Market Value Management
Agenda

• What is Market Value Management?
  • Reasons to implement?
  • Example project approach
  • Key leaning points so far
Stakeholders in the insurance sector are demanding better risk management, more transparency and higher returns…

- Optimising costs of capital
- Risk transfer via capital markets
- Direct relation between risk management and cost of funding
- Optimise (transferable) free surplus
- IFRS 4 Phase II
- Solvency II
- MCEV
- Single European financial market
- API

…which requires integration of performance, risk and capital management
Balancing capital adequacy and capital efficiency benefits various stakeholders...

Cost of Capital

Risk management impacting the cost of funding capital

Capital regimes mean that risk management is having an impact on the level of capital required

Regulatory Capital

Shareholder Value

View of future earnings and sustainability is impacted by perception of risk and its management

Want well managed insurers who can manage the risks they face

Customer Value

Regulators / Policyholders

Value Management

Profit

Risk

Solvency

Capital

Capital market / rating agencies

Cost of Capital

Performance

...requires a common denominator: Market Value Management
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## Timelines from a compliance perspective – Where are the milestones?

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<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
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<tbody>
<tr>
<td><strong>ECAP</strong></td>
<td><strong>QIS 3</strong></td>
<td><strong>QIS 4</strong></td>
<td>Periodic reporting based on MVBS</td>
<td>Starting 2010 calculations based on both internal and standard model</td>
<td>2012 (quarterly) reporting to supervisors</td>
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<tr>
<td><strong>Solvency II</strong></td>
<td>July 2007: Draft Framework</td>
<td>End of 2008: Adoption of Principles</td>
<td>MVBS and MVIS / attribution analysis as basis</td>
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<tr>
<td><strong>MCEV</strong></td>
<td>Sept 2008 Principles CFO forum</td>
<td>2009: periodic (MCEV) and quarterly (market VNB) reporting</td>
<td>2012: adjusted IFRS reporting</td>
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*For companies publishing EEV; For CRO members optional starting 2008*
Market Value Management leads to a shared vision across the business …
Balancing business benefits and compliance

**Business benefits**

- Lower required capital due to usage of internal model
- Diversification benefits
- Increase performance by risk selection
- Competitive pricing
- Lower cost of capital by maintaining or improving rating
- Eventually, decrease workload for Finance, Actuary and Risk Management staff

**Compliance**

- Compliance MCEV, Solvency II and IFRS 4 Phase II
- Harmonisation of financial reporting, solvency management and business strategy
- Embedding in performance management
- Understanding and reconciling results
- Audit trail: assumptions, methodologies, data, systems, validation, consolidation, etc.

...balancing business benefits and compliance
Differences and similarities in reporting methods

**Differences**

- Each includes a different population of contracts
  - IFRS II comprises only IFRS 4 insurance contracts (and contracts with dpf)
  - Solvency II comprises all ‘regulatory’ insurance business
  - MCEV comprises all life business, and potentially mutual funds and service companies

**Similarities**

- Different definitions for cash flows
  - S-II - Probability-weighted average of future cash-flows
  - IFRS Phase II - Expected present value (probability-weighted average)
  - MCEV - Best estimate assumptions

**Cash flows**
- Time value of money
- Margins
Overlap in shared framework…

• ECAP is required to measure market value liabilities
• MVBS is required to achieve integrated view
• IFRS start point is market value of insurance liabilities
• Need risk adjusted performance numbers
• Need to implement the use-test
• Equally holds for “adequate”/“strong” ERM rating
Reporting methods have shared drivers and dependencies

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<tr>
<th>MCEV</th>
<th>Solvency II</th>
<th>Phase II</th>
<th>Economic capital</th>
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**Accounting and Reporting**
- Phase II and Solvency II differences
- Income Statement and Balance Sheet volatility
- Asset / Liability Management
- Distributable Profits
- Tax
- Local GAAP implications

**IT Systems and Processes**
- Management Information
- Robust data
- Systems and Controls
- IT Systems

**Risk Management**
- Enhancing risk frameworks
- Embedded
- Systems and Controls
- Management Information
- IT Systems

**People and Communications**
- Training and Skills
- Incentives
- Communications

**Business and Financial**
- Mergers & Acquisitions
- Analyst Ratings
- Share Price
- Cost of Capital
- Pricing

**Capital Modelling**
- More risk sensitive
- Transforming ICA models
- Embedding in the business
- Data collection
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Managing the overlap …

There are real challenges in organising the programme to deliver consistent, efficient and aligned solutions across the business fitting in the group framework.

**SOLUTION:**
- Organise the programme into function-led work streams, rather than technical and segmental.
- Multi disciplinary work streams: various group functions as well as business.

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*AFR Munich Life 2009*
Example organisation of an MVM programme

- **Management Board (MB)**
- **Steering Committee (SC)**
- **Programme Management (PM)**

**Content workstreams**
- Economic Framework
- MCEV
- Solvency II
- IFRS

**Delivery work streams**
- Perf. Mgmt.
- Standard setting
- Reporting
- BPR
- People & change
- Division projects

- QA issue resolution desk
Mobilisation from vision to work programme

Design criteria
- Legal structure
- Operating model
- Degree of standardisation
- ...

- Ambition drives vision and objectives
- This then forms the to-be situation
- The work programme can be established
- The top-down objectives and deliverables should be regularly updated
Workflows mapped to deliverables and plateaus

- **Plateau 1**
  - Prototype
  - Internal management and external reporting (conventional standards)

- **Plateau 2**
  - Prototype ready for use (pre-production)
  - Internal management reporting (primarily conventional basis)
  - External reporting (conventional basis)

- **Plateau 3**
  - Up and running
  - Internal management operational (MV basis)
  - External reporting 2010 (conventional basis)

- **Plateau 4**
  - Embedded MvM
  - Internal management on MV basis from 2011
  - External reporting from 2012 (MV basis and IFRS)
  - Additional external reporting from 2011 on the basis of MV

**Management and Reporting**

Example for an insurer publishing EEV currently and a proactive ambition

- 31/12/2008
- 31/12/2009
- 31/12/2010
- 2012
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Lessons learned from ongoing projects

Programme
Important aspects:
• Effort balanced across data, model and process embedding
• Modelling should be pragmatic.
• Calculation should be designed to be as frequent as possible
• Phased design to allow for external development
• Gap analyses, redesign and implementation iterative
• A three-step approach should be adopted
  1) Design of company wide framework
  2) Add detail for business segments
  3) Tailor design to division specifics

People
For the people involved the following have proved to be important:
• Participation and buy-in from all involved
• Leadership by senior team
• A multiple team structure needs to be in place
• Market value remuneration base
• Ensure understanding of results by management

Questions to consider
• How to avoid focusing purely on compliance?
• How to manage business on MVM?
• How to involve all parts of the company?
• What exactly are the market / analyst reqs?
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