MARKET NEWS, DATA AND INSIGHT ALL DAY, EVERY DAY

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Japan faces elevated typhoon risk

North-west Pacific's largest exposure at increased risk in 2012 due to El Niño

AP Photo/Shuji Kajiyama

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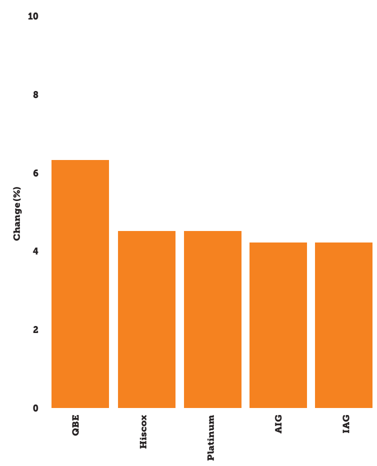

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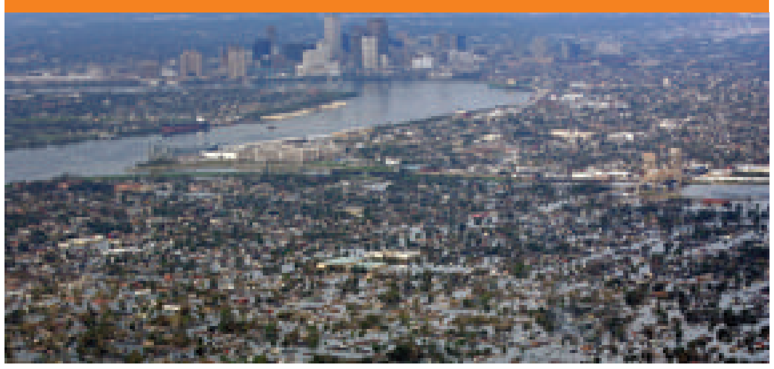

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Market news, data and insight all day, everyday
Insurance Day is the world's only daily newspaper for the international insurance and reinsurance and risk industries. Its primary focus is on the London market and what affects it, concentrating on the key areas of catastrophe, property and marine, aviation and transportation. It is available in print, PDF, mobile and online versions and is read by more than 10,000 people in more than 70 countries worldwide.

First published in 1995, *Insurance Day* has become the favourite publication for the London market, which relies on its mix of news, analysis and data to keep in touch with this fast-moving and vitally important sector. Its experienced and highly skilled insurance writers are well known and respected in the market and their insight is both compelling and valuable.

Insurance Day also produces a number of must-attend annual events to complement its daily output. The London and Bermuda summits are exclusive networking conferences for senior executives; meanwhile, the London Market Awards recognise and celebrate the very best in the industry. The new Insurance Technology Congress provides a unique focus on how IT is helping to transform the London market.

For more detail on Insurance Day and how to subscribe or attend its events, go to info.insuranceday.com

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Japan at risk as El Niño slowly develops

Conditions favour stronger storms that curve northwards

Scott Vincent
Deputy editor

Japan is at greater risk of typhoon landfalls this year as a result of the slow transition to El Niño, which brings favourable conditions for a Japanese landfall.

Dr Peter Sousounis, senior principal atmospheric scientist at AIR Worldwide, said he is expecting the 2012 north-west Pacific season to have between 23 and 24 named storms, largely in line with the long-term average. "But I expect a more significant impact for Japan than we've seen for the past two or three years, largely as a result of the gradual transition towards El Niño," he told *Insurance Day*.

Sousounis said the onset of El Niño causes storms to form further to the east, giving them a longer track over the ocean in which to intensify, as well as a better opportunity to curve northward – all factors which point to a heightened risk for Japan.

Sousounis was speaking after the eight named storm of the season – typhoon Vicente – narrowly missed Hong Kong before making landfall in China's Guangdong province.

Vicente made landfall as a category-three typhoon, having earlier undergone explosive intensification, which saw it become a ferocious category-four storm as it approached Hong Kong.

Such was the strength of the storm, the Hong Kong Observatory issued a Signal 10 warning – its highest alert level – as Vicente approached.

It was the first time the observatory had issued a Signal 10 since 1999.

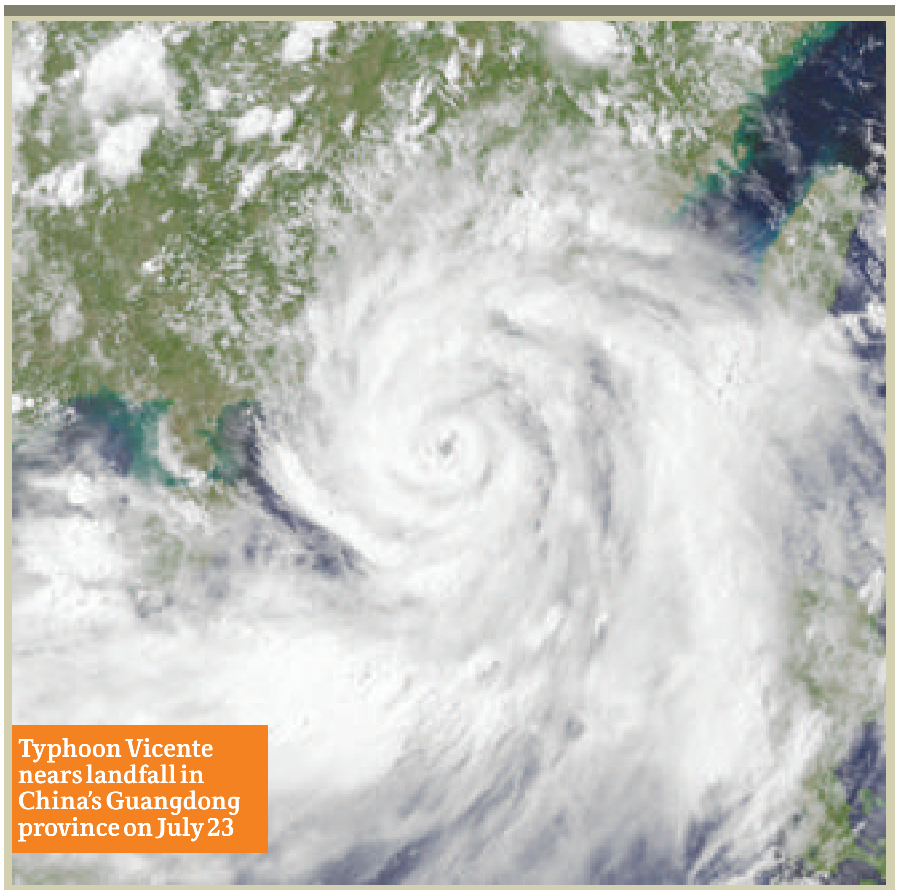
"Vicente would have been a very significant loss event for Hong Kong had it made a more direct hit," Sousounis said.

The storm eventually made landfall 120 km south of Hong Kong on July 23 and its relatively small radius meant damage in both Hong Kong and Macau was relatively minor.

"The strongest winds observed in Hong Kong were around 65 km/hr, which is barely strong enough to cause any notable damage," he said.

Rival modelling company Eqecat has estimated the insured loss from Vicente to be between $100m and $300m.

Taishan, the main affected area on China's coast, has a population of close to one million people and Eqecat said it expects economic damage to cost between $600m and $1.5bn.



Typhoon Vicente nears landfall in China's Guangdong province on July 23

Typhoon Vicente: th storm in brief

Vicente became a named storm on July 21 while it was churning in the South China Sea. On July 23, the storm intensified to become a category-one typhoon.

Owing to low vertical windshear and high sea-surface temperatures (conditions conducive to storm intensification), Vicente rapidly intensified near the Pearl River Delta and became a category-four typhoon. Before making landfall, Vicente weakened to a category-three typhoon.

The maximum storm surge from this event was close to 3.5 metres and is not likely to cause significant insured losses from storm surge. Macau reported one to two metres of storm surge and Hong Kong reported less than one metre of storm surge. Macau is largely built on reclaimed land and the Macau airport, which is in close proximity to the South China Sea, did not experience significant impact from this event. The event caused denuded trees, power outages and debris, which disrupted public transportation in Hong Kong and Macau. Low windspeeds and storm surge impact within Hong Kong and Macau are not likely to cause significant insured loss.

Source: Eqecat

"I expect a more significant impact for Japan than we've seen for the past two or three years, largely as a result of the gradual transition towards El Niño"

Dr Peter Sousounis
AIR Worldwide

NEWS

Disconnect emerging between aviation insurance and reinsurance

Christopher Munro
Senior reporter

A significant disconnect is emerging between pricing in the aviation insurance and reinsurance markets, as although both lines of business are reporting reductions, those in the primary market are far more pronounced.

This means primary airline underwriters are putting their profitability at increased risk as margins get ever tighter.

According to Aon's latest report on the airline insurance market, premium volume has continued last year's trend and carried on decreasing. In July to date, premiums have dropped 12% year on year, while in 2012 so far, premium has fallen 9%.

And although pricing in the aviation reinsurance market has also decreased, it has not done so to the same extent.

Guy Carpenter's recent review of the July 1 aviation reinsurance renewal, which includes portfolios of both airline and aerospace business, said reductions on pricing of 3% to 5% for like-for-like exposure were commonplace. Programmes with increased exposure levels, a higher number of expected passengers or average fleet value (AFV), for example, renewed at as-before terms or with slight increases.

The key difference is in the primary market, premium volume has fallen while at the same time underwriters' exposure to loss has increased substantially.

"Rates in the airline insurance market continue to decline, with the price of premium falling despite rising AFV and passenger number forecasts," Aon said.

So while premiums have fallen in the primary market 9% in 2012 to date, AFV has risen by 4% and expected passenger numbers have grown 6%.

"Capacity continues to be a key driver, with healthy competition for attractive risks. The low level of claims in 2011 and so far in 2012 is also a significant factor," Aon said.

The July 1 renewal is an important date for both the airline and aviation insurance and reinsurance markets. On the primary side, it is the first time in the year when a considerable amount of airline business is concluded. Indeed, close to 40% of the year's 2012 year-to-date lead hull and liability premium is placed on this day, with airlines such as American Airlines, Federal Express, Republic, Indigo Partners and Pinnacle/Colgan all renewing on July 1.

In the general aviation reinsurance sector, the tuly 1 renewals varied by market. International business became more competitive as positive results continued, while US risks stayed competitive, and rates fell as exposure grew and profitability margins became tighter.

Costa Concordia loss felt on July 1 ILW pricing

The impact of the *Costa Concordia* disaster on reinsurers' bottom lines caused pricing and attachment levels for marine and energy industry loss warranties (ILW) to rise at the recent July 1 renewals, one of the few areas of the market where this actually occurred, *writes Christopher Munro*.

$1bn
Loss reserve for the Costa Concordia loss

Ample ILW capacity has meant buyers' demand has been met, although pricing itself was up significantly year on year, Guy Carpenter reported.

ILW pricing for the marine and energy market increased across the board primarily because of the *Costa Concordia* loss, the original loss reserve of which was recently upped to $1bn.

But it was only this segment of the marine and energy insurance market where any notable increases were imposed at the July 1 renewals, Guy Carpenter has reported.

"In general terms, primary rates on global marine and energy covers were flat. Despite the relatively large losses that occurred, even energy rate increases tailed off somewhat.

"There were no specific moves to increase primary rates, which filtered through to marine reinsurance placements, where individual accounts were treated on case-by-case bases," the broker said.

The recent upward revision of the *Costa Concordia* loss reserve comes as the family of the youngest victim of the disaster reportedly received a seven-figure sum from the operator of the liner.

€11,000
Compensation Costa Cruises is reported to have offered to passengers not injured or bereaved

Costa Cruises paid the compensation to the relatives of five-year-old Dayana Arlotti, whose body was found alongside that of her dead father, Williams Arlotti.

This settlement is the first major payout of what is sure to be a long and complex compensatory process. Lloyd's List Intelligence reported Costa Cruises has already offered €11,000 ($13,336) to passengers who were not injured or bereaved, with those who accept the money agreeing to drop all future litigation against the firm.

However, the Italian consumer group heading the class action against Costa Cruises, Codacons, is urging passengers to decline the offer and called on them to demand a minimum of €125,000 each to take into account the psychological trauma they will have undergone.

In the immediate aftermath of the incident, Codacons said it expected compensation to be "at least €125,000 for each passenger, up to two or three times more for specific cases and more than €1m for the most serious cases".

The organisation launched the international class action against Costa Cruises in Miami, Florida.

Eiopa highlights lack of IGS harmonisation

Eiopa has published a report on the role of Insurance Guarantee Schemes (IGS) when winding up insolvent operations in the EU and the European Economic Area, *writes Peter Birks*.

The report highlights a lack of harmonisation in areas such as which authority takes a decision to intervene when an insurer becomes insolvent; the ability to provide for portfolio transfers; a lack of "pre-warning systems" for insurers in difficulties but not yet insolvent; and the role of the relevant supervisory authority when an insurer collapses.

Eiopa also points out policyholders face the possibility of inconsistent treatment, depending on the country in which the insurer goes into insolvency. In more detail, only two respondent countries had no IGS at all. Seven had a life IGS and five had a non-life IGS, while five more had an IGS that covered both sectors. "Comprehensive cover is scarce and cover is often limited to the motor insurance sector," Eiopa said.

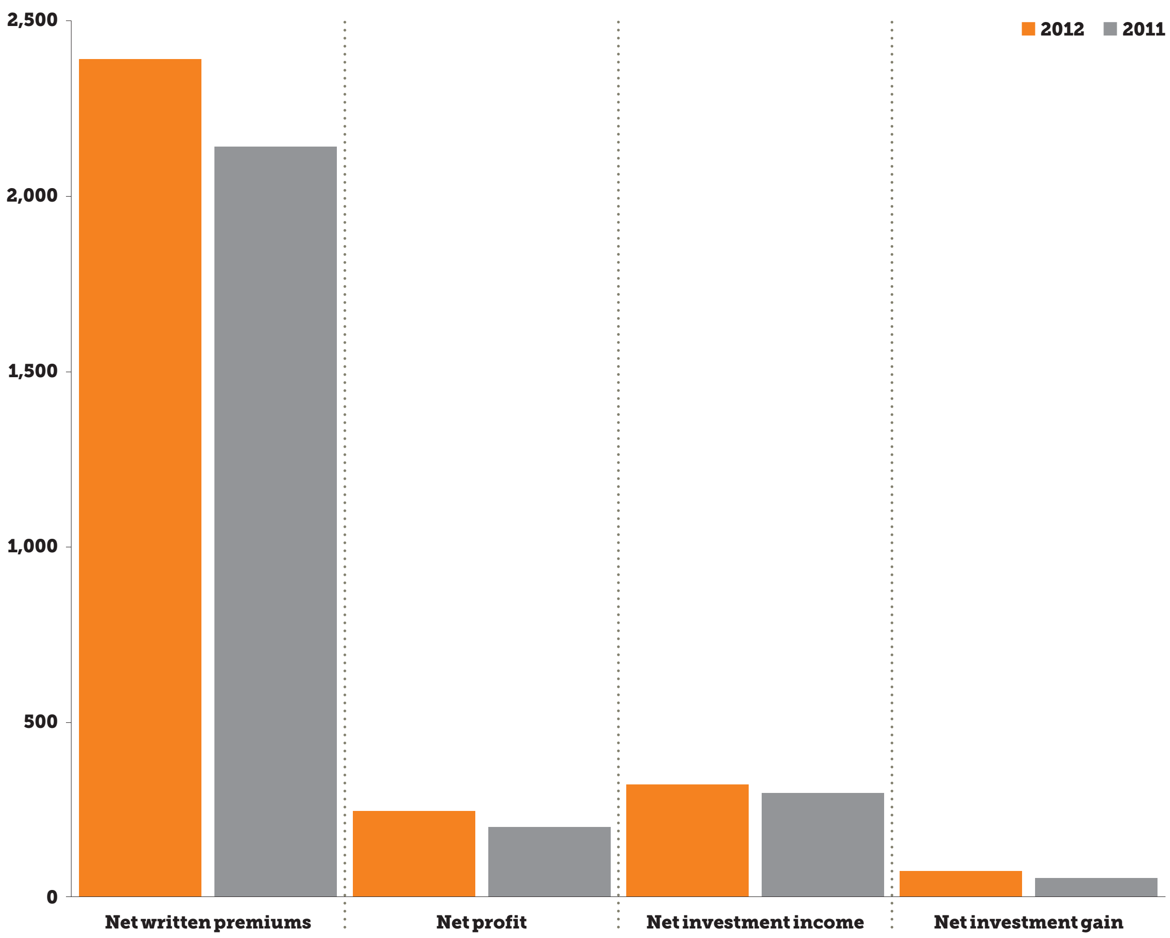
"Comprehensive cover is scarce and cover is often limited to the motor insurance sector"

Eiopa

One example of the many areas where powers and treatment differ is whether continued insurance cover is provided. Fourteen member states reported the IGS does not provide continuance of cover, while in nine member states the IGS did provide for continuance of cover.

NEWS

Graph: WR Berkley, first-half financials, 2011 versus 2012 ($m)



Source: WR Berkley

Surge in premium pushes WR Berkley 1H net income up 23% to $244.2m

"In spite of the difficult environment, our overall investment returns have proven to be satisfactory and we have continued to benefit from substantial realised gains from our non-fixed-income portfolio. This is in part a result of our continuing ability to find small opportunities offering attractive returns"

William Berkley
WR Berkley

A surge in growth in net premiums written during the second quarter helped US insurer WR Berkley to post net income of $244.2m for the first half of the year, up 23%, *writes Greg Dobie.*

However, the property/casualty (p/c) group's chairman and chief executive, William Berkley, said the pace of price increases was not accelerating as fast as the company had anticipated, with the carrier's average renewal rate increasing 6% during the second quarter.

Berkley said he expects this to change later this year as more companies begin to realise their loss reserves are weakening.

The p/c group saw its net premiums increase 12.6% between April and June to $1.19bn. Meanwhile, net premiums written during the first half of 2012 totalled $2.39bn, up 11% year on year.

The improved bottom line also reflected an 8% increase in investment income to $318.9m and a 38% jump in realised gains to $71.8m.

Berkley attributed the rise in investment income to the strong performance of the carrier's funds during the second quarter.

"In spite of the difficult environment, our overall investment returns have proven to be satisfactory and we have continued to benefit from substantial realised gains from our non-fixed-income portfolio," he said. "This is in part a result of our continuing ability to find small opportunities offering attractive returns."

The combined ratio improved to 97.4% from 98.9%, as a 10% rise in claims costs to $1.41bn did not match the increase in premiums.

Each of the group's regional alternative markets, reinsurance and international segments posted improved combined ratios; only its specialty segment did not.

Net income during the second quarter totalled $108.8m, up from $82.2m a year earlier.

"We still see pricing momentum throughout the balance of the year," Berkley said. "Many companies are beginning to recognise their weakening loss reserve position, which will continue to put forward upward pressure on the pricing environment. We continue to have a positive outlook for the second half of the year, as we work diligently to grow our business and effectively manage our capital."

Lancashire plans unless conditions

Company reports $103.7m profit in 1H

Scott Vincent
Deputy editor

Lancashire revealed plans to return capital to shareholders unless market conditions improve as it unveiled a net operating profit of $102.6m for the first half of the year.

Jonny Creagh-Coen, Lancashire's head of investor relations, told *Insurance Day* the rating environment has proved disappointing in light of last year's record-breaking international catastrophe losses.

"The property direct and facultative market has hardly moved at all and it's 40% to 50% off where it was in 2005/06," he said. "We'll probably move some PML [probable maximum loss] from the direct and facultative book and put it into treaty."

One region in which Lancashire has increased its presence is Japan, where the company grew its book at the April 1 renewal. "This is a

"As we enter the US wind season we are comfortable with capital levels and an interim dividend of 5¢ per common share has been declared by the board"

Richard Brindle
Lancashire

Lancashire first-half financial highlights

$102.6m
Lancashire's net profit for the first six months of this year, up from $97.5m for the first half of the previous year

6%
Average price change at renewal – likely to be better than rivals and driven by...

Strong Japanese yen

US-based supplemental health insurer Aflac has booked net earnings of $1.27bn for the first half of 2012, up from $663m in the comparable period last year, *writes Peter Birks.*

Aflac generated revenues of $12.1bn during the six-month period, up from $10.2bn in the first half of 2011. The Columbus, Georgia-based company said results for the period benefited from a stronger Japanese yen. New annualised premium sales for the period for Aflac Japan were ¥105.6bn ($1.3bn).

Aflac's US operation reported a 3% increase in total new sales,

to return capital improve

but warns of static price environment

market we intend to keep as a core part of our business," Creagh-Coen said.

The Japanese growth was a major driver in Lancashire's increased gross written premiums, which rose 36% to $514.8m for the period.

Sarah Lewandowski, analyst at Peel Hunt, said: "Lancashire's interim results show again how it is quick to act on market conditions, pulling back from direct and facultative and onshore energy business and announcing it expects to return capital should the trading environment not improve before the end of the year.

"This decisive action highlights Lancashire's strength: it is truly opportunistic and will not write business it deems unprofitable."

Lewandowski said Lancashire's 6% average renewal rate change was likely to be stronger than its peers. The increase was driven by a 25% rise in retrocession and reinsurance renewal rates.

"Lancashire's marine portfolio also saw a 15% rate rise. Aviation and terrorism are still seeing pressure, down 5% and 3% respectively year-to-date. Overall, Lancashire expects to reduce risk levels slightly and reduce capital accordingly, should the trading environment not improve throughout the rest of 2012.

Lancashire's first-half combined ratio improved year on year to 67.2% from 69.5%, helped by a significant decline in the accident loss year ratio, down to 46.5% from 73.0%.

The first-half numbers include an estimated net loss of $58.7m after reinsurance and reinstatement premium relating to the total loss of the *Costa Concordia*. In 1H 2011, Lancashire suffered net losses of $142m because of the Tohoku and Christchurch earthquakes and the *Gryphon Alpha* floating production, storage and offloading vessel.

Lancashire chief executive, Richard Brindle, said: "As we enter the US wind season we are comfortable with capital levels and an interim dividend of 5¢ per common share has been declared by the board."

25%
Rate increase Lancashire achieved at renewal for retrocession and reinsurance

$58.7m
Estimated first-half net loss Lancashire booked in relation to the Costa Concordia total loss

boosts Aflac growth

"Aflac Japan had another strong quarter, continuing impressive sales momentum, especially through the bank channel"

Daniel Amos
Aflac

bringing the total figure to $709m.

Aflac's chief executive, Daniel Amos, said: "Aflac Japan had another strong quarter, continuing impressive sales momentum, especially through the bank channel."

He said he expects operating earnings for the year to increase in the range of 3% to 6%.

Greenberg warns of US drought as Ace 1H net profit soars 50% to $1.3bn

Ace's Zurich, Switzerland headquarters: the insurer cut its full-year earnings guidance by 19¢ a share

Ace saw its net profit soar more than 50% to $1.3bn in the first half of 2012, bolstered by a significant year-on-year fall in catastrophe-related losses, *writes Greg Dobie*.

However, Ace chief executive, Evan Greenberg, warned drought conditions in the US continue to affect the insurer's crop insurance business and will also affect its second-half earnings.

Its updated guidance for the full year includes a reduction of 19¢ a share to reflect a projected third-quarter increase in the year-to-date crop insurance loss ratio, amid the worst drought in the US for half a century.

Crop insurance aside, Ace said it is optimistic about its revenue and earnings prospects for the remainder of the year as it revealed its premium growth rate had accelerated 4.5% during the second quarter. Full-year guidance is now $7.20 to $7.60 a share after-tax operating income, from the previously projected range of $7.03 to $7.43.

Greenberg said Ace is benefiting from "strong, broad-based growth, both geographic and product, along with an improving property/casualty [p/c] price environment globally", adding: "For the first time, pricing in our international p/c operations in aggregate turned positive, whereas for our US business rates continued to rise, up 4.7% on average for the quarter."

The insurer's improved first half largely reflected a decline in catastrophe-related losses to $74m from $557m a year earlier.

Underwriting income of $767m was more than four times the year-earlier $190m, with the combined ratio for the first half improving to 88.9% from 98.5%. Ace's underwriting income from p/c business during the second quarter of the year was $374m, compared with $239m in 2011. The p/c combined ratio for the second quarter was 88.7%, a result Greenberg called "distinguishing".

However, the carrier's net income for the second quarter actually declined year on year to $328m, down 45%, as a jump in realised losses took its toll on the Zurich-based group.

Realised losses soared to $394m from $73m, primarily owing to variable-annuity reinsurance derivatives.

Gross written premiums for the year-to-date totalled $9.4bn, up from $9.1bn a year earlier.

$1.3bn
Ace's first-half net profit, up 54.1% on the same period last year

88.9%
Combined ratio for the six-month period versus 98.5% during 1H 2011

$9.4bn
Gross written premium for the year to date, up from $9.1bn for 2011

WORLD LOSS INTELLIGENCE/LIABILITY

Sandusky case: Insurer seeks release from obligations

Jerry Sandusky leaves court after being found guilty of multiple charges of child sexual abuse

AP Photo/Gene J Puskar

PENNSYLVANIA: Illinois-based State Farm has sought a formal court decision that would release it from any possible obligation to convicted sex offender Jerry Sandusky under Sandusky's homeowners' insurance policy.

State Farm said in a submission to the US District Court for the Middle District of Pennsylvania that the homeowner's policy issued to Sandusky does not cover claims for injuries caused by intentional acts.

Sandusky was convicted last month of 45 counts related to the sexual abuse of 10 young boys over the course of 15 years, with some of the offences taking place at his home. During the trial of Sandusky, evidence presented by the defence claimed signs of a personality disorder.

This, observers said, could lead to a claim Sandusky's actions were not intentional acts, but the result of mental illness. Homeowners' policies cover policyholders against negligent acts, provided there was no intent.

Medical malpractice: Payou

US: Medical malpractice insurers in th 9,758 claims last year, the lowest an since full-year figures started being co 1991, marking the eight consecutive decline, according to a report by consu cacy group Public Citizen, which anal from the federal National Practitioner D

The inflation-adjusted value of claim the year was $3.2bn, another record lov lays in 2011 were also down for the eigh year and were at their lowest since report said.

Public Citizen said the figures show mal lawsuits are not responsible for cost of healthcare.

Settlement: AIG agrees to pay settlement to Californian city

CALIFORNIA: AIG's Californian insurance unit has agreed to pay $1.1m to the city of Glendale, just north of Los Angeles.

The payment settles a lawsuit the city filed to recover close to $15.4m it paid out to nine local homeowners and their attorneys in the wake of a destructive mudslide in 2005.

Appeal ruling: Citizens policyholders proceed in collecting $104m

Floodwaters in New Orleans the day after hurricane Katrina passed through the city

AP Photo

LOUISIANA: On July 23, Louisiana Citizens Property Insurance, the state's last-resort property insurer, paid out a $104m jury award, which will be distributed later this year to more than 18,500 policyholders who sued the company for its slow handling of claims in the wake of 2005's hurricanes Katrina and Rita.

The funds are to be held in trust for three to six months while a state court judge determines how much of the award, which includes interest, will go toward attorneys' fees. Citizens made the payment in the wake of a state appeals court ruling last Friday to grant a Regions Bank's writ to deny the insurer's request to block the seizure of its assets.

The payment ends a drawn-out appeals process that reportedly was adding $300,000 a month in interest to the award. With the payment, Citizens has close to $100m in cash reserves for claims payments into the foreseeable future, chief executive, Richard Robertson, said.

IN TOMORROW'S WORL LIVES & LIV

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9,758
Claims paid by US medmal insurers last year

$3.2bn
Inflation-adjusted value of claims payments for the year

CF Arch Cru claims: FSA warns insurers not to breach obligations

UK: The Financial Services Authority (FSA) has warned professional indemnity (PI) insurers it will take action against any firm that breaches its obligations under the policies they wrote for CF Arch Cru Investment & Diversified Funds, which collapsed in 2009.

In a Dear CEO letter, the FSA said it had been contacted by independent financial advisers who are concerned their PI policies might not cover claims for mis-selling compensation. The FSA said: "Firms have told us they have attempted to notify their insurers of circumstances which are likely to lead to a claim... and have been told such notifications cannot be made simply on the basis the FSA is consulting on a proposed consumer redress scheme."

Clive Adamson, director of supervision, said: "To be clear, it is not our intention to dictate what risks insurers should cover, nor are we seeking to require insurers to go beyond the cover as described in the relevant PI insurance policies, but we are certainly prepared to consider taking action where insurers seek to breach or avoid their obligations to the detriment of consumers."

In the Dear CEO letter, the FSA asks insurers a number of PI/Arch Cru-related questions. The FSA's consultation over its £110m ($171m) redress scheme ends this month. The proposed redress scheme is in addition to a £54m payment scheme announced in 2011. That involved Capita Financial Managers, BNY Mellon Trust & Depositary (UK) and HSBC Bank.

"Firms have told us they have attempted to notify their insurers of circumstances which are likely to lead to a claim... and have been told such notifications cannot be made simply on the basis the FSA is consulting on a proposed consumer redress scheme"

FSA

alum outage: Norsk Hydro receives $23m insurance settlement

TAR: The second-quarter results of aluminium producer Norsk Hydro have been boosted by the final insurance settlement worth
140m ($23m) relating to the 2010 power outage at its Qatalum plant.
orsk Hydro, a global supplier of aluminium that participates in all facets of the metal's production, including bauxite extraction
creation itself, is a joint partner in the Qatalum facility along with Qatar Petroleum.
e facility was shut down for more than a month following a five-hour power outage on August 9, 2010. The delay in restarting the
ity occurred because the Qatar-based operator had to prepare the 444 cells affected by the outage for a safe and secure restart.
the time, Qatalum's chief executive, Jan Arve Haugan, said: "We have insurance related to property damage and loss owing to
ness interruption and we are in a constructive dialogue with our insurers to determine the financial impacts of this incident."
orsk Hydro initially predicted a loss of close to NKr625m, with the company receiving a NKr300m payout from its insurers
ng the course of 2010 to offset some of the losses associated with the shutdown. The final insurance payout is not far off the
625m initially estimated, with the Qatalum facility receiving a total of NKr600m in claims payments.
uring the second quarter of the year, underlying earnings before interest and tax for Qatalum division increased compared
the first three months of 2012, mainly owing to this final insurance payout.
nderlying net income amounted to NKr15m at the end of 2012's second quarter, compared with a NKr64m loss in the first
e months of the year.
e most recent result was negatively affected by costs relating to a fire that erupted in a seawater cooling tower at the Qatalum site.
llowing publication of the first-quarter results earlier this year, Bent Andersen, head of corporate financial reporting, perform-
and tax at the operation, said insurance coverage is in place to offset the costs of the fire, but it will be some time before the extent of
settlement can be accurately assessed. Three months down the line, it remains unclear how large the ultimate claim will be.
is is because although no injuries occurred and production of primary aluminium has not been affected, additional operating costs
ose to NKr70m were incurred during the second quarter because the company has had to buy electricity from the grid rather than using
wn resources. This situation is expected to continue into the next quarter.

© Norsk Hydro

LD LOSS INTELLIGENCE:
VELIHOODS

FINANCIAL WORLD TODAY

Sector stocks boosted by resilience of US corporate earnings

Early reporting insurance groups such as Platinum and Travellers saw vastly improved second-quarter results owing to lower catastrophe losses

Rasaad Jamie
Global markets editor

Very much reflecting the pattern of sharp peaks and deep troughs that has characterised the recent financial market fortunes of the sector, insurance and reinsurance stocks rallied strongly during the week ending July 19.

Upward drift

Inevitably, the upward drift was facilitated by broader financial market developments rather than by insurance sector-specific issues, although during the period under review there were no shortage of the latter, particularly relating to the cost of severe weather events to the industry in the US now insurers are beginning to report second-quarter results.

But it was the surprising resilience of US corporate profits more broadly that moved the market and, indeed, prompted European stock indices to a 15-week high. Very much against the run of play, of the 63 companies in the S&P 500 that reported their second-quarter earnings, close to 72% exceeded analysts' expectations, 11% were in line with analysts' prediction and only 17% delivered results that were worse than expectations.

A week earlier, the markets had braced themselves for a sharp reduction in corporate earnings as a result of the slowdown in the US, the eurozone and the Japanese and Chinese economies, the signs of which were pretty much in evidence during the week under review. For example, the usually vibrant Chinese stock markets fell to a six-month low after China's premier, Wen Jiabao, warned the economic recovery is still very much in doubt and there are still some tough times ahead.

Generali: Italian, German and French units downgraded by Moody's

So much so, at the beginning of the week, the markets were boosted by better-than-expected results from JP Morgan Chase and Citigroup, even as the global investment banking sector continued to be pressured by the fallout from the eurozone debt crisis. For example, there was a record decline in Spanish bank deposits in May compared with the same period last year. In addition, the number of bad loans in the Spanish banking sector increased for the 14th consecutive month.

Italian downgrades

In terms of the insurance sector, Moody's downgraded the financial strength ratings of three Italian insurers, including the ratings of the Italian, German and French operations of Generali and the ratings of Allianz Italy. This was not unexpected, as Moody's downgraded Italy's sovereign credit rating a week earlier and the rating agency is now in the process of aligning its corporate ratings to reflect the wider reality.

Indeed, the recent much-publicised consensus among eurozone leaders as to how to deal with the regional crisis was also under pressure as investors became increasingly uneasy about a number of reported delays of bail-out funds being made available to some of the peripheral economies. But they were even more uneasy about the outcome of a ruling by Germany's constitutional court on September 12 as to whether the regional bailout fund (the European Stability Mechanism) itself, as well as the recent changes to some of the eurozone fiscal rules to relieve the pressure on some of the most indebted countries, are compatible with German law.

There were further pressure on insurance sector stocks from reports detailing the rising costs to insurers of the recent severe weather events in the US, as well as from the news that as a result of the prolonged periods of drought in the Midwest, crop insurers (which include Ace, QBE and Everest Re) could face their first underwriting loss since 2002. Outside the US, a year's worth of rain fell in southern Japan over the previous week-end, flooding 10,000 residential and non-residential buildings and killing 26 people.

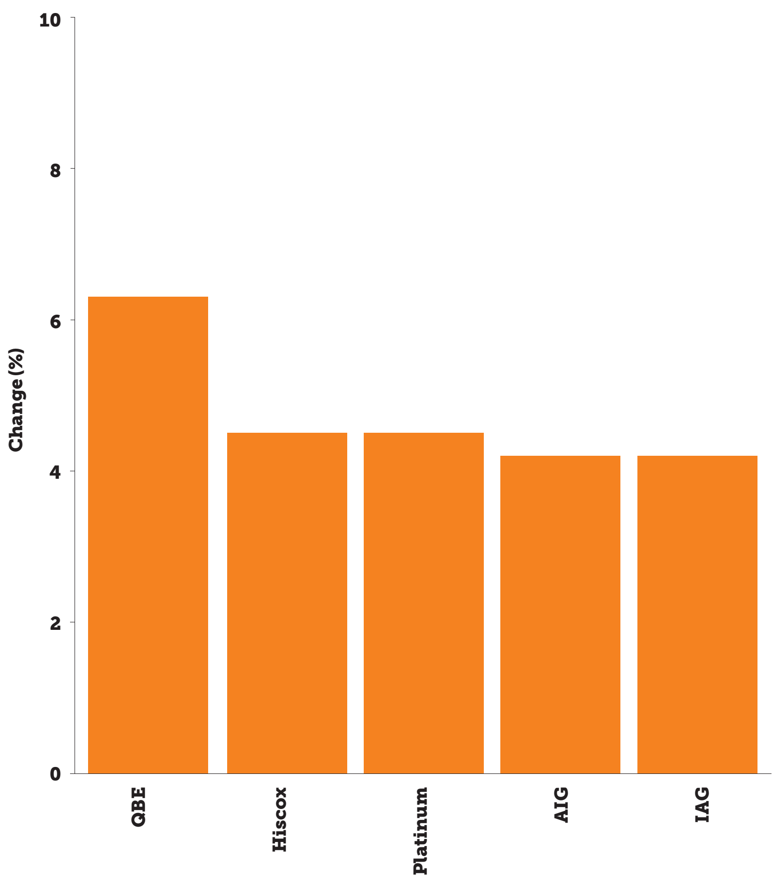
Table: Share prices as at close July 19, 2012

Company/group	Currency
Ace	US dollar
AIG	US dollar
Alleghany Corporation	US dollar
Allianz	Euro
Allstate	US dollar
Alterra	US dollar
Amlin	Pence
Arch Capital	US dollar
Aspen	US dollar
Aviva	Pence
Axa	Euro
Axis Capital	US dollar
Berkshire Hathaway (A)	US dollar
Catlin	Pence
Chubb	US dollar
CNA Financial	US dollar
Endurance Specialty	US dollar
Everest Re	US dollar
Generali	Euro
Hannover Re	Euro
Hiscox	Pence
Insurance Australia Group	Australian dollar
Korean Re	South Korean won
Montpelier Re	US dollar
MS&AD Insurance Group	Yen
Munich Re	Euro
NKSJ Holdings	Yen
PartnerRe	US dollar
Platinum	US dollar
QBE Insurance Group	Australian dollar
RenaissanceRe	US dollar
RSA	Pence
Scor Paris	Euro
Scor Zurich	Swiss franc
Swiss Re	Swiss franc
Travelers Companies	US dollar
Tokio Marine Holdings	Yen
XL Group	US dollar
Zurich Insurance Group	Swiss franc

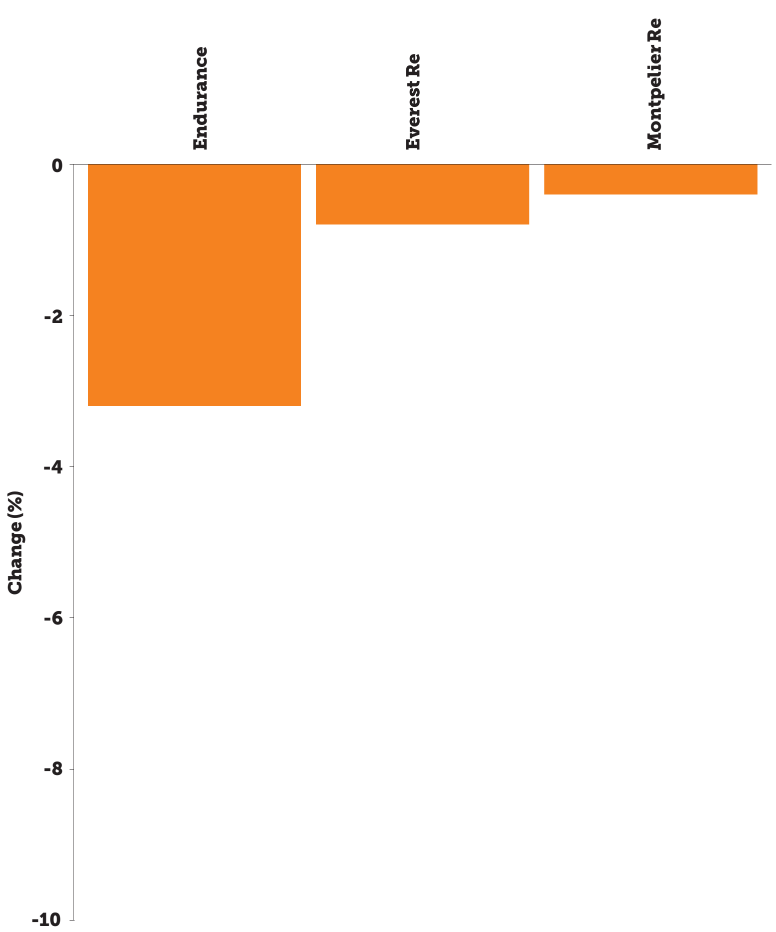
Source: Insurance Day

Dec 31, 2011	Jul 12, 2012	Jul 19, 2012	Change from Jul 12 (%)	Capitalisation ($m)
70.12	71.52	71.64	0.2	24,264
23.20	30.47	31.76	4.2	56,978
285.29	341.20	344.06	0.8	5,825
73.43	77.68	80.85	4.1	45,107
27.41	33.65	34.71	3.2	17,055
23.63	23.54	23.71	0.7	2,383
313.90	361.00	374.10	3.6	2,917
37.23	39.03	39.56	1.4	5,358
26.50	29.34	29.56	0.7	2,114
300.80	288.70	300.10	3.9	13,235
10.05	9.97	10.16	1.9	28,560
31.96	32.98	33.26	0.8	4,304
114,755.00	125,321.00	126,995.00	1.3	118,232
398.70	428.50	444.20	3.7	2,508
69.22	70.61	71.65	1.5	19,342
26.75	26.85	27.49	2.4	7,405
38.25	36.59	35.43	(3.2)	1,537
84.09	103.98	103.13	(0.8)	5,440
11.63	9.94	9.98	0.4	18,958
38.30	47.10	48.70	3.4	7,210
373.50	419.20	438.00	4.5	2,620
2.98	3.59	3.74	4.2	8,071
15,000.00	11,200.00	11,600.00	3.6	1,161
17.75	21.39	21.30	(0.4)	1,233
1,426.00	1,325.00	1,336.00	0.8	7,163
94.59	112.00	116.00	3.6	28,109
1,510.00	1,566.00	1,579.00	0.8	31,746
64.21	74.32	74.42	0.1	4,804
34.11	38.29	40.02	4.5	1,394
12.95	13.24	14.08	6.3	15,119
74.37	75.52	76.11	0.8	3,940
105.20	108.20	111.60	3.1	6,051
18.06	18.99	19.45	2.4	4,397
21.50	23.15	23.15	0.0	4,442
47.87	59.35	61.40	3.5	23,262
59.17	62.24	63.69	2.3	24,778
1,705.00	1,883.00	1,922.00	2.1	19,264
19.77	20.29	20.84	2.7	6,496
212.50	214.20	220.50	2.9	33,214

Graph: This week's winners...



...and losers



Lower cat losses

On the bright side, early reporting insurance groups such as Platinum and Travellers posted vastly improved second-quarter results owing to lower catastrophe losses. This sense of a positive outlook for the sector in 2012 was further underlined by a report from the Insurance Information Institute (III), which revealed the US property/casualty (p/c) industry could be set for its most profitable year since 2008, despite the heavy insured losses (estimated at $8.8bn by the III) suffered during the first half of this year. However, this compared with insured losses of more than $24bn over the same period last year.

According to the III, the sector's first-quarter profits were up by nearly 30% compared with the same period in 2011 and was likely to exceed the $62.5bn net profit achieved in 2008. Last year, despite a steep increase in underwriting losses and difficult financial market environment, the US p/c sector recorded a net profit of $19.2bn.

As the European debt crisis continues to disorientate the financial markets, the global reinsurance sector received what amounted to a clean bill of health from a body no less than the International Association of Insurance Supervisors (IAIS), which in a report said the failure of a traditional reinsurer is unlikely to represent a systemic risk to the financial system. Notably, the IAIS applied the same status to non-traditional reinsurance or alternative risk transfer (ART) arrangements. Commenting on the latter, the IAIS said ART does not intermediate credit and therefore, "the failure of a reinsurer engaged in ART would not undermine a larger credit pyramid and it is unlikely to affect other financial market participants or the real economy".

In terms of the traditional reinsurance industry, the report said there had only been 29 reinsurance failures in the past 32 years. These failures represent a total loss of $1.8bn. According to the IAIS, this amounted to just 0.43% of reinsurance premiums collected over that period. ■

Marine kidnap and ransom coverage: who needs it?

A look at the world of marine kidnap and ransom insurance

Lars Gustafson, senior vice-president, global marine practice
Marsh

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Marine kidnap and ransom (K&R) insurance is a relatively new product developed in response to the number of ships seized by Somali pirates. Before 2008, it was unusual for shipowners to purchase K&R, although K&R has been purchased for years by international businesses operating in countries where kidnapping is common.

Today, almost every shipowner whose vessels transit the Gulf of Aden/Indian Ocean region purchases some form of K&R coverage.

A new era

Traditionally, a shipowner purchases an annual hull and machinery (H&M) policy to cover its physical loss or damage to its vessel, protection and indemnity insurance to cover liability stemming from the operation of the vessel and war risk insurance to cover war-related damages.

Ransom demands made by pirates do not always fit neatly within these typical coverages, nor are they specifically covered in the shipowners' existing policies. Nevertheless, shipowners have made successful arguments to underwriters for contribution or payment of ransom demands.

As the Somali pirate risk developed, however, it became apparent traditional marine underwriters did not want to cover ransoms specifically. Shipowners and their insurance brokers then turned to the K&R market for certainty of coverage.

While comprehensive K&R policies already existed, a tailor-made marine K&R policy needed to be developed. The marine K&R policies that ensued took modelling from typical war risk policies and traditional K&R policies.

Additional coverages were also developed to address the loss of hire (income) exposure, as well as port of refuge expenses. Many marine K&R policies today reference high-risk areas (HRAs) as defined by the marine war risk market.

In addition to the geographic risk profile, the vessel's freeboard (height above water), speed capabilities, age and, most importantly, security measures aboard the vessel are critical to the K&R underwriting process.

Underwriters typically base their pricing using vessels that have four metres or greater freeboard, are capable of maintaining 12 knots through the HRAs, are 15 years old or younger and are compliant with best management practices – a set of recommendations for shipowners developed by the shipping industry for security measures while transiting HRAs.

For instance, if a vessel owner chooses to hire armed guards, the underwriter typically gives a 50% discount to the premium charged. Also, an owner can choose to insure its exposure on a one-off transit policy or a more comprehensive annual policy against pre-agreed rating.

As copy-cat piracy acts are already occurring off the west coast of Africa, an annual worldwide coverage is recommended by marine insurance brokers.

K&R pricing

Today, the marine K&R market comprises only a handful of underwriters. Pricing appears to be the overall driving factor when reviewing insurance offerings. The years 2010 and 2011 were particularly bad underwriting years for a few underwriters, given the frequency of successful attacks that occurred.

Increased loss-prevention measures, additional armed guard transits and a greater naval presence has significantly reduced the successful pirate captures in the first half of this year. This is certainly a welcome trend for owners, underwriters and crew that sail this region of the world.

Security: hiring armed guards can get vessel owners as much as a 50% discount to their premium

Can an owner recover without K&R?

There is a way for owners to recover ransoms and other expenses paid in connection with a pirate attack through a legal theory known as general average. This concept recognises all voyages are essentially joint ventures between ship and cargo. It is a fairness principle as old as the earliest commercial sea voyages.

It recognises in extraordinary circumstances, all the parties to the venture must contribute proportionally to the cost of rescuing their cargo and ship from danger. For example, if discarding easily accessible cargo is the only way to save a rapidly sinking ship, it would be unfair to cargo if it was to bear the entire cost of the discarded goods alone.

The law of general average prevents injustice by requiring all the parties to contribute a portion to the cost of the loss. General average law is anchored in fairness and it exists even without marine insurance and is not dependent on contract.

The law of general average requires four elements: peril, extraordinary loss/expenditure, voluntary incurrence of the loss/expenditure and a common benefit. While general average law has evolved with slight differences throughout the world, the English and US legal regimes are the most commonly encountered in practice.

Courts have long recognised ransom payment as a general average expenditure. Armed pirates on board a ship constitute a peril. Ransom payments are extraordinary because they are not reasonably contemplated in a voyage. Ransom payments are voluntary because a shipowner has no legal duty to pay a ransom. Common benefit is achieved when the ship and cargo are released upon payment of ransom and the voyage is completed.

The recovery of general average payments will be apportioned between the hull and cargo according to their relative value. The H&M, cargo and war risk insurers will indemnify the owner for such payments according to the policy wording. Accordingly, under their traditional insurances an owner can recover some or all of the ransom paid without K&R cover. However, general average does not cover all piracy expenses.

Expenses recoverable in general average can include ransom, ransom delivery costs, negotiators' fees, lawyers' fees, transit insurance on the ransom, delivery of bunkers and stores, port of refuge expenses, average disbursement insurance and commission and interest for the advancement of payments. K&R typically covers even more, including theft of ransom, public relations costs, psychological assistance for crew and others.

How to choose?

The first step in recovery under the law of general average is an appraisal by an adjuster. This takes time – months at least. A K&R policy, however, will normally indemnify the shipowner (K&R is a "pay to be paid" policy) within 10 days of payment of the ransom.

The fact the general average process is time-consuming and covers fewer expenses makes it a difficult route for owners, particularly those who are short on cash and cannot afford to front a ransom and then wait months or more for recovery.

K&R may require more up-front expense but, in the event of a successful pirate attack, it can be an invaluable asset. ■

• *Joyce Lai assisted in the preparation of this article*

Expecting the unexpected

Costas Frangeskides, partner, and Ben Atkinson, associate
Holman Fenwick Willan

The continuing eurozone debt crisis has caused the (re)insurance market to consider the consequences of the exit of a eurozone state from the euro and a redenomination into a local currency.

Any withdrawing state would be likely to enact new laws making compulsory the redenomination of contractual payment obligations governed by local law into a replacement local currency, as well as requiring payments into that state to be in the new local currency. The governing law and jurisdiction that applies to such contracts will be crucial in determining the impact of such redenomination provisions.

Contracts governed by express local law and jurisdiction clauses will have to comply with local laws on redenomination, which will be difficult to avoid as they are likely to trump any currency conversion or redenomination clauses providing for other harder currencies (eg, euro, pound sterling and US dollar).

However, even where contracts incorporate express English choice of law and jurisdiction clauses, issues may still arise because of two conflict of laws principles.

First, there is the principle of *lex monetae*, where the choice in a contract of a particular currency is taken to imply a choice of the country of that currency to determine, where necessary, what that currency is or may redenominate into.

In the context of the risk of redenomination into a replacement local currency, issues may arise as to whether an English court should regard the choice of the euro in a contract as a choice of the law of a particular member state or a choice of the law of the eurozone as a whole.

To avoid such difficulties, currency fluctuation or conversion clauses should be incorporated into policies. Such clauses should also say what rate of exchange will apply.

Second, there is the principle of *lex loci solutionis*, whereby under Rome I regulation, art 9(3), English courts may also give effect to the overriding mandatory rules of the law of the place of performance of a contract.

Courts then have the discretion to render performance unlawful if payment of a claim under a contract is unlawful in the country where payment must be made.

Possible solutions include incorporating clauses that require payment to be made to a party outside the country at risk of currency redenomination. It would be sensible to incorporate such clauses before any redenomination occurs.

The prospect of redenomination presents various uncertainties and parties to potentially affected contracts may wish to act now to mitigate any future impact. To avoid exposures, parties should consider revising their contracts as above to avoid those EU states perceived as higher risk.

In the case of existing contracts, this may be achievable by endorsement; in the case of new contracts, by express provision. Where necessary, standard market clauses can be modified for these purposes. They should also consider including contract continuity clauses, which maintain the validity of the contracts in the event of a eurozone redenomination.

While redenomination could affect contractual obligations, it will also of course affect counterparty and investment risks. In that context, parties to (re)insurance undertakings must consider minimising their exposure through careful negotiation of their future and existing contracts, with a particular focus on governing law, jurisdiction, currency conversion, validity and place of performance provisions. ■

ABSolutely fabulous?

A recent survey of 100 commercial law firms in the UK furthers the debate on changes to the legal market under the Legal Services Act (LSA) and looks at the appetite for alternative business structures (ABS). "ABSolutely fabulous – A study of alternative business structures and their role in a changing legal market", commissioned by Fox Williams LLP and undertaken by legal research company Jures, looks at the ABSs available; a changing partnership model; and the arrival of private equity investment into law firms and legal services providers.

The research shows it would be wrong to dismiss a low-profile start to the new regime as evidence of disinterest by the profession in the legislation-liberalising agenda.

Of the 100 respondents, 54% described as either "compelling" or "very compelling" accessing private equity or other third-party investment to finance their firms' growth as a reason for ABS conversion.

Access to finance (not available from partners or traditional bank borrowing) was considered either "important" or "very important" by 77% when converting to an ABS.

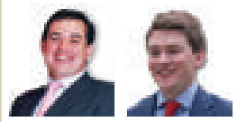
But such a radical structural change in the legal services market does not come without internal opposition. "Loss of control" was identified as the biggest barrier to ABS conversion (62%), followed by resistance from partners (51%).

Other main findings from the survey include:

- Almost half of respondents (49%) said they were "not confident" in the Solicitors Regulattion Authority's (SRA) ability to manage the ABS application process successfully;
- 39% have already changed their management strategy as a result of the LSA and 14% have changed their partnership structure;
- 70% of respondents said improving cashflow was either "important" or "very important" when considering an ABS conversion;
- One-third of respondents were looking to spin off services through an ABS (33%) or alternatively looking to access external investment to fund growth (29%);
- One-fifth of respondents were looking to incentivise staff through offers of private equity (20%);
- 23% of respondents were interested in being part of a collective membership organisation with other law firms "to share common services as part of the network";
- 35% of respondents said "ownership by a recognised brand" was a "compelling" or "very compelling" reason for ABS conversion; and
- Regulatory and tax issues topped the list of areas where specialist advice is needed (35% and 41% respectively).

The variety of business models of the early adopters of ABS – from consumer brand and volume conveyance through to the first foreign-owned ABS and the first to be part of a stock exchange-listed company – shows members of the profession willing to embrace change to gain a competitive advantage. ■

A sea change ahead



CLYDE&CO

As the sea ice along Russia's coastline makes its annual summer retreat, the Northern Sea Route (NSR), the shipping passage from Murmansk to the Barents Strait, is now open for shipping companies to take advantage of the potential cost savings of transiting the route.

Sovcomflot, the Russian state-owned shipping company, is forecasting the NSR may remain open until as late as November 2012. Hull and protection and indemnity (P&I) insurers can therefore expect assureds to start considering the commercial viability of transiting the passage, which is the shortest route between Europe and Asia.

The potential benefits are significant; it is estimated a voyage from Kirkness, Norway to Shanghai, China through the NSR, rather than the Suez Canal, could save 16 days' sailing time and 1,000 tonnes of bunkers. However, there are considerable risks unique to the Arctic region for insurers to consider before insuring vessels to sail outside the institute warranty limits in hull policies.

Sea ice in the Arctic Ocean has retreated at record levels recently and scientists forecast increasing temperatures will mean the Arctic will be ice-free during the summer by the end of this century, or even within the next 30 to 40 years.

The increase in shipping activity in the region has been considerable. In 2011, 34 vessels carrying 820,000 tonnes of cargo passed through the NSR. More than one million tourists visited the region, many on cruiseships. Russia's Ministry of Transport estimates 1.5 million tonnes of cargo will be shipped along the NSR this year, with 64 million tonnes being carried by 2020.

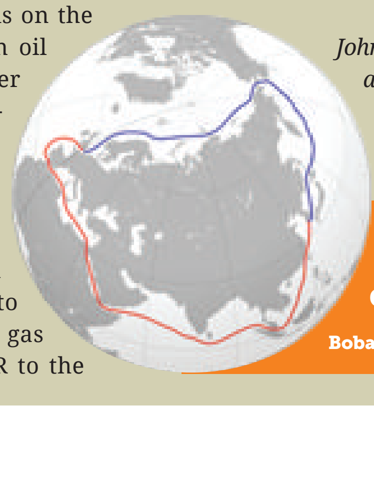
Extraction of the wealth of hydrocarbons locked under the Arctic's seabed is on the horizon. Russian oil and gas producer Gazprom commenced drilling of its first well in the Yamal field last month and has stated its intention to export oil and gas through the NSR to the Asian markets. The Russian government has authorised plans to develop ports in the Ob bay and Yamal Peninsula and Vladimir Putin has promised significant investment to develop the NSR as an alternative to the Suez Canal. As a result, a sharp increase in shipping activity is expected.

Russian regulations impose requirements on ships transiting the NSR, including that vessels are built to Ice Class 1A standard and are escorted by ice-breakers. However, there remain considerable risks as unpredictable weather conditions, varying water depths and a lack of charts exacerbate the risk of collision or grounding. Without significant investment the geographical remoteness of the Arctic will be a major constraint to effective rescue and salvage facilities. This was illustrated by the grounding of the *MV Clipper Adventurer* in August 2010.

The London market's joint hull committee has expressed concerns regarding the Arctic's geographical remoteness and also highlighted the need for underwriters to consider a number of issues before providing cover to vessels transiting Arctic waters, including the proposed route, date and time of the voyage, experience of the crew, access to weather/ice information and presence of an ice pilot.

Substantial sums are being invested to develop a shipping infrastructure in the Arctic, but the challenges of navigating its waters remain considerable. The dawn of Arctic shipping has arrived, but we are unlikely to see Gulf of Aden pirates flocking to Arctic waters as the Suez Canal will remain, for now at least, the main passageway between Europe and Asia. ■

John Flaherty, partner, and Tom Gorrard-Smith, associate, Clyde & Co



Northern Sea Route (blue) and the Suez Canal (red)

Bobamnertiopsis