



**Amlin plc**  
**Amlin's Approach to Solvency II**  
**October 21 2009**



**AMLIN**



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# Programme

Introduction: Charles Philipps, CEO

Presentation:

1. Solvency II : Background and Progress:  
Richard Hextall, Finance Director
2. Internal Model vs. Standard Formula:  
Peter Tavner, Deputy Group Actuary
3. Solvency II: Application at Amlin  
Richard Hextall
4. Q&A



## Section 1 – Solvency II: Background and Progress

# Solvency II: Introduction

- Far reaching changes to EU insurance regulation
- Other jurisdictions watching closely and following suit e.g. Bermuda Monetary Authority
- More than just solvency capital: large emphasis on improving risk management at all levels across the firm

# Solvency II Overview – Three Pillars

## Pillar 1 Quantitative section

- Prescribed approach for solvency balance sheet
- Market consistency
- Solvency Capital Requirement: Standard vs. Internal Model

## Pillar 2 Supervisor review

- Focus on enterprise risk management
- Policies and governance
- The 'ORSA'

## Pillar 3 Disclosure

- Public and private requirements
- Increased risk transparency

# Solvency II – Current Status

- Framework Directive now passed by European Parliament
- Group capital support removed, group supervision retained
- CEIOPS ‘Level 2’ guidance released and under review
- FSA deadline for ‘Gap Analyses’ for all UK firms by June 2009
- FSA communication for internal model pre-application in UK
- Lloyd’s developing approach for Lloyd’s syndicates, and in close dialogue with FSA

## Solvency II – application at Lloyd’s

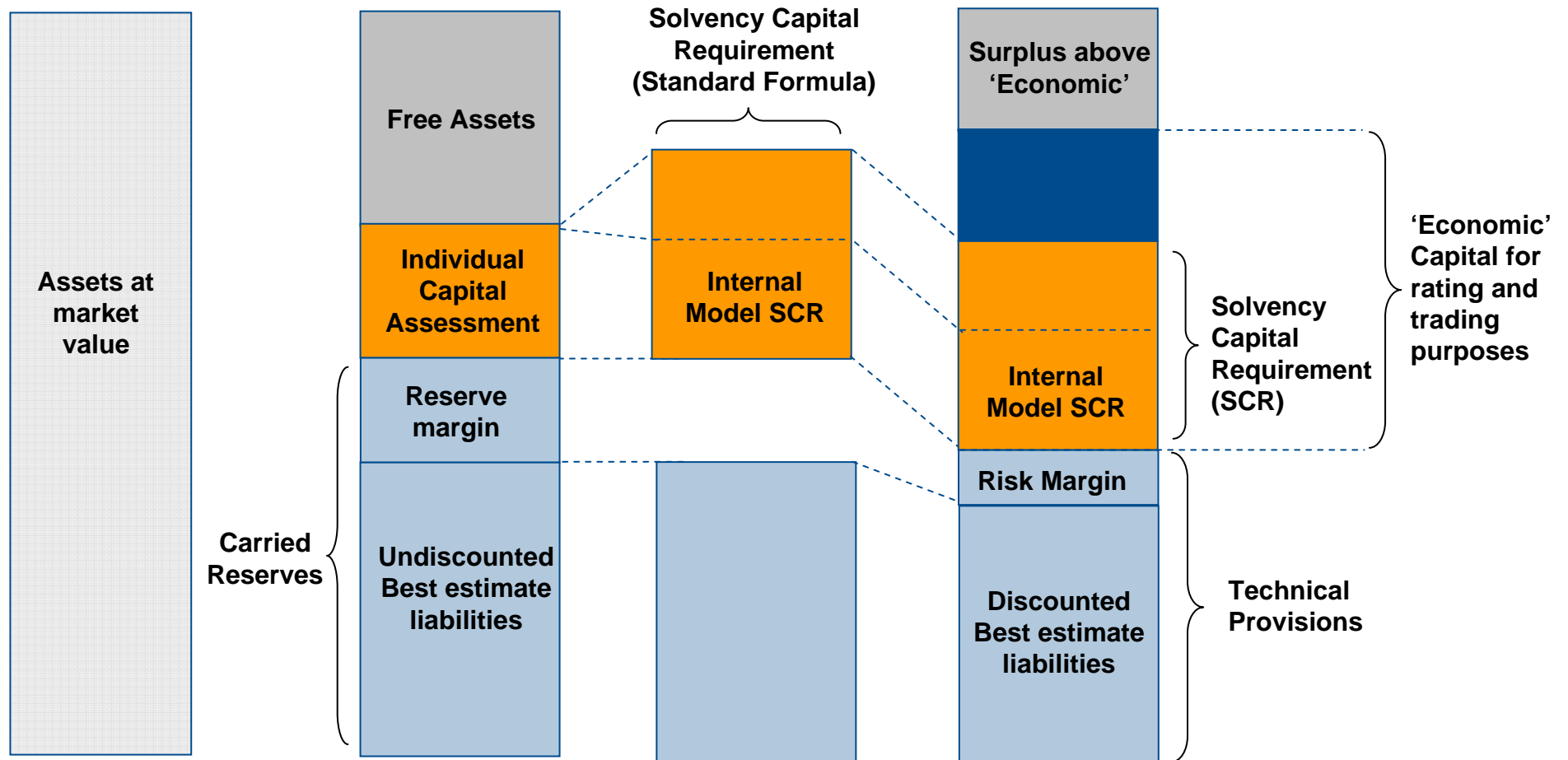
- Directive describes “the association of underwriters known as Lloyd’s”
- FSA will consider Lloyd’s as a whole
- Central Fund and LoCs recognised as available capital
- Lloyd’s will review agency internal models, subject to FSA sampling
- Proportionality **may** lead to greater agency level scrutiny

# Solvency II market impact – a view

- Solvency II will favour insurers with:
  - Diverse risk portfolios
  - A strong risk management culture
  - Deep understanding of specialist risk
  - Track record of managing specialist risk
  - A longer term view of managing risks and maintaining longer term client relationships
- And will make it more difficult for:
  - Opportunistic and transient risk takers
  - Monoline insurers vulnerable to risk volatility and risk aggregations
  - Smaller firms with inadequate risk and capital management infrastructure
  - Those underwriting for volume rather than profit

## Section 2 – Internal Model vs. Standard Formula

# Solvency Assessment



# Standard Formula Solvency Capital Requirement (SCR)

- Deterministic approach
- “One size fits all”
- Modular: Separate capital calculation for different risk categories:
  - Insurance risk (Premium / Reserve / Catastrophe)
  - Market risk (Interest / Equity / Property / Spread / Currency)
  - Counterparty risk
  - Operational risk
- Combination of capital charge factors and scenarios
- Calibrated to encourage internal model development
- QIS5\* likely to increase requirements further

\*QIS = Quantitative Impact Study

# Internal Model

- Firm's own capital view covering all risks
- Full recognition of diversification (if justified)
- Credit for expected profits
  
- More than just a calculation engine:
  - Must be linked to integrated risk assessment process
  - Includes model governance, data inputs, validation of outputs
  
- **Critical to demonstrate embedding and model 'use'**
- Formal internal model application prescribed
  - Firms must submit 'application pack' to supervisor
  - 6 month turn-around
  - Re-approval of major changes

# Ratio of Internal Model SCR to Standard SCR (Non-life)

Average ratio of the internal model SCR to standard SCR (QIS4) was around 68%



Retail  
Personal  
Lines

Lloyd's &  
London  
Market

Large-  
Medium  
Diversified

Specialist  
Niche  
Operators

Source: FSA



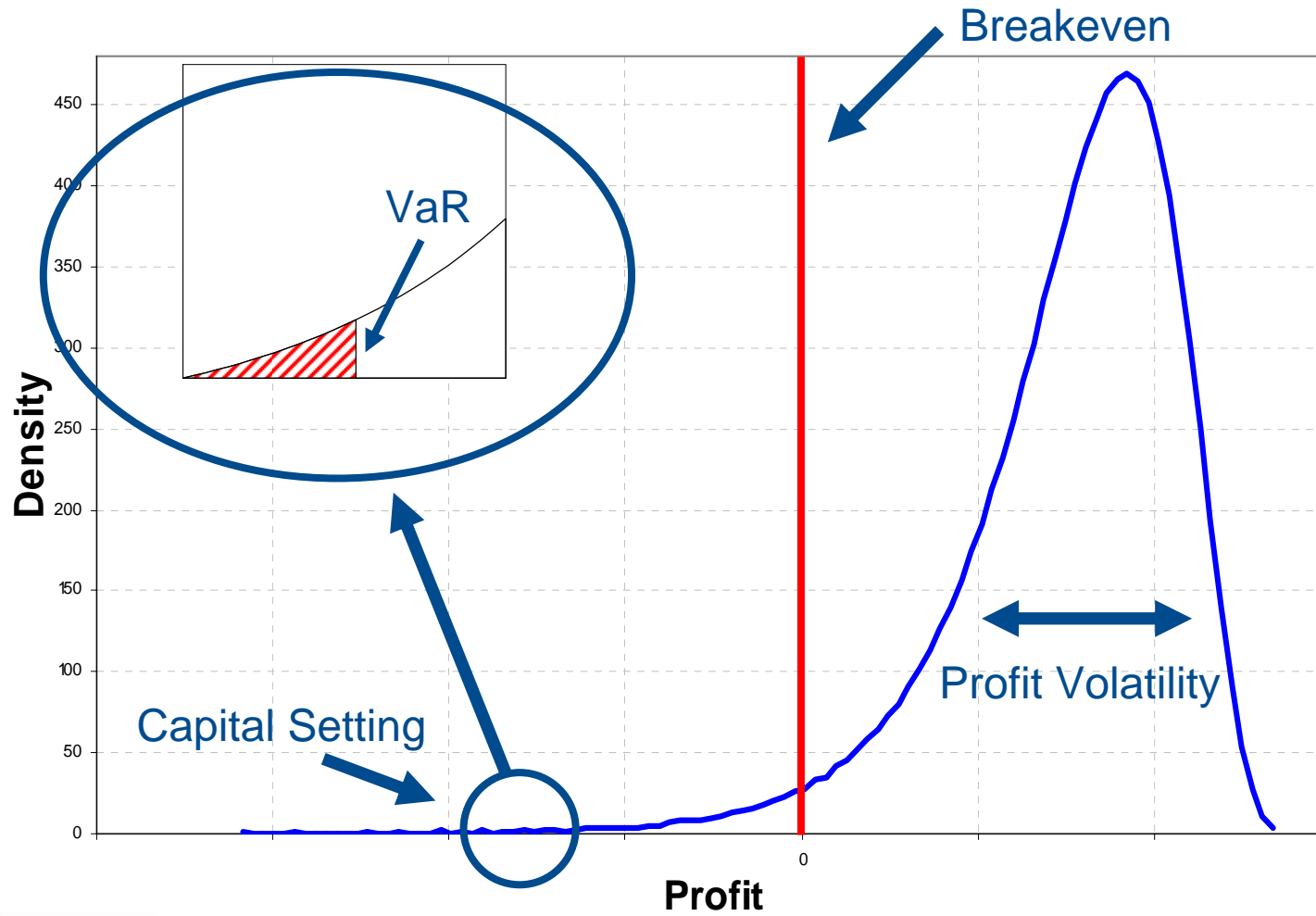
## Standard Formula: London Market issues

- European focus, not designed for international risk portfolios
- Insufficient diversification credit across London market insurance classes (Solvency II classes too broad)
- No recognition of expected profits, performs badly for 'high margin' business
- Catastrophe risk double count
- Non-proportional reinsurance: benefits not fully recognised
- Prudential loads following financial crisis?

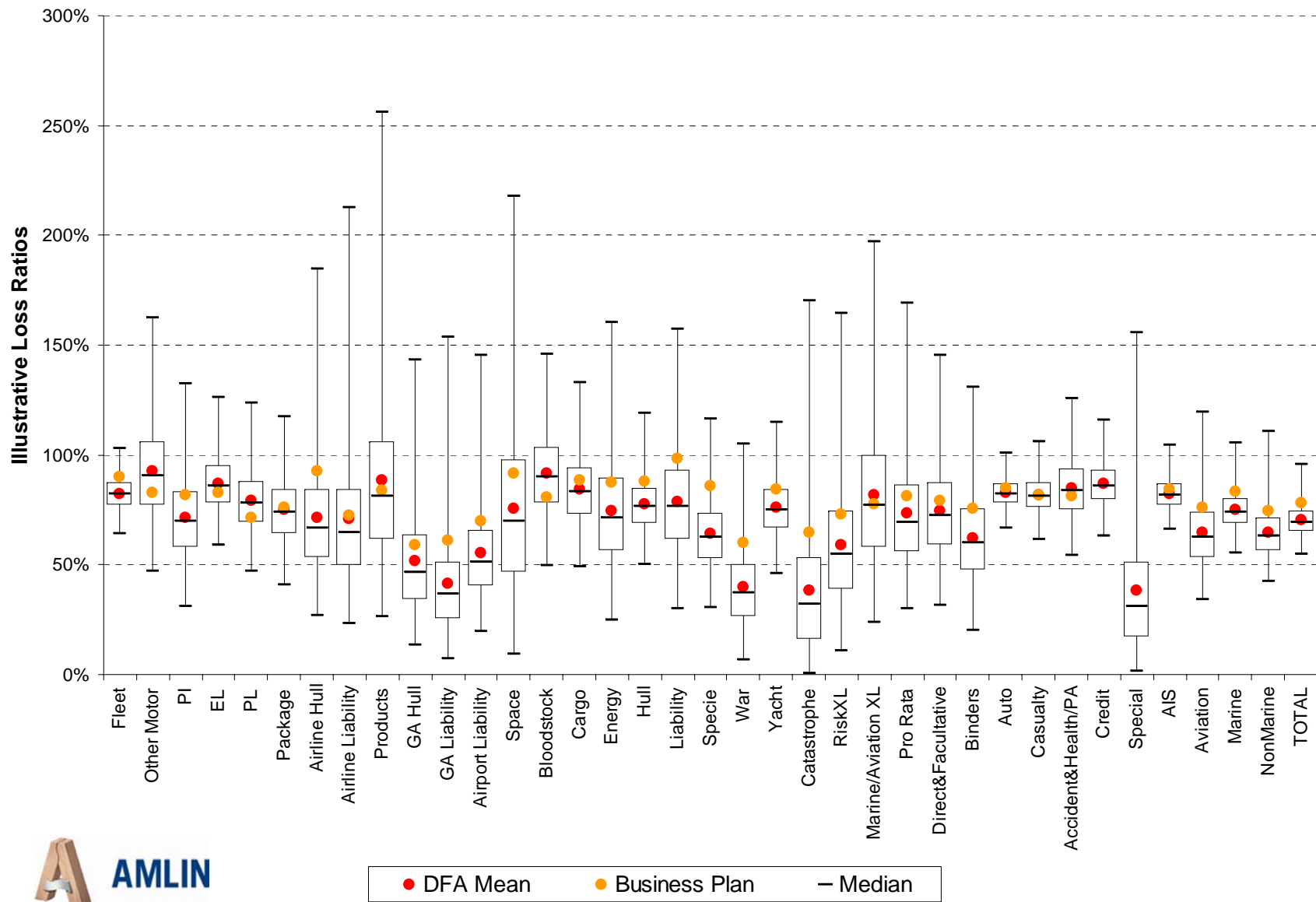
In general for Amlin the divergence is caused by the standard model's failure to deal with a specialist catastrophe (re)insurer supported by a diversified and profitable portfolio of non-cat business

# DFA – how capital is calculated

## Capital Setting

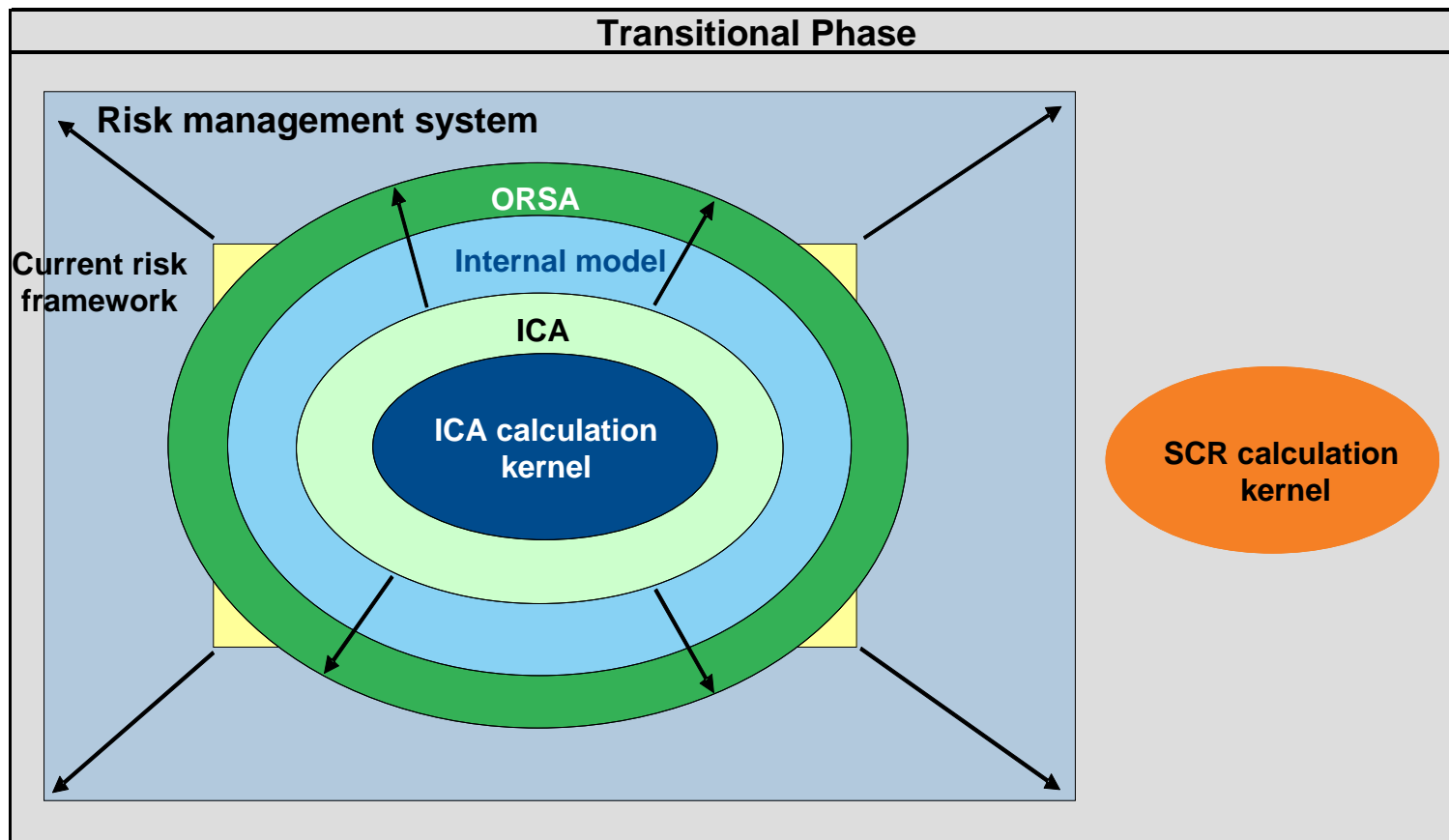


# DFA - business plan scoring



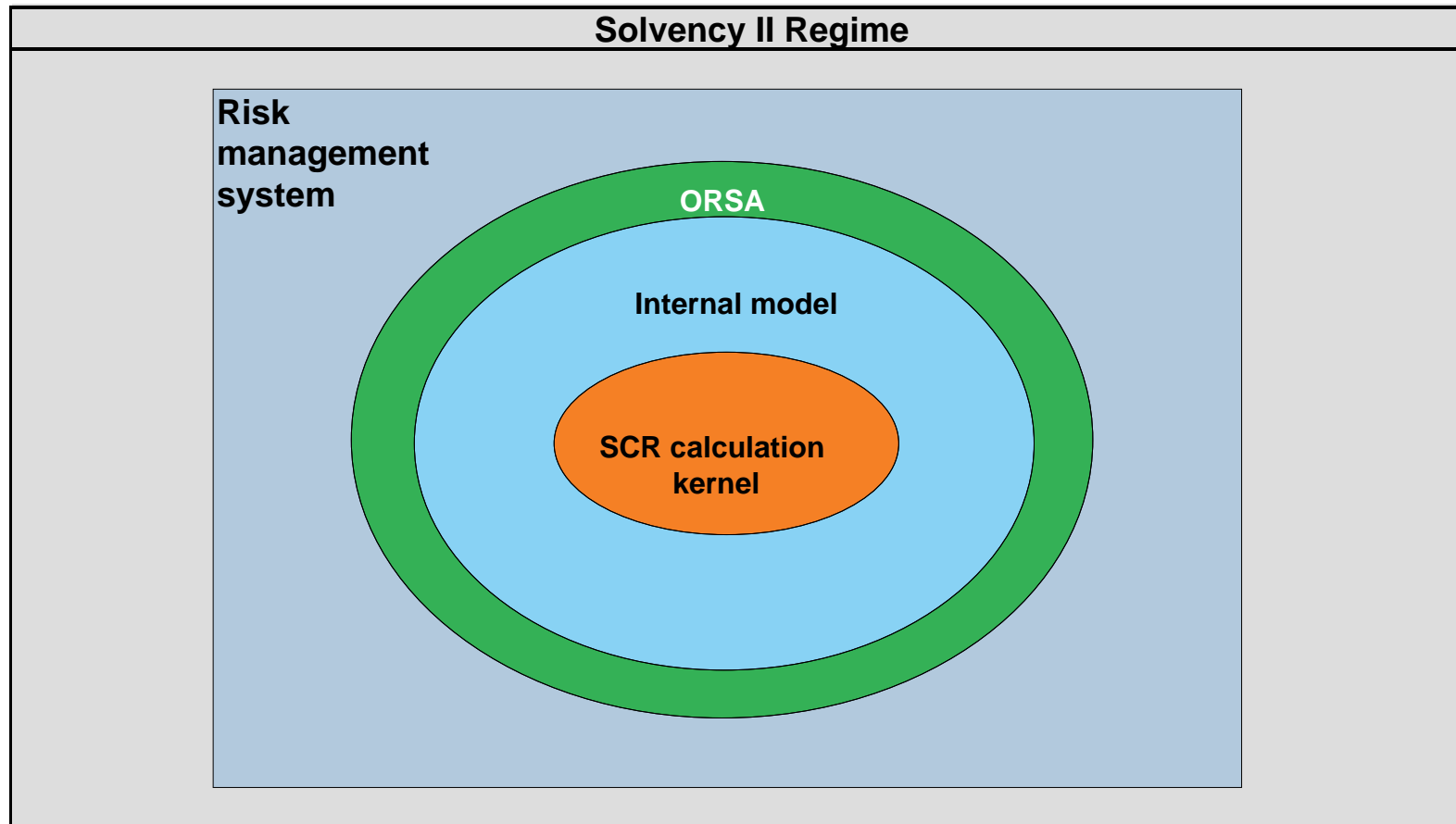
● DFA Mean    ● Business Plan    — Median

# ICAS transition to Solvency II (1)



Source: Lloyd's

# ICAS transition to Solvency II (2)



Source: Lloyd's

# Challenges facing the market

- Recognising the gap between ICA and Solvency II
- Changing risk culture
- Use test and embedding
- Model myopia / driving by 'sat-nav'
- Data and systems
- Resources!

## FSA view

“Without senior management endorsement, implementation plans have little value.”

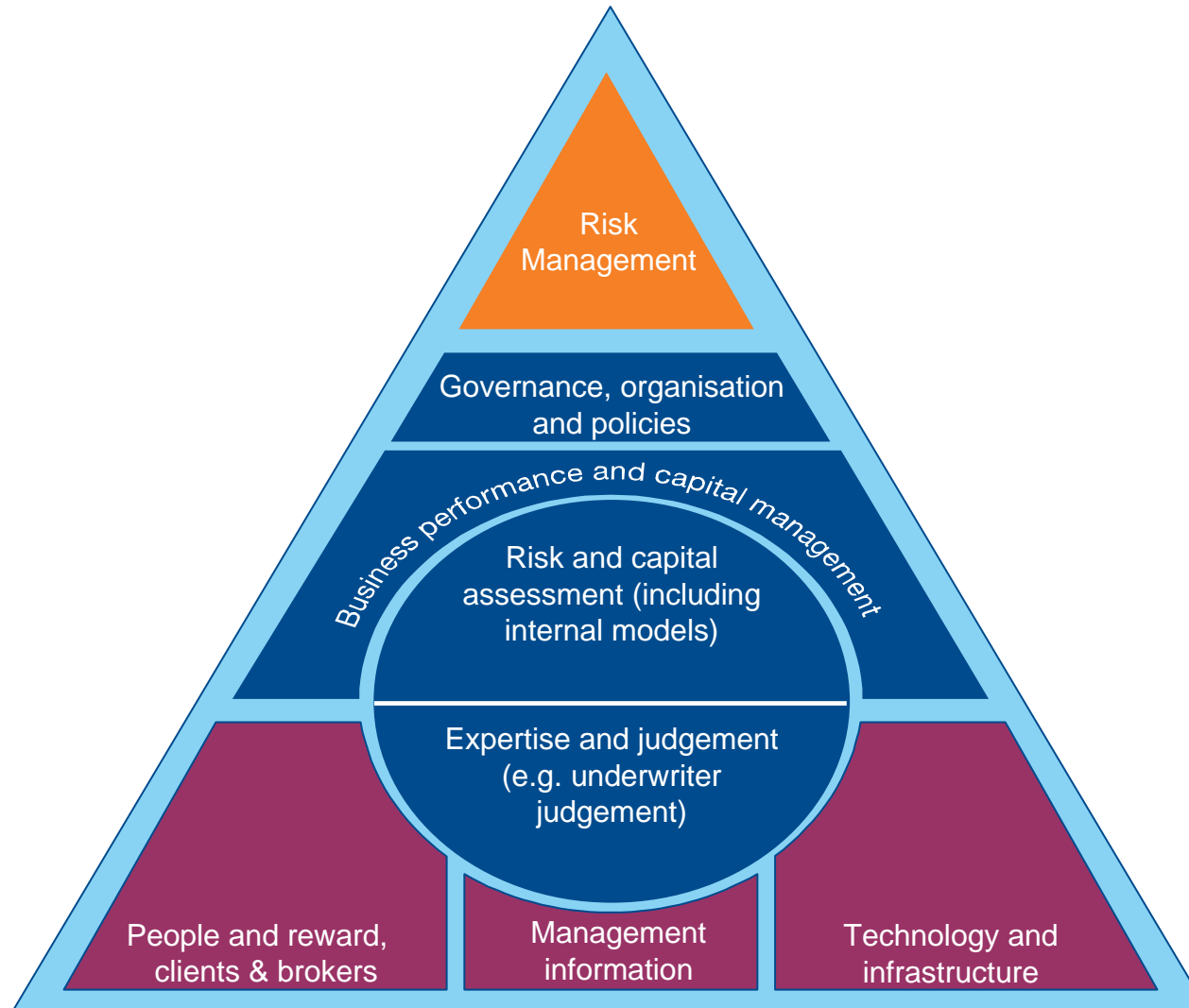
## Section 3 – Solvency II Application at Amlin



# A proactive approach

- Amlin has been improving risk and capital management practices for over ten years
- The Solvency II principles are aligned with the investments made and the continuing business strategy for the group
  - Capital model is developed and robust
  - Risk has been central to what we do
- The gap for Amlin is manageable but we do not underestimate the effort required
  - Focus on risk governance
  - Increasing level of business embedding
- We have agreed our end state in our Target Operating Model

# Target Operating Model (TOM)



# Risk and capital principles

## Risk

- Risk appetite & tolerances agreed
- Expert judgement remains key, but will be supplemented by tools/models
- Prudence remains but we will quantify

## Capital

- Capital will be allocated based on risk assessment
- Technical pricing will be calibrated to assist marginal capital allocation
- Risk adjusted return will become a greater feature

# Practical implications

- Deterministic (RDS) and modelled cat risk appetites co-exist
  - Suite of events
  - Aggregate 1 in 250 tolerance determined
- Aggregate management
  - Improved granularity of data
  - Greater use of technology
- Reinsurance programme “value for money” challenge
- Dedicated independent investment risk analysis

## Practical implications (2)

- Risk adjusted, calibrated technical pricing will inform relative underwriting decisions
- Improved risk governance
  - Modelled outcomes used to value risk and control
  - Greater formality improves rigour and buy in
  - Synergies from sharing

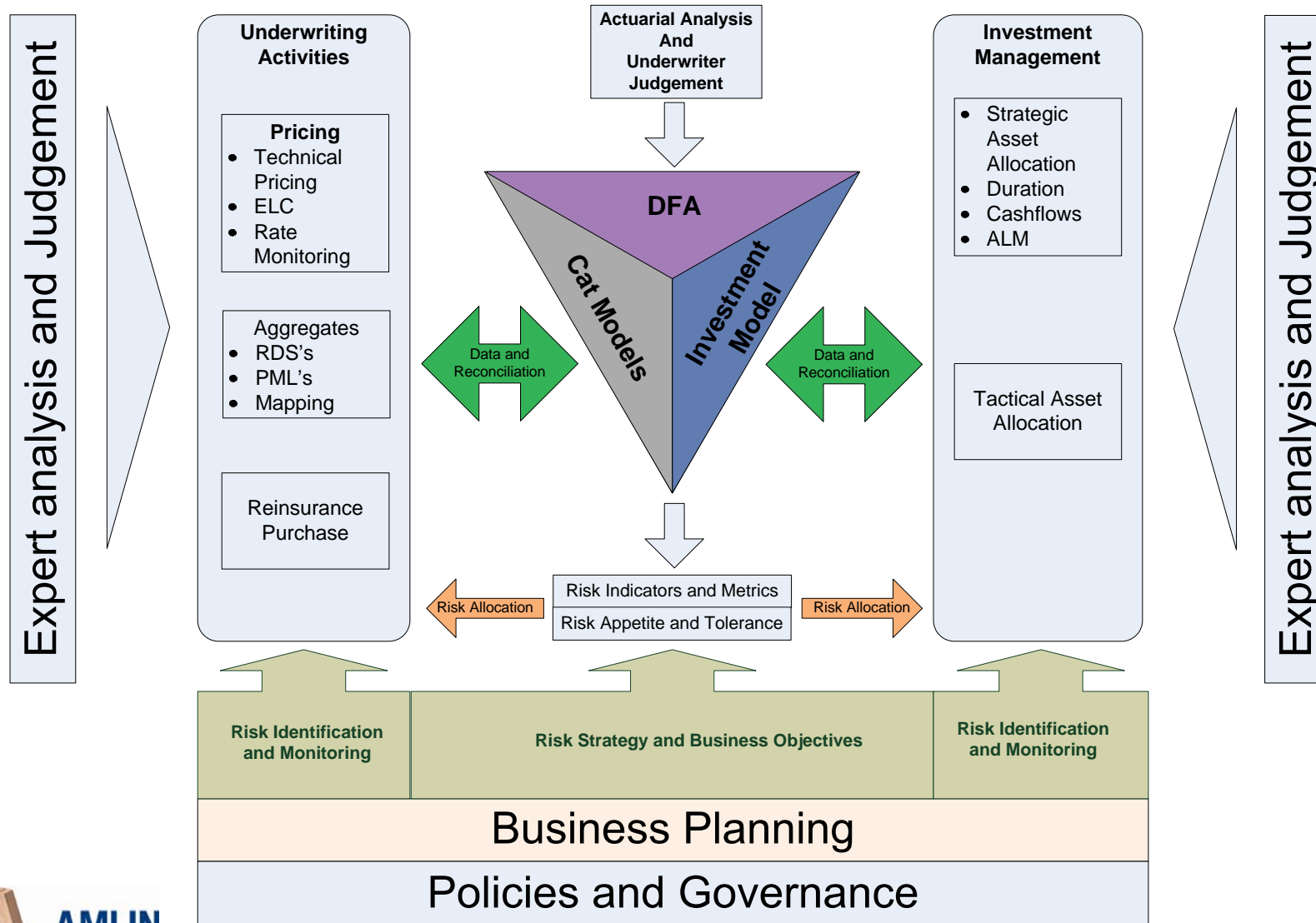
# Business performance & technical analysis

Process	Information provided by Technical Analysis	Influence of Technical Analysis		
		Inform decision making	Challenge decision making	Lead decision making
Underwriting strategy	Capital & tail risk, earnings volatility & rating implications	✓	✓	
Business planning – Divisional/Sub-division level	Capital allocated to division to determine earnings/profitability target Measurement against agreed appetite/tolerance Proposed incremental adjustments to underwriting volumes	✓	✓	
Business planning – Class level	Proposed incremental adjustments to underwriting volumes at Divisional level will impact Class level business plans Volatility of class & level of prudence in plan	✓		
Technical pricing	Indicative class level risk loadings	✓	✓	
Reinsurance purchase – individual contract	Evaluate cost/benefit of RI contract	✓	✓	
Reinsurance purchase – internal Reinsurance	Evaluate benefits & capital needs of retaining external reinsurance within the group	✓	✓	
Aggregated risk analysis	Measure aggregate exposures vs agreed appetite/tolerance	✓	✓	✓
Reserving	Actuarial best estimate reserves form the basis for carried reserves Calculated reserve margin	✓	✓	(✓)
Investments	Optimal asset allocations Measure of risk exposure vs agreed risk appetite Risk budgeting for Investments and Underwriting	✓	✓	

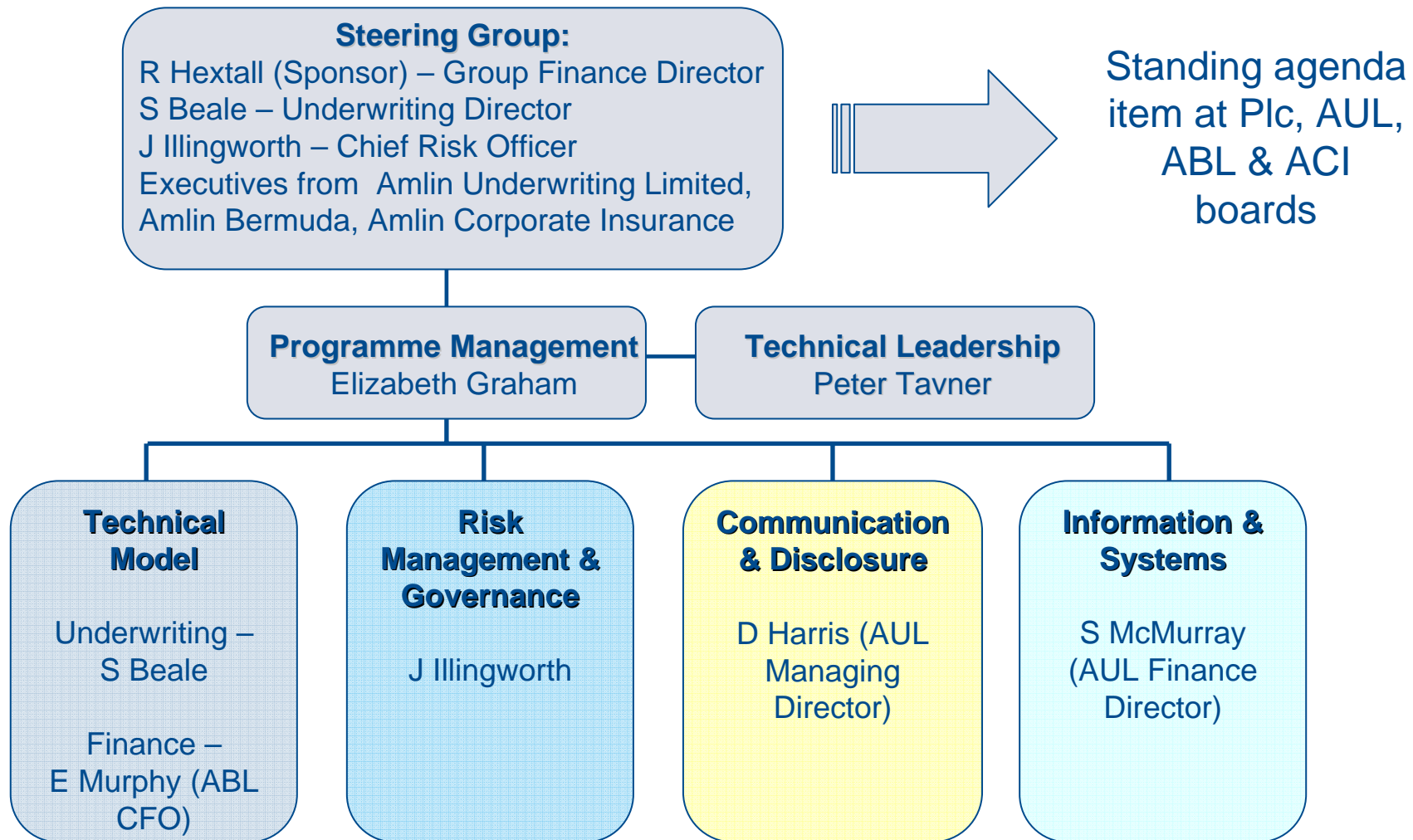
# Benefits of Amlin's approach

- A Solvency II compliant Internal capital model provides flexibility
- We will have greater visibility of risk versus risk appetite
- Should provide better management of the downside of risk exposure
- Greater transparency on performance and contribution of specific underwriting entities within the group
- We should enhance rating agency scoring
- Improved risk focus could contribute to more stable earnings
- All of the above will support growth both within and outside the current platforms

# Embedding the model



# TOMCaT Programme



# Summary

- Better management of capital and performance on a risk adjusted basis
- Enterprise risk management is strengthened
- Capital efficiency improved leading to better cross cycle return

**Amlin on track for Solvency II compliance before 2012**

# Questions



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