



Interview with Javier Navas Olóriz, deputy general manager for Corporate Risks, Insurance and Contingencies of Telefónica

“The downturn in the cycle is putting enormous pressure on the markets”

At moments of economic uncertainty such as at present, Telefónica has a privileged position as a well-provisioned company, with relatively low debts and a capitalisation which makes it the second ranking telecommunications operator in Europe, after Vodafone. This situation has been greatly helped by the company's rigorous risk control affecting not only property risks. The setting up of separate companies, such as the reinsurer Casiopea, the life insurer Antares and the brokerage Pleyade, have helped to maximize the management. According to Javier Navas' opinion they have not been alone. The insurance market has always been very helpful to the group, it has understood us and has accompanied us, says Javier Navas.



Javier Navas Olóriz was born in Segovia on September 6, 1946. He is a graduate in economics and actuarial sciences from Complutense University in Madrid. He also has other academic qualifications such as a master's degree awarded by the Escuela de Organización Industrial (EOI), he is an accounts and pension plan auditor and insurance broker. He has attended several training programmes in various European countries and the USA. At the present time he is deputy general manager of Corporate Risks, Insurance and Contingencies of Telefónica, S.A., chairman of Casiopea Re and managing director and vice chairman of Seguros de Vida y Pensiones Antares, S. A. Javier Navas is a university lecturer and regular speaker in professional forums in Spain and abroad and has published books and a large number of articles.



Question: Telefónica has an important place in Spain's history with respect to risk management and transfer. How did insurance develop in this company?

Answer: Although this may seem immodest, its development has been closely linked to me. The modern history of insurance in Telefónica started in 1975, just at a time when the deputy finance manager of the old Telefónica de España started to try to increase the level of technical coherence in a range of small policies. At this time I started with very few resources but

great enthusiasm. Telefónica was at that time a service monopoly and had a large degree of complexity in certain risks. There was a certain lack of order in the contracts. We worked with various broking companies, for example, Gil y Carvajal, which today is AON, and also with a brokerage linked to Plus Ultra, called Castellanos Seguros, today Willis. As we all know, the concentration process amongst brokers has been incredible. It is a long story, with many complex situations from which we have always emerged satisfactorily.

Q: Were there various stages from the Seventies until the present time?

A: Yes, before the Eighties there was an important stage of self-insurance when Telefónica was not subject to corporation tax, but rather had to pay a state levy, and had some accounting privileges. The second stage started with the loss which was caused by the terrorist attack on the Telefónica building in Ríos Rosas Street in Madrid. It was then that the company realised that its risks were possibly very large. We were caught with risks ceded to third

INWARDS AND OUTWARDS

Q: How is the corporate insurance programme designed?

A: The hub and core of all the risks is the reinsurer Casiopea which seeks the protection of the professional reinsurance market with companies such as Allianz, Munich Re, Swiss Re, Hanover, Zurich, Gerling, and some Spanish companies such as MAPFRE, Musini, etc. The insurance programme is led and designed by Casiopea which reaches agreements with the international reinsurance market and distributes what it believes necessary in order to protect its profit and loss account.

Q: What volume of business does Casiopea handle?

A: The group's assumed premiums totalled EUR 27 million. This is a purely instrumental company whose object is not to bring profits but rather to optimise costs; it does however have a reserve of EUR 112 million to cover fluctuations in the loss ratio, the result of many years of careful management. With respect to its shareholders' equity, this is what was required by Luxembourg legislation - to which it is subject - when it was set up, EUR 3.6 million. Corporación Telefónica S.A. holds the entire share capital. Its clients are made up of the Telefónica group on an international level, and we provide services in more or less 35 countries.

Q: What is the greatest threat which a service company such as Telefónica can have from the point of view of business risk?


A: Probably third-party liability liabilities in markets such as the USA and Canada. These dynamic risks are not foreseeable because there is no previous loss experience. They may pose some problem for the profit and loss account.

Q: This has made you tighten protection measures?

A: Yes, we have sought covers with more legal rigour than are normally offered on the market. We need more sophisticated and complex products since Anglo-Saxon law is different. There you pay for the fact of causing damage, irrespective of whether there is blame or negligence. In Latin derived law you normally pay when there is blame or negligence. This nuance is very important.

Q: Which of your insurance companies was the first to be set up?

A: The life insurer Antares was set up in 1988, as was the reinsurer Casiopea. It was set up for cost efficiency since we had a very complex internal social welfare reorganisation process and we needed this tool. Initially the Telefónica group's pension plans were handled through Antares, and a specific management company was set up, Fonditel, when agreement was reached with the union organisations. Antares has thousands of policyholders, because those who have retired are also our clients. In reality the company is aimed at employees and retired employees. This company started making money from its first year, ESP 12 million (EUR 72.121.45). At the present time its turnover is ESP 107 billion (EUR 643.08 million) and gross profit in the year 2000 was ESP 3,142 million (EUR 18.88 million). Total structural expenses run at 0.31% of premiums and it has 19 employees. Our business is in-house. We also collaborate with the life insurance market in general, but the risk director is Antares.



parties, both loss of profits and property damage. It must be said that both the Consorcio de Compensacion de Seguros and the insurance sector responded very well. We came to satisfactory agreements, some immediate and others over time. It was then that the group's culture changed, the true nature of the situation was realised and we were offered more resources. The first step was to organise a risk management department between 1982 and 1983. We have been growing ever since, reaching the point where we have set up separate insurance companies.

Q: Apart from the general principles of risk management, what other factors brought about the decision to set up a department which has served as an example for the majority of risk management departments which have been created in Spain?

A: There were simple but important reasons: to achieve cost efficiency and maximum cover. At that time insurance had not made its leap into modernity; it was a relatively regulated market with rates set by the state. We took advantage of this time of change in order to organise and modernise the company's whole risk and insurance area. The main aim was to optimise costs, above all in life insurance.

Q: Was this expansion of the risk and insurance department accompanied by the company's geographic expansion into other markets, Latin America for example?

A: Yes, of course, these matters were always closely linked. International expansion gave us the opportunity to demonstrate that it is possible to do things in industrial companies which have no aspirations to be leaders in the insurance world, but rather simply wish to have available



instruments which help them to manage their risks, as is done by any North American multinational.

Q: What made to Telefónica decide to create its own instruments, in other words, its own insurance companies?

A: It was a process of becoming convinced - of seeing the advantages. The first to be set up was Casiopea, a Luxembourg based reinsurer.

Q: Again, this company promoted a model which was later followed by other Spanish companies.

A: That is a correct assessment, to the point where today captive insurance companies have become key elements within organisations for the financing of risks, and even more so after the terrorist attacks of September 11. The narrowing of the markets, the decrease in covers and the increase in prices will bring with them serious problems for companies that do not have these types of instruments.

Q: It is clear that risks, seen from a holistic or global point of view, no longer adhere to the traditional parameters. Today, captive reinsurance companies are one of the most efficient instru-

ments to channel alternative risk transfers (ART). All of this comes within the financial role of insurance.

A: Insurance is an important part of the financial sector - this is clearer every day. We need do nothing more than look at the case of the losses arising from the September 11 event, these will be close to 50% of all the technical reserves which the insurance sector worldwide had for catastrophic risks in the world. The loss of human lives will amount to 2% or 3% of the reserves.

Q: We will see even more - there will later be a cascade of compensation payments for third-party liability and loss of profits.

A: Yes, but the international insurance sector already accepts the USD 50 billion (EUR 55,25 billion) compensation figure. This figure will probably rise further, but the market has accepted that it will have to pay at least that amount. It is an astronomical figure - without any doubt the largest loss in history. And this, together with the fact that the cycle had already started its downturn, is putting the markets under enormous pressure. The result will be that the large risk capacity buyers - as is the case of multinational companies, including this one, will need a lot of imagination, professionalism and the availability of alternative instruments in order to move ahead.

Q: What was Telefónica's approach to risks and insurance before September 11?

A: Before dealing with this matter, I would first of all like to make clear that in all the cases of the reinsurer Casiopea, the life insurer Antares and the brokerage Pleyade, these are internal management instruments. We are not competing in the markets for specific risks; we do not want to compete with anyone. We concentrate on serving



AMERICA

Q: What peculiarities does the insurance programme have in Latin America?

A: Latin America is a mosaic of cultures, races and life philosophies. Argentina bears no similarity to Brazil or Peru. Each country has its own individual characteristics, very different one from the other. On the Pacific coast, in Chile and Peru, there is the possibility of earthquakes. In Brazil, flooding. In Venezuela, heavy rainfalls and ground slippage. Puerto Rico is threatened by hurricanes. In Central America it is hurricanes and earthquakes.

The complete insurance programme for the area is focussed in Casiopea. The objective of Antares is different. Until now Pleyade, which is our brokerage, has been involved in providing a supporting role from the point of view of technology and providing products for employees and their families, but initially focused on Spain. It is now the only one which may be considered to be undergoing business expansion because the group has decided to set up instrumental brokerages in Latin America - specifically in Brazil, Argentina, Peru, Chile and Mexico. Its aim is to help each director of the various regions to finance risks with a greater degree of autonomy. They will all be under Pleyade and will be administered by the shared service centres which are being set up in the whole group.

Q: Is it the case that the involvement of Telefónica's risk and insurance department caused the replacement of other previous forms of management?

A: We export our know-how. When we go into a new business or acquire a company, we introduce ourselves, do an introspective study, we see what the real problems are, and once these have been studied and defined we present our insurance programme and explain how we work. We find a local brokerage that gives us the service, and we include the members of the new company in the corporate insurance programme. It is a very simple system.

the Telefónica group and we do this efficiently. And this is from a client's point of view. The development of our group itself is so great that we do not need to think about other markets, this is emphasised by Standard & Poor's, which is our rating agency. With regard to the Telefónica group's position before September 11, we saw the last moments of a long period of favourable costs and covers. At the end of last year we detected a change and we designed a new strategy taking into account these changes in the reinsurance market. What nobody could predict was what happened on September 11. This brought about an enormous and very rapid change in the situation, it brought a problem into the light which, sooner or later, would have become evident.

Q: In your opinion what will happen after September 11?

A: I am very worried about the panorama. I also believe that the markets will be very responsible and make headway in

the payments of claims. I am optimistic in this respect, but not with regard to what may happen. There will be companies which leave the markets, in other words capital will leave, but new capital is appearing and new companies are being set up. The reason for this is the spectacular increase in prices. It is clear that profit margins will increase. Those who are going to provide capital should act with caution, their intention may be to profit from this time of turbulence, but in the long-term they may end up paying the claims resulting from September 11.

Q: We are in the renewals period, and there are reinsurers which are renewing without even knowing whether they will continue trading.

A: Yes, this is happening. There will be bankruptcies. All reinsurance has been slightly affected. What is clear is that we will all of us pay this loss, and when there are problems and a private company cannot meet its

claims, then it is very common to turn to the state.

Q: With regard to this, what is your opinion of the role which the Consorcio de Compensación de Seguros plays in Spain?

A: Let us start by saying that the Consorcio is an extremely interesting institution, clearly exportable, and now more than ever. In fact, there are very serious contacts going on in order to see if it is possible to adopt this model in other countries. The Consorcio has allowed us to buy risk capacity at reasonable prices and with a guarantee such as is the state. It has been efficient. I can only say good things.

Q: How do you see the risks derived from new technologies?

A: With enormous expectation and great interest, to the point that we have set up a section named "new technology risks" which is to study these risks and search for insurance or other types of alternatives in order to manage them. ■