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Book Review

Bank and insurance capital management, Frans de Weert, Chichester: Wiley Finance, 2011, 246pp. (hardback), £45.00. ISBN: 978-0-470-66477-3.

The publication of this well-written book is timely, given: 1) the increasing focus on capital management following the credit crunch and Eurozone debt crisis and 2) with insurers actively engaged in reviewing and bolstering their capital management capabilities in the run up to Solvency II.

Reflecting the author's experience in the finance industry, *Bank and insurance capital management* is aimed at practitioners (e.g. capital managers, risk managers, senior managers of banks and insurers, regulators, investors) but will no doubt also be useful reading for academics and business students. Numerous examples and comparisons between bank and insurance balance sheets help to cement the reader's understanding. As an actuary working in insurance capital management, I found the balance of discussion and examples weighted slightly more towards banking rather than insurance. Nevertheless, most of the principles apply equally well to an insurance context, albeit sometimes requiring additional thought as to how to implement them. I found the chapters describing the "strategy, risk and capital management cycle" and the emerging role of capital and risk management particularly interesting and thought-provoking.

In the introductory chapter, the primary purpose of capital management – to create value – is framed in terms of the two objectives: to optimise performance (i.e. return on capital) and optimise capital structure (i.e. cost of capital). The remainder of the book discusses how this can be achieved in practice – from translating business strategy into capital allocation through to optimising economic profit by business unit and achieving an optimal level of debt financing, whilst fulfilling regulatory requirements and managing stakeholder expectations.

The book is organised into four main sections representing the different perspectives that impact on capital management decisions:

1. <u>Accounting perspective</u> – provides an overview of bank and insurance business models and balance sheets including topics such as: goodwill, economic capital and IFRS versus regulatory balance sheets. This section also describes typical decision making and governance structures within organisations for capital management (e.g. the role of the CEO, CFO, CRO, Asset Liability Committee (ALCO), Capital Management and Risk Management teams).
2. <u>Regulatory perspective</u> – Part II discusses the regulatory capital requirements for banks and insurers, including Basel II and Solvency II. It includes chapters on the different types of available capital (Tier 1, Tier 2, etc.) and capital instruments (common and preference shares, hybrid equity, convertibles, etc.). This section also considers how diversification benefits can be achieved through different organisational structures.
3. <u>Risk and capital management perspective</u> – describes the "strategy, risk and capital management cycle", the interaction between risk and capital management and their emerging roles. Topics covered include economic profit and the use of risk adjusted return on capital performance measures.

4. Corporate finance perspective – is concerned largely with optimising capital structure. Topics discussed include: enterprise value versus market value, cost of capital, optimising the level of debt financing and strategic diversification as a means to stabilising earnings and creating value.

This book provides a useful framework for thinking about capital management principles and strategies. However, whilst the tools employed by capital managers (e.g. hedging) are mentioned, the more technical details such as how to implement hedging strategies, use of reinsurance or methods for allocating diversification benefits across business units are outside of scope.

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