A life insurer’s ALM - a practical approach
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Agenda

1. Introduction
2. Elements of asset & liability management
3. Putting the pieces together
4. Further development
Change in business model leads to different balance sheet structure

Conceptual

Excerpt from corporate strategy:
“Position Swiss Life as a safe life insurance company that can fulfil its promises to policyholders, while meeting shareholder expectations“

Note: FI: fixed income; EQ: equity; ALM: ALM portfolio; ABS: absolute return portfolio; GL: guaranteed liabilities; NGL: non-guaranteed liabilities
1. Introduction

2. Elements of asset & liability management
   2.1 Overview
   2.2 Credit policy & liability modelling
   2.3 Risk budget
   2.4 Balance sheet constraints
   2.5 Strategic asset allocation

3. Putting the pieces together

4. Further development
Asymmetry of Returns and ALM Targets

Loss (Borne by Shareholder)

Gain (Shareholder only receives partial share)

Target 1
Asset allocation (Risk/Return)

Target 2
Crediting policy

Target 3
Product Principles
Different ALM elements are interrelated

1 Strategic Asset Allocation
High investment return volatility reduces value compared to stable (yet lower) returns

Illustrative, in CHF million

Volatile returns therefore cause lower average new business, higher lapse rate and lower valuation

Note: All values based on business cycle macro-economic environment
Crediting policy takes into account competitors’ behavior

- Disproportionate loss of market share
- Only marginal gain in market share
- Requirement

- Comfort zone
  - Average competitor
  - Volume
  - Return
Changes in liability notation lead to the expression of “insurance obligations”
Liability cash flows are complex in reality and vary with market returns.

AA determined by:
- comparison with competitors
- own risk capacity

Duration:
- long
- short

Degree of CF matching:
- low

Minimum guaranteed return

Guarantees

Bonus

Guarantees

Guarantees

Risk budget defines the free risk capital

Conceptual

Marked-to-market balance sheet

Risk budget

1. I.e. operational, business and strategic risk

Note: Waterfall shows risk contribution of individual risk types net of diversification effect
The SST\textsuperscript{1}-target capital needs to be determined.

Analytical model
(expected shortfall as risk measure)

- Market risks
- Insurance risks

Scenario aggregation

- e.g.,
  - pandemic
  - financial distress
  - reinsurance defaults

Weighted average of scenarios with results from analytical model

\[ \text{Target capital} = \text{Credit risk charge} + \text{Risk margin} \]

1 Swiss Solvency Test
The SAA is influenced and/or constrained by various factors

Illustrative

Inputs have different weightings leading to a situation where we might end up having one single input as a must and thus a “killer” constraint for the SAA

1 SiFo (security fund): Regulatory coverage ratio of assets to liabilities
Risk/return considerations and non-economic constraints determine SAA

Risk
- Risk budget
  - Economic net worth
  - Free risk capital
- Measures to generate further risk capital
- Risk tolerance

Non-economic constraints
- Security fund
- Solvency margin
- Target capital
- IFRS accounting mismatch
- Earnings at risk

SAA
- Expected return & risk by asset class
- Feasibility
- Competitor behavior
- Portfolio optimization
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Closed-looped system is necessary to appropriately weight all elements

- Each ALM element by itself might be controllable
- The art of ALM lies in balancing out every element with the others
- Communication among the involved departments is crucial
The new business model will be implemented in a holistic approach

New business model

ALM \hline GL \hline NGL \hline Equity

ABS

Implementation approach

Tight Risk Management Process

\begin{itemize}
\item Asset portfolio
\item Insurance obligations
\item +
\item Supplementary insurance payments
\item +
\item Equity
\end{itemize}

Benefits through holistic approach
• Simplicity through only one portfolio on asset side
• Without neglecting liability structure in AA

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Further development

• Roll-out to all business units

• Achieve further know-how development and transfer between headquarters and business units

• Further improvement of cooperation between involved departments

• Monitor development of SST/Solvency II
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