



# frontiers in finance

for decision makers in financial services

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FINANCIAL SERVICES



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2007 award

AUDIT ■ TAX ■ ADVISORY

# Special Insurance Edition

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Growth, performance and governance are key issues for CEOs of insurance companies around the world. To become, or remain, a major player, insurers are expected to consistently deliver double-digit revenue growth. Cost management, operational excellence and the optimization of business operating models are all on the CEO agenda. Governance is also crucial in an industry that is fundamentally concerned with the management of risk and is closely watched by a range of global, national and state regulators.

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Climate change is likely to represent the single biggest issue facing insurers over the next 50 years or so. Having been substantially researched, there is no longer a debate over whether it will occur, but rather how insurers will adapt and who the winners will be. In the last few years, climate change has rapidly risen up the survey lists of hot issues, appearing from nowhere to right at the top. It is clear that this is now an insurance CEO issue and for good reasons.

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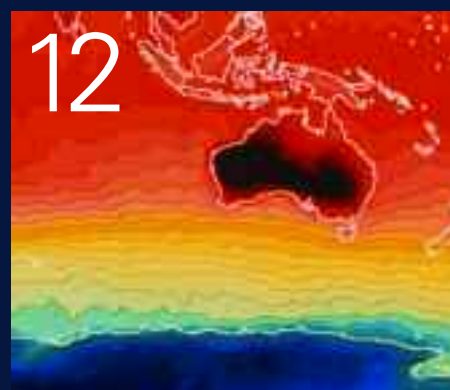
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Insurance companies have traditionally been among the slowest adopters of outsourcing/offshoring. But in the past few years the market has changed as a result of shrinking margins, higher claims disbursement and increasing competitions, especially since September 11, 2001. The size of the insurance industry, with over 1,500 property and casualty insurance companies and 1,300 health insurance companies in the U.S. alone, makes insurance outsourcing an attractive market.

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Why should an insurance group, awash with cash, prioritize effective cash management? The general insurance industry generates an abundance of cash, retains it for long periods, and pays out vast amounts in claims settlements, so why worry? The answer is simple



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### **Beating insurance fraud – there is a smarter way**

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### **Bringing down the barriers: Securitizations go global**

The increasing speed of globalization and the blurring of boundaries between financial services providers are helping drive the significant rise in securitizations. Barriers to securitizations, such as the quality of data and the understanding of risk by the capital markets, are slowly being eroded. However, insurers are best advised to carry out feasibility studies to understand whether an insurance securitization is the right option.

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### **Building a robust defense – transfer pricing**

Transfer pricing is a key issue for multi-national groups because it is one of the main mechanisms by which capital, and hence profits, are allocated between headquarters and operating subsidiaries. Careful allocation of capital and application of appropriate transfer pricing policies can also be a legitimate means of ensuring profits are taxed in the lowest possible jurisdictions. Historically, transfer pricing policies for cross-border reinsurance in multi-national insurers have tended to escape the closest scrutiny, but this has now changed...

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### **Taking an enterprise-wide view of risk: The evolving role of the CRO**

The insurance industry is all about risk, and some aspects of risk management have been developed to a high level of sophistication. But in the past, the focus was on managing risk separately within individual business areas. At the same time, individual business units concentrated only on those risks they perceived to be key. By its nature, this approach to risk management was quantitative and analytical. The disadvantages of this approach were recognized some years later and it has since changed dramatically.

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### **New IASB discussion paper: What's the story?**

On May 3, 2007 the International Accounting Standards Board (IASB) published a discussion paper on Phase II of its insurance project. The paper is in line with expectations, but the grouping of the various issues allows a better understanding of the way in which the views were reached. However, at some points a theoretically sound and principle-based approach is still lacking.

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### **Time to take a look under the hood of your economic capital models?**

Internal economic capital models are continuously gaining in importance due to regulatory and business drivers such as regulators, ratings and risk and return optimization. While the drivers for models are universal, internal models exhibit – more often than not – highly complex and company-specific features reflecting firms' individual business plans, market views and management assumptions. On the one hand these features are part of their appeal. On the other hand they make it difficult for senior management to assess their quality and accuracy.

## **KPMG's Global Insurance practice named by Reactions Magazine as the Best Accounting Firm of the Year 2007**

Each year Reactions, the leading monthly insurance magazine, poll their readers to assess which firms and people are the leaders in the insurance industry. The magazine contacted over 3,000 individuals with a target audience consisting of risk managers, brokers, reinsurance or insurance managers, directors and CEOs.

These leading industry figures chose KPMG's Global Insurance practice as the Best Accounting Firm of the Year 2007. More information about this award and why KPMG's Global Insurance practice is a leading advisor to the industry can be found at [www.kpmg.com/Industries/FS/Insurance](http://www.kpmg.com/Industries/FS/Insurance)



# Foreword

## **Growth, Performance and Governance – key challenges in insurance**

**Growth** is a constant in the insurance industry. To become, or remain, a major player, insurers are expected to consistently deliver double-digit revenue growth.

Mergers and acquisitions, geographic expansion, product development, cross-selling and client retention are all vital strategies. Insurers are expanding into emerging markets such as Central and Eastern Europe (CEE), Russia and India, which are generally underinsured but increasingly affluent. In the mature markets, demographic changes are driving new product development as insurance companies adjust to the changing needs of their core domestic client base.

Our articles in this edition explore some of these key geographic markets and also look at climate change – possibly a threat to the industry but also an opportunity for those entities that fully understand and can manage its implications.

**Performance** across a range of different financial indicators, and ultimately delivering strong and consistent earnings, is crucial. Cost management, operational excellence and the optimization of business operating models are all on the agenda. Many of the larger insurers are complex, diverse entities that have been very successful in mergers and acquisitions and in growing their product sets and geographic scope. There is huge potential in the industry for increased IT investment, improved operational efficiency and cost savings.

We have a range of articles covering a number of cost-saving and operational initiatives.

**Governance** is crucial in an industry that is fundamentally concerned with the management of risk and is closely watched by a range of global, national and state regulators. Good corporate governance, with strong internal controls, effective risk management and efficient, timely reporting, is vital to the management of a complex integrated financial services organization. Insurance companies face challenges to improve the quality of their risk management, underwriting discipline and risk pricing. In many cases improvements are still required in the basic documentation and reporting of risk. This is a growing challenge as the evolving industry standards of IFRS Phase II and Solvency II place new demands on insurers for increased control and transparency.

Our articles look at the developing role of the CRO in driving good risk governance, recent developments in IFRS for insurers and the importance of economic capital models.

We hope you find this edition of *frontiers in finance* valuable and relevant to your work in the industry.

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Tallinn, Estonia

# Pace of change opens up further opportunities in Central and Eastern Europe

In the countries of Central and Eastern Europe (CEE) and the Commonwealth of Independent States (CIS), economies are growing and the regulatory environment for insurance is strengthening. No wonder they continue to be a focus of interest for the major global insurance players. Roger Gascoigne, Csilla Leposa and Jacek Fiedorowicz set out the current position in this fast-changing region.

**S**ince the insurance markets of Central and Eastern Europe began to open up to foreign investment in the early 1990s, we have witnessed the increased presence in the region of most of the major global insurance groups. In the early years the main emphasis was on establishing a presence, building a network and gaining market share. Many of the former state monopolies have been privatized, new companies have been set up by national as well as international investors and regulation and regulators have been bolstered.

Yet, despite strong growth rates over the last 15 years, and impressive figures of 19 percent growth in life and 9 percent in non-life insurance in 2006<sup>1</sup>, the region's insurance markets continue to lag behind Western Europe, both as a percentage of GDP and per capita. To put this into perspective, the total written premiums for the combined CEE/CIS region are slightly higher than those of Ireland while the

combined population exceeds that of the United States of America.

## **A region of contrasts**

It would be a mistake to treat the region, even if one excludes Russia from the definition, as homogenous. When one considers economic development, population, pension and health reform, regulation, European Union membership or even demographics, no two countries are alike. Most obviously, the countries vary widely in size – the populations of Ukraine, Poland and Romania amount to more than 100 million; the three Baltic States total just 7 million in aggregate. More generally, the countries' insurance markets are also at very different stages of their economic and regulatory development. EU accession has had a significant impact on the legal, regulatory and accounting environment in the existing member states as well as exerting pressure for reform in the aspiring candidates, predominantly in the Balkans and Ukraine. Nevertheless, EU regulations,

even where implementation has resulted in some inconsistencies, provide greater political and business stability.

The precise interaction of these factors will likely drive the potential market entry and development strategies for a specific market.

As insurance groups such as Allianz, Vienna Insurance Group, Generali and ING begin to dominate the region whether measured by written premiums or by geographical footprints, the question is – is it already too late?

## **Looking for opportunities**

Following the recently announced joint venture between Generali and Ceska pojistovna<sup>2</sup>, which will combine the Czech market leader with Generali's CEE operations, the four Central European markets – Poland, the Czech Republic, Hungary and Slovakia (CE4) – are now, with the major exception of PZU in Poland, dominated by foreign-controlled insurance groups.

These markets have been experiencing a battle for market share, evidenced by ongoing consolidation within the markets and tough competition for brokers, banking partnerships and other key distribution channels.

Here the opportunities for new entrants would seem largely limited to niche products, such as credit or agricultural cover, or innovative distribution models, such as the recent arrival of direct insurance writers (see white box on the right).

Since EU accession only Aegon has tried to buck this trend by launching an ambitious greenfield program to expand its successful Hungarian operations into the Czech and Slovak Republics and Romania.

As a result, interest over the last 18 months has turned towards the new EU member states, Romania and Bulgaria, as well as countries which are even less developed such as Ukraine and Serbia. Unlike the CE4 these markets offer potential acquisition targets for those investors with strong nerves and deep pockets. As always where potential buyers significantly outnumber willing sellers prices for such targets have been bid up to often seemingly ludicrous figures. Nevertheless, demand continues to mount as ever more insurers announce their intention to offset declining margins in established markets with expansion into CEE.

### Critical success factors

The history of the CEE insurance markets over the last 18 years illustrates the advantages and the disadvantages of both greenfield start-up operations and acquisitions. The former allowed insurers to avoid the pitfalls of historical legacies, such as poor underwriting and inadequate reserves, and to establish corporate principles of governance and reporting; the latter (particularly with the privatization of a state monopoly) offered immediate market share, experienced management, strong brands and established distribution networks. Some insurers, such as ING and AIG, have almost exclusively followed a greenfield approach; others, such as Allianz and Vienna Insurance Group, have varied their approach on a country-by-country basis. Interestingly, as noted above, Aegon has recently been forced to vary its strategy of acquisitions by the absence of suitable targets in the Czech Republic and Slovakia, while Generali has complemented its regional network of

greenfield operations through its Czech joint venture.

Market observers often comment that the key to a successful acquisition has so far been the strength of the local management, combined with thorough due diligence. In these economies, any uncertainties over the adequacy of reserves may even be outweighed by the benefits brought by excellent, honest managers with good selling skills and a long contacts list who can drive the growth of the business.

The process of establishing a greenfield operation, meanwhile, has become significantly easier due to the application of EU and WTO rules across the region. Nevertheless, there can be many unexpected minor technicalities that can catch out the unwary. For example, the licence application in the Czech Republic must be accompanied by certification from a locally-registered actuary – while a foreign actuary can register, this can slow down the process.

In both cases, experience shows that it is virtually impossible to transfer in the complete management from headquarters. Successful operations have tended to combine one expatriate, often the CFO, who brings knowledge of corporate rules and a hotline to head office, with local managers – sales director, CEO – who know the customers, regulators and distribution channels.

### “He who hesitates is lost”

Despite the incredible development of the CEE markets over recent years, significant growth opportunities still remain. Going

forward, the largely unreformed pension and health markets should throw up fresh incentives to existing and new players. The previous examples of Poland and Slovakia, and the current scramble for pension policyholders in Romania, exemplify the importance of pension reform as a one-off shock to shake-up the market. As capital adequacy rules align with EU standards, the less-developed markets to the south and east will likely see further market consolidation.

Each market is different. Of course, there is a greater element of risk and uncertainty in approaching countries such as Ukraine, Belarus, Albania, Serbia, Macedonia or Kazakhstan. But the experience of the last 15 years shows that there is little downside to expansion into developing markets; and the majority of the benefits have accrued to the companies that entered the markets first. If we look across the region, today's market leaders, tend to be those who acquired companies with strong market positions or were among the first to establish local operations.

Because of the diversity of the region, any approach has to be tailored to meet the specific market, economic and political situation of the target country – and even then, the approach has to be flexible enough to move quickly as opportunities arise. But the prospects for growth are significant, and delay could be expensive.

**Because of the diversity of the region, any approach has to be tailored to meet the specific market, economic and political situation of the target country.**

1. Swiss Re sigma: World Insurance in 2006: Premiums came back to “life”, April 2007

2. Joint Press Release of Generali and PPF Group of April 27, 2007, available from [www.generali.com](http://www.generali.com), [www.ppf.cz](http://www.ppf.cz), [www.ceskapojistovna.cz](http://www.ceskapojistovna.cz)

## Distribution

### Can the Internet and the phone replace the agent?

Traditionally, most companies in the region have sold through its own sales force and/or tied agents, individuals with strong personal relationships in the community.

In terms of direct channels, many countries in CEE/CIS, are technologically advanced; and telephone and the Internet have changed the face of banking over the past five years. But direct selling of insurance is only in its infancy. The first Property and Casualty (P&C) insurer to rely solely on direct channels, Link4, was established by the Israeli Direct Insurance group in Poland in 2003. Since then, Link4 has grown rapidly, writing motor and household business by phone and the Internet, and the group has recently begun a second operation in the Czech Republic, and is looking at other markets. As group CEO, Doron Schneidman, notes: "In the last decade the Western consumers showed a clear tendency towards the direct model and we tend to believe that the consumers in the CEE countries will follow the same trend. This trend and the current lack of complexity and innovation in these countries represent a big opportunity for Direct Insurance."

Although many companies already offer travel insurance over the Internet, insurers such as Allianz and AXA have begun direct operations alongside their traditional businesses. But the challenge for non "pure-play" direct insurers is to capture new customers, rather than simply selling to the same customers in a new way and thereby undermining the existing distribution network. To avoid conflicts with their current sales network, they often develop a separate brand and set of insurance products (such as Allianz Direct).

Direct channels currently account for less than 2 percent of P&C premiums in Poland. Nevertheless, there are currently, at least 11 companies that have implemented, or are implementing,

direct sales and service channels for the distribution of their P&C products in Poland.

To some extent, direct selling is constrained by the poor market penetration to date of credit cards in the region, although this sector is also expected to grow rapidly. Nevertheless, change is happening rapidly and KPMG member firms' research suggests that the direct channel will grow significantly over the next few years.

Recent research<sup>3</sup> by KPMG in Poland into the behavior and preferences of Internet users who are consumers of direct P&C insurance indicates that while 90 percent of respondents search the Internet for information on insurance before purchase, only 20 percent of respondents have so far bought insurance over the phone and 20 percent over the Internet. However, more than one-third of the respondents have never considered using direct channels.

Future prospects look good though as consumers adapt to the convenience offered by the Internet. According to KPMG's research, one-third of respondents intend to buy P&C insurance over the phone and more than a half over the Internet. Furthermore, most respondents expect to use the Internet for after-sales service and claims handling. Interestingly, more respondents declared their intention to purchase insurance online than over the phone. Is it possible that the rapid technological advances will result in the CEE markets effectively skipping a generation in terms of distribution channels by going to the Internet without ever really implementing the call center? This has already occurred with electronic banking which has rapidly replaced phone banking. The challenges are numerous – to compete not only on price and convenience but also on the speed and quality of customer service.

3. eInsurance – a chance or an experiment? 2007

## Moving into CEE

### A checklist

- **Flexibility** be prepared to adapt strategy by country (and even company) according to the opportunities available.
- **Preparation** do the groundwork to understand the local environment, culture and regulations (even in EU member states there may be certain specific requirements which can delay the project).
- **Local knowledge** strong local management is almost priceless.
- **Be alert to the risks without over-caution** due diligence is crucial but don't fall into the trap of exaggerating the perceived risks.
- **Realism** everyone is looking for well-managed companies with strong balance sheets, adequate reserves, strong management and which operate in a stable political environment. If you find one, be prepared to pay an appropriate price!
- **Patience** it takes time to establish a presence in the market and sometimes regulatory, tax and accounting compliance seem dauntingly frustrating, but persevere...

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The Russian insurance market continues to experience strong growth. Annual growth rates of up to 30 percent, combined with low levels of insurance penetration, are attracting large amounts of capital and many investors. There are great opportunities for new entrants to the market – as long as they get their homework right. Adrian Quinton, Anthony Coops and Mat Gorman review the prospects.

# Russian insurance booms

**Vorobyovy Gory Towers (Apartment buildings),  
Moscow, Russia.**  
Photograph by Ivan Vdovin, Jon Arnold Images



The Russian economy has grown rapidly and consistently for the last nine years, since the financial crisis of 1998. GDP growth of 6–7 percent annually has been driven principally by high oil prices, and the resulting flow of cash into the economy has in turn spurred increased disposable incomes, consumer demand and corporate investment. Capital investment has grown by over 10 percent annually for the last 5 years, and personal incomes by more than 12 percent. The commercial sector is enjoying growing profitability and increasing access to international capital markets and at the same time a consumer society is emerging, marked by increasing personal consumption and market choice.

These factors are having a significant impact on Russia's insurance industry which is seeing tremendous growth in both the retail and commercial sectors and is seeing increased foreign and local investment. The level of "grey insurance", being schemes driven by tax rather than risk transfer factors, has decreased significantly as a result of an aggressive drive by the regulatory authorities to clean up the industry (see Chart 1). Given favorable conditions, the Russian insurance sector is forecast to grow at an average annual rate of 30 percent between 2006 and 2010<sup>1</sup>.

From the perspective of the retail insurance market, one of the most important structural changes is the emergence of a significant middle class. A dramatic rise in disposable income is fueling a boom in the retail insurance sector. In addition, growth in consumer financing in the form of car loans, credit cards, and mortgage lending is driving increased consumption of non-essential durable goods and demand for housing and real estate, which in turn spurs increased demand for retail insurance products such as motor insurance and property insurance.

The introduction of compulsory third party motor liability insurance in 2003 has provided insurers with a large new client

base which previously had little exposure to insurance products and they are actively looking at opportunities at cross-selling non-compulsory products to this new market.

In the commercial market, Russian companies have experienced growing levels of profitability in recent years, and are realizing that they need, and can afford, cover for their businesses, property and personnel. In addition, with the increased levels of foreign investment into Russia and greater exposure to international capital markets, debt and capital providers are imposing requirements on Russian companies to improve their insurance cover. Some leading edge companies are venturing into more sophisticated market sectors, such as key man insurance and environmental insurance. However, these more sophisticated products are more likely to be arranged through international brokers, rather than by local Russian insurers.

However, the extremely low – almost non-existent – baseline means that despite this rapid growth, penetration rates remain low. The non-life sector was worth about US\$14 billion in 2006 (in terms of gross written premium)<sup>2</sup>. This is equivalent to about 1.2 percent of GDP, significantly below the comparable levels in Central and Eastern Europe (see Chart 2). Growth rates in Russia are much higher, but there is still a way to go before market penetration reaches CEE levels, let alone the much higher levels seen in Western Europe and the USA.

As Chart 2 also shows, market penetration in the life sector is still very low. Only about 1 percent of the population has life insurance. Traditionally, Russians have not had the long-term trust or confidence in financial institutions which is necessary to underpin significant life insurance business. There is little tradition of saving, and little understanding of the benefits of long-term protection. This is changing rapidly, with economic stability and more effective regulation responding to fast-growing consumer demand. But there is clearly massive future potential.

In view of the current dynamism of the insurance market, and the scope for continued rapid growth, it is unsurprising that many multi-national insurers are moving into the market, or planning to do so. Unlike some sectors of the Russian economy, there are relatively few regulatory barriers to foreign investment into the Russian insurance industry. However, this does not mean that market entry is easy.

Russia is a massive country, with many unfamiliar economic and cultural characteristics. Starting up an effective distribution network which can yield the necessary economies of scale is more or less impossible. The typical entry route is therefore through an initial investment in an existing Russian company, which can subsequently be increased in the light of performance. But again it's not easy. There are still a large number of poorly-performing domestic insurers, and homing in on the right targets takes substantial research, time, effort and negotiation. Premiums for the most attractive prospects are rising.

So far Allianz, AIG and Zurich Financial Services are the only foreign insurers to hold significant market positions (see Table 1), although several foreign life companies have entered the Russian market in 2005–2006: Fortis, ING, ACE and Aviva. The next few years are likely to see increasing foreign investment, paralleled by continuing domestic consolidation. While the market is currently booming, and the prospects are excellent, the opportunities for profitable investment are expected to become more limited. The lesson is clear: if you want to get in, get in now; but make sure you do your homework.

1. Deutsche UFG  
2. www.insur-info.ru

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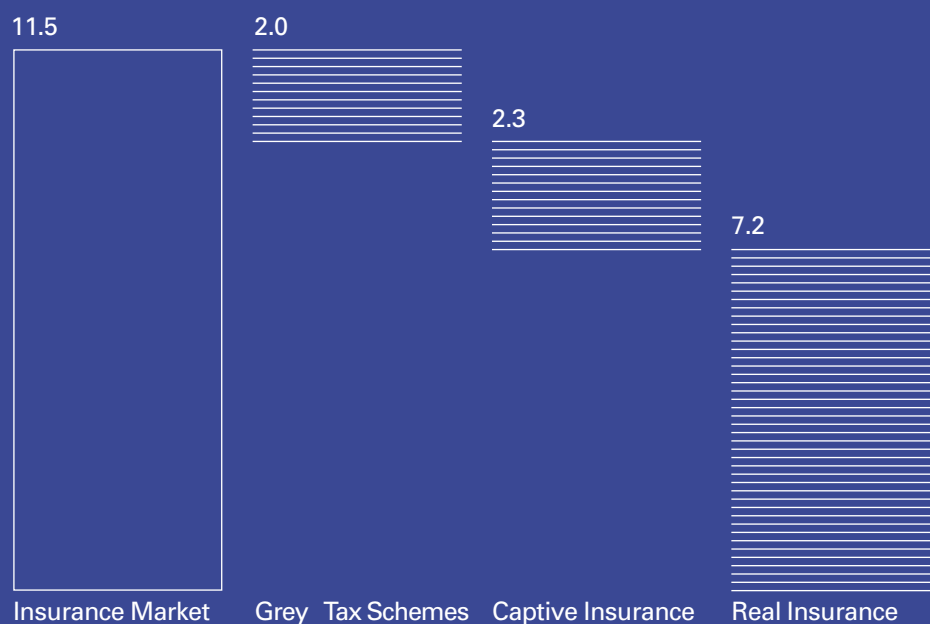
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**Chart 1**  
Russian non-life insurance market structure in 2005

Figures in US\$ billion

Source: 2005 & Beyond: Stronger for longer, Deutsche UFG, 2007

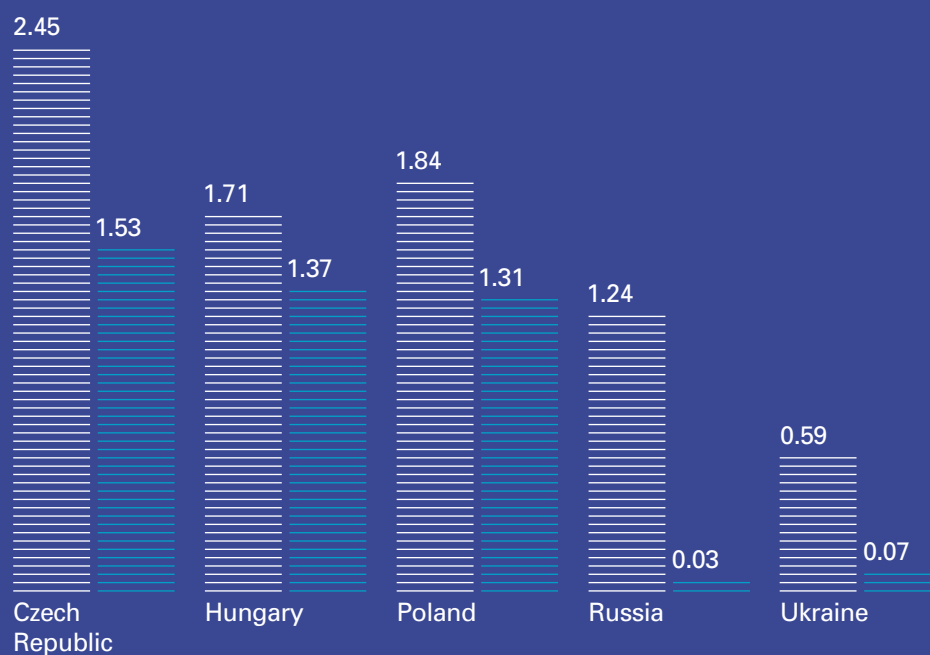


**Chart 2**  
Non-life and life premiums in Russia and CEE Peers, 2005

Figures as a % of GDP

Non-life premiums  
Life premiums

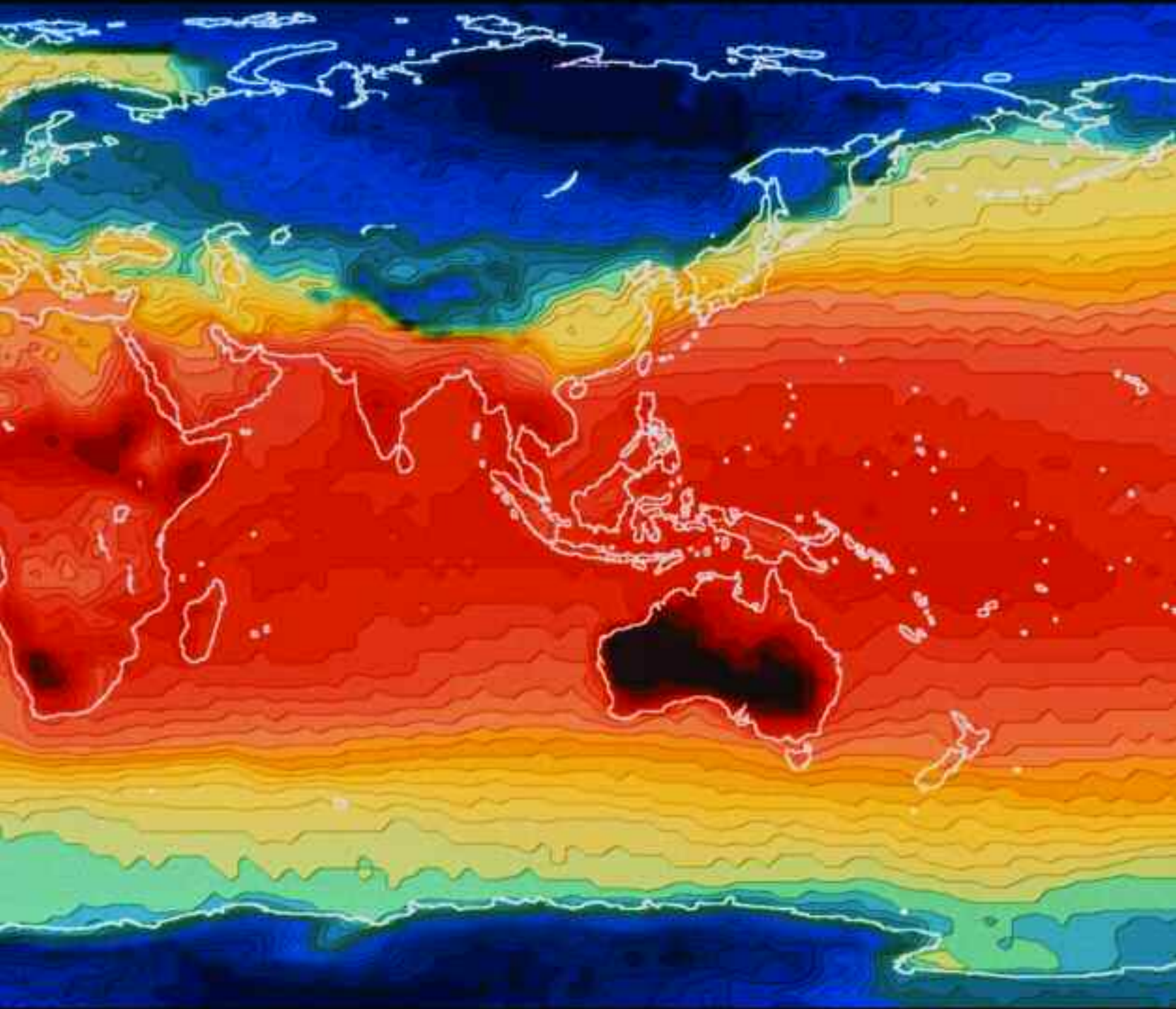
Source: 2005 & Beyond: Stronger for longer, Deutsche UFG, 2007



**Table 1**  
Selected non-life insurance companies with foreign participation in Russia

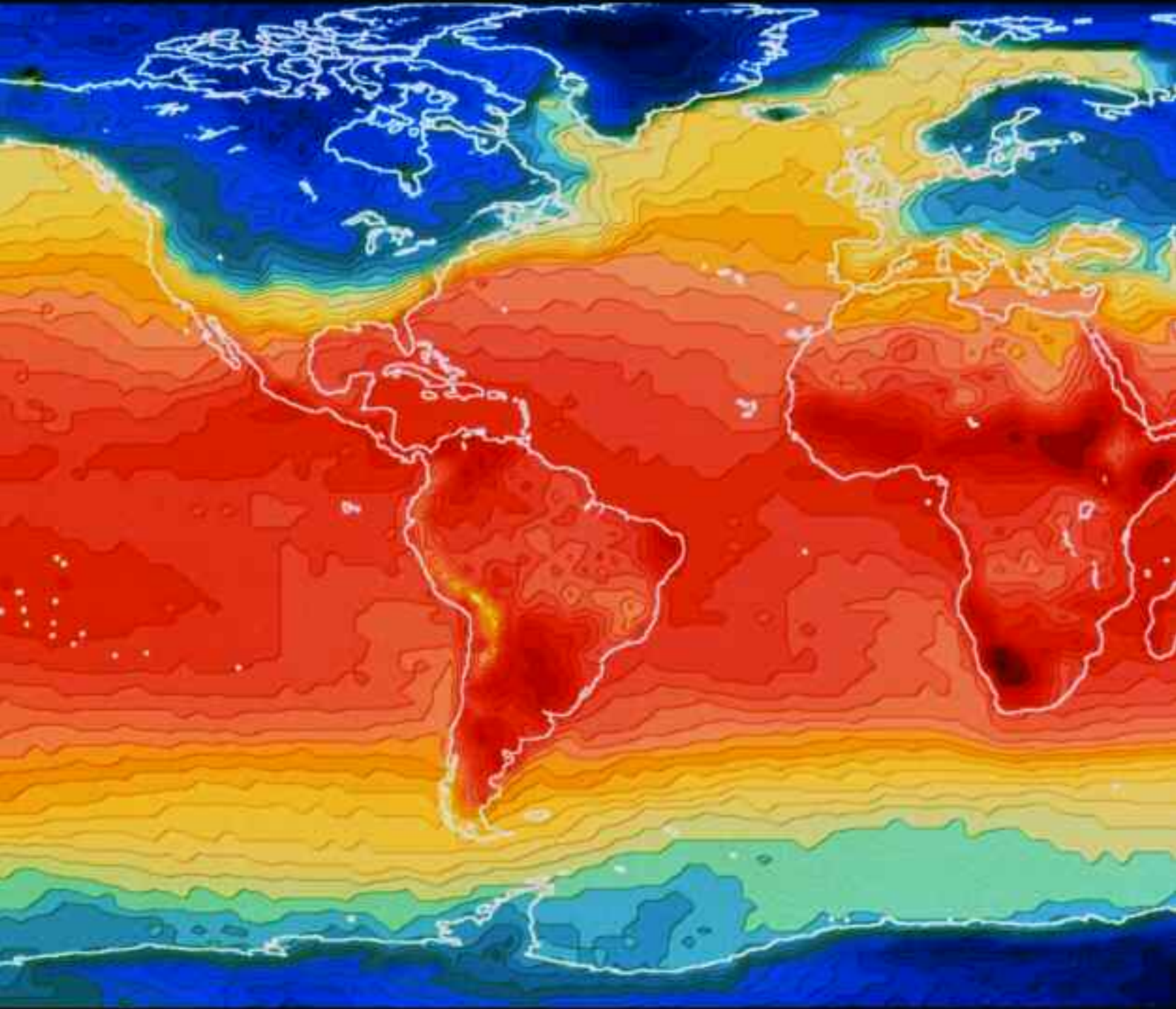
Source: Princeton Partners Group, WPS, Interfax, Vedemosti and KPMG Analysis

| Date | Russian company  | Foreign company           | Share of foreign capital (%) | Premiums collected by Russian company in 2006 (US\$ million) |
|------|------------------|---------------------------|------------------------------|--|
| 1994 | AIG Russia       | AIG                       | 100.0                        | 110.6  |
| 1996 | Zurich-Rus       | Zurich Financial Services | 100.0                        | 34.7   |
| 2006 | Energopolis      | DIFI                      | 100.0                        | 2.0  |
| 2006 | Standard Reserve | Wiener Staedtische        | 15.0                         | 183.4  |
| 2007 | Rosno            | Allianz SE                | 96.6                         | 739.0  |
| 2007 | Nasta            | Zurich Financial Services | 66.0                         | 241.1  |



**Global temperature. Satellite map of the world's average surface temperature.**

Photograph by NASA/Science Photo Library



# A changing climate

Climate change is likely to represent the single biggest issue facing insurers over the next 50 years or so. There is no longer a debate over whether it will occur, but rather how insurers will adapt and who the winners will be. [Brian Greig](#), [Chris Le Serve](#) and [Una O'Sullivan](#) explore the issues surrounding climate change.



Climate change is likely to represent the single biggest issue facing insurers over the next 50 years or so. Having been substantially researched, there is no longer a debate over whether it will occur, but rather how insurers will adapt and who the winners will be. In the last few years, climate change has rapidly risen up the survey lists of hot issues, appearing from nowhere to right at the top. It is clear that this is now an insurance CEO issue and for good reasons. Climate change as a whole presents numerous challenges to today's insurance leaders and not all of these challenges are as well understood as required.

We believe there are three core reasons as to why the insurance industry should take this issue seriously. Firstly, the risks and perils are changing. Records are being broken for the most hurricanes, the warmest winters, the most rainfall in a day, and consequently the most claims. Each new record should stand as a reminder to insurers to review their risk management processes and ensure that they are aware of their aggregate exposures. Secondly, we are witnessing a rise in stakeholder interest in how insurers are adapting to climate change. Investors, regulators, rating agencies and policyholders all have a vested interest in understanding insurance companies' overall exposure to climate change and the steps they are taking to account for it. Finally, as with all change, there will be those organizations that spot competitive opportunities, innovate and steal a competitive advantage. It may not be long before we see companies and products with a much stronger focus on "green business".

#### **Risks and perils**

The insurance industry has its founding principles in avoiding adverse selection and risk diversification. Climate change is likely to reinforce these principles further

with risk management becoming an increasingly complex and crucial tool. The speed of change no longer means Property and Casualty (P&C) insurers writing single year contracts can take comfort because that change is occurring from year to year. All research is pointing to exponential growth of insured losses due to extreme weather events, which is leading to increased capital requirements for insurers. Losses due to catastrophic weather have already increased 15 fold in the past 30 years. In an environment where solvency controls and enterprise risk management are causing insurers to improve their techniques for evaluating exposure, the risks associated with climate change have to be factored into these considerations. Adding to these firms' difficulties is the fact that historical weather datasets are becoming increasingly irrelevant, even with improvements to modeling techniques and larger datasets. As the old saying goes, "what we learn from history is that we don't learn from history".

Claims surge which led to inflated claims costs following Katrina are likely to present further risk management challenges and considerations. The sudden huge swell in demand combined with a highly restricted supply can only mean that the cost of claims will rise further due to short-term price inflation.

For the life insurers, the changing weather patterns are likely to present new perils to be considered. With the potential for warmer winters in Europe, will we witness the emergence of tropical diseases in Paris and London? Will people live longer due to the warmer weather? Who is accounting for this in the mortality tables?

There are no quick solutions, but the insurers who deal most effectively with this issue are those who are already taking steps to view climate change as a material risk that can impair future

# “Too little but not yet too late. The insurance industry must do more now to understand and actively manage climate change risk.”

## Lloyds 360 Risk Project

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earnings. This means a thorough assessment of exposure, keeping abreast of new knowledge from industry leaders, improvements to modeling techniques and better product portfolio management.

**Stakeholder demands**

As well as managing their own risks, insurers need to demonstrate to their stakeholders that they are doing this well. Climate change is moving beyond the Corporate Social Responsibility section of the annual report and insurers are increasingly required to disclose their exposure to the associated risks. Simultaneously, there is pressure on the industry to make available a range of new products, from insurance for new kinds of businesses through to more environmentally conscious products such as liability awareness for ecological impairment. Added to this, a lack of significant data can lead to uncertainty in the areas of pricing and risk analysis when new products are launched.

Alongside these changes, insurers are under pressure to demonstrate good practice. With industry leaders actively championing emissions reductions and “greener” businesses, many international insurance groups are accepting the challenge that they should lead by example. This is closely aligned to the industry's tradition of leading cultural change, and evidenced already by the growing number of insurers who are proclaiming more environmentally friendly initiatives for their own business operations. This already ranges from a declared intention to become “carbon neutral” through to active participation in environmental initiatives and financial services industry lobby groups. In the long term, this is consistent with the industry's desire to promote the integration of risk management and energy management.

**Competitive differentiation**

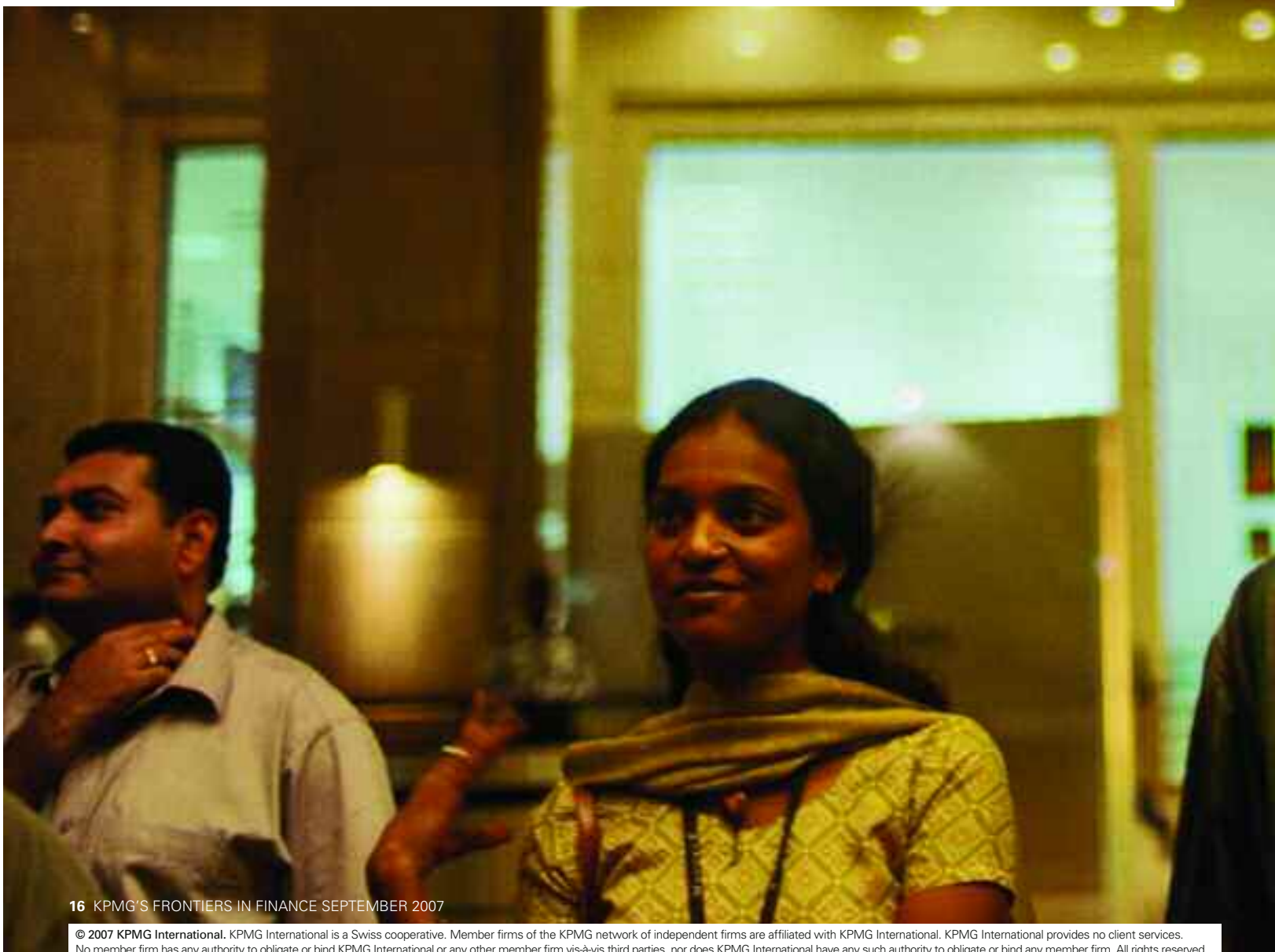
As climate change becomes directly linked to record insured losses, rating downgrades, reductions in coverage, price shocks and reduced capacity, insurers are under pressure to differentiate themselves by combining recognition and understanding of the risks associated with this issue together with a product portfolio and customer services that directly address consumers' own concerns. Already there is considerable progress, with the range of new products and services including hurricane loss prevention methods, “green” coverage that rewards environmentally conscious choices, participation in carbon offset projects and adjusting investment portfolios to promote sustainability.

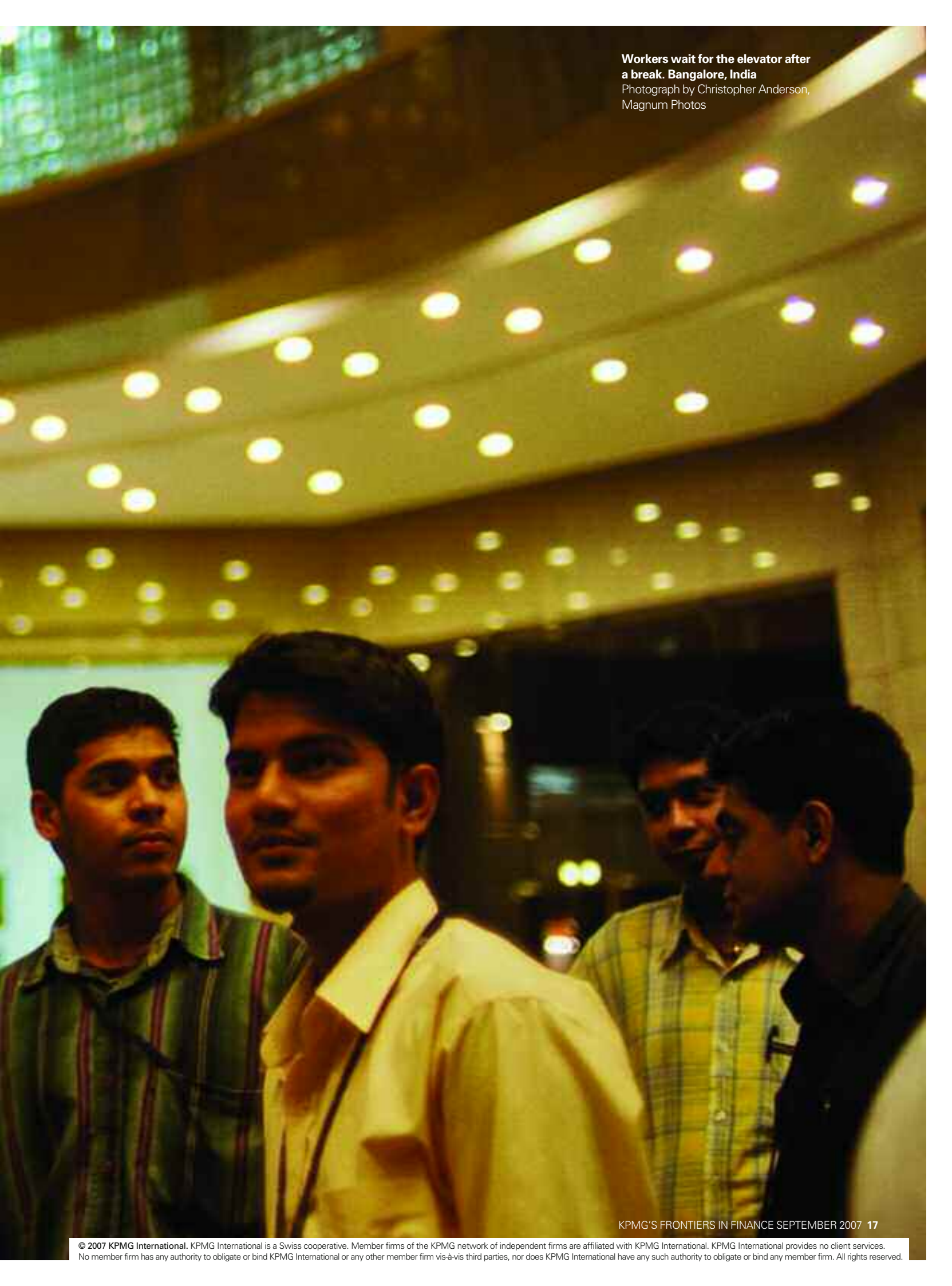
When balanced against a proper appreciation of exposure to climate change, and the demands of stakeholders to be both environmentally responsible and risk focused, the importance of competitive differentiation becomes clear. We predict that the early winners will be those who directly address the concerns of their stakeholders not simply by paying lip service to green business but by demonstrating good practice and offering an environmentally-aware portfolio of products and services.

In conclusion, climate change represents an unavoidable and rapidly growing risk to business in the insurance industry. Insurers have the advantage of being thought leaders and advisers at the highest levels, but they also need to translate this knowledge into better risk management, better disclosure of the steps they are taking to mitigate this risk, and deeper involvement in the development and promotion of climate change mitigation strategies. The time to act is now.

# Insurance outsourcing: India leads the way

Insurance companies have traditionally been among the slowest adopters of outsourcing/offshoring. But in the past few years the market has changed as a result of shrinking margins, higher claims disbursement and increasing competition, especially since September 11, 2001. [Sanjay Aggarwal](#) reviews how, as a result, insurance companies have been forced to look at outsourcing/offshoring to improve efficiencies and channel resources towards the core functions of product development and innovation.





Workers wait for the elevator after a break. Bangalore, India  
Photograph by Christopher Anderson, Magnum Photos

The size of the insurance industry, with over 1,500 property and casualty insurance companies and 1,300 health insurance companies in the U.S. alone, makes insurance outsourcing an attractive market. To cash in on the growth potential, several niche providers with relevant expertise are investing, and encouraging insurance companies to outsource more value-added services. Some of the key drivers of insurance offshoring include:

- Cost saving
- Focus on core processes
- Speed to market
- Technology risk
- Better quality through specialized services
- Insurance regulation and statutory documentation in the U.S.
- Deregulation of insurance markets
- Health Maintenance Organizations moving their processes offshore
- Availability of credible service providers
- Minimizing risk through multiple delivery locations
- Resolving inquiries without handing off the caller to other administrators.

Factors inhibiting insurance companies from offshoring include:

- Cultural differences
- Perception of loss of control
- Local data protection and regulation.

**Insurance offshoring: The growth opportunity**

Primary insurers currently dominate the buyer landscape. However, in the future the industry may also see offshoring from intermediaries and reinsurance companies. Buyers in the U.K. and Europe are likely to increase their share of the insurance offshoring market, while the share of business from the U.S. buyers is expected to fall by 2010. As the industry matures, the share of higher value services such as underwriting support and analytics are likely to increase.



**Insurance outsourcing in India**

The Indian offshoring industry is particularly strong in this sector. Total estimated revenues from offshore insurance business process outsourcing (BPO) services from India were expected to rise from US\$790 million in 2007 to about US\$2 billion by 2010. Employment in the Indian insurance offshoring sector is likely to increase from 41,600 to 100,500 in 2010.

India has several benefits as a leading insurance outsourcing destination:

- Low cost advantage
- Established destination for outsourcing
- Indian companies offer near-shore services
- Indian IT outsourcers can leverage their existing relationships with large insurers
- Indian vendors are expanding organically and inorganically to establish a multi-location presence and to de-risk their business.

As insurance services mature and more high-end processes like analytics, actuarial

and underwriting services move to India, the BPO industry is expected to grow further. Another growth area is claims and policy administration.

Providers include large, mid-size and small service companies. The larger BPO companies are diversified across many sectors; they have significant global reach, with marketing and delivery centers spread across the world. This group is likely to continue to dominate the landscape in the next two to three years. Most mid-size players have grown considerably in the last two years. They have diversified into additional insurance segments (life, healthcare and property and casualty) and broadened their service offerings. Some of these players, especially the BPO offshoots of IT companies, have good potential to grow both in size and specialization in the next two to three years.

The table below illustrates typical processes within the insurance sector that are currently being offshored:

**Typically offshored processes**

| New business acquisition | Policy management              | Claims processing            | Financial accounting        | Support functions       |
|--------------------------|--------------------------------|------------------------------|-----------------------------|-------------------------|
| ▫ Proposal acquisition   | ▫ Policy holder correspondence | ▫ Claim set up               | ▫ Closed book accounting    | ▫ Help desk             |
| ▫ Digitalization         | ▫ Mailroom services            | ▫ Account settlement         | ▫ Fund performance analysis | ▫ Broker support        |
| ▫ Policy issuance        | ▫ Record changes               | ▫ Validation and eligibility | ▫ Compliance verification   | ▫ Payroll processing    |
| ▫ Risk assessment        |                                | ▫ Excess reinsurance         |                             | ▫ Facilities management |

By 2010, a large number of Indian vendors are expected to evolve into mature, end-to-end service providers, competing with multi-national outsourcing companies. Players such as Genpact, WNS and EXL Services, as well as BPO offshoots of IT companies such as IBM, TCS, Infosys (Progeon) and Wipro, are expected to emerge as competitive global players.

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**Left and below: Workers in Bangalore, India.**

Photographs by Christopher Anderson,  
Magnum Photos

## Insurance outsourcing

### Key concerns and risks

- Data security, intellectual property protection
- Managing the retained and remote organization
- Cost inflation, competitiveness and trade-offs
- Critical mass: what should not be offshored?
- Infrastructure capacity and quality
- Tax and legal issues
- Attrition and people availability
- Regulatory concerns and compliance
- Reputation risks
- Exit barriers
- Geocapital concerns
- Concentration risk and country exposure
- Business continuity/disaster recovery
- Vendor capability

### Likely future trends

- Fortune 500 companies to increase their IT outsourcing budget in 2007. Insurance outsourcing likely to grow to US\$790 million in 2007 from an estimated US\$367 million in 2003, at a CAGR of 21 percent
- Companies will focus more on security, storage and disaster recovery services
- Indian vendors will expand organically and inorganically to establish a multi-location presence, to de-risk their business
- More business is expected out of the European insurance market, which is likely to increase from the present 24 percent to 36 percent by 2010
- Rising trend towards outsourcing of higher-end insurance processes such as underwriting, actuarial and analytics
- Benefit from external supplier expertise, by tapping potential skills sets across IT and operations

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**W**hy should an insurance group, awash with cash, prioritize effective cash management? The general insurance industry generates an abundance of cash, retains it for long periods, and pays out vast amounts in claims settlements, so why worry?

The answer is simple. Cash management affects profitability. It's surprising then that cash management does not seem to be at the top of every insurance group's agenda.

If premium income, reinsurance claims and investment income are the metaphorical taps supplying the "cash" bath then claims payments, reinsurance premium and operating expenses are the main items forming an orderly queue down the drain. Effective cash management is about maximizing the flow through the taps, letting as little down the drain as possible and limiting the amounts lost through splashes caused by inefficient management of the cash operating cycle.

Ultimately it is about keeping the level of bath water as high as possible to improve returns to shareholders.

Consolidation in the general insurance sector, new investors looking to make

quick returns, lower investment income, new capital adequacy requirements and client money rules are all factors which have begun to shift the focus onto managing cash efficiently. Successfully managing cash can increase the confidence of the regulator and ratings agencies in the business and improve the returns for shareholders.

So where do the leakages and splashes come from that might flush a group's profits down the drain?

#### Premium income leakages

- Bad debts, where the underwriting team focus on writing the risk itself but not on the insured's ability to pay
- Incomplete and inaccurate billing
- Failure to process reinstatement premiums promptly
- Ineffective credit control
- The net accounting system which means that companies may not even be aware who they are owed premium by, let alone chase it
- Unallocated cash.

#### Reinsurance function leakages

- Failure to claim resulting from inadequate linkage between inwards claim agreement and processing of reinsurance collection notes

- Time lags between inwards claims being paid and the associated reinsurance being billed
- Bad debt through reinsurer credit risk
- Avoidance by reinsurers through poor or missing policy wording
- Inadequate credit control policies and procedures
- Unallocated cash not being processed.

#### Investment income leakages

- Lack of a group-wide treasury function pooling all the group's free cash and maximizing returns on a group basis
- The treasury function not being equipped to follow industry best practice
- Lack of a system to upstream cash leading to monies sitting in low or no interest rate accounts for too long
- Lack of cash forecasting leading to investment penalties when monies are required at short notice
- Inefficient or non-existent asset versus liability matching leading to losses from interest rate and exchange rate fluctuations.

Effective cash management is not about squeezing your creditors or increasing the risk profile of your investment portfolio. There are many reasonably simple ways, borrowed largely from other industries,

# Profits

## down the drain?

John Milsom and Arndt Gossmann look at cost management for insurance companies.

of plugging these leakages and reducing the impact from the splashes in the cash operating cycle:

- Introduction of robust cash forecasting for the key areas of the business
- A review of the investment strategy and processes for the business to identify the areas where improvements can be made to help maximize the group's return on their investments
- Introduction of cash targets and KPIs for the credit control and other functions
- Introduction of principal to principal accounting to demonstrate the global relationships between a group and insurers and reinsurers
- Review of service level agreements with brokers and other intermediaries, and monitoring compliance to help ensure cash held is paid over within agreed terms
- A better understanding of the workings of the reinsurance program to help ensure maximum cessions
- Improving communication between the claims and reinsurance teams to reduce the lag in billing reinsurance and improve the quality of the information sent to reinsurers
- Introduction of project appraisal procedures to help ensure that projects are properly supported, adequately

funded and phased to suit the businesses objectives

- Review of expense payment controls to identify areas for improvement and reduce operating expenses.

One of the keys to the success of any proposed response is embedding a cash culture within the business. This might take time and is likely to be a staged process. First, senior management needs to be made aware of the issues or leakages from the current system. This will only be possible by improving the visibility of the issues through simple forecasting, and demonstrating the effect that inefficient cash management is having on profitability.

Second, the proposed changes and their key benefits will need to be explained to senior management and it will also be necessary to show that the changes fit with known and strategic priorities for the group. Once senior management sponsorship for the changes has been obtained, appropriate structures need to be put in place to implement these changes on the ground, both from a training and reward perspective.

Encouraging management to focus on the future cash requirements and performance of the business will

necessarily involve an examination of the key business cash drivers. This can help to strengthen the underlying business. Improved visibility and reliability of information should allow key decisions to be taken with confidence and in a timely fashion.

In addition to the potential benefits outlined above, proactive management of cash can generate additional free cash and profits for the group. Perhaps rather than plugging the leaks, it will be a case of dealing with an overflowing bath – a problem most groups would be very happy to deal with.

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Insurance fraud is a massive problem in all advanced economies. With increased pressure on insurers' margins, even incremental reductions in leakage can yield substantial benefits. Traditionally, insurers relied on internal identification and referral processes and specialist investigators to spot suspicious claims. But the sophisticated use of technology is playing an ever bigger role, as David Hicks, Patricia Tilton and Frank Weller explain.

# Beating insurance fraud there is a smarter way

Claiming on insurance? Everybody exaggerates a bit, don't they? It's perhaps unsurprising that when the U.K.'s Association of British Insurers (ABI) recently undertook a survey, it revealed that 1 in 10 adults – 5 million people in the U.K. – admits to having made a fraudulent claim on a general insurance policy, such as home or motor insurance.<sup>1</sup> Opportunistic fraud carried out by individual customers alone costs over £800 million a year. In total, the ABI estimates that insurance fraud costs £1.6 billion annually. Other estimates are much higher, and according to the Financial Services Authority, insurance fraud as a whole costs the U.K. economy around £14–20 billion a year.<sup>2</sup>

Nor is the U.K. untypical. There is also a serious issue in the U.S. Information from the KPMG Fraud Survey<sup>3</sup>, and surveys conducted by the Association of Certified Fraud Examiners and other industry groups, suggest that claims fraud remains one of the top reported instances of fraud. By definition, precise figures are difficult to establish. But the Coalition Against Insurance Fraud (CAIF) estimates that fraudulent insurance claims cost at least US\$80 billion every year.<sup>4</sup> Healthcare insurance fraud is a particularly serious issue. The National Health Care Anti-Fraud Association (NHCAA) estimates that of the nation's annual health care outlay, at least 3 percent – over US\$50 billion – is lost to outright fraud. Other estimates

by government and law enforcement agencies place the loss as high as 10 percent of the total: up to US\$200 billion each year.<sup>5</sup>

Although insurance fraud is often seen as a victimless crime, it is obvious that the related costs are borne by all consumers, through higher premiums. In addition, the costs of prevention, detection and investigation can impose a substantial economic penalty on insurance companies – both directly and indirectly.

Insurance fraudsters fall into a number of categories. At one extreme is the individual consumer who suffers a genuine loss, but pads the claim to recover more than is due. He may well feel: "I've paid these premiums for years, it's time to get a bit back." More premeditated fraud may involve outright deception. It is increasingly clear that organized gangs are involved in systematic fraud campaigns. In the U.K. some years ago, there was a wave of injury claims alleged to have been caused by tripping over broken paving slabs. More recently, organized criminals on both sides of the Atlantic have been operating "crash for cash" scams, deliberately staging car crashes and claiming for loss, damage and injuries such as whiplash, which are difficult to diagnose and assess. In the U.K., it is estimated that these gangs earn up to £4 million a week<sup>6</sup> from such fraud – money which may often be used to fund other crimes.

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## £800m

**Opportunistic fraud carried out by individual customers alone costs the U.K. over £800 million a year.**

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## £1.6bn

**In total, the ABI estimates that insurance fraud costs the U.K. £1.6 billion annually**

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There are even suggestions that national governments may be getting in on the act. A growing number of underwriters around the world strongly suspect that the North Korean government may be involved in a major and systematic international insurance scam.<sup>7</sup>

As developing countries experience growing insurance penetration (see, for example, the article on Russian insurance in this issue), it is inevitable that fraudsters will follow.

Insurers have fought for years to stem the rising tide of fraud, using a variety of techniques of forensic analysis, and with some success. Industry organizations and regulatory authorities in a number of countries are becoming more coordinated in sharing information, conducting investigations, and promoting training and awareness. But the costs of fighting fraud are high. Especially in a time of increased pressure on margins, there is a growing imperative to improve success rates in identification, detection, and prevention. Such improvements can bring two benefits: reduced costs of fraudulent payouts, and reduced costs of investigation and scrutiny of suspicious claims.

New technology-based systems can now use intelligent data mining and analysis techniques such as social network analysis, fuzzy matching and sophisticated modeling to spot suspicious patterns of activity and uncover links between claims. These systems can integrate in-house claims data and sophisticated statistical analysis with external information such as the details of known fraudsters, potential third parties involved and data from trade associations or industry bodies. Advanced data gathering and analysis allows claims to be screened and assessed based on defined criteria, to provide clearer indicators of potential fraud exposures. This forensic technology approach allows insurance firms to use their expert investigation resources efficiently and effectively to facilitate the detection of fraud, and reduce the risk that such crime may go unnoticed.

The financial benefits of this type of analysis are potentially significant both in lower loss and loss adjustment costs and also in internal costs. If improved detection and prevention can eliminate just a small proportion of fraudulent claims, this could add hundreds of millions of dollars to insurers' bottom lines –

this in turn may provide opportunity for increased margin.

But techniques of fraud, and the patterns of organized fraud activity, are constantly changing. It often seems that when one opportunity closes off another opens. This means that the most effective systems need constant, up-to-date access to claims data and relevant databases, and from the widest range of sources as possible. Many leading firms are considering outsourcing, or have outsourced, their fraud protection to specialists. A good analogy is with computer virus protection: the market-leading software companies offer subscription services to anti-virus technology which is updated daily, in response to a vast amount of information on new viruses collected world-wide.

This market for dedicated fraud protection and avoidance services is in its infancy, but set to grow rapidly. By subscribing to such technology services to reduce their exposure to fraud, insurers can put themselves in a strong position to price more competitively in what may be considered an already commoditized market. An insurance firm which gains a tough reputation for anti-fraud measures will become a highly unattractive prospect for potential fraudsters.

The ultimate aim of the new anti-fraud technology is to be able to identify patterns of fraudulent activity so effectively, and so rapidly, that it can feed back into the underwriting decision itself: rather than chase fraudulent claims once they have been made, the "holy grail" is to prevent policies, which are likely to generate them, being written in the first place. Early adopters of these new technologies may well gain significant commercial advantages.

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**\$80bn**

**The Coalition Against Insurance Fraud (CAIF) estimates that fraudulent insurance claims cost the U.S. at least US\$80 billion every year**

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**€4bn**

**The German Insurance Association estimates that insurance fraud costs Germany around €4bn every year.<sup>8</sup>**

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Straits of Gibraltar and the Mediterranean Sea  
from Space Shuttle.

A satellite photograph showing the Straits of Gibraltar and the Mediterranean Sea from space. The landmasses are visible in shades of green and brown, with the deep blue of the sea contrasting against the lighter blue of the atmosphere. The text is overlaid on the image.

# Bringing down the barriers: Securitizations go global

## An analysis of the advantages and implications

Today's insurance company CFO has more tools and options for the allocation and re-deployment of capital than ever before. The insurance industry as a whole is being driven forward by some key players which are creating innovative structures such as securitizations, contingent capital and finite risk reinsurance which are starting to change the traditional insurance landscape. Prior to the arrival of these innovations, the purchase of reinsurance and retrocessional capacity were the only options. Nick Dexter, Chris Le Serve and Erik Rood take a closer look on the developments in insurance securitization.





**R**ecent years have witnessed a growing trend in companies bundling up insurance risk and transferring it to an increasingly willing capital market.

Catastrophe bonds have been around since the early 1970's, but we are starting to witness different classes of business being transferred. AXA broke the mold with their securitization of the French motor book, signaling the possibility of transferring low severity, high frequency risks to the market. One can assume this was a success as AXA is now looking at doing the same with their Belgian, German, Italian and Spanish motor books of business.<sup>1</sup> Further innovation has come from Swiss Re with their Crystal Credit structure which was the first securitization of credit reinsurance treaties, and OIL Casualty with its US\$405m securitization of third party liabilities.<sup>2</sup> All this innovation suggests that there is a growing acceptance among the capital markets community of this type of product.

The increasing speed of globalization and the blurring of boundaries between financial services providers are helping drive this rise in securitizations. Barriers to securitizations, such as the quality of data and the understanding of risk by the capital markets, are slowly being eroded. The erosion of these barriers coincides with a time when there is surplus capital in the world seeking diversified investment opportunities, thus it is likely

that we will continue to witness insurance securitizations providing a viable capital management tool for the CFO for the near future.

However, it is important for firms to carry out feasibility studies to understand whether an insurance securitization is the right option. First of all, the securitization mechanism should fit the specific capital demands of the company. Insurers face many competing demands for capital, including growing new business, funding their acquisition strategies and meeting the demands of rating agencies and regulators. At the same time there is pressure on insurers to control earnings volatility and enhance their return on equity (ROE).

The attractiveness of each financing option will depend on a combination of factors such as supply in the market, pricing, structuring costs, execution time and risk. For example, fixed-income investors have a lot of appetite for catastrophe bonds because they yield reasonable returns. Moreover, since there is little correlation between cat bonds and corporate bonds or equity, they provide attractive opportunities to diversify a portfolio. A financial model that calculates the attractiveness of each option, for instance in terms of ROE, can be a very useful tool.

Besides assessing the economic soundness of the securitization (see example on next page), it is essential to

address all relevant regulatory, accounting and tax issues. The regulatory capital benefits of insurance-linked securities are sometimes unclear or understated. When AXA securitized the tail risks (catastrophe-like) of their motor portfolio they obtained rating agency capital relief and claimed that they would obtain regulatory capital relief from the French regulator. However, under Solvency I it is unlikely that by transferring the remote risks of a portfolio, substantial regulatory capital relief will be achieved. Therefore, it is vital to contact the regulator as early in the process as possible to address all relevant regulatory requirements.

With the introduction of the new Solvency II framework a much more risk-based approach will be taken to establish the minimum capital requirements. For example, this will mean that the transfer of peak risks receives the appropriate credit from the regulator. Moreover, it is anticipated that capital benefits achieved through securitization will become consistent between the regulatory position and the rating agency position, which should benefit the business case for securitizations.

The accounting treatment of insurance-linked securities obviously depends on the structure of the transaction and should be assessed on a case by case basis. Indemnity catastrophe bonds for instance, provided they are properly structured, are receiving similar

**With the introduction of the new Solvency II framework a much more risk-based approach will be taken to establish the minimum capital requirements. For example, this will mean that the transfer of peak risks receives the appropriate credit from the regulator.**

### Example

#### **Friends Provident Life and Pensions (FPLP)<sup>3</sup>**

FPLP in the U.K. raised £380m of Tier 1 regulatory capital at a cost of 20 bp by securitizing future cash flows (Value-In-Force) of its life portfolio. In total the cost of this regulatory capital amounted to 5.5 percent. The estimated cost for debt financing for FPLP, an A+ rated insurer, could be 7 percent, and is not recognized as Tier 1 regulatory capital. The cost of regulatory capital by equity financing for FPLP may be estimated at 9–10 percent. This example shows that securitization brought FPLP regulatory capital which can be used for financing future growth at a lower cost than traditional financing. FPLP stock prices increased by 2 percent in the weeks following the announcement and Merrill Lynch upgraded FPLP by 3 percent. Also it demonstrated that for FPLP there was no first mover disadvantage as was the case for first mover in the early days of mortgage-backed securitization (MBS).

accounting treatment to traditional reinsurance. For Value-In-Force (VIF) securitizations the main issue is how the special purpose entity (SPE) will be accounted for in the consolidated financial statements of the group raising finance. On this point you will likely see different treatments under IFRS versus local GAAP accounting.

When structuring an insurance securitization, careful and detailed tax planning is required to achieve tax neutrality. In some cases it is even possible that the securitization structure provides tax advantages.

Other important parts of the feasibility study include an initial assessment of the insurer's underlying systems to check the quality of the data, a detailed analysis of the insurer's position as underwriter and the terms and conditions of the insurance products.

The immediate future for insurance securitizations looks very positive with growing acceptance by the capital markets. It is clear that as frictional costs decrease and the volume of transactions rises, barriers to insurance securitizations will decline, leaving insurance companies with a credible capital management tool for the future.

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# Building a robust defense transfer pricing

Insurers are facing increasing scrutiny from fiscal authorities of intra-group reinsurance.

**Hugh von Bergen** and **Graham Seymour** explore some of the issues around how to justify and defend legitimate capital allocation decisions.





**A** key business issue  
 Transfer pricing is a key issue for multi-national groups because it is one of the main mechanisms by which capital, and hence profits, are allocated between headquarters and operating subsidiaries. Careful allocation of capital and application of appropriate transfer pricing policies can also be a legitimate means of ensuring profits are taxed in the lowest possible jurisdictions. Equally, of course, national fiscal authorities take close interest in transfer pricing to ensure that they maximize their tax revenues.

Historically, transfer pricing policies for cross-border reinsurance in multi-national insurers have tended to escape the closest scrutiny. The issues are complex, and many fiscs have lacked the expertise to mount a credible challenge to the pricing policy used. But this has now changed. In many jurisdictions, tax authorities have been turning renewed attention to transfer pricing issues generally, in order to maximize their tax take. And they are increasingly focusing on insurers, especially when low-tax territories such as Bermuda come into the equation.

#### **Transfer pricing and reinsurance**

Insurance companies have long used intra-group reinsurance (IGR) to reduce the amount of capital which is required by the local regulator and to optimize capital management at a group level.

Reinsurance is a complex business transaction. The uniqueness of each

portfolio of risks means that it cannot be treated as a commodity for which a price can be easily established. This complexity, together with a perceived lack of transparency, means that insufficient understanding of the role and pricing of reinsurance and a degree of scepticism are both evident among some fiscal authorities. The need to prepare and maintain robust transfer pricing analysis is therefore paramount.

#### **No comparable price**

According to the Organization for Economic Co-operation and Development's (OECD) guidelines, the fundamental tool in assessing the validity or justifiability of a particular transfer price is a so-called Comparable Uncontrolled Price (CUP), the price which two independent parties have struck for a comparable transaction. However, the CUP method does not normally provide a viable way of ascertaining an arm's length price for an individual IGR. Reinsurance involves wholesale transfer of risk from one party to another by way of a bespoke contract for which there is unlikely to be a comparable market reference transaction.

The underlying principle of the CUP can in theory be applied more fruitfully by examining a reinsurer's own pricing policies. This modified CUP approach uses the company's actuarial pricing model to generate an arm's length price for the transaction. It seeks to answer the question: "At what price would I be prepared to assume the liabilities being ceded, if this business were offered to

me by an external insurer?" In practice, such an approach is often not possible. One drawback is that this methodology assumes that the insurance group needs, and uses, an actuarially-based model for pricing inwards reinsurance business. For many direct writers, the in-house model may not in fact exist or, even if it does, it may not be possible to demonstrate that the model is used in practice to price analogous reinsurance transactions.

#### **Functional analysis**

Choosing an appropriate pricing methodology needs to be underpinned by a full account of the functions performed, assets owned, and liabilities assumed by each party to the transaction. Done properly, a functional analysis should address whether the skills, capital and assets in the ceding and reinsuring companies are sufficient to support the proposition that the parties, if independent and acting in a commercially rational manner, would enter into the reinsurance treaty being tested on the terms being used.

To answer this question, functional analysis needs to describe the business model of both parties to the transaction and the activities performed by the cedant in respect of the business being reinsured, and the other functions performed by the cedant which benefit other parts of the group (and vice versa). Functional analysis should ideally set out which entities:

- perform which functions – these should encompass the whole of the

**REINSURANCE IS A COMPLEX BUSINESS TRANSACTION. THE UNIQUENESS OF EACH PORTFOLIO OF RISKS MEANS THAT IT CANNOT BE TREATED AS A COMMODITY FOR WHICH A PRICE CAN BE EASILY ESTABLISHED.**

insurance value chain from business strategy and management through to support services

- own which assets e.g., brand, financial strength and pricing model(s)
- manage which risks e.g., liquidity, credit, reserve, legal, market and underwriting.

### **Transactional net margin method**

On the basis of an effective functional analysis, an alternative approach to the pricing issue, also endorsed by the OECD, can be adopted: the transactional net margin method (TNMM). Under this method the cedant seeks to demonstrate that, from the perspective of its shareholders, the pricing of the reinsurance transaction is such that the decision to enter into it is at worst economically neutral, i.e., the cedant's shareholder is projected to be at least in the same overall financial position after the IGR as it would have been without it. Put another way, the premium which the cedant pays is set at such a level that the net present value of the cash-flows after the IGR is at least equal to the net present value of the cash flows without the IGR.

This approach, while being technically robust and compellingly objective, is quite data hungry, although a well-managed company should not need to create data which it would not have created anyway for business purposes.

### **OECD's branch taxation proposals**

A complicating factor in the broad picture is the OECD's proposals on how their recommendations on branch taxation



and the attribution of profit to "permanent establishments" should apply to insurance. The OECD's philosophy is strongly influenced by the concept of the key entrepreneurial risk taking function (KERT). This locates value-creating activities in business functions and the individuals who undertake them, as a basis for attributing profit share. Its application to the reinsurance process, which is fundamentally an issue of capital rather than labor, remains problematic. The OECD recommendations are likely to strengthen tax authorities' scepticism about the validity of reinsurance as a legitimate tool of capital management.

### **Insurers need to take the initiative**

In short, cross-border taxation of global insurance companies is becoming a real focus of attention from tax authorities, prompted inter alia by:

- increasingly sophisticated transfer pricing rules
- the suspicion on the part of tax authorities that IGRs are being priced in a way which does not conform to an arm's length standard
- an increasing willingness on their part to look more closely at IGRs
- the attention which Part IV of the OECD work on branch taxation draws to this area.

Against this background, insurers cannot afford to sit on their hands. A robust defense of transfer pricing policy is going to be increasingly important in sustaining a group's effective tax rate. Developing such a defense will take time and effort, and needs to start now.

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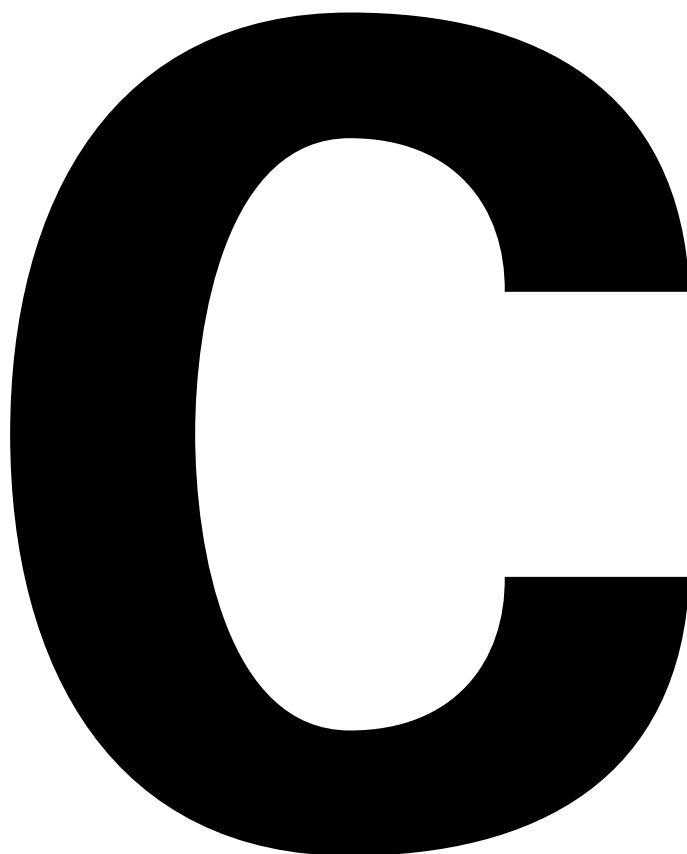
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Taking an  
enterprise-  
wide view  
of risk:  
The evolving  
role of the



The role of the Chief Risk Officer (CRO) is key if insurance companies are to deliver their vision of thorough, enterprise-wide risk management. Aaron Halpert and Frederik Boetius explore the challenges faced by CROs and the skills and experience they need to be successful.

# R





**T**he insurance industry is all about risk; and some aspects of risk management have been developed to a high level of sophistication. But in the past, the focus was on managing risk separately within individual areas such as underwriting, reserving and investment; with risk mitigation activities such as reinsurance and asset liability matching addressed within these silos. At the same time, individual business units concentrated only on those risks they perceived to be key – such as underwriting and reserving in Property and Casualty, or asset liability management in life. By its nature, this approach to risk management was quantitative and analytical.

Some five to eight years ago, financial services businesses in general began realizing the downside to the traditional approach of managing risk in silos – not least because of a number of high profile business failures. In response, they began to adopt an enterprise-wide risk management approach.

“Enterprise Risk Management” (ERM) involves a holistic view of risk across the organization. In addition to connecting up the traditional silos and ensuring that the measurement and management of insurance risk is consistent, ERM also embraces more qualitative aspects of risk, such as operational and reputational risks. Inevitably, the move to ERM created the need for a senior manager to take organization-wide responsibility for it – the Chief Risk Officer (CRO).

### Role of the CRO

It is the task of the CRO to work with the Board to establish a clear statement of the

group’s risk appetite, risk limits and expectations of return, and then to apply that knowledge to an integrated and well-defined understanding of the suite of risks the company faces across its business activities. This allows for a mechanism by which strategic decisions are made with a clear knowledge of the risks involved. The aim is partly defensive – to ensure that the group has sufficient financial resources to discharge their liabilities with a sufficient level of confidence, consistent with the agreed risk appetite. But it is also partly about enabling the group to move quickly to assess “upside” risk and seize the right opportunities when they arise.

The CRO is the catalyst in delivering these objectives. Working in conjunction with senior management, the CRO must establish an integrated risk management framework for all aspects of risk across the whole organization, develop appropriate policies, implement consistent risk metrics and reports, and put in place the analytical systems and data management capabilities that will support the ERM program. Capital should be allocated to business activities based on risk, and the company’s risk profile further enhanced through risk transfer and other risk mitigation strategies.

In the case of insurance, the concept of economic capital is generally well-established; and underwriting and reserving risks, together with asset and liability management, may already be built into an economic capital model. However, insurance companies, and others, are learning that required economic capital must also be reflective of other risks, and that the focus on capital is not the end game. It is, rather,

**ERM is still evolving – and with it the role of the CRO. From a baseline of assessing and mitigating traditional insurance risk, with the focus on each individual business unit, the duties of a CRO have expanded considerably.**

a reflection of the amount of risk the organization is accepting. And there are some aspects of risk, in particular operational risk, that may not be well understood. For example, a critical aspect of operational risk is the group’s relationships with vendors. In this case, it would be the task of the CRO to put in place suitable protocols to manage this risk (and the task of Internal Audit to ensure they are being applied scrupulously).

Equally, in traditional areas like reserving and underwriting, an insurance group may already have adequate tools to measure and monitor risk, which the CRO can harvest. But in operational risk, the quality of the historical data is usually too poor or limited and other ways of assessing and managing risk, such as scenario analysis, may need to be developed.

While damage to a firm’s reputation is normally a consequence of other failures – operational, control – reputational risk is another aspect that the CRO has to consider. For example, a company that has to increase its technical reserves may not only incur direct financial losses, its management may also suffer a loss of credibility with rating agencies and regulators that could, for example, restrict their ability to grow or even maintain their current level of business.

All this needs to be underpinned by an ERM culture built through relevant communications, training and incentives. This includes raising awareness of risk at all levels of the organization, including a strong and sustained articulation of the risk management value proposition – namely that better risk management



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means lower required capital and greater competitive advantage.

Building a modern risk management culture does not happen overnight. It is a multi-year project. So the CRO has to set out a clear vision, direction of travel and milestones against which progress can be measured. All the relevant stakeholders have to be engaged in the new, enterprise-wide way of working. And in addition to driving this change, the day-to-day work of identifying and managing risk still has to be conducted.

**CRO's place in the organization**

There is, as yet, no single "best practice" way of organizing ERM within large insurance groups – apart from the recognition that the CRO must report directly, and regularly, to the Board. In other aspects, the function is still evolving and different insurance groups are applying different structures. It is, though, important that there is complete clarity, not just about individual roles and responsibilities, but also about how they all fit together.

Whatever the formal and informal reporting lines, all business units need to take an enterprise first view of risk and maintain constant communication, so that everyone understands the potential impact of one business unit's action on other units – and on the whole organization.

**Broad range of skills and experience needed**

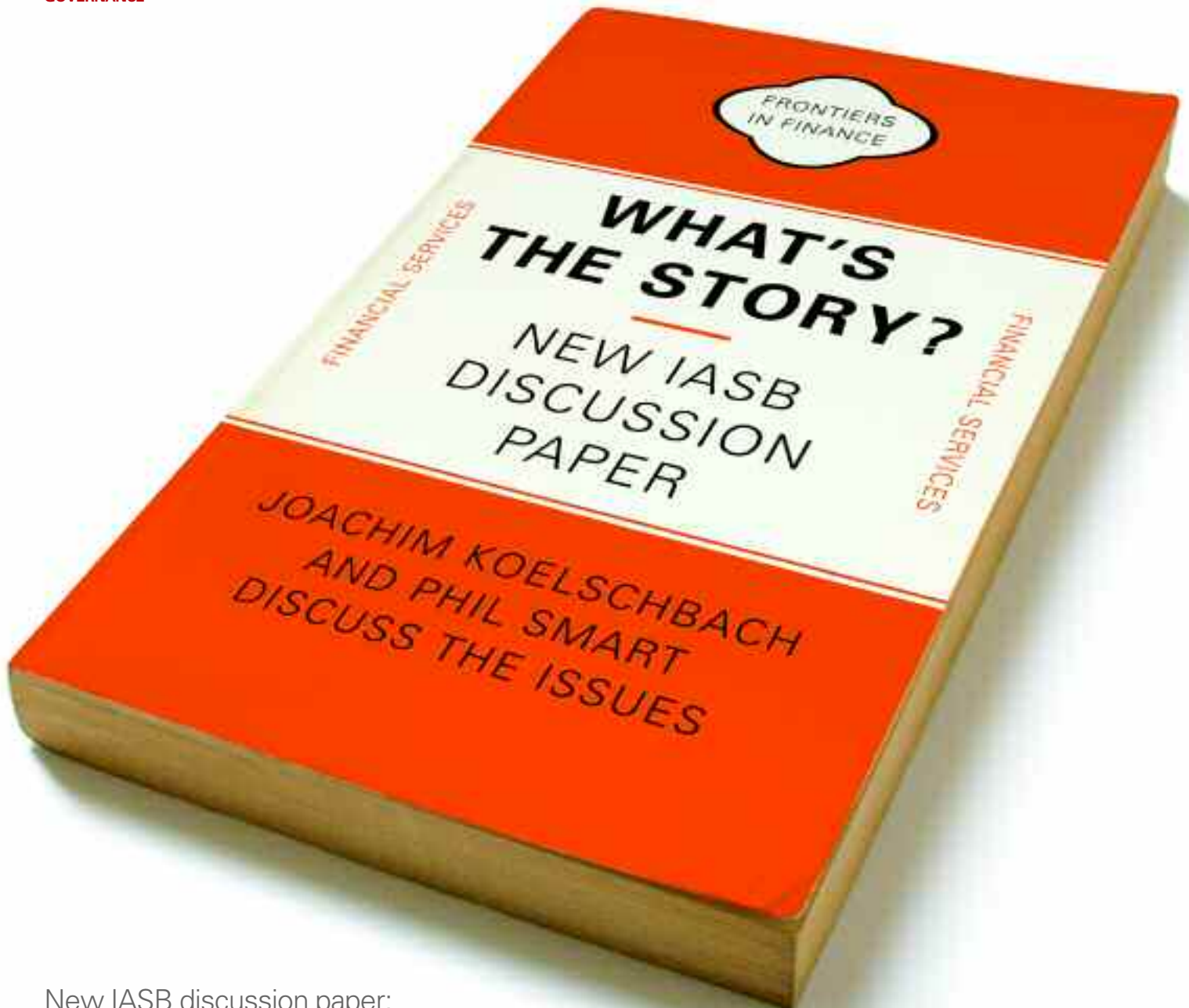
A new CRO has a lot to do to understand his/her organization's appetite for risk, demonstrate significant risk mitigation, and optimize the return on capital. The job

involves far more than just analyzing figures. Not least, the CRO has many stakeholders to manage – from the regulator, to policyholders, to shareholders. Sensitivity is often required. It may be difficult for business units that had significantly more autonomy or power under the old silo system of risk management to adapt to an ERM system in which they have to operate very much as a team player. Under ERM, for example, Internal Audit plays a key role in providing assurance that the group-wide risk management protocols are being correctly applied, but it is just one part of the group's risk management. The CRO may have to convince the Internal Audit team that this does not diminish their importance, but rather places their activities in a broader context. To succeed in the role, a CRO therefore needs a wide variety of skills and experience. At first glance, analytical skills to understand risk identification, quantification and aggregation would appear to be paramount. But in fact, the technical side of this work can readily be delegated. Rather, the CRO needs to embody a broader range of abilities:

- Understanding every aspect of the business: not just underwriting, claims and investments, but IT, human resources, communications, procurement and so on
- Communication skills, including the ability to educate, to be a "change agent", and to interact confidently with both internal and external stakeholders
- The willingness and strength of character to probe and not to accept things at face value

- Credibility with senior management. ERM may require fundamental strategic changes in group policies and decision-making processes, which will only happen if the CRO can convince senior colleagues of their value
- Political awareness. The change to an ERM culture will inevitably affect internal jurisdictions and roles. A CRO needs to be alert to these issues – and able to identify the best strategies to address them
- Leadership qualities. Above all, the CRO has to be a leader, capable of getting the group's senior management, risk management community and line management aligned behind the ERM vision and contributing to its success.

ERM is still evolving – and with it the role of the CRO. From a baseline of assessing and mitigating traditional insurance risk, with the focus on each individual business unit, the duties of a CRO have expanded considerably. These duties now encompass all areas of an insurer's operations, requiring close teaming with senior management, the Board and all business units. The skill sets and leadership qualities necessary for effective CROs have elevated their status to the most senior levels. These are exciting times for CROs, who have a great chance to broaden their thinking and add even more value to their organizations.



New IASB discussion paper:  
What's the story?  
Joachim Koelschbach and  
Phil Smart discuss the issues

**O**n May 3, 2007 the International Accounting Standards Board (IASB) published a discussion paper on Phase II of its insurance project, which sets out the IAS Board's preliminary views on insurance contracts and which is open for comment until November 16, 2007. The paper is in line with expectations, but the grouping of the various issues allows a better understanding of the way in which the views were reached. However, at some points, e.g., where the consideration of favorable policyholders' behavior and the valuation

of a policyholder's right to participate in favorable contract performance are dealt with, a theoretically sound and principle-based approach is still lacking.

The core issue of the paper is the valuation of insurance contracts at a "current exit value". Market prices exist for insurance risks in very few individual cases, therefore valuation techniques will need to be applied in an attempt to reproduce the presumed pricing process of a market participant on a theoretical basis.

The proposed method of measuring insurance liabilities is comprised of three components:

1. an unbiased estimate of future cash flows on the basis of rights and obligations arising from the insurance contract, which must be
2. discounted to allow for the time value of money, and
3. be increased by a margin that market participants would require for bearing risk and providing other services.

This basically complies with conventional actuarial processes in life assurance. However, the devil is in the detail. The method is intended to apply to all types of insurance contracts.

In contrast with, for example, embedded value, only cash flows arising from legal and constructive obligations arising from the contract can be taken into account; expected but not compulsory cash flows, such as future premiums or voluntary policyholder dividends should be excluded. In doing so, the cash flows to be taken into account should be the same as those that would be taken into account by an acquirer of the rights and obligations arising from the contract; therefore the company-specific amount of cash flows, e.g., due to market-atypical administrative (in)efficiencies are not relevant. The expected value of the cash flows should be unbiased, therefore must not be assessed on a prudent basis, but the risk of error should be taken into account in the risk margin. Discounting is not affected by the expected investment income, but solely on the basis of current market rates of interest for cash flows of corresponding duration, currency and liquidity. The margins are to be estimated solely for the assumed risk of deviation (risk margin), and/or for the assumption of a service (service margin).

The choice of the "current exit value" as the measurement attribute is not meant to imply the intention to transfer the insurance liabilities; it is only meant to provide an objectively comparable assessment of the risks based on a criterion that would be applied by market participants, and therefore to provide useful information that will help users make economic decisions. In this context, the IASB takes into consideration the pooling of risks within a portfolio, and considers that risk margins should be determined for contracts with similar risks that are managed together as a single portfolio.

The question arises as to whether a "current exit value" is an appropriate valuation method. A theoretical "current exit

value" may deviate considerably from the price charged to the policyholder, so that the initial recording of the contract in the balance sheet may result in the recognition of a profit on the inception of a contract. As a result of the lack of observable prices for an objective evaluation, there are reservations regarding the reliability and decision-usefulness of the results.

The industry rightly points out that the provision of insurance cover means the rendering of a service over time and that the profits should as a consequence be recognized in line with the risk profile. However, the paper implies that some compromise may be possible. One possibility is that the calibration would include a reputable assumption that market participants require a margin consistent with that implied by the actual premium (less acquisition costs). Observable company-specific cost expectations should be considered when there is uncertainty about the expectations that market participants would have.

As a matter of principle, the paper stipulates that the only premiums that are permitted to be taken into account are those where the insurer has a legal right. Conversely, all costs of acquiring insurance contracts must be expensed when incurred. As non-enforceable future premiums are not taken into account, the acquisition costs may not be covered by future premiums permitted to be considered, which may lead to the recognition of an initial loss. Thus the reported result will clearly deviate from the economic expectations arising from the business model of the insurance industry. A compromise is proposed here as well: in certain circumstances, non-enforceable future premiums may be taken into account, where the criterion of "guaranteed insurability" (a right that permits continued

coverage without reconfirmation of the policyholders risk profile and at a price that is contractually constrained) is met. However, that criterion does not provide solutions in the case of, for instance, annuity contracts.

The issue of subsequent valuation has hardly been considered by the paper, nor has the problem of high volatility resulting from the adjustment of all assumptions to current circumstances been addressed, where the statistical conditions are even more unfavorable. In these circumstances it may be advisable to consider how acceptable calibrations can result in improved reliability.

The treatment of policyholder participation rights is crucial to the valuation of life assurance liabilities. The IASB has thoroughly dealt with this particularly complex issue and has adopted a principle-based approach. Accordingly, the risk margin is determined on the basis of the residual risk to the insurer after the participation process. The valuation method otherwise largely depends on the policyholder's rights, whereby discretionary dividends must not be taken into account as a liability. In some countries, e.g., Germany, there is a contractual collective claim to a share in the periodic surplus, which results in a process similar to current US-GAAP, i.e., by the creation of a provision for deferred premium refunds. There will be no projection of future surplus payouts to the individual policyholder.

The paper will certainly meet with considerable criticism by reason of its adoption of a theoretical exit value. However, the IASB is bound by its framework, and the challenge will be to find solutions that reconcile the pragmatic approach of the insurance industry with the framework using a principle-based method that can be applied worldwide.

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**The treatment of policyholder participation rights is crucial to the valuation of life assurance liabilities. The IASB has comprehensively dealt with this particularly complex issue and has adopted a principle-based approach.**



# Time to take a look under the hood of your economic capital models?

In the following article Aaron Halpert, Giselle Lim and Peter Ott explain what should be found under the hood.



## **E**conomic capital models

Internal economic capital models are continuously gaining in importance due to regulatory and business drivers which include:

- **Regulators:** for EU insurers internal economic capital models are encouraged as an alternative to the standard economic capital model for the calculation of the Solvency Capital Requirement (SCR) under Solvency II. There will be quantitative incentives for firms to invest in their own internal models which will more accurately reflect their individual risk exposures and mitigation strategies. Integration of such models into business processes and decision-making should lead to better risk management and deliver Pillar 2 benefits.
- **Ratings:** rating agencies are placing increasing weight on firms' internal modeling as a key part of their Enterprise Risk Management framework. This focus is likely to increase over time and be reinforced by the changes brought about by Solvency II. The insurance industry is expecting that internal economic capital models will become part of the key criteria used to assess a well-managed insurer and thus impact the views of financial analysts.
- **Risk and return optimization:** internal models are not just about regulatory capital, they can provide information to support key business decisions around capital allocation, assessment of risk adjusted return on capital by line, risk or deal. Models can also support technical pricing, active portfolio management, concentration analysis, risk transfer analysis and optimal reinsurance structures.

### **What is the case for objective validation?**

While the drivers for models are universal, internal models exhibit – more often than not – highly complex and company specific features reflecting firms' individual business plans, market views and management assumptions. On the one hand these features are part of their appeal. On the other hand they make it difficult for senior management to assess their quality and accuracy. Proper quality assurance is essential because of the importance of internal models in modern business management, to regulators, and to rating agencies.

While the high level architecture of most

internal economic capital models will have some commonalities, there are a multitude of possibilities when it comes to detailed implementation, including issues such as the approach to the model's integration into the firm's business processes. For model reviewers it is good practice not to have been directly involved in the development or deployment process of the model, to be able to make a knowledgeable evaluation of the entire modeling process, and to be able to draw comparisons to leading industry practice. The scarcity of such resources is a key issue, and in many instances makes the case for an external review.

In addition, external stakeholders such as rating agencies and regulators may explicitly require external reviews. Moody's has explicitly raised the subject of external reviews in a recent document<sup>1</sup> concerning the impact of internal models on their ratings. Solvency II is likely to require an annual model validation exercise.

Board and senior management members will gain comfort in the knowledge that the model on which they plan to base far-reaching decisions has been independently reviewed and validated to a high professional standard.

**An approach to economic capital model validation**

Models are validated against their objective and their intended use. A comprehensive model validation will include reviews of the modeling methodology and approach, the accuracy and robustness of the technical implementation, the data driving the model, and the procedural and governance aspects surrounding its use. Figure 1 depicts this approach to model validation.

**What decisions are to be modeled?**

The investigation of *objectives* is a fact-gathering step identifying senior management's goals for the model and its use. This step should sketch the basic facts about the business environment the model is to be used in, the types of decisions it will support, and the benefits and value it is expected to create. Creating a model suitable for both current and future use is a considerable challenge and it is important to understand these objectives fully. Ultimate findings would compare the "as is" state with these objectives.

**Is the model fit for purpose?**

Due to the complexity of economic capital models, structure and *methodology* are

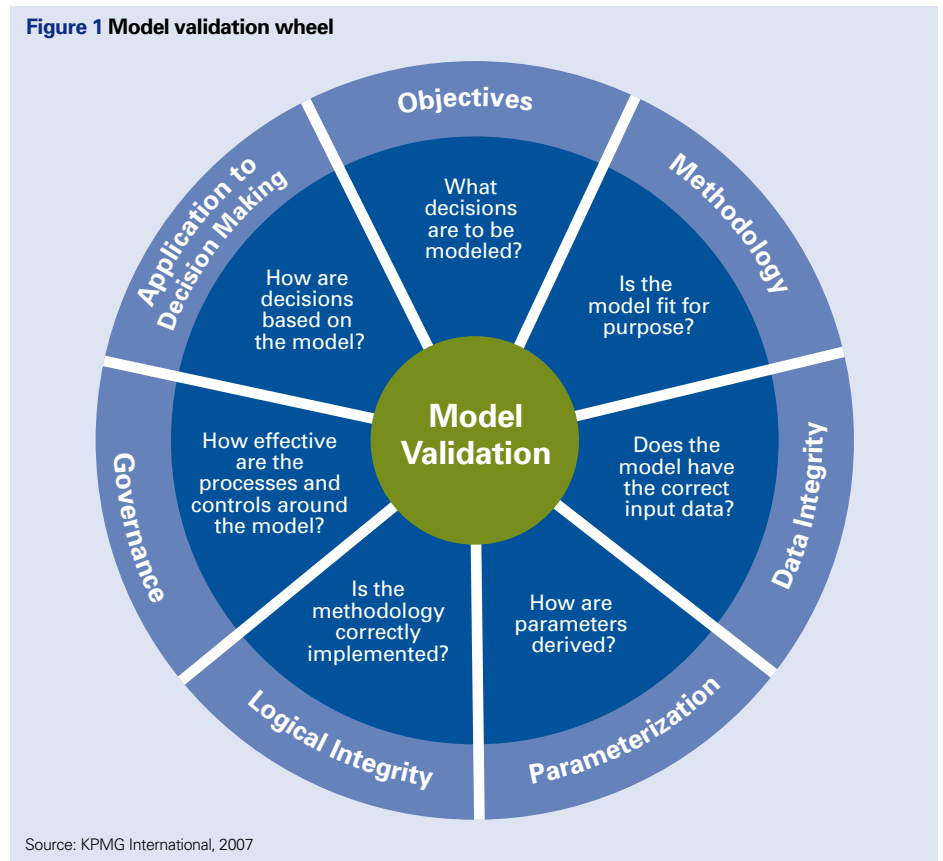
typically described and validated in several complementary layers of abstraction. This is usually a substantial part of the validation exercise. Its main purpose is the assessment of the methodology and its appropriateness for achieving the objectives identified above. This stage considers whether the model is "fit for purpose" in terms of what it is trying to do and how management wants to use it.

**Does the model have the correct input data?**

The output of a model depends as much on the data it uses as on the modeling methodology which is employed. The validation of *data integrity* addresses the adequacy of the data gathering process for the purpose of the model. It also validates that the interpretation of data in the model's methodology is consistent with the data collected by the insurer. Where appropriate it will also be investigated to what extent the data used in the modeling are consistent with the data used for business planning and other financial reporting.

**How are parameters derived?**

Model parameters are derived from collected data. Since for the purpose of



## External stakeholders such as rating agencies and regulators may explicitly require external reviews.

economic capital calculation collected data are typically very scarce, *parameterization* often requires actuarial judgment as a decisive component. The objective of this step is the assessment of the quality and appropriateness of the process used for choosing parameters.

### *Is the methodology correctly implemented?*

The *logical integrity* of a model is distinct from its methodology and refers to the physical implementation of the model's logic in a computer program or simulation. The objective of this step is to validate that the model is materially free of logical errors, and that the approach taken in the physical implementation matches the intended methodology.

### *How effective are the processes and controls around the model?*

Modeling and usage of models is by itself an extensive process which requires the support of clear *governance*. The responsibilities are usually distributed over several departments and levels of hierarchy. Economic capital models generally attempt to model the company as a whole, requiring interaction with and data from many areas and departments. Care has to be taken that the incentives to support the modeling effort outweigh possible conflicts of interest. The objective of this step is to assess the adequateness of the processes and governance covering the models, including model build and development, and the use of the models in the organization.

### *How are the decisions based on the model?*

In the final step the *application to decision-making* is investigated. This final step identifies any gaps between the

objectives of modeling, the perceived implementation, and its actual use. It also links in very much to the regulatory and rating agency desire to see the "use test" being fulfilled within the business. In other words it is where the firm is able to demonstrate that the model is more than a black box that is dusted off once a year to calculate a capital number.

### **Conclusion**

Models are often key to enabling management to improve corporate decision-making, and economic capital models are fundamental to an insurer's pricing, financing, and capital decisions. As such, management and the Board would be well-advised to undertake the quality assurance necessary to satisfy themselves that the company's internal economic capital model possesses all the elements of integrity presented above.

1. Moody's Investors Service. Company built internal capital models expected to play greater part in Moody's insurance rating process. June 2006

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## Boardroom discussion points

- How does our economic capital influence our strategic decision-making, product pricing, financial investment and financial performance evaluation?
- Are our company models robust enough to get quantitative recognition from the rating agencies or qualify for capital relief from future regulation?
- What is our model telling us about our capacity to absorb losses given the complexity of risks we are assuming in our portfolio?
- In the wake of catastrophes such as hurricane Katrina, how does our model support us in defining our risk tolerance and corresponding risk mitigating strategies for keeping our risk exposure and losses within an acceptable tolerance?
- With the gaining momentum in public discussions on nascent risks such as global warming how is our model being used for extreme event management and emerging risk management?

## Model validation is intended to help insurers:

- Assess the appropriateness of their modeling methodology for their objectives
- Identify any errors, risks or limitations in the implementation of their models
- Identify value-adding opportunities to achieve business benefits by enhancing their models.

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## Performance

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## Bringing down the barriers: Securitized go global

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## Governance

### Taking an enterprise-wide view of risk: The evolving role of the CRO

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## New IASB discussion paper: What's the story?

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## Time to take a look under the hood of your economic capital models?

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## Keeping you informed

### Thought Leadership

KPMG firms' thought leadership library explores the challenges for the financial services sector raised by change in the broader business environment – the economy, the regulatory framework and the forces of globalization. Listed below are KPMG International and KPMG member firms' publications most relevant to the financial services industry:

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### Insurance Sector

China's Pension Market: the heavenly mandate  
Implementing IFRS in the Insurance Industry  
Insurance Insiders: [www.kpmginsiders.com](http://www.kpmginsiders.com)  
Insurance Insight 2007  
M&A appetite and strategy in the global insurance industry  
M&A survey of the Insurance Industry – Run for Cover  
Principles and Presentations  
Risk and Capital Management for Insurers – Second Annual Survey of Capital Assessment Practice in the Insurance Sector  
Solvency II Briefing series  
State of the Insurance Industry

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### Cross-Sector

Anti-money laundering survey  
Being the Best: insights to leading finance functions  
Best Practice in Risk Management – A function comes of age  
Business Continuity Survey: Living on the front line  
Business Resilience – Ensuring continuity in a volatile environment  
Catastrophe Risk Management – Preparing for storms ahead  
Corporate Tax Rate Study  
Disposals Survey – increasing value from disposals  
Financial Services Advisory Magazine: Headroom – Sharp Reactions  
Frontiers in Finance series  
Global Fraud Investigations Survey  
Global VAT Brief  
Globalizing the Risk Business: surviving and competing in the global insurance industry  
Growth and Diversification in Islamic Finance  
Headroom – insights into private equity issues  
Indirect Tax Guides  
International Tax review for Financial Services  
Living on the frontline  
Making the Transition from Niche to Mainstream – Islamic Banking and Finance: A Snapshot of the Industry and Its Challenges Today  
Operating Risk in Emerging Markets  
Profile of a Fraudster  
Rethinking Cost Structures  
Rethinking the business model  
Sourcing: Future Sourcing – Evaluating the risks and benefits of sourcing  
Strategic Evolution: Global Sourcing Survey  
Tax in the boardroom  
Taxation of Cross-Borders and Acquisitions  
Taxation of Real Estate Investment Trusts  
The Governance of Tax White Paper  
Working to rules

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### Banking Sector

Acquisition appetite and strategy in the global private banking and wealth management industry, global update  
Banking Insiders: [www.kpmginsiders.com](http://www.kpmginsiders.com)  
Basel II – a closer look: managing operational risk  
Basel Briefing series  
Capturing the value from MIFID  
M&A Hungry for more series  
Mainland China Banking survey 2006  
Retail Banking: A critical moment – Key themes from the IEA Retail Banking in Europe Conference  
Retail Banking in China: New frontiers  
State of the banking industry

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### Investment Management & Funds Sector

China's fund management joint ventures the growing flow of wealth  
CREATE Report: Towards enhanced business governance – Causes and consequences in global investment  
Fund & Fund Management Guide  
Hedge funds: a catalyst reshaping global investment  
Hedge Funds International Survey  
State of the Investment Management and Funds Industry

If you wish to request your own free copy, please e-Mail [Distributionpublications@kpmg.co.uk](mailto:Distributionpublications@kpmg.co.uk) or download from our publications library at: [www.kpmg.com/financial\\_services](http://www.kpmg.com/financial_services)

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