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(GREECE)

HELLENIC ASSOCIATION OF INSURANCE COMPANIES

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CAPITAL OPTIMIZATION STRATEGIES: THE ROLE OF REINSURANCE

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AGENDA

1

Challenges in SII era : An Overview of the Greek Market

2

Capital Optimization Strategies

3

Optimizing Reinsurance Structure

4

Reinsurance as a source of Capital

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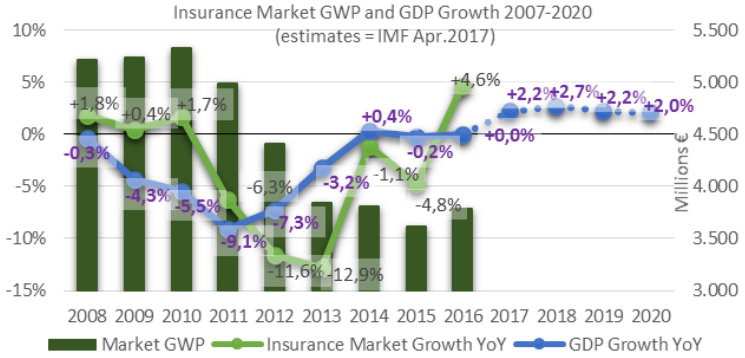
01 THE GREEK MARKET

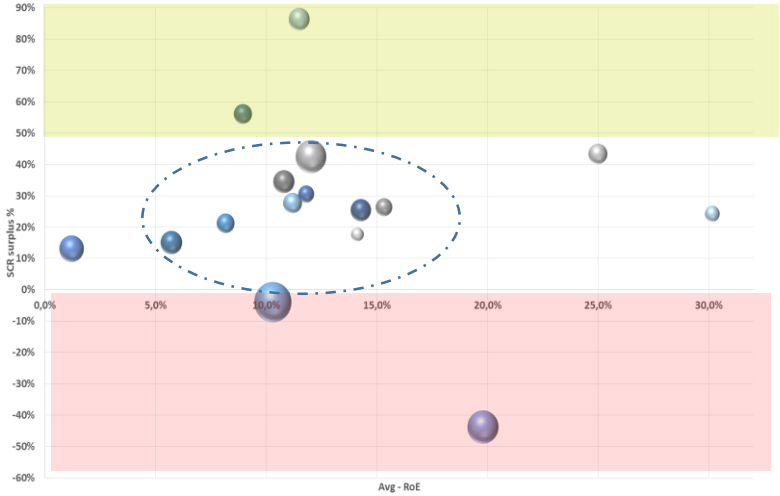
Growth

- Strong impact of the crisis especially in the P&C insurance : 2010 to 2016 GDP (-22,8 %) , Life & Health -14,8% , P&C -39,5% % , total Market -27,7%
- Fierce competition in prices [motor , fire risks]
- Increasing demand (& utilization) in health
- Growth expectations ?



Profitability

- Quite diverse profitability levels
- P&C technical results support profitability
- Low interest rate environment strongly affects life insurers
- Increasing competition results in inflationary pressures in acquisition costs



Solvency

- Resilience to SII implementation challenge : Average SII coverage 163% with TM & LTG. Without the use of LTG and/or TM, the average solvency ratio drops to 120%.*
- Life insurers benefit from LTG implementation.
- Further improvement of Solvency Ratios is a key issue on insurers agenda

* Source : EY Flash Report SFCR 2016

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02 HOW TO MEASURE FINANCIAL PERFORMANCE OF AN INSURANCE COMPANY?

- Level of sophistication varies

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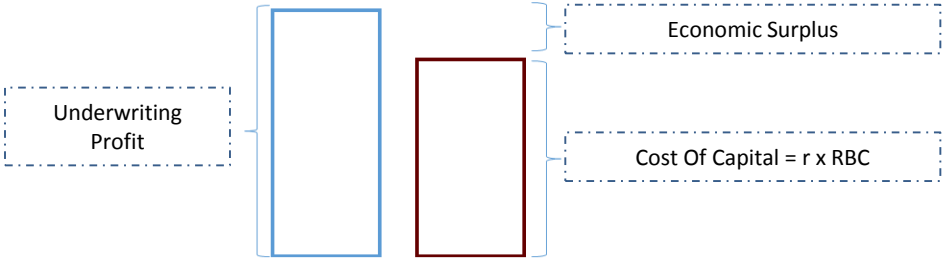
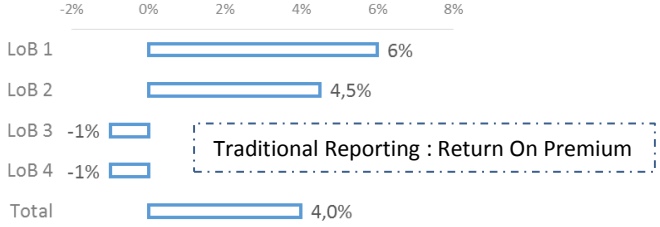
02 RETURN ON RISK BASED CAPITAL

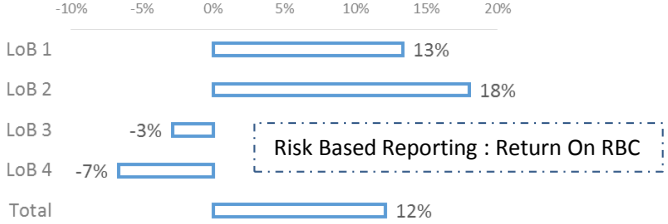
Capital is a key resource for insurers. Return on Risk Based Capital changes the way we evaluate our business.



r = Return expected by the Shareholders / interest expected by the bond holders

Return on RBC Vs Return on Premiums - Changing the Picture





Line Of Business	LoB 1	LoB 2	LoB 3	LoB 4	Total
Premium	100	100	25	25	250
RBC	45	25	8,75	3,75	82,5

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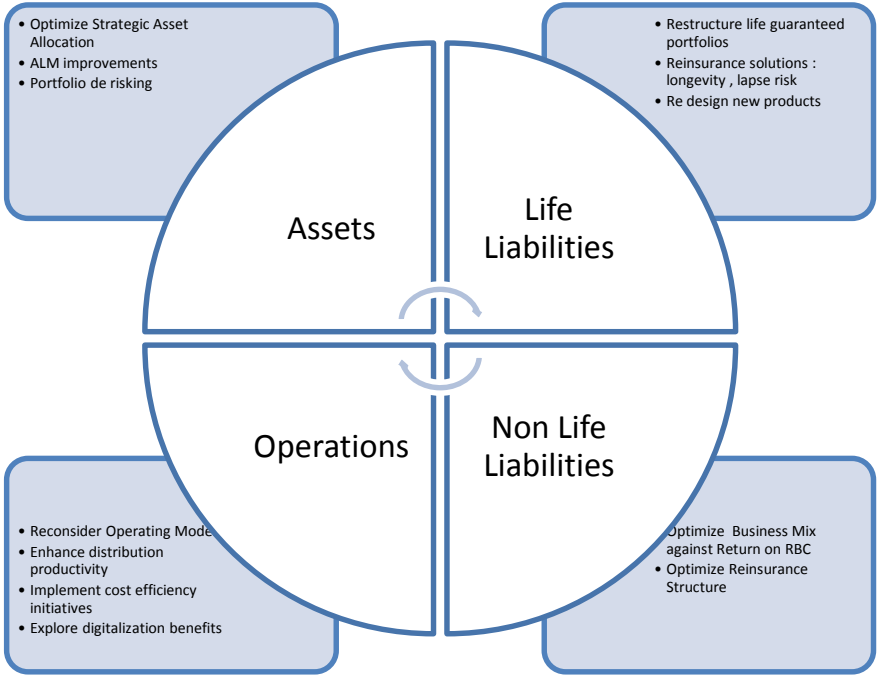
02 CAPITAL OPTIMIZATION STRATEGIES

Capital Optimization projects aim to

maximize the return on risk based capital

while maintaining (or achieving) the target capital surplus.



Optimization of reinsurance strategy becomes increasingly important for insurers

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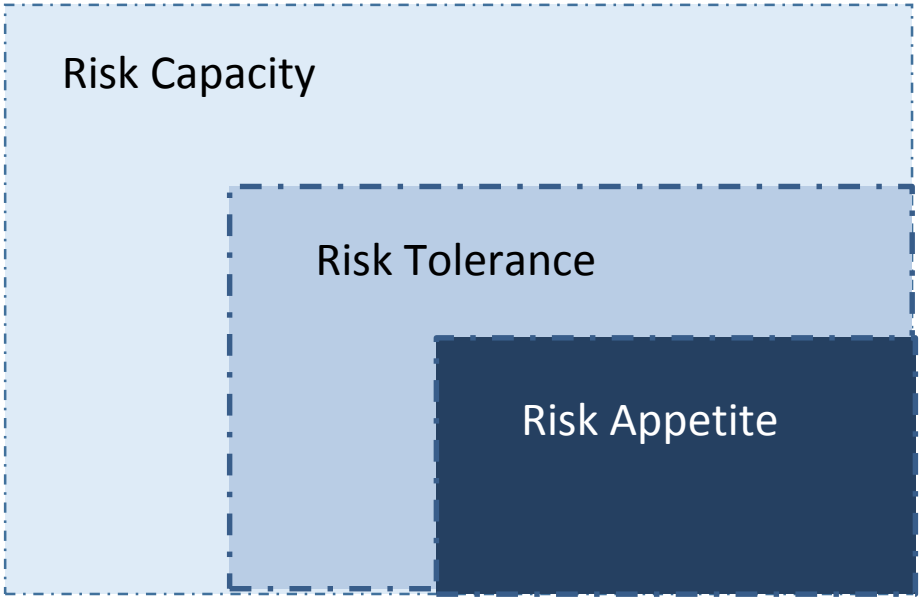
03 REINSURANCE STRATEGY IN THE SII CONTEXT

- Regulation requires insurers to articulate a Reinsurance Strategy in alignment with their Risk Appetite
- Key aspect of the insurer's business planning and ORSA
- Increased transparency around Reinsurance Policy [AF report]
- Increased engagement of the Board and C – suite

Risk Appetite targets should be aligned with shareholder expectations



03 REINSURANCE STRATEGY: INSURER'S OBJECTIVES

Underwriters – Actuaries – Reinsurance

CEO - CFO

Catastrophe Protection	Underwriting Capacity	Reinsurer's Knowhow and services	Impact on Capital	Impact on Profitability
▪ Protect retention from loss accumulation	▪ limit our loss exposure to a single risk ▪ ensure adequate cumulative capacity level	• Product development • Underwriting support • Claims management etc	▪ Improve solvency ratio ▪ Optimize capital allocation ▪ Capital for Growth.	▪ Reduce Reinsurance Cost ▪ Maximize Return On Capital ▪ Reduce earnings uncertainty.

Growth → Maturity → Restructuring

An efficient reinsurance purchase needs to meet the insurer's priorities in an optimal way. Business priorities vary according to the stage of development.

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03 OPTIMIZING REINSURANCE STRUCTURE

Risk Analysis

- Loss modelling is a prerequisite for any optimization exercise.
- To be considered in the framework of the Company's risk appetite definition

Modelling requirements :Comprehensive risk analysis requires stochastic modelling and articulated projections models

Define Key Metrics

Different Key metrics can be used to reflect the insurer objectives and risk appetite e.g. : Expected Net Result , Std Of Net Result, Var1%, PML, Expected RI Cost , Capital Coverage etc.

Data availability : loss modelling credibility could be a challenge for some portfolios

Decision Framework

Optimization targets are set according to business priorities and constraints e.g. reduce reinsurance cost, improve capital coverage, reduce earnings volatility, maximize return on capital , decrease MPL.

Process complexity: assessment of impact on regulatory capital requires further sophistication.

Review current program

- Assessment of current RI program against , business requirements and optimization objectives.
- Definition of alternative RI structures.

Balance of various management objectives could be a complicated exercise. Extensive scenario testing is required.

Scorecard

- Comparison of the different RI structures according to the optimization key metrics and constraints.
- Conclude on a short list of RI structures and request pricing.

Reinsurance pricing is not available at the pre selection step as a result short listing of RI structures could be a challenge.

Conclusion

- RI short list final evaluation based on reinsurers quotations
- Decision

Qualitative aspects, like ancillary services provided should be captured in the final decisions.

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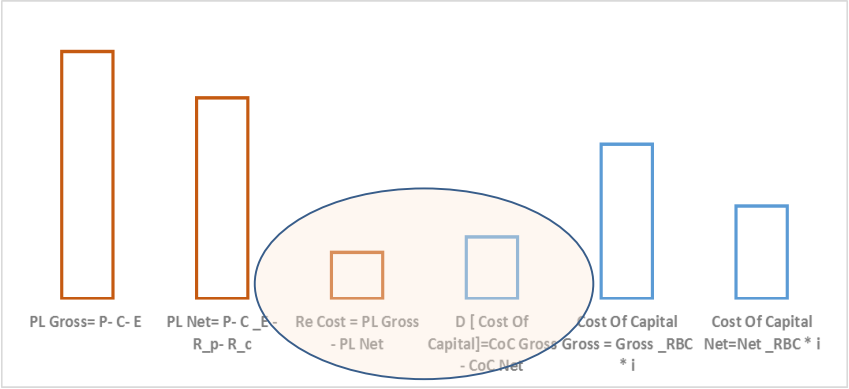
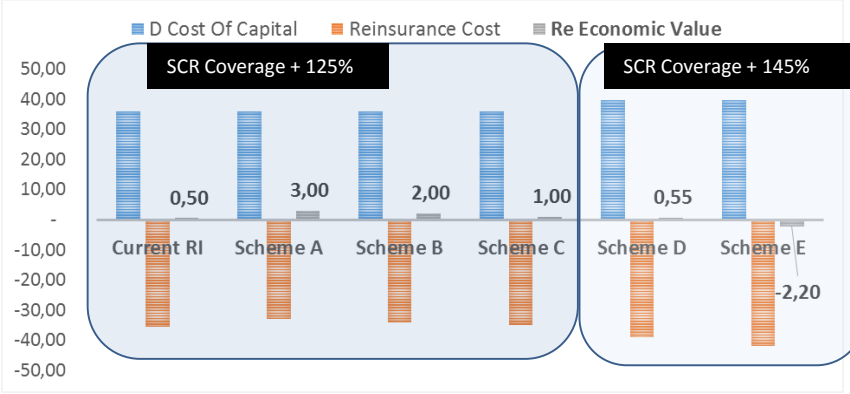
OPTIMIZING REINSURANCE STRUCTURE :THE EFFICIENCY CONCEPT

An RI structure needs to meet a range of criteria in order to be consistent with the insurers objectives . Assuming that this the case and an RI structures meets a range of management objectives it needs to be efficient on an economic basis, i.e. the economic value of the reinsurance scheme is positive .



Economic Value of Reinsurance= [Savings in Cost Of Capital]- [Expected Cost of Reinsurance]



For different set of objectives the optimal scheme is the one that maximizes the economic value of the portfolio

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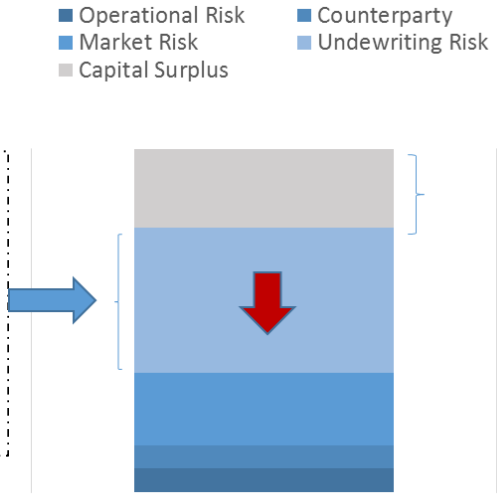
04 REINSURANCE AS A SOURCE OF CAPITAL

Reinsurance could be used as an alternative source of capital, to improve solvency ratios, as a mean to release capital trapped in run off portfolios, it could be used as a tool to improve the ability to pay dividends to shareholders. Different solutions could be considered:

- Review standard covers - Quota share , excess of loss , stop loss
- Retroactive covers - Loss Portfolio Transfer , Adverse Development Covers
- Structured Solutions



Benefits

- Flexibility : [scope, risk transfer, duration]
- Short to medium term
- Relatively quick and easy to execute
- Risk transfer : e.g reduction of earnings volatility
- Optimization tool for RBC allocation per LoB

Challenges

- Customization to Insurer's needs
- Risk evaluation : not always easy to share the same view with the re insurer
- Insurer's Cost Of Capital vs Cost Of Reinsurance
- Impact on Regulatory Capital: for insurer's that use the standard formula certain covers might not be properly reflected.

The prerequisite : Reinsurer can provide access to capital with a cost below the Insurer's capital costs.

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04 REINSURANCE AS A SOURCE OF CAPITAL

Illustrative Examples

Case A : the issue

Mixed insurer with an important run off portfolio of guaranteed pensions business with interest rate guarantees. The key capital consumption is related to longevity risk and lapse risk.

- The insurer has an overall capital coverage of 150% which is in line with the share holders risk appetite.
- The insurer aims to free capital from the run off portfolio in order to use it for growth purposes in other profitable areas.
- Insurer's cost of capital amounts to 14%.

Case A : Considerations

The insurer is interested for an LPT solution still the following issues need to be resolved:

Risk evaluation: Liabilities evaluation is quite sensitive to policy holder behavior (lapse risk, annuity take up option) , where experience is quite volatile.

Reinsurance Cost: Inherent risk of the portfolio increases the cost of the transaction

Case B : the issue

Non Life insurer underwrites mainly motor and Property & Casualty commercial and industrial risk. Although the insurer's underwriting performance reaches on average 18% on regulatory capital, the insurer's capital coverage is limited to 105%.

De risking on asset portfolio is considered that is expected to achieve an improvement in terms of solvency ratio to 115%.

The insurer aims to improve further capital coverage to 140%.

Insurer's cost of capital amounts to 16%.

Case B : Considerations

The insurer is at Growth phase and premium risk is a key concern in terms of capital consumption.

A quota share solution would be highly effective in terms of capital relief still it is important to limit the ceded technical result.

A cost effective solution is of high priority as following assets de risking technical results is the key source of profitability.

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