Heriot-Watt University February 2012

The Actuarial "Watt"?

EDITOR'S NOTE

We hope everyone had a great winter holiday and are prepared for the new semester. We hope that the articles we have published so far were informative yet entertaining to our readers.

The financial world is ever changing and hence it is of great use if we keep updating our knowledge on the current news and issues. If you find that our articles are lacking in any way, your feedback is very much appreciated. Just send us an email at mcs4@hw.ac.uk and we will try to make the newsletter even better!

Besides current issues, we will also update you on upcoming SAS events. As usual, we encourage everyone to come and participate in the events as it would prove extremely useful in the future.

We also post a lot of other useful information on the HWSAS website, www.hwsas.com

-Mei Chen, Soon-

RISING MOTOR INSURANCE PREMIUMS

BY BALQISH SYAHIRA SHAIR

Over the past year motor insurance premiums have increased by 40%. Car insurance premiums were rising 16%, with household premiums 4% higher. Rocketing car insurance premiums have added significantly to the record-breaking inflation, according to the Office for National Statistics. These increasing insurance premiums have led to near total dissatisfaction among drivers.

Apart from petrol, car insurance premiums are the fastest rising of the price categories. It was monitored by the ONS (Office for National Statistics), with the annual rise hitting 26.1%. Car insurance is a relatively minor part of most household budgets, but the hike has added about 0.1% to the 3.7% annual rate of inflation.

The reasons for the hike in motor premiums are due to two primary factors. One is the opportunist claims and so many fraudulent motor claims are set up by highly organised and sophisticated criminal gangs. Many claims are for whiplash that is an injury where diagnosis is often subjective and therefore very costly for insurers to challenge. The transport committee says the Government should impose a higher threshold for the payment of any compensation in whiplash cases, and should improve the management of car accident claims.

The second one is the system which permits recovery of high legal costs from insurers rather than the claimant. It is also caused by the "no win, no fee" legal environment by most UK law firms. People now seem willing to pursue claims for minor injuries that in the past they would not have been bothered claiming for. All encouraged by personal injury claims lawyers.

This whole situation is incompetent at best, but given its impact on motor premiums, it is also immoral and unsustainable. Hence, although the cost of premium is getting out of hand, there are a number of ways that can help reduce the amount of premium payment

- Not buying vehicles with powerful engines. Statistically, these kinds of cars are more likely to get into an accident.
- Adding security features to your car such as alarms and steering locks

- Keep your car in a garage to reduce risk of theft
- Adding an experienced older driver to your policy if you are under the age of 25.
- Getting a range of quotes when looking for a new supplier and make comparisons
- Paying for your insurance in a lump sum, rather than monthly installments.

IRAN SANCTIONS: CAUSES AND EFFECTS

Over the years, multiple sanctions have been imposed on trades with Iran by multiple countries. The on-going sanctions against Iran are estimated to have cost the government of Tehran more than US$60 billion particularly in energy investment, oil sales and gasoline exports. Recently in December 2011, President Barrack Obama signed the Iran sanctions bill into law, with aims to "close down" the Iranian central bank. The EU has also banned imports of oil from Iran recently and imposed other economic sanctions in the hope of persuading Iran to deflect its alleged nuclear weapons programmes.

What are the recent economic sanctions?

- **United States**

Foreign firms that do business with the Iranian Central Bank will be cut off from the US financial system.

- **European Union**

Freeze the asset on individuals and organisations linked with nuclear programme. Ban any export on natural gas technology to Iran

- **United Nations**

Ban on sales of heavy weaponry and nuclear technology to Iran

Iranian arms exports blocked, and asset freeze for key individuals and firms

What are the effects of the sanctions on Iran and the world's economy?

- The sanctions particularly on Iran's Central Bank could force the global price of oil to increase abruptly and will indirectly give a financial windfall on existing oil sales in Iran. The rise in oil prices could also crimp the fragile economic recovery in the United States in addition with the threat from Iran to block the Strait of Hormuz, which more than a third of the world's tanker-borne oil passes.
- Iran will have fewer choices of trading partners. The US authorities have already placed sanctions on three oil companies from China, Singapore and U.A.E based company. The companies would be barred from receiving U.S export licenses, export-import funding and loans over $1 million from US financial institutions.
- Iran will have difficulties in financial transaction since half of the country's revenues are from the export of crude oil.
- The EU currently accounts for around 20% of Iranian oil exports. Therefore, if the EU stops trading oil with Iran, Iran will have to turn to countries in Asia to replace its lost trade. Some Asian countries such as China, India, Turkey, Japan and South Korea have already refused to go along with the latest round of economic sanctions against Iran.
- Russia has also rejected any further sanctions. The Foreign Minister, Sergei Lavrov said that once all the sanctions over the nuclear programme had been exhausted, any additional measures were probably intended to provoke discontent in the Iranian population.

THE EUROZONE CRISIS:
CREDIT AGENCIES AND BAILOUTS

BY JACK PATON

A new problem

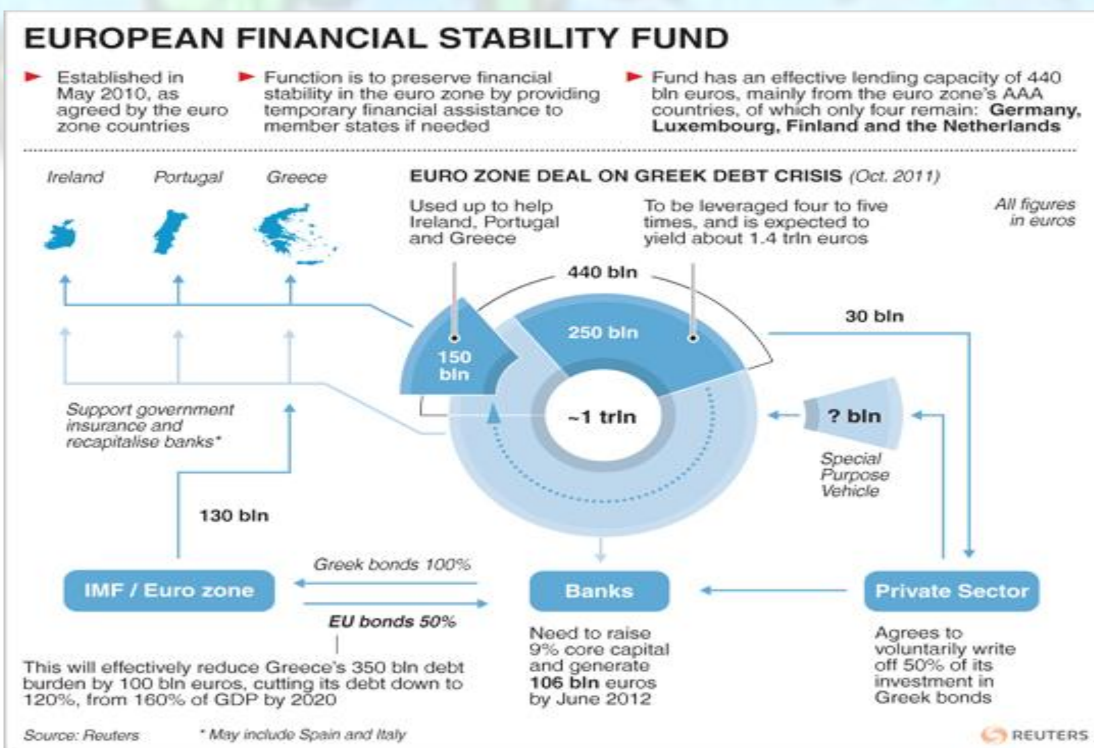
Intense speculation throughout 2011 of impending financial doom for the eurozone countries has edged ever so closer to reality following Standard & Poor's (S&P) mass credit downgrade of over half of the eurozone countries. S&P, one of the 'Big Three' credit ratings agencies alongside Moody's Investor Service and Fitch Ratings, left Cyprus, Italy, Portugal and Spain downgraded by two notches and Austria, France, Malta, Slovakia and Slovenia all cut by one notch.

As Europe seeks to escape from a spiraling debt crisis, the prospect of higher borrowing costs and increased market scrutiny is hardly welcoming after a relatively calm Christmas period. In particular, the S&P downgrade of the European Financial Stability Facility (EFSF) from AAA to AA+ is particularly alarming.

A bit of background

The European Financial Stability Facility (EFSF) was produced by the European Union in 2010 to address the European sovereign debt crisis by providing temporary financial assistance to each member if needed and deemed solvent. In addition to this a separate, smaller emergency fund known as the European Financial Stabilisation Mechanism (EFSM) was also created by the EU to be used alongside either the EFSF or the International Monetary Fund (IMF) for the same purpose.

The EFSF is financed by the seventeen members of the eurozone and has since, most notably, provided support packages to Greece, Ireland and Portugal. The scheme currently has a lending capacity of around €400 billion with the EFSM given the authority to rise up to €60 billion but both have been generally viewed to be ill-equipped to deal with the fallout of a default from a particularly large country, economically speaking, such as Italy. The general consensus has been that the EFSF should be boosted with a so-called "big bazooka" of cash if it is to reassure the bond markets. This has not happened.



The impact

The basic idea behind the European Financial Stability Facility is that it can lend cash cheaply to countries with AAA credit ratings, which they in turn can lend to countries struggling under the economic downturn. But with countries including Austria and France losing their AAA credit ratings by S&P, this idea is quickly deteriorating. Furthermore, with the credit rating of the EFSF cut by S&P - as a consequence of the bailout fund losing a number of AAA guarantors - its ability to raise much needed cash quickly and cheaply has been damaged at arguably one of the most important periods in the eurozone's history. It leaves the EFSF with a smaller capacity to lend when it is likely to play an important role in a new, massive bailout plan for Greece alongside the IMF. But it also leaves the EFSF with much more difficulty in raising cash from potentially large investors such as China

The future

Now that the biggest guarantor of the EFSF – Germany – has even less reason to strain its own budget to strengthen its funds, all hope seems to rest on the successful creation of the new, larger bailout fund: the European Stability Mechanism. This is expected to fully replace the EFSF and EFSM by July 2013 and take the role as a permanent bailout fund with a capacity of around €500 billion. Still, that is a long way away and leaves the eurozone to rely on its temporary bailout funds, the largest of which having lost its AAA credit rating. So with the potential of Greece defaulting on its debts and spreading a toxic debt contagion to Italy, a frankly massive economy compared to Greece the EFSF will again be expected to lend a hand. However, with a smaller ability to lend, the idea of Italy defaulting on its debts is not completely improbable and not unlike the concept of a sort of financial Armageddon. That's a problem for a later date though.

WEATHER WOES

BY GAETANO DONATO

The Scottish storms

For those of us stuck in Scotland for the end-of-semester exams and winter holidays; the unusually severe weather was difficult to avoid. With gales in excess of 160mph recorded on Cairngorm summit on the 8th of December and winds of nearly 100mph in Edinburgh alone on the 3rd of January; either one of these events in isolation would have been significant enough to cause disruption to the infrastructure of the UK and Northern Europe but considered together they reminded us that snow and ice is not required to produce one of the most damaging winters in recent memory. Indeed, the wind speed figures broke, or came very close to, records in many areas.

The total extent remains unclear but it is believed that the December event may have caused slightly less than £100m of damage, with the January storm having exceeded this figure.

Insurance

As may be expected, it is buildings insurers who are bearing the brunt of the losses with both domestic and commercial properties suffering from missing roof tiles, fallen fences and other structural damage. Tree fall damage is also a major concern with the risk of large claims from owners of irreparable properties or properties left uninhabitable for weeks or months.

However, it is not all bad news for insurers. Buildings in Scotland are largely designed to take account of severe winds despite weather on this scale being relatively rare; the belief is that this has minimised losses compared to a similar event centred on other parts of the UK. Insurers will also be relieved by the nature of the claims which are likely to be small, although many, and settled over a relatively long time period.

Increased claims will not be confined to buildings insurers, however. Businesses with suitable policies may claim lost earnings with doors shut early and lost output from employees sent home. Even when businesses remained largely functional, local power outages will have cost productivity and caused damage to perishable goods. Earnings will be lost as deliveries were unable to navigate through road and bridge closures and damage to vehicles will have to be compensated for with claims from both commercial and personal motor policyholders.

Impact on consumers

Whilst most consumers are likely to be grateful for the comfort and reassurance their buildings insurance policy has provided this winter; this has not been the case for a few. A possible lack of understanding of claims procedures and ambiguity over exactly what constitutes emergency repair work has resulted in some claims being rejected. Although insurers must be mindful of the risk of fraudulent or exaggerated claims, providing clearer information on procedures will be seen as a priority if consumer confidence is to be retained. One letter to a major Scottish newspaper complained:

> *"It is utterly disgraceful but not unexpected that some home insurance companies… are attempting to duck their responsibilities to customers caught up in the storms"*

Economic effects

The total effect on the economy of this type of event is always difficult to judge. Whilst severe weather brings misery and cost to most; there is a counterbalance with roofers and domestic heating suppliers having a particularly profitable day. In the end, there is a limit to the amount of damage one, or even two, freak weather events is going to do in the UK and Northern Europe. A crippling effect on the regional economy was never really on the cards.

However, even small effects can tip individual businesses over the edge; retailers, in particular, a prime example. These events came at the most awkward time in the run up to Christmas and the January sales. With critical sales lost, deliveries delayed, absent staff and damaged assets this was a disruption that many could ill afford.

ENTERTAINMENT SECTION

STUDENT SEMINAR:
THE START OF SOMETHING NEW

BY ANYA BACH

The student seminar which was organised on Wednesday of week 3 was held in response to students concerns of not having enough presentation opportunities. The seminar will then be an event where students have the opportunity to volunteer and present in groups or individually on topics concerning the financial world.

For our first ever student seminar, there were 3 very interesting presentations with the topics Income Protection Insurance, RDR (retail distribution review) and How Obesity Affects the Economy. Each presentation lasted for about 10 to 15 minutes with a 5 minute Q and A session. The audience turn up was impressive both consisting of students and lecturers.

The presentations really interested the audience and lecturers. The environment was light and casual and overall, the presenters did a job well done. Insights and participation from lecturers and students were astounding and this only meant that the knowledge imparted was very beneficial and insightful.

Starting with the first presentation by Koh Chin Yee, Muhammad Shafiq and Frederick Ho. They introduced us to the topic of "Income Protection Insurance" and its alternatives. They also covered some current issues facing this product and gave us a clue on how and what this product is all about. This was followed by an impressive presentation by Cormac Mackle on RDR answering the whats, whys and hows. The seminar ended with a presentation which for most of the time brought laughter to the room with the topic "How Obesity Affects the Economy" by Eric Wong. This was a commendable and highly engaging presentation which gave us an insight into the facts and figures behind obesity and its effects on the economy.

Overall, the seminar was a huge success, and it will be a greater success if more students come forward and participate in terms of presenting or attending for future seminars.

Hopefully, as mentioned in the headline, this seminar will be a start of a new tradition in SAS. I would like to extend my gratitude to those who participated and Jennie Hansen for her assistance in making this seminar a success.

UPCOMING SAS EVENTS

The SAS Conference

- Date: 21st February 2012
- Time: 6.30pm to 9.30pm
- Venue: Postgraduate Centre, Heriot-Watt University
- Food will be served.

THESE ARE "ACTUARY" FUNNY!

BY ANGELINA WONG & JEYAMALAR THURAI

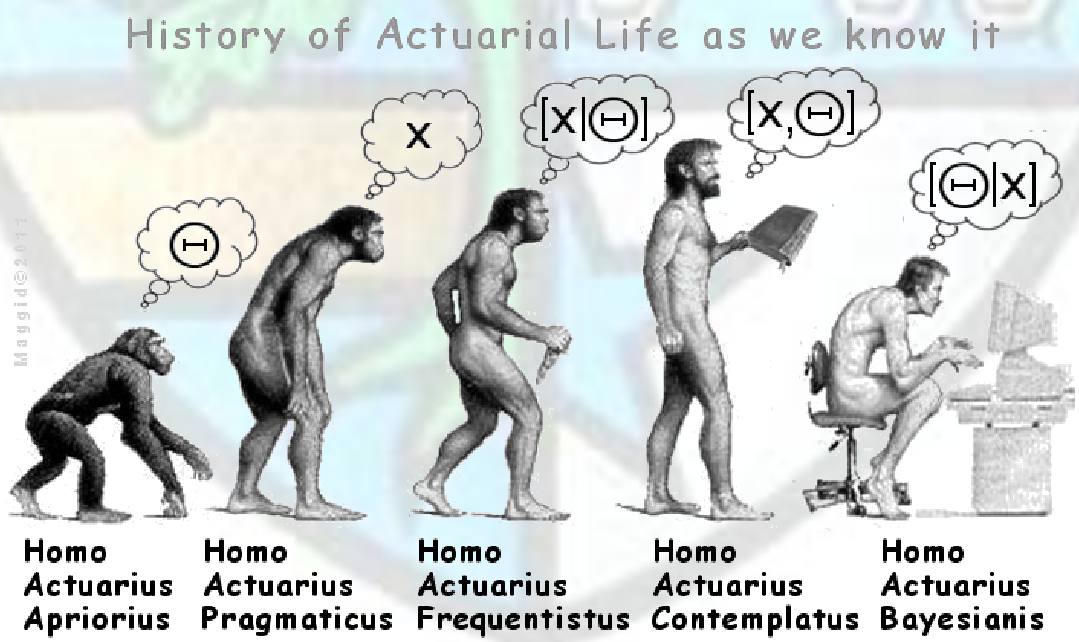
1. There is an actuary who is trying to pick someone up at a bar. The person at the bar asks, "So, what do you do for a living?" The actuary responds, "I model." The person at the bar responds, "Really?! I never would have guessed. What kind of modelling?" The actuary answers, "Actuarial Modelling!"

2. Two people are flying in a hot air balloon and realize they are lost. They see a man on the ground, so they navigate the balloon to where they can speak to him. They yell to him, "Can you help us – we're lost." The man on the ground replies, "You're in a hot air balloon, about two hundred feet off the ground." One of the people in the balloon replies to the man on the ground, "You must be an actuary. You gave us information that is accurate, but completely useless."

3. Q: What is the difference between an Actuary and an Accountant?
   A: About 25 grand!

4. Q: Why does a Heavy Metal fan want to become an actuary?
   A: He wants to be paid for predicting death and destruction.

5. What does an actuary's wife do when she has insomnia? She rolls over and says, "Tell me again, darling. Just what is it you do for a living?"



BRAIN TEASER

BY ANGELINA WONG & JEYAMALAR THURAI

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Complete the puzzle above and stand a chance to win £20! Just scan or take a picture of the completed puzzle (make sure its readable) and send it to mcs4@hw.ac.uk. We will select one lucky winner from all the submissions with the most correct answer and that person will receive £20 in cash. **Contest ends 29th February 2012.**