

# Risk Management in a General Insurer “Post-HIH”



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# Presentation Agenda



- Australian General Insurance Industry
  - APRA regulatory regime
  - “Stage 2” reforms
  
- Risk management model
  
  
  
  
  
  
  
  
  
  
- Risk management at IAG



# Australian General Insurance Industry



- Premium pool \$21 billion (approx) – private sector (IAG \$6.3 billion)
- 120 licensed insurers, including 9 Non Operating Holding Companies (NOHCs)
- Major industry consolidation 2001 - 2003
- Fragmented regulation of Statutory Classes
- Public Liability, Tort Law reform under way
- Focus on overseas (unregulated) insurers
- Entering FSR regime – uniform consumer protection legislation for banks, insurers, fund managers, brokers and other intermediaries



# Background

## - APRA Regulatory Regime



- **Technical standards**
  - Capital adequacy (“Minimum Capital Requirement”)
  - Liability Valuation
- **Governance standards**
  - Fit and proper person requirements
  - Directors and Boards
  - Risk Management Strategy (RMS)
  - Reinsurance Management Strategy (REMS)
- **Transfers and amalgamations**
- **New statistical reporting regime**
- **Effective date: 1 July 2002**



# APRA Stage 2 Reform Proposals

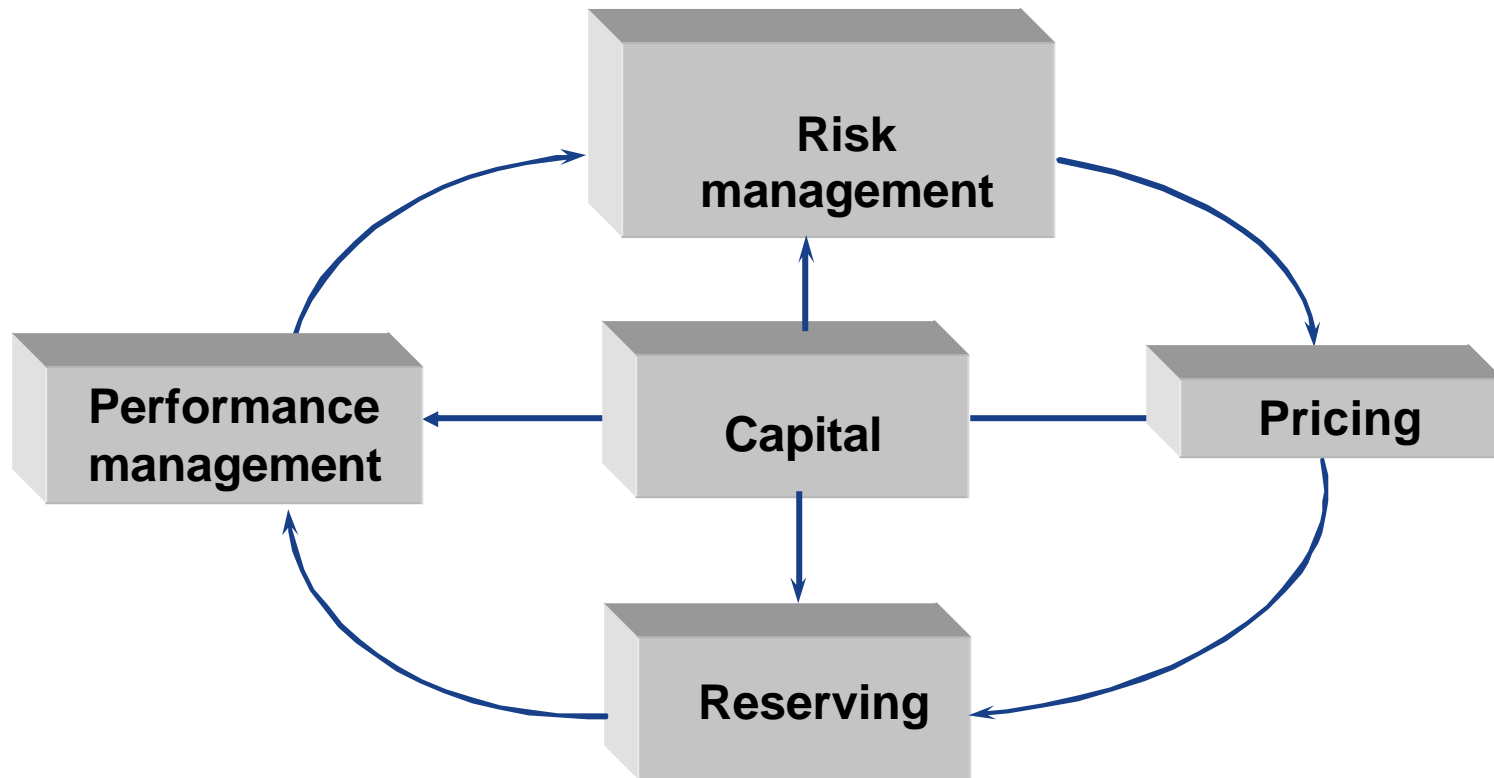
- **Regulatory response to HIH Royal Commission**
- **Further reform to come in 2004**
  - Consolidated supervision
  - Enhancement of fit & proper requirements
- **Stage 2 proposals**
  - Tighter capital requirements for inter-group arrangements
  - Better, more transparent, capital management
  - Tighter governance requirements
  - More prescriptive RMS, REMS, reinsurance rules
  - Disclosure framework
- **IAG response – main themes**

# Recent Industry Challenges

- **Sept 11 2001 & World Trade Centre**
- **Crisis in Public Liability Insurance**
- **Crisis in Builders Warranty Insurance**
- **Asbestos Liabilities**
- **Reduction in Equities Markets**
- **Reinsurer Failures/Credit Downgrades**
- **Industry Consolidation**
- **Climate change**

# Effective Insurance Risk Management

Risk management uses a control cycle

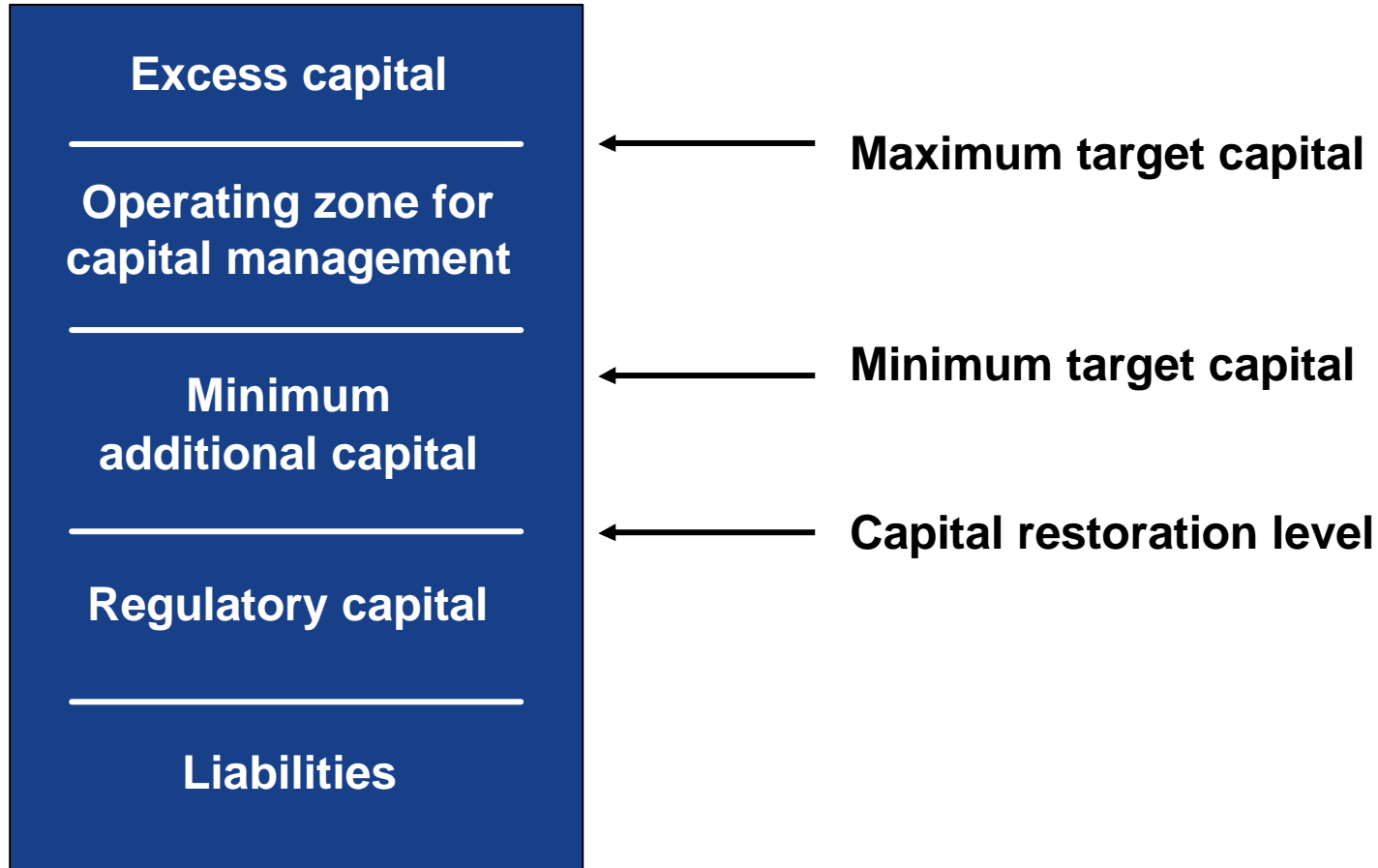


# Capital plays a central role in the cycle of turning risk into shareholder value

- Finances growth, capital expenditure and development plans
- Provides support in face of adverse outcomes from:
  - insurance activities
  - investment performance
  - operations
- Meet strategic risks and plans



# Components of Capital



# Role of Pricing

- Meet expected claims
- Meet operational expenses
- Provide a return on capital
- Be competitive

# Role of Reserving

- Establish central estimate of outstanding claims
- Provide a margin to cover the value of uncertainty (*the risk margin*)
- Ensure the outstanding claims liability covers any premium rate inadequacy

# Role of Performance Management

- Allocate capital to business units / lines commensurate with risk
- Measure outcomes and returns against those expected
- Respond to issues
- Adapt risk management, capital and pricing to improve shareholder value

# Role of Risk Management

- Establish risk appetite
  - decide what risks are essential, shed others
  - decide target financial strength (“risk of ruin”)
- Identify and assess risks
  - understand *ALL* material risks (including operational)
  - quantify the distribution of outcomes from the risks undertaken
- Keep risks “in control”
  - monitor exposures and outcomes
  - respond to “out of control” outcomes

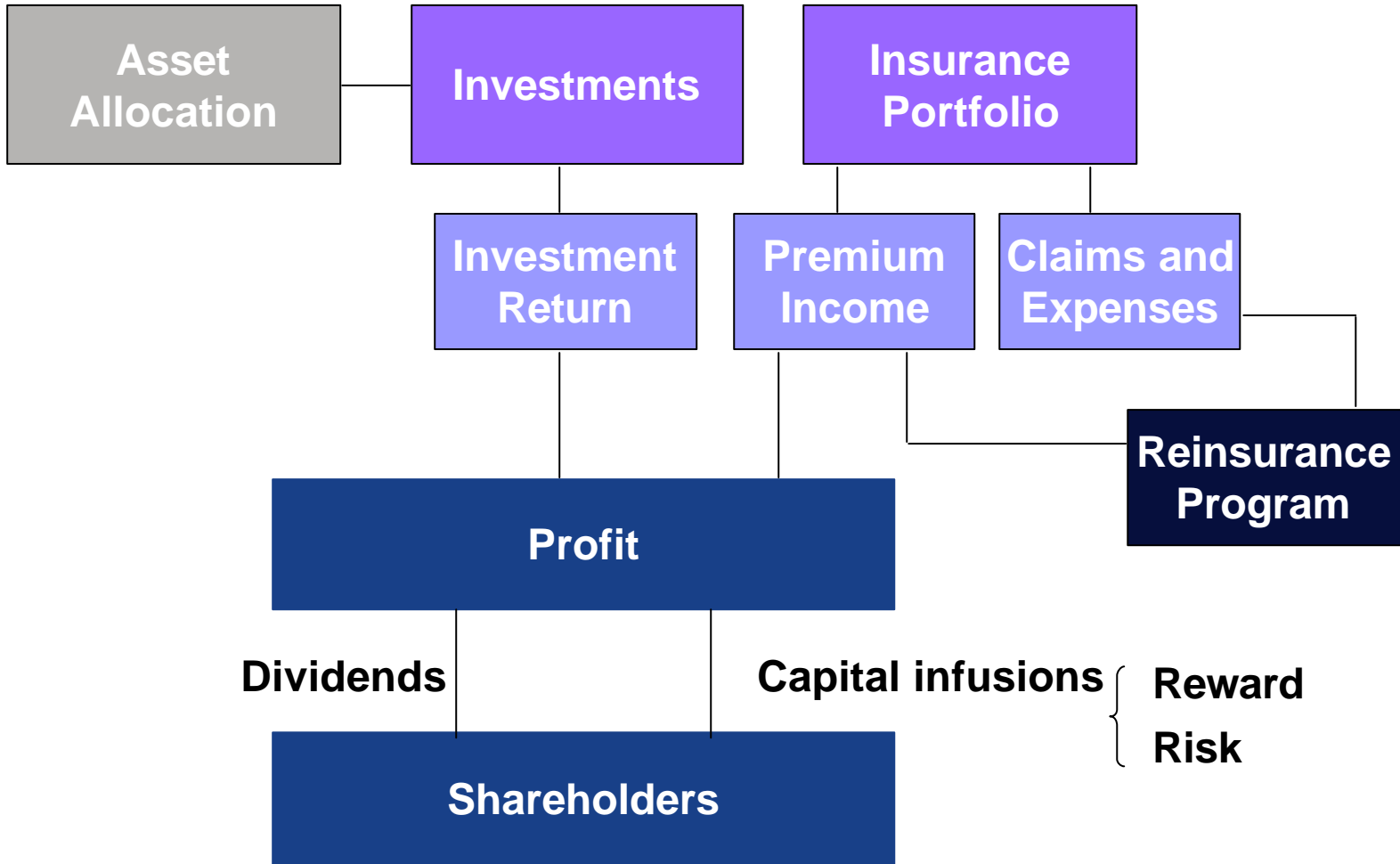
# The new Capital Management paradigm

- Regulatory capital to be less clearly defined, more complex to calculate and more risk-sensitive
- Closer alignment between regulatory and “real” capital requirements
- Acceptance of dynamic models to measure risk and capital needs

# Overview of Dynamic Model

- Comprises integrated asset and liability models
- Simulates experience over future periods
- Output comprises balance sheet and P&L accounts and *distributions* of:
  - profit
  - capital
  - rates of return on capital
- Distributions enable management to take a view on probability of key indicators falling outside an acceptable level

# Dynamic Financial Analysis





# Potential Benefits and Uses of Model



- Financial condition reporting
- Understanding of dynamics in balance sheet on basis of current strategy
- Illustrate the effects of alternative asset and liability (including reinsurance) strategies
- Model effects of acquisition / divestment decisions
- Capital allocation by territory and product

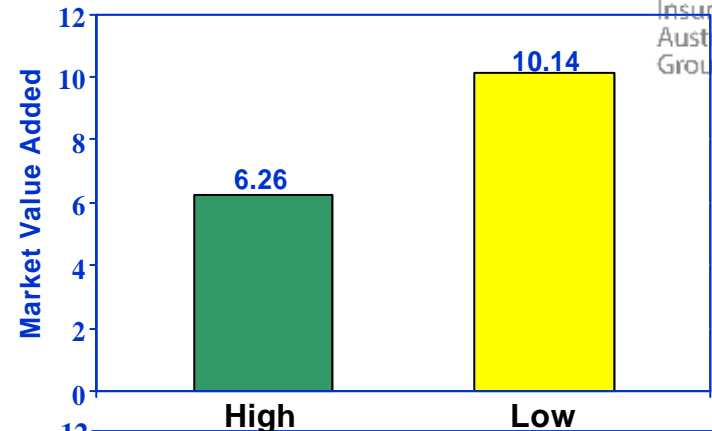
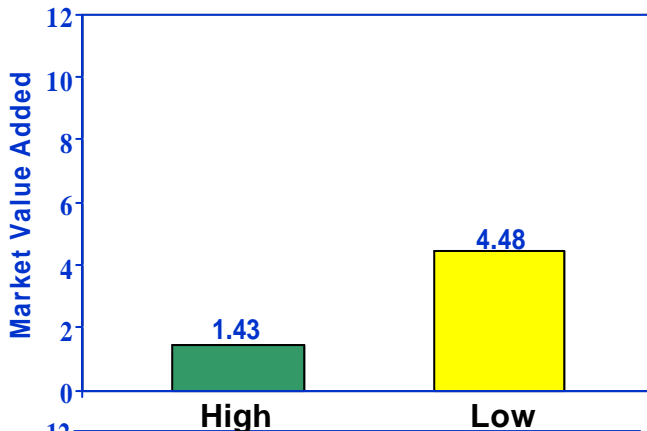


# Management of Volatility

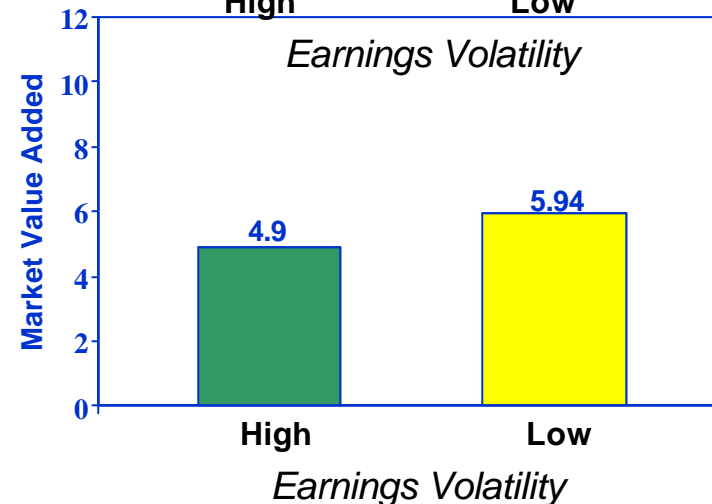
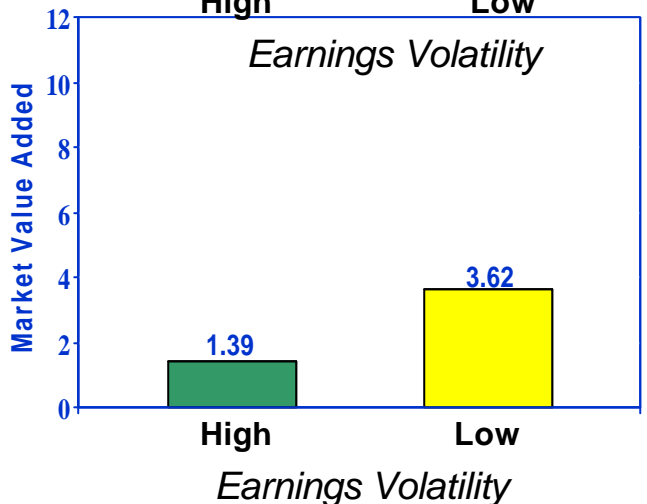
- Volatility and the risk / return trade-off
- Dimensions of volatility
  - business process / operational
  - balance sheet
  - strategic

# Volatility and Shareholder Value

High Return Companies



Low Return Companies



Low Earnings Growth Companies

High Earnings Growth Companies



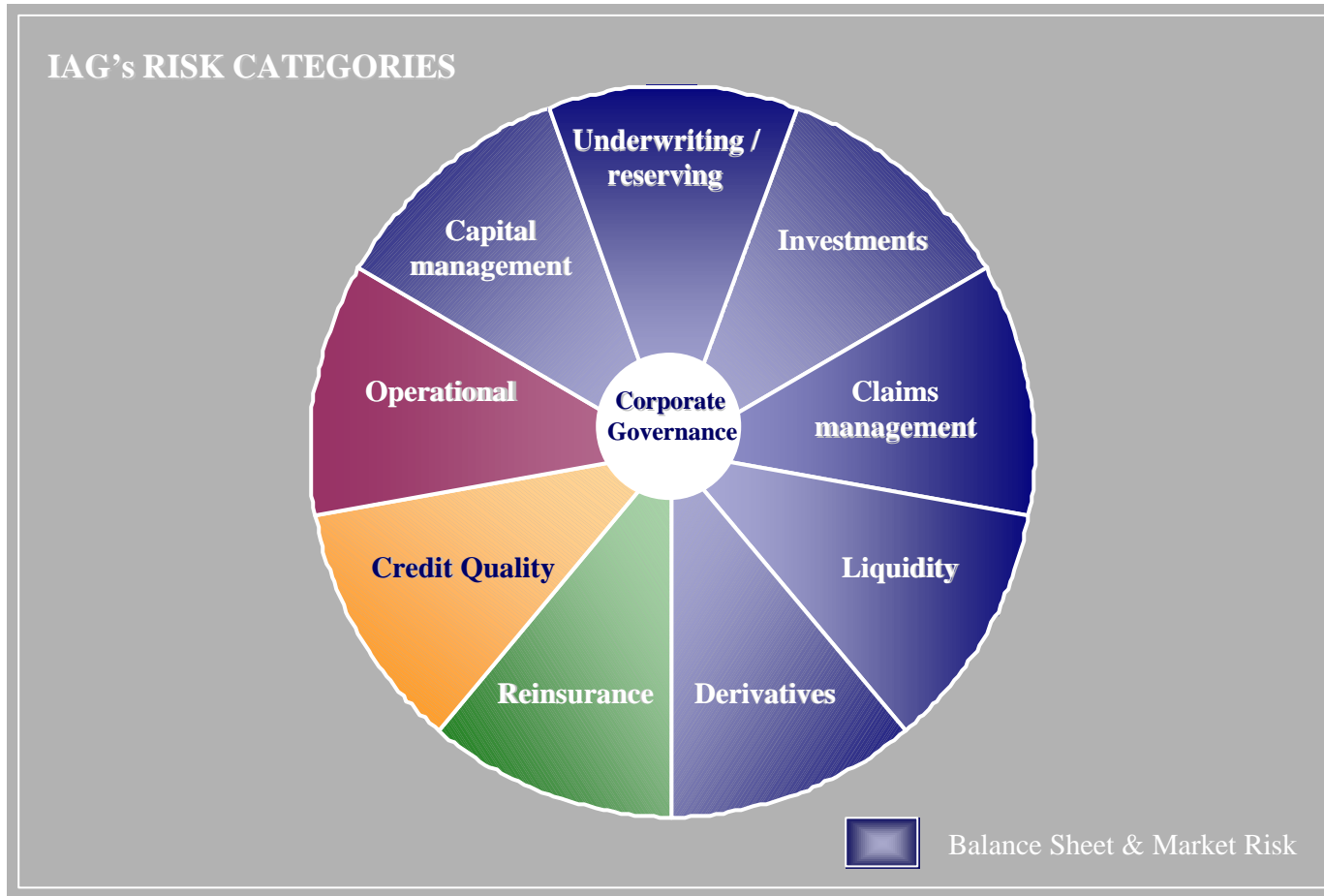
# Risk Management at IAG



- Risk “universe”
- Corporate governance
- Management Assurance Framework
- Chief Risk Officer structure



# IAG Risk Universe

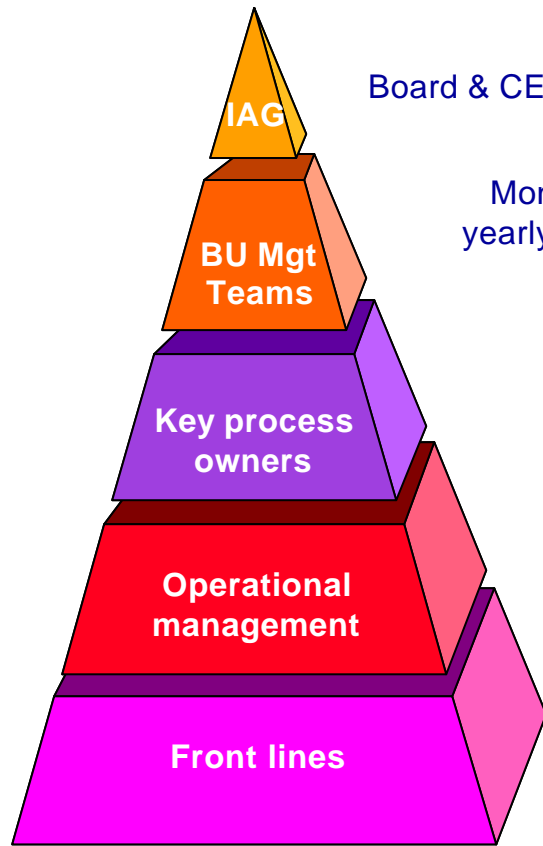


# Corporate Governance



# Management Assurance Framework

## Management Assurance Framework



Board & CEO declarations to APRA & statements in the Annual Report, based on monitoring of RMS

Monthly ORM report, self assessment answers to twice yearly Director's Questionnaire to Management based on RMS, ad hoc investigation and reporting on issues

Discussion at BU level, report on the health of operational risks, detail on exceptions

Automated self assessment of control effectiveness

Follow and monitor adherence with the processes in operational guidelines / policies / systems

# Chief Risk Officer Structure

