Allianz Global Corporate & Specialty

Solvency II and Take-aways for North America

CAS Centennial Meeting

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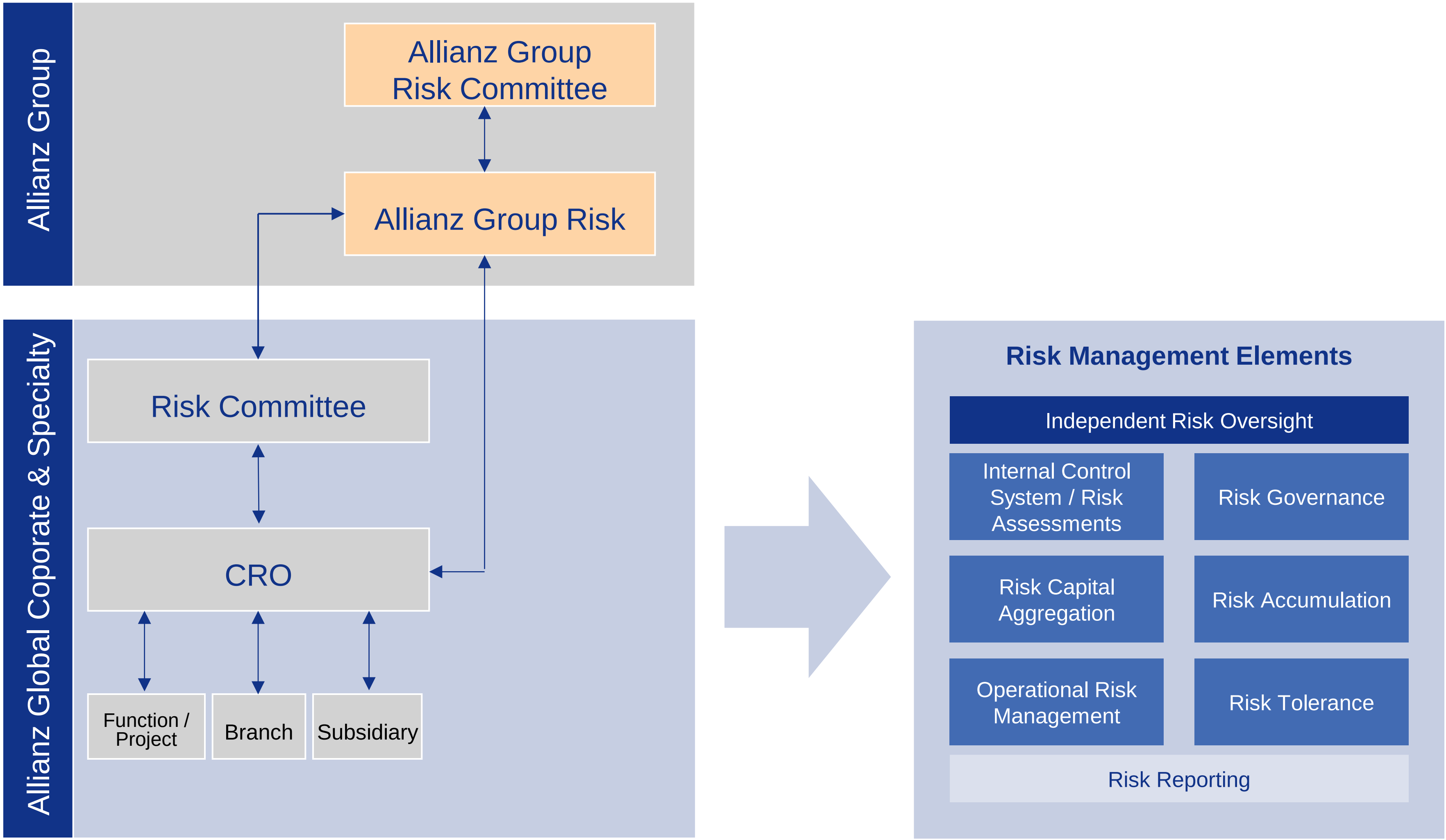
Allianz

Agenda

1

Risk Management Structure

Our success relies on a sound Risk Management approach, that is embedded in the Allianz Group Framework…



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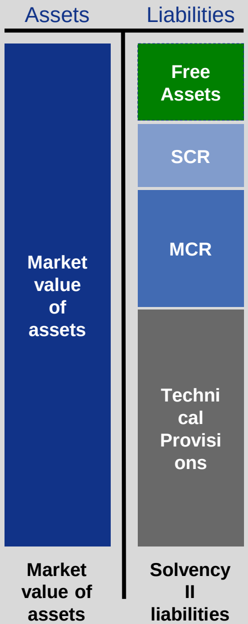
Capital Management

Tightening regulatory requirements focusing on enterprise-wide risk view…

Importance of this balance…



…raises the question of capital adequacy vs. capital efficiency

Capital Adequacy

<u>Available</u>

How much capital do I have?

<u>Required</u>

How much capital do I need?

Capital Efficiency

- Return on IFRS Shareholder Equity (RoE)[1]
- Return on Adjusted Capital (RoAC)[1]
- Return on Risk Capital (RoRC)[2]

1) Return on Available Capital
2) Return on Required Capital

And in Allianz…

- **Capital Scorecard (global initiative)** is implemented to effectively monitor our capital situation and steer our dividend capacity across the various legal entities (incl. US) and capital regimes.
- **Solvency II Internal Model** is used for US entity. Figures are analyzed within Capital Scorecard.
- **RoRC** is implemented for all Lines of Business ensuring a risk-based business steering.

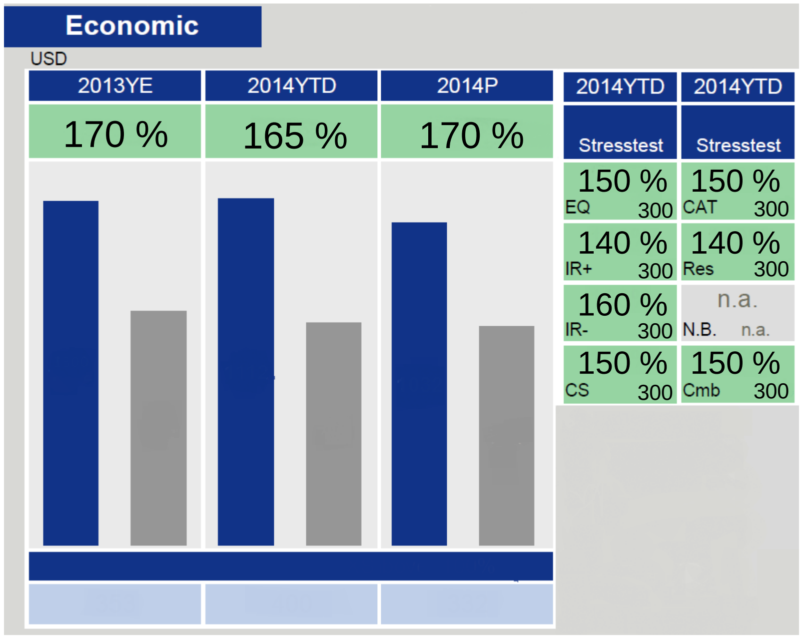
The challenge is to maximize our capital efficiency while ensuring permanent capital adequacy.

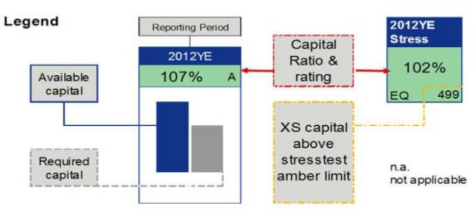
Internal Model

Communicating internal model figures and impact analysis for better decision-taking…

Capital Scorecard – Economic Capital

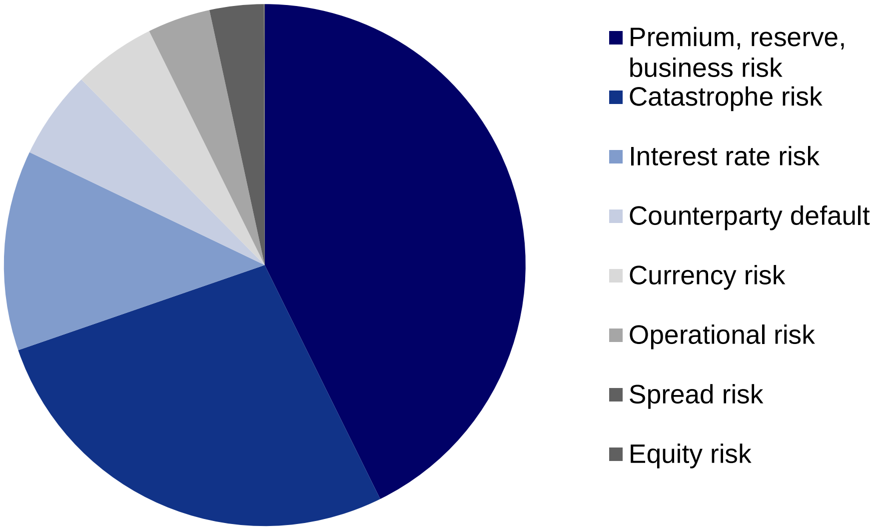
Illustrative figures





Internal Model Risks

Illustrative figures



- Internal Model includes **Catastrophe Risk** and **Operational Risk** (not explicitly) which are key risks of the company; however these are not covered in NAIC RBC model framework

Use Internal Model results and conclusions of assessments in decision-taking; rather than considering only as figures.

Return on Risk Capital (RoRC)

Providing forward-looking comparisons of business performance and attractiveness…

$$\text{Return on Risk Capital} = \frac{\text{Economic Profit}}{\text{Allocated Risk Capital}}$$

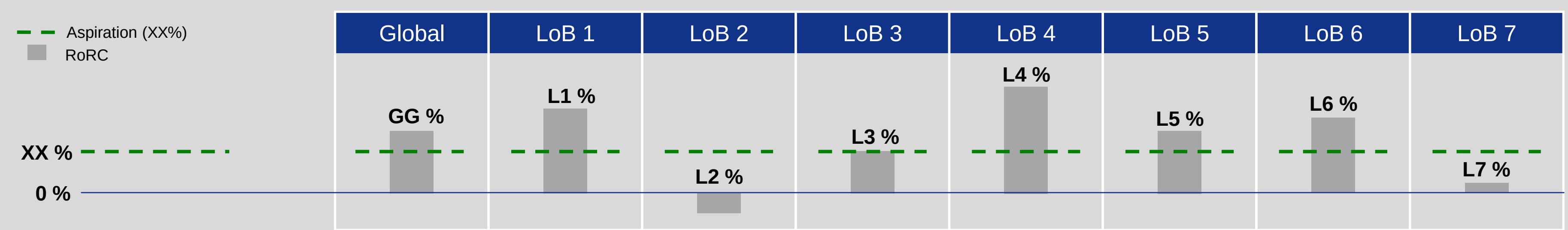
RoRC Characteristics

- **Profitability measure** (expected economic profit vs. riskiness of the business)
- It is **forward looking**
- The **key drivers for RoRC** are the major components of profit

RoRC Benefits

- Economic perspective: **taking risks into account**
- Considers the **capital needed to write business**
- Comparisons of relative economic **attractiveness of lines of business** (LoB)
- Allows **more efficient allocation of capital**

RoRC Reporting



Governance Framework

Bringing a more formal approach to governance, organization and decision-making…

Committee Framework

Certain matters are delegated for decision making or the provision of advice to a dedicated body, so-called committee. This facilitates business steering and safeguards the company's oversight function.

Policy Framework

Steering and controlling within the company is achieved by a set of corporate rules, in order to establish binding regulation and guidelines within the company.

Internal Controls Framework

It is designed to ensure:

- **Strategic business** objectives are achieved
- **Compliance** with applicable laws, regulations and Allianz internal corporate rules
- Internal and external processes supports **effective internal management decisions**

Solvency II defines Risk Management, Compliance, Internal Audit and Actuarial as key governance functions…

Governance Framework

The Solvency II Governance framework consists of ten policies…

Top Governance Policies

- Governance Policy
- ERIC[1] Policy
- Compliance Policy
- Fit & Proper Policy

Functional Policies

- Risk Policy
- Actuarial Policy
- Audit Policy

Topical Policies

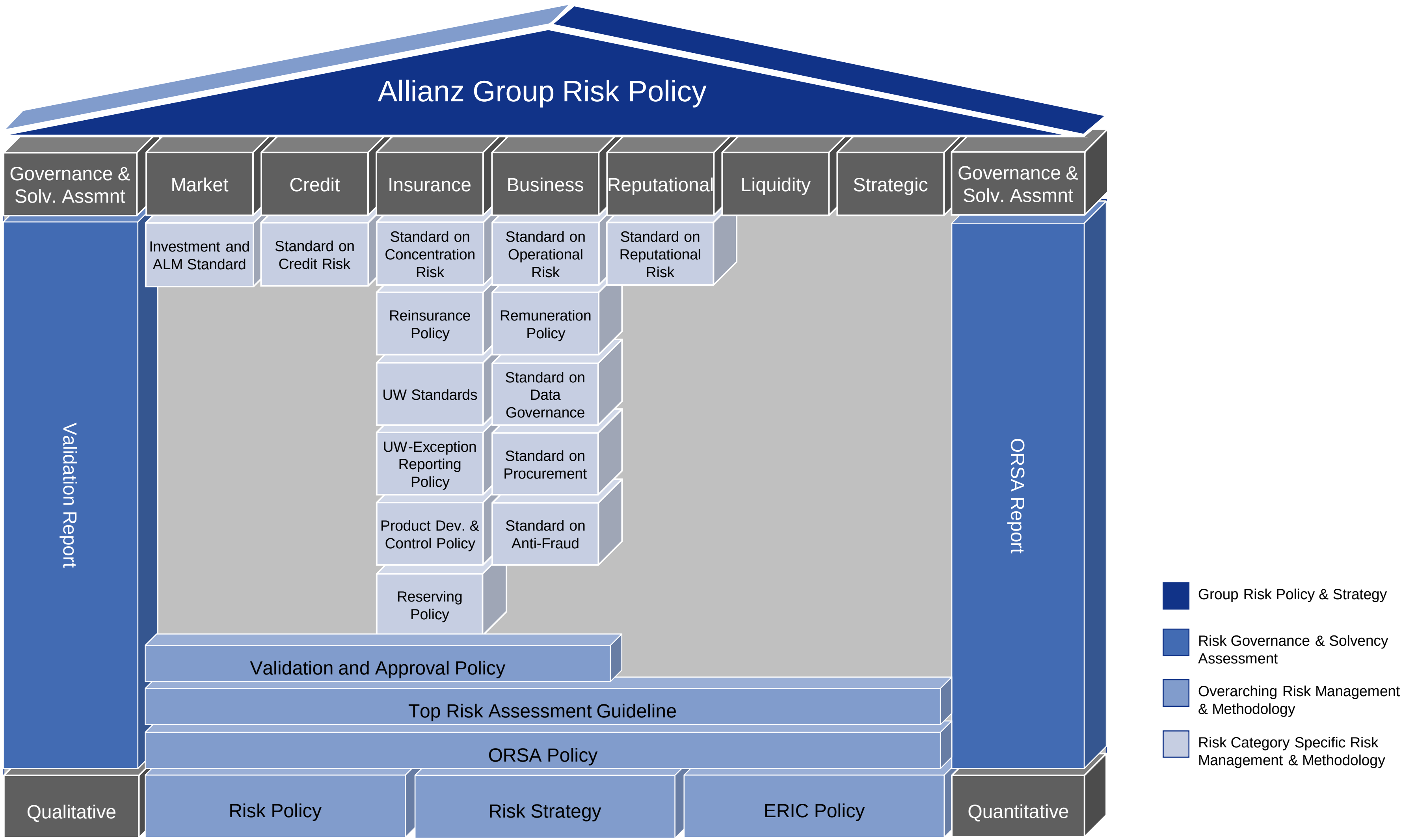
- Procurement & Outsourcing Policy
- Capital Management Policy
- Accounting & Reporting Policy

1) ERIC: Enterprise-wide Risk-based Internal Controls system

These policies are in line with Allianz Group and Solvency II regulations.

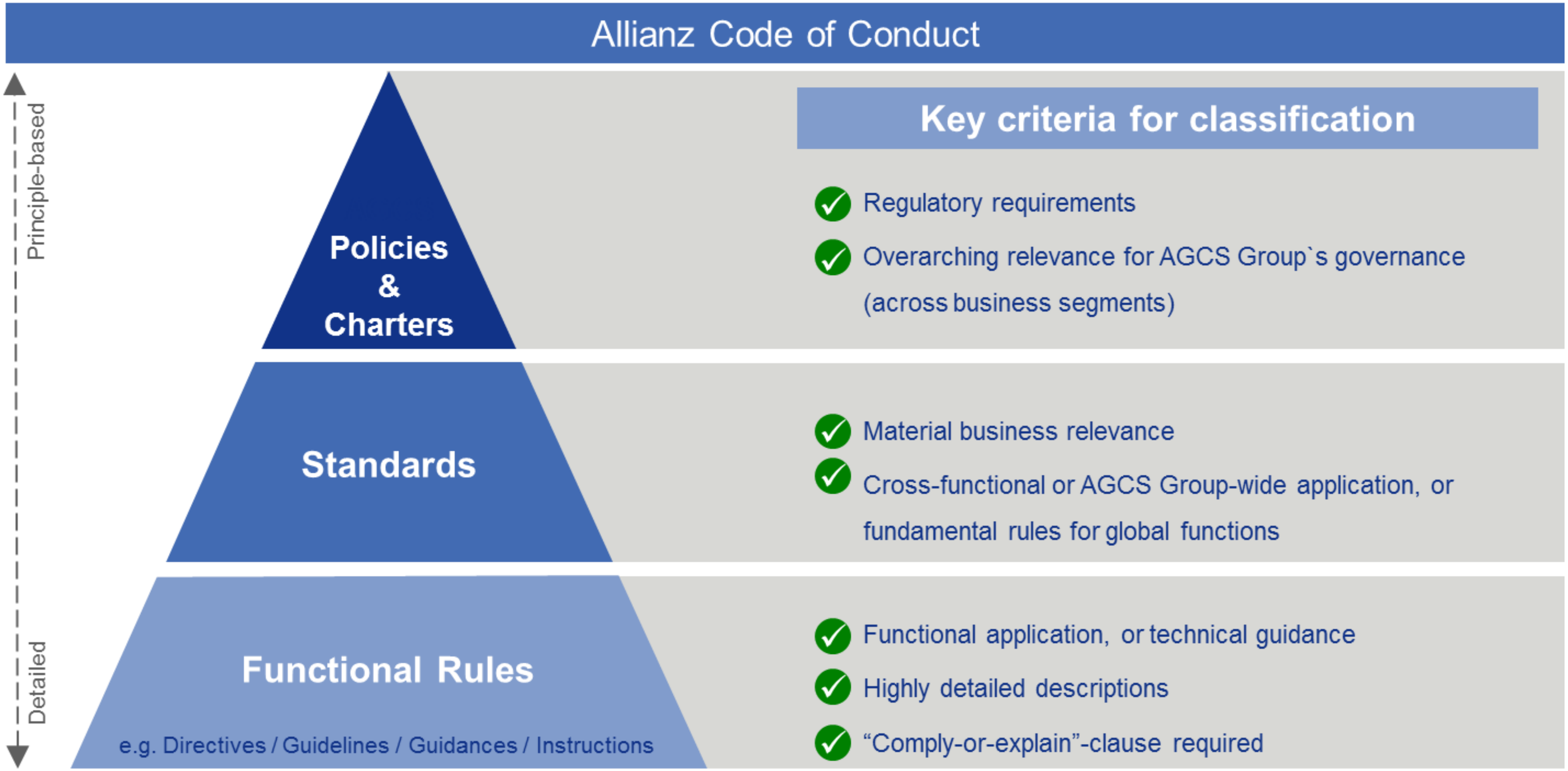
Policy Framework

The risk policies framework sets the scene for organization-wide risk management…



Corporate Rules Book

A one-stop-shop platform, that ensures a standard and clear policy framework; that aligns with the global structure…



Three Lines of Defense

A key component of the Internal Controls Framework…

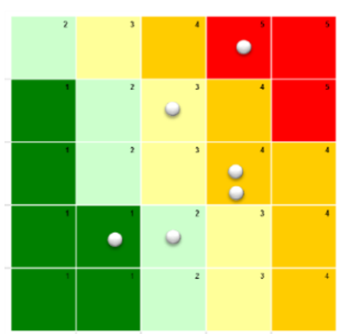
1st Line of Defense **Business**	*2nd Line of Defense* **Control Functions**	*3rd Line of Defense* **Internal Audit**
Underwriting, Pricing, Claims, Finance, Human Resources, Distribution Management, Customer Service, Agents, etc	Risk Management, Compliance, Actuarial, Legal	Internal Audit
▪ **Management**, Board Members, CEOs, Business Unit Managers, etc. ▪ **Senior management is ultimately responsible** for both the profitability and risk in their business	▪ Design **control environment** ▪ Develop **frameworks** ▪ **Support business** for managing risks ▪ **Independent** risk oversight ▪ Monitor and control **risk exposure**	▪ **Challenge** risk management controls, processes and systems ▪ **Independent verification** that policies are being adhered to and control environment is effective

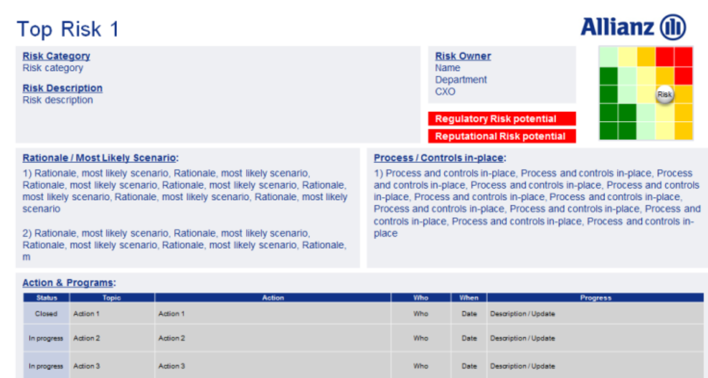
Risk Ownership

Having senior management carry ownership of key risks …

Our Top Risk Assessment process is managed in four steps:

Risk Management Process	Identification	Analysis & Evaluation	Steering	Monitoring
Objective	Be aware of the most material risks AGCS is exposed to	Be in a position to judge the main impacts on AGCS	Take measures necessary to limit risks and focus risk mitigating measures	Monitor risk developments and changes in the risk environment
Tools	Risk Scenarios	Heat Map	Risk Report and Quarterly Risk Updates	





Catastrophe Management Model Validations

Understanding the models better through validation and suitability assessments…

As part of the preparation for Solvency II, we look into our business and available tools for many US and non-US models and risks; **aiming the most accurate fit**.

Geographic Extent

Does the model appropriately capture the geographic extent and nature of the peril risk?

Insured Business

Does the model reasonably reflect the nature of insured business?

Policy Structure

Can the model have appropriate financial module to capture the complext policy structures?

Historical Information

Do the model outputs fit market claims experience?

Regulators' increasing technical expertise…

There may be many financial impacts on European insurers from non-European business (Catastrophe, Contingent Business Interruption, etc).

Discussion and model questioning among European regulators, with deep technical expertise; will only bring more improvements for these companies and more accurate results.

3

Own Risk & Solvency Assessment (ORSA)

A great tool for the company's own decision making; and for supervisors to better understand the risk profile of the company

Leadership team is expected to use ORSA to review and challenge its results. It is a tool for **forward-looking self-assessment** of risks and capital requirements.

So far:

- ORSA Canada submitted in 2014
- ORSA US to be submitted in 2015

- Executive Summary
- Introduction
- Allianz Structure
  - ✓ Allianz Structure in North America
  - ✓ Business Plan for North America
  - ✓ Risk Management
    - Fundamental Principles
    - Risk Governance
    - Risk Management and Control Process
    - Internal Control System
  - ✓ Reinsurance Structure in North America
- ORSA
  - ✓ Capital Positions
    - Regulatory Capital
    - Economic Capital
    - Rating Agency Capital
  - ✓ Prospective Capital Positions
    - Regulatory Capital
    - Economic Capital

Rating Agencies

Raising the bar on enterprise risk management having a state-of-the-art framework…

A significant effect of Solvency II will be on enterprise risk management practices of insurers and **evaluation by rating agencies**. Rating agency reviews involve:

- **Enterprise Risk Management components**, including:
  - Policies and procedures,
  - Modeling capabilities
  - Risk tolerance
  - Risk scenarios
- **Capital Management**, including risk-based capital, rate adequacy
- **Investments**, current portfolio diversification, evaluation of market conditions

Solvency II will…

raise the rating agencies' expectations and the bar for a stronger and consistent enterprise risk management framework

All these items and more are being effected and challenged by Solvency II structure

4

Overarching Effects

Calculating the long-term effects of Solvency II implementation…

Business steering based on **Risk-adjusted performance** will drive various discussions such as performance of existing lines of business, product development, product pricing, portfolio mix and most importantly, strategic decision.

A **strong Enterprise Risk Management framework** is encouraged. Stronger risk management and governance procedures are key components of stronger and better managed insurance companies.

Solvency II supports **long-term competitiveness**; by improving practices of risk management, capital management, governance, compliance. Consequently there will be more efficient use of capital.

Rating agencies' expectations and **local regulatory requirements** are changing due to many factors, one of which is the Solvency II framework. These changes will have effects on market competition, in both the short and long terms.

Thank you!

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