OLIVER WYMAN

A CONVERSATION WITH

GEORGE QUINN
CHIEF FINANCIAL OFFICER SWISS RE GROUP

MATT LEONARD, PARTNER, OLIVER WYMAN

MARSH & McLENNAN COMPANIES

Matt Leonard: You've been CFO and Member of the Executive Committee for five years. What are the things you learned over that time period that you would have really liked to have known from the start?

George Quinn: First and foremost, to maintain a healthy skepticism, especially when it comes to complex financial models. I started as CFO on March 1, 2007, the day we announced our 2006 results – the highest earnings Swiss Re has ever had and then went straight into the subprime and broader financial market crisis that followed. Hindsight is a wonderful thing, but models are just models. If they were perfect, Swiss Re would not even exist. They are obviously not perfect, but it is hard to look at the output – the numbers – and see it as the uncertain estimate that it is. We could have saved a lot of money being less focused on model – the 'how' – and instead spending our time on 'why'.

Second is being able to hold on to your first reaction, especially when the news is not as expected. Given sufficient time we can all turn negatives into positives, and 'sufficient' can be days rather than weeks or years. I had this experience in 2010 with a headline result that was well above expectations, but where the underlying performance was below. In the end, I was seduced by the headline and emphasized the positive but my 'customers', the analysts and investors, had exactly the same reaction that I had initially. A quarter's worth of weaker performance is not the end of the world, but you can create bigger problems with your credibility if you leave the impression that you don't even recognize it. I don't see 'spin' as compatible with the CFO's job description.

I've also learned a lot about the investment process our investors go through. I like the company I work for and I like the business that we run, but there's a big temptation to see yourself as the center of the universe. Complexity has a certain beauty but not when it comes to explaining insurance or reinsurance to investors. I've learned that this is not an intellectual exercise but is about communication and simple is better every time. Not only externally but internally too. I say I've learned this but it would be more accurate to say I understand this. I have some way to go before I am good at this.

Lastly, over the past few years I've learned the value of having a very open exchange of views. I'm not a very emotional person, but I think having an emotional argument can actually help drive out better solutions.

"I DON'T SEE 'SPIN' AS COMPATIBLE WITH THE CFO'S JOB DESCRIPTION."

ML: Swiss Re has spent a lot of time and resources preparing for Solvency II. As CFO of a company that has long been a vocal supporter of the initiative and the principles behind it, what do you think of the timeline being pushed back by at least one year to Jan. 1, 2014?

GQ: Solvency II creates the right incentives for insurance companies to focus on underwriting and less on the asset management side of things. We're still big supporters of it.

The delay is not surprising. If Solvency II had been implemented eight years ago, it would have happened very quickly indeed. In a calmer environment, it's easier to implement these complex changes. So, the fact that there is an extensive debate going on doesn't worry me. It will pose some significant challenges to the industry, especially on the asset side of the balance sheet, and the current market environment just reminds us of those challenges.

If I have a fear, it's that the regulators overreact. Solvency II represents a substantial modernization for an industry that, in general, survived the challenges of 2008 relatively well. We really have to be careful that we don't go way beyond the need to protect policyholders and start to create an economic imposition that makes the business far less competitive.

> "IF SOLVENCY II HAD BEEN IMPLEMENTED EIGHT YEARS AGO, IT WOULD HAVE HAPPENED VERY QUICKLY."

ML: Has Solvency II changed the way that you look at your business?

GQ: Less on the liability side. With underwriting, for P&C, we've gone through a process over the last 10 years globally and rolled it out to Life more recently.

Assets are different, and in fact our change in philosophy came out of the equity market issues of 2001-2002. This is still one of the biggest challenges that we face today. An insurance company cannot be a benchmark investor – we need to be able to pay claims in the future – yet that's how the asset management world runs. How do you judge asset management performance? If I look at a year like this one, when assets have fallen, how do you judge the performance of your asset manager? I think we did a good job, but we clearly lost money – just not as much as the other people have. You're back to taking a longer term view. That's where we have the biggest challenge.

ML: Assuming Solvency II becomes a reality in something resembling its current form, what changes do you expect in competitive landscape as a result?

GQ: If there's a day of reckoning, we won't know it for certain until years after it has taken place.

This is a bit cynical, but I used to see Life companies primarily as asset gatherers, and expected that there would be a long period of denial around Solvency II. But as I've talked to Life insurers, especially in Europe, they seem to be skipping the denial stage and focusing on making changes to make sure they can stay competitive and manage capital requirements for their product base. This is a pretty significant shift in the business model; I'm pretty impressed. It's hard for me to imagine how Swiss Re would react if a new solvency model came along that challenged P&C underwriting for example, so I'm impressed that the Life companies have really tried to get this under control and respond as quickly as they have.

"THIS IS A PRETTY SIGNIFICANT SHIFT IN THE [LIFE INSURER] BUSINESS MODEL."

ML: IFRS Phase 4 goes some way towards driving convergence between European regulatory and financial accounting regimes, yet the elephant in the room is the uncertainty around convergence of US standards. Is the lack of convergence a risk?

GQ: I'm not convinced we're closer today to an answer than when we started. It would be a positive development for the European insurers and reinsurers to see convergence. But I get less and less convinced that we're actually going to see that initial convergence, much less this issue of US GAAP versus IFRS in the first place. Again it's a challenge of the financial crisis that if the IASB had set out converging standards prior to the crisis, it would be done by now, certainly from a European perspective. It feels as if the chance has started to slip away, far more than I worry about Solvency II.

ML: The global financial crisis focused a lot of attention on credit rating agencies, their role in providing market transparency and how their revenue model might conflict with this mandate. Do you see them continuing to play important roles in the evaluation of insurance companies and insurance-related investments?

GQ: Yes and no. We could debate how rating agencies or companies or regulators or politicians dealt with the challenges we saw with the financial crisis. But there's no getting away from the fact that many sectors of the market no longer rely on them as they did before, although they do look to them as a relevant opinion. As to the business model, it's very difficult to see how you get around it. Investors seem to prefer the current set-up.

I have seen a real change in the way senior management at rating agencies approach things. They're clearly focused on the quality of what they do and have a real zeal about getting it right, although they're more humble today, for reasons that are obvious. I went through a downgrade back in 2009, just got through an upgrade with two of them, and I don't think I can complain about the circumstances that led to the changes two years ago.

One big thing I've been impressed with is that all of the rating agencies are far more careful about making sure that the reasons for their conclusions and outlooks are spelled out clearly. There's nothing that S&P has been telling Swiss Re in private for the last three years that wasn't said in public. When you have that type of openness, it certainly helps me, and I assume it helps investors.

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ML: Some of the discount built into reinsurer valuations would appear to characterize investors' low expectations for future growth. What is your expectation of growth prospects for the sector overall and are there any segments that you view as potential growth engines?

GQ: I think valuations are more to do with current returns than with growth prospects. Either because of challenges with assets, or because of volatility on liability side, investors fear that the risk premium for the industry has gone up a lot and returns have not, and as a result we have the valuations we currently see.

There's a huge potential for us to grow further. One of the amazing things is that China will become Swiss Re's number three market inside a year – out of nowhere. But China hasn't developed as a traditional market for us. Swiss Re's value proposition in the US – which still accounts for around half our business – is our capacity to take volatility from peak risks and combine that with other risks we take around the world. The P&C proposition in China is more around traditional solvency relief, supporting the growth of the local market players.

The reason China is such a large market for us and for our largest peers is that it's a concentrated market of companies that need a lot of help. So if you turn up with a small amount of capacity, you're not very interesting. If you show up with a few hundred million, then it's worth having a discussion. This is not only true in China; it's true for companies that drive the global market dynamics in insurance. These companies need substantial support. If you're a small player, for the time being, you can still break off pieces. We saw the results of that earlier this year – the surprise of some of the exposure of some of the smaller players in Japan and New Zealand. I actually feel very good about the ability of companies like Swiss Re to leverage its competitive position in the market and I think that as market prices move up, it puts us in an even stronger position. It's way too early to declare victory on this but the needs of the most important clients in the market have changed fundamentally over the past 10 years, and that means the value proposition that companies like Swiss Re have are much stronger.

> "ONE OF THE AMAZING THINGS IS THAT CHINA WILL BECOME SWISS RE'S NUMBER THREE MARKET INSIDE OF A YEAR."

ML: Is that fundamentally a scale issue?

GQ: It's not only that. Again, compare Swiss Re to our largest clients; our largest clients are all bigger. But it's about being prepared to accept their volatility which is the fundamental basis for what we do. One of the things we announced in 2005, we used the expertise of the insurance-linked securities market to expand the capacity we can offer our largest clients and not have the worry about the credit quality of the company we're going to retrocede the risk to. We use the capital markets, we accept the basis risk and as a result, we can offer these largest companies the kind of line size that makes a big difference and allows them to operate. That's the good news.

The bigger challenge is in Life and Health. We have a different approach that makes it difficult to be competitive in that market, especially because of the issues around assets. I thought 2008 would start a change fundamentally around the way things were looked at, but equity markets recovered very quickly in 2009. As a result some of the changes I thought would come have not materialized.

ML: How much of that is due to a time lag before analysts figure out that products are being underwritten at uneconomic prices?

GQ: The current interest rate environment will make this issue far clearer. The process takes a very long time and goes back to the accounting issues earlier. The results of Swiss Re's Life book are more related to what we did 10 years ago than last year. It's a real challenge. You just don't see the impact of the market environment changing as quickly as you may expect if you were a generalist and you came from a different world.

ML: Few people would admit to having started their professional lives aspiring to a career in the re/insurance industry. How did you get into the sector?

GQ: I ended up in insurance by accident. I'm a mechanical engineer, and I did a job interview at an accounting firm with no intention of being an accountant. The person interviewing me turned out to be very charismatic, and I came out of the interview thinking, "this is quite interesting". I joined the firm and ended up in the same person's department, and by chance the department was largely focused on insurance. So I got into accounting by chance, the insurance aspect by chance, and I stayed in it.

"I ENDED UP IN INSURANCE BY ACCIDENT."

ML: Has there been anyone along the way that you would point to as being a really influential role model?

GQ: The most important advice I can give is that you need to quickly pick the kind of people you want to work for in your career because they're going to be the ones that have the biggest impact on you. What I learned from the person who interviewed me for my first accounting job wasn't some technical skill, it was behavioral – how he deals with other people. With all the bright and capable people I've worked with, it's always been about that. The good ones go out of their way when you're younger to teach you some of the technical stuff you need to know. But in reality it's not what they taught you, it's the fact that they went out of their way to teach you something that matters later in life.

ML: The demands on senior management of a global financial institution are ever-expanding; if you could find an extra hour in each day, how would you use it?

GQ: It's all about how much time you spend thinking about the things you're doing in the most mundane circumstances. So, you're in the shower in the morning and you're thinking about the things you're working on and the challenges you face and even when you sleep at night, you have something on your mind that you try to clear. I think that's the real challenge; it's the extent to which many of the things you're dealing with in the environment of the organization take over almost all the time that you have, whether you're in the office or not.

ML: So, if you had to change your routine…

GQ: I'm not a physical fitness fanatic, but I get on the machine for half an hour to 45 minutes and I find that takes a lot of the stress away. With things getting tougher, I've had to work out more and I find it really helps.

If I had an extra hour in the day for free, it would be for my family. It wouldn't be for the office. The office gets quite a lot of my time already.

GEORGE QUINN

Chief Financial Officer
and Member of the
Executive Committee
Swiss Re Group

Born in 1966, he holds a degree in engineering from the University of Strathclyde and is a member of the Institute of Chartered Accountants of England and Wales. He started his career at KPMG in London, where he held a number of positions as adviser and consultant to insurance and reinsurance companies.

George joined Swiss Re in Zurich in 1999 as Chief Accounting Officer. In 2003, he was appointed Chief Financial Officer for the Financial Services business group. He moved to New York in 2005 to become Regional Chief Financial Officer for Swiss Re Americas, and has served as Chief Financial Officer of Swiss Re Group since March 1, 2007.

George has had a major influence on international accounting developments affecting the reinsurance industry, representing Swiss Re in discussions with key regulatory bodies such as the SEC, the IASB and the Swiss regulatory bodies.

MATT LEONARD

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Matt Leonard is a Partner in Oliver Wyman's Insurance practice and is based in the firm's Chicago office. He has advised major P&C and Life companies, investors and regulators in North America, Europe and Asia. His work spans market strategy, organizational design, financial effectiveness and public policy.

Matt has over 18 years' experience in the financial services sector. He joined Oliver Wyman's London office in 2003 and previously spent several years working in the Corporate P&C sector.

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