private



sector. The rate for open defined benefit schemes – those where the benefits are specified, usually related to final salary – was 4.9% for members and 14.2% for employers. Whereas the rate for open defined contribution schemes – also known as ‘money purchase’ schemes – was 3.0% for members and 5.8% for employers.

Between 2004 and 2006, the combined contribution rates of members and employers to open private sector defined benefit schemes increased from 16.8% to 19.2%. However, there was little change for defined contribution schemes.

## Dangers of pensions advice

Pensions professionals are increasingly likely to face the threat of litigation, said Barlow Lyde & Gilbert litigation partner Tim Strong.

Solicitors and pensions consultancy firms have all faced an increased number of claims as the combination of increased life expectancy of the workforce and lower investment returns has left some pension funds facing large shortfalls. High-profile insolvencies – in some cases leaving employees with no pension provision – and increased scrutiny of the pensions industry from regulators, have also meant further pressure on employers and pension trustees. In this environment, an increase in the number claims is inevitable.

Handling and resolving pensions-related claims can be notoriously difficult, said professional liability partner Fergal Cathie. He presented a case study which examined professional negligence issues for actuaries at pensions consultancy firms and solicitors, and highlighted the risk of contribution claims and the importance of properly scoping the engagement terms.

## Uncertain future for defined benefit

There is considerable uncertainty concerning the future for DB schemes in the private sector according to ‘The changing landscape for private sector defined benefit [DB] pension schemes’, a research report published last month by the Pensions Policy Institute (PPI).

The research shows that DB pensions have been in decline for a number of reasons, including better than expected increases in life expectancy, low investment returns and increased regulation and legislation.

Scheme sponsors are reacting in a number of different ways to the challenges they face: reducing deficits or scheme benefits; changing investment strategies; shifting all, or some, of the risks associated with DB to the scheme members; or, taking the final step and winding-up or selling-on DB pensions.

Around two-thirds of private sector DB schemes have already been wound up or are closed (or are in the process of closing) to new members. Where there are replacement schemes they are predominantly defined contribution (DC) schemes, which can be less generous (see above), place greater risk on the employee and have lower take-up rates.

Chris Curry, PPI research director, said: ‘The cost pressures on DB schemes from rising longevity and uncertain investment returns are likely to remain. On an optimistic view, not all schemes are closing, and the rate of scheme closure has slowed in recent years. Some of the pressure could be eased by deregulation, and by greater encouragement for risk-sharing between

schemes and employees.

‘On a pessimistic view, the requirement for employers to auto-enrol their employees into existing pension schemes or into personal accounts from 2012 could increase cost pressures further, and hasten the switch to DC provision.

‘The future for DB pensions in the private sector remains uncertain. But it is likely that any future DB pension provision in the private sector will look very different to the provision of the recent past, with fewer schemes and risks shared differently between employers and employees.’

## Watson Wyatt alters pension scheme

Watson Wyatt has switched its own defined benefit (DB) scheme from final salary, to career average, and raised the retirement age from 60 to 65. The company closed its DB scheme to new members in 2002 and has entered into consultations to affect the changes in January 2008.

Babloo Ramamurthy, regional manager for Watson Wyatt Europe, said: ‘Our business faces exactly the same risks that many of our clients and other companies have faced in relation to the increasing costs of maintaining a final salary pension scheme.’

Watson Wyatt claimed this recent move would make the scheme more affordable as risk would be shared with its members and was not linked to investment issues.

Ramamurthy continued: ‘With the proposed changes we are also able to achieve a better balance in the value of the benefits being offered to all our associates.’

## Danger of pandemic underestimated

A new report issued recently by Marsh and The Albright Group warns that the catastrophic impacts of a longlasting pandemic are not only likely to happen, but overdue. The study also states the impact of a pandemic is likely to exceed what most corporate and governmental leaders have imagined, or are prepared for. This comes on the heels of US government reports issued earlier that come to similar conclusions.

The Marsh–Albright Group report has two primary focuses: social and economic. The social impact looks at the health and well-being of citizens, families, employees, customers, and business partners. The economic impact includes a deeper understanding of the potential for disruption of operations and supply chains, as well as diminishing or fluctuating demand for products and services. The report’s findings

were discussed by experts during the 5th International Bird Flu Summit.

‘Corporate Pandemic Preparedness: Current Challenges to and Best Practices for Building a More Resilient Enterprise’ was funded through an educational grant by Roche to help it better gauge potential global markets needs should a pandemic occur.

The scientific consensus is that an avian pandemic could sicken 20% of the world’s population, result in absenteeism of 40% of the global workforce, and kill tens, if not hundreds, of millions of people. The report goes on to say that outbreaks are likely to move along modern transport and distribution chains, with transport hubs being especially vulnerable. Disruption at these hubs will be significant and could have an irreversible impact on businesses.

The report is available at [www.marsh.com](http://www.marsh.com).

## From the world of general insurance

### Asbestos developments

The number of people prosecuted by the UK Health and Safety Executive for breaches of regulations involving asbestos rose from 12 in 2004/5 to 37 in 2005/6, according to recently released figures. While fines and other penalties involved in such cases will not be covered by insurance policies, there is usually liability cover for related defence costs, this appears to indicate a continuing increase in the level of asbestos-related injury claims.

### Terrorism and World Trade Center (WTC)

In mid-September, the US House of Representatives comfortably passed the Terrorism Risk Insurance Revision and Extension Act, but added a 'pay-as-you-go' provision, under which Congress would be required to approve payments after each individual attack – this was an attempt to appease President Bush, who appeared to remain opposed to the extension in principle. Insurers were unhappy with this change, which they believed to be potentially unworkable. In addition, there was concern that the Senate may weaken the bill further when it comes to vote on it – at the time of writing (early October), this is still pending.

In parallel with the position in the US, moves are afoot in Germany for a two-year extension of the life of EXTREMUS AG, the German backstop terrorism insurer, which had previously been said to be approaching the end of its existence, and for which the government wished to terminate its €8bn guarantee. Insurance industry representatives and risk managers for major commercial entities are now lobbying for this arrangement to be extended to 2010 when its current life runs out next year. It is thought that the government may require an increase from the current €2bn to €3bn in reinsurance coverage provided to EXTREMUS by commercial insurers, as a prerequisite of such an extension.

### Payment Protection Insurance (PPI)

In its latest report on PPI published at the end of September, the Financial Services Authority (FSA) has said that insurers of this business had made little progress and are still not treating customers fairly. The FSA is planning further enforcement measures, including fines. Which?, the UK consumer association, has called for offenders to be named and shamed.

### US sub-prime mortgage crisis

While the impact on general insurers appears to have been relatively limited, there is some concern that, in the event of a major loss or losses, such as the terrorist events of 11 September 2001 or the US hurricane season 2005, the industry may not be able to recapitalise as quickly as they did on those previous occasions, owing to the impact of the recent credit squeeze. Although there has been a series of announcements from major insurers that they have negligible exposure to US sub-prime investments, Maurice Greenberg, chairman and chief executive of CV Starr, has stated that he believes the actual position is much worse than has been indicated. This, he asserted recently, was because the way the debt obligations had been packaged meant that insurance investors often did not know what they had bought.

### Lloyd's

At the end of September Lloyd's announced that its pre-tax profit for the first six months of 2007 was £1.8bn, a 29% increase from the first half of 2006, in spite of a small reduction in premium income. The improvement has been partly attributed to the lack of major catastrophe activity, but with the warning that premium rates are softening in many of the business classes in which Lloyd's participates. In view of the strength of the Central Fund, it was also confirmed that the rate of levy

to the Central Fund for 2008 would be halved from 1% to 0.5%.

### Independent Insurance

In early September, Michael Bright (ex-chief executive of the failed company) admitted in court that he knew that some millions of pounds of claims against the company had not been entered onto their systems. This appeared to contradict a statement he had made earlier in the trial. It is believed that the consequent distortion of the results could have been of the order of £220m. It is now believed that only 38% by amount of claims were entered in 1998, and this had dropped to 20% by 2001, when Bright left the company and it collapsed. He was accused by the prosecution of withholding claims information to prevent the actuarial consultants (Watson Wyatt) from insisting on higher reserves. He subsequently also admitted to signing important legal documents, including a reinsurance contract providing coverage of £1bn, which he had not read.

When his turn in the witness box arrived, Philip Condon (ex-chief underwriter of Independent), claimed that he had not written certain letters which provided misleading information to the actuarial consultants, although they were signed in his name.

The third accused, Dennis Lomas (ex-financial director) also admitted knowing about the company's inadequate funds, but denied intending to mislead the actuaries, arguing that they would have over-reacted if they had received the full information, and raised again the issue of intimidation by Bright. This was also used to account for the fact that he (Lomas) apparently signed fraudulent stop-loss policies which were used in an attempt to save the company from insolvency – he could not remember these, and like Bright claimed that stress had caused him to lose his memory.

### New Cap Reinsurance Australia

Paul Williams, who was deputy managing director of the now-failed company from 1996 to 1999, has been disqualified by the Australian regulators from being a director or senior manager of a general insurer as a result of his role in negotiating a financial reinsurance contract with the company's parent to improve its reported profit in 1998.

### Large losses

Loss updates and related issues include:

■ **Hurricane Katrina (25–30 August 2005)** A federal court has ruled that an excess property policy containing a flood-exclusion clause nevertheless provides coverage for the wind-driven storm surge which inundated New Orleans. While the decision only applies to a policy provided by Factory Mutual Insurance Co to a shipbuilding company which suffered losses of over \$1bn, it is likely to have much wider ramifications, as there are a significant number of policies with similar wordings where Katrina claims are being contested. At the end of August, there was a flood of (at least 3,000) Katrina-related lawsuits in Louisiana as the deadline approached for cases arising from the hurricane to be brought. Many of these cases relate to the treatment of flood exclusions in policies.

■ **Tornadoes and storms in eastern and southern US (13–17 April)** The estimated insured cost of these storms has continued to increase and the latest figures have reached \$1.35bn.

■ **Cyclone Gonu, the Arabian peninsula (4–8 June)** (see August issue) The loss estimates in Oman have now been clarified. The economic loss is estimated at \$4bn, and the insured loss at \$1bn. The majority of the insured loss is understood to arise from loss of (or damage to) motor vehicles.

■ **Hurricane Dean (mid-August)** The authorities in Martinique and ➤

## From the world of general insurance

► Guadeloupe have increased their estimate of economic loss in the islands from €250m to €500m, of which they believe €185m to be insured.

■ **Hurricane Felix (1–6 September)** This category 5 storm hit Nicaragua and Honduras, producing up to 10 inches of rainfall and storm surges of 18 feet, but missing most major concentrations of insured property. Consequently insured losses are estimated at under \$200m. Felix is understood to have caused at least 38 fatalities, with around 200 others believed to be missing and many thousands made homeless. Following Dean, Felix makes 2007 the first year on record that two category 5 hurricanes have made landfall in the same year but, importantly for insurers, neither hit the US.

■ **Typhoon Fitow, Japan (5–8 September)** Although this made landfall not far south of Tokyo, it had surprisingly moderated from category 3 to category 1 by the time it did so. As a consequence, losses were estimated to be less than \$1bn.

■ **Loss of a communications satellite on launch from Kazakhstan (7 September)** This Japanese satellite failed to attain orbit after its launch by a Russian Proton rocket. Launch insurance for \$180m was placed by Marsh, mainly in the London market.

■ **Earthquake in Colombia (9 September)** This measured 6.8 on the Richter scale, but principally affected a sparsely populated area in the south-west of the country – as a consequence, losses are expected to be low.

■ **Undersea earthquakes, Indonesia (12 September)** These were centred 40 miles off the west coast of Sumatra and measured 7.8 and 8.4 on the Richter scale, fuelling fears of a major tsunami. However, although the impact was also felt in Malaysia, Singapore, and Thailand, there was no significant tsunami effect. Insured losses are unlikely to prove material given the relatively poor economic situation and low insurance penetration in the area, although at least 11 people were killed and many buildings were

damaged.

■ **Typhoon Nari, South Korea (13–17 September)** This struck the southern coast near Daedoek, causing at least 20 fatalities, severe flooding, the collapse of hundreds of buildings and widespread loss of power. No insured loss estimates are currently to hand.

■ **Air crash in Phuket, Thailand (17 September)** This involved a One-Two-Go Airlines MD-82 which crashed at Phuket airport, killing at least 90 passengers and crew, with several others seriously injured. The crash occurred as the pilot made a second attempt to land in heavy rain. Many of the passengers (over 40 of whom survived the crash) were foreign tourists, which may result in higher liability claims, possibly up to \$100m, in addition to the hull loss of \$3m. It is understood that the insurance is led by Global Aerospace Underwriting Managers in London – reinsurers are unlikely to be involved.

■ **Typhoon Wipha, Taiwan and eastern China (18–20 September)** This storm, which reached category

5 strength at its peak, passed close to the Taiwanese coast near the capital, Taipei, causing heavy rain and flash flooding. It then hit the Chinese coast well south of Shanghai, although the city had at one time seemed likely to receive a direct hit. It is understood that about 2.7m people were evacuated from their homes along the Chinese coast, principally in Zhejiang and Shanghai provinces, where severe damage was caused. The majority of the property is uninsured and estimated insured losses are around \$250m, although it is believed that economic losses exceeded \$1bn.

### 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](http://www.actuaries.org.uk/Display_Page.cgi?url=/general_insurance/gen_ins-curr-issues.html)

 DAVID HART

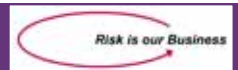
### Questioning enterprise risk management

'The End of Enterprise Risk Management' is a provocative paper by David Martin (CRO of AllianceBernstein) and Michael Power (professor of accounting at LSE). The paper can be found at <http://aei-brookings.org/> and we reproduce the abstract here.

'Enterprise risk management (ERM) has grown in significance since the mid-1990s to become a key resource in the conceptualisation and design of risk management systems. We argue that this emphasis is misplaced and contributes to the problem of a divide between analysis and action. ERM may be relevant for regulators and others in need of proof of good governance, but its formulations have become progressively detached from the reality of modern financial organisations. We argue that buy-side risk management practices provide an alternative conception of risk management which is more grounded in operations and which avoids the problems of actionability created by controls-based ERM.'

This sceptical view is echoed in a recent article

### Risk is our Business



in American Banker by Joe Rizzi, which includes a swipe at our own profession! Mr Rizzi is a managing director in risk management at ABN Amro in Chicago.

'Risk management has become a hypertechnical, specialist control activity with limited linkage to management or shareholders. Even worse are the unintended adverse consequences. A reliance on models may encourage us to become lax and amplify market volatility. The current collateralised debt obligation problem is an example of such an outcome.

'Risk management began as an exposure accounting and control system. The objective was to control risk by keeping exposures within certain limits that were frequently based on loss avoidance, not value considerations. The next development, quantitative risk measurement, took shape in the 1990s and uses an actuarial statistical approach to estimate future probabilities

based on past events. Unfortunately, markets are not actuarial tables.

'Quantitative risk measurement is essentially a sophisticated cost accounting system used to assign risk units – economic capital – to activities. The purpose of these measurement activities should be insight, not the measures themselves. Otherwise, risk management practices fail to address business issues and will be ignored by business managers.'

Mr Rizzi concludes: 'The most important component of risk management is management not measurement. Senior management must regain control of the process. It is too important to be left to specialists. If successful, enterprise risk management will transform risk management into a strategic value enabler, and not just a specialist control function.'

*The Actuary* welcomes views from its own readers – are these strictures justified?

## ► Insurance sector contributes £6.5b to exchequer

UK insurers provide £6.5bn in tax revenue for the government, new research commissioned by the Association of British Insurers (ABI) has revealed. Its members paid £3.1bn in taxes in 2006–07, with the UK insurance industry paying the third highest amount of corporation tax of any sector.

The research, which was compiled by business advisers PricewaterhouseCoopers (PwC), also revealed an additional £3.4bn in tax is collected on behalf of the government by insurance companies, through taxes such as PAYE, employee National Insurance (NI), and Insurance Premium Tax (IPT).

Insurance industry contribution to total tax take	
	£m
UK taxes borne	
– Corporation tax	1,875
– Other business taxes	1,213
	3,088
UK taxes collected	
	3,404
<b>Total tax contribution</b>	<b>6,492</b>

## Yet another new pensions company

Pensions First is expected to open for business late in 2007, following recent authorisation by the FSA. Chairman of the new company is Amelia Fawcett, who until April of this year was vice-chairman of Morgan Stanley's European business and is reported to be regarded as one of the most

powerful women in the securities industry.

## European reinsurance

The EU Reinsurance Directive is due to be implemented in all EU and EEA member states by 10 December 2007. Implementation of the Directive should see the harmonisation of the regulation of the reinsurance industry across Europe. The reforms, aimed at protecting consumers, will also mean significant changes for reinsurers, particularly those who do business on both sides of the Atlantic.

The key differences will be:

- Non-EU reinsurers will need to obtain authorisation separately in every member state in which they want to do business.
- Companies wanting authorisation for the whole EU will need a subsidiary in a member state.
- Member states will no longer impose collateral requirements on reinsurers from inside the EU.
- Once domiciled within the EU, reinsurers will have 'passporting' rights to all member states.
- The solvency margin requirements for reinsurers will be made the same as for direct insurers, but with the possibility of a 50% increase for certain risks categories.

These reforms will make it easier for EU reinsurers to enter the US market thanks to mutual recognition agreements. US regulators were reluctant to enter into such agreements until EU regulation had been harmonised. One consequence of mutual recognition will be that collateral requirements will be more likely to be based on the financial strength of the reinsurer and not just on its geographical location.

The impact of the new regulations has already been felt. Swiss Re has established Swiss Re Europe in Luxembourg and Munich Re is planning to merge with its subsidiaries in the EU. In London, trade in insurance-linked securities has increased dramatically in the year since the regulations were implemented in the UK.

## Should you be at work today?

'The Quality of Working Life 2007', based on the views of 1,511 managers, reveals that 42% of managers feel illness rates in their organisation have gone up over the past 12 months. One in three, however, claims a culture of not taking time off work for sickness exists in their organisation. Only 53% feel they would be treated sympathetically if they were ill.

The impact of this culture is seen through declining performance, waning enthusiasm, and increasing levels of suspicion. Only 36% of respondents claim to be operating 'at or near peak productivity'. With 67% claiming their productivity was reduced by ill-health, there is a clear indication of the extent to which health and productivity are linked.

More at [www.managers.org.uk](http://www.managers.org.uk).

## You should be at work today!

Also last month, Buck Consultants (Buck) announced the results of its global survey on workplace wellness strategies. Buck's study, 'Working Well: A Global Survey of Health Promotion and Workplace Wellness Strategies', analysed responses from 555 organisations representing approximately 7m employees.

Such programmes are most prevalent in the US, with 86% of responding organisations offering them. But even outside North America, about one in five employers offers wellness programmes. Multinational employers that have developed a global wellness strategy are 50% more likely to provide wellness programmes outside the US than other employers in those areas.

Objectives for wellness programmes vary by region. In Europe, top goals are to reduce employee absences due to sickness or disability. Canadian employers cite employee attraction and retention as the primary objective, while in the US, healthcare cost reduction is the top goal. Respondents in other regions seek improved workplace morale as the main objective for offering wellness programmes. Improving worker productivity is also among the top goals in all parts of the world.

More at [www.buckconsultants.co.uk](http://www.buckconsultants.co.uk).

## Investing in climate change

HSBC Corporate, Investment Banking and Markets (CIBM) has announced the launch of the HSBC Global Climate Change Benchmark Index, together with a family of four investable global climate change index products – a comprehensive range of climate change indices.

The HSBC Global Climate Change Benchmark Index, developed by CIBM's Global Research team, is a global reference index which has been designed to reflect and track the stock market performance of key companies that are best placed to profit from the challenges presented by climate change. The performance of the benchmark has been tracked back to 2004 and has outperformed the MSCI World Index by 80%.

From this benchmark, HSBC has established

four investable climate change indices that can be used to create portfolios for a diverse range of investment needs such as long only funds, hedge funds, exchange traded funds, discretionary funds and structured products. The indices are:

- ◆ HSBC Climate Change Index;
- ◆ HSBC Low Carbon Energy Production Index (including solar, wind, biofuels, geothermal);
- ◆ HSBC Energy Efficiency & Energy Management Index (including fuel-efficiency autos, energy-efficient solutions, fuel cells);
- ◆ HSBC Water, Waste & Pollution Control Index (including water recycling, waste technologies, environmental pollution control).