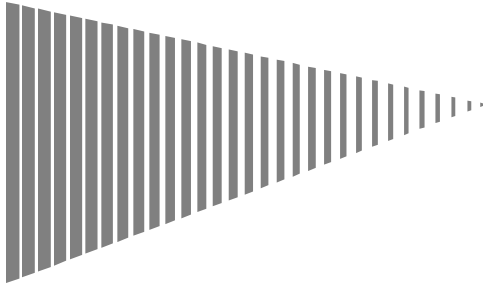


Capital management

Singapore Actuarial Society

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Building a better
working world

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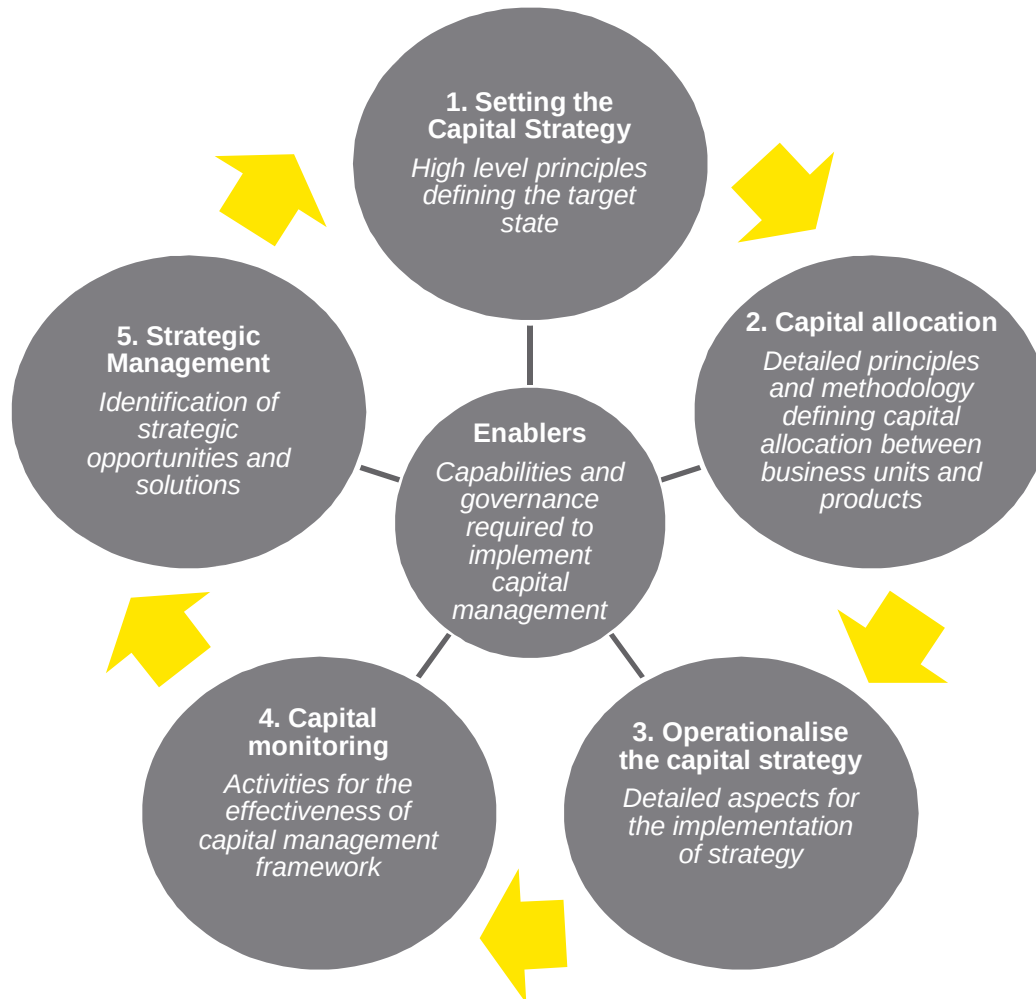
We will cover today...

- ▶ Capital management process
- ▶ Implications of changing regulations
- ▶ Capital optimisation themes
- ▶ Q&A

Capital management process



Overview of capital management process



Key considerations

- ▶ Is the capital strategy aligned with your risk preferences?
- ▶ Is the business plan aligned with the intended use of capital?
- ▶ Is there a systematic approach to capital allocation and the use of capital? Is it proactive or reactive?
- ▶ Is capital reporting just retrospective or includes forecasts?
- ▶ Is the need for additional capital conveyed in a timely manner?

1. Setting capital strategy



Agree risk preferences

- ▶ Board and Senior Management discuss the risk preferences to articulate **Capital appetite statement**

"We want to take insurance and market risk but are highly averse to credit risk in current business environment"

Capital capacity

- ▶ Capital appetite statement is translated into scenarios that the Board will like to withstand
- ▶ Derive a capital measure to quantify these scenarios into **capital capacity**

"The maximum level of risks taken should be such that CAR on internal economic capital basis does not fall below 100% with a more than 10% probability"

Capital appetite

- ▶ Depending on the business environment and company's strategy, decide on the **buffer** to derive the **capital appetite**

"We will operate in the CAR range of 120% - 150% with actions taken if CAR falls below 120%"

Key considerations

- ▶ What scenarios?
- ▶ Which capital measures (VaR, Tail VaR, others)?
- ▶ Which basis (regulatory, internal, credit rating)?
- ▶ With or without diversification?
- ▶ Other constraints (liquidity, dividend planning, regulatory risk)?
- ▶ Cultural issues?

Capital strategy – insights



Company	Capital Targets
UK based multinational	1 in 10 over Economic Capital
European based multinational	99.97% percentile capital to maintain an internal view of AA rating
European based multinational	1 in 20 over Solvency Capital Requirement
European reinsurer	175% over Solvency Capital Requirement
UK Banking subsidiary	1 in 10 over Solvency Capital Requirement
UK Fund	125% over Economic Capital
European reinsurer	1 in 200 over Economic Capital
UK Banking subsidiary	130% over SCR
European based multinational	99.75% percentile capital to maintain an internal view of AA rating
UK Mutual	1 in 10 over ICA

Practices for setting target level of capital varies and reflects the Board's risk averseness to taking risks. Other factors affecting the target level are business environment and regulatory framework

2. Capital allocation



Allocate capital

- ▶ Decision on capital provided to support business units or products/portfolio
- ▶ Decide on maximum/minimum capitalisation levels



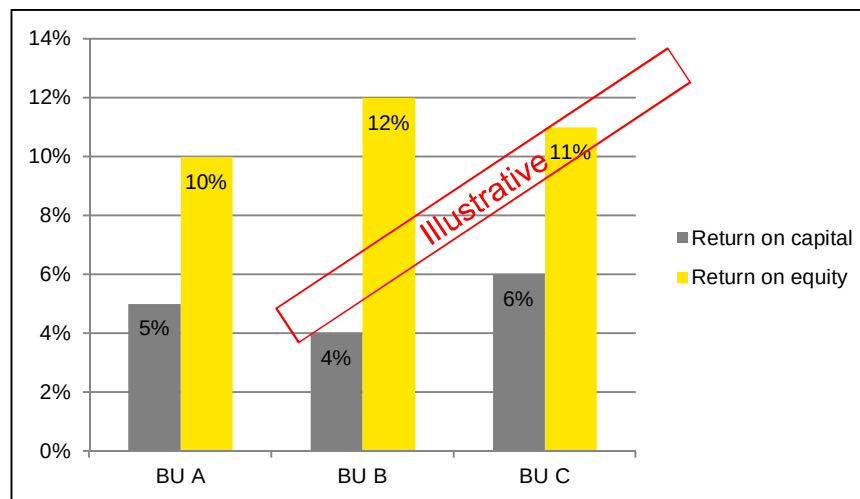
Measure current capital utilisation

- ▶ Identify business units or portfolios where the capital is not efficiently utilised or where there is under/over use of capital



Initiate management actions

- ▶ Management actions and processes to transfer in/out capital
- ▶ Identify and implement changes in the business planning due to capital transfers



Key considerations

- ▶ Which KPIs (return on equity, return on capital, others)? Prioritisation?
- ▶ What definition of return and capital?
- ▶ How to allocate diversification benefit?
- ▶ Long term objectives
- ▶ Trigger points and establishment of escalation processes

Capital allocation - insights



KPIs for in-force management	Risk sensitive	Acceptability	Simplicity	Applicability
Cash generated	●	●	●	●
IFRS operating profit	●	●	●	●
EV operating profit	●	●	●	●
Economic value added	●	●	●	●
IRR	●	●	●	●
Return on equity	●	●	●	●
Return on capital metrics	●	●	●	●

Illustrative

Key for any metric to be effective is to secure stakeholders' buy-in

3. Operationalise the strategy



Translate allocated capital to exposure limits

- ▶ Capital inputs into the risk limits decisions for assets and liabilities



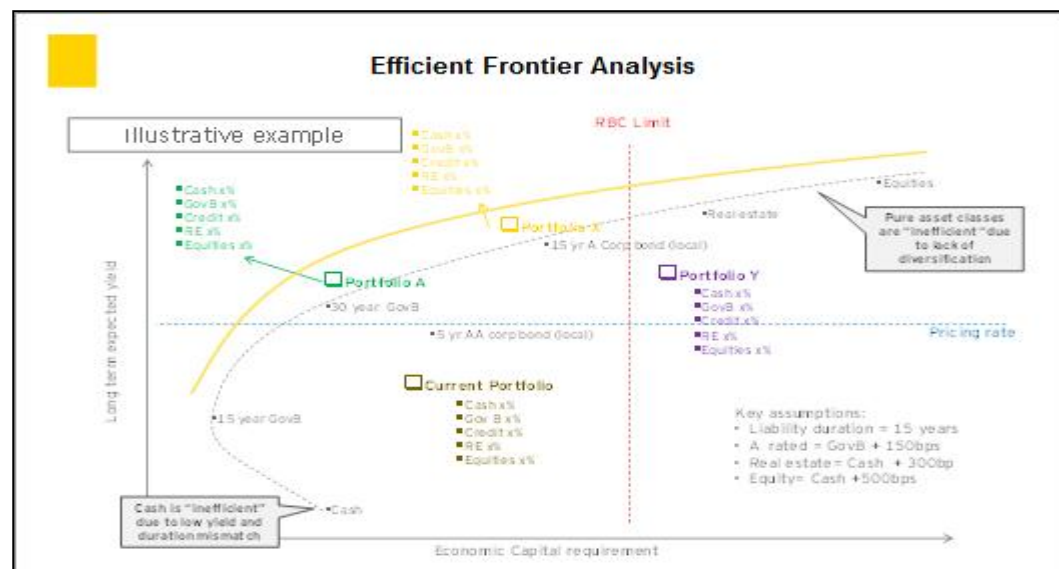
Review the current exposure and initiate any actions

- ▶ Identification of under/over utilisation at product and risk level
- ▶ Understand the source of value generation
- ▶ Initiate any management actions for realignment of exposure



Capital planning

- ▶ Capital projections showing cover ratios under different bases for a range of scenarios
- ▶ Funding / Dividend planning
- ▶ Contingency Planning



Key considerations

- ▶ Cost of movement of capital (e.g. tax)
- ▶ Quality of capital
- ▶ Balance between short-term vs. long-term
- ▶ Consistency across business units (methodology, models, assumptions)

4. Capital monitoring



Define metrics and triggers

- ▶ Forward-looking metrics
- ▶ Triggers defined for initiating any actions



Define reporting processes

- ▶ Frequency of regular monitoring
- ▶ Content of capital reports



Identify any actions from monitoring

- ▶ Escalation triggers
- ▶ Route to Green planning
- ▶ Identification of management actions
- ▶ Ownership

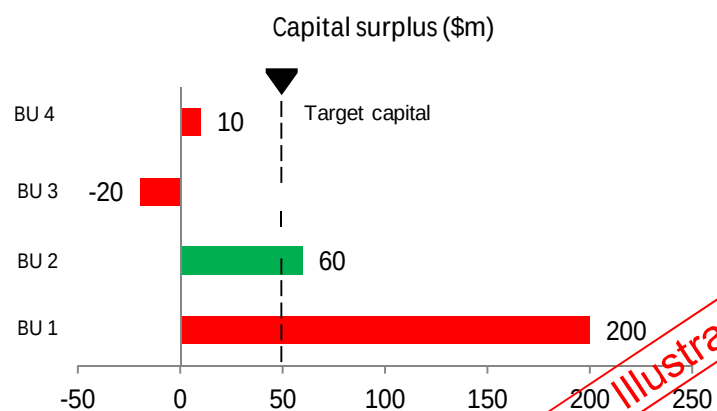
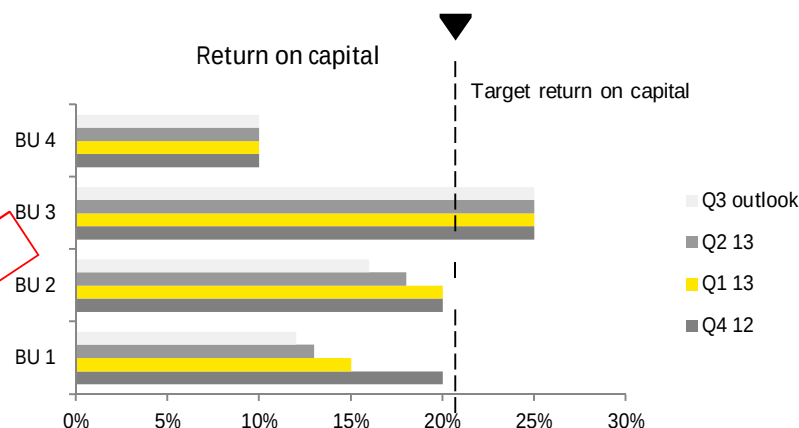
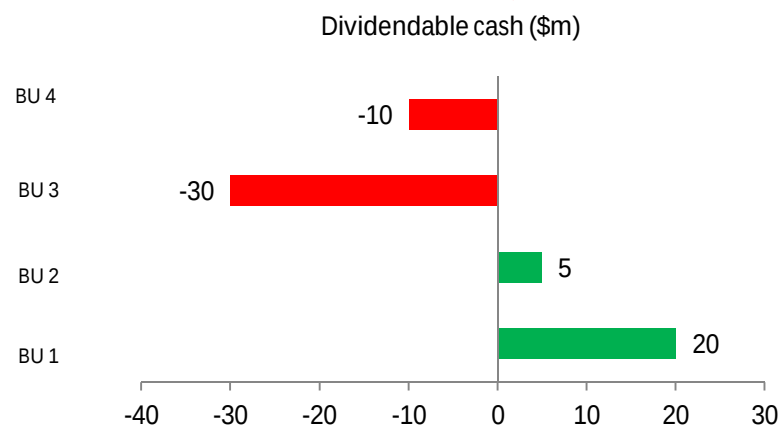
Capital Dashboard	Prior quarters				Latest month	Outlook	Commentary
RBC ratio	●	●	●	●	●	●	De-risking planned (reinsurance, hedging)
Economic capital ratio	●	●	●	●	●	●	De-risking planned (reinsurance, hedging)
Return on capital	●	●	●	●	●	●	Asset strategy changed to yield higher returns
Liquidity ratio	●	●	●	●	●	●	OK, Ongoing close monitoring
Dividends (as planned)	●	●	●	●	●	●	Impact of de-risking will take some time

Illustrative

Key considerations

- ▶ Forward looking and action oriented
- ▶ Integration with Finance reporting processes
- ▶ Approval and escalation processes
- ▶ Agility of reporting capability
- ▶ Investment in reporting infrastructure?

Capital monitoring - insights



Commentary

- BU 3 high potential for future growth. Capital needed to support the growth
- Over capitalisation in BU 1 with downward outlook for return. Capital from BU 1 to be extracted to support BU 3
- BU 2 return on capital downward outlook. Initiate management actions as important from strategic point of view
- Outlook steady for BU 4 but under capitalised and return lower. Explore investing further to increase the return

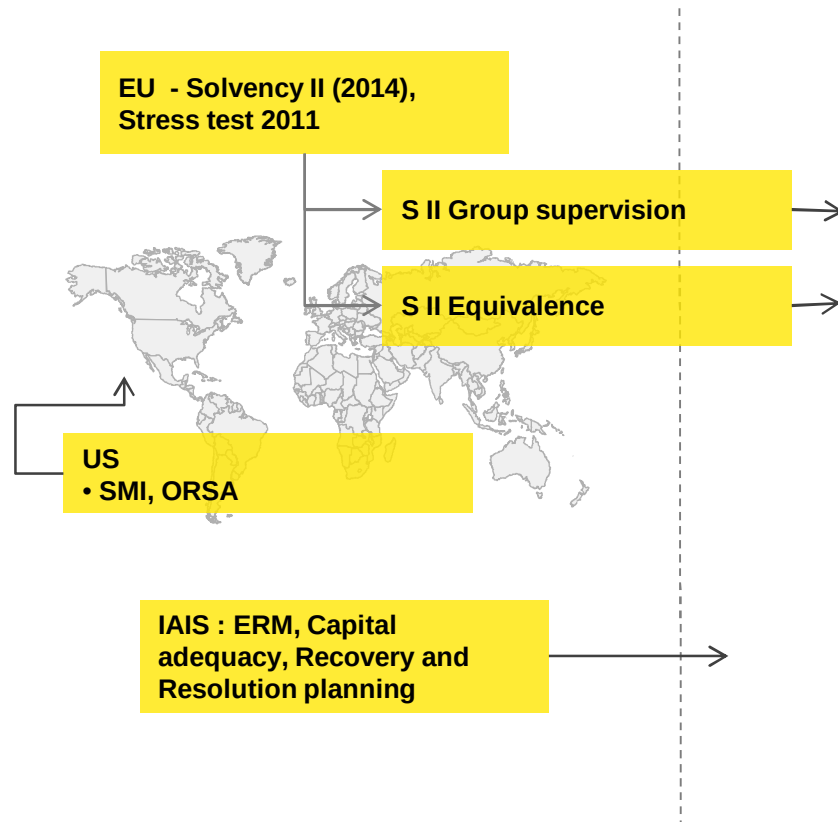
Implications of changing regulations



Global regulatory and Capital reforms

This global regulatory trend extends to Asia Pacific with a “second wave” of risk and capital regulations in markets across the region

Global regulatory changes



Asia Pacific regulatory changes

In some cases it's a direct regulatory or compliance requirement

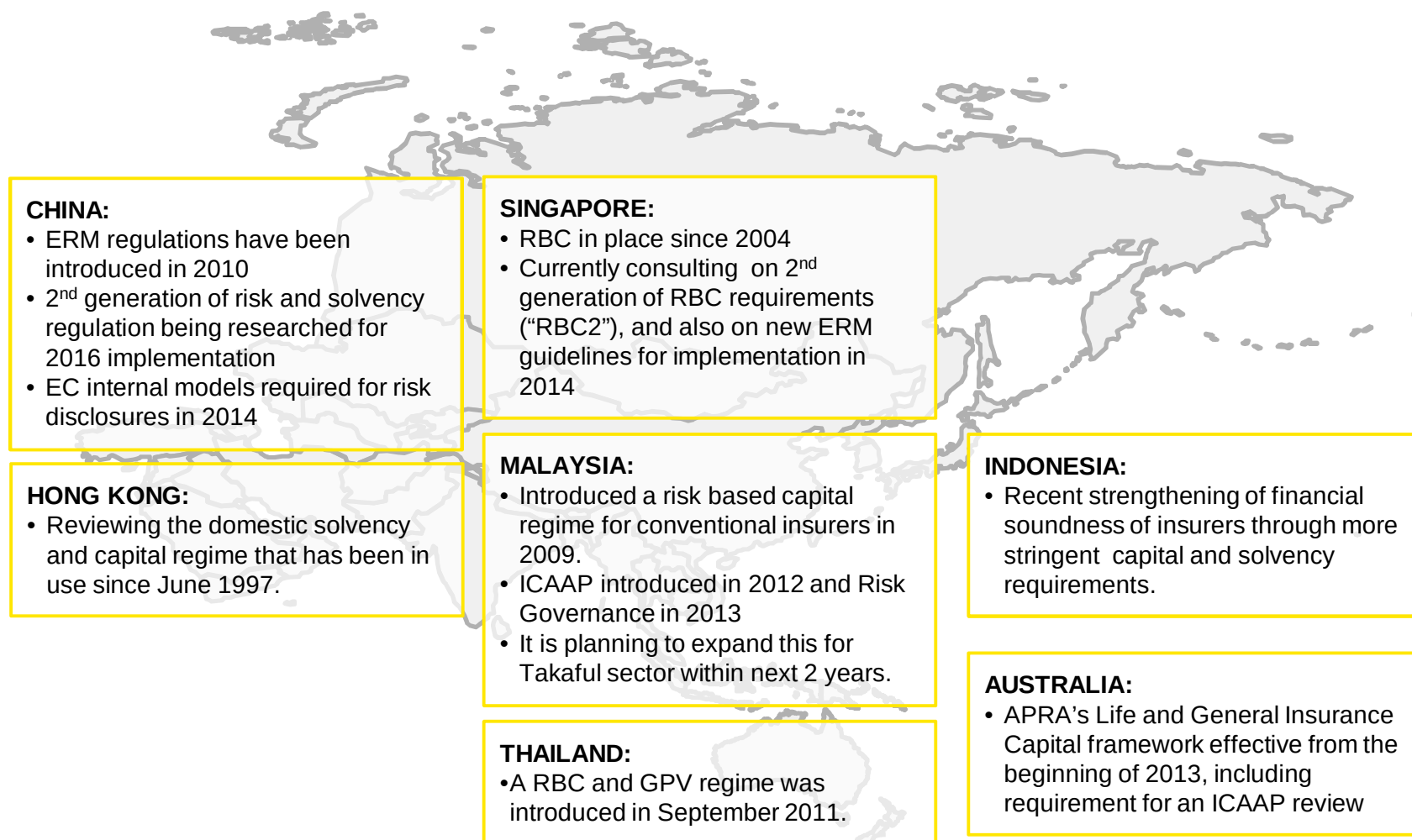
- New regime for supervision of insurance groups (Solvency II and IAIS ComFrame)
- Equivalence discussions (formal and transitional)
- Basel II and III global standards (banking)

... but perhaps more importantly, is the influence on local regulations & practices

- Asian subsidiaries/branches of MNC companies to conform to group standards,
- Inspiring similar supervisory and management ambition for local insurers
- General international alignment (IAIS principles) towards risk-based supervision

Regulatory developments in Asia

Change is happening in almost all markets, albeit with varying pace and scope



Implications for capital management

Risk modelling

- ▶ Economic capital modelling (Risk calibration and aggregation)
- ▶ Comprehensive Stress and Scenario Testing

Model governance

- ▶ Strong focus on understanding model reliances and limitations
- ▶ Documentation and regular independent validation of models

Embedding of capital management

- ▶ Development of risk appetite framework and limits
- ▶ Integration of capital management with the business planning

Contingency planning

- ▶ Requirement for reverse stress testing (forward looking, resolvability)
- ▶ Documentation of processes enabling the execution of the plan

Return prospects

- ▶ Required capital increasing – how to meet the return criteria?
- ▶ Search for higher yielding assets

Capital optimisation themes



Themes include both capital and return aspects

Reducing volatility

- ▶ Asset Liability matching, Hedging
- ▶ External reinsurance

Unlocking VIF

- ▶ Internal reinsurance
- ▶ More exotic ideas!

Risk transfer

- ▶ Reinsurance
- ▶ Use of capital markets

Optimal entity structure

- ▶ Entity restructuring
- ▶ Tax and cost optimisation

Return angle

- ▶ Higher yielding assets (e.g. illiquid assets)
- ▶ Product design and pricing

Q&A



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