Asset Allocation in Europe

Insurance companies - The case for equity

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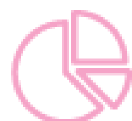
Covéa : key figures

Key figures at 31 December 2016



CONSOLIDATED ACCOUNTS in euros

16.3 billion	825 million	13.4 billion	104.8 billion	351%
Turnover	Group net result (portion of the Group)	Equity capital (portion of the Group)	Financial investments (in realizable value)	Solvency ratio

TURNOVER France/Abroad

France

International

PORTFOLIOS IN FRANCE in million

11.5	10.5	7.8
members and customers	insured vehicles	insured homes
1.6	**1.3**	
individual health customers	collective health customers	

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Reasons for investing and the impact on economy

- Reminder : **importance of insurers investments for financial markets** (volume, sustainability, counter-cyclicality)

- **Investments are carefully selected** in order to :
  - ✓ allow the service of all the payments ahead (coverage of liabilities)
  - ✓ **optimize** the performance (for the policyholder and the insurer)

- According to the different business models and environments **optimization is an area where constraints might differ in types and number**

- **Greater performance is shared between the stakeholders** and creates a virtuous circle :
  - ✓ Worthier revalorization of policyholders' life contracts
  - ✓ More competitive tariffs for property & casualty insurance
  - ✓ Improve sustainability and performance of the insurance business
  - ✓ Favors the building of own funds
  - ✓ Directs investments to the productive economy and favors innovation and growth

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How do we invest ?

- **Different practices** across Europe and between insurance undertakings (business model biodiversity)

- Typical business case for a non life insurer and a life insurer with no ring fenced funds or segregated assets :
  - ✓ **Total balance sheet approach for assets** : diversification is the highest, maximum performance can be achieved, all liabilities are included

- In this context **common listed equity investments improve the financial performance** of the insurance undertaking :
  - ✓ Higher investment returns in the long run
  - ✓ Higher risk diversification (reduce idiosyncratic risk, short term risk mitigated when long term approach)

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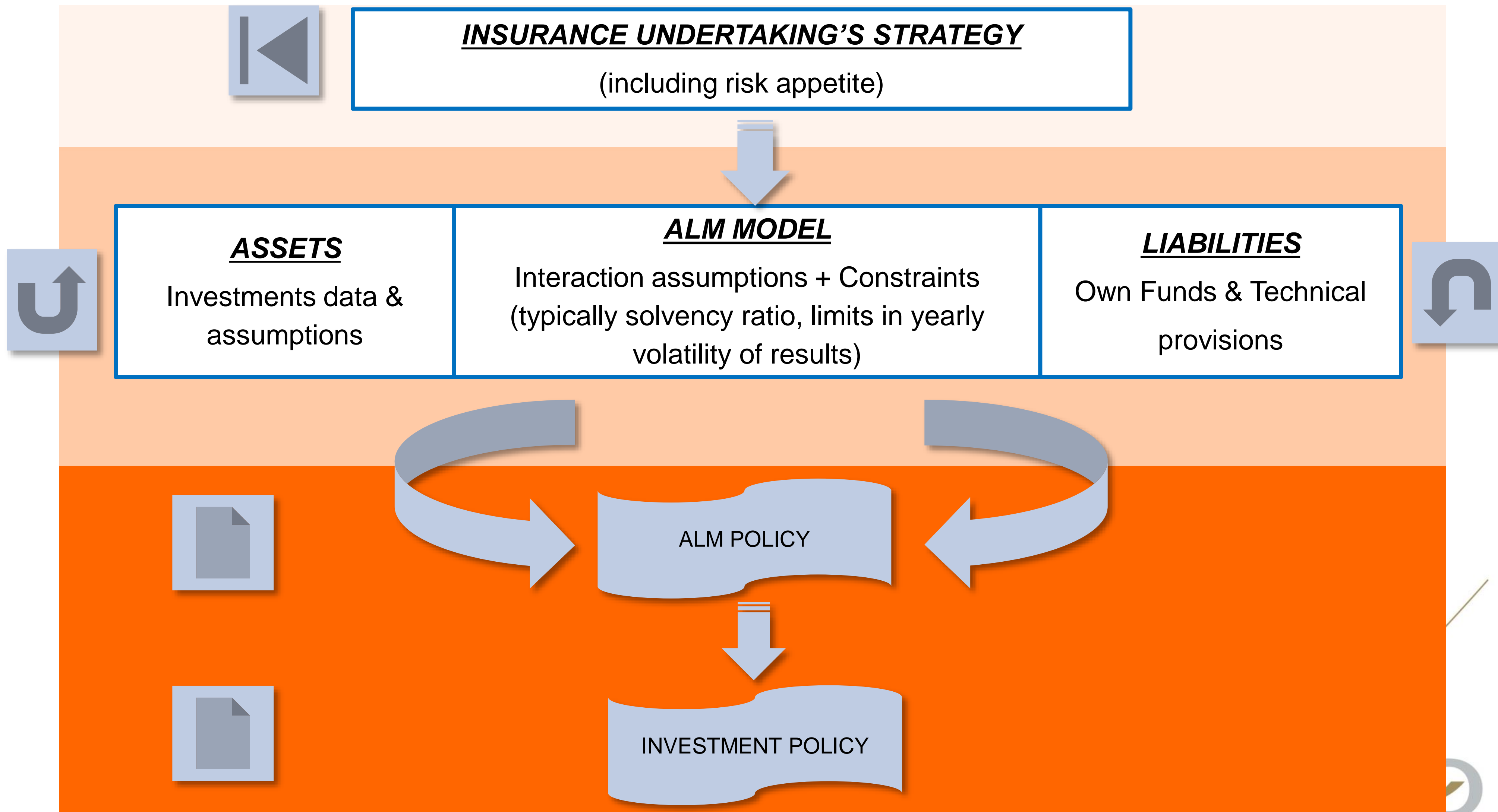
The investment process at glance



Case study, the regulatory challenge for equities

- Non-life insurer
  - ✓ assets at starting date = EIOPA's reference portfolio (27% govies, 44% corporates)
  - ✓ liabilities : 20% long term products (15 years) and 80% mid term products (5 years)
  - ✓ initial solvency ratio at 180%, i.e. own funds represent 35% of total liabilities
  - ✓ Corrective actions undertaken when solvency ratio equal or below 130%.

- Target asset allocation in equity increases from 10% to 15% when solvency calibration is improved

- We assume a shock of 40% on listed equities and of 20% on real estate followed by recovery within 5 years. Interest rates remain at low levels.
  - → solvency ratio drops at 121%, action is required in order to improve solvency
  - → insurer starts to sell stocks on the year of the shock (instead of buying them)
  - → the company will not be able to benefit from the future successive market improvements, and after five years has worsen where it should not be the case

→ In this case Solvency 2 leads to counter-productive pro-cyclical behaviors

The capital charge currently required for standard listed equity investments in Solvency 2 is prohibitive and fails to capture how the management actions of the insurer can act as a strong dampener of the gross behavior of financial market risks

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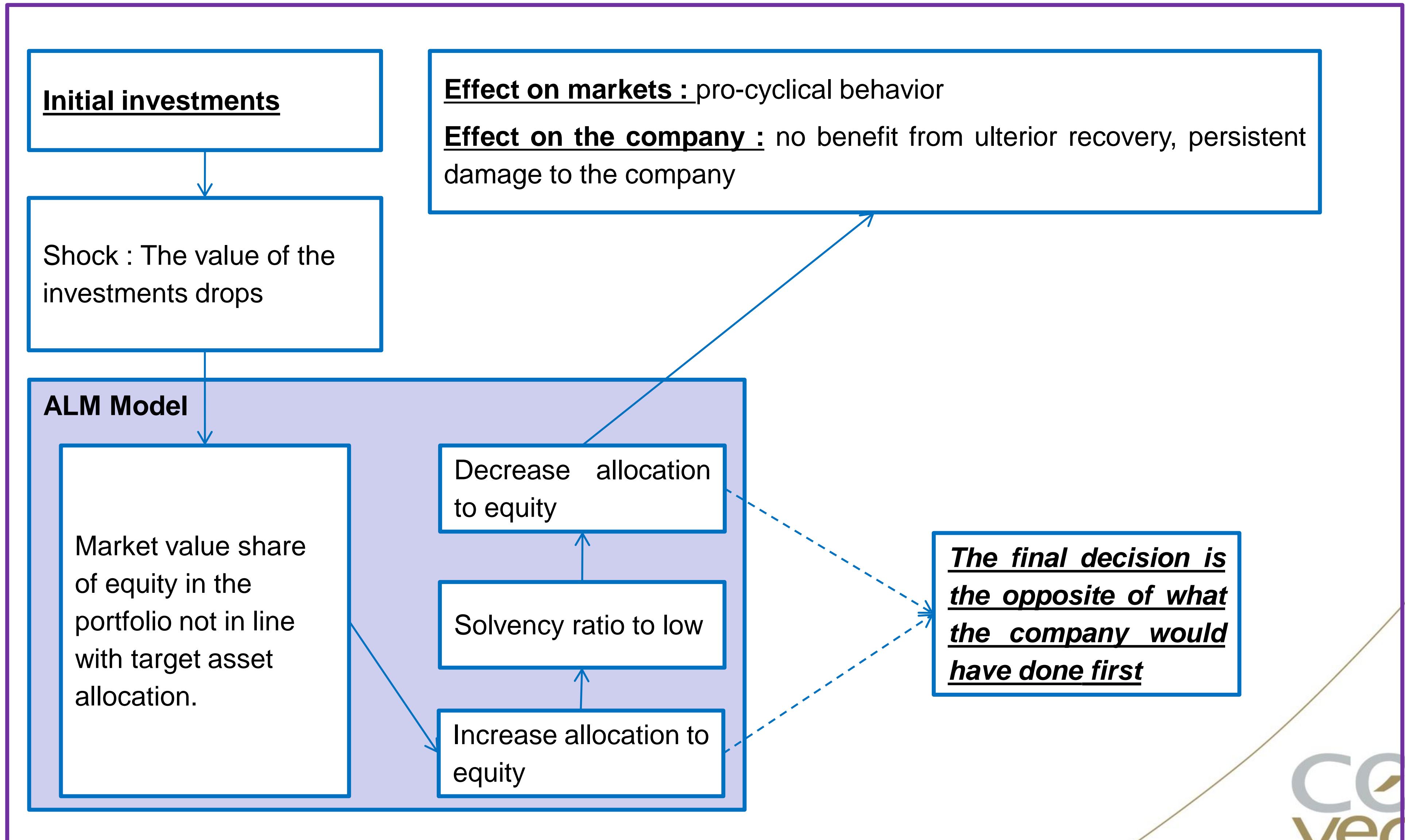
Case study, the regulatory challenge for equities



Conclusion and solution

- **Fair principles**
  - ✓ Solvency 2 regulation has been based on the concept that insurers should set aside capital in proportion to the risks taken
  - ✓ a correct hierarchy between the risks should be established
  - ✓ the loss in own funds should be estimated on a year basis **net** of management actions
- **Something is wrong**
  - ✓ insurers that manage equities with LT strategies should not be prevented to do so
- **The false solution**
  - ✓ reducing risks and decreasing capital charges by avoiding risks does not do the job
- **The appropriate solution**
  - ✓ encouraging insurers to do their job of taking risks and investing actively in the productive economy by measuring accurately the capital charge needed and providing the right incentive to manage risks appropriately : early warning indicators are needed, remediation should not be brutal and pro-cyclical

Urgent action is needed ! Because changes in asset allocations need several years to get achieved and translate in balance sheets !

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