



International Association for the
Study of Insurance Economics

Études et Dossiers

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**Solvency II: Strategic Stakes for
the Insurance Industry**

Brussels, 14 November 2005

&

**Solvency II: Challenging Issues for
Insurance Industry**

Milan, 23 November 2005

March 2006

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The Geneva Association

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Layout & Distribution: Pascal Clerc & Valéria Kozakova

Integrated risks: challenges and views of a global player insurance

Mel Carvill

Enterprise Risk Management

2

- Risk mapping
- Risk governance
- Promoting a risk culture

ERM is a process for identifying and prioritising critical risk factors facing an organisation, quantifying their impact on financial and strategic objectives, and implementing financial and organizational solutions to address them – Casualty Actuarial Society

with the objective of enhancing shareholder value – Generali



Macroeconomic Context – Recent Evolution

3

- The European insurance industry has faced dramatic change
- Market share no longer a key metric
- De-regulation and competition demand new management capabilities
- During 1990s prices fell, asset liability mismatches widened and costs grew
- Economic results were obscured by high investment income and poor accounting
- Consequence was need to raise over €50 billion in 2001 to 2003



Parenting Style – Synergy Management


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- Risk management
 - Group wide risk management process
- Asset management
 - Central strategic and tactical allocation
 - Capture synergies with European Asset Management organization
- Capital management
 - Understanding of risk and required capital
 - Optimization of capital to maximize RoEV
- Business innovation
 - Development of business innovation strategy




Solvency II 5

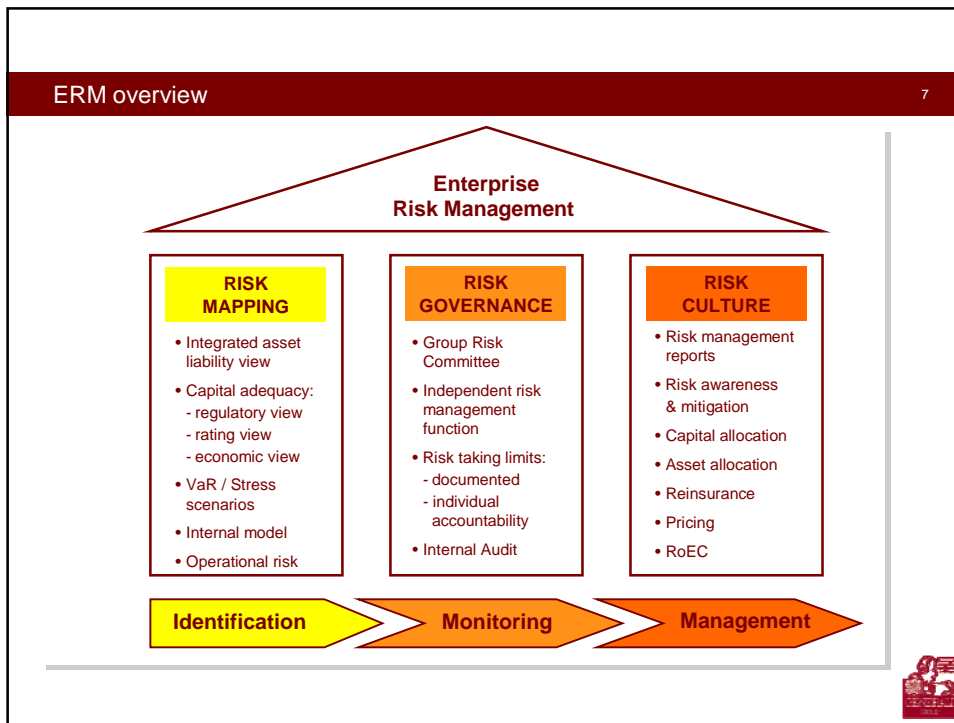
- The view of a large international group.
- Shift from “portfolio” to “synergy” manager
- Need to capture the economic benefits of being a Group.
- We run our business according to the capital employed and our business is global.
- Solvency II needs to respond.



Solvency II 6

- An economic risk based approach which:
 - Avoids doubling up of prudence
 - Incorporates risk diversification
 - Lead supervision
- We run our business on the economics and we hope regulators will too.





- Risk mapping 8
- Group-wide internal stochastic ALM process:
 - Life
 - P&C


 - Economic approach to cash flows, allowing for:
 - profit sharing & guarantees
 - “gestione separata”
 - policyholder discretion e.g surrenders, extension options
 - management discretion e.g dynamic asset allocation

 - Common group-wide economic capital methodology

 - ALM output impacts:
 - Strategic asset allocation (SAA)
 - Economic capital
 - Future bonus rates
 - Reinsurance


Risk governance 9

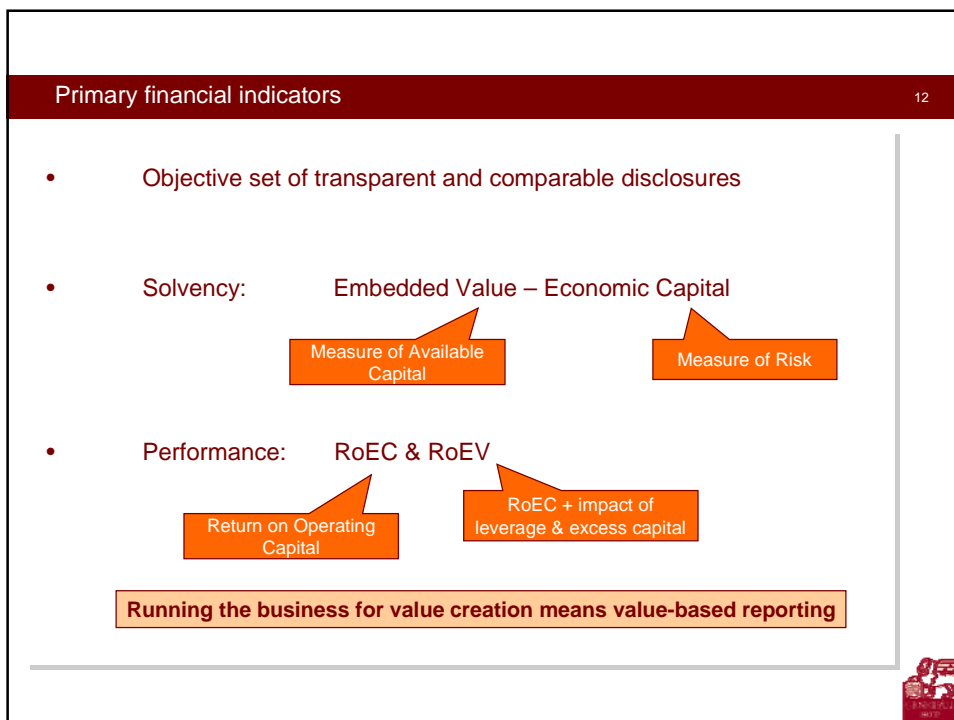
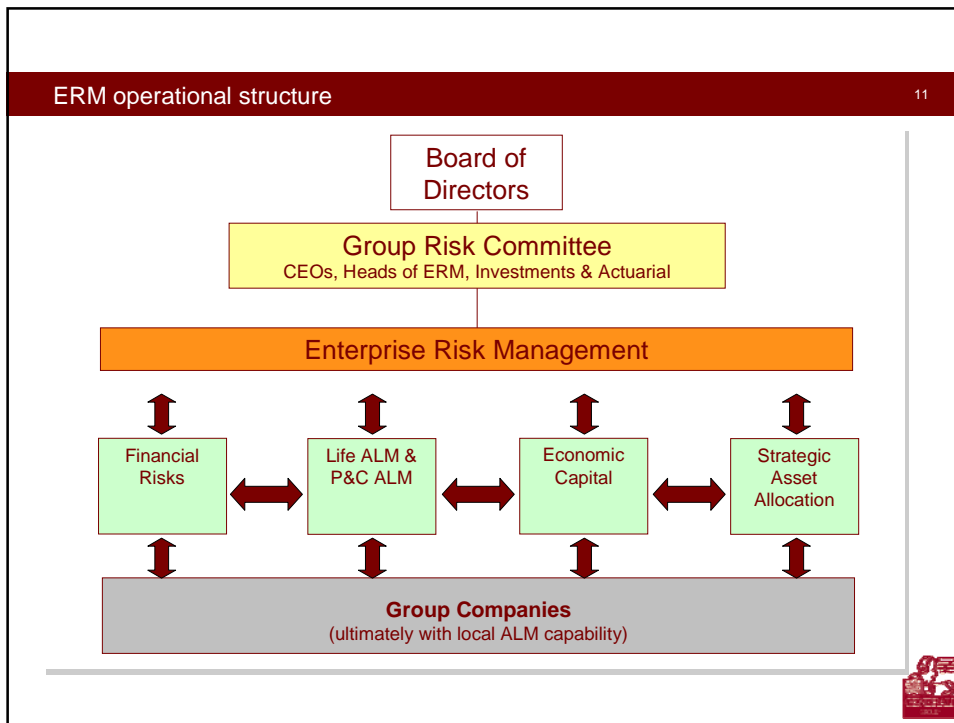
- Group Risk Committee (GRC):
 - CEOs + Head of ERM, Head of Finance, Head of Actuarial
 - meets six monthly, if no exceptions
 - sets group's risk management standards and policy (no guidelines)
- GRC activities:
 - sets limits on asset allocation, insurance capacity, reinsurance & contract limits
 - approves any breach of limits
 - reviews economic solvency & risk heat map by BU
 - considers risk management proposals
- ERM activities:
 - documents management decision rules
 - enforces standards, via Finance, Actuarial and Distribution dept.
 - develops local BU Risk Committees





Promoting a risk culture 10

- Corporate centre ERM:
 - interacts closely with ALM, SAA & EC
 - prepares risk management reports
 - proposes strategic actions to GRC
 - implements & monitors decisions of GRC
- Group-wide risk & value management culture impacts:
 - capital allocation
 - strategic planning
 - performance measurement & management compensation
 - balance sheet structure and funding
 - asset allocation
 - product design & pricing
 - reinsurance
- Develop local BU ERM process
 - local CEO sign-off





Operational impact of risk management process		13
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 risk management process		14
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	

Key Performance Indicators: RoEV and RoEC			15												
Return on Embedded Value			Comments <ul style="list-style-type: none"> Return on Economic Capital well in excess of Cost of Capital Driven by substantial increase in life NBV and improving combined ratio Achieved in spite of further interest rates decline and lower life risk discount rate Positive variances from financial assets Normalised assumptions: <table border="1"> <thead> <tr> <th></th> <th>1H04</th> <th>1H05</th> </tr> </thead> <tbody> <tr> <td>Tax rate (*)</td> <td>35%</td> <td>32%</td> </tr> <tr> <td>Inv. Return Life</td> <td>4.8%</td> <td>4.2%</td> </tr> <tr> <td>Inv. Return P&C</td> <td>5.0%</td> <td>4.2%</td> </tr> </tbody> </table> <p>(*) Tax rate applied to P&L account</p>		1H04	1H05	Tax rate (*)	35%	32%	Inv. Return Life	4.8%	4.2%	Inv. Return P&C	5.0%	4.2%
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	1H04	1H05													
Property & Casualty	18.8%	14.5%													
Life & Health	11.2%	11.5%													
Asset Management	11.3%	14.2%													
RoEC normalised	13.5%	12.4%													
Excess Capital	3.7%	3.3%													
RoEV normalised	12.8%	12.1%													
Cost of Debt	-0.7%	-0.7%													
Tax & Inv. Variances	-5.1%	2.1%													
RoEV	7.0%	13.5%													

