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Insurance Day

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Risk carriers urged to seize the initiative

Instead of waiting for a market change, property insurers should take action, Ahuja says

Amy Tiernan

Offices: Ahuja believes commercial property insurers would be better off acting than calling for rate hikes

COMMERCIAL property insurers in international insurance markets would be better served by making fundamental changes to their business rather than calling for blanket rate increases that are unlikely to materialise, a leading actuarial consultant has warned.

EMB partner, Raj Ahuja, told *Insurance Day* underperforming players in the London and international markets need to stop waiting for the market to move and take control of their own destiny. "There is no doubt some commercial property insurers need a rate increase but they are not going to get it by simply waiting for the market to move because the market in totality is not motivated to do that," he said.

A substantial number of players are calling for rate increases in the sector as they view the market as being at an unprofitable, unsustainable stage.

However, according to research conducted by EMB, while all commercial property insurers would like rates to go up, not everyone needs them to rise. EMB's analysis of 52 players in the commercial property market revealed the overall premium base to be unsatisfactory at slightly more than £6bn ($9.92bn), which "confirmed the need superficially for a rate increase", Ahuja said.

But on deeper analysis, EMB found two distinct blocks of players in the commercial property market: those that have been consistently profitable over a four-year period (A-list) and those that have not (B-list). It also revealed a near-30-point spread between the underwriting performance of the A-list and B-list insurers.

Ahuja said: "The A-list is not motivated at this stage to make material changes [as they are consistently profitable]. The B-list needs to take control of its own destiny and stop waiting for the market to move. They need to make changes in their own businesses to make the changes to where they want to be."

EMB found the differential factors between the A- and B-list insurers included the sophistication of pricing methodologies and pricing platforms. "We also feel there is a difference between the way the pricing process is governed and the way reinsurance is purchased," Ahuja said.

He added a more informative and crude methodology surrounding risk selection will heighten the probability of B-list insurers joining the elite A-list, which are remaining profitable year on year. "Better risk selection will enable commercial property insurers to call for selective rate increases but they need to be careful about how they consider these rate increases and implement them," he said.

p2: Comment

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Call for pricing based on quality

A LEADING marine underwriting expert has been sounding out the specialist market on its readiness to give shipowners tangible pricing benefits for quality operation.

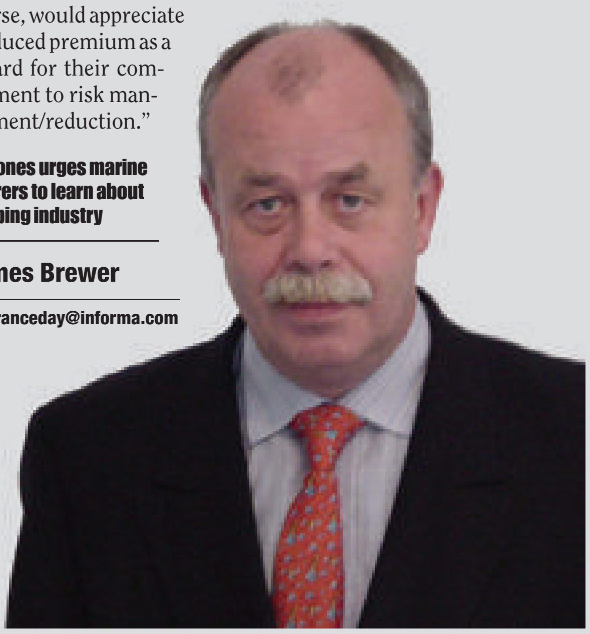
"I think the key issue in shipping is the need to move towards a 'no-blame' culture," Jonathan Jones (*pictured*), a Greek-based practitioner with extensive experience of international markets, said. "To do this, underwriters need to become proactive, not reactive and penal. If underwriters look to reward shipowners with premium credits for adopting a no blame culture, that must be a move in the right direction."

Jones, managing director of insurance consultancy JLJ Maritime of Glyfada and an underwriting agent for RESO-Garantia Insurance of Moscow, has prepared a detailed questionnaire that would elicit information confidentially from shipowners about their observance of best practice in running their vessels.

Underwriters needed to investigate how shipping companies manage the non-technical/soft skills required in running any business, Jones said.

He admitted the potential complexities of the scheme would not appeal to all, "especially the less professional broking firms, which will see this as simply more work for no extra reward. On the other hand, professional brokers must surely be keen to encourage openness, a greater degree of understanding and trust, and creating real, longstanding partnerships that are not simply price-driven.

"I think the client would really welcome underwriters adopting a positive approach and, of course, would appreciate a reduced premium as a reward for their commitment to risk management/reduction."



p3: Jones urges marine insurers to learn about shipping industry

James Brewer

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Heitz (left) and Kempchen: the men will share chief executive duties

OVB management board forces out chief Michael Frahnert for alleged lack of loyalty

Herbert Fromme, Cologne

THE INSURERS that own Cologne-based independent financial adviser OVB have sacked its chief executive with immediate effect, with market sources suggesting he was ousted because of an alleged lack of loyalty to the firm.

Michael Frahnert has been with the organisation since 1993 but has now departed after a unanimous decision by the supervisory board. He has been replaced on the management board by Wilfried Kempchen, who will share Frahnert's duties with chief financial officer, Oskar Heitz.

OVB, which stands for Organisation für Vermögensberatung, (organisation for asset management) is owned by Deutscher Ring, Signal Iduna and Generali, with 8.4% free float, mainly held by management and staff.

The row with Frahnert had nothing to do with shareholders' bitter row over other matters in the Deutsche Ring group, insiders said. They point to the fact all members of the supervisory board agreed to the sacking.

Sources have suggested Frahnert was preparing to leave OVB and set up his own independent financial adviser, taking important personnel with him.

Splits and start-ups of this nature are common in the business, with the economic downturn increasing the potential for this to happen.

OVB has not commented on its reasons for the instant sacking of its chief executive. Frahnert, who is on holiday at the moment, also did not want to comment.

One person close to Frahnert said a "long-term process of alienation" had taken place, suggesting there was pressure from the company's ownership for the company to increase its international business.

OVB is already experiencing difficulties in eastern Europe, where the company writes half of its business.

OVB sells policies for insurers, banks and other financial service providers through freelance sales representatives. With its 4,862 agents, OVB earned commission amounting to €260m ($370.6m) in 2008, a rise of 5.7%. The group's result rose from €20m to €24m. The result for the first half of 2009 is said to be much worse; OVB will publish it in August.

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COMMENT

Commercial market needs to take control

IT HAS been clear for some time the commercial property market is not behaving uniformly, both at primary and reinsurance level.

As EMB's Raj Ahuja points out in today's *Insurance Day*, those in the sector waiting for the market to act in totality will need to rethink their strategy because there is no motivation for this to happen.

Historically, market cycles have been far more succinct than the state of flux in which the industry currently finds itself.

At the reinsurance level, there was much talk one year ago that rates were set for a dramatic hike, with one reinsurer declaring we had now entered a hard market in the run-up to last year's conference season.

But subsequent renewal seasons have failed to deliver rate hikes at the level that reinsurers desired, which is perhaps not surprising given the challenges primary insurers have faced in achieving rate increases themselves.

The message from Ahuja is clear – now is time to take control of your own destiny. Those waiting on rate increases to achieve profitability are unlikely to experience any joy in the near term, particularly given the financial uncertainty facing the industrialised world.

People have talked of an approaching hard market for so long, yet no-one seems to be quite sure if it ever arrived. The increasingly technical nature of the insurance and reinsurance business has meant the difference between stronger and weaker players is becoming increasingly defined.

Even major losses of recent years have tended to only mean rate increases in related lines of business – a hurricane hitting the US no longer means catastrophe rates are rising in Japan as a result.

Talk of hard and soft markets will in time become a thing of the past, with the increasing sophistication of the industry finally ridding it of the cyclical trends that have dogged the sector in difficult times and provided inflated rewards during the good years.

The evolving financial services landscape of which insurance, like it or not, remains a part, will help further rid the industry of its historical trends. As regulatory measures strengthen and capital management becomes core at major international players, peaks and troughs will slowly become a thing of the past.

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3 Premiums reduced

More than half the aerospace policies written so far in 2009 have seen their lead premiums reduce. According to the latest Aon aerospace market update, it is predicted there will be 245 aerospace renewals in 2009

4 Allianz ailing in US

Allianz will have to strengthen the capital base of its US life subsidiary considerably after severe problems in the market and difficulties with its variable annuity products

5 21st Century cuts

Former AIG motor unit 21st Century Auto Insurance has been given the go-ahead for a $34m rate cut in California. The insurer was bought earlier this month by Zurich subsidiary Farmers Insurance

6 Rewriting the rules

The recent House of Lords ruling in the UK case of *Chartbrook v Persimmon* is one of the most important decisions on the interpretation of contracts in the past decade

7 French revolution

France looks likely to abolish the role of *juge d'instruction* or investigating magistrate, a member of the judiciary who investigates cases for which the prosecuting authority has requested special investigation

8 This Week...

A federal insurance regulator in the US has long been on the discussion table but this week calls for its introduction were redoubled to prevent potentially costly litigation

NEWS

Aerospace policies see lead premium reductions

Christopher Munro

MORE than half the aerospace policies written so far in 2009 have seen their lead premiums reduce.

According to the latest Aon Aerospace market update, it is predicted there will be 245 aerospace renewals in 2009 and of the 137 that have been placed so far, around 55% have been given reductions on their lead premiums. Approximately 30% have seen premium increases, while 15% have renewed at the same price as in 2008.

Some clients have seen their lead premiums fall by around 2% on average and a reduction in exposure brought about by the economic downturn has been the biggest factor in achieving these pricing decreases.

In the airport and air traffic control sector, the 3% reduction in lead premium witnessed so far this year is likely to be indicative of the full-year result as around half of the placements expected in 2009 – equal to about two-thirds of the sector's annual lead premium – have now been made.

The service provider section of the aerospace market has seen considerable reductions in lead premium, with the sector posting decreases of 8% on average.

However, the manufacturer and maintenance, repair and overhaul sub-sector is the one area where, in general, lead premium reductions have not been achieved.

In this area, around 30% of the year's total premium – representing approximately half the programmes expected to be placed this year – has now been paid to the insurance market, with average lead premium increases of 2% given to programmes that have renewed.

However, these increases have been heavily influenced by the five maintenance, repair and overhaul renewals that have been conducted so far. These programmes have seen their lead premiums increase by 8% on average and, when these are removed, the aerospace manufacturer market's lead premiums have only increased by 1% on average compared to 2008.

So far this year, 55% of aerospace policies written have had their lead premiums reduced

Marine underwriters must learn more about shipping industry, Jones warns

James Brewer

MARINE underwriters need to understand more about the business they insure, which in turn will benefit the shipping sector, a market practitioner has warned.

Greek-based practioner Jonathan Jones told *Insurance Day*: "It is clear that underwriters, including myself, know relatively little about the shipping industry and how it functions and therefore the business they insure, which frankly is rather bizarre . If the shareholders realised this, if the European Maritime Safety Agency [EMSA] and the International Maritime Organisation knew, it might raise eyebrows to say the least."

Jones, whose career has spanned Lloyd's and later the company sector, said the drive to increase understanding of the shipping business is timely, given the launch in June 2009 of the European agency, which was created in the aftermath of the *Erika (pictured)* and *Prestige* tanker disasters, and aims to enhance the maritime safety system in the European community.

Coinciding with the official opening of EMSA headquarters in Lisbon, the agency published a review that showed in 2008, there were 754 vessels involved in 670 sinkings, collisions, groundings, fires/explosions and other significant accidents in and around European Union waters. In that year, 82 seafarers were reported to have lost their lives on ships operating in the region.

Jones researched his project in collaboration with Dr Nikos Frydas of the KC Lyrintzis group of Athens, which is able to audit shipping companies in relation to the "human factor" and recommend improvements in "soft" non-technical skills.

In a speech at the recent Marine Insurance Forum 2009: Russia & CIS, Jones urged underwriters to start reviewing how human behaviour functions in shipping. Among the problems were, he said, that "many shipping companies are very hierarchical. Clearly that is not conducive to creating an open-minded and team approach".

Referring to a recent Intertanko report, which said that the collision of two Boeing 747s with the loss of 583 people in 1977 had spurred a change from reactive to proactive safety management in aviation, Jones remarked of the maritime sector: "As with the aviation industry, we must change attitude or even culture."

Jones added: "The insurance industry has to play its part in creating and supporting change, which in itself will need a change in the way the insurance industry functions."

He said statistics showed shipping was 13 times more dangerous than industry generally, although it had greatly improved its safety record in relation to passenger and tanker operations.

Shipping and the marine insurance industry needed to address some "historical" issues, which if ignored would continue to cost huge sums of money. They urgently needed to move towards a supportive , proactive and no-blame culture, said Jones.

AP PHOTO/MARINE NATIONALE/FRENCH NAVY/HO/FILE

European captive market will face Solvency II threat

Jonathan Rest

SOLVENCY II represents the major threat to the sustainabilty of the European captive insurance market, AM Best has warned.

In a report on the sector, the agency said a range of concerns are mounting for captives domiciled within the European Union (EU), with the primary fear that they will have to increase their capital significantly, despite any flexibility brought about by proportionality. Indeed, the Committee of European Insurance and Occupational Pensions Supervisors' latest Quantitative Impact Study (QIS 4) helped illustrate this concern: of the 99 captives that took part in the survey, 28.3% did not meet the solvency capital requirement.

Furthermore, almost three-quarters of the captives that took part in QIS4 were resident in Luxembourg, which is not seen as a typical cross-section of the captive industry because it is heavily skewed toward reinsurance captives.

According to AM Best, it is possible some captives may have to put up less capital, but this is thought to be the exception, rather than the rule. Solvency II will make captives look at the way they spread risk and at their diversification. both in terms of the lines of business underwritten and the pool of invested assets, which could create a challenge for captives, as they tend toward liquid investments, such as tracker funds.

The rating agency said this growing financial and administrative burden of compliance will make businesses think more carefully about where they need to domicile their captives, and potentially look outside the EU.

There is already evidence to suggest Guernsey and the Isle of Man are seeing an increase in inquiries about captive formations as a result of the pending directive. "It is inevitable domiciles outside the EU will see a pick-up in interest, as Solvency II represents an enormous change to the framework for insurance business in general," the report said.

But the problems do not end there; there is a feeling Solvency II will set a benchmark and non-EU domiciles will have to show increased transparency, leading to a shake-up of existing global regulation.

"There is also the prospect fronting insurers may increase fees or ask for higher letters of credit and collateral from non-EU-domiciled captives for greater security. Solvency II could lead to an insurer demanding higher charges if it is ceding risks to a non-rated entity," AM Best continued.

The rating agency also predicted Africa and the Middle East could emerge as the captive domiciles of tomorrow, once the necessary infrastructure is in place. It explained: "It is still early days, but a shift in risk management in developing regions is being driven by increasingly sophisticated knowledge and better advice from insurance brokers. The insurance industry is also adapting models to cater to the demand from new customers."

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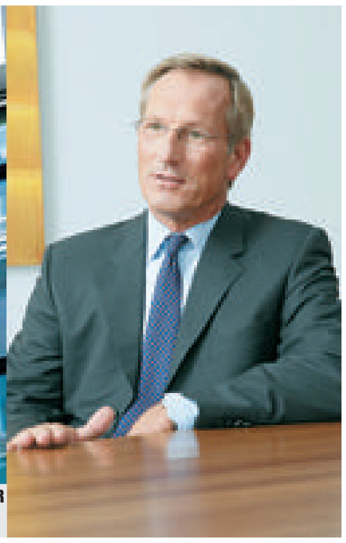
NEWS



BLOOMBERG NEWS/HANNELORE FOERSTER

Allianz: the German giant is in a 'very solid' position, Diekmann (*right*) said

Allianz well positioned to take advantage of crisis

Herbert Fromme, Cologne

ALLIANZ will have to strengthen the capital base of its US life subsidiary considerably after severe problems in the market and difficulties with its variable annuity products.

"The rating agencies are asking for more capital support if we want to keep our good rating," Michael Diekmann, Allianz chief executive, told German business magazine *Capital*.

Market sources mentioned $1.5bn, although Diekmann did not comment on the figure. "The sum we provide will be the result of our discussions with the rating agencies," he said.

Diekmann said he believes AIG's woes and the problems experienced by other insurers "open up room that was not there so far", both in the US and in other markets. He predicted many industry players will have problems in 2009, and 2010 will be even more difficult. "Many will then have problems with their turnover," Diekmann said.

Allianz, on the other hand, is in a "very solid" position despite the crisis, he said, and is seeking to expand its business mainly by growing organically.

Diekmann did not rule out selective acquisitions for 2010, with Germany probably not being the major target. However, he did rule out "from today's perspective" a takeover of Hartford Life, which Allianz last year supported by means of a cash injection. "Hartford is a purely financial investment," he said.

Diekmann was adamant Allianz had not needed any government aid during the crisis. However, critics among German insurance executives argue it was only with billions of euros from the government that Commerzbank was able to buy Dresdner Bank from Allianz and thus rid the insurer of its burdensome subsidiary. Diekmann said this criticism was not valid. "It is a fact we signed the contract on August 31, 2008", he said. "At that time, government aid was not a topic. The Lehman Brothers collapse came two weeks later."

The group's cost-cutting programme will not lead to fresh job cuts, Diekmann said. Allianz will even remain below the target agreed with German staff representatives in the latest round of cuts. "We wanted cut 5,700 jobs, and now it will be 4,700 or 4,800," he said.

The group has also kicked off new projects, such as its online insurer, and has rehired many IT people who had been working as contractors.

Scor XLRLA deal proves its mettle

SCOR'S acquisition of XL Re Life America (XLRLA) has proved the French reinsurer can profit from market opportunities in the present environment, according to chairman and chief executive, Denis Kessler.

Scor announced it was buying XLRLA from XL Capital for €31.7m ($45.1m) in cash earlier this week and Kessler said: "This small acquisition is one of the so-called 'gardening deals' as described during Scor's investors' day in July. The business acquired shows a strong compatibility with Scor's life strategy, which is rooted in focusing on traditional protection business that is not correlated with economic risks."

Gilles Meyer (*pictured*), chief executive of Scor Global Life, said the acquisition would help Scor Global Life to strengthen its services in the mortality-protection field and reinforce its position in the US. "The acquisition demonstrates the in-roads Scor is making in the most important life market in the world," he said.

The deal is expected to close by September 30, subject to regulatory approval.

XLRLA generated premium income of €22.1m in 2008, mainly from traditional mortality business, including yearly renewable terms and co-insurance.

Scor said Scor Global Life intends to offer employment to the XLRLA team on completion of the transaction.

Fitch downgrades Swiss Life to BBB with negative outlook

SWISS LIFE has had its financial strength rating downgraded to BBB from BBB+ by Fitch.

The rating has also been placed on negative outlook.

Fitch said the negative outlook reflected Swiss Life's exposure to unfavourable interest rate movements, as well as the potential for the economic downturn to have a negative impact on sales and future profits.

The downgrade followed a switch in the way Swiss Life reports its future profits. The insurer had previously reported the value of its future profits on a traditional embedded value basis, which does not quantify the time value of options and guarantees on insurance business. On July 1, Swiss Life reported its future profits on a market-consistent embedded value (MCEV) basis for the first time.

According to Clara Hughes, associate director in Fitch's insurance team, Swiss Life's MCEV disclosure showed the company's future profits are highly sensitive to further interest rate drops and losses on equity and property.

Swiss Life's 2008 full-year results included a net loss on continuing operations of SFr1.1bn ($1bn). All segments apart from asset management showed sharp declines in profitability or operating losses. In particular, the segment result of the Swiss business showed a loss of SFr748m, which Fitch said demonstrated the sensitivity of this business to investment returns.

The rating agency said other contributory factors to the downgrade were Swiss Life's lower capital, increased leverage and reduced interest cover.

Swiss Life: the insurer's exposure to unfavourable interest rate movements contributed to the downgrade

S&P negative on Fondiaria

FONDIARIA-SAI has had its outlook revised to negative from stable by Standard & Poor's (S&P).

"The outlook revision reflects deteriorated operating performance and capital adequacy, as well as our anticipation that results will be constrained over the medium term," Paola Del Curatolo, S&P credit analyst, said.

Despite the negative outlook, Fitch has affirmed Fondiaria's A- financial strength rating, as well as that of its core entity, Milano Assicurazioni SpA.

"The negative outlook reflects our expectation that we could lower the ratings on Fondiaria-SAI and its core subsidiaries if the combined ratio increases to more than 101% in 2009 and doesn't recover in 2010, or if the new business margin on the annual premium equivalent further deteriorates to less than the 6.5% realised in 2008," Del Curatolo said, adding a further fall in capitalisation could also trigger a downgrade.

However, a revision to a stable outlook is likely if the group's underlying performance recovers, with a combined ratio of less than 97%, and it rebuilds capital adequacy to a strong level in the next 12 to 24 months.

Poizner approves $34m rate cut for 21st Century

Richard Banks

FORMER AIG motor unit 21st Century Auto Insurance has been given the go-ahead for a $34m rate cut in California. The insurer was bought earlier this month by Zurich Financial Services subsidiary Farmers Insurance.

California insurance commissioner, Steve Poizner (*pictured*), gave his approval to the rate reduction, which equates to an average reduction of 3.4%.

Poizner, who has to greenlight any insurance rate increase or decrease in the state before it can take effect, said: "I'm pleased that 21st Century is demonstrating responsible business practices by passing along savings to valuable customers."

The insurer is the seventh-largest motor carrier in California, with more than one million vehicles on its books. Policyholders will save an average of $50 per policy per year with the new rates that take effect from June 21.

Drivers in Los Angeles County stand to be the biggest winners, Poizner said, with average savings of 4.9% or $80 per policy per year.

Poizner, an elected insurance commissioner whose term of office is up in November next year, is proud of the motor rate cuts that have been approved during his time in time office, which he claims total more than $500m.

In May this year he gave the go-ahead to the state's largest motor insurer, State Farm, to push through rate reductions totalling $219m.

But he is less vocal about the rate increases he approves. In June last year, as he touted a rate reduction of 3% for Mercury motor insurance policyholders, he announced that since his election he had approved $1.28bn in reductions for auto insurance policies.

By February this year, when he confirmed a $101m rate reduction for Automobile Club of Southern California policyholders, the total overall saving was down to $800m and at the time of the State Farm announcement in May this year it was just $500m.

AP PHOTO/MARK LENNIHAN

The Abu Dhabi National Insurance Company has enjoyed improved profits in the first half of this year

Writedown pushes ADNIC into an H1 loss

NEW-BUSINESS growth in aviation, marine and life and medical business drove an improvement in first-half underwriting profit for Abu Dhabi National Insurance Company (ADNIC).

However a Dirham307.7m ($83.7m) writedown on its available-for-sale investments left the insurer with a Dirham150.3m net loss for the period.

Gross premium written over the first six months by ADNIC was up 3% year on year to Dirham866.7m.

The second quarter was especially strong, with gross premium rising 6.6% year on year to Dirham314.3m.

Underwriting profit was up 6% at Dirham152.6m for the first half.

ADNIC chief executive, Walid Sidani, said this growth was the result of "a sustained focus on customer retention and new customer acquisition particularly in aviation, marine, and life and medical insurance".

He added: "We are optimistic that ADNIC is well positioned to continue to capitalise on the growing focus on healthcare in the UAE [United Arab Emirates] through our recent launch of SHIFA – worldwide health insurance protection."

Sidani said excluding the investment writedown, the group would have achieved a net profit for the period of Dirham157.5m.

Of that writedown, Dirham235.2m was recorded in the first quarter, with the balance falling in the second quarter.

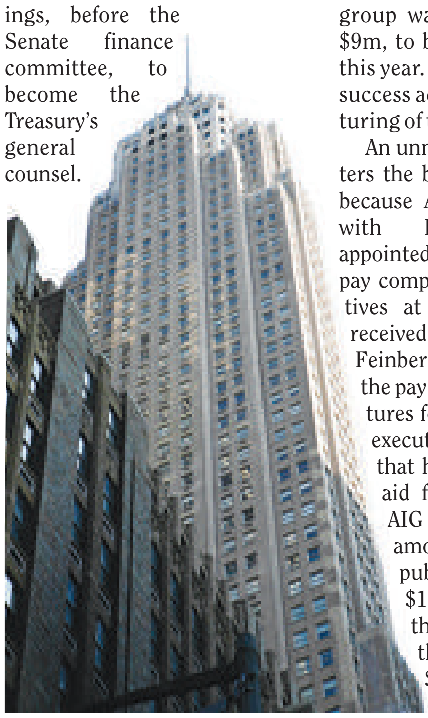
First-half investment income was down 66.4% at Dirham54.52m.

Payment of AIG bonuses shelved

Peter Birks

AIG did not go through with $2.4m in bonus payments to executives last week because the US Treasury refused to approve the outlays.

The withholding of the payments was disclosed by George Madison in response to questions during his confirmation hearings, before the Senate finance committee, to become the Treasury's general counsel.



Madison said AIG did not pay the initial $2.4m in bonuses because the Treasury withheld its permission, adding that AIG was in discussions with executives about reducing the $235m in bonuses that were scheduled for payment in 2010. Bonus payments for around 40 AIG executives were due to be paid last week, based on their performance throughout 2008. The group was awarded a total of $9m, to be paid in instalments this year. The rewards related to success achieved in the restructuring of the company.

An unnamed source told Reuters the bonuses were withheld because AIG was still working with Kenneth Feinberg, appointed in June to oversee the pay compensation of top executives at companies that had received US federal assistance. Feinberg has the power to set the pay levels and bonus structures for the 100 most senior executives at the seven firms that have received the most aid from the government.

AIG generated an outcry among lawmakers and the public after doling out $165m in bonuses earlier this year in the wake of the US government's $173bn bailout of the New York-based group.

Zenith suffers Q2 94% drop in profit

CALIFORNIA-BASED workers' compensation insurer Zenith was hit hard by the recession during the second quarter of 2009, with net profit dropping by almost 94%.

The insurer generated a net profit of $1.8m for the quarter, down from $28.4m.

Stanley Zax, chairman and president of Zenith, said the decrease in profitability was due to an increase in unemployment and a drop in payrolls.

"Competition relative to our pricing and underwriting strategies continues to impact our workers' compensation business," he said. "However, our results are about break-even for the quarter, with our recurring investment income offsetting our loss in the workers' compensation business."

Zax added the market value of Zenith's investment portfolio had improved by $100m during the quarter.

Net profit for the first half of the year was $4.4m, down from $70.3m during the first six months of 2008.

The underwriting loss for workers' compensation business was $17.6m for the quarter and $40.8m for the half, compared with an underwriting profit of $26.5m and $65.6m for the same period last year.

The California-based insurer has felt the impact of the economic downturn this year

AM Best revises A- outlook for Central Re

CAPITAL losses at Central Re have prompted a revision to the rating outlook for the Taiwanese reinsurer.

AM Best has revised its A- (excellent) financial strength rating on Central Re to stable from positive.

The rating agency noted Central Re's adjusted capital and surplus fell 7.4% last year on the back of realised and unrealised capital losses.

It said its rating outlook decision reflected the adverse impact of the economic turmoil on the company's profitability and adjusted capital and surplus.

Still, AM Best acknowledged Central Re produced consistently profitable and stable underwriting results. The reinsurer's combined ratio fell within the 88% to 97% level in the past five years.

At the same time, although Central Re's position in Taiwan was dominant given its role as the only domestic reinsurer, AM Best said Central Re's overseas expansion plans were being challenged by other established reinsurers in Asia.

The Taiwanese insurer has had its rating outlook taken down to stable

LEGAL FOCUS

Inconsistency in fraud treatment

NICK STARLING, the Association of British Insurers' director of general insurance and health, has emphasised the insurance industry's determination to deal with insurance fraud, saying: "Fraud thrives in a recession, so insurers are intensifying their crackdown on insurance cheats." Unfortunately, report Gavin Reese, a partner, and Paul Lowe, both of Reynolds Porter Chamberlain LLP, the same resolve is not always shown by the courts.

Two recent cases before the English courts have demonstrated the different ways insurance fraud is dealt with. While the cases show the courts are aware of the problems fraudulent claimants cause insurers, some of the results are, on the face of it, surprising.

Carol Walton v Joanne Kirk [2009] will be welcomed by insurers. In this case, the claimant was found to be in contempt of court as a result of false statements she made during proceedings. In brief, the facts are the claimant brought a claim for personal injuries after a road traffic accident. She claimed damages in excess of £750,000 ($1.2m) and relied on expert evidence suggesting she had developed fibromyalgia.

The defendant's insurers believed the claimant was exaggerating her claim. Insurers commissioned surveillance footage that demonstrated a disparity between the alleged and real condition of the claimant.

The claimant eventually settled the claim for £25,000 and paid insurers' costs of £21,000. Insurers subsequently sought to commit the claimant for contempt of court and the claimant was found guilty. The court here gave a strong message to deter future fraudulent claimants.

In *Shah v Ul-Haq* [2009], the claimants, including Wasim Ul-Haq, were involved in a car accident and Ul-Haq and his wife claimed they suffered whiplash injuries. Ul-Haq's mother, Mrs Khatoon, alleged she was also in the car and had suffered whiplash. Ul-Haq and his wife gave evidence to support her claim.

The courts found Khatoon had not been a passenger and Ul-Haq and his wife had conspired to support Khatoon's fraudulent claim. The Court of Appeal was also made aware of the seriousness of fraudulent claims for insurers.

It might seem commonsense that to conspire in a clear fraud should debar a claimant from pursuing his own claim. However, while the court held that costs could be ordered against the claimants, it would not allow their claims to be struck out for assisting in fraud.

It is clear the courts and insurers are not seeing eye to eye about the strictness with which insurance fraudsters should be treated. The high cost of fraud to the insurance industry means the alignment of their approaches should be a priority. In a tightened regulatory atmosphere, insurance fraud should not be the weak link.

House of Lords ushers in hands-on policy rewriting

House of Lords: *Charterbrook* ruling encourages courts to adopt interventionist approach to rewriting

THE RECENT House of Lords ruling in the UK case of *Chartbrook v Persimmon** is one of the most important decisions on the interpretation of contracts in the past decade, report Daniel Futter, an employed barrister and Andrew Westlake, an associate at Mayer Brown.

This was a case where, in Lord Hoffman's words: "The drafting was careless but no-one noticed." It is unfortunately a fact of life in the insurance market that occasionally the drafting of a policy will go awry.

Although the dispute concerned a property development contract, the difficulties encountered in interpreting unclear wordings are a familiar problem for insurers and brokers and the principles that can be distilled from the decision apply equally to contracts of insurance.

The key point from the case is Lord Hoffman's authoritative statement on how much freedom a judge has to rewrite a contract in circumstances where the words on the page of the contract make literal sense but the result is a commercial nonsense.

Where the parties have sought to formalise their agreement, the courts are usually slow to intervene. In a previous case, the Court of Appeal had held that where a literal interpretation led to an absurd result or one otherwise clearly contrary to the intention of the parties, the court should adopt an alternative, more reasonable, construction but only if it could do so "without doing violence to the language used".

However, in *Chartbrook*, Lord Hoffman clearly did not feel unduly concerned about doing violence to the language of the contract in such circumstances. He emphatically said in cases where it is clear something has "gone wrong with the language" and it is "clear what a reasonable person would have understood the parties to have meant", there is no "limit to the amount of red ink or verbal rearrangement or correction which the court is allowed".

In other words, once a court is convinced a literal interpretation of a contract leads to an absurd result or clearly does not reflect the intentions of the parties at the time of the contract, it is entitled to rewrite that aspect of the contract completely.

Thus, the House of Lords has provided encouragement to courts to adopt a more interventionist approach where it is clear that something has gone wrong with the drafting.

This bolder approach to construction will need to be taken into account by insurers, policyholders and brokers (as well as their lawyers) when considering potential coverage issues arising from policies that are less than clearly drafted.

** A Mayer Brown team led by Andrew Legg acted for Persimmon throughout this action*

Fire claims seminar

SPECIALIST insurance claims barristers from commercial and construction set 4 Pump Court, in London, teamed up with forensic investigators from Burgoynes to host a seminar on fire claims. Around 150 delegates from insurance solicitors, loss adjusters and insurers involved in fire claims attended the jointly organised event held at Inner Temple.

The seminar was devised and chaired by Nick Vineall QC, who highlighted the importance of understanding the legal and forensic approaches to fire causation. He said: "Even in breach of warranty claims where the insurer does not have to prove the breach caused the fire in order to be entitled to decline the claim, in practice it is often essential to establish the precise cause of fire in order to prove that the warranty has in fact been breached".

Michael Davie, of 4 Pump Court, who appeared for the successful claimant in the Court of Appeal case *Drake v Harbour*, spoke about the "Sherlock Holmes approach" to causation. The famous detective told Dr Watson: "When you have eliminated the impossible, whatever remains, however improbable, must be the truth". But, Davie asked, is that a proper approach for a court to take?

He said no court would conclude an ultimately improbable cause was the cause of a fire. But if other causes could be excluded a court can properly infer a *prima facie* improbable cause was, on all the evidence, in fact the likely cause of a particular fire.

Burgoynes' partner and fire and explosion expert, Dr Neil Sanders, explained the forensic techniques available, even after catastrophic fire damage, and the importance of early site investigations. Delegates were particularly interested in the use of electrical evidence to identify the likely location of the seat of fire, even when the fire did not have an electrical cause.

His colleague, Ian Griffiths, explained how the investigation of the Cutty Sark fire had concluded the likely cause was an industrial vacuum cleaner that had been left on over the weekend and had burst into flames.

Finally, 4 Pump Court's Alex Charlton QC, an insurance and construction law specialist, reviewed the law on waste warranties and hot work warranties and conditions, focusing on the cases of *Bennett v Axa*, *Cornhill v Stamp* and *Ecclesiastical v Axa*.

The panel was asked whether, bearing in mind the backdrop of recession, there had been a noticeable increase in fraudulent fire claims. The answer was… not yet.

Legal news in brief

Holman Fenwick Willan LLP

HOLMAN FENWICK WILLAN LLP has expanded its Australian insurance and reinsurance capability with the transfer of London-based partner Andrew Dunn to the firm's Melbourne office, the recruitment of Sydney-based consultant Philip Purcell and the promotion of Melbourne-based Hazel Brasington to partner.

Conyers Dill & Pearman

CONYERS DILL & PEARMAN has announced the formal opening of its law office in Mauritius. Conyers received regulatory approval and registration of Conyers Dill & Pearman (Mauritius) Ltd as a joint law venture under the Mauritius Law Practitioners Act 1984. The Mauritius practice comprises a globally integrated team, with Nicolas Richard and Sameer Tegally in Mauritius, Sonia Xavier advising on Mauritius law from Dubai and Devalingum Gopalla advising on Mauritius law from London. Gopalla has recently joined the London office as an associate.

Beachcroft wins Investor in People Silver Award

BEACHCROFT LLP has been successfully accredited by the UK's Investors in People (IiP) for the third time and has been given a Silver Award. IiP works with more than 35,000 organisations across the UK and Beachcroft has become the 71st organisation overall and only the second law firm to have been recognised in this way. The Silver Award was made in recognition of having met a total of 115 evidence requirements, which included those needed to meet the basic standard. The additional 76 evidence requirements that were selected were chosen to test the capability within the organisation to meet their business strategy and objectives.

Imminent legal reforms in France divide opinion

ELEANOR HEINE explains changes in the French criminal justice system and the role of the investigating magistrate

QUESTION: What is the difference between a *juge d'instruction* and a *juge de l'instruction*?

Answer 1: The end of the separation of powers in France.

Answer 2: A major step in the reform of criminal procedure in France.

Either way, the end result may bring increased defence costs for directors and officers of French companies and for their insurers.

The investigation and prosecution of criminal conduct is fraught with pitfalls and no jurisdiction has the perfect solution. Common-law countries rely on an adversarial system, whose roots are said to be in medieval trials by combat, whereas civil law countries long adhered to an inquisitorial system initially bequeathed by Pope Gregory IX in 1231.

The former has the merit of clearly defined opposing parties, whose arguments and explanations of the evidence are presented to an impartial jury, which decides the truth of the matter. Defence lawyers in France have long admired the rights enjoyed by their counterparts in England, where a suspect has the right to an advocate from the outset of the investigation.

At the same time, English defence lawyers have considered wistfully the advantages of an impartial and independent investigating magistrate. These issues, long debated, are again the focus of attention as France looks likely to abolish the role of *juge d'instruction* or investigating magistrate.

The investigating magistrate in France is a member of the judiciary. His role is to investigate those cases – generally more serious and/or complex crimes, including sensitive economic and financial matters – for which the prosecuting authority has requested special investigation. His remit is strictly defined by the *procureur* and his ultimate decision is whether or not the case is appropriate for trial.

Certain aspects of the magistrate's investigation are often carried out, under his supervision, by the investigating police, but only the magistrate himself can interview suspects and the victim. (The suspect can request that additional inquiries be undertaken by the magistrate, at no cost to the defence.)

In addition to his investigatory powers – which are extensive – the magistrate has certain judicial powers, such as designating suspects and recommending they be held on remand or subject to (in Anglo-Saxon terms) certain bail conditions. (The final decision as to remand/bail is currently made by a different judge.)

These dual aspects of the investigating magistrate's role have often been seen as contradictory and reform has been mooted in France for more than 20 years. These issues were given wide attention in the aftermath of what is known as l'affaire d'Outreau.

This commenced with a three-year investigation (2001-03) into an alleged paedophile ring, initially undertaken by a young and inexperienced magistrate in the north of France. (It should be recalled that law students in civil law countries generally have the choice of career paths and can specialise from the outset as lawyers or as magistrates – unlike the Anglo-Saxon system, where judges are generally drawn from the ranks of practising lawyers.)

In all, 18 people were imprisoned on remand for periods of up to three years. Of those, 13 protested their innocence. When the matter came to trial in 2004, seven of the defendants were acquitted. Another six were released in 2005 on appeal. Even the prosecution had to recognise witnesses had lied and undue importance had been given to unreliable expert evidence.

Investigation into the circumstances revealed the magistrate had been out of his depth and on his own, with no means of seeking guidance from more experienced colleagues. Indeed, none of the three magistrates to whom the file could have been entrusted in 2001 had more than 18 months' experience. The system was in disrepute.

In March 2007 a number of reforms were introduced by law: henceforth, a team of three magistrates (including a senior magistrate) would be instructed on every file sent for judicial investigation; measures safeguarding the rights of the defendants were also introduced, such as open hearings for remand decisions and videotaped interviews of suspects.

In October 2008, a criminal reform commission was formed and was due to report its preliminary conclusions in February 2009.

Before it could do so, on January 7, in the course of an exceptional New Year's address to the French judiciary, president Nicolas Sarkozy (*pictured*) announced his intention to do away with the *juge d'instruction* and replace him with a *juge de l'instruction*.

BLOOMBERG NEWS/MICHELE TANTUSSI

The new instructing magistrate (the English language does not readily reproduce the subtleties of the French) would, as before, head the investigation, but he would not have the judicial powers of his predecessor as regards suspects, remand, bail, etc.

The president did not state that the "new" magistrate would be under the prosecuting authority (ie, part of the executive branch), but fears were rampant that this would be the case. At first glance, this should not be cause for concern, as 95% of all relevant crimes in France are already prosecuted by the executive, the remaining 5% being referred to the investigating magistrate.

However, the magistrate's remit has traditionally included politically sensitive matters (eg, corruption, financial crimes) where his independence from the executive has ensured that justice has been seen to be done. (Recall the frustrations of Silvio Berlusconi and the mafia faced with similarly enshrined independence of Italian investigating magistrates.)

In addition, civil claims against criminal defendants currently depend on criminal proceedings being brought by the authorities and there are fears that private individuals' interests may not be protected under a new regime.

As it turns out, the commission's interim report recommends replacing the *juge d'instruction* with a *juge de l'enquête et des libertés*, whose focus would be judicial rather than investigative. While the *procureur* would conduct the investigation and decide whether or not to prosecute, any measure affecting an individual's liberty (for example, arrest warrants, extension of custody limits, detention on remand, searches, or the use of wire-tapping or any other listening device) would require the approval of the *juge de l'enquête*.

He would also be empowered to enjoin the prosecuting authorities to pursue certain inquiries requested by the defendant or by the victim.

Other proposed reforms would affect the trial judge (who deliberates with the jury), defence lawyers (who would have greater access to their clients during police questioning) and criminal trial procedure (introducing something akin to Anglo-Saxon guilty pleas, cross-examination and reasoned decisions).

Debate on the issues is vigorous. The measures strengthening the rights of the defendant are welcomed, although argued insufficient. However, the primary concern is that sensitive investigations will no longer be under the control of an independent authority: although prosecuting magistrates are nominally guaranteed a certain measure of independence under the Constitution, increased pressure from the executive has become evident.

Defence lawyers will welcome measures that increase their powers in the run-up to trial. English lawyers would advise them to ascertain that finance for those measures is ensured as well, in order to avoid a two-tier justice system.

For the insurers of French directors and officers, the potential consequences are both positive and negative. If all criminal investigations remain under the control of the procureur, then matters deemed sensitive to the state (eg, in companies such as Elf or EDF) may be subject to little or no investigation, hence incur lower defence costs.

However, insofar as reform includes increased rights for the defence, the cost of protecting the defendant's rights may eventually shift from the state to the defendant – and to his insurers.

Eleanor Heine is a senior associate in Sedgwick, Detert, Moran & Arnold's London office and its principal liaison with Sedgwick's Paris office

LEGAL BRIEF

BARLOW LYDE & GILBERT

Draft flood Bill will allow more effective management of risk

ON APRIL 21, 2009 the UK's Department for Environment, Food, and Rural Affairs (Defra) published the draft Flood and Water Management Bill for consultation.

Defra proposes that the Bill, when enacted, will apply across England and, in many cases, Wales. What are the key changes to the law from the standpoint of the insurance industry?

The summer 2007 floods were the main catalyst for new legislation. Sir Michael Pitt's subsequent review identified clear gaps in the way that flood risk is managed, particularly in relation to surface run-off, and on the need for a more risk-based approach to reservoir safety.

However, even before the 2007 floods, existing flood-related legislation had long been recognised as incorporating outmoded approaches and organisational structures with roots in the 1930s and 1940s.

It was already understood that work would have to be done sooner or later to get flood and water-management law into shape to deal with climate change and the effects predicted to result from it.

The draft Bill proposes a new approach to flood and coastal erosion risk management. The existing law only covers flooding from rivers and the sea (surface run-off, a key component in the 2007 floods, is not adequately covered, nor is flooding from groundwater sources). In addition, the existing law does not allow for much flexibility of response.

However, the draft Bill covers all sources of flooding. It retains the various existing powers of the agencies involved in this area and introduces new ones so they are able to undertake a wider suite of measures in the future.

The draft Bill attempts to set out clearly which body is responsible for what bit of managing flood risk. At the moment, Defra has policy responsibility for flood and coastal erosion risk management while delivery on the ground is the role of the Environment Agency, regional flood defence committees, local authorities, internal drainage boards, highways authorities and water companies.

At a local level, no body is charged with carrying out a comprehensive assessment of flood risks, needs and priorities. Nor does any body have responsibility for surface run-off or groundwater, or is required to co-operate or share information with others generally. The draft Bill:

- gives the Environment Agency a strategic overview role and provides it with additional tools for this role;
- sets out the precise role to be played by other bodies;
- gives local authorities the leadership role for local flood risk management; and
- requires bodies to co-operate and share information with one another.

The draft Bill requires developers to include sustainable drainage in new developments where practicable, built to standards that reduce flood damage and improve water quality.

At present the law allows developers to connect to the sewers for surface water drainage with the result that the sewers can gradually become overloaded. In new developments connection will now be conditional upon developers putting sustainable drainage systems in place.

Finally, the Bill also contains specific provisions on reservoir safety. It introduces a more risk-based approach to reservoir safety than is currently in place which better reflects the dangers posed. The Environment Agency will have a role in relation to the necessary risk classification.

Even when the consultation ends today, the Bill still has a long way to go before it becomes law. At this early stage, however, it is clear that significant change is afoot.

Flooding and coastal erosion risk should be managed in future in a more effective and organised manner.

If it is not, and damage results, the draft Bill may make responsibility much easier to pinpoint.

Aidan Thomson is a partner and head of the environment group at Barlow Lyde & Gilbert LLP

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Insurance Day

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This Week...

A FEDERAL insurance regulator in the US has long been on the discussion table but this week calls for its introduction were redoubled to prevent potentially costly litigation.

The latest Memorandums of Understanding (MoUs) were signed this week between Florida and the UK's Financial Services Authority (FSA) and New York and Thailand but the American Insurance Association's David Snyder threw a spanner in the works when he told *Insurance Day* MoUs raised major issues about the legal authority of the state under the US Constitution and could breach privacy, confidence and trade secret laws. Snyder said the only way to bring clarity is to establish a a federal regulator.

Travelers has also been beating the federal drum this week. The US insurer wants a united approach to regulating homeowners' insurance rates in four hurricane-vulnerable zones along the Atlantic and Gulf coasts, running from Texas to Maine. Group president and chief operating officer, Brian MacLean, said federal oversight of wind insurance rates would establish a more stable market for homeowners and insurers. Under the Travelers proposal, a new federal panel would have oversight of wind insurance rates only for named storms, leaving state regulators to oversee all other perils.

Talent hit the headlines this week as an *Insurance Day* special report into employment revealed insurers are benefitting from the sharp contraction of graduate positions in other financial services sectors as more university leavers flock to the industry than ever before. Yet despite insurers receiving record numbers of applications for their graduate schemes, it still has a long way to go to compete with banking.

Staying with the issue of retaining and improving talent, the Central Bank of Bahrain this week issued new rules requiring representatives of insurance companies to have a minimum qualification. The Bahrain Institute of Banking and Finance and the Chartered Insurance Institute worked together to introduce what they described as an internationally recognised qualification with a regional emphasis.

In Germany, the remaining 13 companies that were due to contest fines imposed by the federal cartel office are expected to follow HDI and Gothaer in withdrawing their complaints, *Insurance Day* learned. In 2005, the cartel office fined 18 insurers and 22 board members a total of €150m ($211.7m). It was alleged the insurers broke anti-cartel rules between July 1999 and March 2003 by reaching agreements that restricted competition and raised prices in industrial lines. Axa Germany also abandoned the case last week, while Allianz and Württembergische paid up in 2008. It is believed the insurers' fear that any fines set by the court would be higher than those set by the cartel office.

Back in the UK, the FSA's future is in jeopardy after the Conservative Party claimed it would abolish the regulator should it win the next general election. Shadow chancellor, George Osborne, said the Tories would give the Bank of England greater regulatory powers to try to prevent future financial crises. In place of the FSA would be a consumer protection agency.

And in the week when the UK's terror level was downgraded to substantial from severe, broker Miller has admitted that despite high demand, very few London underwriters are willing to offer cover for nuclear risks. Among the concerns for insurers is that the massive dispersion and distances reached by nuclear attacks means it is more difficult to model and aggregate the risks.

Jonathan Rest

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LLOYD'S will today open its first Irish office in Dublin, as One Lime Street continues to expand its global offering. Ireland is Lloyd's 12th-largest source of premium income. Lloyd's chairman, Lord Levene, will be in the Irish capital today to open the operation officially and will take part in a networking lunch alongside Eamonn Egan, Lloyd's country manager in Ireland, to help build relationships between the London market and the Irish insurance industry.

NEWS IN BRIEF

Mongolian flooding

MONGOLIA has been hit by severe flooding that has left thousands of properties damaged. According to the latest Risk Management Solutions catastrophe response report on the floods, at least 26 people have been killed as a result of extremely heavy rainfall falling on urban and rural areas of Mongolia on July 16 and 17. Severe flooding occurred in the Bayanzurkh and Khan-Uul districts of Ulan Bator and in the Tseel and Togrog soums (districts) of the Gobi-Altai province, as well as some areas of Dundgobi and Tov provinces. Ulan Bator, Mongolia's capital, has a population of one million and is the political, economic and financial centre of the country, with important industries based there including coal mining, textiles and food production. The city is also the centre of the country's road network and is connected by rail to the Trans-Siberian Railway and the Chinese railway network. The Mongolian Red Cross has described the flooding as the worst to hit the country since 1966.

Bancassurance still China's top life channel

BANCASSURANCE continues to act as the largest channel for life insurance sales in China's major financial hub, Shanghai. However, figures show there was a year-on-year decline in the value of sales. During the first six months of this year life insurers in Shanghai wrote premiums totalling Yuan27.04bn ($3.9bn), a 1.15% increase compared with the same period a year ago. Bancassurance accounted for Yuan12.09bn of the total, down 3.5% year on year. Personal insurance agency business contributed Yuan9.28bn, an 8.2% increase compared with a year ago.

Tranquilidade could suffer Fitch downgrade

PORTUGUESE insurer Companhia de Seguros Tranquilidade is facing a potential rating downgrade after having its outlook moved to negative from stable by Fitch. The negative outlook on the A- financial strength reflects Tranquilidade's weakened capital position based on Fitch's own risk-adjusted capital assessment, mainly owing to the impact of unrealised mark-to-market and realised investment losses at year-end 2008. The outlook revision also reflects the agency's concerns about Tranquilidade's ability to return to profitable underwriting in the near term, given the highly competitive nature of the Portuguese insurance market, which represents the insurer's core business. However, Fitch has maintained a favourable view of the insurer's experienced management team and highlighted its strong franchise and market position within Portugal, as well as the financial flexibility offered by being part of the Espirito Santo Financial Group. Although Tranquilidade reported a profit in 2008, the insurer's main life insurance operation, T-Vida, reported a net loss of €13.2m ($18.7m), reflecting negative investment results. Recently formed Seguros LOGO also reported a net loss of €9.5m, although Fitch said that result was ahead of management forecast and reflected the start-up nature of the business, which commenced trading on January 1, 2008.

Cat bond ratings fall

STANDARD & POOR'S (S&P) has downgraded six catastrophe bonds and placed four on credit watch negative. All were issued in either 2007 or 2008. S&P said the lowering of ratings by a single notch reflected the increased probability of attachment for each bond resulting from S&P applying its criteria from recently supplied information. Caelus Re 2008-1 Class A (Nationwide Mutual), Carillon Series 2 Class E (Munich Re), East Lane Re II 2008-1 Class C, East Lane Re 2007-1 Class B (both Chubb) and Residential Re 2008 Class 1 (USAA) were all downgraded. The new ratings range from double-B (Caelus, East Lane Re) to triple-C+ (East Lane Re II). In addition, four Residential Re 2007 classes were placed on credit watch negative. S&P referred readers to its article "Methodology And Assumptions For Rating Natural Catastrophe Bonds" (May 12), noting when it applied certain stress levels to various exceedence curves, a probability of attachment was generated that was higher than in annual reset reports seen by S&P.