

Managing Value using Market Consistent Methodologies

MCEV –value management accelerator or hand brake?

Abstract

In the light of the financial crisis, financial markets are taking a closer look at value creation within individual companies. The complexity of value measurement in the insurance industry is a topic occupying a multitude of working groups such as the IASB (fair accounting of value creation), the European commission (solvency standards), rating agencies (enterprise risk management and value creation) and local regulators. The introduction of Solvency II will force insurance companies to calculate and communicate risk capital figures in addition to financial results. Companies will be increasingly confronted with the issue of risk adjusted profitability of their business, intensified further by regulatory requirements such as ORSA (own risk and solvency assessment) and the use test for internal solvency models.

Stakeholders such as regulators, shareholders, capital markets and rating agencies expect companies to clearly communicate the steps taken to increase the value of the company while keeping the risk profile within tolerance limits. The implementation of a value based management system is an important step towards meeting these requirements and being seen to do so. The design of a risk adjusted performance management system requires the definition and calculation of added value and required risk capital.

During this presentation the characteristics of appropriate value and risk measurements will be illustrated. A particular emphasis will be placed on the requirements for these measures to function as input parameters for the calculation of risk adjusted performance metrics. The question will be addressed to whether market consistent valuation methodologies are suitable for determining the value added to an insurance company and for calculating the risk capital requirement. It will be highlighted to what extent MCEV fulfils the requirements to be embedded in a value based management system. Market consistent valuation methods will be compared to other possible methods of value and risk quantification. The discussion will focus on the advantages and disadvantages of using MCEV instead of other value indicators and whether MCEV is the most appropriate measure. Keeping the pros and cons in mind, the presentation will consider ways in which MCEV calculations can be integrated into value based management and what adjustments or refinements may be necessary to increase its usefulness in the context of value management.