

Turn capital ideas into reality

In the second of a two-part interview, **Eric Paire** (EP) talks to *The Review* (TR) about how more efficient management of capital can be achieved by reinsurers. Today, the spotlight falls on capital structure and capital allocation



TR: Yesterday, you mentioned that capital management can be divided into three main areas: capital adequacy, capital allocation and capital structure. So, now let's talk about capital allocation and capital structure.

EP: Once we know how much capital a client needs, we ask two questions: 'How can we reduce the cost of capital?' and, 'How can we maximize the return on capital?'. To optimise capital on a day-to-day basis, you should allocate capital down to the lines of business, driving the cost of risk down to the production and underwriting level.

MISSED YESTERDAY

See the first part of this interview on www.idnewscentre.com and www.delegatedairy.com

If you don't get it right there, maximising return on capital (ROC) will prove difficult at the corporate consolidated level.

This internal rollout of capital allocation and economic capital-based pricing takes time and skill. You need to talk 'business' with the people in the field while helping them understand the economics behind the models. This is a consulting assignment where we can be very helpful to our clients.

TR: And how can you affect cost of capital (COC)?

EP: The optimal capital structure actually reduces cost of capital for a given level of total risk. This is why, for instance, there is a limit to how much debt an insurer can have, or why reinsurer security matters. Ultimately we get to the key

element, which is economic value added (EVA). EVA equals ROC minus COC. Plans to maximise ROC and minimise COC are really plans to maximise EVA and, in fact, maximise either share price for a listed company or surplus growth for a mutual company.

TR: But once there's a plan to optimise each of the three elements through specific transactions, what comes next?

EP: Putting an effective capital structure in place requires equity, debt, reinsurance and capital market solutions.

TR: Advising on improving capital management efficiency is now an extremely competitive area among reinsurance brokers. What does a broker need to offer to stand out

from the competition?

EP: What differentiates us is our ability to bring academics, actuaries, software developers and brokers into an integrated team with two obsessions: 'keep it simple' and 'make it work'.



Eric Paire (EP) is head of Guy Carpenter's newly created European Solutions Group, which focuses on capital management initiatives and related transactions in Europe.