

Institute of Risk Management

29 April 2008

FINANCIAL RISK MANAGEMENT DEPARTMENT

“Driving Risk Measurement Into Decision Making”



Be Life Confident

Contents

1. Background to UK ICAS P&C Regime
2. Method used to calculate ICA

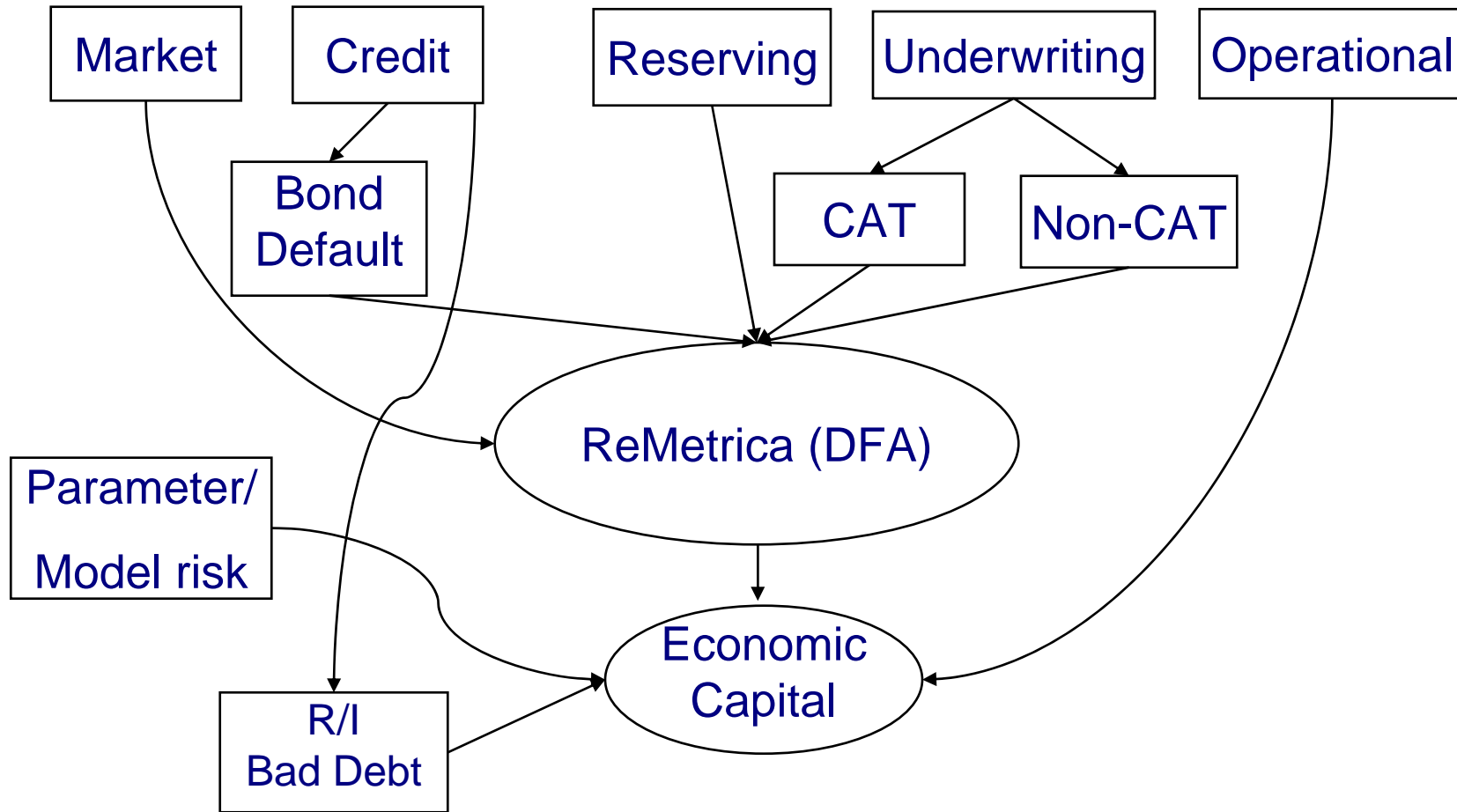
Background to UK ICAS regime

- Solvency I regime based on the higher of
 - %age of premiums
 - %age of reserves
- Widely viewed as ineffective and due to be replaced by Solvency II (currently due 2012)
- Under pressure from the Govt for its failure to prevent Equitable/Independent failures FSA decided to jump the gun with its ICAS regime
- Capital should be sufficient to ensure that policyholders claims are paid in full with 99.5% probability. Company is assumed to write business for next 12 months then go into run-off.

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AXA Economic Capital Model



Market Risk

- Based on Barrie & Hibbert model
- Impacts within each simulation
 - Assets (100% shareholder owned)
 - Liabilities via claims inflation
 - Discount rate used (partial offset to claims inflation)

Credit Risk

- Main risk is reinsurer default in the event of a major CAT during next 24 months
 - Currently based on high level analysis of reinsurer balance sheet strength, factoring in contagion and a high level of guess work
- Second risk is risk of reinsurer default impacting collectibility of ceded reinsurance open claims
 - Estimated by analysing ceded reserves split by S&P rating and assigning default factor to them based on Bond default rates
- Third risk is counterparty default risk within our Bond portfolio
 - Derived using Barrie & Hibbert model

Reserving risk

- Major risk is deterioration in our Asbestos reserves
 - Enormous uncertainties caused by the very slow emergence of Mesothelioma claims
 - Assessed by benchmarking against competitors but mainly by judgement
- Asbestos reserves assumed to be 100% correlated by accident year
- Deterioration of non-asbestos reserves is assessed statistically by applying the Thomas Mack method to our claims triangles.
 - ReMetrica was not able to allow for correlation between Accident Year and/or between Product. This was estimated outside the model and added onto the final answer (£100m).
- Correlation between reserves from accident years and between different products was separately assessed outside of the ReMetrica model

Underwriting Risk

- Major risk is CAT
 - Assessed by GRM based on our sum insured by postcode data using commercial CAT modelling software
 - Losses are fed through local and group reinsurance structure
- Non CAT loss risk is currently based on fitting an AR2 curve to time series of loss ratios by product. The means of the distributions were forced to be equal to Strat plan
- CAT and non-CAT losses are assumed to be independent

Operational Risk

- Produced by FRM (Peter Barnard)
- Starting point is Letters of Representation signed by CEOs
 - List of areas felt to be of greatest op risk concern
- We assumed a 75% correlation between op risk and other risk types