# Exercise: Assessing the Governance and Risk Management of an Insurer and its Insurance Group

## Acquisition of a life insurer in trouble

A life insurer in your country called **Providence** had experienced some solvency problems the last couple of years and its capital position needed urgently to be strengthened. As the supervisor, you therefore welcomed the offer of a global insurance group and its holding company, **Expand**,to buy the life insurer and make a significant capital injection, thus restoring the solvency position to an acceptable level.

## Senior management, members of the board and control functions

Expand changed the CEO of Providence and replaced him with a very talented young man, who had been to the same university as the CEO of Expand. Four board members were also exchanged, three of the new members also sitting on the board of Expand and the forth being a retired CEO with extensive insurance knowledge. The remaining four members consisted of the new CEO, who was also the Chair of the board, the remaining men having been on the board for the last 15 years. The CRO and the Head of Internal Audit of Providence left shortly after the acquisition and had to be replaced with new recruits. The CEO recruited them shortly after, having personally vetted their merits from the insurance sector. The rest of the staff otherwise remained the same.

## Competing to become the leading insurer

In order to gain market shares, Expand ordered Providence to get into new products and innovate. At the same time Providence was instructed to press the prices in order to compete with the leading firms in the local market. Expand also encouraged Providence to compete with the other subsidiaries in the group in order to make the group competitive on a global level. To achieve the goal of becoming the leading company, Providence was furthermore instructed to offer high guarantee products and invest in high yielding assets. These assets were poorly matched to the liabilities but Expand considered the risks of the mismatch negligible.

## Sticking to the group strategy

Providence grew considerably at first due to the high interest rates and good investment climate. There was, however, a significant increase in the expenses to fund the growth, with much smaller increase in expense recoveries from the new revenue streams. Due to the then leading position in the local market and the success of the guaranteed products, Providence continued to offer them although interest rates were starting to fall to worrying levels. They also kept up with their investment strategy, although the assets had started losing in value.

The Appointed Actuary and the Investment Committee of Providence had major reservations to the strategy of the group and wanted to change it locally for Providence. The strategic direction as outlined by the CEO of Expand, whom the CEO of Providence trusted fully, had, however, proved successful in the past, so the Board of Providence chose to disregard their criticism and stick to the same strategy.

## Lending a helping hand

Providence’s main competitor in the Expand group, the life insurer **Confidence**, which was located in a neighbouring country to Providence’s, started having liquidity problems due to problems experienced in its guaranteed life insurance products and illiquid asset portfolio. Confidence could not get affordable loans in its market due to its solvency problems, which were publicly known. Providence was therefore instructed by Expand to lend them the sums needed and to do so on favourable terms so that Confidence could sort out its problems. Although Providence wasn’t particularly happy to assist a competitor, the board saw no other solution than to provide the loan on the indicated terms. Providence was later to extend the loan as Confidence’s liquidity problems grew and more capital was needed urgently.

## The end

Confidence later ceased payments and went bankrupt, soon to be followed by Providence, which had lost considerable money on guaranteed insurance products and the loans to Confidence that were never repaid. The asset portfolio of Providence had furthermore lost in value and become illiquid. There was no group support from Expand, which decided to divest Providence and Confidence as they were considered less crucial to the group’s strategy and reputation. There was not enough money left for all of Providence’s creditors, including their policyholders, which had to take a cut in what was owed to them.

### Questions:

1. What governance, internal control and risk management concerns would you have had as the supervisor of Providence?
2. What regulatory framework should you have had in place and what supervisory measures could you have taken to prevent or mitigate the problems that later occurred?
3. How could you incentivise the insurance industry to adopt better governance frameworks and practices and what would be on your list of improvements to make?