

MODERN CAPITAL INVESTMENT MANAGEMENT IN INSURANCE COMPANIES

1. Initial situation and determining factors in capital investment management

Ongoing low interest rates increasingly pose challenges for the insurance industry, whose approach to capital investment traditionally tends to be conservative. In order to leverage urgently needed return potential in capital investments, increasing the risk tolerance within the portfolio structure is a key lever, albeit a subject of controversial market debate. The insurers' investment portfolios, predominantly consisting of bonds, will therefore increasingly be opened to equities and real estate as well as alternative assets such as private equity and infrastructure—in this matter, market leader Allianz Life is blazing a trail.

It will also be necessary to harmonize and synchronize a number of management perspectives, such as the classic German Commercial Code (HGB), regulatory, (Solvency II), economic (ORSA) and liquidity views, as well as associated sub-processes such as ORSA, planning or ALM processes within the framework of capital investment management.

2. Key challenges in capital investment management

The existing determining factors therefore require a methodical and organizationally robust capital investment management system. According to zeb project experience, the following fields of action summarize the main conceptual pain points:

- **Organization:** what should an ideal organizational integration of capital investment, in terms of a stringent organizational and operational structure within the capital investment function, look like?
- **Management:** how should the management methodology be set up against the background of the requirement perspectives previously described?
- **IT/technology:** how must a data/IT system architecture be designed in order to efficiently and precisely support management logic?

3. Solution approaches

3.1 Organization

Within the scope of the determining factors outlined in chapter 1, insurers' back office activities have to undergo an efficiency and appropriateness test. The complexity increase caused by alternative asset classes, multidimensional management logic and regulatory reporting obligations regularly causes capacity and know-how bottlenecks, especially in smaller insurers. Consequently, small to medium-sized institutions increasingly outsource

their capital investment functions (front and, in particular, back office) to third-party providers. Larger insurers, however, bundle their capital investment functions in their own investment companies and offer asset management services for third parties (insourcing).

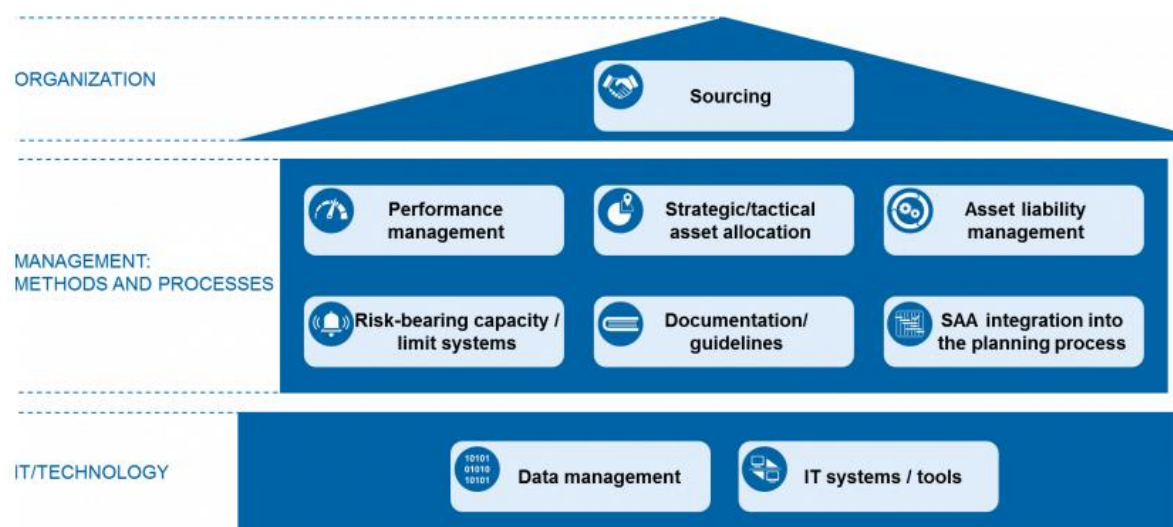


Figure 1: Fields of action

zeb has broad project experience for both strategic alternatives and provides support in the area of outsourcing and insourcing capital investment services, e.g. determining the scope of services to be outsourced, evaluating and selecting potential outsourcing partners and agreeing appropriate service level agreements.

3.2 Management

Due to its interdependence with general and risk management, planning and strategy departments as well as with asset liability management, capital investment management often involves a high degree of methodological complexity. Three key fields of action are discussed in greater detail below:

Performance management

Current performance management, which is often based on HGB key figures, can be expanded to a modern management logic by integrating both an economic and a regulatory management dimension. In the context of this expansion, stringently aligning the management to 3-5 key figures from all three management dimensions, can improve the clear focus on a few key management parameters. Streamlining and graphically refining and optimizing the sometimes confusing management reports will enable managers to clearly assess their current capital investment positioning within the respective department.

Based on longstanding project experience with insurance companies and banks of various sizes, zeb offers tailor-made performance management overhauls. Starting with the definition of relevant management KPIs, zeb provides support in setting up a practical digital management report, from the functional concept to its technical implementation.

Strategic and tactical asset allocation

Many insurance companies currently design both their strategic and subsequent tactical asset allocation for a one-year period, using purely economic models. The consideration of further restrictions, such as risk-bearing capacity or required minimum interest rate, is then analyzed by means of a backtest. Moreover, these allocations are often determined without sufficient front office involvement.

In order to derive a strategic asset allocation valid for several years, it is therefore necessary to develop a target image that links all three management dimensions (commercial law-oriented, economic and regulatory) in an appropriate manner and explicitly incorporates front office expertise. Calibrating the optimization model also requires the use of long-term expectations with regard to return and risk parameters. This approach ensures consistent capital investment management involving all stakeholders. Audit-proof documentation provides the necessary transparency.

zeb supports this solution approach by combining many years of project experience in asset management with in-depth knowledge of the insurance industry.

Asset liability management

At present, all insurers have installed the ALM procedures and processes required by regulations. Following initial audits, however, the supervisory authorities have in some cases identified a pronounced need for action. ALM-based corporate management is becoming increasingly important, especially for life insurance policies. This is due to the stricter supervisory audits, but also to the current low-interest environment.

Based on the further development of the ALM target image, we not only focus on the methodologically consistent development of an overall framework with a view to relevant management KPIs, but also on designing both the process and organizational structure as well as on technical support. As part of the 2017 ALM study, zeb has already identified the current implementation status and the existing fields of action in an industry comparison. zeb supports the expansion of a future-oriented ALM with practical experience and a concrete view of challenges and industry standards.

3.3 IT/technology

Multidimensional management logic within capital investments currently imposes high demands on often outdated and unstructured data systems. Today's data management is mostly decentralized and involves a large proportion of manual processes consisting of Excel-based imports and exports, thus contributing to poor data quality.

Institutions using state-of-the-art systems bundle capital investment data for all relevant management dimensions (HGB, economic and regulatory) from internal and external sources in a centralized data pool ("single point of truth") as a critical success factor for consistent management.

As a provider of holistic solutions, zeb supports the development of efficient data management systems from the definition of functional requirements, to the conceptual design of the data architecture, testing and go-live.

4. Conclusion

In view of persistently low interest rates and increasing complexity, current procedures in the area of capital investment management are increasingly being put to the test. A future-proof capital investment function not only has to make use of the apparent room for improvement in the methods and management areas, but also, and in particular, leverage potentials in the fields of organization, IT and technology.

zeb supports you with holistic solution approaches from conceptual design to implementation, always taking into account company-specific requirements and circumstances.