Capital – multiple issues require multifaceted solutions

What drives (re)insurer capital planning? Maybe it is risk appetite, internal dynamic capital modelling or actuarial analysis? Or perhaps it is external pressure from regulators, rating agencies or investors?

In reality, it is probably a combination of all of these factors. Faced with conflicting views of what constitutes both the available capital and the assessment of the amount required relative to the risk, optimising (re)insurer capital adequacy is likely to be a key challenge for a company; and rarely will the company be able to fully satisfy all the demands. Developing a management framework to evaluate, analyse and compare these divergent needs is therefore essential to extract the maximum efficiency from a (re)insurer corporate capital structure.

Typically, the capital dilemma has been depicted as a set of balance scales, with available capital on one side and capital needs on the other. Guy Carpenter's Strategic Advisory team is looking to revolutionise this dated method to better inform (re)insurers' capital management strategy by adopting a multifaceted approach. Capital adequacy is no longer a two-dimensional static concern. Indeed, factors such as timeline developments, multiple stakeholders with changing standards, unmodellable risks and earnings adequacy should be considered.

Change in the capital landscape is accelerating

The evolution – and subsequent delay – of the Solvency II regime, new criteria and capital models from the rating agencies, numerous updates to vendor catastrophe models, and the global financial crisis have all led to both tangible capital shocks and changes to assumptions and capital model calibration.

Companies that have the flexibility to pre-empt, understand and respond to developments such as these are able to guide their capital management process more smoothly over time.

Increasingly, the components of both available capital and capital needs have been broadened to strengthen the rigour of the analysis. This has also increased the complexity of the process.

Equity and debt capital have rightly been joined by reinsurance capital, partially driven by the shift from rated paper to collateralised capacity, insurance-linked securities (ILS) and sidecars. These relatively recent developments now offer management three "levers" to pull in order to grow, optimise and react to changes in the capital structure.

The evaluation of required capital has coincided with greater rigour within modelled and unmodelled catastrophe risk, bringing about a new understanding of the underwriting and reserve risks, as well as an increased focus on the asset side and operational risk.

Complexity has driven the need for bespoke solutions

Guy Carpenter's Strategic Advisory team, bringing together specialists in one cohesive client-facing unit, is able to assist (re)insurers in a number of areas, including:

Regulatory capital – identifying both the challenges and opportunities from Solvency II will enhance the understanding of the drivers of this key capital constraint.

Economic capital – mutual review, challenge and development of economic capital assessment may improve the understanding between the client and the broker to ensure that traditional and enhanced client solutions are articulated internally and to reinsurers/stakeholders.

Rating agency capital – the typical "one size fits all" approach to capital adequacy, which is then factored into a qualitative assessment, presents a unique challenge. Guy Carpenter's specialists, many of whom are former rating agency analysts, are well-suited to ensure that clients' capital decisions contribute positively to rating outcomes.

Operational risk – by analysing and understanding this risk through best-in-class approaches, Guy Carpenter's risk management specialists can help clients mitigate, eliminate and protect their potential exposure through an appropriate capital buffer.

Catastrophe risk – Guy Carpenter's multi-discipline catastrophe modelling team, offering products and services that include new model development, Model Suitability Analysis (MSA)®, ILS, catastrophe bonds, and GC-CPR^{sm} (catastrophe planning and response), assists clients in managing their post-catastrophe claims and operational response.

Centralised reinsurance – elevating the benefits of greater control and efficiency of the outwards reinsurance purchase or the use of internal reinsurance vehicles from a capital management perspective.

Holistic balance sheet advisory – for every action, there is an equal and opposite reaction, a physical rule that also applies to the corporate balance sheet and capital evaluation. Within defined risk appetites and capital constraints, corporate decisions can rarely be confined to either the asset or liability side in isolation. Guy Carpenter's approach, in conjunction with its affiliate Mercer, is to adopt an all-inclusive view of capital. This includes the potential impact on diversification credit and allows for the full implication of decisions to be assessed or for potential arbitrage opportunities as risk is switched from one class to another.

In response to the changing capital landscape, coupled with an increasingly complex and challenging economic backdrop, Guy Carpenter is not only able to advise and help clients understand and evaluate their capital needs and options, but also provide robust and innovative solutions.

These include bespoke capital and reinsurance transactions, such as retrospective and run-off solutions, earnings volatility and dividend protection, ILS and tailored reinsurance customised to specific capital targets.

This combination of advisory and transactional services allows Guy Carpenter to gain greater insight into clients' needs and drivers, ensuring that the solutions developed target optimised capital, enhanced earnings and growth and, ultimately, improved enterprise value.

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