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Life Conference 2011
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Closed Life Blocks
Consolidation in Europe?

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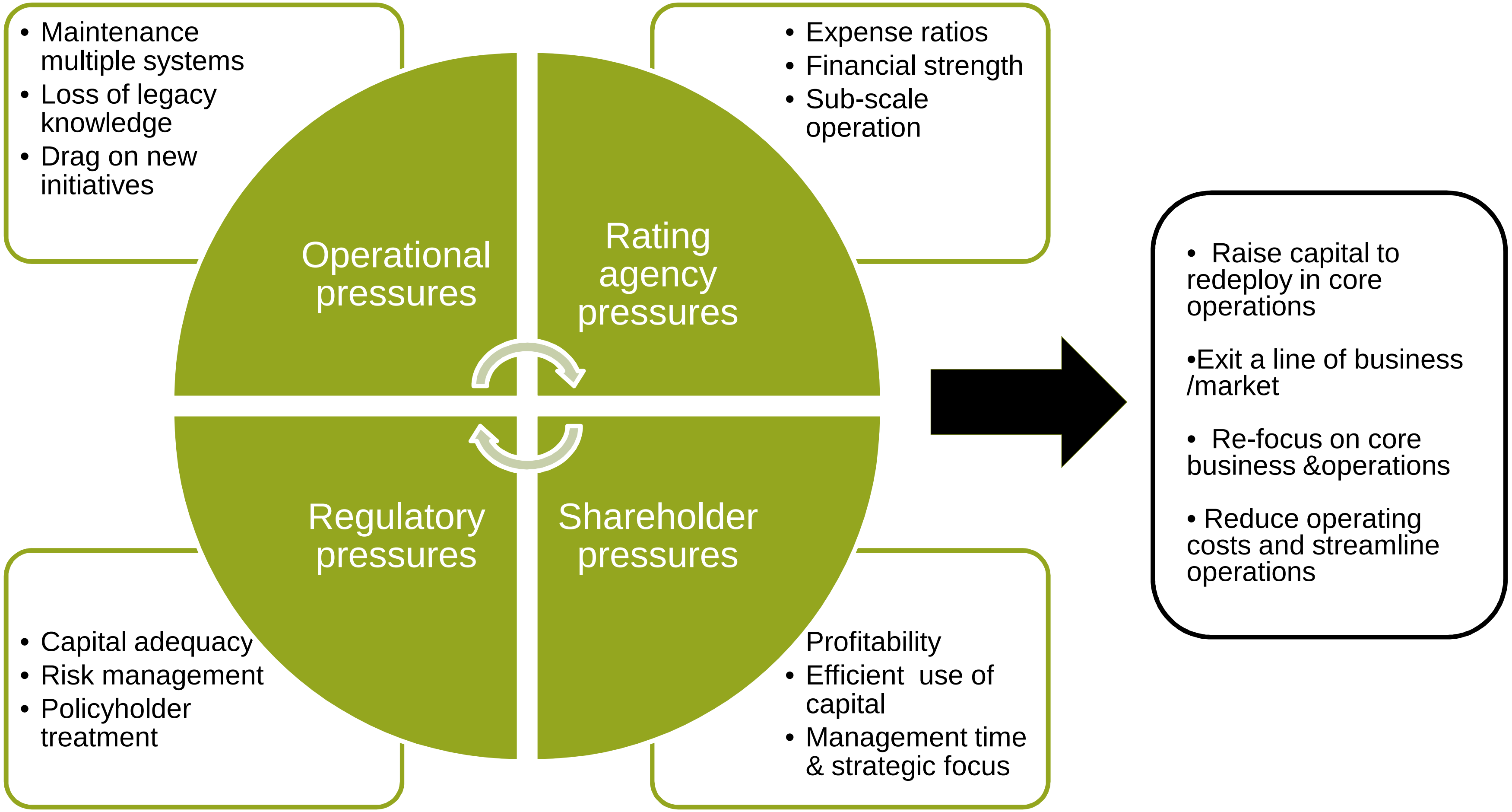
Agenda

- Drivers of UK closed-block market development
- Analysis of European markets
  - Germany
  - Netherlands
  - Distressed EURO markets
- Winners and losers

Drivers of UK Closed Block Consolidation

Driver	UK from 2000
Mis-selling scandal	Pension mis-selling, Endowment mortgage compensation
Changing Product Mix	Market reduced to Pensions & Protection
Financial Crisis	2001 “mini-crisis”
Changing Regulation	Treating Customers Fairly, RDR, etc
Increasing capital requirements	ICA Regime introduced increase with-profits capital requirements
Weak new business	Falling sales, Low NB Margins, some mutuals writing on negative VNB

Pressures to resolve legacy issues



The cost of carrying non-core portfolios

More than just cost of capital:

- Management time & focus, skills
- Legacy systems
- Inefficiencies
- Onerous regulatory requirements
- Unknown risks
- Reputational risks

Although there may also be benefits in retaining portfolios

- Cross selling
- Economies of scale
- Brand protection
- Customer affiliation
- Assets under management / premium income

source: Negotiating the Best Deal for Non Core Portfolios - Actuarial Profession

The cost of carrying non-core portfolios

The shareholders point of view

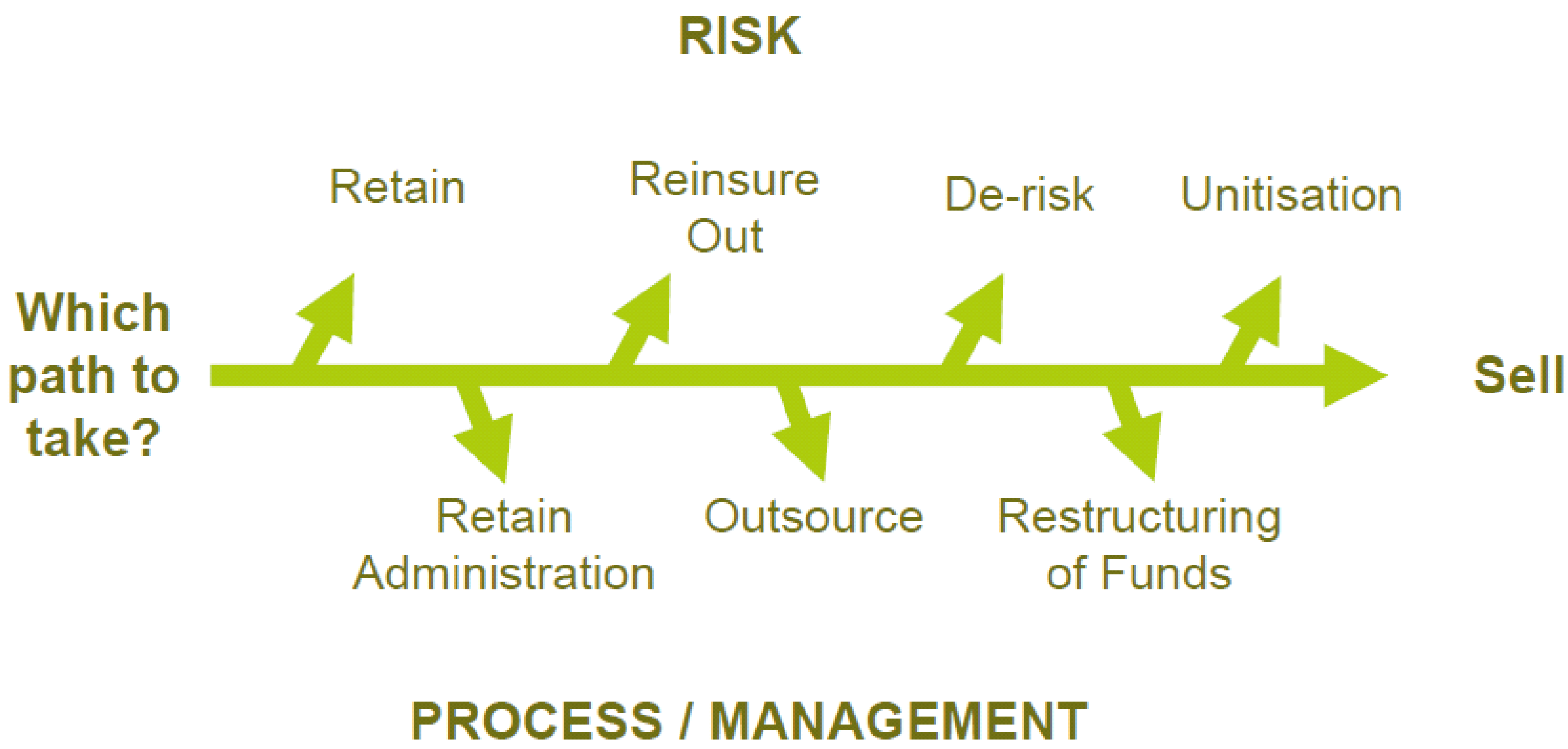
- Opportunity cost
- Earnings drag
- Capital tied up in illiquid investments
- Market gives credit for focus
- Credit for pro-activity

The policyholders point of view

- Treating customers fairly (TCF) issues on non-core blocks
- Ability to meet policyholder obligations and requirements
- Policyholder vs shareholder considerations

source: Negotiating the Best Deal for Non Core Portfolios - Actuarial Profession

Spectrum of strategic options

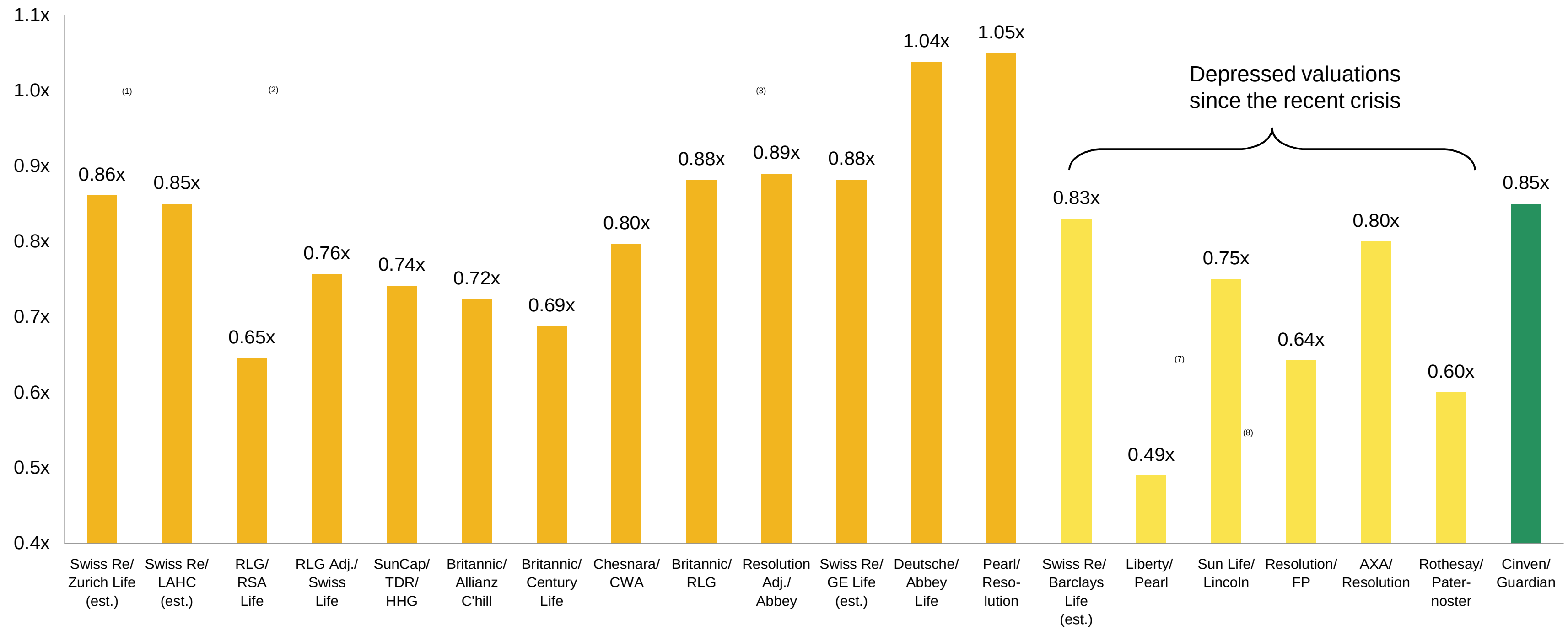


Multiple paths are possible

UK Closed Block Transaction Multiples

Price/Embedded Value (ex. Vestings/Increments)

Announcement	Aug-03	Jul-04	Jul-04	Dec-04	Dec-04	Dec-04	Mar-05	May-05	Jun-05	Jun-06	Oct-06	Jun-07	Nov-07	Oct-08	Jun-09	Jun-09	Aug-09	Jun-10	Jan-11	Aug-11
Price £ MM	149	333	850	205	1,070	110	44	48	835	2,200	465	977	4,537	753	673	195	1,680	2,750	260	275



Source Company Information, FSA Returns, Morgan Stanley

Notes

1. Adjusted for dividend payment pre-completion, not headline price; USD/GBP Exchange Rate as at 06/08/2003 = 0.6204
2. No adjustment to EV for cost of capital (estimated at £100 MM)
3. Adjusted for excess capital of £1,300 MM, £100 MM attributed to new business
4. Estimated Tangible EV Basis; 3x New Business Value deducted
5. Deal value reduced by asset management value, assuming 12x 1H07 earnings annualised, and EV adjusted to exclude NAV of asset management and include announced tax synergies of £250 MM
6. As stated in Liberty investor presentation; announcement price based on €10 per share and Liberty shareholding post transaction of 60%
7. Outside-in estimate
8. Based on 1H'09 EV

Winners and ………………….Losers in the UK

- Buyers who bought cheap
- Buyers who extracted synergies
- Buyers who knew (or where lucky) when to quit
  - And sold high!
- Those with clear constant strategic rationale communicated to investors

- Sellers who sold early from position of weakness
- Buyers who bought too expensive
- Banks who lent unwisely

- Regulator
  - Avoided possible multiple small insolvencies
- Policyholders??

- Inland Revenue due to tax synergies
- Staff – large scale redundancies
  - But was this inevitable?

Europe Life Insurance Market

The European insurance industry has survived the financial crisis relatively well. But the economic slowdown as well as the Solvency II are posing significant challenges to existing business models

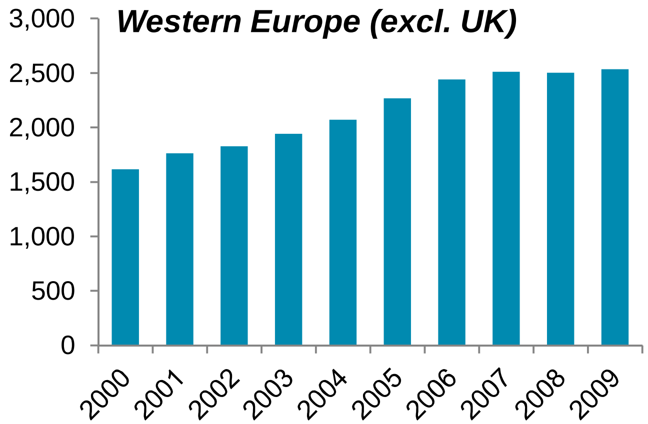
To assess the relative attractiveness of markets for closed-block consolidation we look at

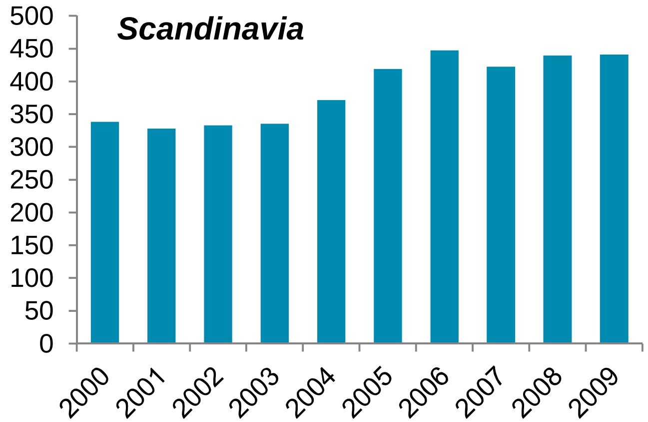
1. **Market potential**
2. **Propensity of deals to happen**
3. **Feasibility and ease of execution**

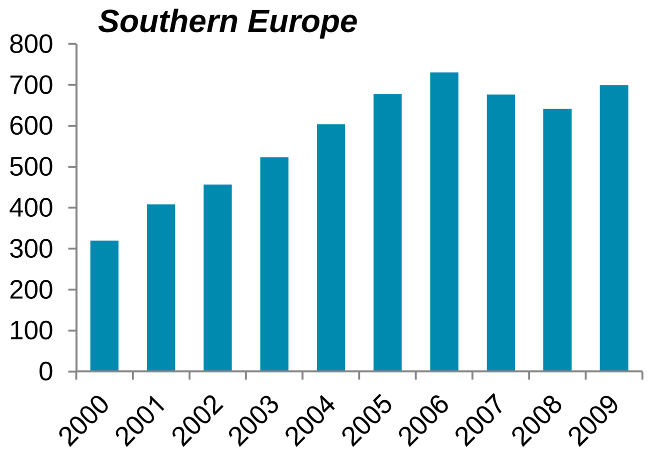
Potential: size matters

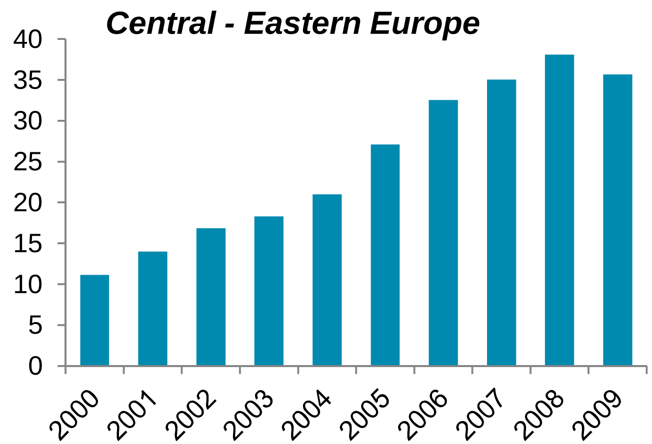
Potential
Propensity
Feasibility

- Evolution of Life technical provisions (€bn)









Source : CEA/European Insurance figures - 2009

Main markets at a glance

Potential
Propensity
Feasibility

	Country	Population (m)	Number of life insurance writers	Life Technical Provisions (€bn)
	UK	61.5	237	1 544
	France	64.3	127	1 233
	Germany	82.0	97	741
	Italy	60.0	82	378
	Spain	47.0	140	145
	The Netherlands	16.5	67	259

Source : CEA/European Insurance figures - 2009

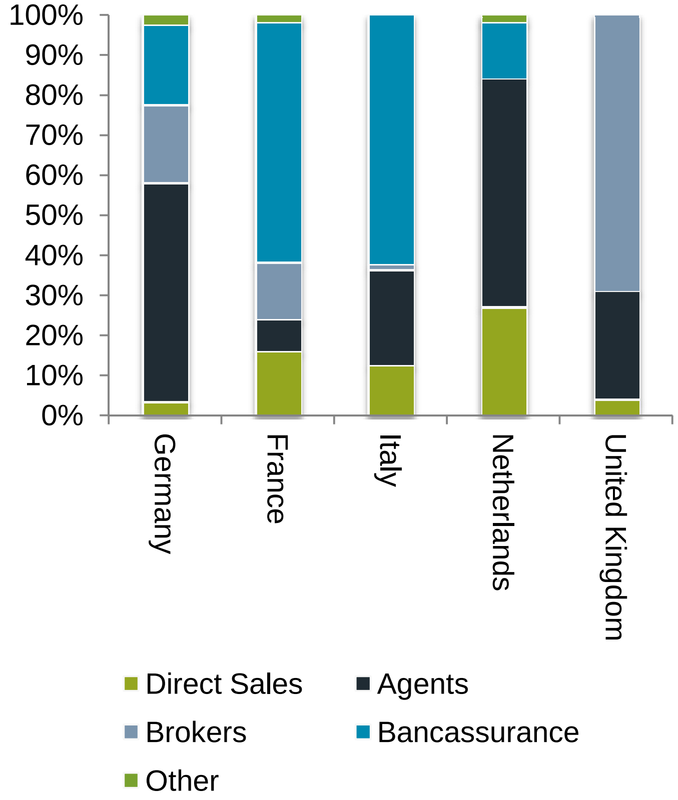
Other considerations

Potential
Propensity
Feasibility

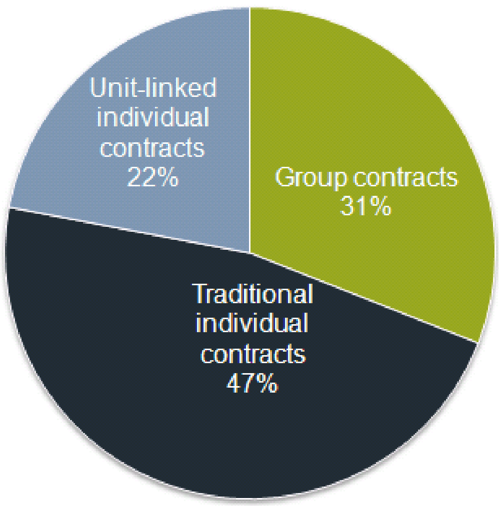
Market concentration

Country	First 5	First 10	First 15
Germany	48.5%	67.9%	78.4%
France	55.5%	80.5%	91.8%
Italy	56.4%	79.3%	89.3%
Netherlands	76.6%	82.5%	97.1%
UK	53.8%	79.9%	88.1%

Distribution channels



Product mix, nature of risks



Source : CEA/European Insurance figures - 2009

Propensity: macro drivers

Drivers for sellers

- Economic and debt crisis
- Regulatory developments
  - Solvency II
  - Distribution review
- Products fitness
- Operational pressures

Enablers for buyers

- Access to funding / ability to leverage
- Rule certainty
- Relative stability of financial markets
- Availability of BPO/ ITO solutions
- Scalability

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Feasibility and ease of implementation

- Mechanics for portfolio transfers
  - Local equivalents of Part VII
- Human Resources
  - Transfer of Undertakings (Protection of Employment) Regulations (TUPE)
  - Level of unionisation
- Tax environment
- Regulatory attitudes
- Reputational issues / public opinion

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Our views – summary of European markets attractiveness for Closed Block consolidation

	POTENTIAL	PROPENSITY	FEASIBILITY
GERMANY	+++	++	++
FRANCE	+	-	+
ITALY	++	++	-
NETHERLANDS	++	+++	+++
SPAIN	+	+	+
SCANDINAVIA	++	+	+++
…			
IRELAND	- / +	+++	+++
...			
GREECE	-	+++	-

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Germany - background

- 97 life insurers (2009), many with a small market share
- Mature tax-driven market with slow growth
- Relevant events
  - Protektor founded to maintain public trust (2002)
  - Insolvency Mannheimer Leben (2003)
  - Victoria Leben (ERGO) put into run-off (2009)
  - 2011 has seen possible start of restructuring activity
    - Delta Lloyd Leben (Nomura)
    - Fortis Deutschland (Augur Capital)

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Germany – local drivers

Overdue consolidation	Relatively large number of sub-scale unprofitable players
Continued low interest rates	German government bond yields do not support in-force guarantees and buffers are hit by financial market volatility
Changing Regulation	Solvency II will require increase in capital in particular for smaller players that can least afford it
Weak new business	The government has stalled on further pension reform.

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Germany – challenges

Profit sharing	Policyholders are entitled to up to 90% profits. The strong mutuality nature also means any upside from restructuring may need to be shared.
Guarantees	The average German policyholder is risk-averse and most products (including UL) have guarantees.
Role of Free RfB	Some insurers have little hard capital invested, but it also means gearing on results is high
Public perception	Heightened sensitivity to ‘vulture fund’ investors and to ‘run-off’ model in general
Bafin	Regulator Bafin has far reaching powers, both on day-to-day decisions and restructuring approval.

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Germany – challenges

Allianz Group

Measures to be adopted in case a German life insurer gets into financial difficulties

By law, BaFin is given far-reaching powers to intervene:

1. **Financial reorganization under supervision of BaFin**
   Various options: Injection of new capital, appointment of a trustee, etc.
2. **Search for an insurer willing to buy the company**

Should these measures fail:

3. **Takeover of portfolio by Protektor Lebensversicherungs-AG**
   "Security net" established for difficulties caused by falling equity markets

Should interest rates decrease below technical interest rate for business in force:

The last resort: Reduction of benefits
According to § 89 (2) VAG*, "BaFin can, if necessary, reduce the obligations of a life insurance company from its insurance contracts in accordance with its assets."

*) Versicherungsaufsichtsgesetz (German insurance supervisory law)

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Netherlands - background

- 67 life insurers
- Dominated by six Dutch-based players.
  - Last decade or so saw retreat of Prudential, Axa, Swiss Life and more recently Aviva (Delta Lloyd).
- Relevant events
  - Vie d'Or insolvency (1995)
  - Government investment in industry during crisis: ING, Aegon, Fortis ASR, SNS Reaal
  - Collapse in new business 2008- present

Netherlands – local drivers

Mis-selling scandal	“Woekerpolis” affair exposed industry wide hidden charges on unit-linked policies
Changing Product Mix	Bank Savings get level tax treatment, PPI non-insurance pensions savings
Financial crisis	Government needs to unwind stakes
Changing Regulation	- Solvency II capital increase in respect of guarantees and longevity - Up-front commission outlawed
Increasing capital requirements	Regulator “encourages” solvency ratios above 150%
Weak new business	Weak housing sales, protection margins squeezed

Netherlands – challenges for providers

Mis-selling risk	Is 'woekerpolis' the end?
Longevity risk	Almost unavoidable risk as part of larger transfers. Market has historically under-reserved this risk.
Group pension business	Complex, highly competitive market that makes up 50% of technical provisions. Closed-blocks do exist already, but on the whole not very well suited to run-off.
Lack of credible BPO/ITO solutions	History of legislative changes and bespoke systems development on 1970/80s systems leaves significant operational and cost challenges, also for buyers

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Strategies of 6 Largest Dutch Life Insurers

- ING
- EUREKO
- SNS REAAL
- AEGON
- Delta Lloyd
- ASR

Distressed EURO markets

- Bancassurance is dominant in many of the distressed European markets (IPIGS)
- Survival of some insurers is strongly linked to fate of banks and/or fate of governments through asset holdings
- Keeping trust of policyholders in these industries is crucial
- Restructuring discussions at different levels of maturity

- From a run-off perspective distressed markets represent a major, if very risky, opportunity

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Winners and …………………Losers in Europe

- Buy cheap
- Borrow prudently
- Convince regulators
- Appease consumer lobby
- Extract Synergies
- Keep policyholders happy
- Effective exit strategy and timing

- Forced sellers
- First movers?
- Ineffective management of synergies

Questions or comments?

Expressions of individual views by members of The Actuarial Profession and its staff are encouraged.

The views expressed in this presentation are those of the presenter.