

RISK AND VALUE MANAGEMENT: INSURANCE INDUSTRY DEVELOPMENTS

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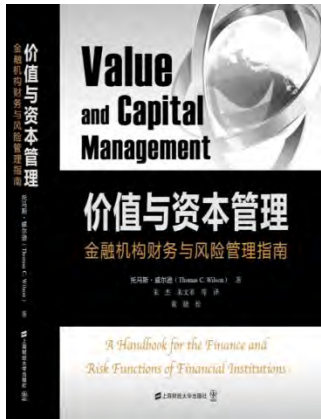
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- 2005 – 2008 CRO, ING Insurance
- 2002 – 2005 Global Head, Finance & Risk, Oliver Wyman
- 1998 – 2002 CFO, Swiss Re New Markets
- 1990 - 1998 Global Head, Risk Practice, McKinsey
- 1989 PhD Economics, Stanford
- 1984 BSc Business Administration, UC Berkeley



Professor, Applied Risk in Insurance, Ludwig-Maximilian-University, Munich
Author, *Value and Capital Management: A Handbook for the Finance and Risk Functions of Financial Institutions*

CONTENT

01

EVOLUTIONARY FORCES

Regulation has had a fundamental impact on the industry but is only one of many forces at work, all of which have helped Risk Management to evolve from a regulatory compliance and technical role to one supporting capital management and value creation.

02

BLUEPRINT FOR ENTERPRISE RISK MGMT

As a consequence, Risk has evolved a broader mandate, integrated and aligned with Finance, Actuarial and Business and requiring new skills and perspectives.

EVOLUTION OF RISK MANAGEMENT

A PERSONAL PERSPECTIVE

Prior to 2001:

- Limited „enlightened self-interest“
- Bancassurance, led by bank regulation

2001 EQ crisis: Solvency II modelled on Basle II

- Risk-based capital, internal model
- Supervision and risk governance
- Public disclosures

Looking forward

- C-ROSS, K-ICS, etc
- IAIS ICS, IFRS 17

Regulatory
Driven

<2000-08

2008-12

2012-2016

2016-Today

RISK ORGANIZATION

Independent reporting lines

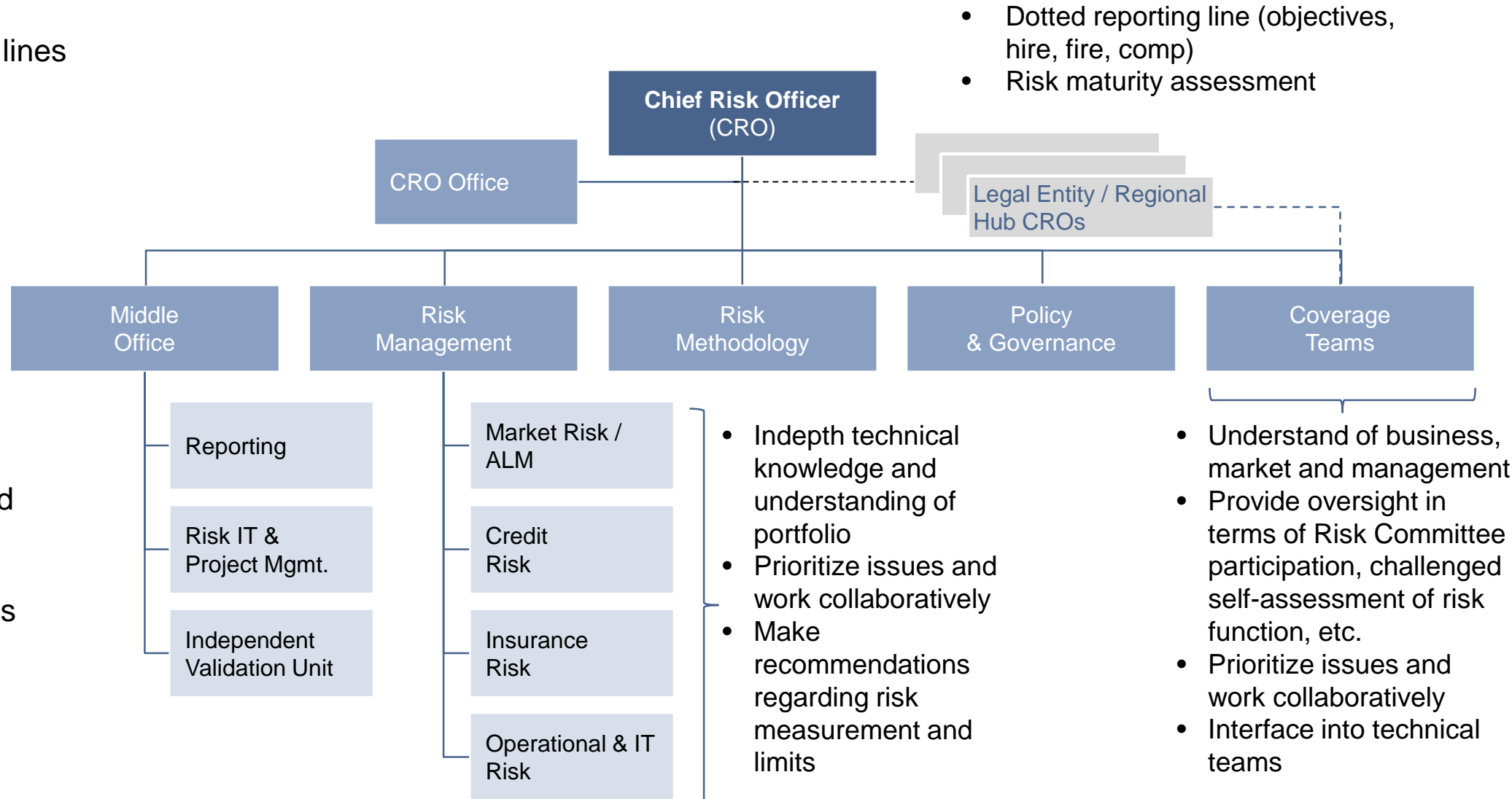
Group Committees

- Finance & Risk
- Investment
- Underwriting
- Reinsurance
- Reserve
- Reputation
- Governance
- Product Approval

Policies, guidelines and standards

Additional key functions

- Compliance & Legal
- Actuarial
- Accounting Policy
- Audit



EVOLUTION OF RISK MANAGEMENT

A PERSONAL PERSPECTIVE

Regulatory Driven

Crisis Driven

2000-08

2008-12

2012-2016

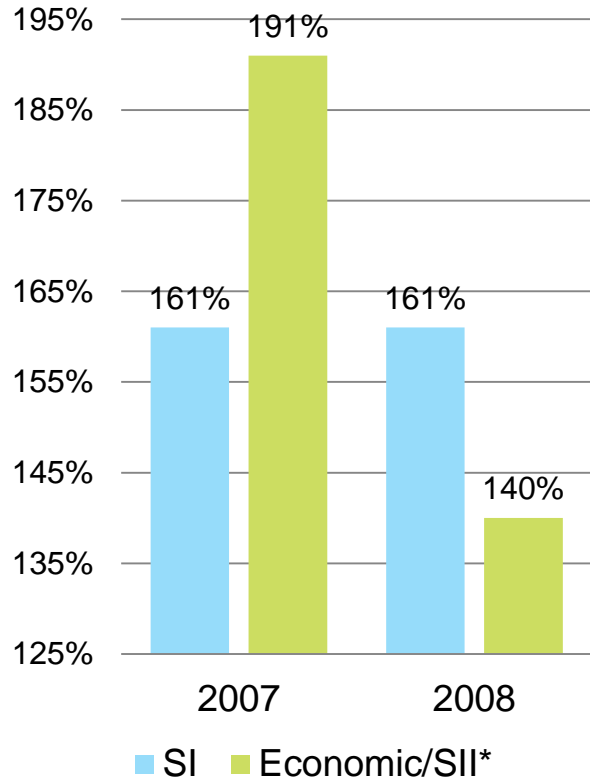
2016-



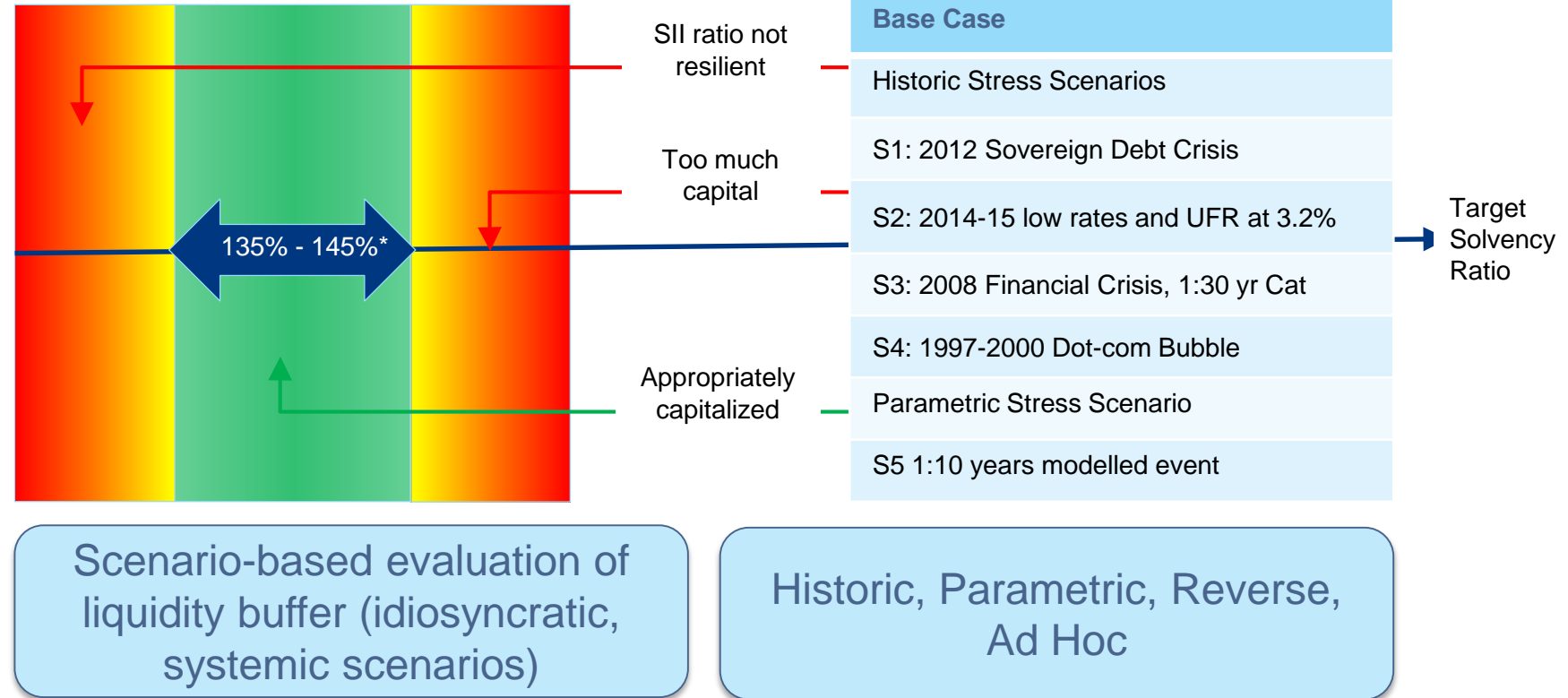
— 2008 crisis
— 2011/12 crisis
— "New Normal"

LESSON 1: STRESS TESTING FOR RESILIENCE

Allianz Solvency Ratios*



Minimum ratio after the worst stress



* Up to 10%p for SII credit spread risk, deemed less relevant for liability driven investors

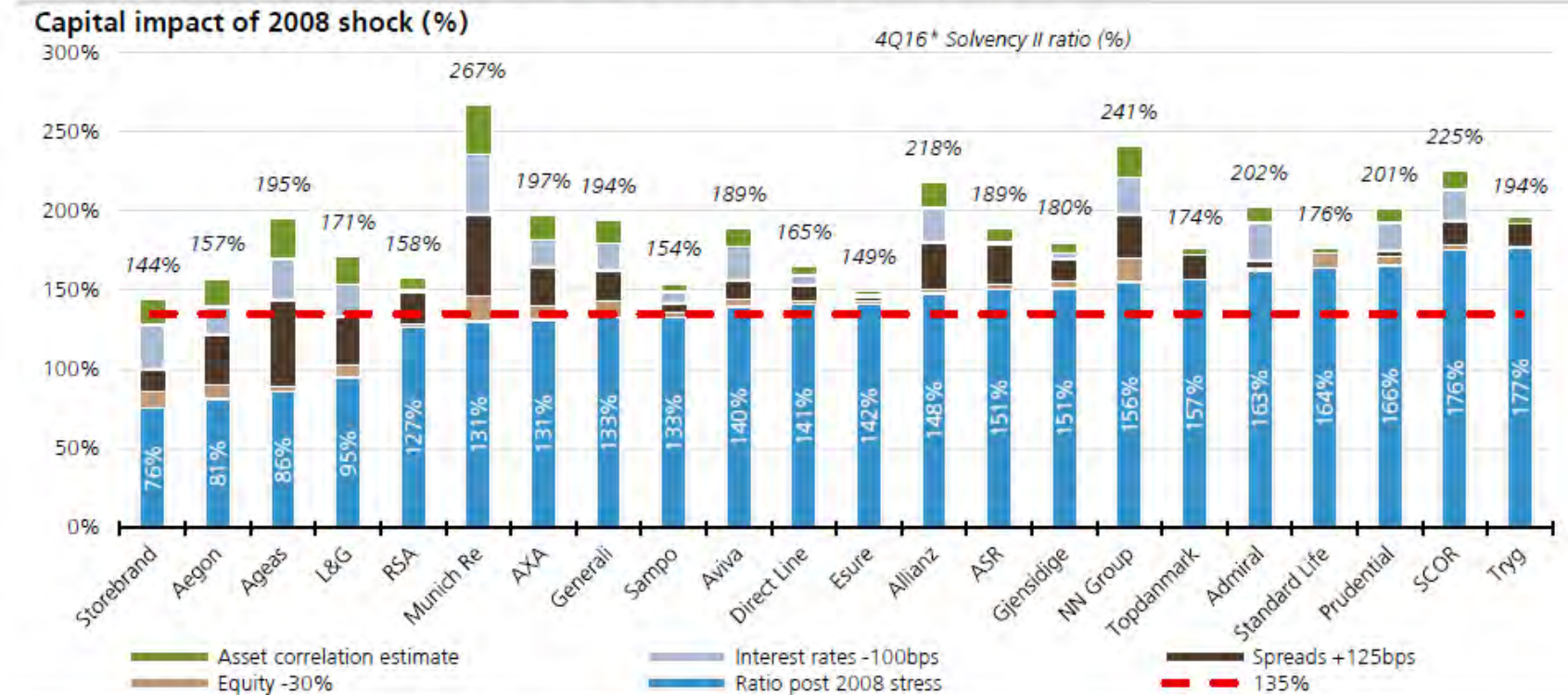
INDUSTRY ACCEPTANCE OF ALLIANZ APPROACH

Figure 5: Methodology

We highlight the following on our methodology:

- The basis of this methodology is centred on how Allianz calibrates its Solvency II target range. It calibrates its Solvency II target level as a Solvency II ratio that would enable it to absorb a 2008 shock, and remain above a 135%, a level where the company believes it would not need to raise capital. Allianz has disclosed an 80ppt hit from a 2008 scenario; a 'floor' of 135% therefore implies it targets a Solvency II ratio of 205%, in the middle of its 180-220% range;
- In calculating this 2008 scenario, we stress for movements observed in the 18 months from the date Lehman Brothers filed for bankruptcy (15 September 2008). This equates to 125bps widening in credit spreads, a 30% reduction in equity markets and a 100bps reduction in yields;
- Note that we have adjusted for positive spread sensitivities as we do not see these as a real world reflection of the risks. Please see adjacent footnotes;
- Backing out Allianz's disclosed 80ppt hit for a 2008 Solvency shock, implies an amplification of 1.3x to its disclosed sensitivities due to correlation between sensitivities. We apply this 1.3x factor to companies disclosed sensitivities (see Figure to the right). This is consistent with the average diversification credit (c30%) across the sector.

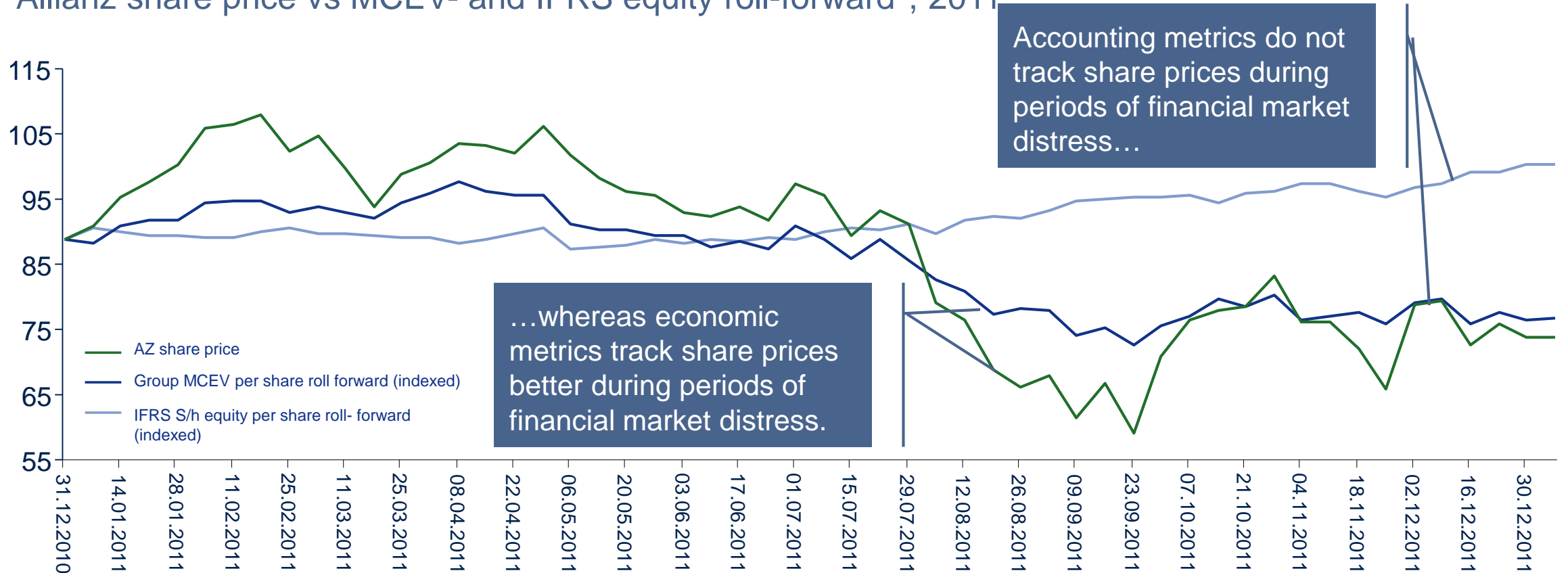
Figure 7: Illustrative capital positions after 2008 shock to 4Q16 capital positions



Source: UBS estimates. *4Q16 UK Life shown on a shareholder basis, except Standard Life.

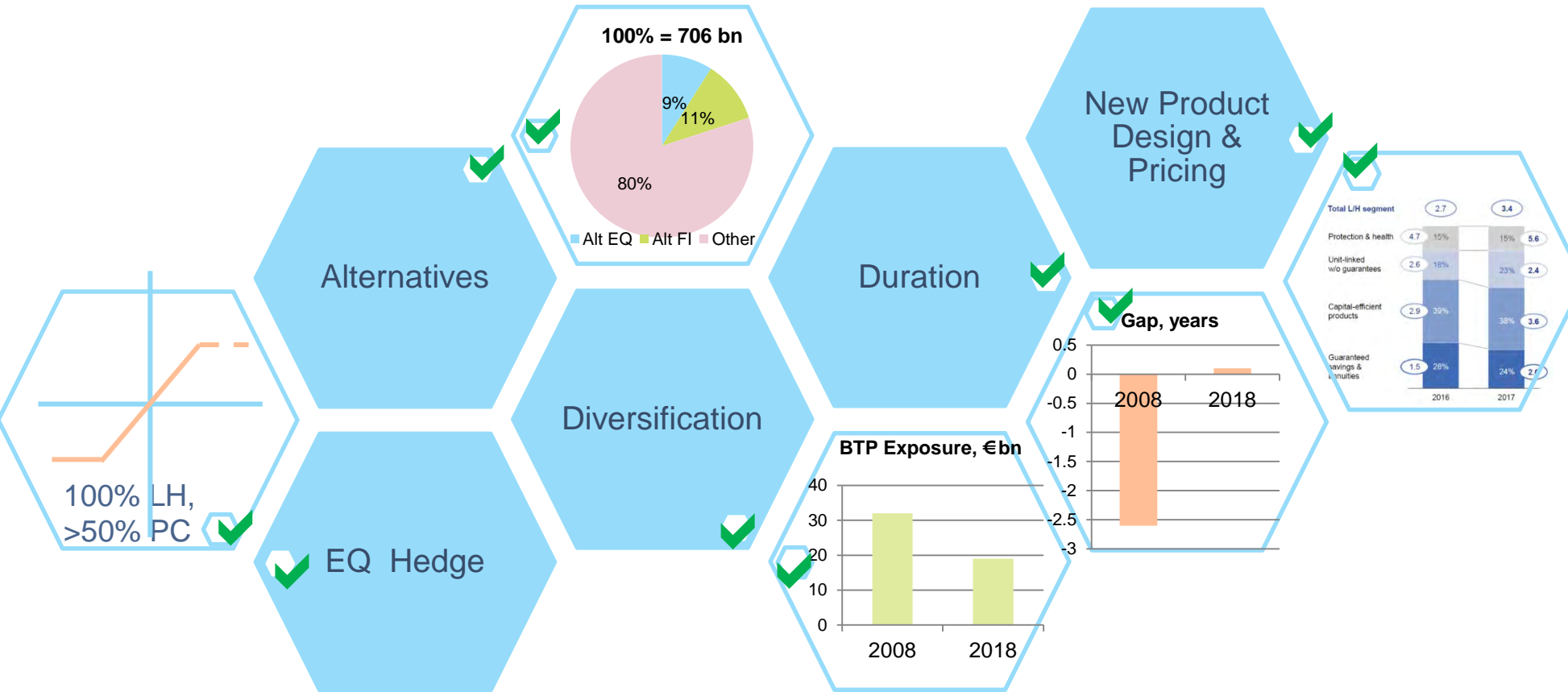
LESSON 2: VALUATIONS TRACK ECONOMICS DURING CRISIS

Allianz share price vs MCEV- and IFRS equity roll-forward*, 2011



* Roll-forward based on 2010 disclosed IFRS and MCEV sensitivities without quarterly rebalancing.

LESSON 3: ASSET & A/L MANAGEMENT

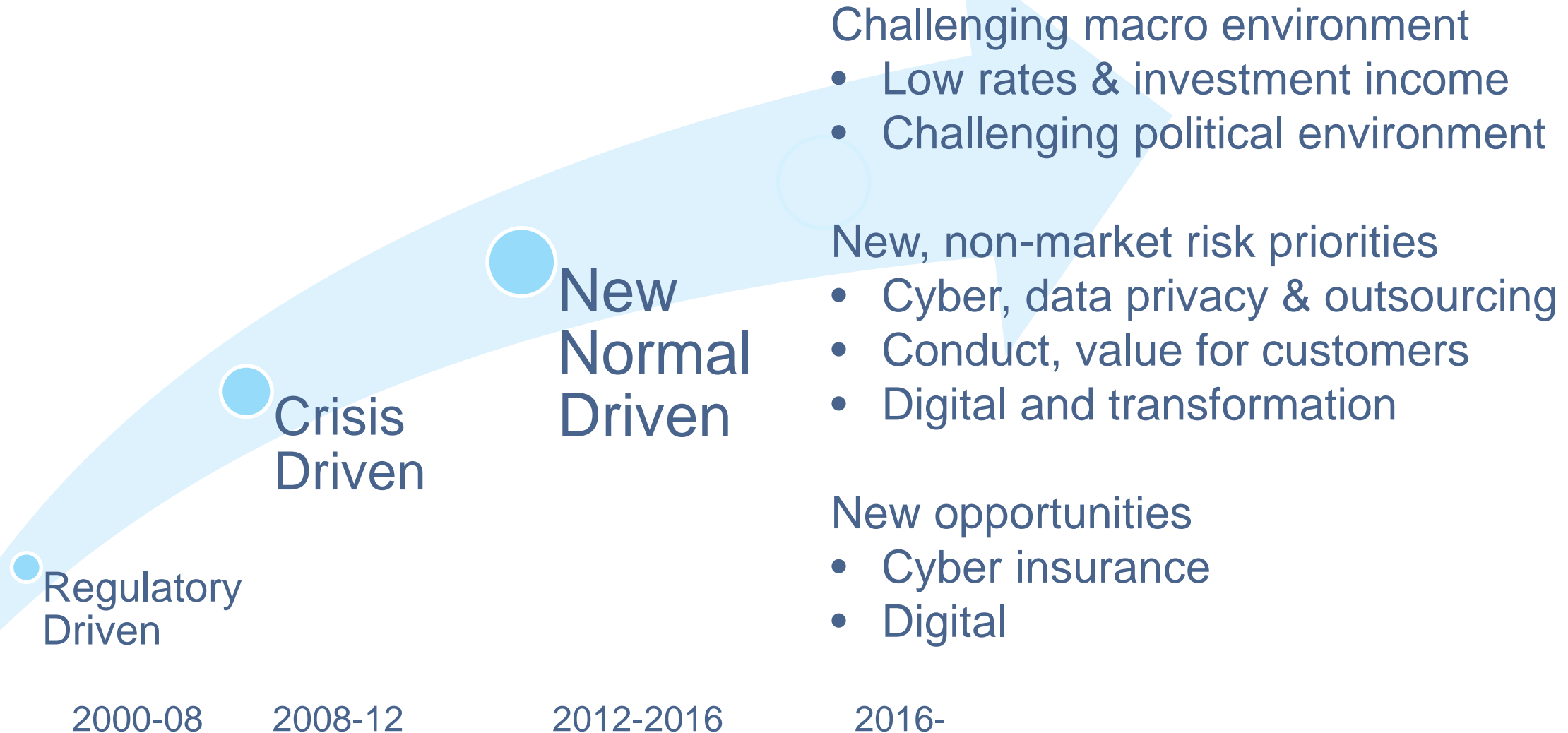


Skills

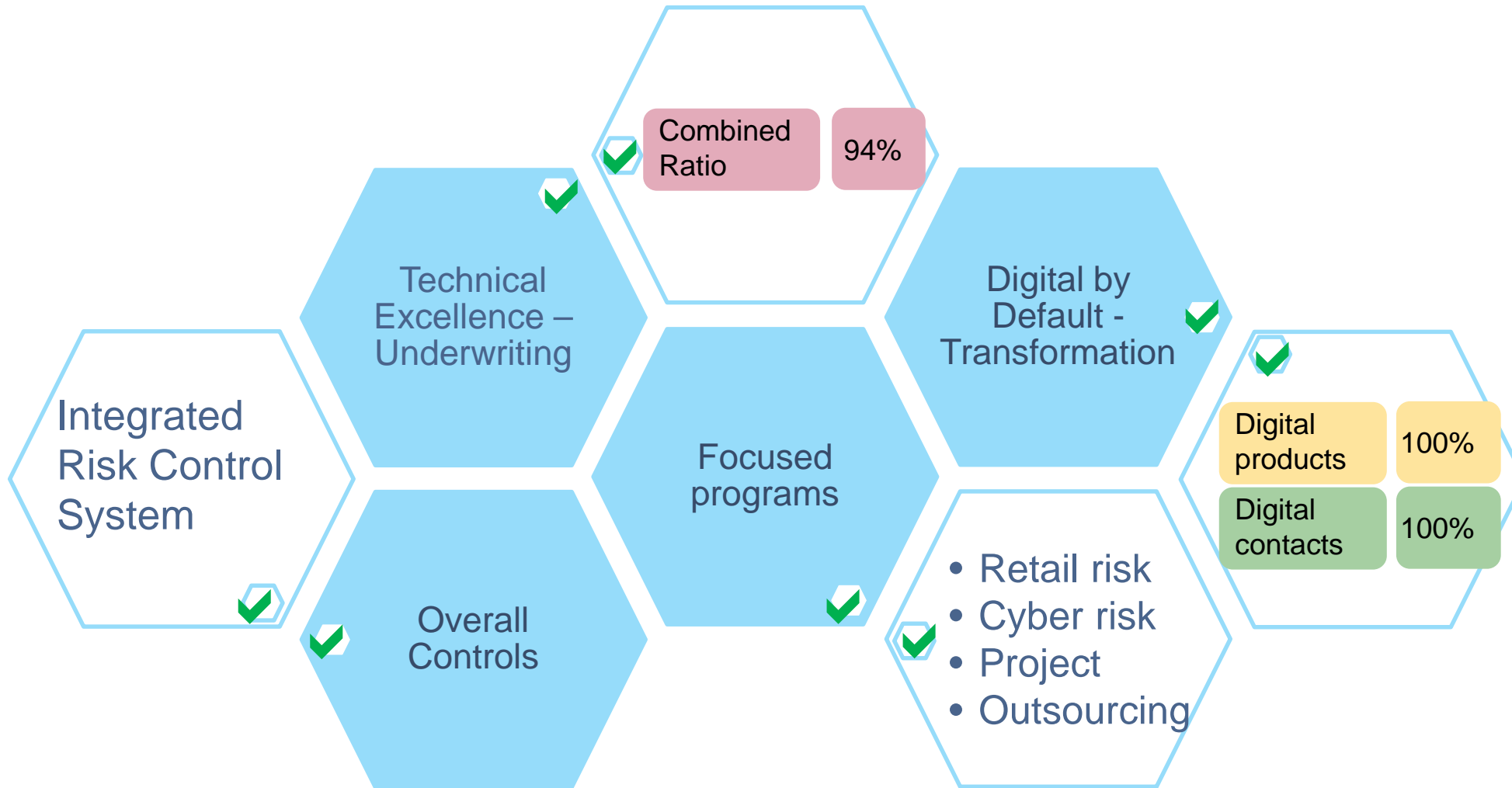
- Liability design
- A/LM
- Investment
- Credit assessment
- Alternative asset assessment
- Hedging

EVOLUTION OF RISK MANAGEMENT

A PERSONAL PERSPECTIVE



LESSON 4: MAKE A BETTER ORGANIZATION



Skills

- Broader, business perspective
- Impact first line
- Balanced controls
- Culture of operational excellence

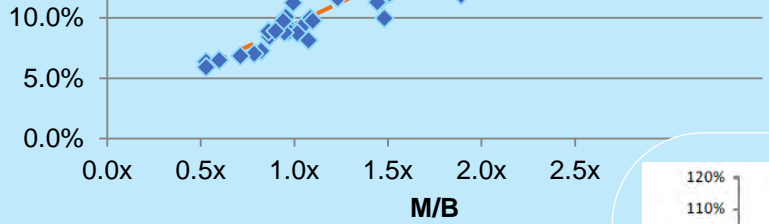
EVOLUTION OF RISK MANAGEMENT

A PERSONAL PERSPECTIVE



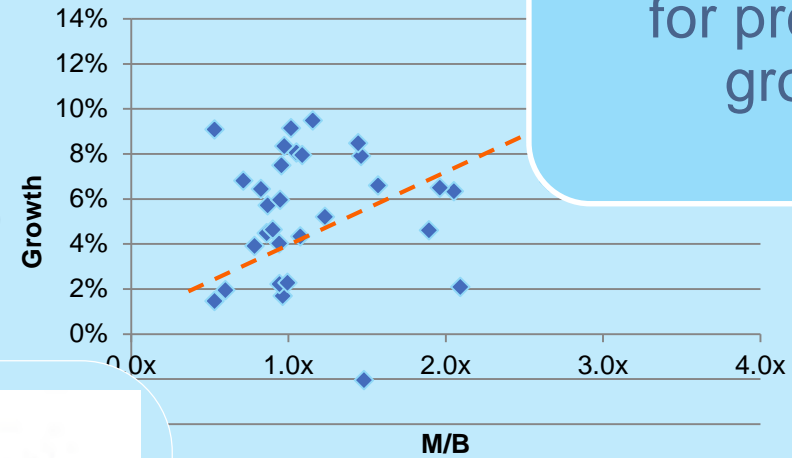
LESSON 5: A VIRTUOUS CYCLE

Superior operating performance at an appropriate capital intensity - RoE



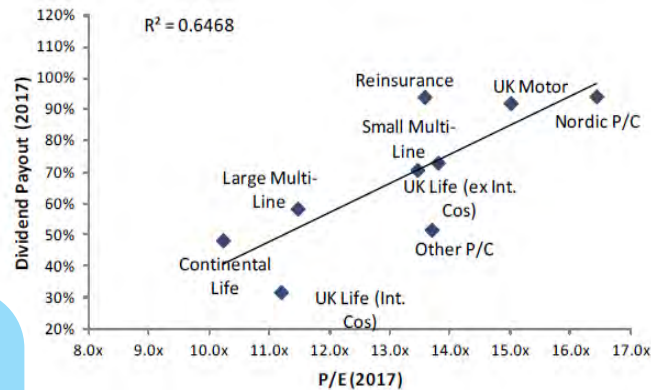
Operating profit, Capital intensity

Re-invest earnings for profitable growth



Growth

A Virtuous Cycle



Dividends in lieu of growth

Return excess to shareholders

* BofA Merrill Lynch Eur
RoE = Return on Equity,

ings valuation multiple

REQUESTED BY SHAREHOLDERS

“Earnings analysis is of limited use ... We prefer composites that i) generate strong cash flow after ‘maintenance capex’ ... , ii) have high growth capex that supports future earnings and iii) ... surplus cash generation, driving financial flexibility.”

Morgan Stanley 2012

“(Investors need to understand how) ... capital is spent. We are supportive of new business ... (at) IRRs above the company’s cost of capital and reasonable payback periods ... (but) business at or sub 9% IRRs which takes 9 years to break even ... is not a viable source of value for shareholders.”

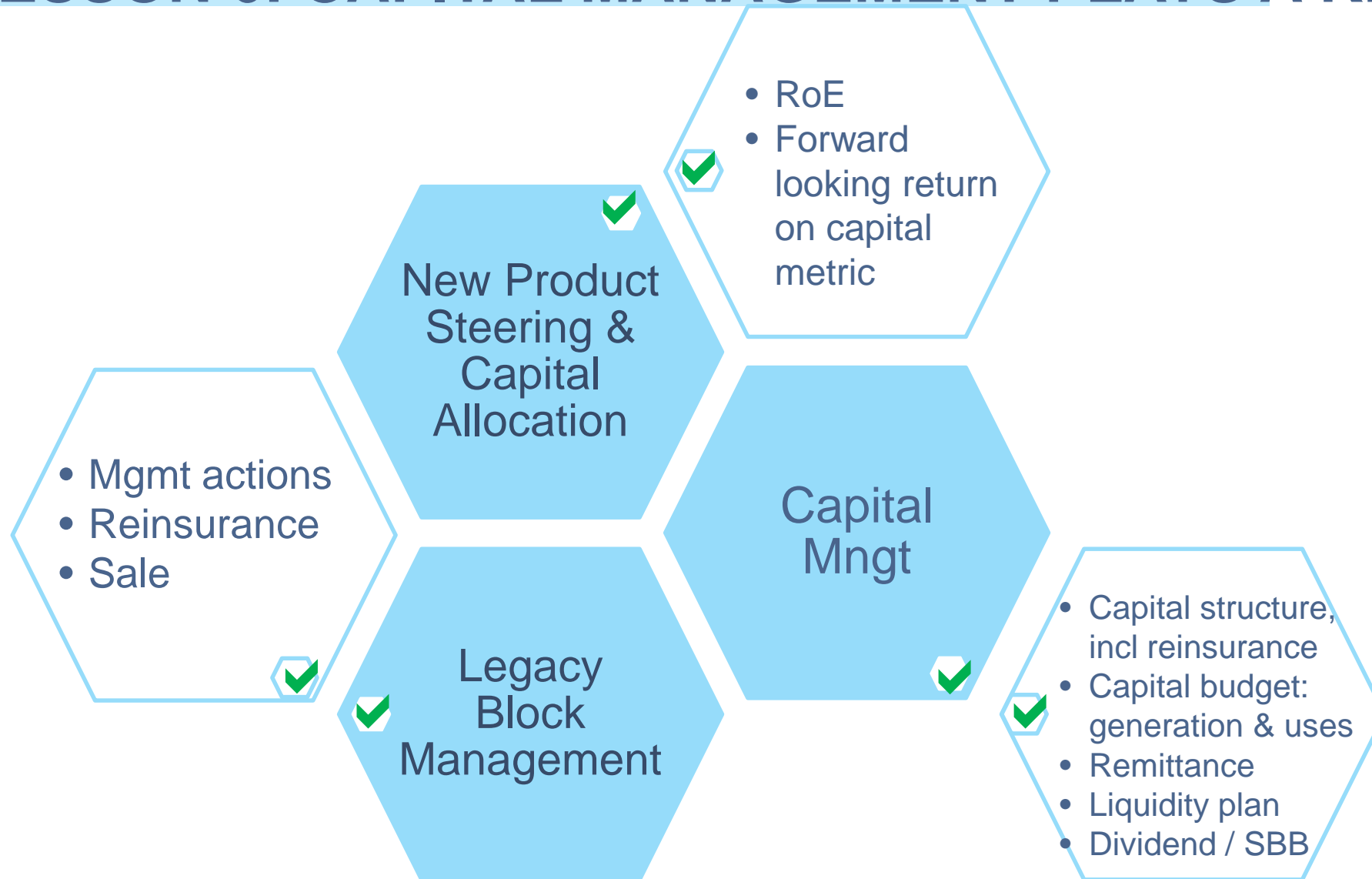
Barclays 2011

“Surplus capital deployment to become a key driver of sector performance. With scope for positive earnings revisions limited, deployment of surplus capital could become a key driver of sector performance. Those with strong Solvency II positions, and strong capital generation, can deploy / return excess capital to drive EPS”

UBS 2017



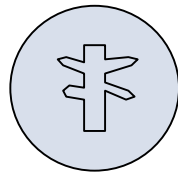
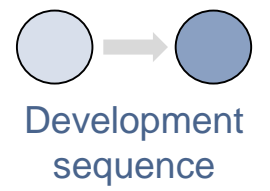
LESSON 6: CAPITAL MANAGEMENT PLAYS A KEY ROLE



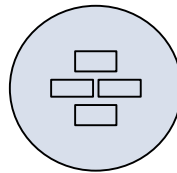
Skills

- Interaction with Finance, Actuarial, Treasury, Product
- Alignment of incentives
- Culture of shareholder value

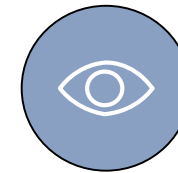
ACTIVITIES ALONG ALL THREE PILLARS



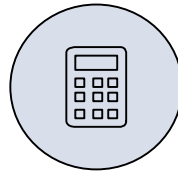
Measurement



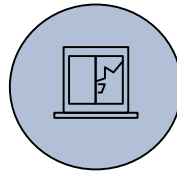
Organization



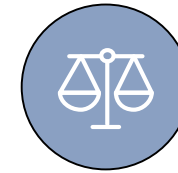
Transparency



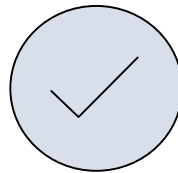
Systems



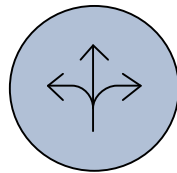
Analysis



(E)valuation



Controls



Resilience

CONTENT

01

EVOLUTIONARY FORCES

Regulation has had a fundamental impact on the industry but is only one of many forces at work, all of which have helped Risk Management to evolve from a regulatory compliance and technical role to one supporting capital management and value creation.

02

BLUEPRINT FOR ENTERPRISE RISK MGMT

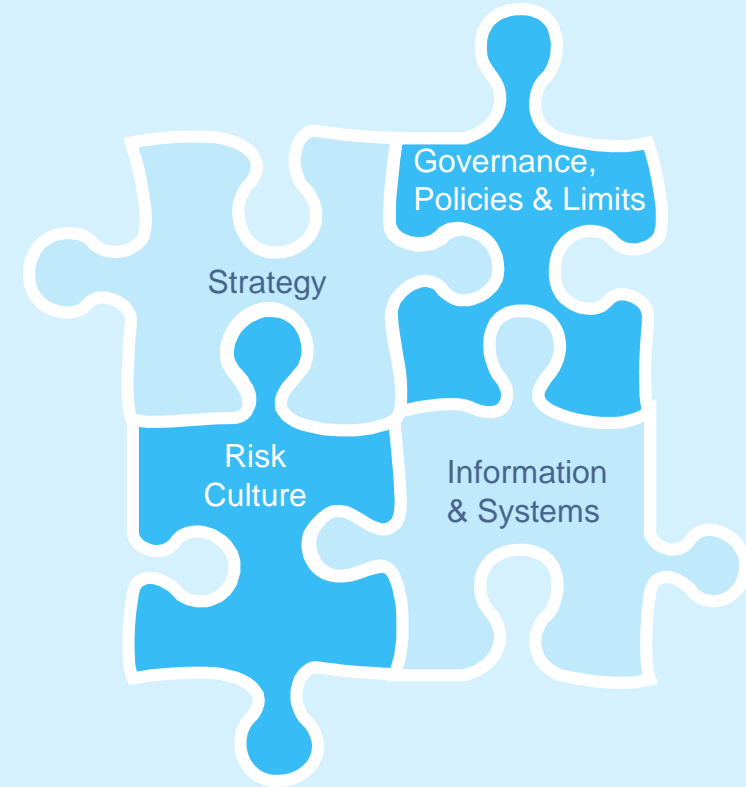
As a consequence, Risk has evolved a broader mandate, integrated and aligned with Finance, Actuarial and Business and requiring new skills and perspectives.

HOW DOES RISK MANAGEMENT ADD VALUE?

Asking the right questions ...

In practice ...

Risk Communication	<ul style="list-style-type: none"> ▪ Is our risk profile and strategy understood by analysts & regulators and fairly reflected in our valuation multiple and required capital?
Risk Strategy	<ul style="list-style-type: none"> ▪ Do we optimize our risk / reward profile for the benefit of shareholders and policy holders? ▪ Are delegated authorities set consistent with this strategy?
Risk Controlling	<ul style="list-style-type: none"> ▪ Is our risk profile transparent to management? ▪ Is it within delegated authorities?
Risk Underwriting	<ul style="list-style-type: none"> ▪ Are the risks we want appropriately structured, underwritten and priced? ▪ Are all other risks (e.g. operational / reputational risk) appropriately identified and managed?



LESSON 7: A TEAM SPORT



LESSON 8:

RISK IS MORE THAN CONTROLLING

First-Line	Second-Line	Third-Line
Business responsible for both profit and loss, risk and returns Business Units	Independent functions define <i>ERM framework</i> within which the business operates Risk, Legal, Compliance, Accounting, Actuarial	Ensure that the framework is adhered to Audit

- Models are abstractions of reality and will be wrong in the next crisis
- Frameworks can be arbitrated
- Framework may not adapt to new business needs

Risk Controlling

- Define frameworks within which business can be done
- Control risk and limits and provide transparency
- Provide technical analysis to support business decisions

Risk Management

- Have a deep, professional understanding of the business (not just the models!)
- Be close to the business, discussing key decisions before they are taken
- Encourage profitable growth but exercise professional judgement when framework inadequate
- In case of veto, allow the right to escalate up the chain of command

LESSON 9: NEW SKILLS AND CAPABILITIES

- Senior partner in the business – „tone at the top“
- Focus on long-term sustainable value creation, aligned objectives
- Provide technical information, advice and an opinion
- Critically challenge when necessary
- Balance between IQ (Intelligence Quotient), EQ (Emotional Quotient)
- Excel in leadership and development as a cultural accelerator

RISK MANAGEMENT LESSONS LEARNED

1. Stress test for resilience
2. Valuation tracks economics in crisis
3. Asset and A/L Management is critical
4. Make a better organization, influencing first line activities
5. Value is a virtuous cycle of profitable growth at good capital intensities
6. Capital management plays a key role
7. A team sport
8. Risk management, not risk controlling
9. A new set of skills



Questions?

Comments?

The views expressed in this presentation are those of the presenter only.