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FROM CAPITAL MANAGEMENT TO CAPITAL OPTIMIZATION

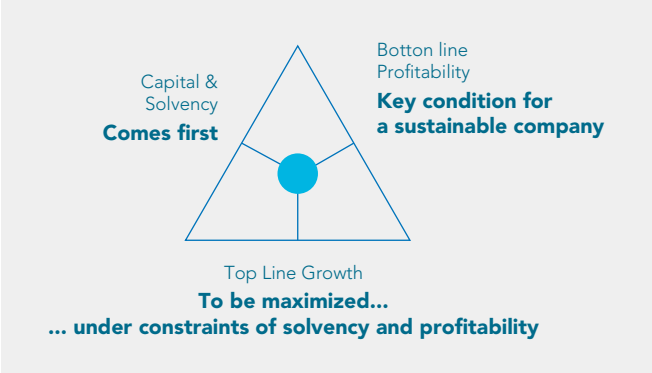
INTRODUCTION

As top line growth is harder to achieve for insurers, and bottom line profitability is under pressure from the challenging macro (economic, political, regulatory and financial) environment, capital management has for several years now been subject to particular scrutiny to improve returns and, more generally speaking, protection for policyholders and value proposition (risk / return profile) to shareholders.

To date, capital management solutions have focused on one-dimensional actions, aimed mostly at calibrating capital at the right level in a rather static way. But as insurers are progressively becoming more sophisticated in relation to capital management, economic-based regulations (such as Solvency II) are acting as further catalysts, and the focus is moving towards risk-based capital frameworks. Within risk-based frameworks, reinsurance solutions (whether traditional or structured) are positioned as efficient capital optimization tools, acting on both the capital available and the capital required.

MANAGING COMPETING CONSTRAINTS

Before engaging in the specifics of capital management and optimization, let's first investigate the various parts of the equation that (re)insurance company management teams have to solve. These can simplistically be represented through the triangle below, with the optimal point being the barycentre:



THIS IS THE PERFECT CASE TO ILLUSTRATE THE CONCEPT OF MAXIMIZATION UNDER CONSTRAINTS: CAPITAL & SOLVENCY COME FIRST WHEN MANAGING AN INSURANCE COMPANY. GROWTH ONLY COMES NEXT.

Profitability would come second, as a means to feed capital, and address capital providers' required returns at an acceptable level of volatility. Finally, growth is the component to be maximized, under capital and profitability constraints. These three parameters (Solvency, Profitability, Growth) interact dynamically, and have to be articulated in a way that sets concrete objectives and methods of getting as close as possible to the barycentre of the triangle.

In this paper, we will focus on the various options available to manage and most importantly to optimize capital in a way that makes the other two variables (profitability and growth) fit into the overall management equation, and in a way that is fully part of an organization's governance and culture.

STRUCTURING A THOROUGH CAPITAL MANAGEMENT FRAMEWORK

SETTING THE CONCRETE OBJECTIVES OF CAPITAL AND SOLVENCY MANAGEMENT

Managing capital and solvency includes meeting a number of objectives that can be directly applied in the day-to-day running of an organization. These objectives can be summarized in the following manner:

Objectives	1 Manage adequate Solvency	2 Maximize financial flexibility and earnings capacity	3 Seek capital fungibility[1]	4 Ensure consistent and attractive shareholder remuneration
Constraints	◆ Solvency II ◆ Rating Agencies ◆ ComFrame ◆ Any other local regime ◆ Tax authorities	◆ Accounting principles ◆ Debt limit / conditions ◆ Bond markets	◆ Legal Entity Structure ◆ Business Development needs ◆ Unexpected Large Payment (e.g. Nat Cat)	◆ Remunerate capital (Risk Appetite / Tolerance) with the adequate returns ◆ Valuation of the company (Price to Book)
KPIs	• Consistent Risk Limit • Solvency Ratio: absolute level, and volatility • Rating model outputs	• Recurrent Net Income • Economic Earnings[2] • Debt leverage • Cash flow recurrence	• Liquidity • Diversification benefits	• Value creation = [RoE - Cost of Capital] • Sustainable dividend

Source: SCOR

These four components interact with each other and should be looked at in a dynamic way. But they can also be described individually, as follows:

1. First things first: capital & solvency. Capital has different meanings, depending on whom you speak to.

◆ For a shareholder, and policyholders for mutual companies, capital is a source of risk and profit. To the question of how much capital an insurer should hold, a shareholder would answer "not too much": the more capital you hold, the more difficult it is to get it to be attractively (competitively) remunerated – over-capitalization leads to a dilution in returns. Put simply, a shareholder would prefer the lowest amount of sustainable capitalization.

◆ Regulators, on the other hand, like capital to be as high as possible, to protect policyholders: a mix of global / supra-national and local / national regulations with a growing unbalance in favor of local requirements and constraints (like on internal reinsurances & retrocessions) leading to unproductive fragmentation & dispersion of capital.

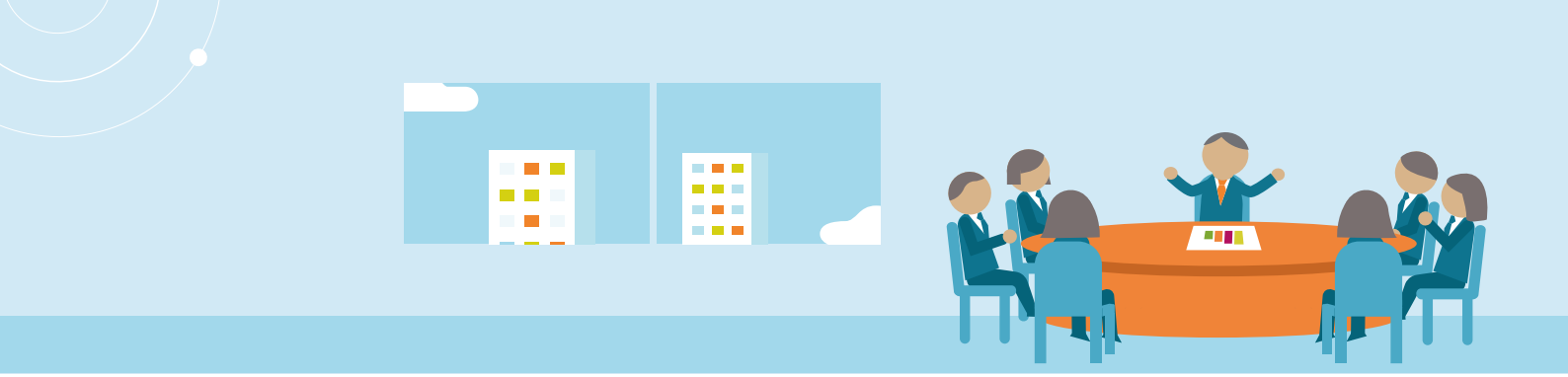
◆ Rating agencies want capital to be towards the top end of capital requirements, whether for insurers or reinsurers. They also look at overall profitability, but as a means of sustaining and growing the existing capital base attentive to the quality of the capital (leverage, hard vs soft…).

The various approaches are summarized in the table below:

	Shareholders	Regulators	Rating agencies
Role of capital	Source of risks and profits Investment to be remunerated	Cushion to absorb shocks in order to protect policyholders	Cushion to pay policyholders and then bondholders
Optimum level of capital	Not too high (otherwise, profitability drags)	As high as possible	Comfortably in excess of ratings thresholds

2. The second point is to ensure that **financial flexibility and earnings generation capacity** are maximized when managing capital and solvency. Flexibility in a market environment or an economic framework is critical because Solvency II and economic regulations introduce volatility in the balance sheet, as they are based on market valuation and discounted cash flows. When there is volatility in the balance sheet, management actions need to be all the more flexible.

1.Fungibility: capacity to transfer capital from one entity to another one. Hurdle is to continue complying with minimum required capital in all entities after transfer
2.Economic Earnings: Economic capital variance between two periods, similar to an IFRS P&L but on an full economic basis



3. Having enough capital is useful only to the extent that it is liquid and/or "transportable / distributable" so as to be accessible, drawn upon, and allocated properly, whether in terms of managing capital flows or the statutory capital of local and separate legal entities via internal risk transfer mecanisms. This fungibility of capital can be achieved in the context of groups with various operating entities, equally for life or non-life companies, or within varying geographies.

4. There are different forms of shareholders' remuneration.

- Dividends are the purest form of value upstream to shareholders, while others prefer share buybacks.
- Long-term economic value creation is another form, and can be best measured as the difference between the return on equity and the cost of capital, according to Economic Value Added theory.

Having set these objectives, it is now important to define the governance and progressive steps that will ultimately embed the capital management and optimization culture in the organization.

IT ALL STARTS WITH A "RISK APPETITE / REWARD" FRAMEWORK, FROM THE ROLE OF THE BOARD OF DIRECTORS TO THE ROLE OF MANAGEMENT

Having set a framework, and objectives, the next step is to look at how actions can be embedded in the management of an insurance company: how is a risk appetite defined and applied? It is the Board of Directors' role to define the risk appetite of the company. This will set the level of capital to be remunerated to shareholders and an acceptable risk-taking (volatility) corridor.

The Board of Directors sets the risk appetite for the Group

Top down approach

Risk appetite	Risk preferences	Risk tolerances
• Maximum risk a company can take	• The risks the insurer is willing to accept / wants to focus on • The risks the insurer does not want at all • The risks the insurer accepts as collateral effect (e.g. interest rate risk)	• Capitalization level / Solvency target • Risk drivers (probabilistic) • Extreme scenarios (deterministic)
• Management sets clear Risk Limits at the Business Unit level for quarterly / annual monitoring… • …and moves from a risk appetite framework to a risk mitigation (reinsurance) framework		

Source: SCOR

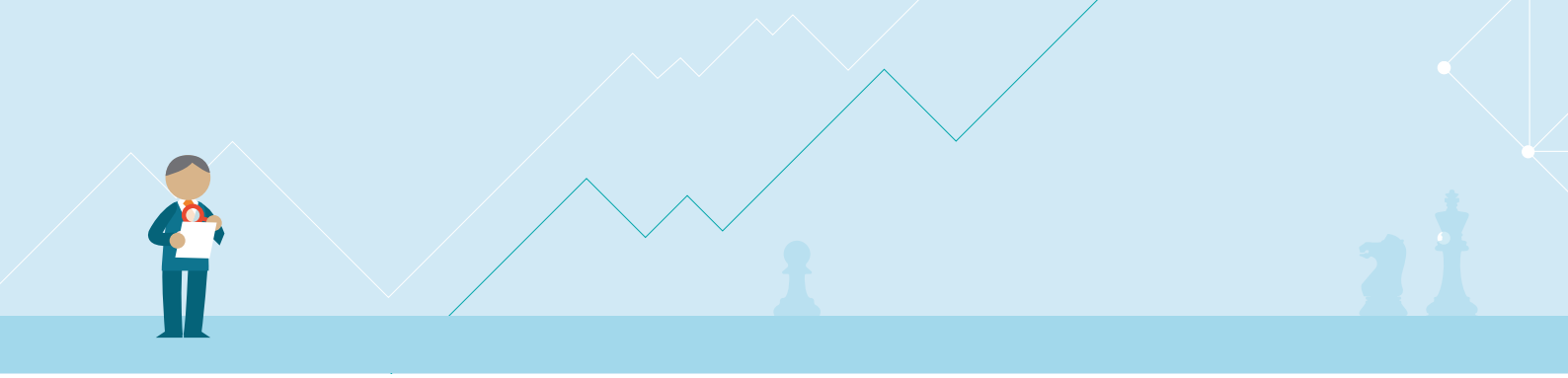
The meaning of a "risk appetite" is set in article 45 of the 2009 European Directive: *"As part of its risk-management system every insurance undertaking and reinsurance undertaking shall conduct its own risk and solvency assessment. This assessment shall include at least the following: the overall solvency needs taking into account the specific risk profile, approved risk tolerance limits and the business strategy of the undertaking (…)."*

The risk appetite should take into account the expectations of various stakeholders: customers, regulators, rating agencies, bond and equity investors. Stakeholder expectations are likely to increase to reach a clearer understanding of the risk appetite and the actions to be taken in order to remain within that appetite:

- Whether an insurer would need to target (say) 140% or 170% capital buffer levels depends on their risk profile, the volatility of their balance sheet and their appetite for potential capital raising (or dividend retention).
- An increase in an insurer's risk appetite definition should also include more clarity on how the capital buffers are managed in the local / operating entities within a group of companies: some insurers are targeting lower buffers in local entities, preferring to keep more excess capital at the group level, subject to local solvency needs and regulations.
- The risk appetite would also vary through cycles, depending on how "shocks" apply to a given insurer's business model.

Consequently, the range of "risk appetite" definitions observed[3] in the industry is quite broad, and some appear more relevant than others.

3.Sources: SCOR, EDHEC Business School "How to calibrate risk appetite, tolerance and limits"



		Quantitative approach	Risk-based approach
Capital & Solvency	• Buffer levels of capital or excess capital ratios • A minimum solvency margin, or a corridor: based on statutory solvency or internal model		✓ ✓
Profitability	• A minimum or target level of economic profitability • A minimum or target level of IFRS-compliant profitability or compliance with local GAAP standards • Related to Equity or Allocated Capital: RoE or RoRaC	✓	✓ ✓
Profits or budget target	• A maximum volatility of the budget when compared to the business plan • A maximum volatility of IFRS profit or technical profits • A maximum loss (economic and/or technical) ✗ A turnover target	✓ ✓	✓ ✓
Others	• Value: Market Consistent Embedded Value target • Liquidity: The company must ensure payments to policyholders and collateral after a plausible shock ✗ Satisfaction indicators: customers and/or staff satisfaction index	✓ ✓	✓

Sources: SCOR, EDHEC Business School « How to calibrate risk appetite, tolerance and limits », Morgan Stanley
Note: crossed in red are the observed risk appetite measures which SCOR believes are not adequate or relevant to measure risk appetite

HOW DOES REINSURANCE FEATURE AS A CAPITAL OPTIMIZATION TOOL?

REINSURANCE IS ONE OF SEVERAL TOOLS TO OPTIMIZE CAPITAL

There are many ways to optimize capital and to make it more efficient under Solvency II, including in particular:

1 Solvency II calculation approach	• Undertaking Specific Parameters ("USP") and (partial) internal models for relevant parts of the business • Optimizing base balance sheet calculation, e.g. removing prudence from best estimate assumptions; reviewing risk margin calculation • Ensuring stresses are appropriately calibrated and assets exposures are shocked correctly, i.e. not too conservatively
2 Management actions	• Embedding management actions in models can improve solvency but can also reduce management discretion, e.g. contingent actions under stress • Product optimization: capital efficient product design, including review and re-design of existing products where appropriate
3 ALM and investment strategy	• Asset & Liability Management is a key lever e.g. investment portfolio optimization for Solvency II • Optimized strategic asset allocation • Hedging strategies to reduce market risk SCR • Reducing asset management fees
4 Balance sheet structure and volatility management	• Changes to legal entity structure • Changes in capital structure (including Subordinated Debt) • Contingent instruments and structures (loan / equity) • Internal reinsurance / risk mixing / captives • **External reinsurance / risk transfer: traditional AND alternative solutions are complementary tools**

› Reinsurance is one feature among several

Source: SCOR, Morgan Stanley, Oliver Wyman

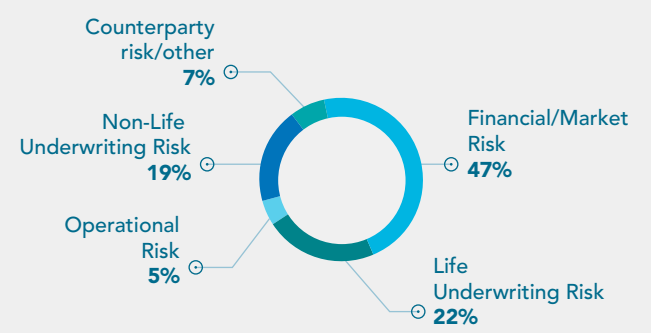
1. One way to optimize capital is to make the capital model more relevant and efficient. Larger insurance groups have built internal models, to better capture the specificities of each risk and their company's profile.

2. Management actions can help to optimize capital with the aim of providing flexibility and adaptability to external factors: contingent management tools and actions reflect the very nature of the (re)insurance business. In this volatile environment, which is reflected directly in the balance sheet, management teams need to implement contingency planning.

3. Solvency II provides significant optimization levers on the asset side of insurers' balance sheets, given the volatile market valuation of invested assets. Asset liability management is therefore a critical topic.

4. Optimizing the balance sheet structure is another efficient way, whether through issuing various types of capital instruments (subordinated debt, contingent instruments) or through reinsurance (traditional or structured). Reinsurance, and P&C reinsurance more specifically, is a tool but not necessarily the biggest tool. Invested asset volatility and asset leverage are much greater than underwriting volatility and leverage for most insurers.

Looking at the Solvency II standard formula, even if the average Solvency Capital Requirement breakdown masks wide dispersions among players and disclosure levels, financial / market risk appears by far to be the largest driver of SCR among European insurers. The P&C underwriting risk module in the Solvency II standard formula represents 19% of the average SCR, as shown in the chart below:



BREAKDOWN OF SOLVENCY II SCR: EUROPEAN SAMPLE

Source: S&P Global estimates, Company data

USE OF REINSURANCE IN MANAGING RISK APPETITE

Two coinciding trends have taken place:

1. From an organizational point of view: the purchase of reinsurance is increasingly centralized.

Reinsurance buying has traditionally been managed in a bottom-up way, with local entities defining their own risk appetite and calibrating their reinsurance needs, then placing their business into the reinsurance market. But as insurance companies grow, consolidate and extend the scale of their operations, reinsurance buying has increasingly become part of a top down, holistic process, trickling down to local entities.

Reinsurance management has progressively shifted from individual underwriters to local and then central reinsurance teams, and eventually reporting either to the CRO or the CFO. Over 25 years ago, underwriters themselves had the ability to structure and place their own reinsurance. Often underwriters would be "net underwriters" and would be managed and judged based on their net underwriting profitability. In some insurers, reinsurance centralization was then mostly driven by a focus on cost reductions.

Centralization has allowed reinsurance to be used at an increasingly "aggregated level" to manage business unit and then overall company earnings and / or risk management.

2. The purpose of reinsurance buying: historically, the point of reinsurance has primarily been to manage earnings volatility and capital preservation. In addition to this approach, which remains very valid, we increasingly see a value-based approach, whereby insurers assess their risk profile and the associated cost of capital for holding risks. Reinsurers' balance sheets and their lower cost of capital then become a source of value (and arbitrage) for insurers: by transferring to reinsurers risks that diversify better in a reinsurer's balance sheet.

Thanks to their greater diversification and lower asset risk profile reinsurers normally benefit from a lower cost of capital than insurers, reflecting lower volatility in terms of risk profile, earnings, and capital.

Today the average cost of capital for reinsurers is about 6-7%, while the cost of capital for insurers is closer to 9-10%. The difference is largely explained by differences in stock beta: 0.7-0.9 for reinsurers, versus 1.0-1.2 for (large and diversified) insurers.

WAYS REINSURANCE IMPACTS INSURERS' CAPITAL FRAMEWORK

Reinsurance solutions (whether traditional or so-called "alternative" solutions) generally fulfil at least one of the 3 purposes described below:

1 Reduce Solvency Capital Requirement	2 Free-up or generate Capital	3 Increase Available Capital & Liquidity
• Solutions aiming to • Release solvency requirement • Remove conservatism on solvency requirement • Improve risk diversification • Improve profitability indicators	• Solutions aiming to • Remove conservatism from reserving requirement • Improve profitability indicators • Transform inadmissible / intangible assets into admissible assets	• Solutions aiming to • Provide capital and Cash • Transform inadmissible / intangible assets into admissible / tangible assets
• Solutions most often applied to capital intensive LoBs • Contribute to finance business growth or dividend payment	• Solutions most often applied to long-term business with stringent reserving rules • Contribute to finance business growth or dividend payment	• Solutions most often applied to long-term business • Contribute to finance business growth or dividend payment
Structures	**Structures**	**Structures**
• Wide range of solutions varying from simple to more sophisticated structures (QS, XL, stop-loss) • Adapted to the relevant solvency regime (risk-based, factor-based)	• Wide range of solutions (e.g. reserves hedging tools, profit monetization solutions…) • Adapted to the relevant solvency regime (risk-based, factor-based)	• Various forms and variants (e.g. profit monetization solutions…) • Adapted to the relevant solvency regime (risk-based, factor-based)

Source: SCOR

The question of liquidity (in the third category "Increase available capital and liquidity") is often more relevant during the growth / ramp-up period of an insurance business, whether it is a new company, a new subsidiary or even a new line of business for an existing insurer (for example a life insurer starting-up a P&C business).

For the reasons explained above, reinsurance is a key tool for capital optimization, generating the most benefits for insurers operating in a risk-based approach. Capital optimization goes beyond capital management in the sense that it can act both on the numerator and denominator of capital and provide sustainable protection through earnings-driven solutions.

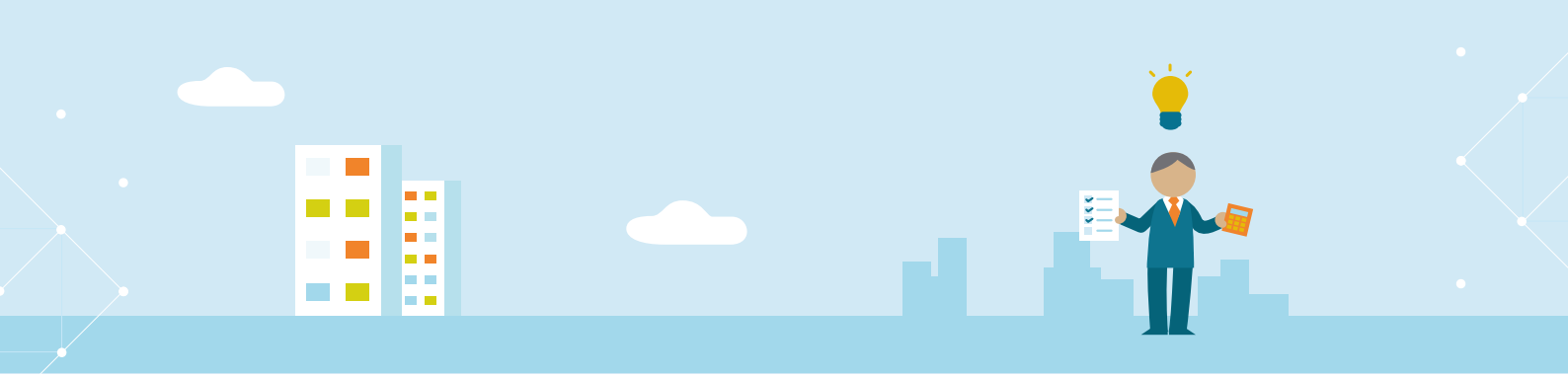
Looking at the three capital drivers of the Solvency II Standard Formula P&C underwriting module (premiums, reserves and Nat Cat capital requirements), you can see below the different impacts of various reinsurance structures on an insurance company's Solvency Capital Requirement (SCR):

	Capitalization	SCR Premiums	SCR Reserves	SCR Cat	
Quota Share, Surplus	• Decrease net income • Should increase SCR diversification • Should improve liquidity position	✓	✓	✓	**Remains the most capital efficient**
Working XS, Aggregate Stop Loss	• Reduce earnings volatility • Reduce Required Capital	✗	✓	✗	
Cat XS	• Reduce earnings volatility • Reduce Required Capital • Should increase SCR diversification • Should improve liquidity position under stressed conditions	N/A	✓	✓	

✓ SCR reflects inherent risk transfer of capitalization

✗ SCR does not appropriately reflect risk transfer of capitalization

Source: SCOR



Similarly, the impact of more structured (so-called "alternative") reinsurance solutions is set out below:

	Capitalize impact	SCR Premiums	SCR Reserves	SCR Cat
Structured Quota Share	• Decrease net income • Should increase SCR diversification • Should improve liquidity position	✓	✓	✓
Multiyear Single / Multi-line AXL / Stop-Loss	• Reduce earnings volatility • To some extent, can reduce Required Capital	✗	✗	✗
Retrospective reinsurance (ADC / LPT)	• Generate immediate profit (release of reserving conservatism) • Reduce Solvency Requirement • Limited cash impact (if funds held solution set up)	N/A	✓	N/A
Cat Bonds / ILS	• Accounting scheme can either be financing (booked in other income / expenses) or reinsurance (booked at ceded premiums) • No SCR difference compared to traditional reinsurance	N/A	N/A	✓

Remains the most capital efficient

Source: SCOR

✓ SCR reflects inherent risk transfer of capitalization

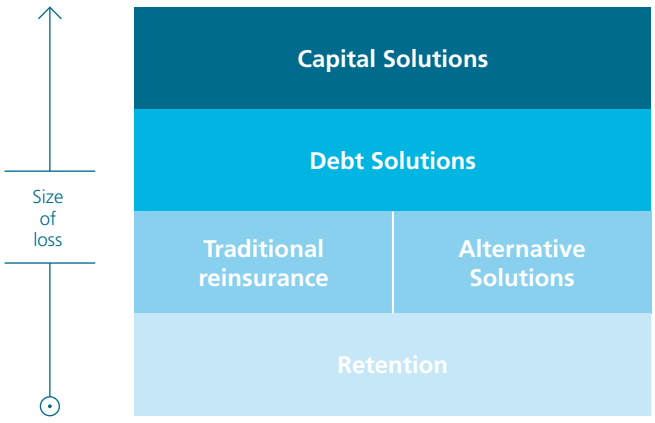
✗ SCR does not appropriately reflect risk transfer of capitalization

The growing sophistication and complexity of regulatory frameworks throughout the world has led to an increase of interest in so-called "alternative" and "structured" reinsurance solutions.

These transactions can be complex but tailored to specific insurance company profiles. They require active engagement with regulators to obtain sign-off.

COMPARING REINSURANCE SOLUTIONS TO OTHER FORMS OF CAPITAL

Reinsurance and capital solutions address varying needs, depending on the size and broader profile of the risks to be covered.



Source: SCOR

In the table below, we have assessed the effectiveness of reinsurance and capital solutions in terms of insurance companies' "concrete objectives of capital and solvency management" combined with various strategic objectives that a company might have at different stages of its life: improve capital adequacy, enable organic versus external growth, optimize capital structure, and stabilize earnings.

		Traditional Reinsurance	Alternative Solutions	Debt Solutions	Capital Solutions
Improve Capital Adequacy	1	✓	✓	✓	✓
Enable Organic Growth	2 & 4	✓	✓	✓	✓
Enable External Growth	2 & 4	~	~	✓	✓
Optimise Capital Structure	2 & 3	✓	✓	✓	✓
Stabilize Earnings	2 & 4	✓	✓	×	×

Reinsurance solutions are the most flexible

1 Manage adequate Solvency

2 Maximize financial flexibility and earnings capacity

3 Seek capital optimization

4 Ensure consistent and attractive shareholder remuneration

Source: SCOR

The table above raises a number of questions and comments:

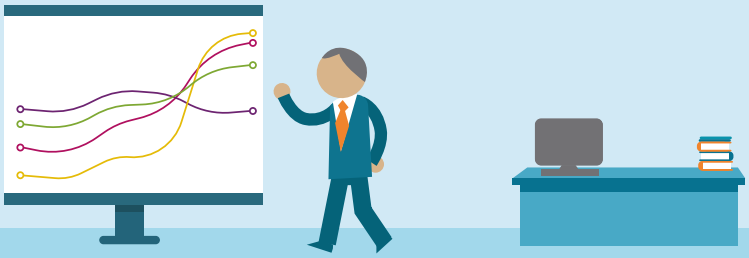
- The external growth tilt in the case of traditional reinsurance relates mostly to risk transfer in the first few years of an acquisition. Does the acquirers want to reduce risk-taking post-acquisition while better understanding the acquired portfolio?
- Traditional and structured reinsurance solutions are complementary when they address different parts of the same risk. Usually, traditional reinsurance solutions are more cost efficient but not necessarily the most capital efficient.
- Traditional reinsurance often works best for all criteria in a one-year agreement, but in multiyear structures alternative, reinsurance solutions can be more efficient.
- More often than not, the various reinsurance and capital solutions complement one another, and are combined in an overall capital management strategy geared towards the diversification of resources.

Debt instruments

As insurers progressively become more sophisticated concerning capital management, with economic-based regulations such as Solvency II acting as further catalysts, their focus moves towards capital optimization.

Capital optimization includes the comparison, if not the intermingling, of insurance solutions with corporate and capital market-based solutions. Some insurers look at how to arbitrage subordinated debt with reinsurance, even though reinsurance and debt address different needs. Debt can be used to manage the (available) capital, while reinsurance remains a capital optimization tool, by potentially acting on both the numerator and denominator of the solvency ratio and both the numerator and denominator of the Return on Allocated Capital formulae. More specifically:

- Issuing debt can be more efficient than purchasing quota share (QS) reinsurance if the primary goal is to manage the SCR coverage ratio. Debt is not efficient for controlling losses and managing risk in general.
- Purchasing reinsurance (e.g. QS) can be efficient in terms of limiting losses. It can also be efficient for managing the SCR coverage ratio, if it includes portofolio entries, which play as retroactive Loss Portfolio Transfers covers. However, reinsurance contracts, unlike debt contracts, are easy to recalibrate and should adjust such a need occur.



Equity-based instruments

The ultimate capital instruments, but also the most expensive and dilutive for economic returns, are equity-based instruments. To date, we have seen only a small number of insurance companies in certain countries requiring equity increases because of Solvency II.

Equity-based instruments have also become more sophisticated, with contingency features being added, whereby the pre-defined additional equity is subscribed / underwritten by a banking partner[5].

	Capitalize impact
Equity increase	• Immediate increase in Eligible Own Funds • Increase income (increasing producing assets) • Decrease profitability and shareholders remuneration
Derivatives / Letters of credit	• SCR reduction for derivatives • Eligible Own Funds increase for LoC • LoC needs regulatory approval to be included in Tier 3
Contingent Capital	• No shareholder dilution if event not triggered • Favorable treatment by rating agencies potentially • Shareholders play the role of the reinsurers – but protect capital, not earnings / combined ratio • Contribute to finance business growth / dividend payment

Source: SCOR

CONCLUSION

FROM CAPITAL STOCK TO CAPITAL FLOWS AND SOLVENCY VOLATILITY

Up until a few years ago, and to some extent still today, the main question faced by insurance companies was whether they had sufficient capital to meet solvency needs. It may seem like a binary question. To date, insurers using capital markets (whether equity or debt) have increased their disclosures to meet investors' transparency expectations. This is shown below as part of the "stock of capital".

This initial focus has already given way to other considerations, namely:

- The flow (of cash and earnings) feeding into the balance sheet, and addressing the question of future capital stock fluctuations: moving from a static view of solvency, to a projected, dynamic one.
- The potential volatility of capital stock and solvency. The underlying volatility of solvency ratios is provided by certain (listed) insurers through the sensitivity of solvency to defined (mostly macro) indicators. History shows that financial market volatility is a factor that should not be underestimated.

The progressive development and sophistication of the metrics used to assess capital optimization can be represented as follows:

Stock of capital & solvency

- Manage the balance sheet level: Quantum and quality of the current capital stock – surplus, solvency ratio (e.g. statutory levels, internal model)
- Syndrome of the "magic number": (re)insurers aiming for the highest level when publishing solvency ratio
- Increasing sophistication in analysis of risks sources (e.g. focus on risk margin, arbitrage between sources of capital)

Earnings and cash flows

- Analysis of economic profitability, including normalized / long-term profitability
- Increasing focus on cash flows – a key constraint in stressed periods
- Value of future profits embedded in the balance sheet, assuming certain assumptions in "normal" or stressed market conditions

Volatility

- The shift to « market value » implies a greater volatility in balance sheet: own funds are more volatile than in Solvency I because future profits are included in Own Funds
- Recent macroeconomic and financial volatility have shown certain Solvency ratios were more volatile than others

› Requires improved management information systems, capital allocation and projection, product approval and scenario testing capabilities

Source: SCOR

5. See, for example, SCOR's contingent capital facility: https://www.scor.com/en/media/press-releases/item/4066-scor-issues-a-new-contingent-capital-facility.html?lout=sgrc

The shift of focus from capital "stock" to earnings "flow" has also led to a growing interest in purely P&L volatility-driven reinsurance covers, which have very little if any direct impact on capital requirements. In an environment of expensive equity and increasing risk aversion, sophisticated capital modelling frameworks have been accompanied by an earnings-driven approach, which ultimately decreases insurers' cost of capital and reduces the overall volatility of companies' earnings and economic value.

ANTICIPATING THE IMPACT OF GREATER PUBLIC DISCLOSURES

With regard to Solvency II more specifically, the impacts of imposed public disclosures (as part of Pillar III) are probably under-estimated, especially by companies that have been accustomed to lower levels of disclosure, such as mutuals and privately-owned insurers. Solvency II requires every regulated insurance carrier to publish a so-called "Solvency and Financial Condition Report" (SFCR) by May 2017 (for full-year 2016 financials). The SFCR includes the "Quantitative Reporting Templates" (QRTs) as appendices. The QRTs are standard EIOPA forms detailing the results of the Solvency II calculations. They will provide useful information on insurance companies, such as the company's Eligible Own Funds (EOF), the risk margin, the complete breakdown of the Solvency Capital Requirement (SCR), the impact of transitional / long-term guarantee packages and a breakdown of reserves by business line and geography. A more detailed overview is provided below:

	Questions	Key Performance Indicators
Business	• What is the main activity of the insurer? • What is the weight of claims provisions? • What is the evolution of the risk profile and the activity over time?	• Split of the activity (premiums, Technical Provisions) by Solvency II Line of Business to identify main activities / new activities, and diversification across the insurer's portfolio • Weight of best estimate claims provisions (in % of gross written premiums) • Duration of the liabilities portfolio
Risk profile & quality of capital	• What is the solvency position of the insurer? • What is the risk profile of the insurer, and its evolution over time? • What is the structure of the own funds: presence of Sub Debt, letters of credit, guarantees, and evolution N-1/N? • Classification of eligible elements by Tier	• Solvency II coverage ratio to identify potential needs for capital protection or SCR "optimization" • Split of the SCR by risk modules in order to identify the SCR risk drivers • Increase in ordinary share capital and evolution N-1/N; Presence of Sub Debt and evolution N-1/N • Identification if the insurer has reached or is close to reach the tiering limit
Claims experience and P&L	• Loss ratio and overall technical profitability of the insurer? • How reinsurance impacts the loss ratio and the P&L protection? • Is there an evolution of the claims experience over time?	• Gross and net loss ratios by Solvency II Lines of Business (identification of the profitability and impact of reinsurance on P&L) • Technical result by Solvency II LoB in % of gross earned premiums • Claims development result
Use of reinsurance	• What is the % of the activity reinsured, at what cost? • How reinsurance impacts the loss ratio and the P&L protection?	• Gross to net ratios (premiums, incurred, overall and by SII LoB) • Reinsurance cost by SII LoB and total
Benchmarking	• Risk profile, operational performance, use of reinsurance • Granularity by Line of Business	• Comparison of main KPIs between a set of selected insurers, and/or overall market

Source: SCOR

With each annual publication of QRTs[6], greater amounts of information will become available with which to assess the intrinsic and relative performance of insurance companies, both at specific points in time and over time, as regulatory reports (public "QRTs") become available.

6.QRT: Quantitative Reporting Templates - https://eiopa.europa.eu/Pages/Consultations/Public-consultation-on-the-Set-2-of-the-Solvency-II-Implementing-Technical-Standards-(ITS)-and-Guidelines.aspx

AFTER SOLVENCY II: WHAT COMES NEXT?

Solvency II came into force on 1st January 2016. It did not lead to any major surprises and did not reveal any "hidden truths" that had not been anticipated by companies themselves or by outside stakeholders. At first glance, this date might appear to be a non-event. 1st January 2016 was a technical regulatory hurdle, which has generated a vast amount of work for companies, consultants and regulators, with Pillar I probably representing the greater focus. And it has been passed rather successfully.

However:

- The nature of regulatory process tends to avoid publicity.
- Transitional measures made passing the 1/1/16 deadline easier. But less prepared insurers will be pressured as transitional measures lapse and alternative capital / mitigation are needed to keep up with the SCR coverage.
- Regulators will likely continue to maintain pressure on insurers to bring higher sophistication, solvency and quality across the board.

2016 has had – and most of 2017 will probably have – much more of an operational and governance focus for insurance companies. Pillar II and Pillar III requirements are well defined, but are yet to be developed and fully implemented within insurers' organizations. Producing new information (whether it is private or public) is still a major operational burden for insurers. The full cost and consequences of these efforts remain to be seen.

Separately, as unknowns and uncertainties concerning capital treatments under Solvency II recede further regulations loom. Most notably, the new IFRS standard for insurance contract accounting (previously referred to as IFRS 4 Phase II, now branded as IFRS 17). Standard is expected to become effective in 2020 (with the potential to be postponed to 2021). IFRS 17 will fundamentally impact insurers' profit recognition patterns, thereby leading to increased profits and equity volatility.

1 Technical challenge: Passing the solvency test	2 Operational challenge: producing new disclosures	3 Increasing strategic focus on capital optimization
✓	~	?
1st January 2016		**1st January 2017**
◆ Insurers focused on meeting timetable for models (internal or standard formula) submission by 1/1/2016 ◆ Focus on "magic number": the highest possible solvency ratio ◆ Regulators have adapted themselves to the industry, setting the bar high relative to individual companies' capabilities ✓ Essentially no major surprise (all insurers passed the test)	◆ Insurance companies are having an operational focus to: • Update their models applications on a regular basis • Produce new required disclosures and anticipate May 2017 deadline for public information to be ready ◆ A number of insurance companies are already well advanced, and CRO + CFO teams work on options to optimize capital consumption	◆ Once the technical and operational challenges are passed: focus on management actions to optimize balance sheet and capital consumption ◆ Reinsurance is one tool among others in the capital optimization toolbox

› As insurance companies go through these regulatory bottlenecks, optimizing the capital framework and turning regulatory constraints into potential sources of opportunities, will form the basis of strategic differentiation.

Source: SCOR

This article is written by :

LAURENT ROUSSEAU
Chief Underwriting Officer
P&C Treaties, Europe,
Middle East & Africa

lrousseau@scor.com

For more information, please contact our team
Europe, Middle East & Africa P&C Treaties

Anne-Marie Cical - France, BeLux, Iberia, Italy acical@scor.com
Fabrice de Dianous - Austria, Switzerland, Central & Eastern Europe fdedianous@scor.com
Hedi Hachicha - Africa, Near & Middle East hhachicha@scor.com
Peter Koefod - Nordics & Netherlands pkoefod@scor.com
Helmut Soehler - Germany hsoehler@scor.com
Joanne Woodcock - UK & Ireland jwoodcock@scor.com

You can also contact our SCOR Alternative Solutions experts
Vincent Foucart - Chief Underwriting Officer vfoucart@scor.com
Eric Le Mercier - Deputy Chief Underwriting Officer, Asia Pacific, Western Europe and Corporate elemercier@scor.com
Martin Hanek - Specialty Lines mhanek@scor.com
Ross Paltridge - Americas, UK & Ireland rpaltridge@scor.com
Thomas Renggli - Nordic, Central & Eastern Europe, Middle East and Africa trenggli@scor.com

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SCOR P&C
5, avenue Kléber - 75795 Paris Cedex 16
France
scorglobalpc@scor.com

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