Actuarial Risk Management
Global Actuarial Consultancy

Strategies & Risk Solutions for Executives
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To Our Subscribers

We want to thank our new subscribers and welcome everyone to the seventh issue of the ARM quarterly newsletter! During the past 3 months, our list of subscribers has grown past 300! We hope that you all find this publication valuable. With a few short articles meant to provide unique insights, we present ideas about how to address specific problems and introduce potential risks and opportunities that may not yet be on your radar.

The primary authors are Dave Ingram and Max Rudolph. We have been active participants in the risk management, actuarial, investment and insurance spaces for many years.

Subscribers are encouraged to suggest topics for articles and ask questions of the authors during our follow-up webinars and podcasts. Ever cognizant of regulatory requirements, leveraging them to add value to your company in practical ways, will be our focus.

Published by Actuarial Risk Management (ARM), the Strategic and Risk Solutions for Executives (SRSE) subscription is free to all.

A free webcast is also available and our podcasts covering these topics is called Crossing Thin Ice. If you would like to further engage the authors as consultants or for continuing education purposes, please reach out. More info can be found throughout this newsletter. We hope to help you find a solution that meets your needs!

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The content of this newsletter is meant to be educational and thought provoking. Nothing in it should be interpreted as investment advice.

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Risk and Capital

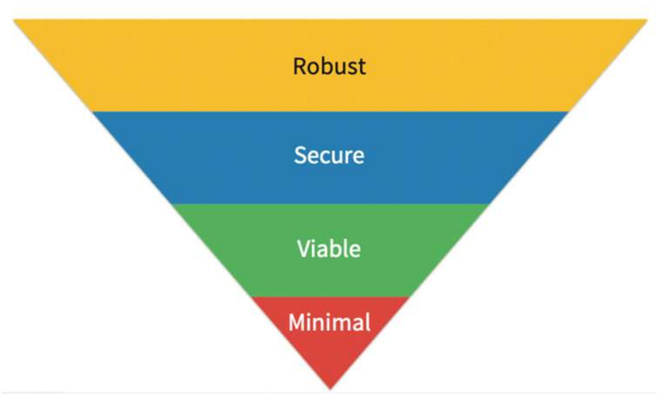
Some insurer executives think of the question as "How much capital do I need to hold?" Others look through the exact same telescope in the opposite direction and ask "How much risk can I take?" The questions seem difficult and the possible answers arbitrary.

But in fact, there seem to be just a few realistic answers and, once exposed to them, most companies will see themselves having in fact been living with just one of those answers most of the time.

Most insurers can be observed to have operated for long periods of time at a relatively stable capital level relative to the risks of the company. Their level of capital compared to their risks are usually determined by the expectations of their customers as well as their history and culture regarding security.

There are effectively four broad levels of capital:

- Minimal – These companies have enough capital to survive under normal volatility, with just a small margin of safety, little to no resilience. A major loss event would render these insurers below the company action level of RBC or even totally insolvent. These insurers effectively use the regulator's risk-based capital authorized control level as their risk capital standard. Often these companies are closely held and the owners regularly withdraw as much of the capital as they are legally permitted.



- Viable – These companies have enough capital to provide for a single major loss event and to avoid reaching minimal level with "normal" volatility. These companies generally operate comfortably in a market where customers are not focused on assessing their insurer's financial strength. Sectors like personal auto, direct sale life and health insurance.

- Secure – Insurers that have enough capital to satisfy sophisticated commercial buyers that they can pay claims in most situations by providing for maintaining a viable level of capital after a major loss event. This might amount to an additional layer of capital above the Viable level, so that they would be expect to be at or above the Viable level even after a major loss event. These insurers

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Risk and Capital (cont'd)

would expect to raise capital to get back to the Secure level after a major loss event. Many life insurers whose products have a strong investment component would also likely fall into this group. Life insurers in this group might end up restricting sales for a period of time to regain the Secure capital level after a loss event.

- Robust – These companies have enough capital to maintain a secure level of capital after a major loss. A few reinsurers operate at this level of capital as well as a few direct writers who have a long tradition of operating at the highest level of security. These insurers would not expect to need to raise capital even after a major loss event, but would expect to be able to build surplus back to the Robust level via earnings. They might say that if there is an industry wide loss that knocks may of their Secure competitors out of that range into the Viable range, they would be able to add market share with business from the most security concerned customers.

These capital levels are generally maintained for many years and are thought of as fundamental to the self-definition of the insurer. They are often then closely linked to rating targets and reinsurance purchasing. These four statements could be used or modified to state an insurer's risk strategy and tolerance. Notice that in all but the lowest category, a major consideration is the position of the insurer after a major loss event. This is in stark contrast to many of the largest banks where the objective, at least prior to the financial crisis, was to close the books each night with capital as close as possible to the required level with no margin whatsoever for losses.

In the end, it almost seems circular – an insurer will be in a business where customer security concerns find their level of risk compared to capital to be sufficiently safe and therefore the company feels compelled to maintain that level of capital compared to risk. But it is really just alignment between risk tolerance and company strategy – a key objective that many insurers include in their risk appetite statement.

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Actual Risk Management

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Strategies & Risk Solutions for Executives

Now providing three ways for you to get insights, strategies and solutions from ARM consultants to help resolve your risk issues.

Newsletter

- 3 to 6 articles quarterly
- Written by Dave Ingram, Max Rudolph and other ARM consultants focusing on risks faced by insurers and risk management strategies
- Available on the ARM website

Webcast

- One-hour live webcast once each quarter following the newsletter publication
- Webcast includes brief presentations, interviews with authors and live Q&A with your questions answered regarding the newsletter topics

Podcasts

- Two per month
- Delivered by Dave Ingram & Max Rudolph
- Presenting material from the newsletters and webcasts in a totally audio format.
- Available wherever you usually download podcasts

* No charge for subscriptions to ay of the three services

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While insurers have been challenged by low interest rates and the pandemic, the next few years will see a radically changing environment for insurers. We will be using this provocative platform to identify emerging risks and delve into what we see as the drivers of future success.

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