Capital Requirement

- Capital Requirement:
  1 : 200 for ICA and
  1 : 250 Rating Agencies
- Feedback shows main driver is Natural Perils exposures
- Property Catastrophe exposures drive Capital Requirements

The Issue

“70% of insurer failures were attributable to Casualty writings” – AM Best
Historic Experience – US Market

- 2005 Katrina, Wilma and Rita combined contributed around $80bn.
- In 2002-2005, we also saw security cases
  - Enron, (to be disclosed), WorldCom ($5.1bn), Parmalat ($1bn), IPO Allocation ($1bn?), Laddering ($1.4bn), Royal Ahold ($1.1bn), AOL Time Warner ($2.5bn)....
- Not to mention in the same period, there are over $50bn in reserve deterioration, with majority coming from Asbestos related claims.

Some Speculations

- So why Nat Cat dominates the DFA tail results?
  - Property risks are easily identified,
    - Perils are known and “relatively” constant in nature.
    - Exposure are known and easily monitored through good Data capturing.
  - Market Loss info from historic Nat Cat events/RDS type scenarios are readily available (modeling firms/brokers etc.)
  - Time – money invested in property modelling
    - Proprietary modelling companies, emerged since late 80s, concentrated on property exposures modelling
    - Significant amount of efforts were put in by governmental and academic organisation as well as the insurance companies to understand Nat Cat.
  - Can we say the same for Casualty?

What are Casualty Cat Events?

- Change in business practice
  - PI, D&O/ML, FI
- Pandemic
  - WCA/EL, D&O, Product, Med Mal/Hospital Liability, GL
- Major product failure
  - Product, GL/Umbrella, Recall, PI, FI, WC/EL
- Economic downturn driven event
  - FI, D&O, PI, Credit
- Unknown/Hidden Hazard – GM, Nanotech, Comp Virus etc
- Tort
  - Med Mal, Product, Med Mal, Auto Liab, EL, FI, D&O
- Nat Cat/Terrorist Attack
The Issue

- Risk of Systemic Aggregation
- Large Diverse Portfolio
- Increased Globalisation
- Complex Business Interactions
- Changing Regulatory Environment

Example 1

Manipulated Stock Options
The Perception

- Illegal (?) behaviour by a number of firms whereby executives were given the right to buy stock at an artificially low price from a previous date
- Limited and known involvements but increasing boundaries to the problem
- Single type of activity / business practice

The Reality

- Single activity / business practice but multiple companies in a variety of different industries

The Reality Continued…

Source: Glass Lewis, cited in USA Today: 17th October 2006
The Reality Continued…

- Constantly growing list of involved companies
- The Big Four accounting firms have recently been urged to determine what role they may have had in the backdating of clients’ stock options

The Perception

Stock Option Manipulation

Altera’s own policies
High Tech Company eg Altera

Accountants, Lawyers etc?

But Many Companies…

Stock Option Manipulation

Altera’s own policies
Asyst’s own policies
Altera’s Accountants, Lawyers etc?
Asyst’s Accountants, Lawyers etc?

Altera
Asyst Technologies

High Tech Industry
...And Many Industries

Stock Option Manipulation

Insurance High Tech Restaurants

Example 2

Enron

Initial Losses

Enron Scandal

Enron's D&O, Fiduciary & Fidelity Policies

Stage 1 Stage 2 Stage 3 Stage 4
Lessons learned

- Increasing correlation between LOBs on high profile losses.
- Increasing time period over which other classes became involved in loss.
- Increasing frequency and value of losses
- Current estimate of Enron event is $7.1bn

Other Concerns

- Heavy consolidations in various industries leads to increase risk aggregation
- Recent trend of increasing outsourcing in manufacturing and service industries
  - less direct control
  - Few specialists supplying to a large no. of clients
  - Risks are “hidden”
  - Increasing dependencies on electronic equipments.
  - Increased human travel

Today’s Issues

Current Sub–Prime situation extends beyond US

“We are seeing things that were 25-standard deviation events, several days in a row” - David Viniar, Goldman CFO
Casualty Catastrophes

- What should they mean for Capital requirements?