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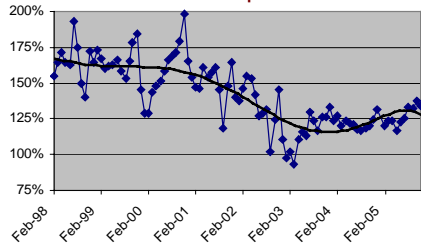
ALM and Strategic Management

Paul Caprez

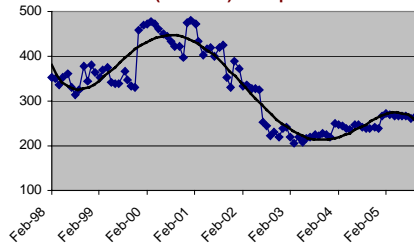
Managing mis-matches will help to align interests

- **Financial guarantees:** - backed by equities, credit and “short” duration bonds
- **Remuneration:** - management compensation not tied to return on capital
- distribution incentives reward volume not value creation
- **Financial reporting:** - “true and fair” accounting & solvency view absent

Price to Embedded Value: European Insurance Sector



Embedded Value (euro mld): European Insurance Sector



Managing mis-matches will help restore investor confidence



Linking ALM to ERM and Strategy (limitations)

- **Accounting mis-match re-emerges as solvency mis-match**
 - ❑ Economic Capital: Risk sensitive and realistic (Solvency II)
 - ❑ Available Capital: Discretionary buffers (profit margins and prudential margins)
- **Public accounts disclosure**
 - ❑ Earnings stability vs earnings credibility
 - ❑ [Asset – Liability] definition of equity
- **Risk management ≠ risk elimination**
 - ❑ Fails to capture diversification across asset classes
 - ❑ Liability convexity and NAV offset
 - ❑ Commercial implications
 - ❑ Policyholder expectations

Economic fundamentals drive Strategy and Risk Management



Primary financial indicators

- Objective set of transparent and comparable disclosures
- **Solvency: Embedded Value – Economic Capital**



- **Performance: RoEC & RoEV**



Will consistency emerge in value-based reporting?



Operational impact of the ERM process (1)

STRATEGIC PLANNING

Economic Capital allocated to existing markets, new markets and lines of business targeted to earn a minimum 10% return

Current RoEC range: P&C 14-16%, Life 10-12%

PERFORMANCE MEASUREMENT

Measurement of management performance based on "return on economic capital" - RoEC

VARIABLE REMUNERATION

Management incentivization and reward based on RoEC

SOLVENCY & LEVERAGE

Driven by risk based economic capital view



Operational impact of the ERM process (2)

ASSET ALLOCATION

Strategic Asset Allocation decisions on equity, credit and interest rate exposures taken against available economic capital

PRODUCT DESIGN

Life financial guarantees modified and structured around economic capital consumed

REINSURANCE

Reinsurance purchasing costed against value of economic capital relief

