

The Actuarial Profession
making financial sense of the future

CILA II seminar
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Solvency II
Risk Management Challenges

1 September 2010

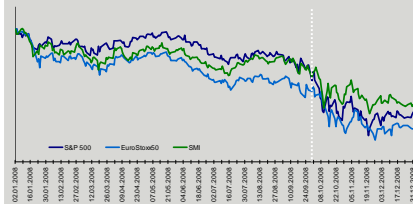
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Risk management challenges

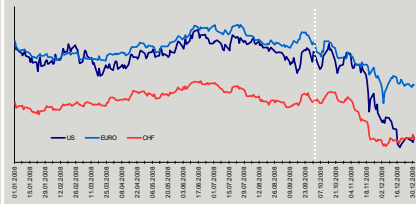
- Managing increased reporting volatility due to mark-to-market approaches
- Alignment of all stakeholders towards a common framework
- Implementing the reporting systems and controls
- Effecting positive cultural change

Market volatility 2007-2009

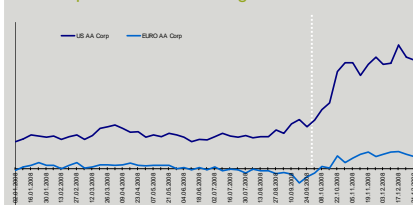
Equity markets extremely volatile



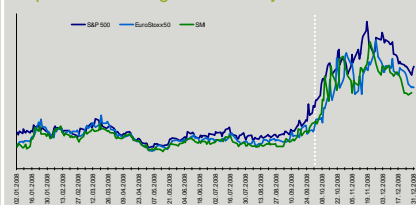
Interest rates at historic low levels



Credit spreads at all time high



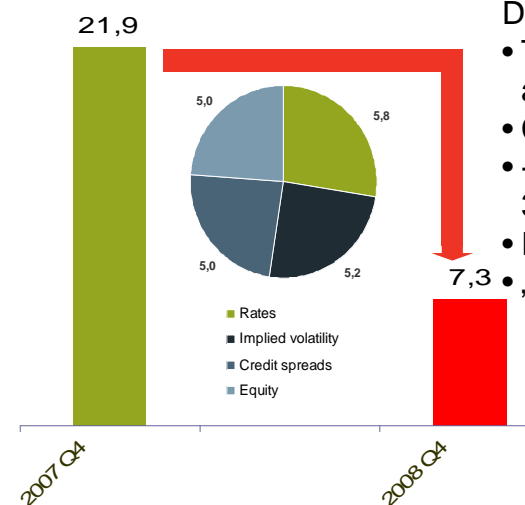
Unprecedented highs in volatility



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2

Large impact driven by distortions in illiquid markets Allianz MCEV 2007-2009, EUR bn



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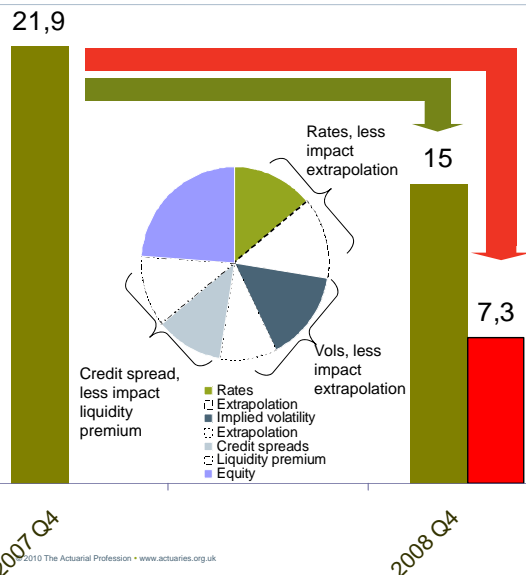
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Dislocated markets:

- Trades in one direction, or not at all
- Cash is king, flight to quality
- -100 bp inversion between 30-60 year EUR swap rates
- Implied volatilities 2-4x
- „A“ bond yields +300 bps

Model changes help, but not enough

Approximate impact, EUR bn



Changes help..

- Curve extension into illiquid markets
- Liquidity premium

4

2. Alignment of other stakeholders

Example: Standard & Poor's

"A New Level Of Enterprise Risk Management Analysis: Methodology For Assessing Insurers' Economic Capital Models".

- Areas: market, credit, insurance, operational, "indistinct risks" e.g. valuation, capital fungibility, etc.
- Criteria: methodology; data quality, assumptions and parameters; process and execution; testing; and validation
- Potential impact on capital requirements

Additional important stakeholders: Internal management, Group and local regulators, Equity analysts, etc.

5

3. Reporting systems and processes

- Decentralized systems landscape
 - Position aggregation
 - Position valuation
- Implementing suitable controls
 - Financial reporting
 - Models, assumptions and parameters
 - End user computing
- Defining the aspirations
 - Regulatory filing
 - Risk management functionality
 - Reporting frequency

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6

4. Cultural change

- Business perspective
 - Some business will benefit, some will not. Dealing with the fallout from a different (and potentially binding) perspective
 - From a long-term, best estimate perspective on taking investment risks to a financial engineering perspective
- Risk and actuarial
 - Moving from risk controlling and reporting to risk management, triggered by the Use Test
 - From „artificial“ analysis to financial reporting

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7

Questions or comments?

Expressions of individual views by members of The Actuarial Profession and its staff are encouraged.

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