

LIFE INSURANCE CFO SURVEY #13: ENTERPRISE RISK MANAGEMENT

SUMMARY OF FINDINGS

In the first installment of its Life Insurance CFO Survey in 2006, the Tillinghast business of Towers Perrin focused on enterprise risk management (ERM) and economic capital (EC). The survey explored how companies are approaching ERM in general terms, their risk management objectives and how they have defined their ERM framework. The survey also analyzed companies' approaches to implementing EC, including planned improvements to their existing EC framework.

A key conclusion from the survey results is that ERM continues to gain momentum as a burning issue among insurance company senior management. Both internal and external pressures are driving many companies to extend their solutions beyond regulatory compliance and control to include value from risk taking. As a result, corporate strategy and shareholder value initiatives require ERM tools and techniques that deliver a more complete business solution.

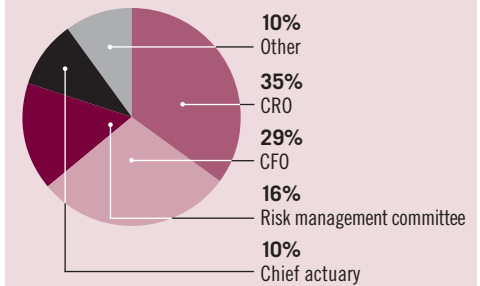
The survey also found that ERM is growing in prominence and gaining increasing legitimacy as a high-profile, senior executive responsibility. ERM and EC are being used more widely to improve risk-based decisions and capital management. Indeed, companies have come far in their use of ERM and EC but recognize they still have room for improvement.

ERM IS A SENIOR EXECUTIVE RESPONSIBILITY

ERM is gaining the attention and high-level accountability it deserves. In most companies (64%), either the chief risk officer (CRO) or chief financial officer (CFO) is responsible for ERM (*Exhibit 1*). In addition, the person responsible for ERM reports to the chief executive officer (CEO) at nearly half of the companies surveyed. The growing number of companies with a CRO, a senior executive position focused solely on risk management, signals the increased strategic importance the industry is assigning to this function. This is further supported by the elevated status of this position, which in many cases reports directly to the CEO. These results are consistent with the findings of Tillinghast's third biennial survey on risk and capital management, conducted in 2004, among 150 insurance industry executives worldwide.

As external stakeholders, analysts and rating agencies demand more information on how an insurer manages its risks, the CRO will play a central role in demonstrating that their risks are well understood and under control. Over the years, our surveys have shown that the CRO role has evolved both in seniority and responsibility in tandem with an increasing awareness and understanding of the value of ERM to an insurer.

EXHIBIT 1
Person Responsible for ERM



PRIMARY OBJECTIVE OF ERM IS BETTER RISK-BASED DECISIONS

Companies increasingly view ERM as a tool that will help them add value to their businesses through better decision making and capital management. Nearly three-quarters of respondents identified "improve risk-based decision making" as one of the top three objectives of their ERM framework (*Exhibit 2*, page 2). Nearly 60% said a key objective of ERM is to "make more effective use of capital." It is clear that companies are no longer simply doing ERM to comply with regulatory changes or for purely defensive reasons. Once again, these findings are consistent with those of our 2004 risk and capital management survey. However, it is notable that 27% of respondents are looking

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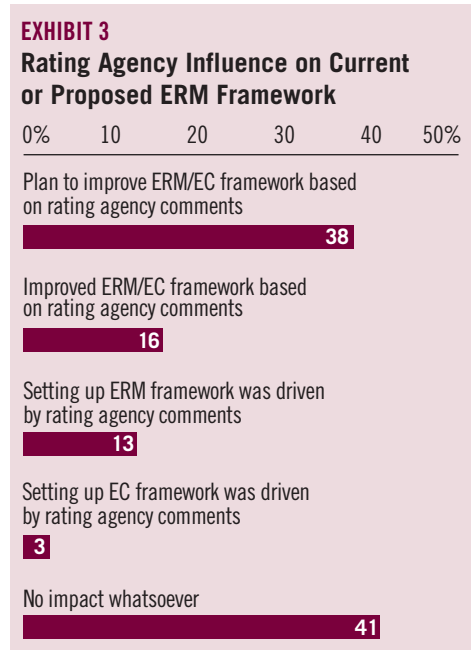
to ERM to help them comply with rating agency requirements in the hopes of improving their rating. This trend is likely to intensify as rating agencies refine their demands on companies and increase their expectations of how sophisticated these organizations should be in managing their risks.

As evidenced by respondents' objectives, rather than a simple, technical task to identify and quantify risks, ERM is now considered a prerequisite for driving business strategy. Indeed, ERM can be viewed as a dynamic business planning tool that provides insurers with more strategic choices and robust analyses than previously available.

RATING AGENCY SCRUTINY IS INFLUENCING ERM IMPLEMENTATION

For most companies, although compliance with regulatory and rating agency requirements is not the primary objective of their ERM framework, it is increasingly influencing how they implement ERM. Nearly 60% of respondents said that increased rating agency scrutiny is influencing how they set up or improve their ERM framework (*Exhibit 3*). Further, a majority of respondents reported that they plan to improve or have improved their current ERM framework based on rating agency comments.

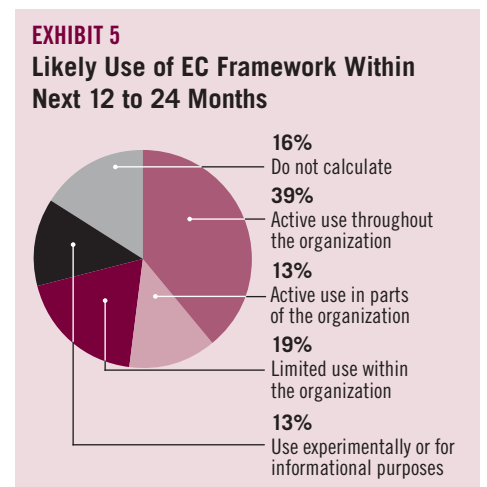
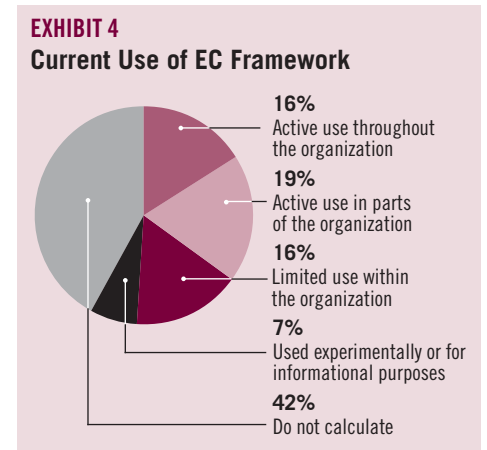
All major rating agencies have stepped up their efforts to incorporate ERM into their overall framework for assessing companies' financial strength ratings. In particular, one major rating agency (Standard & Poor's) assesses the quality of companies' ERM frameworks based on an extensive set of criteria, including questions about how successful ERM was in avoiding losses in the past.



EC IS A KEY TOOL USED FOR ERM

EC is used by nearly 60% of respondents today (*Exhibit 4*) and is expected to become even more widespread in the near future. For example, within two years, nearly 40% of the companies plan to actively use EC throughout their organization, and another 45% plan to use it actively in parts of the organization or at least on a limited or experimental basis (*Exhibit 5*). This projected growth clearly demonstrates the importance of EC as a key tool for ERM.

Over the next year or two, companies plan to significantly increase the breadth of their applications for EC. Currently,



Nearly 80% of respondents are planning to make further improvements in their EC calculations or framework.

most companies use EC to evaluate capital requirements, price and design products, and manage tail risk (*Exhibit 6*). Within the next two years, many more of these companies also plan to use EC to assist with strategic decision making, capital management and rating agency communications.

EC is becoming a key metric within companies' ERM framework. The use of EC is expected to increase further as regulators around the world begin to implement principle-based approaches to capital adequacy. In effect, they will be "prescribing" EC models that will require companies to use internal models for assessing capital adequacy.

COMPANIES ARE IMPROVING EC CALCULATIONS AND FRAMEWORK

While companies have come a long way, they recognize the need for further improvements in their EC calculations or framework. Currently, most respondents (57%) use the more sophisticated structural simulation approach for calculating EC versus the statistical correlation approach (36%) and plan to continue to use this approach long term. The structural simulation approach combines risk factors into stochastic multi-risk scenarios and uses the tail scenarios to develop EC. This approach is consistent with the desire to use EC to make better

risk-based decisions as it allows companies to calculate and aggregate risk capital the way they would manage the business.

In addition, 79% of respondents are planning to make further improvements in their EC calculations or framework. This demonstrates that building EC models is an evolutionary process that is refined and improved over time. These enhancements typically involve improving the quality of their capital models and the application of the models (*Exhibit 7*). Consistent with the results of our 2004 global risk and capital management survey, those respondents that are not planning to improve their EC calculations or framework most often cite resource constraints as the primary reason. Typical improvements include expanding the list of risks included in the models (in particular, adding in operational risks), evaluating diversification and aggregation benefits, improving hardware and software

EXHIBIT 6
Current and Planned Uses of EC Calculations
(respondents include only those companies currently using EC)

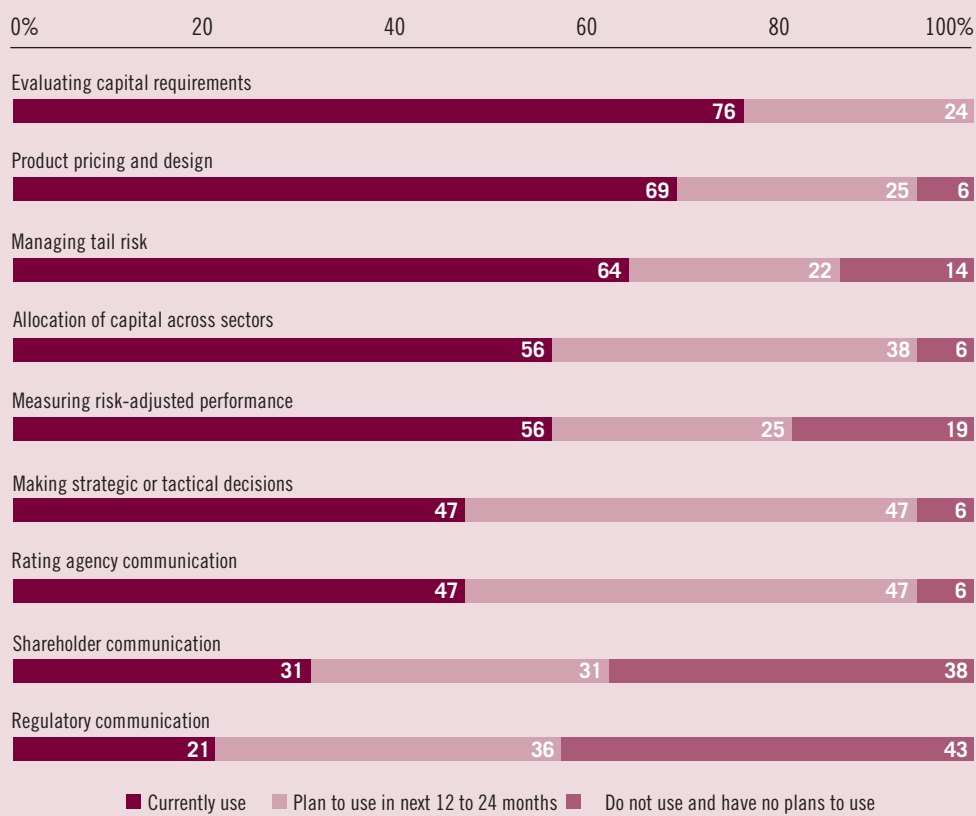
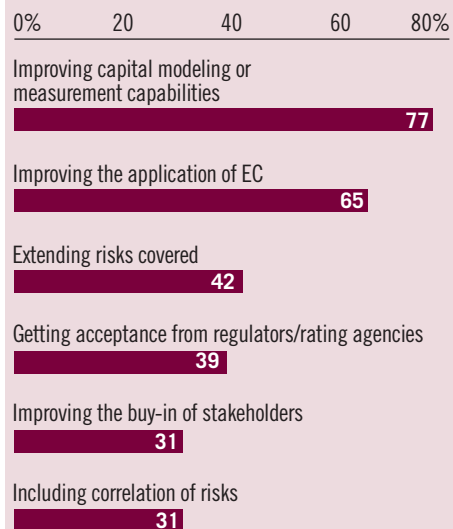


EXHIBIT 7
Goals of Planned Improvements to EC Framework



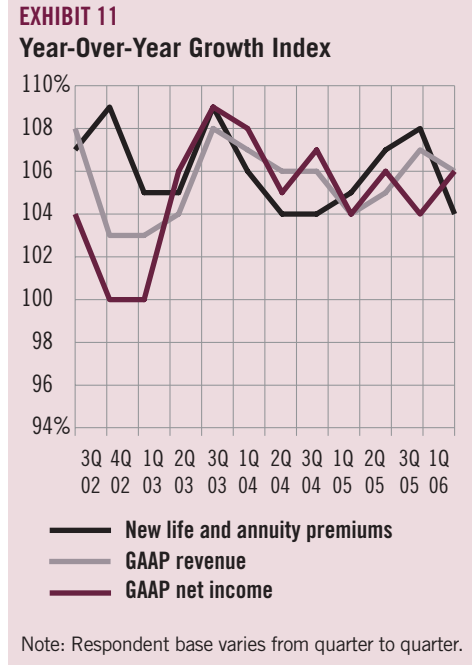
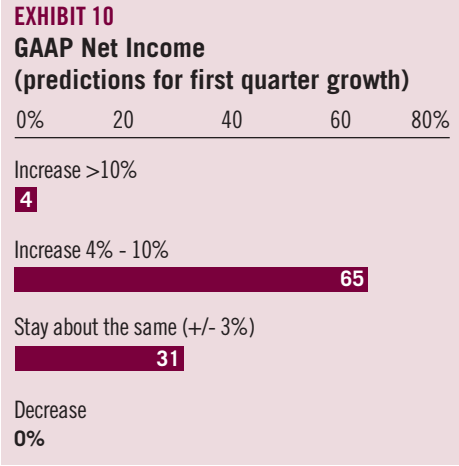
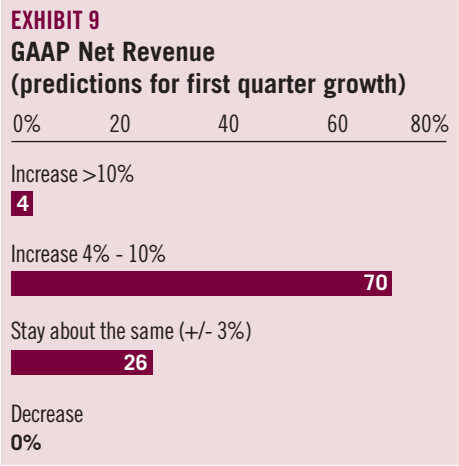
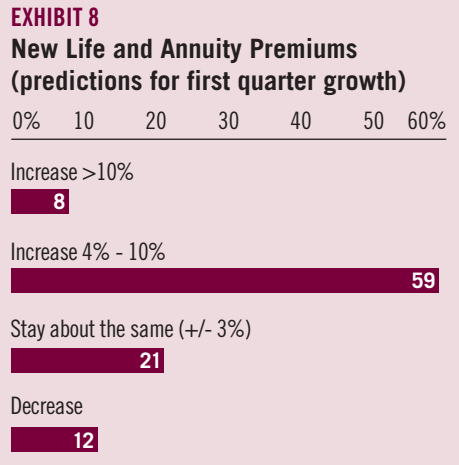
CFOs' outlook for first quarter 2006 results was very optimistic for GAAP net income, but more guarded for new premiums and GAAP net revenue.

capabilities, and enhancing their EC models for use in value-added work such as European embedded value (EEV) and market-consistent embedded value (MCEV).

POSITIVE OUTLOOK FOR FIRST QUARTER 2006 RESULTS

CFOs' outlook for first quarter 2006 results was very optimistic for GAAP net income, but more guarded for new premiums and GAAP net revenue, compared to our last survey. Two-thirds of respondents predicted 4% or higher growth in new life and annuity premiums over the same quarter last year, and 74% expected first quarter GAAP net revenue to increase by 4% or more (*Exhibits 8 and 9*), down from 73% and 76%, respectively, in our last survey. However, 69% expected first quarter GAAP net income to increase 4% or more compared to the same quarter last year (*Exhibit 10*), up from 61% in the last survey. Further, no respondents predicted a decrease in GAAP net income. This indicates companies' continued reliance on generating supplemental income from noncore items like capital gains and mortgage prepayments to help drive GAAP net income.

Tillinghast 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. Currently, indices range from 104 for new life and annuity premiums to 106 for GAAP net revenue and GAAP net income (*Exhibit 11*). This represents an uptick in CFOs' forecasts for year-over-year



growth in GAAP net income. However, consistent with the results noted above, CFO's optimism about growth in new life and annuity premiums is down significantly. Coming off a solid year of sales in 2005, this would indicate an expectation for a slowdown in market growth for at least the first quarter. In fact, at a current level of 104, the CFO Survey Growth Index for new premiums is at its lowest level since we started tracking it in 2002.

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

ABOUT TILLINGHAST'S NORTH AMERICAN LIFE INSURANCE CFO SURVEY

This Web-based survey, which was conducted in February and March 2006 by the Tillinghast business of Towers Perrin, is the 13th in a series of pulse surveys that explore issues of importance to the North American life insurance industry and its CFOs. This three-part survey focused on life insurers' enterprise risk management philosophy,

their approaches to implementing economic capital and CFOs' expectations for first quarter results.

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PARTICIPANT PROFILE

Thirty-three CFOs (46% of the program's 71 registered members) participated in the survey. Since all survey 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; 52% had assets of \$5 billion or more; and 21% were multinationals (*Exhibits 12, 13 and 14*).

EXHIBIT 12

Company's Primary Line of Business

0% 15 30 45 60 75%

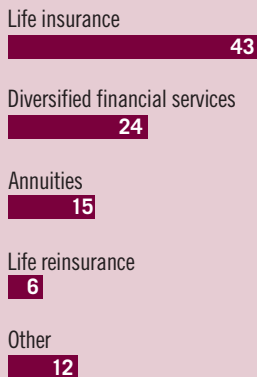


EXHIBIT 13

Life Insurance Organization Structure

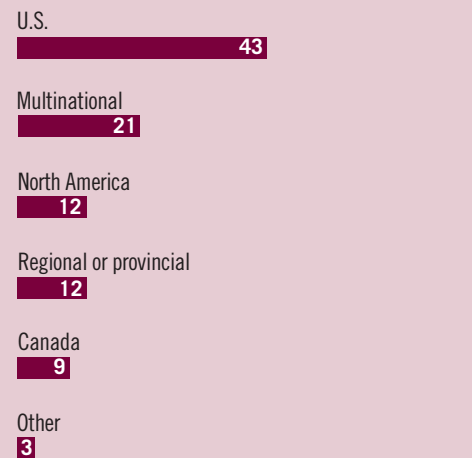
0% 15 30 45 60 75%



EXHIBIT 14

Scope of Company Operations

0% 15 30 45 60 75%





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ABOUT TOWERS PERRIN

Towers Perrin is a global professional services firm that helps organizations around the world optimize performance through effective people, risk and financial management. The firm provides innovative solutions to client issues in the areas of human resource strategy, design and management; actuarial and management consulting to the financial services industry; and reinsurance intermediary services.

Our businesses include HR Services, Reinsurance and Tillinghast.

The Tillinghast business of Towers Perrin provides consulting and software solutions to insurance and financial services companies and advises other organizations on risk financing and self-insurance. We help our clients with issues related to mergers, acquisitions and restructuring; financial and regulatory reporting; risk, capital and value management; products, markets and distribution; and financial modeling software solutions. More information about Tillinghast is available at www.towersperrin.com/tillinghast.