

Thank You to Michelle Roche

Michelle has spent several years editing the Newsletter. Council would like to extend their appreciation to Michelle for her enormous work over the years. The editorial team will miss Michelle as she takes a well deserved break from the Newsletter.



Communication with members via email

In response to the recent Member Survey, the Society will communicate with members, whenever possible, via email. Calender of events, notice and reservation form for meetings will be available on the website. The Society will remind you by email of upcoming events.

If you are not receiving email reminders from the Society then please email Sarah Cahill at Sarah.Cahill@actuaries.ie and Sarah will update your details in the membership database.

Diary Date

Fair Value & Solvency – the international dimension

This meeting will take place on the evening of **Thursday 27 March** in the Conrad Hotel. We expect to have about 20 European actuaries, representing the Groupe Consultatif, attending. We hope to have a good attendance from our own members to meet our visitors and to join them for a reception and dinner in the Conrad following the meeting. Further details and a reservation form will be on our website.

Diary Date

Annual Ball - Saturday 26 April 2003

The Ball will take place in the Shelbourne Hotel. We will shortly announce the theme for the evening! Meanwhile, please diary **Saturday 26 April**.

Practising Certificates

Council has introduced the following new requirement for applicants for Appointed Actuary, Scheme Actuary and Signing Actuary Certificates:

All applicants are now required to submit the names of two referees in support of their application.

10th Anniversary

Our December 2002 issue was the 10th anniversary of the Society's Newsletter and thanks to Jimmy Joyce for drawing this to our attention. A copy of the December 1992 issue is on our website.

Director of Professional Affairs

We will include an article on Aisling Kennedy's appointment as the new Director of Professional Affairs, in our next issue of the Newsletter.

The Qualified Financial Advisory Board

Congratulations to Bill Hannan, FSAI, on his appointment as Chairman of the Qualified Financial Advisory (QFA) Board. This new qualification for financial advisers is expected to become mandatory, according to the Central Bank. The QFA Board was recently established by the Central Bank to oversee the introduction of the qualification in a joint venture with the Institute of Bankers in Ireland, the Insurance Institute of Ireland and the LIA. Congratulations also to Tony Gilhawley, FSAI, who will be the principal author and editor of the syllabus and textbooks for the QFA examinations.

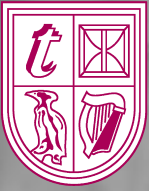
On the Move

⇒ Fellow Members	David Costello has joined Eagle Star from ESG Re
	Brian Foley has joined Ernst & Young in the UK
	Brian Heffernan has joined Imagine International Reinsurance Company from Centre Solutions
	Patrick Grealy has joined Imagine International Reinsurance Company from XL Europe Ltd
⇒ Student Members	Tara Greally has joined Mercer HR Consulting
	David O'Connor has moved from Ernst & Young to Norwich Union International



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Newsletter

The Society of Actuaries in Ireland

February 2003



Pat Rabbitte, T.D., Leader of the Labour Party, John Bowman, Seminar Chairman and Eamonn Heffernan, President of the Society of Actuaries in Ireland.

Where next for Motor Insurance?

Seminar 22nd November 2002.

Eamonn Heffernan, President of the Society of Actuaries in Ireland, opened proceedings by outlining how topical the subject of Motor Insurance is, particularly with the publication earlier in the year of the MIAB report, and subsequently the setting up of the PIAB.

Jimmy Joyce: Consulting Actuary, DETE

Jimmy spoke of the choices of regulatory models for insurance supervision and explained the characteristics of the different models. Regulatory systems balance both

prudential supervision and consumer interests. The Irish model could be described as free market, no failure, permissive, post hoc and indirect. In general, in all jurisdictions, there appears to be a tendency towards more regulation over time.

An inequality between buyers and sellers of motor insurance results from sellers having statistics not available to the buyers, a problem exacerbated by the compulsory nature of motor insurance.

Contd.→

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Where next for Motor Insurance?

Seminar 22nd November 2002. Continued...

In recent times, the unstable financial and economic environment in which insurers operate has left insurers more vulnerable to underwriting setbacks. Regulators' confidence in audit reliability has been shaken by corporate scandals. Increases in litigation and advances in medical technology have altered the market environment further. Shareholders' attitudes have changed, they are less concerned with the longer term, and are more concerned with short-term returns on capital. These conflicting tensions added to market difficulties.

Dorothea Dowling: Chairperson of the MIAB and the PIAB

Dorothea discussed some of the findings from the MIAB report, namely:

- Irish motor insurance made €343m profit in 17 years, which is a 4% return on capital. Consumers resent this.
- On average, legal fees amount to 40% of the claimant's bodily injury awards.
- The cost of insurance per vehicle in Ireland is twice the EU average.
- There is not a cartel in operation in motor insurance in Ireland.
- The industry should standardise renewal notices, and unbundle costs.
- The MIAB believes that while there is no national motor insurance data bank, there is a barrier to entry.
- There has been a reduction in competition in the market due to mergers and takeovers. There were 17 companies providing motor insurance in Ireland in 1993, now there are 5.

The MIAB suspects that one of the drivers for the poor results in motor

insurance in the last few years might be prudent reserving. Dorothea felt the recent introduction of actuarial certification may have caused actuaries to exercise more caution than was necessary.

The interim PIAB was set up on 25 October 2002. The PIAB brief has not been fully determined yet, but all members of the Board agree some broad principles:

- Natural justice and due process must prevail.
- The PIAB awards must be consistent with awards made by the courts.
- The PIAB will only deal with claims where there is no dispute as to liability.
- Claims will only be released to the courts after referral to the PIAB.

The MIAB are advocating better value for consumers, however the PIAB is not to be a means of reducing awards. This inherent conflict was not resolved.

David O'Connor: Risk Management Director, Allianz Ireland

A history of catastrophe losses showed an increasing trend not recovered in pricing. The occurrence of the World Trade Centre loss hastened the scale and timing of the reinsurance increases. A wholesale reassessment of risk and exposures by the insurance market was taking place. Insurers also came under strain from asset / liability correlations, feeling the effects of the bear market on investment returns. The overall result was that markets began pricing the long-term trends in losses, particularly catastrophes.

The domestic market also provides

an overlay of uncertainty with increased regulation and legislation. Correction of pricing deficiencies demands more capital, yet investors face this demand from insurers when capital is scarce and insurers reported profits are on the floor. From an investors perspective the market is undercapitalised following a long period of competition, latent claims, natural perils losses and equity market losses. The view of customers is also negative with a general perception of insurance being a 'rip off'.

What's the future? David set out the features desirable in an insurance market and the balancing required to facilitate opposing elements. He outlined the choices for the Irish market, in relation to legal / regulatory issues and to product / distribution issues. Finally, the headline issues for the Irish motor market were outlined. Whilst insurers margins are now acceptable there is a lack of capacity in the market and this has resulted in some sectors being hard hit. Also, with unlimited liability likely to go in 2003 there are future problems to come. The only barriers to entry currently are our small size in an international context and the level of regulation in the market.

Insurers have welcomed the MIAB report and the 10 insurer recommendations have been largely implemented already. However the 57 recommendations requiring Government action are already behind schedule. The how and who of the main initiatives planned were set out and an indication of the possible consequent reduction in insurance premiums was given.

Hugh Mohan, SC: Bar Council of Ireland

The Bar Council thinks that legal costs are too high and that the legal system needs root and branch reform. The current 3-year delay in accessing the courts could be reduced to 1 year. Expert witnesses could report to the court, rather than the plaintiff or defendant as they do at present. He believes that it is not barristers driving up legal costs and stated that there had been no increase in legal costs in the last 3-4 years. Also our award system differs from others in Europe, where loss of earnings and medical care are provided by the State. This is the principal reason why our bodily injury awards are comparatively high. Added to this is the fact that healthcare inflation has been very high in the last number of years.

In recent times the courts system has been overhauled with listing times radically reduced. The PIAB may only add an extra layer of bureaucracy. He agreed with David O'Connor that the PIAB might be just as useful as a catalyst for reform of existing systems of compensation. The net point was whether the economics of delivery could be improved?

With regard to a Book of Quantum, the Bar would prefer a book of precedence as the former suggests specific values for individual injuries and does not take into account personal circumstances. However, Hugh felt that the insurance industry must commit unequivocally to lowering premiums in response to changes.

Finally, Hugh referred to 'justice' and was concerned that the underlying agenda was to limit damages to genuine injured plaintiffs. He argued that the independence of the legal system ultimately provided the best guarantee of justice.

Pat Rabbitte, T.D., Leader of the Labour Party

In presenting the views of the ordinary citizen, including business people and company executives managing costs, Pat said that policyholders feel exploited by the insurance industry, that the regulators have let them down and that there are cosy cartels in operation. The motor insurance industry must bear some responsibility for these opinions as fraudulent claims are not defended and claims are settled when the policyholder is prepared to go to court. Then the insurance premiums of the insured in question are hiked up.

When in office, Pat Rabbitte had found the financial services industry to be very secretive and felt this is inappropriate in a modern age.

In his opinion, the PIAB is not the sole answer to motor insurance problems in Ireland, especially for young drivers. Our adversarial legal system is in crisis, is time consuming and expensive. Alternatives must be found and Pat suggested a shift to an inquisitorial system, with books of quantum, guidelines and case management.

There followed a very lively exchange of views, with Dorothea Dowling and Hugh Mohan to the fore. Finally Pat Rabbitte took the heat out of the situation by stating that he had never expected a seminar of the Society of Actuaries to be such an exciting event! Laughter ensued, and a hearty lunch followed.

Catherine Murphy, Ger Bradley, Sean McGrath

News in Brief

Cross-Border Life

The Cross-Border Life Committee, membership of which is open to actuaries working in the cross-border

market, met on the 7 January. The main items on the agenda were a discussion of a paper on The Role of the Actuary in Regulation of Life Assurance in Ireland and consideration of a draft Guidance Note on PRE for cross-border business (complementary to GN22 for domestic business) which Sheelagh Malin and her working group had drafted. Both topics generated lively discussions. The Committee deferred approving the draft Guidance Note on PRE until some issues, relating primarily to the disclosure charges on products such as tracker bonds, are resolved.

Life

The Life Committee is considering the implications for policyholders following on changes in the terms at which critical illness business may be reinsured. A Peer Review subcommittee will report back shortly to the Life Committee with a broad framework for the operation of a Peer Review system for Appointed Actuaries.

Pensions

The main issue for the Pensions Committee at present is the ability of defined benefit schemes to meet the Funding Standard, and the consequences of not doing so. The Pensions Board has been considering changes to the Funding Standard system, and met with the Society on this issue in October.

The recently published Social Welfare (Miscellaneous Provisions) Bill 2003 contains proposed changes in the operation of Actuarial Funding Certificates, Funding Proposals, and transfer payments. Some of the Society's guidance notes may need to be amended as a result.

The Pensions Board has also set up an expert group, chaired by Paul Kelly, to look at the nature of the Funding Standard and related issues. The Society has made a submission to this review.

Funding Standard issues will be covered at an evening meeting of the Society on 26 February.

The sub-committee on Defined Contribution schemes, led by Enda Walsh, has prepared a position paper on funding rates for DC arrangements, which will be issued shortly.

Report of the 2002 With-Profits Working Party, chaired by Brenda Dunne, which was presented to the Society on the 4th of December 2002.

Brenda Dunne, Shayne Deighton and Colin Murray presented the report of the With-Profits Working Party established by the Society's Life Committee. Brenda introduced the presentation by outlining the terms of reference of the Working Party, established in March 2002.

She then went on to describe the Irish with-profits market with some summary statistics. Since the market is entirely based on unitised with profits products now, conventional with-profits business was not considered in the report.

In terms of the products available, there are significant variations in the guarantees offered by product providers and it is not clear whether consumers fully understand these differences. In general, annual bonus rates are falling at the rate of about 1% p.a. currently.

A review of product literature revealed a lack of clarity in describing the key features of the product - the nature of the investments, how smoothing operates, the guarantees offered, how bonuses are calculated, MVAs, annual notices and past performance. Different product providers also used different terminology, which the Working Party believes is confusing for consumers. No product provider shows the underlying investment return achieved by their with-profits fund in the past.

Current Financial Management

As part of its research into the way with-profits funds operate, the Working Party conducted interviews with six appointed actuaries. Due to variations in company structures, there are fundamental differences in the nature and degree of profit participation between companies. All companies use asset shares but none make an explicit charge to cover the cost of guarantees and smoothing.

Companies have various techniques for applying smoothing to policies

when determining bonus rates. There is a general tendency to pay less than 100% of asset share for surrenders, with a gradual increase to 100% as policies approach maturity.

In terms of documentation of approach, this is generally achieved through reports to the Board and through policyholder communications. No company had one single document that fully explains the principles and practices of management that are currently being adopted, although some are trying to achieve this.

UK Developments

Shayne Deighton then provided a summary of recent UK developments in relation to with-profits business. There have been several initiatives prompted by events and/or vested interests or government agencies which have led to a myriad of reviews and reports, some of which are still ongoing. Shayne then considered the likely future outcomes arising from all this activity under 4 headings - Product, Governance, Transparency and Regulatory Reporting. Most of the UK developments will have some relevance in Ireland, except that there are no indications of a change in the role of the Appointed Actuary here, and the requirement for a smoothing account may not necessarily develop. Nevertheless, there is no doubt that change will increase rather than reduce the regulatory reporting burden.

Model Office Work

Colin Murray presented the results of the Working Party's model office work. The most thought provoking results were that, for single premium business written in 2000, assuming a sample term of 10 years, a 4.6% annual investment return would be required to support the maturity payout even if no further bonuses were added. This required return increases to 6.1% p.a. if bonuses gradually reduce from their current level.

Recommendations

The Working Party formulated their recommendations with a view to ensuring that with-profits business **does** have a future in Ireland. Recommendations were under 4 headings: Disclosure, Terminology, Principles and Practices of Financial Management and Financial Condition Reports.

Crystal Balls and Discussion

In terms of the future, this will undoubtedly bring reduced bonus rates and reduced guarantees. Some offices may increase their use of hedging, or we may see increased use of reinsurance to strong UK funds. There is a question mark over whether increased transparency, for example the publication of the smoothing account, will harm the product. With-profits products will be acceptable as non-standard PRSAs, but not standard ones.

There followed a wide ranging discussion, covering topics such as equity between generations of policies, the lack of clarity between smoothing and guarantee costs and where they are borne, the impact of the asset mix on projection rates, the publication of appropriate measures of financial strength and various communication issues. In conclusion, it was noted that with-profits policies had historically provided good value to consumers and it was important to educate product distributors so that they fully understood the product in the future.

Eamonn Heffernan closed the meeting by thanking all the members of the Working Party for their valuable contribution. The paper is available on the Society's website.

The members of the Working Party were: Brenda Dunne (Chairperson), Anthony Brennan, Shayne Deighton, Colin Murray, Michael O'Briain, Edel O'Connell, Munro O'Dwyer, Craig Tunstall.

Sheelagh Malin

Christmas Drinks



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Photo 1 Jim Kehoe, Peter Delany, Eamonn Heffernan, Bob Willis

Photo 2 David Costello, Pat Ryan, Jim Kehoe, Bob Willis

Photo 3 David Costello, Derek Bain, Chand Kohli

Photo 4 Patrick Grealy, Paul Walsh, Conor O'Neill, Michael Culligan, Michael Daly

Photo 5 Pat Ryan, Reamonn O'Sullivan



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Alternative Investment for Life

presented to the Society on the 22nd of October 2002,

A very interesting and topical presentation by Peter Caslin and Colin Murray was followed by a lively discussion ably chaired by Society President, Eamonn Heffernan.

Peter Caslin made the first presentation of the evening and covered sections 1, 2, 3 and 4 of the paper (available from the Society's web site). Peter's main points were:

- There is no regulatory barrier to a policy being linked to a hedge fund or a hedge fund related structured product, provided a) the fund's legal structure fits the requirements of Annex V of the EC (Life Assurance) Framework Regulations and b) it satisfies certain liquidity and other requirements in Annex V.
- Future regulation should not follow the UK's interpretation of the Third Life Directive, which effectively prevents hedge fund investment. The downsides of such a development would include the removal of diversification opportunities for investors and the erosion of competitive advantage for Ireland's cross-border life assurance industry.
- Whilst some surveys have demonstrated that hedge funds historically out-perform equity indices, one must be careful in taking at face value the statistics that are presented. Measures such as return, volatility and Sharpe Ratio (i.e. return – riskfree return, divided by standard deviation of return) are easily distorted by a) survivorship bias; b) selection bias; and c) stale or managed pricing. Space constraints preclude an attempt at explanation but for the record, Sharpe ratio = (return – riskfree return) divided by standard deviation of return. See Chapter 3

for more details.

- Despite the above 'health warning', hedge fund indices exist which attempt to mitigate or remove the impacts of the above biases and there is a sound rationale for investing in hedge funds, subject to caveats. Returns must be at least comparable to more conventional asset classes and there should be a low correlation between the hedge fund being considered and the existing portfolio. In such circumstances the possibility exists to maximise expected portfolio return for a given level of risk. A study by the University of Reading suggests that a hedge fund allocation in the range of 10-20% of assets achieves this objective.
- However, the key message is that detailed due diligence of each proposed hedge fund would be required in order to minimise the risk of something going wrong and to provide enough information for the purposes of policyholder disclosure. Recommended criteria for due diligence testing include whether the fund is OECD regulated, holds highly liquid assets, has a transparent strategy and has exhibited normal distribution of returns. (Afterwards, one contributor helpfully noted that the Alternative Investments Managers Association (AIMA) has produced a useful 'due diligence' template).

Colin's presentation covered sections 5, 6 and 7 of the paper and his main points were that:

- One can look to GN1 and GN22 for guidance on policyholder disclosure. The recommendation is

that, in order to satisfy the implicit requirements of the guidance, disclosures should include a) quantitative information, such as: 95% confidence interval for the range of expected returns, probability of losing money, and maximum 'drawdown'; as well as b) qualitative information, such as: parties involved in the hedge fund, counterparty risks, and broader statement of risks. These recommendations were well researched and included a review of Central Bank regulation of investment fund sales and practice in other overseas jurisdictions, such as the Isle of Man.

- There could be difficulty in achieving equity in unit pricing, particularly when performance fees are involved. These fees are payable when asset values move above the so-called 'high water mark'. The problem is that each generation of investors has its own high water mark. One possible solution is to have different tranches of unit for different investment date ranges. Colin suggested that this topic could be the subject of a paper in its own right. (Any takers?)

Colin also presented an analysis of the risk/reward profile of some investment strategies, including: standard equity fund; geared equity product; 'bomb and switch' product; and 'uncovered option' product.

Attendance was high as was praise for the paper, its authors and presenters. This synopsis cannot do justice to the quantity and quality of the subsequent debate and sound-bites. Highlights included:

- A well-timed comment about the importance of the quality of the sales process and of the advice

Assurance Companies & Pension Funds

by a working party of the Life Committee, chaired by Peter Caslin.

given and the need for a well-trained salesforce.

- One member's warning that we are handling 'commercial dynamite'; his apocryphal vision of an actuary in court after 'something goes wrong' at the mercy of a good barrister who would 'walk through' the actuarial profession; and his concern about the 'backside' of the profession. Needless to say, this sparked some lively discussion with mentions of 'Enronitis' and 'Endowments revisited'. Nevertheless, the point about the need to be robust in our logic and arguments was well made.
- Concern was voiced about potential commercial pressure on the Appointed Actuary to approve hedge funds and to scale back due diligence or disclosure requirements. One contributor noted that with no regulation to point to, the Appointed Actuary is left on his own as the 'thin blue line'. On the other hand, another contributor (who is not an actuary!) suggested that directors would be well advised to follow the Appointed Actuary's advice in discharging their duties.
- Many comments emphasised the current difficulties in marketing hedge funds and the pent-up demand for access to hedge fund products that could be satisfied by developments in the life assurance industry.
- The point was made that, in the light of FRS 17, pension scheme sponsors will be interested in hedge fund investment and that trustees will have a huge reliance on the actuarial profession to lead the way.

- A distinction between disclosure and understanding should be made, not only at point of sale but also in the Boardroom and the consequent leadership opportunity for the profession.

There seemed to be consensus that in determining the level of due diligence and disclosure required, there could be some differentiation between investors with different levels of sophistication. Suggested proxies for investor sophistication included product type (e.g. Personal Portfolio Bond); amount available for investment; and investor net wealth. There was also some support for the suggestion of allowing access to hedge funds only through the managed fund route in order to remove the risk of policyholder over-exposure to hedge funds.

In response to the various comments, Peter and Colin pointed out that in making selected hedge funds available the life assurance industry would be operating within existing regulation. Moreover, hedge funds are already available to retail customers in countries such as Germany, Japan, Hong Kong, Italy and France. They emphasised that the key issue is whether it is in a client's interest to offer hedge funds for diversification, subject to disclosure and having conducted due diligence, not least in respect of liquidity.

It is clear that the 'hedge fund' label covers a widely heterogeneous grouping. What is required is the skill and the application to carry out thorough due diligence on the range of funds available and the ability to communicate a) the risks and benefits of investment in selected hedge funds; and b) the fit of these funds within the client's broader investment strategy. Actuaries are well equipped

to take on these challenges and thereby to play a leading part in the continuing evolution of the retail and institutional investment markets. In the absence of a 'nanny state' who else can serve the public interest so well?

I would recommend the paper as an interesting read to any actuary. Along with the recent prize-winning paper on hedge funds written by John Caslin, it should be considered as required reading for all actuaries who are connected with a decision to invest in or to offer a hedge fund or for those who must deal with the practicalities of implementing such a decision.

Finally, this paper was written by a working party of the Cross-Border Life Committee and credit is due to all its authors: **Peter Caslin; Adam Lyon; Colin Murray; Jim Murphy; Martin Considine; Mark Maguire; Philip Ingram; Brian Grimes and Eamonn O'Lideadha.**

Stephen Devine