

# Insights

## Life Insurance CFO Survey #25

### Evolving Capital Management Practices

#### Summary of Findings

The first installment of our Life Insurance CFO Survey in 2010 focused on issues relating to capital management. Specifically, the survey explored how companies are determining, managing, monitoring, funding and allocating capital in light of the popularity of economic capital methodologies, ongoing regulatory changes, rating agency requirements and economic turmoil.

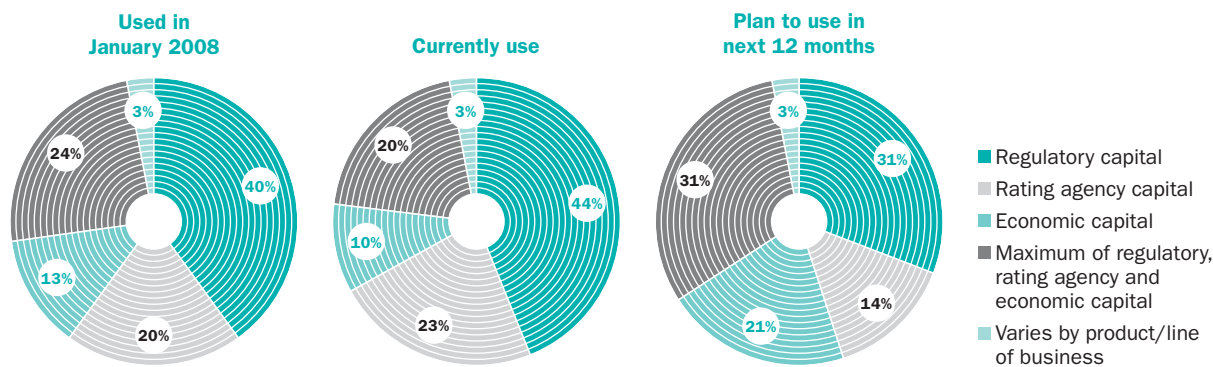
The survey found that respondents did not significantly alter their approach to determining required capital as a result of the financial crisis, but changes are anticipated over the next 12 months. As might be expected, the financial crisis has spurred increased attention to capital management practices. Economic capital is a key capital management tool currently used or planned to be used by 90% of the respondents. Companies have also increased the frequency with which they monitor their current capital position and project their future capital position — and they show no signs of going back to “business as usual.” Finally, respondents foresee increased securitization activity over the next 12 months.

Turning to the outlook for first quarter financial results, CFOs were increasingly optimistic about the outlook for GAAP net revenue and GAAP net income. This continues the trend of our prior two surveys and represents a significant uptick from the lows reported in the first quarter of 2009.

#### Changes Anticipated in Approach to Determining Required Capital

Over the past two years, the definition of capital requirements used by respondents to manage their business has not changed significantly — but this is likely to shift over the next 12 months. In January 2008, 60% of respondents used regulatory or rating agency capital requirements to manage their business overall. Over the past two years, this has ticked up slightly, with 67% of respondents currently using regulatory or rating agency capital. However, over the next 12 months, use of regulatory capital and rating agency capital is expected to drop significantly, with only 45% of respondents using these definitions of required capital to manage their business (Figure 1).

Figure 1. Key Definition of Capital Requirements Used to Manage the Business



At the same time, economic capital is expected to be more widely used to define capital requirements, increasing from 10% of respondents currently, to 21% of respondents over the next 12 months. Also, more companies expect to use the maximum of regulatory, rating agency and economic capital to determine capital requirements over the next 12 months.

Interestingly, the primary driver of how companies define capital requirements is the desire to satisfy rating agencies, rather than a belief that economic capital, regulatory capital or rating agency capital are the “right” level of capital (Figure 2). Respondents cited S&P (48%) and A.M. Best (38%) as the rating agencies having the most influence on capital management decisions.

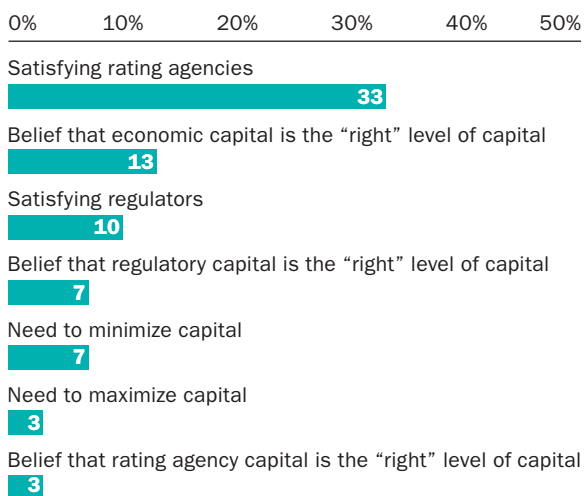
### Capital Management Receiving Increased Attention

The global financial crisis and recession have put pressure on life insurers’ capital positions. The amount of capital required has increased, while life insurers’ available capital has decreased. At the same time, the options available to raise capital have become more limited and more costly. Therefore, it is not surprising that capital management is receiving increased attention and has become a top priority for many companies.

More than three-quarters of respondents said that capital management practices — especially determination of capital requirements, monitoring of capital position and management of capital levels — are receiving greater attention at their companies than they were in January 2008 (Figure 3).

Respondents indicated that this increased attention is due, in large part, to the impact of the recent financial crisis on required capital, available capital, and capital-

**Figure 2. Drivers of Capital Requirement Determination Decision**



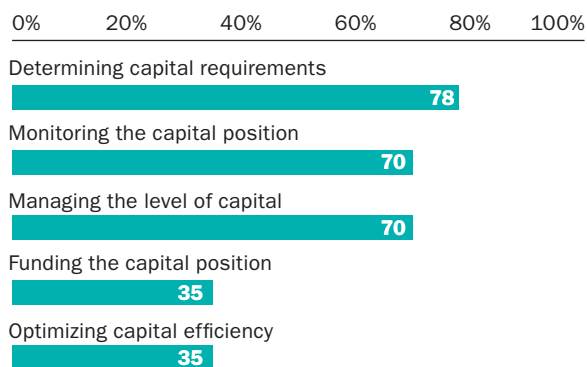
raising options and costs (Figure 4). However, changes in rating agency requirements and the emergence of economic capital methodologies have also had an impact.

In order to address the lack of capital fungibility, about 25% of respondents have streamlined or are streamlining legal entities.

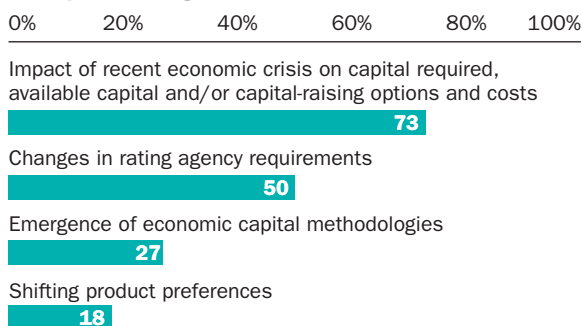
### Economic Capital Widely Used

Respondents are actively managing their capital position using tools such as economic capital. Nearly all respondents (90%) either currently calculate economic capital or plan to do so in the future (Figure 5). In fact, 60% of all respondents currently calculate economic capital on a total company and/or line-of-business basis.

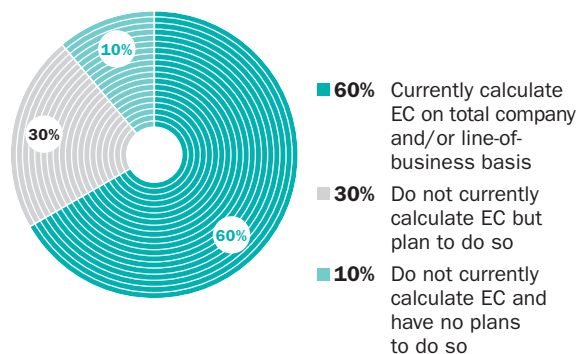
**Figure 3. Aspects of Capital Management Receiving Increased Attention**



**Figure 4. Drivers of Increased Attention to Capital Management**



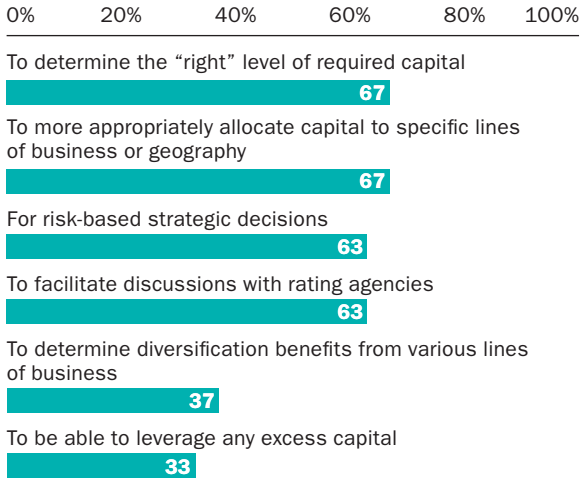
**Figure 5. Basis on Which Company Currently Calculates Economic Capital (EC)**



“Capital management is receiving increased attention and has become a top priority for many companies.”

Respondent companies use the information on economic capital to help manage the business. Two-thirds use it to determine the “right” level of required capital and to more appropriately allocate capital to specific lines of business and geographies (Figure 6). In addition, more than 60% use economic capital information for risk-based strategic decisions and to facilitate discussions with rating agencies.

**Figure 6. How Information on Economic Capital Is Used**



Companies that embed economic capital in the day-to-day risk management of their businesses can use it for a variety of different purposes, including capital adequacy assessment, capital allocation, strategic/business planning, product design/pricing, asset/investment strategy and reinsurance purchasing.

### Companies Stepping Up Monitoring Efforts

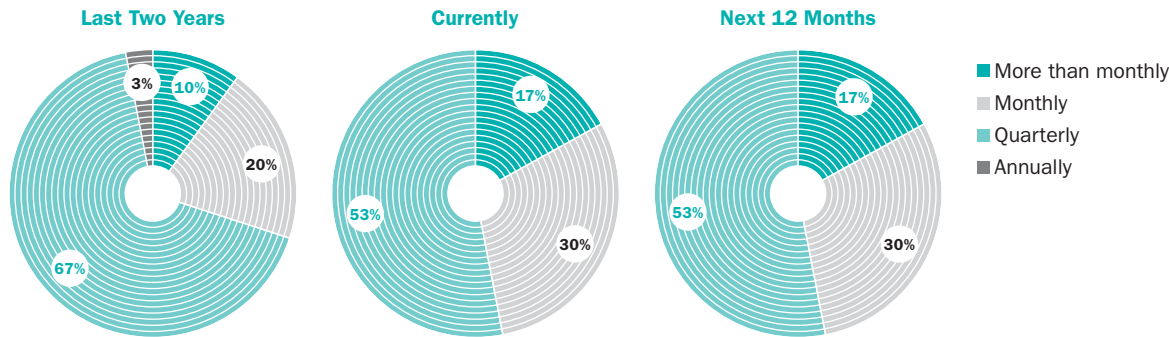
Over the past two years, respondents have moved to more frequent monitoring of their current capital position. During that span, only 30% of the responding companies monitored their capital monthly or more frequently (Figure 7). Now, nearly half do so.

Companies are also projecting their future capital position more frequently. Over the past two years, only 16% of responding companies projected their future capital position monthly or more frequently (Figure 8). Now, 30% do so.

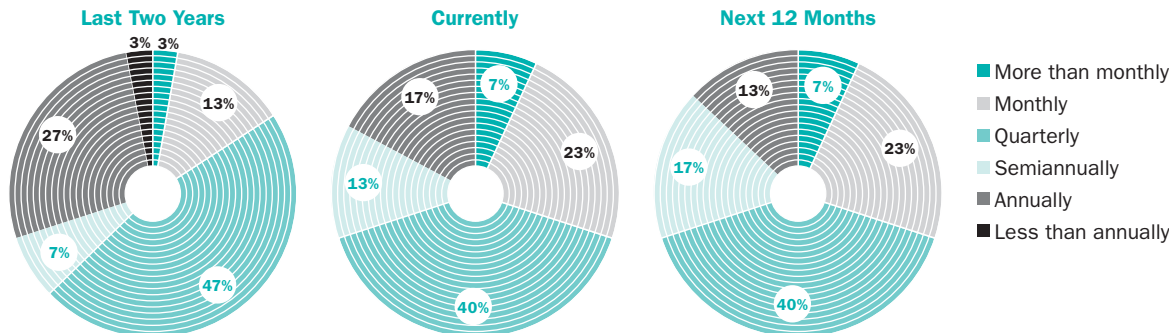
While this shift may have been precipitated by the financial crisis, companies do not plan to revert to their former practices. No substantial changes are expected in the frequency with which companies monitor their current capital position or project their future capital position within the next 12 months.

“Over the past two years, respondents have moved to more frequent monitoring of their current capital position.”

**Figure 7. Frequency of Monitoring Current Capital Position**



**Figure 8. Frequency of Projecting Future Capital Position**



The global economic crisis has increased competitive, regulatory and stakeholder pressures on insurers, thereby accelerating the need for rigorous and timely quantitative analysis of their current and future capital position. To achieve this, we believe insurers require a robust modeling platform that can calculate available and required capital with greater speed and precision.

### More Securitization Activity Expected

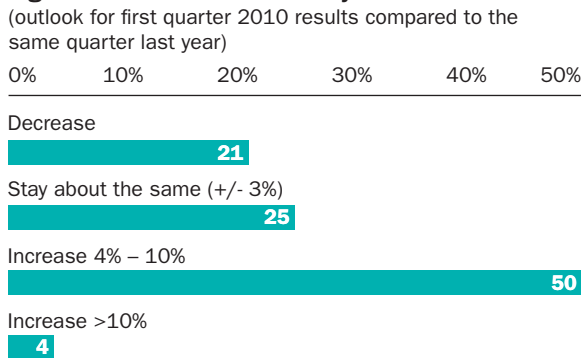
Over the next 12 months, companies expect to focus more on new securitizations and letters of credit to raise capital (Figure 9). Fewer companies expect to have to resort to some of the more drastic measures used over the past two years to raise capital. For example, significantly fewer respondents expect to issue debt, receive a contribution from their parent company, cut shareholder dividends or curtail new business growth in the next 12 months.

Given the improvement in capital markets and decrease in the cost of letters of credit, securitization costs are more palatable to companies and not the barrier that they once represented. Indeed, our consulting practice has seen more securitization activity in recent months.

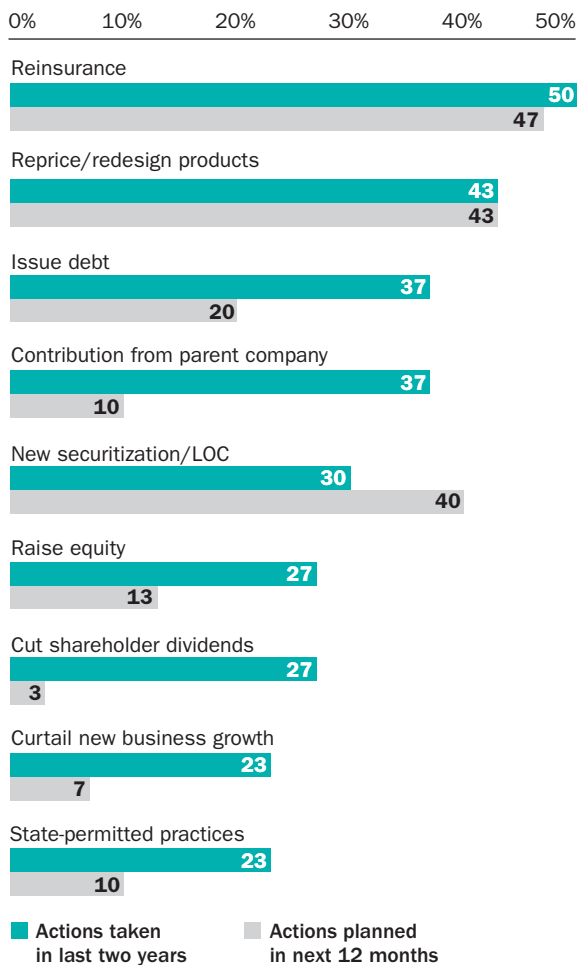
### Improved Outlook for Growth in Revenues and Net Income

CFOs' outlook for first quarter 2010 results is much more optimistic than a year ago, continuing the trend from the prior survey. The majority of respondents said they believe that GAAP net revenue and GAAP net income will increase at least 4% compared to the same quarter last year. Respondents were somewhat split on premium growth — 54% of respondents predicted growth in new life and annuity premiums over the same quarter last year; 25% expected premiums to stay the same, and 21% predicted a decrease (Figure 10). Just over 60% of respondents said that first quarter GAAP net revenue would increase over the same quarter last year, while only 4% predicted a

**Figure 10. New Life and Annuity Premiums**



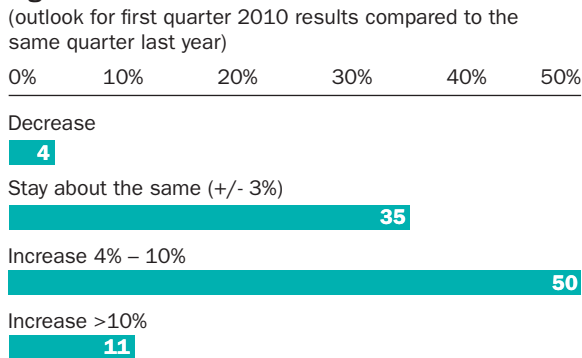
**Figure 9. Actions Taken to Effectively Raise Capital — Past and Future**



“Fewer companies expect to have to resort to some of the more drastic measures used over the past two years to raise capital.”

decline (Figure 11). In addition, 73% said GAAP net income would increase compared to the same quarter last year, and no respondents predicted a decrease (Figure 12, page 5). These improved numbers must be taken in the context of the first quarter 2009, when the economy was deep in a recession.

**Figure 11. GAAP Net Revenue**



Towers Watson has also developed growth indices (based on the weighted average of survey responses) to summarize respondents' year-over-year growth outlook. Values between 97 and 103 are taken to be basically flat growth. After a precipitous drop in the revenue and net income indices in the first quarter of 2009, the indices have been on an upward trajectory, which continued in the current survey. The premium index fell slightly, from 103 to 101, but the GAAP net revenue index rose slightly, from 104 to 105, and the GAAP net income index rose sharply, from 104 to 109, its highest level since the third quarter of 2003 (Figure 13). This is a reflection of the improvement in the economic climate as well as the depressed results of most companies in the first quarter of 2009.

*Note: These results reflect CFOs' outlook at the time they completed the survey, and may or may not reflect company performance actually emerging.*

### About Towers Watson's North American Life Insurance CFO Survey

This web-based survey, which was conducted in February and March 2010 by Towers Watson, is the 25th in a series of pulse surveys that explore issues important to the North American life insurance industry and its CFOs. This two-part survey focused on capital management and explored CFOs' expectations for first quarter 2010 results.

For more information, contact:

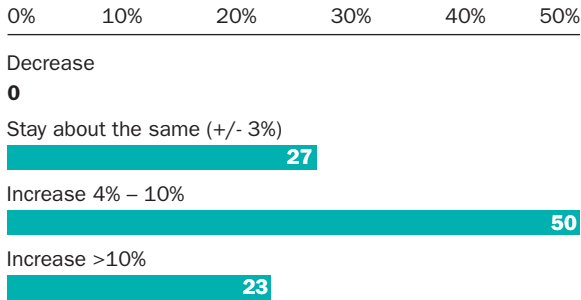
Jack Gibson  
 +1 212 309 3922  
 jack.gibson@towerswatson.com

Todd Erkis  
 +1 215 246 7338  
 todd.erkis@towerswatson.com

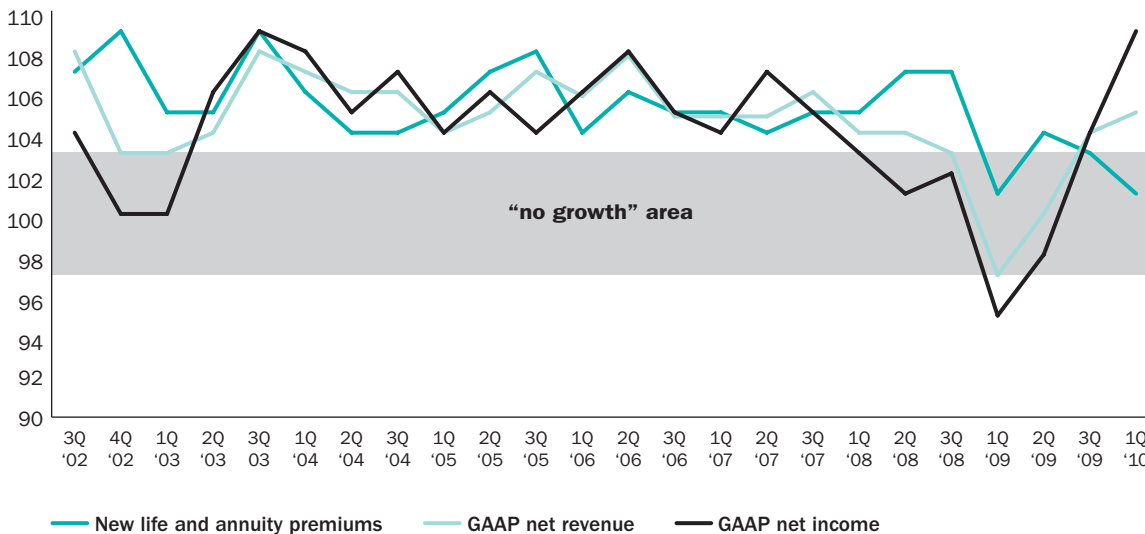
More information about Towers Watson is available at [www.towerswatson.com](http://www.towerswatson.com).

**Figure 12. GAAP Net Income**

(outlook for first quarter 2010 results compared to the same quarter last year)



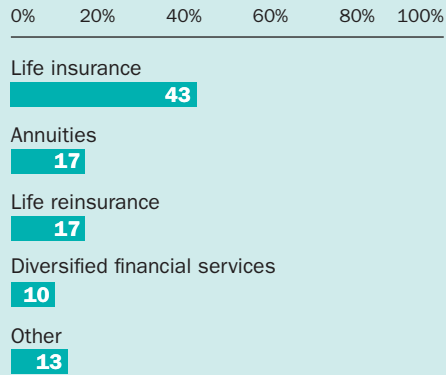
**Figure 13. Year-Over-Year Growth Index**



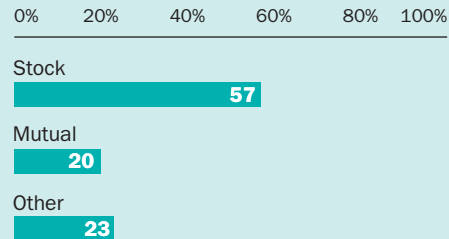
## Participant Profile

Thirty CFOs (43% of the program's 70 registered members) participated in this survey. Since all questions were not applicable to all companies, the respondent base varied from question to question. Respondents primarily included CFOs from large and midsize North American life insurance companies (*Figures 14 and 15*); 59% had assets of \$5 billion or more, and 17% were multinationals (*Figure 16*).

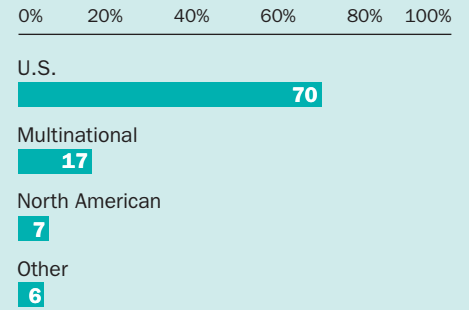
**Figure 14. Company's Primary Line of Business**



**Figure 15. Company's Organization Structure**



**Figure 16. Scope of Company Operations**



## About Towers Watson

Towers Watson is a leading global professional services company that helps organizations improve performance through effective people, risk and financial management. With 14,000 associates around the world, we offer solutions in the areas of employee benefits, talent management, rewards, and risk and capital management.