

XII

CONGRESSO NAZIONALE degli ATTUARI

Upgrading capital management to optimize s/h value and strategic risks


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Key facts and questions for this session

Facts

 New tools available to actuaries, however in a much more complex / disrupting world

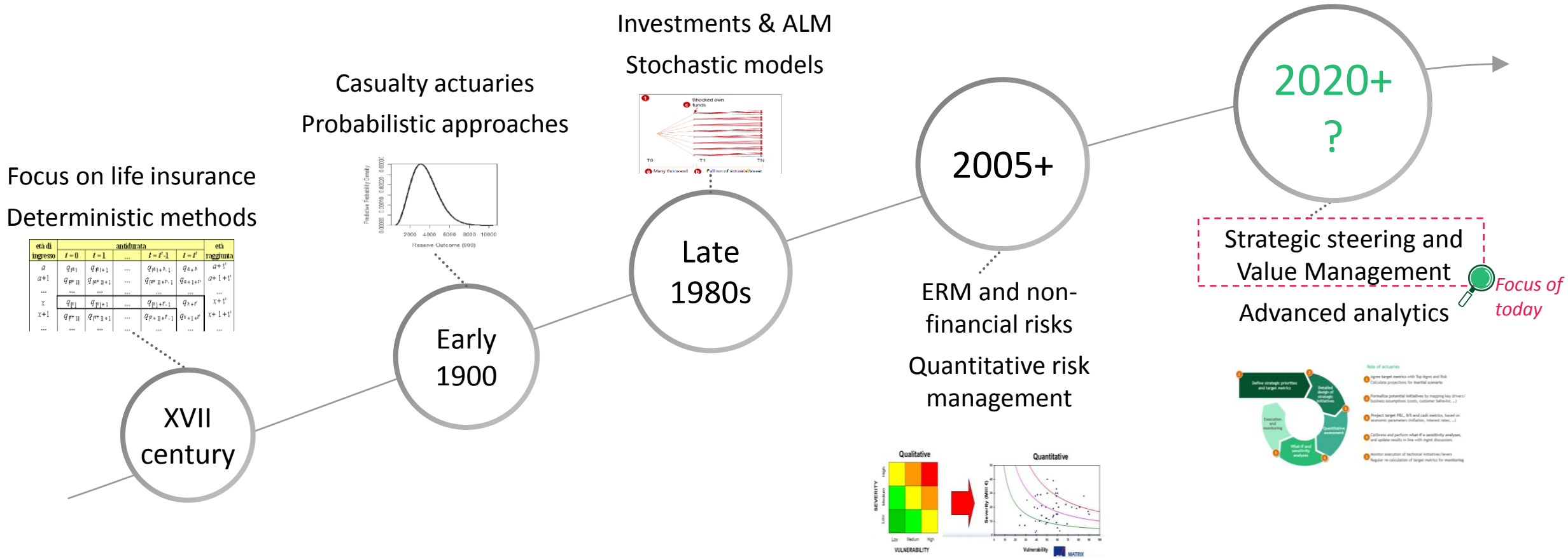
 Companies are taking their bets to win the market, with some clear winners & losers

 Having a clear strategy aimed at optimizing ROE and RoRC is key to maximize s/h value

Questions for the next 20 minutes

- 1 Why do actuaries of the V kind focus on strategic risks?
- 2 What is S/H value and what are its drivers?
- 3 How to optimize capital allocation and productivity across a Group?

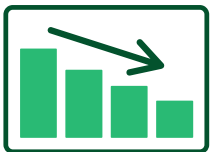
Strategic risk as a new ERM focus area for actuaries of the V kind



Source: Buhlmann (1987); Embrechts (2005)



Context: Tough days for traditional insurers



Pressure on margins due to challenging market conditions (e.g., low-for-long interest rates)



Evolution towards risk-based steering of B/S and P&L fostered by Solvency II and IFRS 17



Disruption from advanced analytics and machine learning with new opportunities but also strategic risks



4 sources for disruption

InsurTech start-up

New technology enables better customer experience



Global technology giants

Individual behavioural data, yielding a competitive advantage



Traditional non-insurers

Ownership of assets or asset sharing platforms



Incumbent insurers

Customer base, with potential to extend the core



Examples



Source: BCG analysis



So all players are taking their bets



Bet 1	Digital customer experience	JVs, M&A and Non-motor
Bet 2	Value-based healthcare	Innovation and data management
Bet 3	Growth in corporate & Asia	Technical excellence (pricing, claims, ...)







Source: Investors' presentations



Strategic risk as failure to adapt to an ever changing environment

Selected examples

	Taking the wrong bet	Missing opportunities	Failing to timely adapt	Failing in the execution
 Product Design	Blockchain-based products ?	Pay-as-you-consume products ?	Keep selling high financial guarantees	Design risk-adjusted metrics w/o embedding in BaU ¹
 ALM	Overexpose to illiquid assets ?	Alternative funds ?	Fail to close duration gap ?	
 Capital management	Lock capital in unprofitable BU	Centralize subsidiaries' capital ?	Keep capital in shrinking mkt ?	Postponing digitalization projects
 Business Model	Peer-to-peer insurance?	Digital agency ?	Partnerships with retailers ?	

Focus of next slides

- Loss of competitiveness
- Invest in unattractive markets
- Drop in market capitalization
- Low profitability vs invested capital
- Loss of top management credibility
- ...

1. Business as Usual; Source: BCG analysis





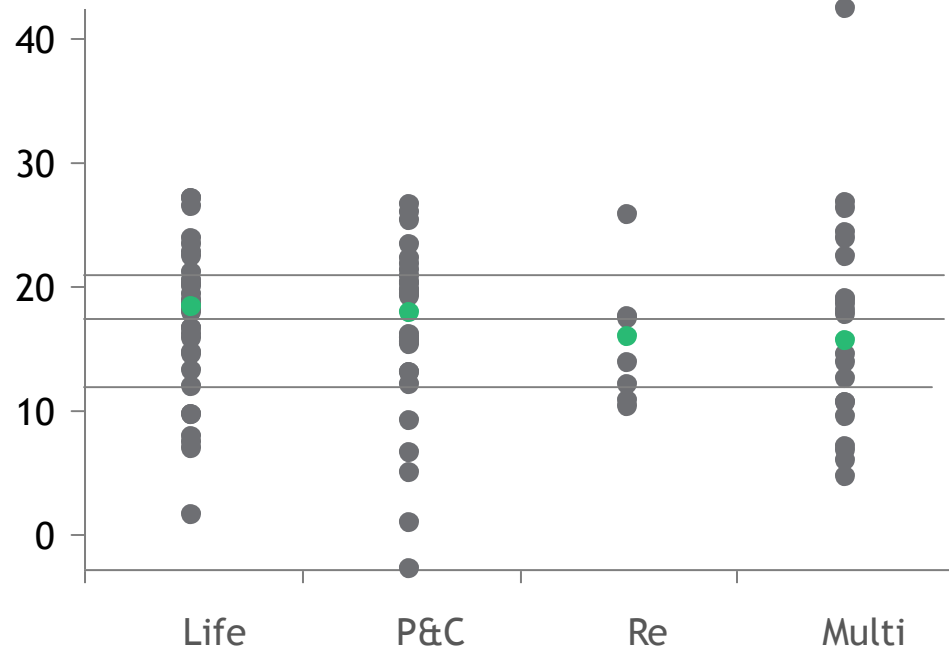
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*Per dare effettivamente
senso a una nozione (e
non una pervenza di senso
metafisico-verbalista),
occorre una definizione
operativa, cioè basata su
un criterio che permette di
misurarla.*

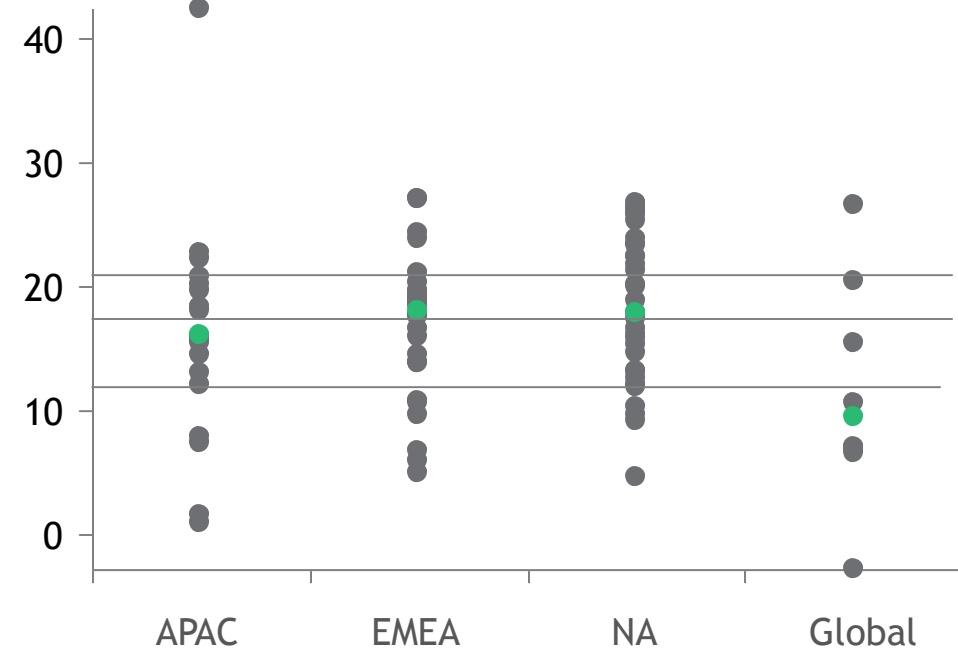
B. De Finetti

All segments & geographies have winners & losers – no excuses!

5 year Total Shareholder Result (TSR)



5 year Total Shareholder Result (TSR)



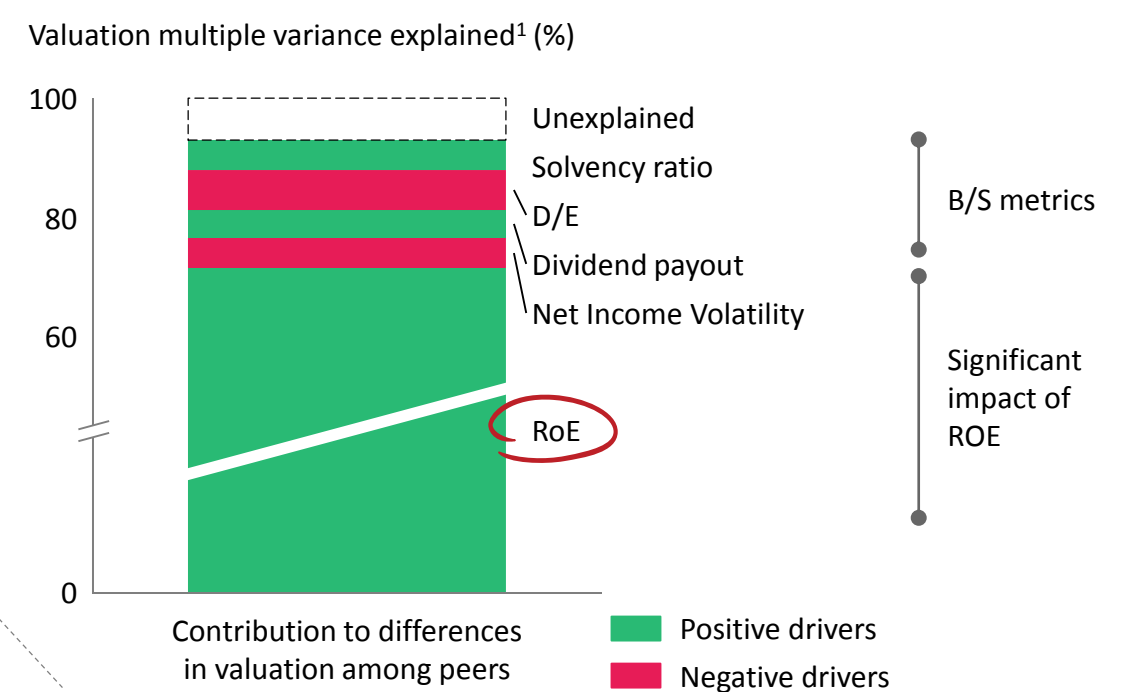
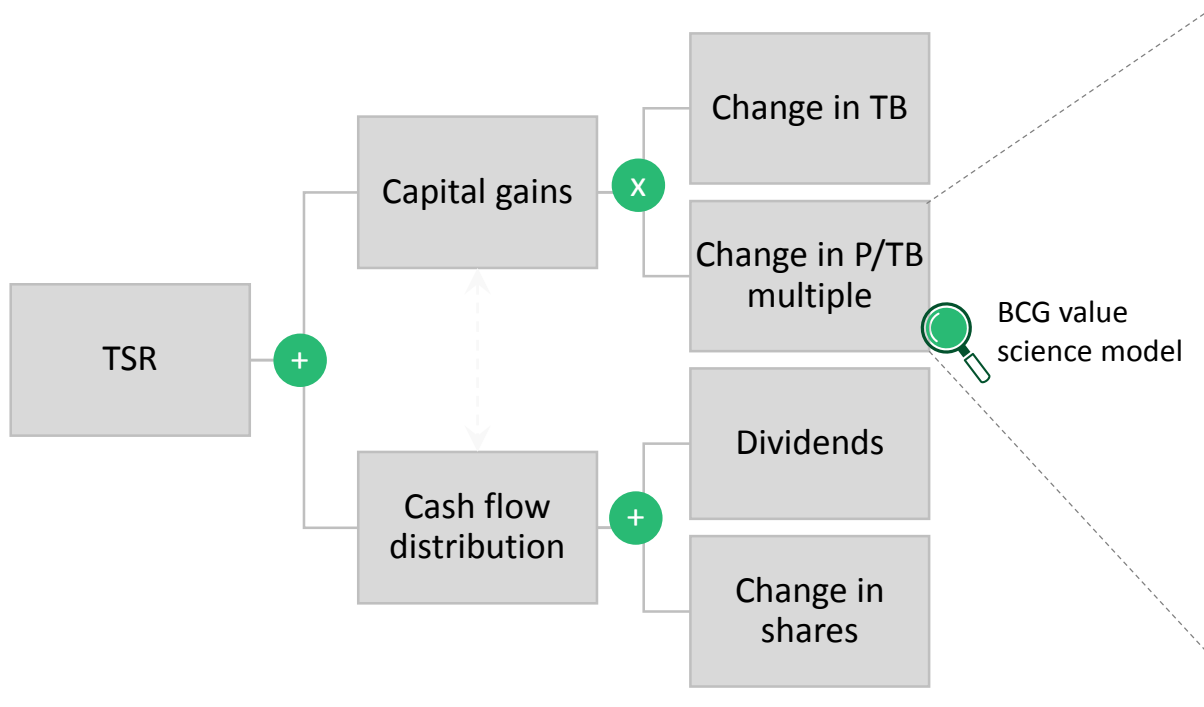
Source: BCG, "A new boldness pays off" (2018)



Drill down into the drivers of Total Shareholder Return

Objective is to maximize value created for s/h

TSR primarily depends on dividends and on the P/TB multiple, which are functions of RoE



1. Estimated on a sample of 30 large Global insurers Source: BCG Value Science



How to cascade targets from Group to company / BU level?

Group target

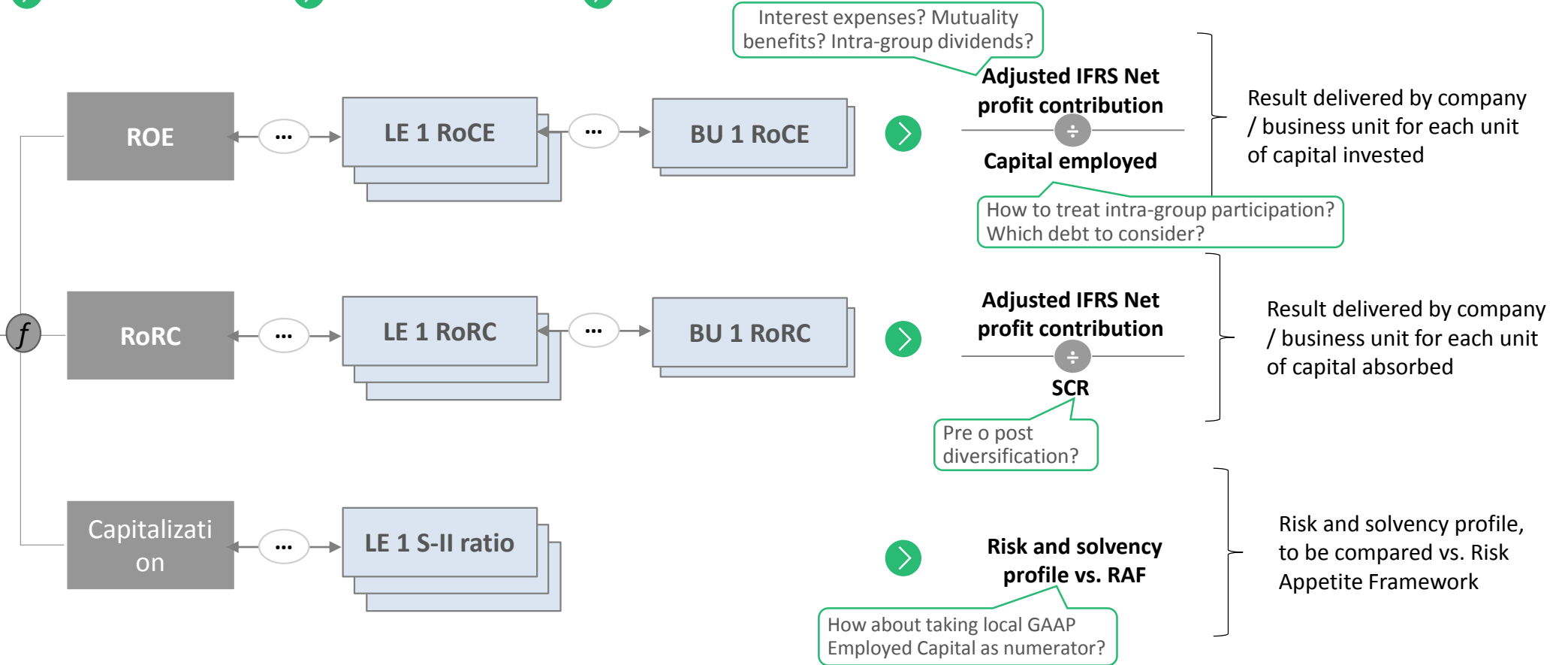
Level 1 Group

Level 2 Company

Level 3 Business Unit

Definition & interpretation

Maximize profit according to Risk Appetite Framework

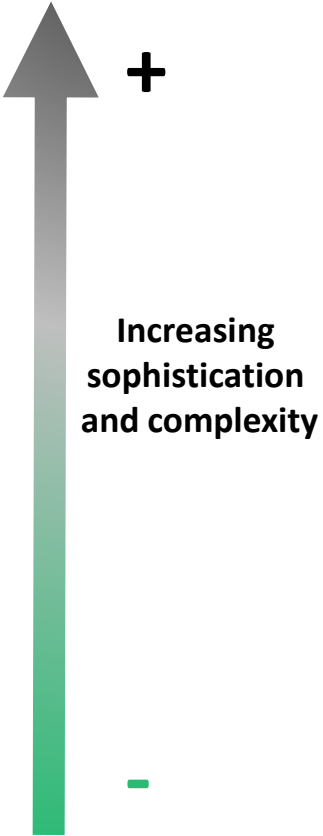


An exercise with more technical challenges than it may look like

- ? Allocation of capital employed to BU / LoB / product level
- ? Definition of RoCE hurdle rates, considering cost of equity and cost of debt
- ? Definition of RoRC hurdle rates
- ? Connection of SII capitalization with actual B/S capitalization to ensure effective use of cash



- Option 1** Different hurdle RoRC at Local Entity level based on specific risk intensity
- Option 2** Different hurdle RoRC at Local Entity level based on local capital structure
- Option 3** Different Group hurdle RoRC for Life and Non-Life businesses
- Option 4** Same hurdle RoRC across the Group

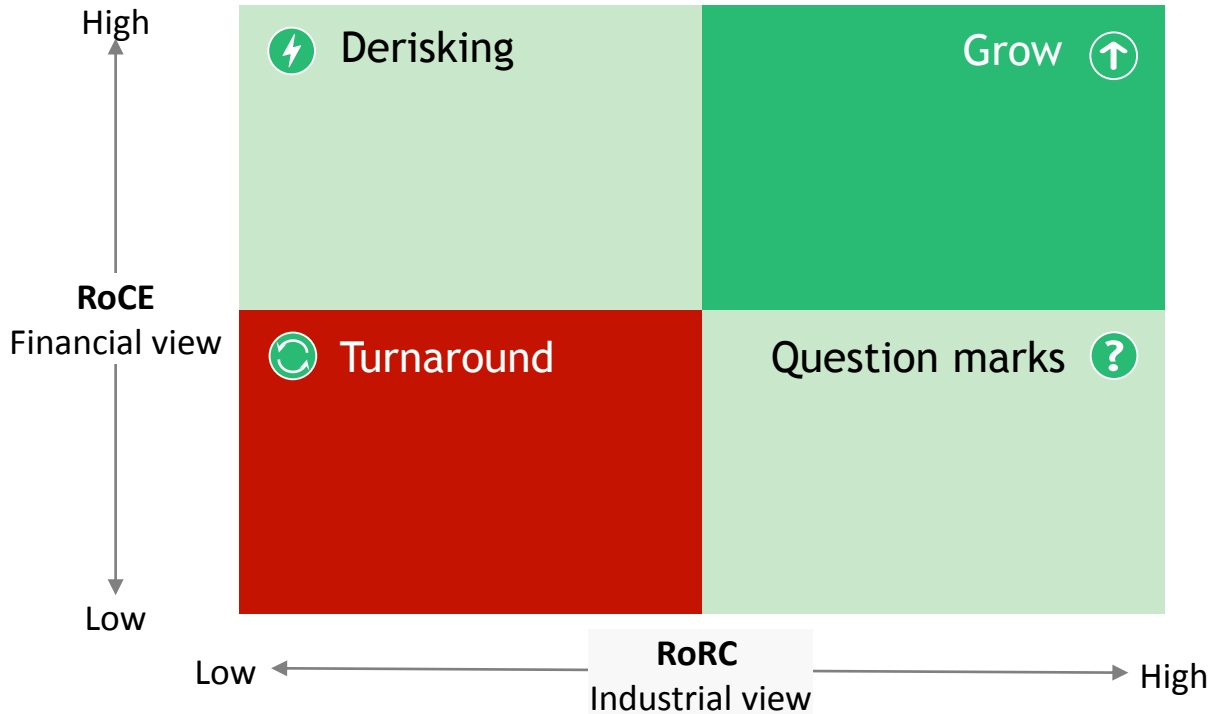


Source: BCG project experience



"Pragmatic" solution to identify capital optimization levers ...

Mapping of BUs by capital productivity



Set of industrial & financial levers based on the capital productivity position

- ⬆ **Grow**
 - Relax constraints to boost growth
 - Take additional risk to improve Group NR
- ⚡ **Derisking**
 - Revise mix to decrease risk/increase div.
 - Consider risk transfer, e.g. VIF monetization
- ? **Question marks**
 - Reallocate capital, e.g. reducing int. debt
 - Take more risk if appropriately remunerated
- 🔄 **Turnaround**
 - IF mgmt program to increase profitability
 - Consider run-off / disposal of selected ptfs

Source: BCG analysis and project experience



... to be tested in order to define & monitor the winning strategy



Potential role of actuaries

- 1** Agree target metrics & approach with Top Mgmt and Risk
Calculate projections for inertial scenario
- 2** Formalize potential initiatives by mapping key drivers /
business assumptions (costs, p/h behavior, asset allocation, ...)
- 3** Project target P&L, B/S and cash, based on business &
economic parameters (inflation, interest rates, ...)
- 4** Calibrate and perform what-if and sensitivity analyses, and
update results in line with mgmt discussions
- 5** Monitor execution of technical initiatives / levers
Regular re-calculation of target metrics for monitoring

Source: BCG analysis



Three final messages



Bold moves are needed to adapt to changing contexts, carefully managing strategic risks



Shareholder value is not magic. It's science.



Actuaries still have a 'competitive advantage' to play a key role to identify winning strategic choices – let's not waste it!

Time for Q&A



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