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Study of Insurance Economics

# Études et Dossiers

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The Geneva Association - General Secretariat - 53, route de Malagnou - CH-1208 Geneva  
Tel.: +41-22-707 66 00 - Fax: +41-22-736 75 36 - [secretariat@genevaassociation.org](mailto:secretariat@genevaassociation.org) - [www.genevaassociation.org](http://www.genevaassociation.org)

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Layout & Distribution: Valéria Kozakova

# Efficient ALM – Active Management of Asset/Liability Risk

Anthony Bice

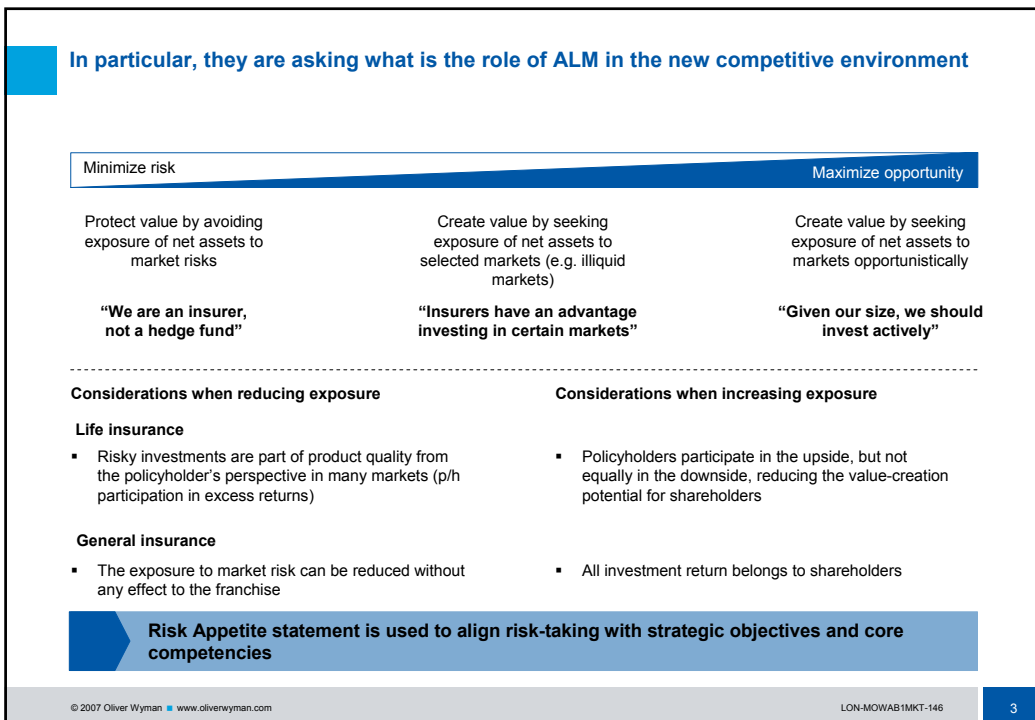
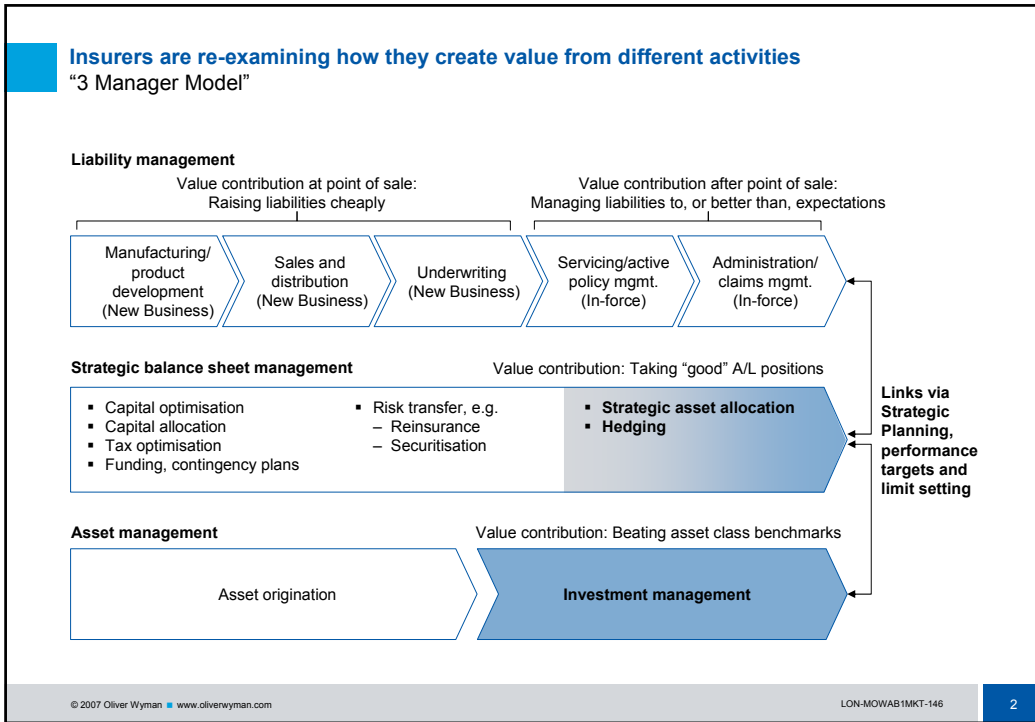
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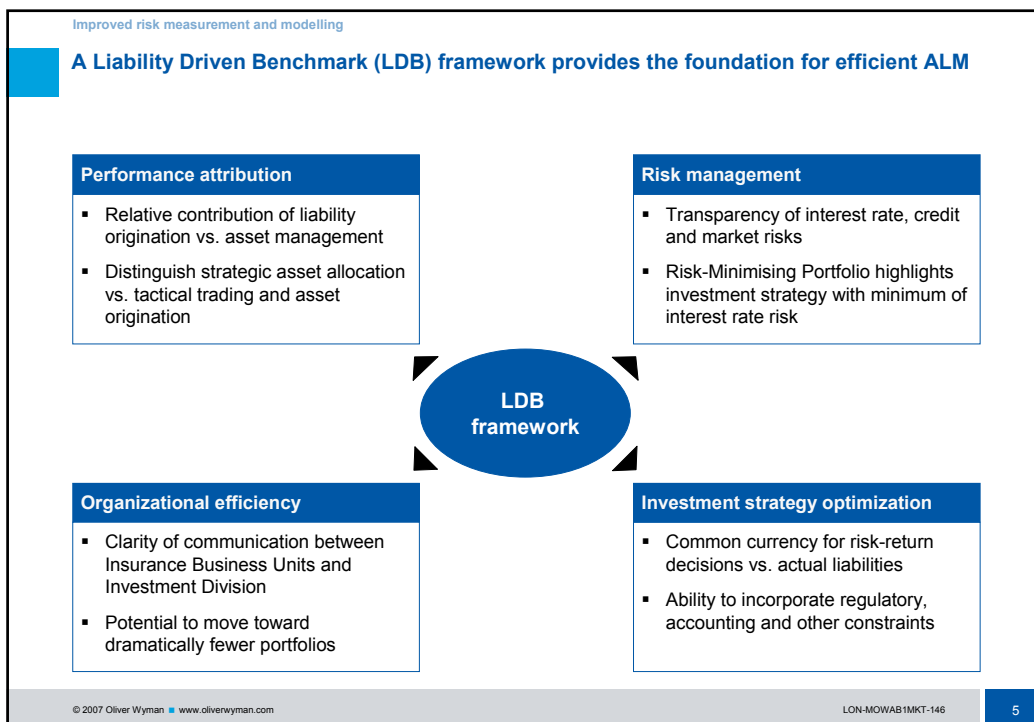
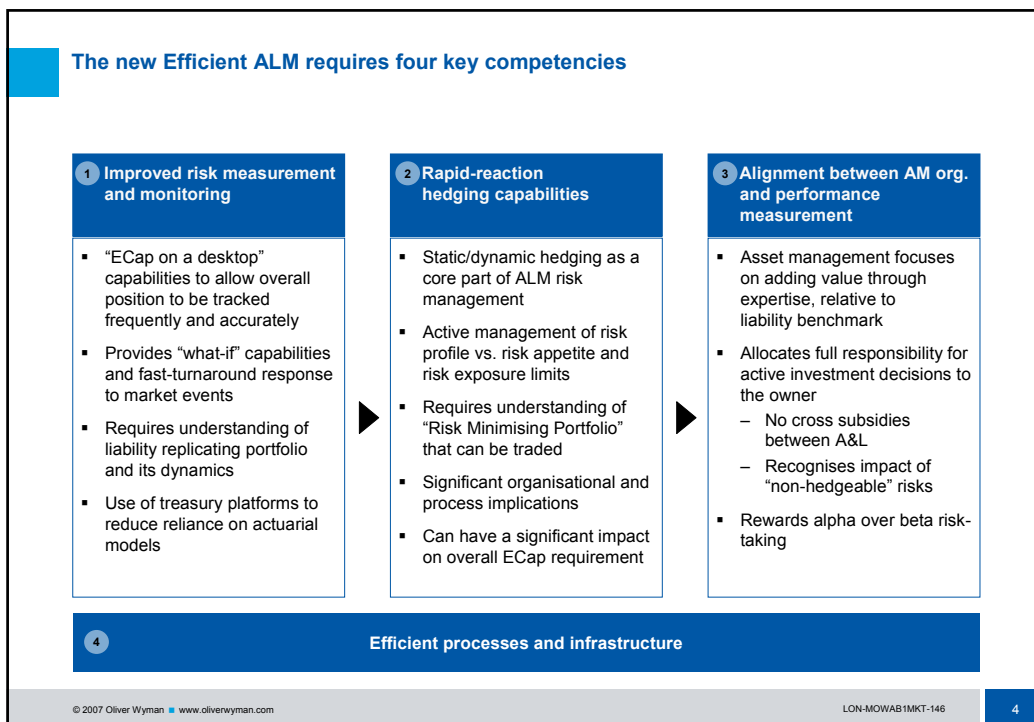
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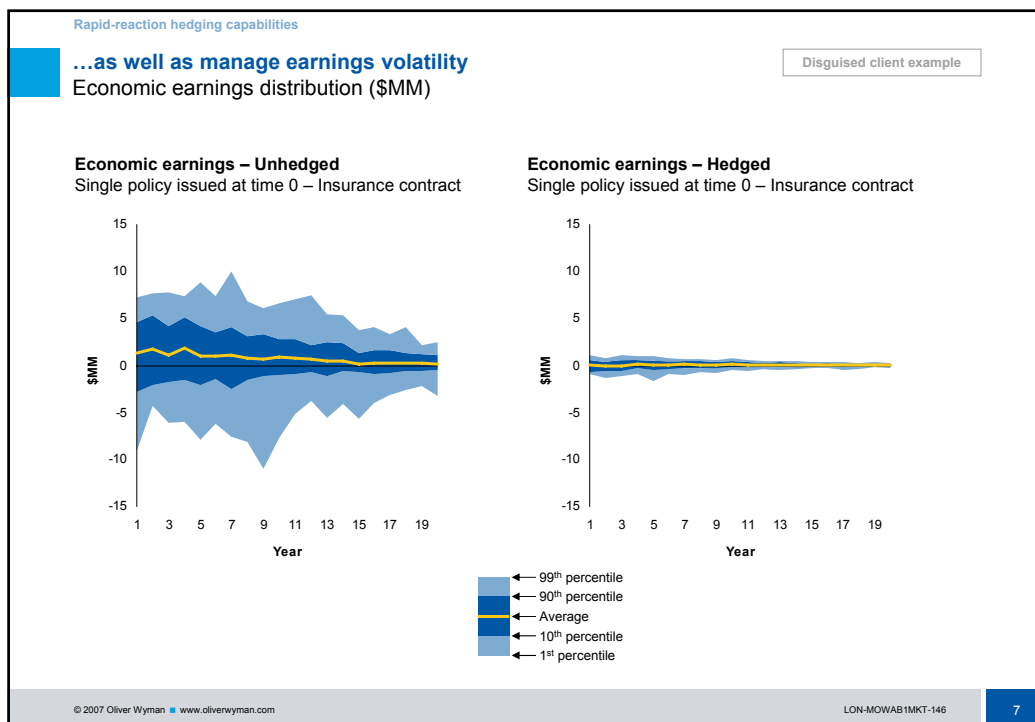
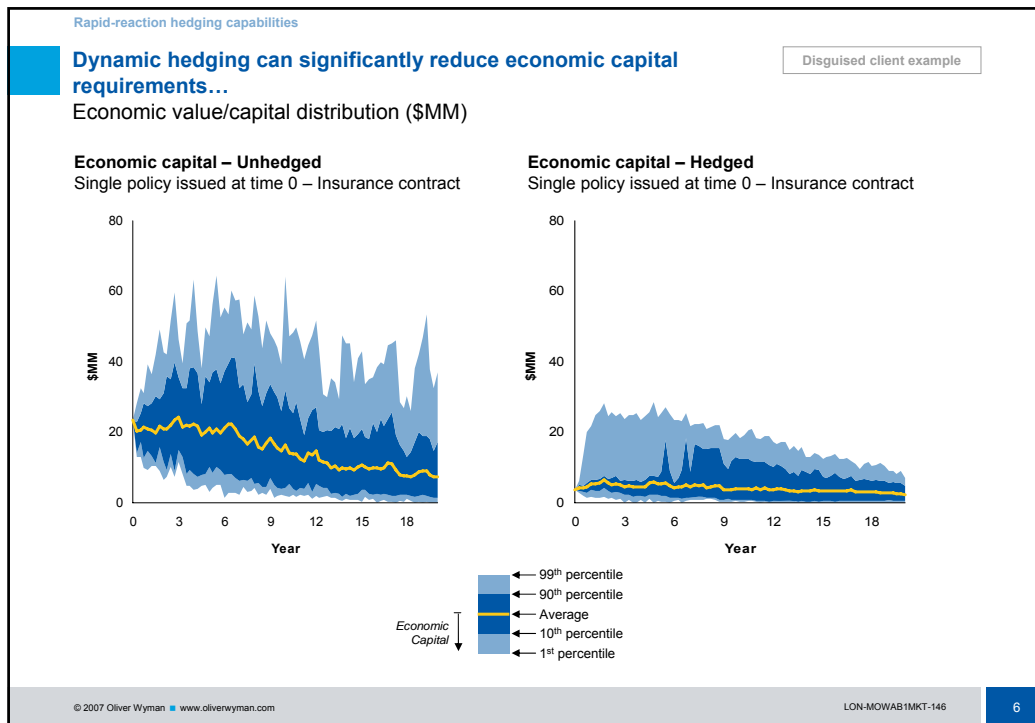
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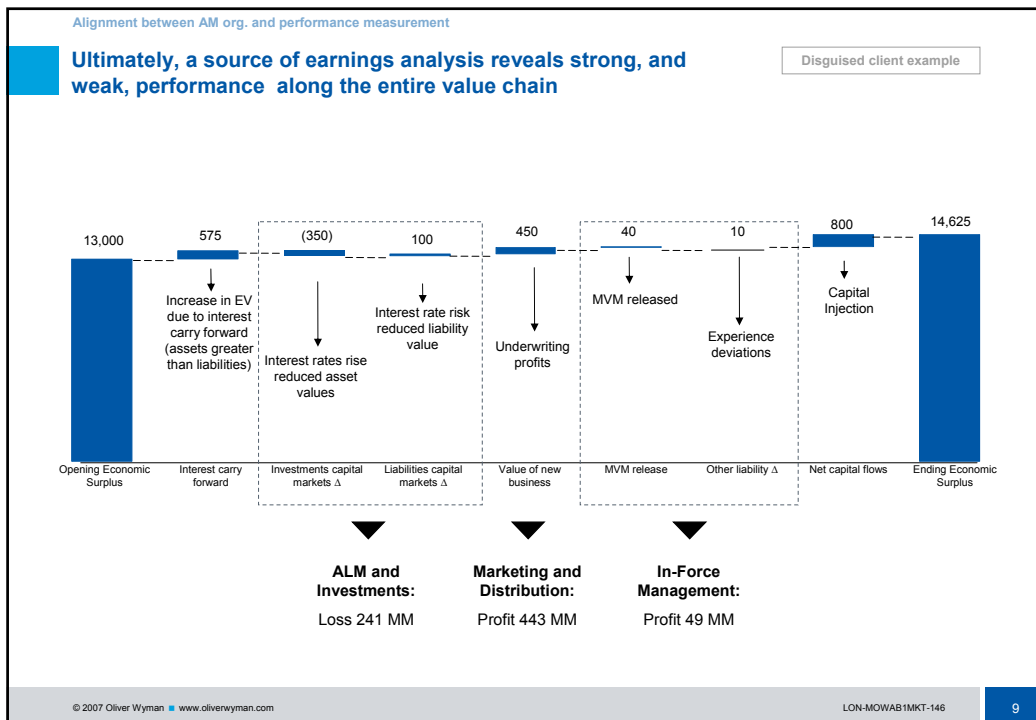
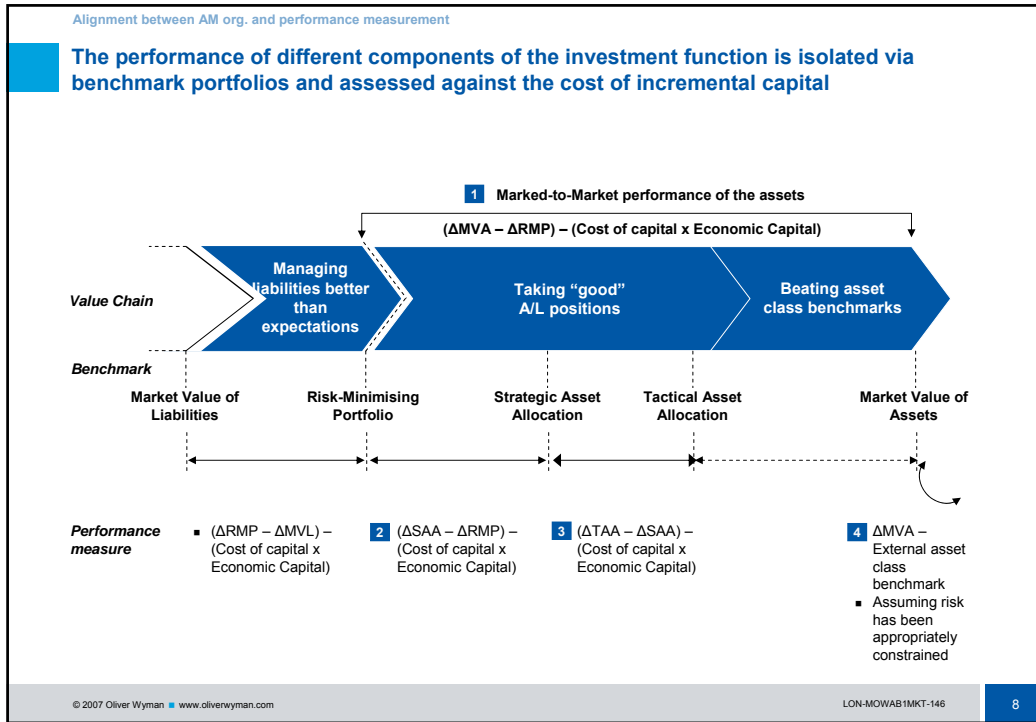
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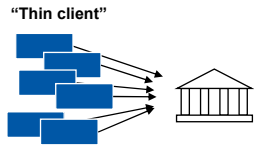
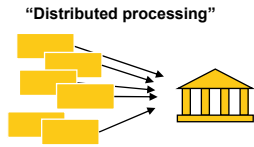
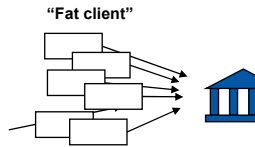






Efficient processes and infrastructure

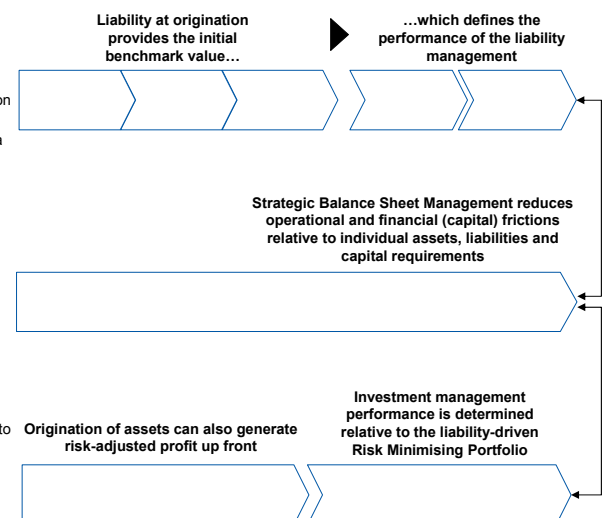
### Need to chose the right model architecture for ALM analytics that is appropriate for the organization

"Thin client"	"Distributed processing"	"Fat client"
 <ul style="list-style-type: none"> <li>▪ BUs analyse ALM position</li> <li>▪ Corporate Centre aggregates</li> </ul>	 <ul style="list-style-type: none"> <li>▪ BUs measure aggregate exposure with models</li> <li>▪ Corporate Centre analyses ALM position</li> </ul>	 <ul style="list-style-type: none"> <li>▪ BUs report their individual exposures</li> <li>▪ Corporate Centre determines and analyses ALM position</li> </ul>
<p><b>+</b></p> <ul style="list-style-type: none"> <li>▪ Decentralised models tailored to local business</li> <li>▪ Low data complexity</li> <li>▪ Little effort at Corporate Centre</li> <li>▪ ...</li> </ul>	<ul style="list-style-type: none"> <li>▪ Local tailoring in measure of aggregate exposure</li> <li>▪ Limited data complexity</li> <li>▪ High Corporate Centre model flexibility</li> <li>▪ ...</li> </ul>	<ul style="list-style-type: none"> <li>▪ Full modelling capability at Corporate Centre</li> <li>▪ Total Corporate Centre control over model design</li> <li>▪ ...</li> </ul>
<p><b>-</b></p> <ul style="list-style-type: none"> <li>▪ No model flexibility at Corporate Centre, e.g. for hedge analytics</li> <li>▪ All effort at BUs; relies on resource commitment</li> <li>▪ ...</li> </ul>	<ul style="list-style-type: none"> <li>▪ Modelling required both at Corporate Centre and BUs</li> <li>▪ ...</li> </ul>	<ul style="list-style-type: none"> <li>▪ High complexity</li> <li>▪ All effort at Corporate Centre; no involvement of BUs</li> <li>▪ ...</li> </ul>

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### The new Efficient ALM can substantially alter the "rules of the game" for insurers

Disguised client implementation

<p><b>Liability management</b></p> <ul style="list-style-type: none"> <li>▪ Responsible for all "non-hedgeable" risks created at origination – both financial and non-financial</li> <li>▪ Performance measure based on origination profit after CoC</li> <li>▪ Requires identification and ownership of a minimum risk "PRE" portfolio for WP business</li> </ul>	<p>Liability at origination provides the initial benchmark value...</p> 	<p>...which defines the performance of the liability management</p>
<p><b>Strategic balance sheet management</b></p> <ul style="list-style-type: none"> <li>▪ Alignment of economic, regulatory and ratings capital requirements</li> <li>▪ Optimization of diversification benefits</li> <li>▪ Defining risk budgets</li> <li>▪ Specifying strategic investment positions</li> <li>▪ Sets LDB and bears the cost of slippage</li> </ul>	<p>Strategic Balance Sheet Management reduces operational and financial (capital) frictions relative to individual assets, liabilities and capital requirements</p>	
<p><b>Asset management</b></p> <ul style="list-style-type: none"> <li>▪ Proactive management of assets relative to liability benchmark and CoC encourages "smart" investing in advantaged asset classes</li> <li>▪ Origination of assets also requires the definition of risk-adjusted profit at issue</li> </ul>	<p>Origination of assets can also generate risk-adjusted profit up front</p>	<p>Investment management performance is determined relative to the liability-driven Risk Minimising Portfolio</p>

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