Capital in Life Insurance Companies

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Speaker’s Notes

- Speaker’s notes for these presentations are attached below each slide.
- To access them, you may need to save the slides in PowerPoint and view/print in “notes view.”

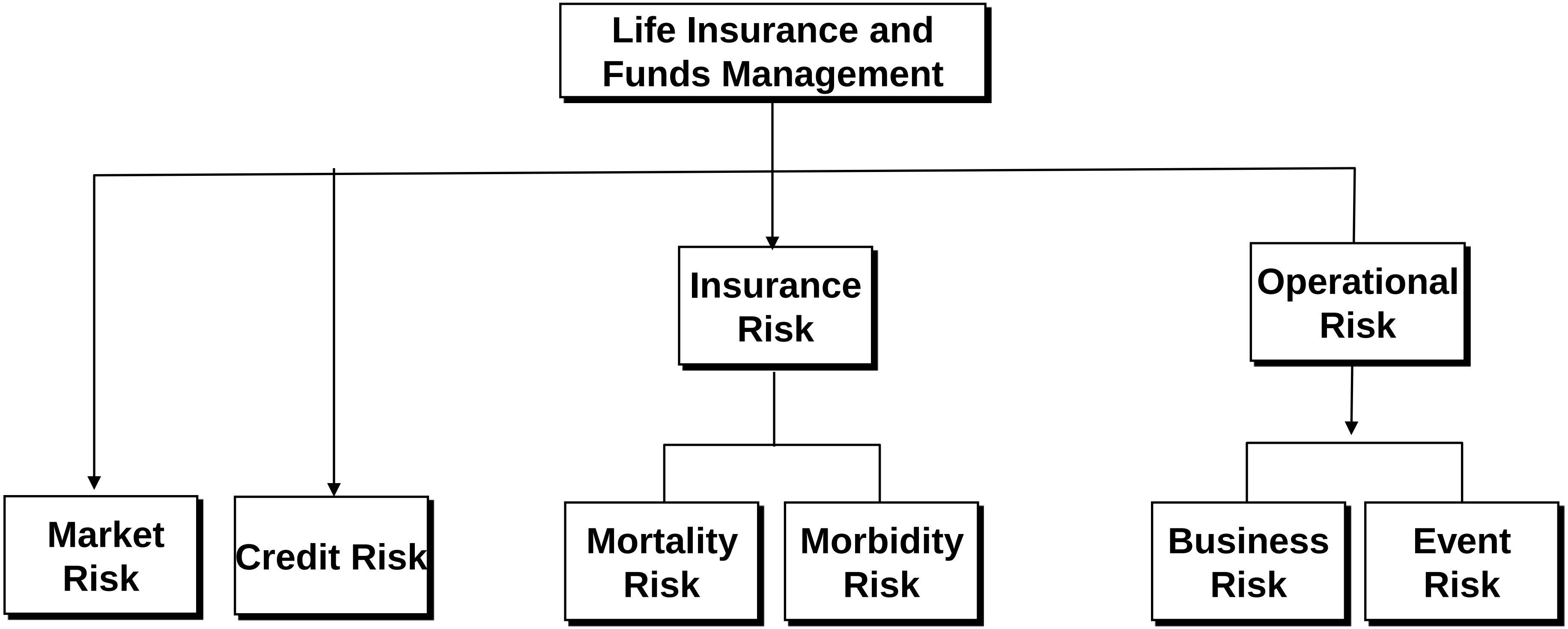
Agenda

- Major Product types
- Risks
- Business Currently Being Written
- Life Insurance Regulation
- Australian Life Companies
- Overseas Life Companies
- Conclusion

Major product types

Product Group	Key Features
Risk	Provides for contingent payments on death, disability or other traumas during the term of the policy
Investment	Various contracts providing for investment or savings often for long terms
Traditional	Contracts with ‘bundled’ savings and risk elements - eg. whole of life or endowment
Annuities	Provides for payments over period in exchange for lump sum

Four risk categories



Personal Risk Risks

Risk	Issues	Controls
Market	No significant build up of assets	N/A
Credit	No significant assets Exposure to reinsurers	Deal with highly rated reinsurers
Insurance	Claim volatility and potential adverse trend	Underwrite; Reinsure; Claims management; Correct pricing
Operational	Expense levels; recovery of acquisition costs from ongoing premiums	Cost control; Competitive pricing; Agency support / service

Group Risk Risks

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Annuities Risks

Risk	Issues	Controls
Market	Significant ALM risk; Lack of suitable long term FI investments	Cash flow matching; Limit sales of lifetime annuities
Credit	Exposure to corporate FI	Apply CBA credit risk processes
Insurance	Annuitants may live longer than expected	Mortality studies, particularly trends
Operational	Expense levels; Competitive pricing	Cost control; Target profitable areas

Investment Unit Linked Risks

Risk	Issues	Controls
Market	Earnings affect future fee income (fee = % assets)	Fixed $ fees reduce risk, but value is created by % fees and FUM scale; Investment performance
Credit	N/a - risk to policyholder	N/a
Insurance	N/a - investment contract	N/a
Operational	Expense levels; Ongoing margins => retain business & maintain fee margins	Cost control; Volumes; Good invest performance and service to retain client and justify fees

Investment Account Risks

Risk	Issues	Controls
Market	SH risk if credit interest > than earned and can't recover by reducing future rates; Guarantees; Earnings affect % fees	Avoid volatile assets and manage crediting rates actively to avoid over-crediting; Investment performance
Credit	Potential loss to SH if combined with market fall	Apply CBA credit risk processes
Insurance	N/a - investment contract	N/a
Operational	Per Investment Linked	Per Investment Linked

Traditional Policy Risks

Risk	Issues	Controls
Market	‘Profit’ from investment return is geared; SH risk if credit bonuses > than earned and can’t recover via lower future bonuses	Manage bonus rates actively to avoid over-crediting; non-guaranteed ‘terminal’ bonuses act as a buffer
Credit	SH exposed to 20% x loss	Apply CBA processes
Insurance	SH exposed to 20% of adverse claim costs	Underwrite; manage claims
Operational	SH exposed to 20% of losses	Manage expenses; good investment performance to retain business

Business currently being written

Product	SH Earnings Drivers	Guarantee	Aus	NZ	Asia
Risk	Premium – Claim – Expense	High	🗐	🗐	🗐
Traditional	Up to 20% of Profits, including investment return	High			🗐
Annuities	Pricing Margins (investment return, expense, mortality)	High	🗐		
Unit Linked	Fees – Expenses	Nil	🗐	🗐	
Masterfund	Fees – Expenses	Nil	🗐	🗐	

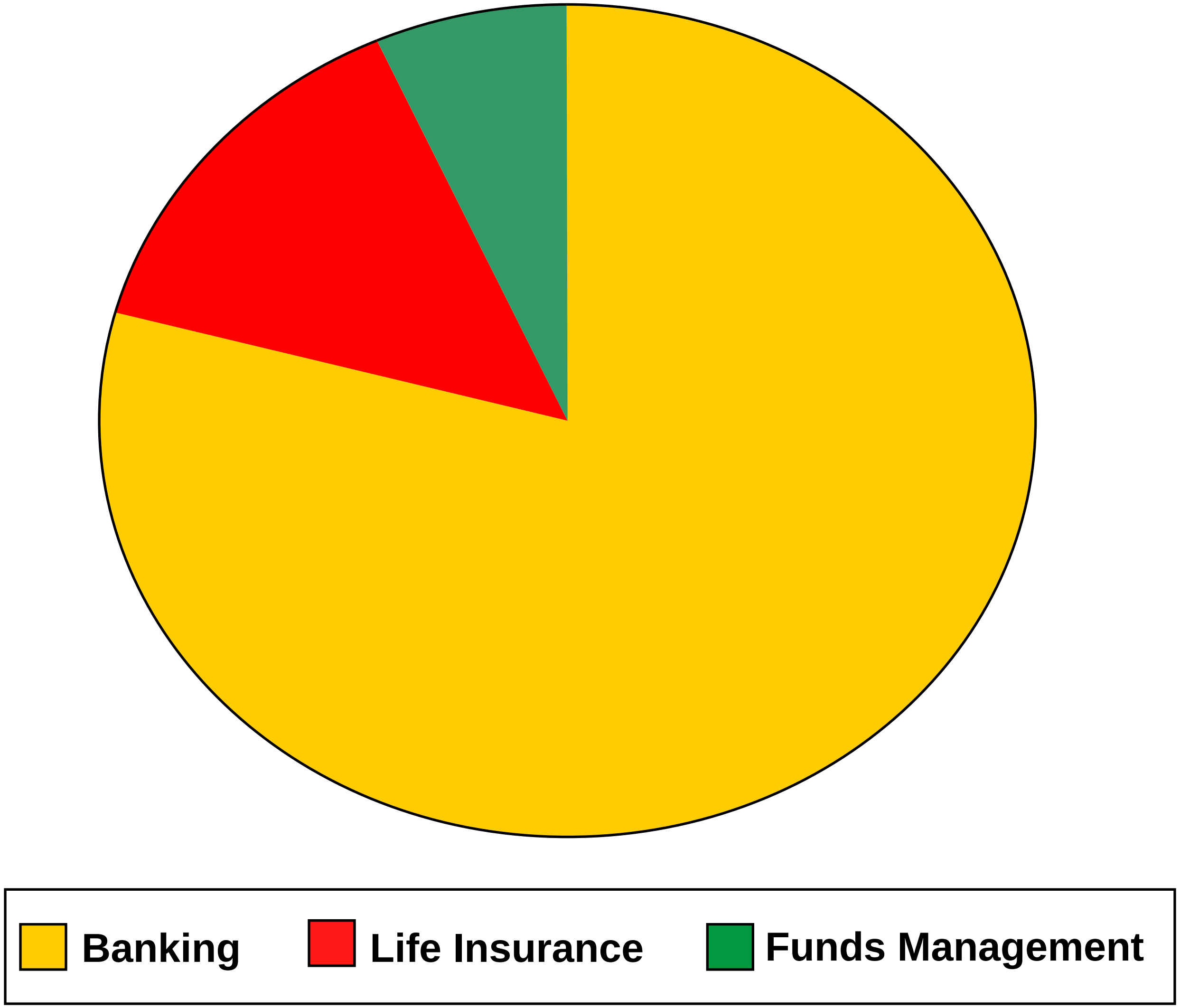
Life insurance regulations in Australia

- Life Insurance Act 1995
- Australian Prudential Regulation Authority (APRA)
- Regulatory capital is calculated by statutory fund, not by company
- Two tier test: solvency (published) and capital adequacy (unpublished)

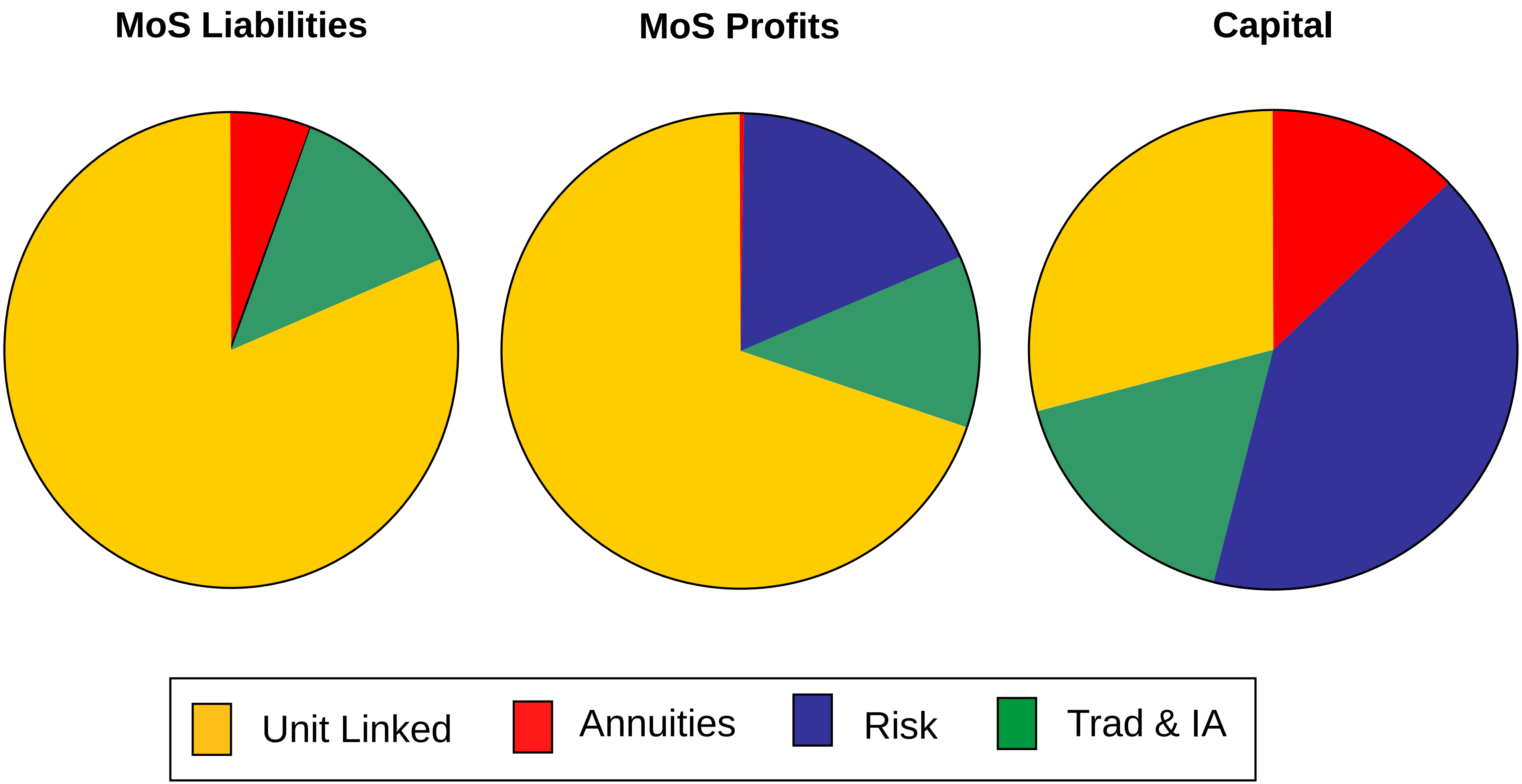
Capital adequacy

- Capital Adequacy Liability
- Other Liabilities
- Resilience Reserve
- Inadmissible Assets Reserve
- New Business Reserve

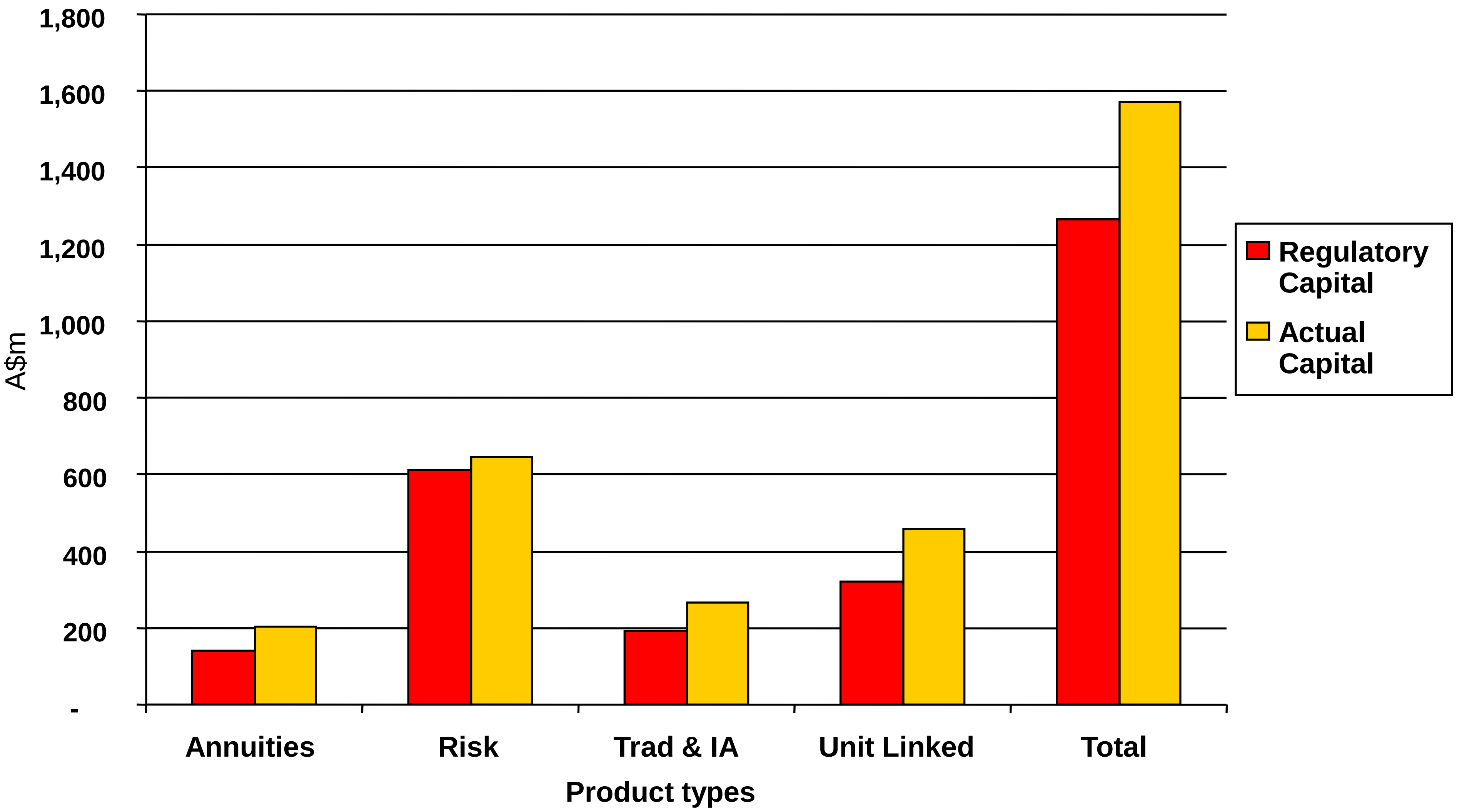
Contribution to profit



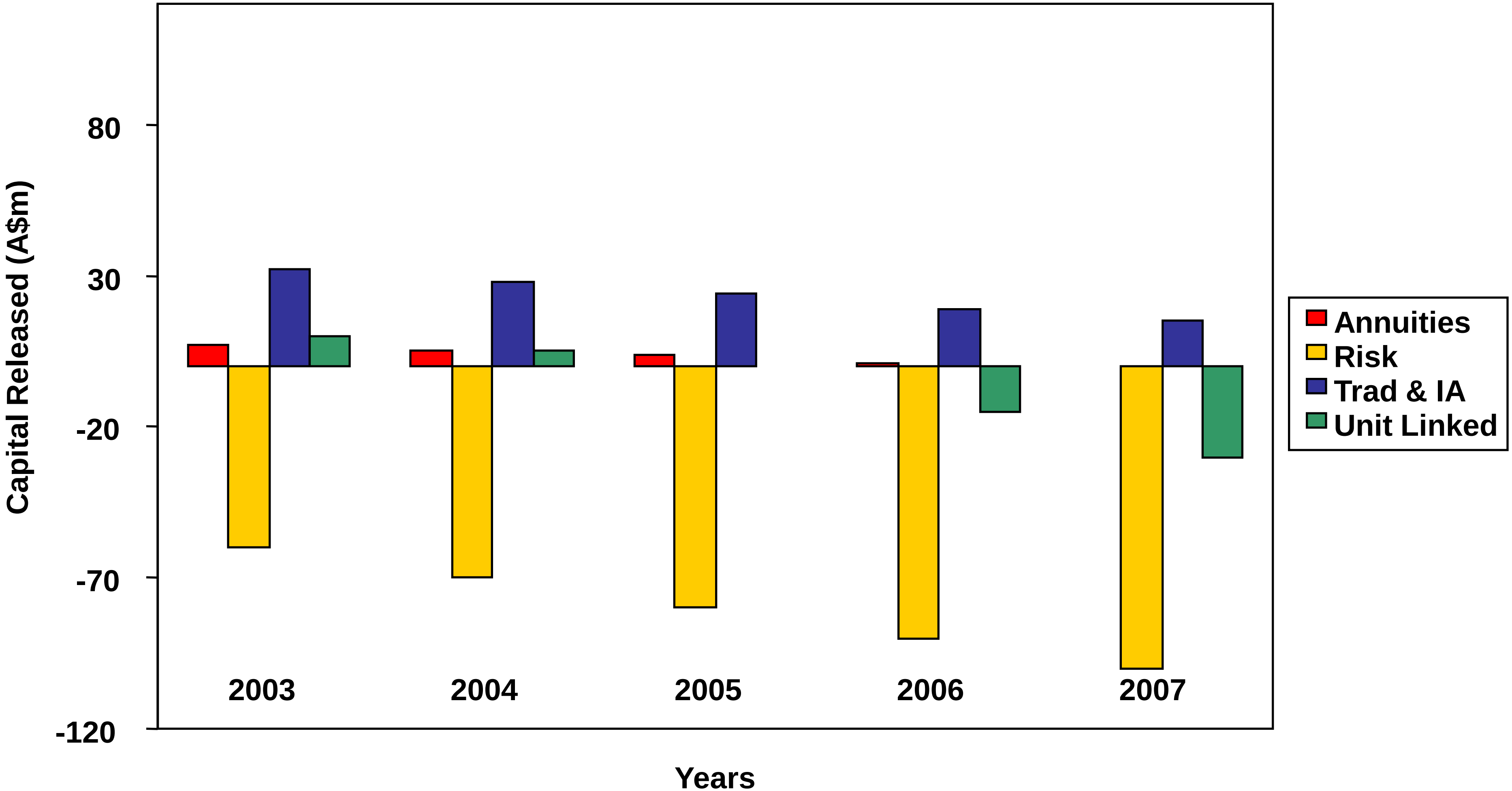
Australian life companies



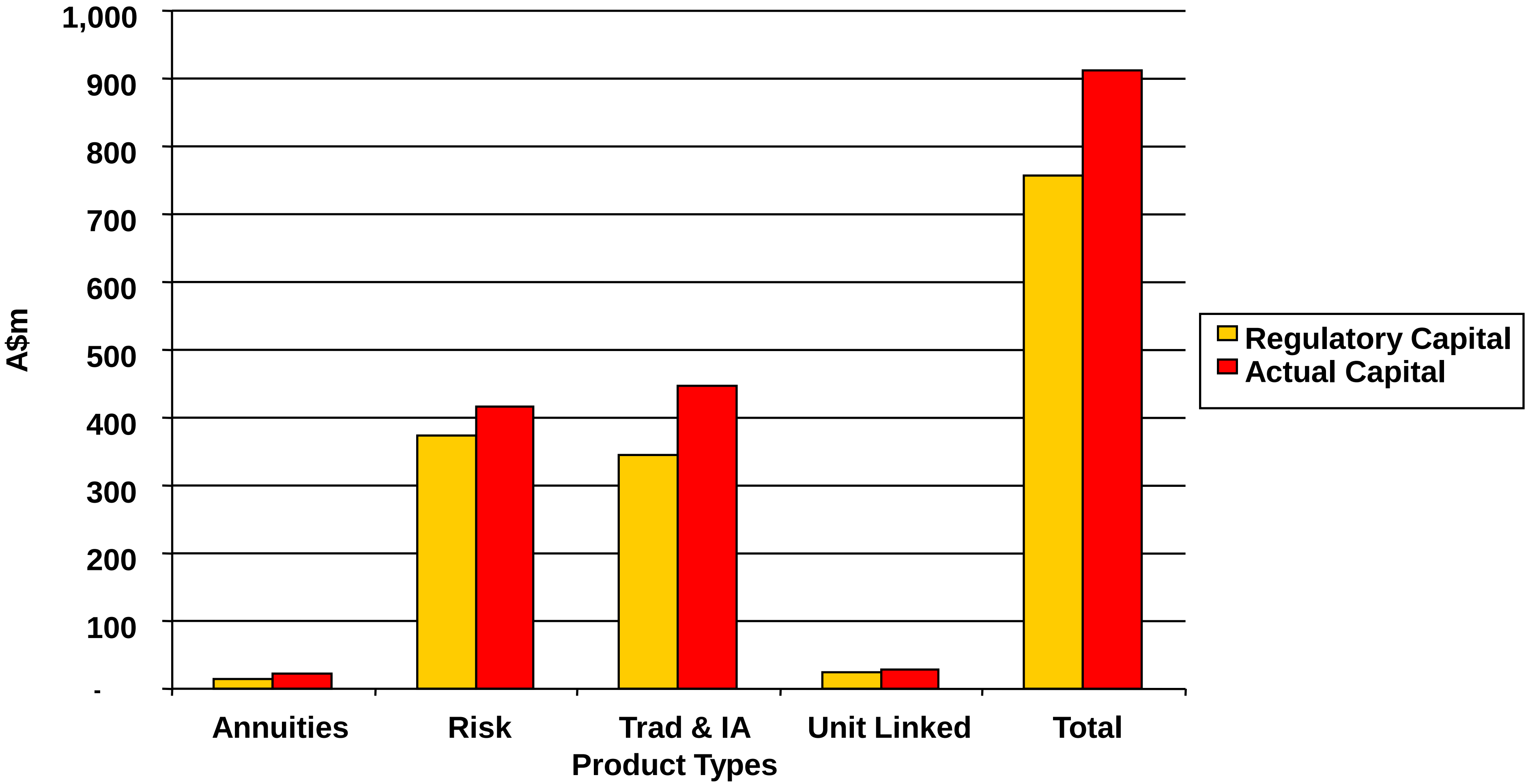
Australian life companies Capital by Risk Type



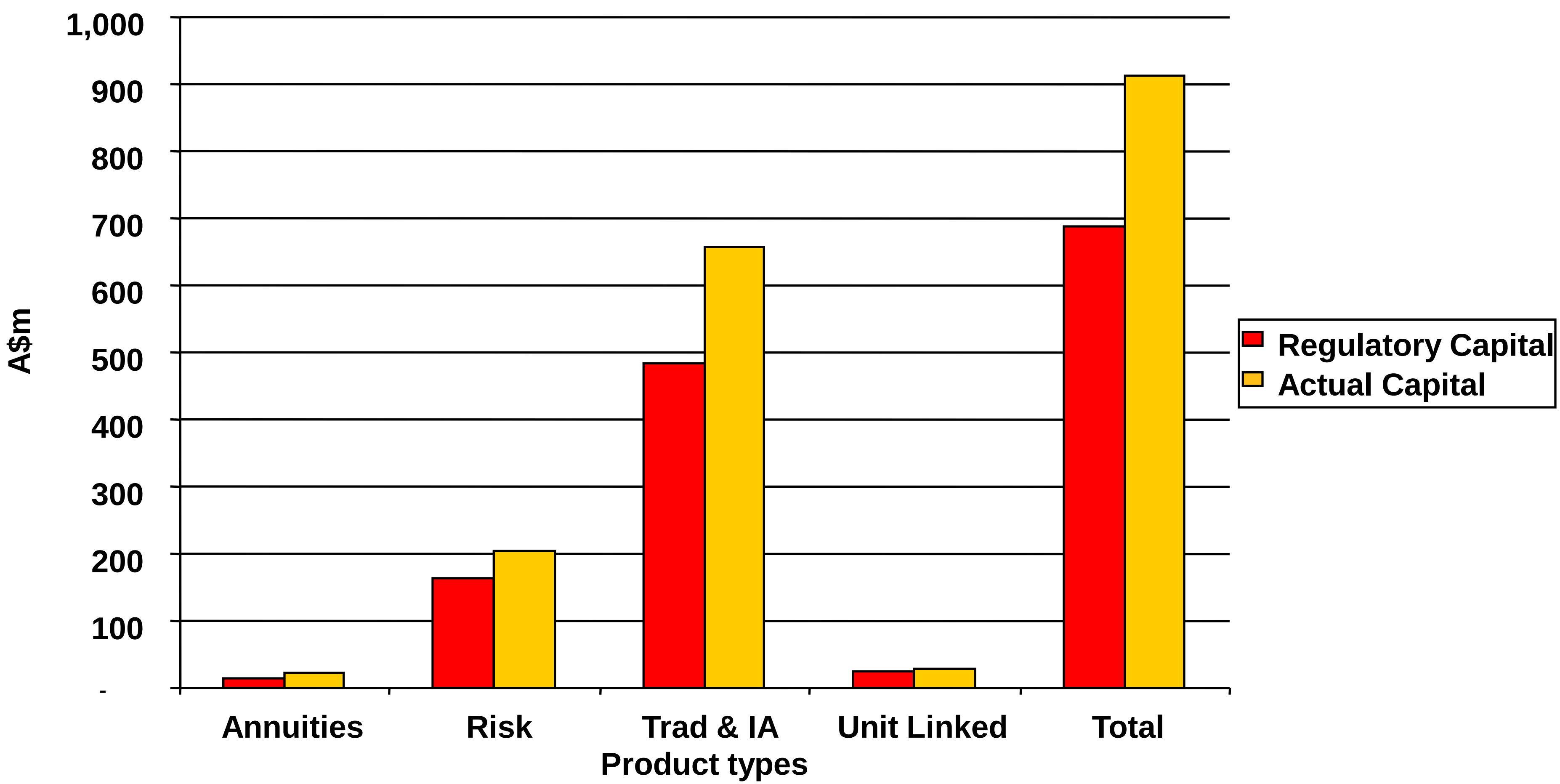
Australian life companies
Future capital requirements



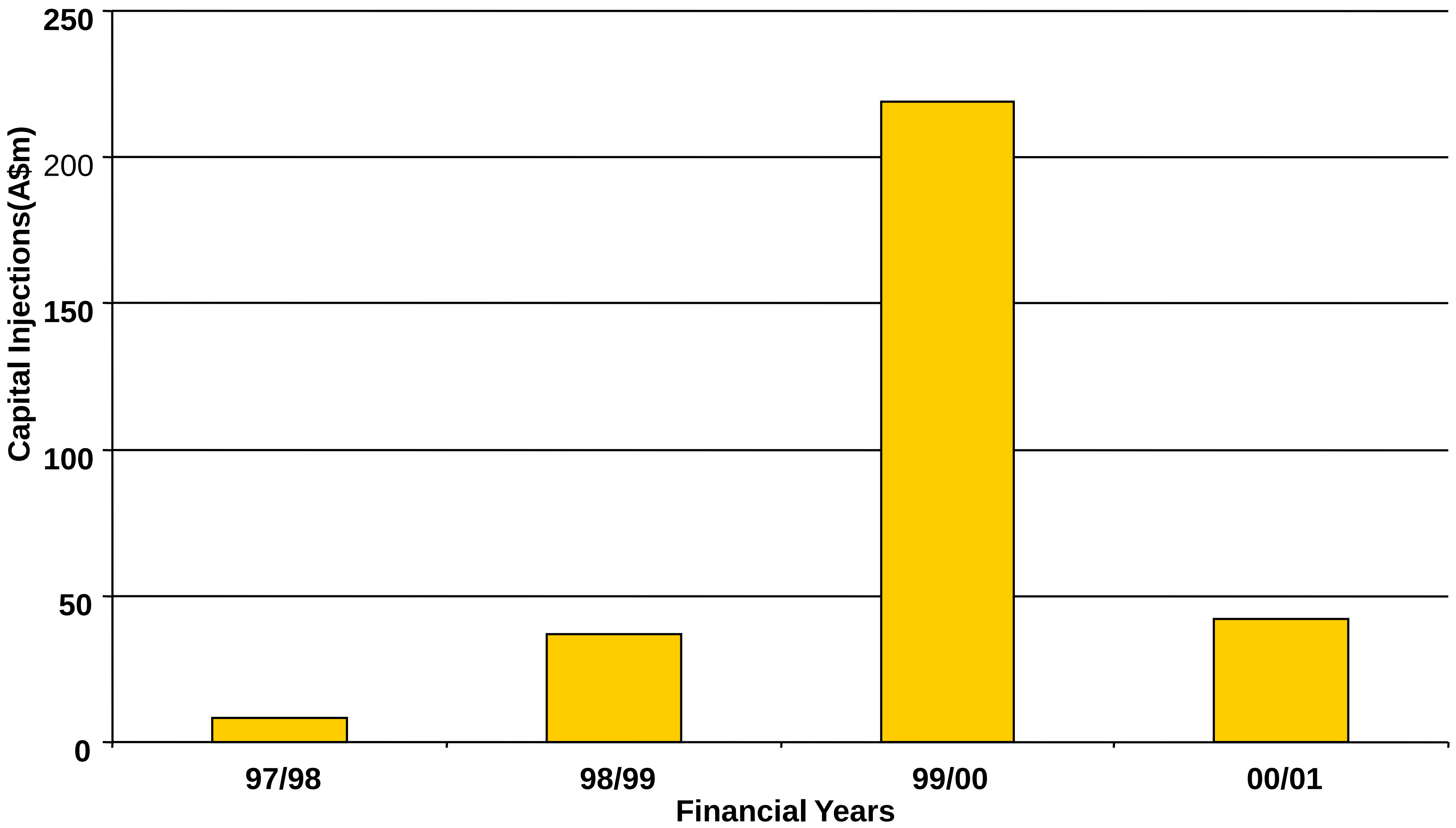
Overseas life companies
Capital on local solvency basis



Overseas life companies Capital on Australian capital adequacy basis



Capital injections into life companies



Conclusions

- Risks identified, measured and managed
- APRA has realistic regulatory capital requirements
- Overseas regulatory capital requirements are more arbitrary
- In the near term, growth of risk business will absorb more capital than is released by closed book

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