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Use of the Internal Capital Model (Replacing the Standard Model)

Lessons learned and implications
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Plan for today

1. Insurance Market: Internal model and market context

2. Internal Model Journey: Customer and Insurer perspective

3. Facts and News

4. Example: Capital Allocation and Portfolio Atomization
   - Capital Adequacy
   - Key Perform Metrics
   - Intra-group reinsurance
   - Implementation Challenges

5. Final Remarks and Questions for the Latin America and Caribbean Market

Insurance Market

Challenges: Internal model implementation in context to market conditions

Business environment

1. Pressure to grow profit in a market environment where rates are falling
2. Increase in capital requirements and costs to comply with new regulatory framework
3. Substantial slow economic growth in the region
4. Changes in accounting models (i.e. IFRS) impacting process, controls, people, data and systems

Challenge: to execute strategies that improve operational efficiency and reduce costs to deal with the pressure driven by rates.

Models

1. Centralized team producing the models without a broader view
2. Models uses defined "on paper" but not fully integrated to the insurer
3. Main focus on building and refining technical aspects of the models
4. Board and Senior management questioning return on investment for the internal models

Challenge: Inconsistent views on how risk considerations are embedded within the existing culture.

Sources:Solvency II Pratica; persrpecitve on value – Mike Wikinson – Towers Watson and AIG internal research

Internal Models Journey

Customer and Insurer Perspective

Cost — *Time* — **Value**

Regulatory → Solvency II / RBC Insights → Internal Model → Recognizing the value → Strategic Tool

Regulatory

Regulators taking actions

- Could be seeing as cost only by insurers
- Recommended open discussions among insurers and regulatory bodies

Solvency II / RBC Insights

Guidance

- Insurers start to explore what is available in other markets
- Companies continue to see as a cost

Internal Model

Role of risk and internal model in business as usual

- As the first results start to challenge current paradigms companies start to have a risk based approach discussions
- Cost and effort of the implementation is normally a surprise

Recognizing the value

Start to become an enabler

- Companies realize that there`s another way to look at risks
- Management sees value but are not able to fully archive

Strategic Tool

Value creation

- Internal models and risk framework start to be a main driver for strategic decisions
- Enterprises move business model to reach better risk adjusted profitability

Is there any value added for our customers and shareholders?

Facts and news

Quotes regarding internal model and Solvency II implementation

One model doesn't fit all companies
Business Insurance
November 20th, 2015

Big insurers get key exemption in proposed British audit rules

- "New European Union rules will require British-based insurance firms from January to meet a minimum solvency capital requirement, or SCR."
- "The Bank of England's Prudential Regulation Authority, in a consultation paper released on Friday, said big firms that use their own models for calculating the SCR would be exempt."

Implementation timing and cost
Investorschronicle
October 30th, 2015

Staring down the barrel of Solvency II

- "… assured the industry that the regulator would give companies "plenty of time" to adapt to the new regime, and allow the use of transition measures, which was welcomed strongly by the market."
- "RSA (RSA) booked £25m-worth of implementation costs in FY 2014, and £20m in FY 2013."

Landscape change
intelligentinsurer
October 29th, 2015

Opportunities in challenges: a post Baden-Baden report

- "Solvency II, being one of the drivers for consolidation, has been another key subject of conversation at Baden-Baden, although it is a done deal." "…in 2014, was a theoretical discussion, this year was a very practical one."
- "proactive run-off is about to become best practice."

Sources: www.businessinsurance.com , www.investorschronicle.com, www.intelligentinsurer.com

Example: Capital Allocation and Portfolio Optimization

Capital Adequacy

- Economic capital, regulatory and rating agency capital
- Capital adequacy targets: Risk Appetite and Stress testing
- Capital management toolkit
  - Capital structure
  - Intra-group reinsurance

Capital Efficiency

- Where / How is capital being deployed : legal entities, regions/countries, profit centers?
- What is the profitability on the capital deployed?
- How to increase capital fungibility and reduce frictional costs?

Capital Allocation

- Dividend policy and return capital to shareholders
- Business mix change: allocate capital to accretive lines of business
- Growth opportunities

Capital Adequacy

How Much Capital Do We Have?		How Much Capital Do We Need?
"Available Capital"	>	"Required Capital"
Determining Factors: • Today's balance sheet: • Available Capital = Assets - Liabilities • Accounting regime / basis		Determining Factors: • Exposures, risks, and financial strength targets • The capital model used

Regulators and Rating Agencies	• Statutory Surplus • Total Adjusted Capital	▪ Focus on financial safety of policyholders and debt holders ▪ Generally, the more capital the better	• Regulatory Risk-Based Capital (RBC) model • Rating Agency Ratings target
Investors	• GAAP Shareholders' Equity	▪ Focus on return on equity ▪ Minimal capital: dividend and share buyback	• Sufficient to avoid financial distress
Management	• All of above + Economic Balance Sheet	▪ Ultimate goal is shareholders value creation and enhancement ▪ Need to work within constraints	• All of the above + Economic Capital Model (ECM)

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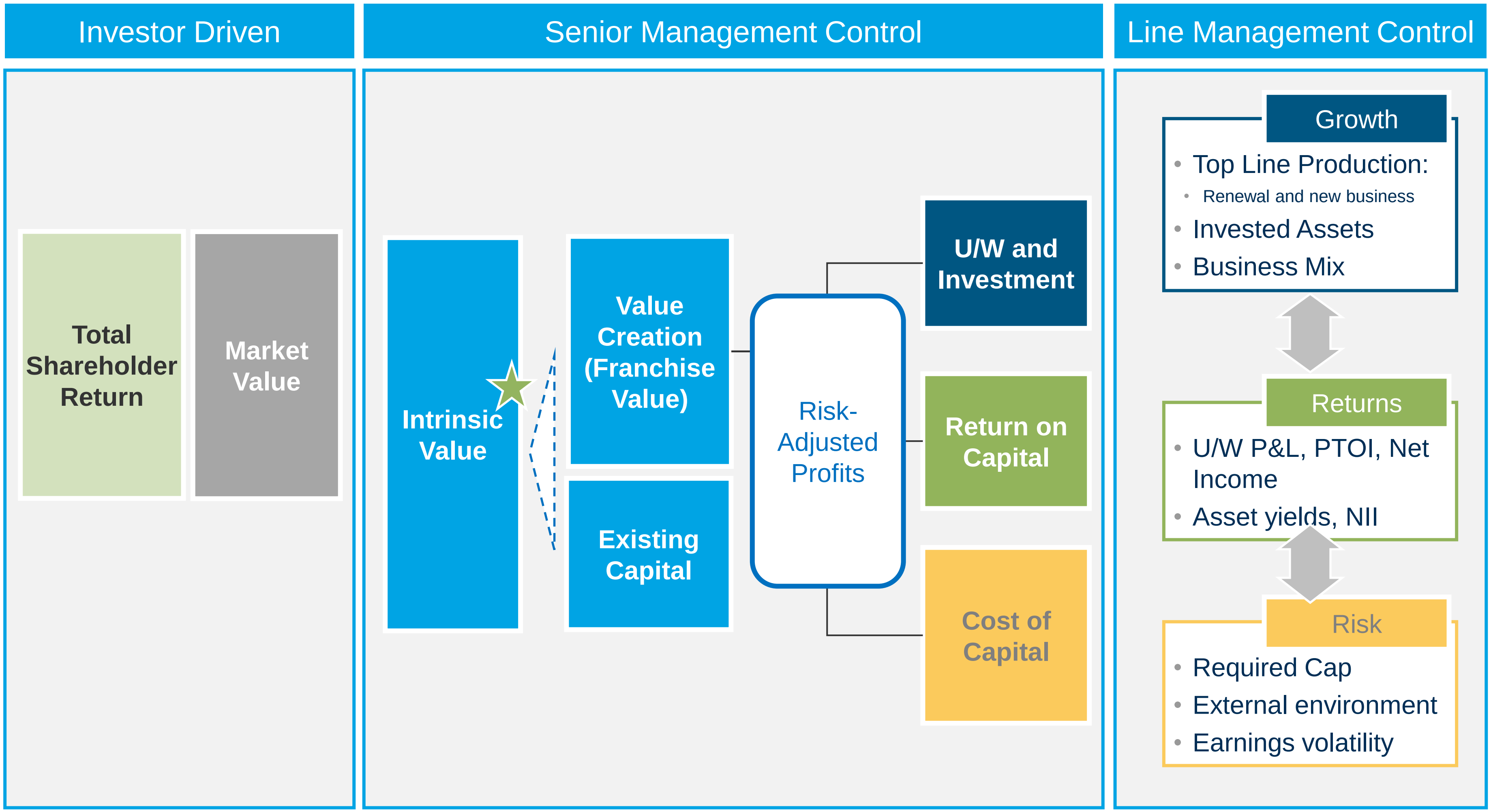
Key Performance Metrics



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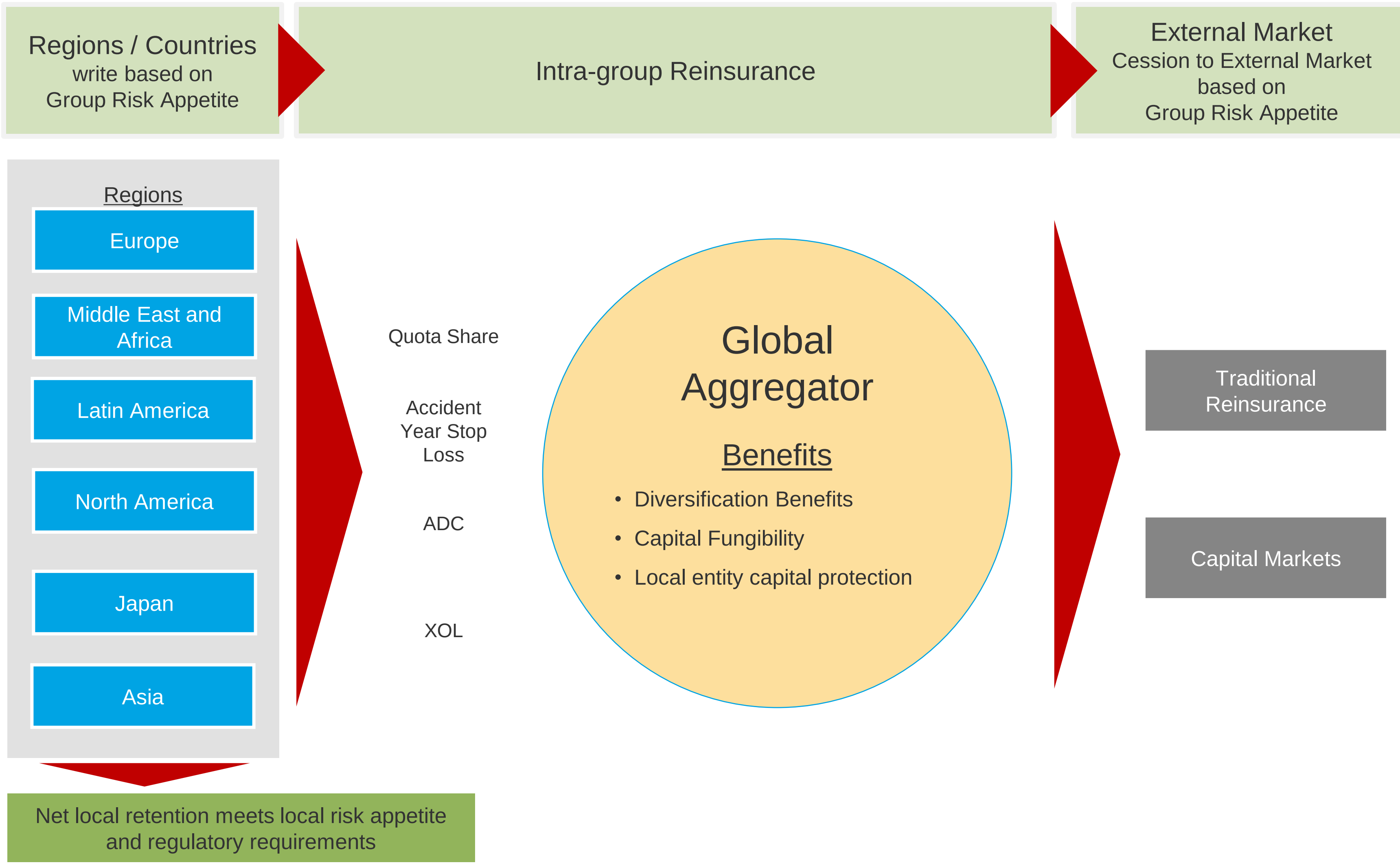
Intra-Group Reinsurance

Key tool to gaining capital efficiency



Implementation Challenges

Alignment of underwriting standards, portfolio optimization, and risk management achieves effective integration of group and local entities. Successful implementation is attainable, yet challenging.

Key Areas:	Buy-in	Methods and Metrics	Group vs. Local	Planning and Timetables
Keys to Success:	• Senior leadership’s support and business units’ / local entities’ commitment • Defining clear purpose. objectives and reasonable timelines • Ensuring sufficient dedicated resources to a clear mandate relative to BAU • Educating key stakeholders	• Defining key performance metrics for the measure of success • Resolving key technical issues early on • Clarifying reporting requirements • Allocation of central resources	• Balancing local execution with global strategy • Keeping local BOD and regulators well informed • Ensuring consistency s across the organization while reflecting unique nature of each local entity • Optimizing local versus central resources	• Ensuring sufficient and high-quality planning • Using existing and well proven templates and approaches • Leveraging internal and external resources • Strong project management and rigorous governance

Final Remarks and Questions