

NEWS FROM THE INDUSTRY – JANUARY 2008

FROM THE WORLD OF GENERAL INSURANCE

Asbestos and pollution developments

The English Technology and Construction Court has found in favour of the main contractor, Briggs & Forrester (B&F), in relation to their role in carrying out minor electrical works in 2003 at Southfield School for Girls in Kettering, Northants. B&F employed a specialist asbestos sub-contractor (B&W) to remove ceiling tiles in preparation for their work. Unfortunately, B&W's work resulted in widespread asbestos contamination of the school, as a result of which B&F were sued for damages and settled the case for £3.1m. The new verdict allows them to obtain recovery from B&W. The judge refused B&W the right to appeal. Interestingly, the B&W contract to remove the tiles was worth £725.

AM Best, the credit rating agency, has estimated that, as at the end of 2006, the US insurance industry has virtually eliminated the funding gap for asbestos losses, with incurred losses (including IBNR reserves held) at US\$62.2bn, against Best's ultimate estimate of US\$65bn. By contrast there remains a significant funding gap on pollution losses between the claims established by insurers (US\$33.7bn) and the agency's estimate of ultimate losses (US\$56bn).

Terrorism

During November, an attempt was made to reconcile the differences of approach by the US House of Representatives and the Senate to the Terrorism Risk Insurance Revision and Extension Act, and to introduce a fall-back 4 month extension of the existing Act in case of failure to resolve these differences by 31 December. In addition, plans were put forward to reduce the potential cost of the measure on the US Treasury by increasing the level and frequency of surcharges to be paid by private policyholders. Just before Christmas, the House passed a revised act (now called the Terrorism Risk Insurance Program Reauthorization and Extension Act), which provides the 7-year extension already agreed by the Senate, but incorporating the increased surcharges. This was signed into law by President Bush on Boxing Day, and met with general approval from the insurance industry.

Similarly, in Germany, the Government agreed to a 2-year extension of its €8bn backstop of Extremus A.G., Germany's terrorism insurance pool.

Regulatory developments

The Financial Services Authority (FSA) in UK has issued a consultation document on the selling of "connected" travel insurance (CTI) – that sold alongside a holiday or other related travel arrangements. This business, although currently excluded, will fall within the regulatory scope of the FSA from the beginning of 2009. The proposals include a requirement that a travel firm wishing to continue to offer CTI would have 4 options, to obtain authorisation, to become a representative of an authorised firm, to become an introducer for an authorised firm or to become an unregulated introducer (who could only provide information to customers). The consultation period closes on 18 March.

Regulations to amend the Sex Discrimination Act 1975 in Great Britain were laid before the UK Parliament in late November, but were then withdrawn following a rethink as to whether implementation of the EU Directive across the whole of the United Kingdom, including Northern Ireland, should be carried out as a single amendment. This results in UK missing the December 2007 deadline for implementing the EU Directive. It is expected that the revised legislation will be agreed early in 2008. Earlier in November, the Treasury had issued guidance on how insurers should meet their obligations under the proposed legislation. This guidance followed the closure of the consultation period in September, and stipulated that data used to support the use of gender as a rating factor must be compiled, published and updated in line with Treasury guidelines. These include a high level of aggregation (not requiring the disclosure of commercially

sensitive information), the use of ratios of male to female information rather than absolute amounts, and also provide for a certain amount of group publication where information for individual insurers may be lacking in statistical credibility. In addition, the guidance stipulates that the Directive does not apply to group policies or to long-term contracts with reviewable premiums where they inceptioned before 21 December 2007.

On 10 December, the EU Reinsurance Directive came into force – this simplifies the transfer of reinsurance business across the EU and lays down minimum regulatory standards including solvency requirements. This will be more onerous for reinsurers in most other member states, as UK has had similar requirements for some time.

At the beginning of December, the UK Government launched a consultation on possible changes to the Financial Services Compensation Scheme under which insurers would be required to make payments into the scheme in advance of insolvencies rather than, as at present, after the event. The proposals also include the possibility of cross-subsidies between different sectors of the financial services industry, such as banking and insurance.

Lloyd's

It was announced in mid-December that Tokio Marine & Nichido Fire Insurance Co Ltd had reached agreement with Kiln Ltd for the former to acquire the latter. It is understood that the purchase price is £1.50 per Kiln share, valuing the Lloyd's agency group at over £440m, well in excess of the market price prior to the acquisition.

US sub-prime mortgage crisis

In November, Swiss Re announced that it had suffered a loss of US\$1.1bn on two recent credit market transactions. The head of the Credit Solutions unit responsible for the loss was suspended. It is understood that the transactions were structured as credit default swap protection on a mortgage-backed security portfolio (and hence the connection to the US sub-prime mortgage situation). A M Best placed the company's A+ rating under review. This is the first major loss of this nature announced by the insurance industry, but may not be the last, as there are rumours of some exposures elsewhere, particularly in Bermuda.

UK work-related ill health

The UK Health and Safety Commission announced in November that there had been a 10% increase in work-related ill health in 2006/07 compared with the previous year. This is a reversal of the downward trend in the previous 5 years, and appears to have been partly caused by a marked increase in back injuries and stress-related illness.

Willis Faber Underwriting Management (WFUM) schemes of arrangement

One of the biggest and most complex schemes of arrangement ever put forward has been sanctioned by the English High Court. This concerns the WFUM pools, involving the insolvent Sovereign Marine and General Insurance Company and 14 other solvent companies (from various countries), which wrote a highly complex portfolio of multinational insurance and reinsurance business until the pools went into run-off in 1991.

Union Indemnity Insurance Company

The liquidator of this US insurance company which collapsed spectacularly in July 1985 with a shortfall initially estimated at US\$138.5m has finally produced an initial report on the status of the company, over 22 years later! This report shows an estimated deficiency of over US\$400m, including administration costs

of nearly US\$70m. The report also requested the court to set 15 November 2007 as the final date for submitting new claims and to authorise a first dividend to creditors. However, even at this stage, no quantification of such a distribution has been put forward. It is interesting to compare this with the previous item, regarding WFUM.

Climate change

The November sessional meeting of the Institute took the form of a series of presentations and discussions on the implications of climate change for the profession, including a specific session regarding general insurance, led by Graham Fulcher. The thought-provoking meeting was well attended, and for those unable to be present, there is a web-cast of the proceedings on the profession's web-site.

In mid-November, the UK Government published its draft climate change bill (believed to be the world's first), putting forward legally binding targets for reducing carbon emissions to 60% below 1990 levels by 2050. The Association of British Insurers welcomed the bill in general but suggested that the proposed 5-yearly reviews of progress were not sufficiently frequent – it preferred an annual assessment.

Also in November, the Intergovernmental Panel on Climate Change produced its fourth report, which indicated, among other things, that sea-levels may be rising more rapidly than previously thought, with obvious implications for flooding of low-lying coastal areas.

The United Nations Climate Change Conference took place in Bali in the first half of December. Whilst there was considerable disagreement over the direction of future policy, the conference eventually agreed the adoption of the so-called Bali road-map, which charts the course for a new negotiating process up to 2009. This would lead to an international agreement on climate change from 2012.

Collisions with deer in US

A report issued in November estimates that there are 1.5m collisions between motor vehicles and deer in the USA every year, at an estimated cost to the insurance industry of US\$1.1bn.

Large Losses

Loss updates and related issues include:-

Earthquake in northern Chile – 14 November – this quake, which measured 7.7 on the Richter scale, hit the Antofagasta region, which is relatively sparsely populated. Two people are reported killed and over 100 injured by collapsing buildings. An early estimate of insured losses suggests a figure of US\$80m.

Cyclone Sidr – Bay of Bengal – 15-16 November – this category 4 cyclone principally affected Bangladesh, where it was the second most powerful on record and where it is estimated to have caused 5000-10000 deaths. Peak estimated wind-speeds of 155mph were reported by the authorities. Massive evacuation of low-lying coastal areas in Bangladesh and Eastern India took place, including around 3.2m in Bangladesh. Enormous damage was sustained by the generally poor coastal communities with more than a quarter of a million homes destroyed and significant damage to the limited infrastructure and to the agricultural industry caused by the winds and storm surges of up to 5 metres. Early estimates of economic loss suggested a figure of around US\$500m, although very little of this is likely to be insured in light of the low insurance penetration in the economically disadvantaged country.

Explosion at coal mine in Donetsk, Ukraine – 18 November- this was caused by a methane explosion deep underground at the Zasyadko mine and resulted in the deaths of over 100 miners and injuries to many others. The families of the dead will each receive compensation of the order of US\$20,000. Incidentally, two further methane explosions occurred at the same mine in early December, causing further fatalities and injuries – it is hardly surprising that it has the reputation of being the most dangerous coal mine in the

world!

Typhoons Mitag and Hagibis, Philippines – 21-27 November – these were the later part of a weather system which had been meandering around the area for several days previously. They caused 29 deaths (9 in the Mindanao and Visayas island groups and 4 elsewhere as a result of Hagibis, and the remainder mainly in the Bicol and Albay regions as a result of Mitag). More than 200,000 people were evacuated from their homes in advance of Mitag which had reported wind-speeds of up to 140mph. The storms produced heavy rainfall, causing flooding and mudslides. No insured loss information is to hand.

Earthquake in Martinique, Dominica and Saint Lucia – 29 November – this quake, which measured 7.4 on the Richter scale, is estimated to be the second strongest to hit the Caribbean in 50 years. Due to the depth of the epicentre, the impact was relatively limited with one reported death and a small number of injuries. Some buildings collapsed in Fort-de-France, the capital of Martinique. Insured losses are likely to be relatively modest, but those in Dominica and Saint Lucia are expected to involve the Caribbean Catastrophe Risk Insurance Facility – Martinique is not a member.

Airliner crash in Turkey – 30 November – this involved an Atlasjet McDonnell Douglas-83 plane, which crashed in the mountains of western Turkey as it approached Isparta airport en route from Istanbul, killing all 57 passengers and crew. The hull is valued at US\$80m. Those killed included several prominent nuclear scientists on their way to a conference.

Cyclone Daman, Fiji – 7 December – this had maximum wind-speeds of 155mph, but fortunately missed most of the more highly populated areas. It did, however, cause extensive damage to homes and agriculture, particularly on the island of Cikobia, where few buildings are reported to remain standing. There are no reports of deaths or injuries as most of the inhabitants of the worst affected areas were able to shelter in caves. Insured losses are unlikely to prove material.

Ice storms in USA and Canada – 8-18 December – the first of these was concentrated in Oklahoma, Missouri, Kansas and Iowa, where strong winds, freezing rain, sleet and snow resulted in at least 38 deaths and loss of electricity to over 1.5m homes and businesses as power lines were brought down. A second storm principally affected New York state and New England, and a third one hit the area from Kansas north and east into the Canadian maritime provinces, causing an estimated further 25 deaths. No insured loss estimates are currently to hand.

The 2008 Hurricane season forecast produced by the team at Colorado State University have suggested that there will be seven hurricanes, three of them reaching category 3 or higher. One of the severe hurricanes is expected to hit the US coast. It should, however, be noted that the team's forecast for 2007 was approximately double the actual outcome.

Current Issues Newsletter

Other recent developments are covered in the General Insurance Current Issues Newsletter which can be accessed via the profession's web-site on www.actuaries.org.uk/link/general_insurance/gen_ins-curr-issues.html.

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