



The Actuarial Profession

making financial sense of the future

Part VII Transfers Involving APH – A Case Study

Lis Gibson and Darren Michaels

33rd ANNUAL GIRO CONVENTION

Hilton Vienna Hotel, Am Stadtpark

Our grateful thanks

On behalf of the Faculty and Institute of Actuaries 33rd GIRO Convention we thank Zurich for granting their permission for details of this Part VII transfer to be used as a case study.

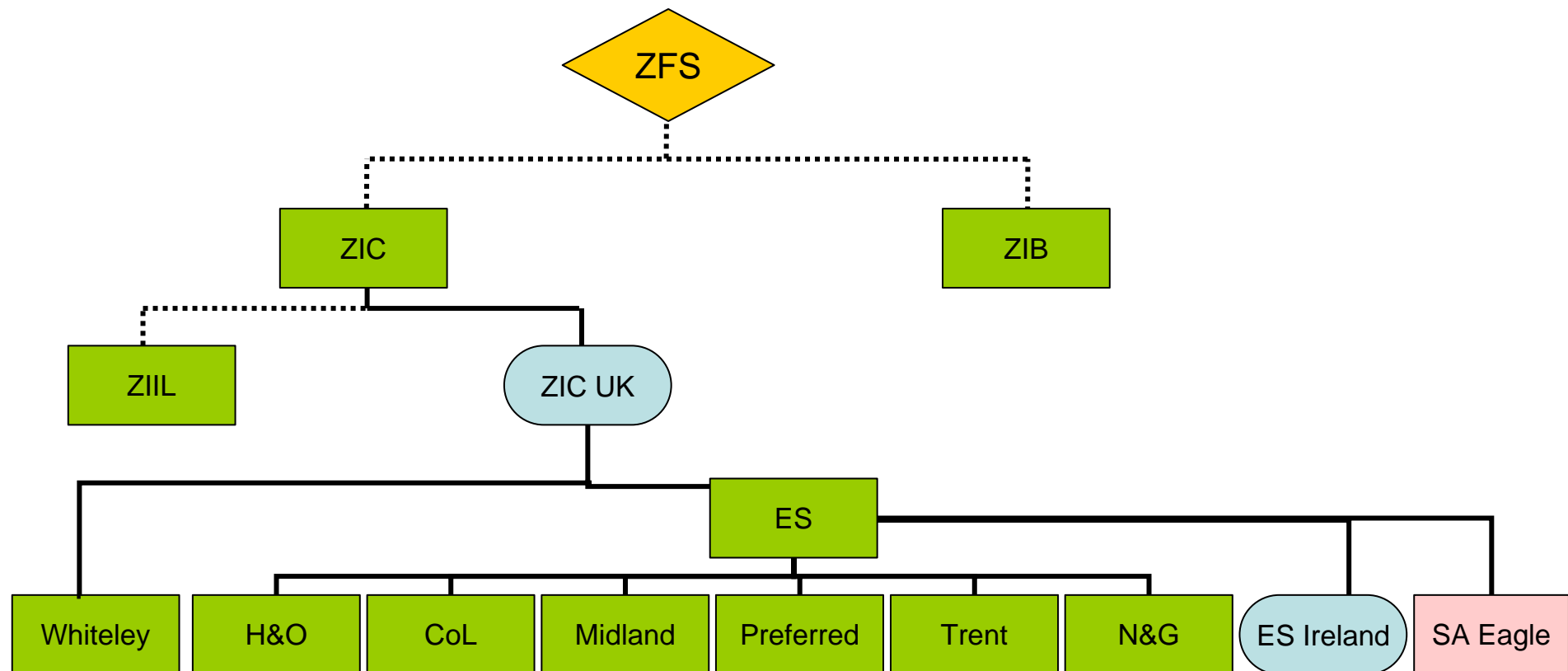
Part VII Transfers Involving APH – A Case Study

- Overview of the Part VII
- Review of Reserves and Capital of ESI
- Objectors and Objections
- Response to Objections
- Court Case and Ruling
- Lessons and Implications

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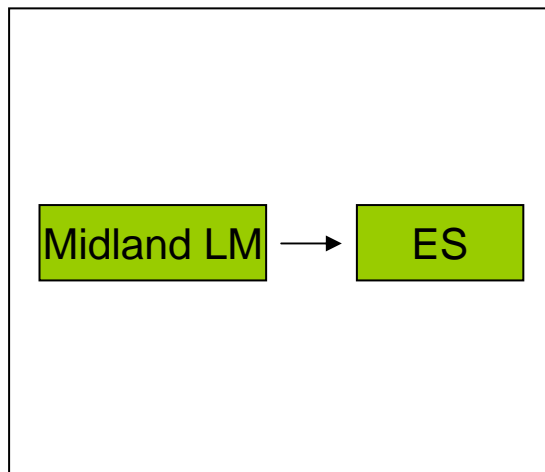
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Overview of the Part VII – Before

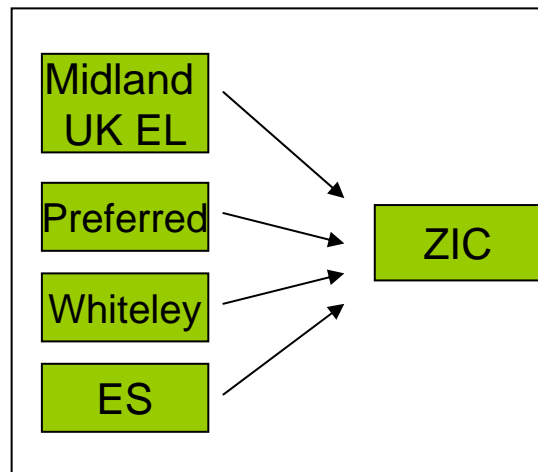


Overview of the Part VII – Transfers

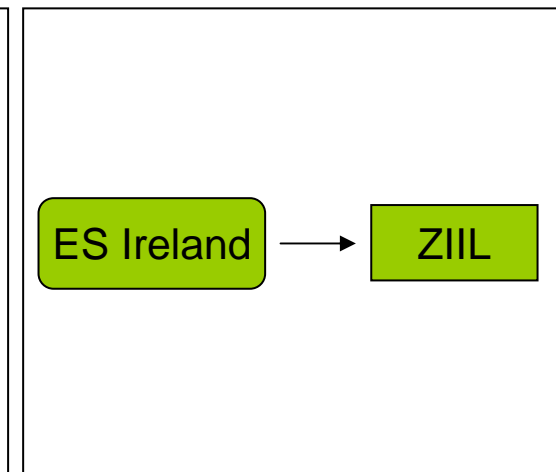
London Market Policyholders
Transferring to ES



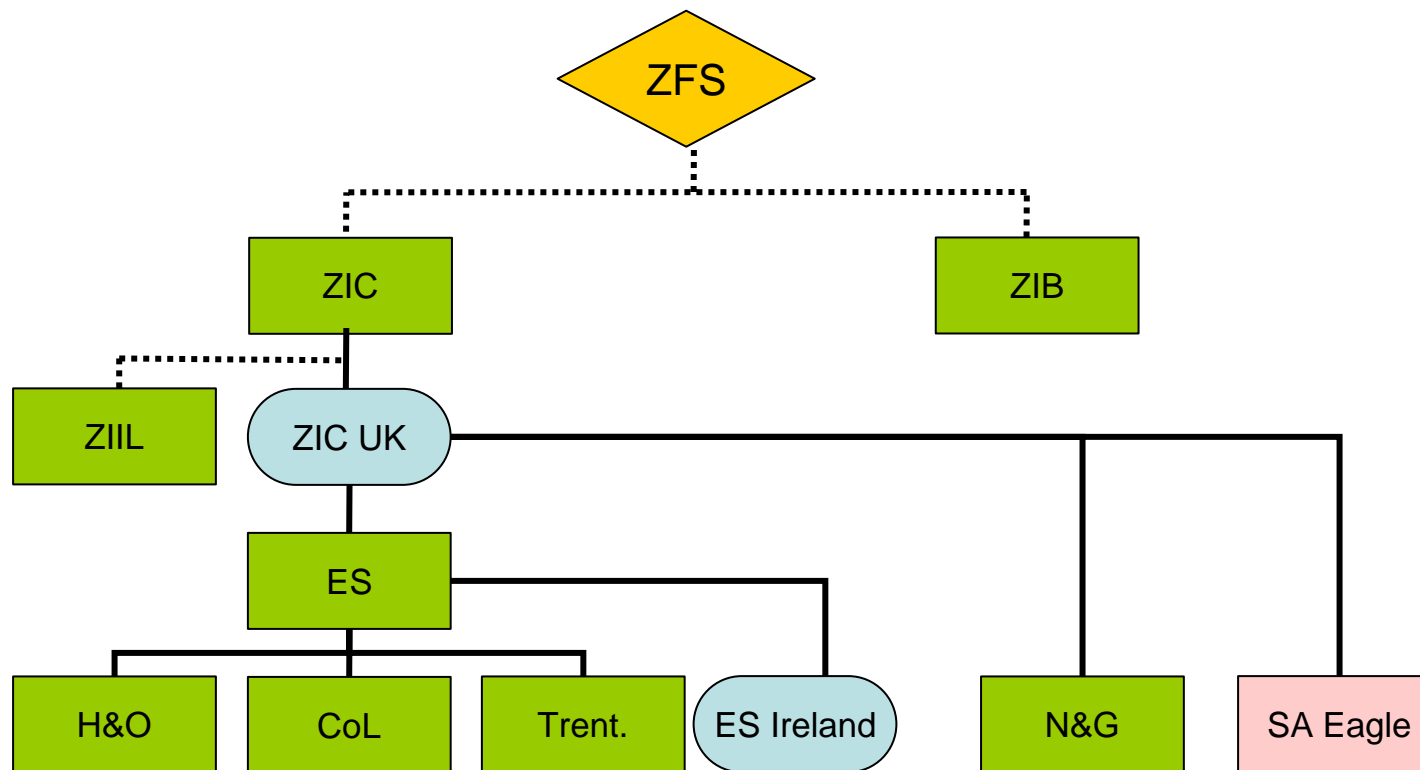
Policyholders Transferring to
ZIC



Irish Branch Policyholders
Transferring to ZIIL



Overview of the Part VII – After



Overview of the Part VII – Key Issues

- Large amount of business and capital transferring out of Eagle Star (ESI)
- APH business retained in Eagle Star
- **Is the combination of capital and reserves remaining in Eagle Star enough**
- When is enough enough?

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Capital Adequacy of ESI Post Transfers

- Key risks to ESI post transfers
 - Reserving (insurance)
 - Credit
 - Foreign exchange rate (market)
 - Liquidity

- The most significant of these was reserving

Reserving Risk

- FSA requested post transfer reserve review
 - Best estimate
 - 97.5% per ICA
 - Discounted
 - Deloitte appointed
- Purpose aligned with IE work
- Majority of liabilities are APH (75%)
 - 80% of which are in relation to asbestos
 - Detailed exposure-based review

Detailed Exposure-Based Review: Direct

- Assured specific assumptions rather than “average” assumptions
 - Products manufactured
 - Where and when
 - How have claims arisen to date?
 - Insurance coverage purchased
 - Relevant legal decisions
 - Detailed understand of (complex) corporate genealogy
- Assumptions continuously monitored and updated

Detailed Exposure-Based Review: Treaty

- Not benchmarks
- In-depth analysis by cedant and original assured
- Identify where claims have arisen to date
- Consider potential for where claims may arise in the future
- Utilise extensive knowledge of assureds
- Same approach in principle for first-time reinsurance and all levels of retrocession

Detailed Exposure-Based Review: 97.5%

- Step changes in current claims environment
- Changes in current legal environment
- Claims from new sources
- New latent claims
- Reasonableness check using benchmarks

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Objectors and Objections

- Class 1 – Malta Life policyholders
- Class 2 – Retired Glass Industry worker
- Class 3 – US Reinsurers
- Class 4 – Potential UK asbestos claimants

Objectors and Objections – Class 3

US Reinsurers' key concerns:

- APH volatile and reserves difficult (or allegedly impossible) to estimate
- Alleged that any reduction in capital necessarily made the transfer scheme unfair – allegedly set the scene for a future solvent scheme
- Concern over alleged inadequate FSA involvement
- Requested access to full IE working papers to facilitate forensic examination by objectors' experts.

Objectors and Objections – Class 4

- Solicitor acting on behalf of various allegedly potential claimants raised objections very close to court date
- Appeared to struggle to identify potential claimants involved in the transfers
- Found Mr B who had made a claim for pleural plaques
- But any relevant exposure was transferring to ZIC
- Reverted to Mrs B – retained by ESI
- Expressed concerns about
 - Right to be heard
 - Adequacy of capital – ZIC and ESI
- Asked the court to instruct Zurich to finance full fact-finding work

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Affected Policyholder Concerns – Class 3

“APH claims are volatile and reserve estimation is difficult, so there is a risk that the remaining capital will be inadequate”

Considered:

- Benchmark ratios implied by asbestos reserves
- Strength of asbestos reserves relative to US industry
- Ability of reserves plus capital to withstand adverse asbestos scenarios

Asbestos IBNR:OS Ratios @ 31.12.04

	Gross	Ceded	Net
US P&C Industry	165%	159%	171%
Company A	197%	108%	n/a
Company B	106%	106%	n/a

- Gross ESI Asbestos IBNR:OS Ratio: 391% (437% ex settlements)

Source Note 33 Data

Asbestos Survival Ratios @ 31.12.04

	Gross	Ceded	Net
US P&C Industry	8.5 yrs	8.4 yrs	8.5 yrs
Company A	10.6 yrs	7.5 yrs	n/a
Company B	9.4 yrs	9.4 yrs	n/a

- Gross ESI Asbestos Survival Ratio: 28.3 years

Source Note 33 Data

Strength of Asbestos Reserves Relative to US Industry

Basis	Net Ultimate (\$ bn)	IBNR:OS Ratio	Survival Ratio
US Industry @ 31.12.04	54.6	171%	8.5 yrs
Tillinghast L	55.0	176%	8.7 yrs
Tillinghast M	60.0	236%	10.5 yrs
Tillinghast H / AM Best	65.0	296%	12.4 yrs
Fitch L / Milliman	70.0	356%	14.3 yrs
Fitch M	75.0	415%	16.2 yrs
Fitch H	80.0	475%	18.0 yrs

Strength of Asbestos Reserves Relative to US Industry

- ESI Asbestos Gross IBNR:OS Ratio: 391%
- Equivalent to US Industry Net Ultimate: \$73bn
- ESI Asbestos Gross Survival Ratio: 28.3 yrs
- Equivalent to US Industry Net Ultimate: \$108bn
- Average Equivalent Ultimate Approx \$90bn
- Beyond most extreme end of current experts' estimates

Withstanding Adverse Scenarios

- Withstand major market events, e.g. massive deterioration in asbestos claims
- Consider net US Industry loss of \$200bn
- Average US insurer's reserves 7 times current
- ESI basis reserves increase 2.88 times
- Still covered by capital and reserves
- Also allows for a degree of deterioration in non-asbestos claims

IE Conclusions

- Reserves are robust
- Stronger than levels typically found in the US
- Stronger than the highest current views of experts
- Capital and reserves sufficient to withstand very extreme market event
- Transfers unlikely to result in material adverse financial impacts on remaining policyholders

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Court Case and Ruling - Adjournment

The Class 3 and Class 4 objectors sought leave to adjourn

- On grounds that they had not had access to the IE detailed papers (Class 3)
- On grounds that scheme was in their view clearly unfair (Class 3)
- On grounds that they did not have the resources to assess the impacts in the time available (Class 4)

Judge declined

Court Case and Ruling – The Scheme

The US Reinsurers then objected to the transfer

- APH volatile
- Capital reduction
- Alleged lack of scrutiny
- Also suggested that the IE was not truly independent
- Made numerous detailed criticisms about the IE's work

Court Case and Ruling – The Ruling

The Judge ruled in favour of the scheme

- Expressed the view that there was no obvious way for objectors to achieve a forensic examination of the IE's work
- The court relied on the IE, in conjunction with the FSA, to ensure the court was properly informed of the potential impacts of the scheme
- Judge found the ICA involvement important
- Expressed sympathy for asbestos claimants but did not agree that Zurich had to fund any data gathering
- Full ruling talks about scheme needing to be “a” fair scheme – not the best possible

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Lessons and Implications

- May be further attempts to achieve forensic challenge to IE work in Part VII transfers
- Difficult to balance adequate disclosure against confidentiality in such a public document
- The perceived link with solvent schemes was interesting, and could recur for future Part VIIs
- The level of adverse asbestos scenarios covered could be cited in future and used as a benchmark?



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