



The Actuarial Profession

making financial sense of the future

Life conference and exhibition 2010
David Prowse & Harish Gohil, Fitch Ratings



UK life in 2010 and beyond

A rating agency perspective

7-9 November 2010

Agenda

Credit Ratings

UK Life Market – Metrics

Ratings Trends

Looking Ahead

Q&A

Credit Ratings

Purpose

- Security / financial strength

Meaning

- Probability of default / loss given default

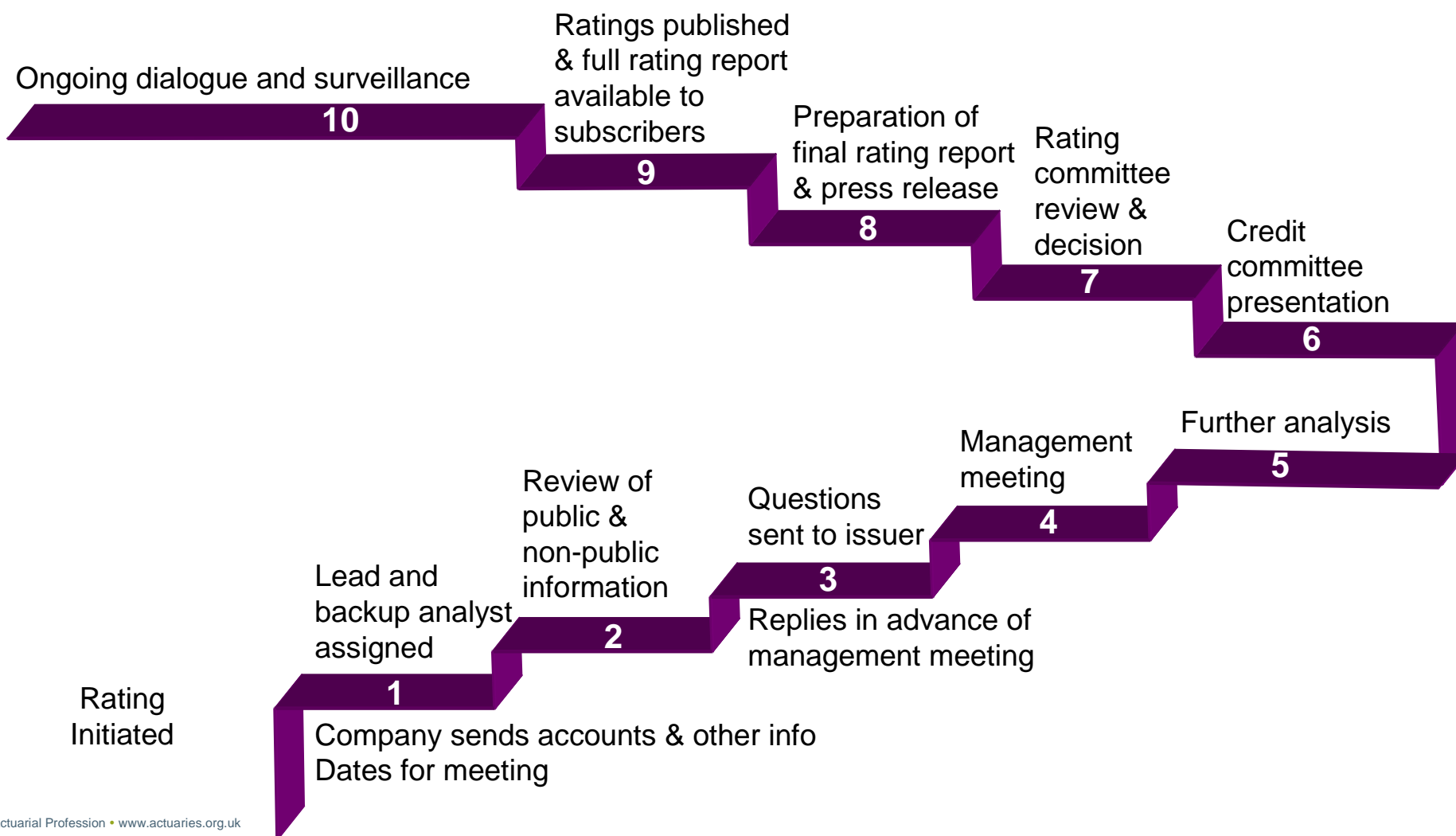
Users

- Investors
- IFAs / policyholders
- Actuaries

Implications

- Cost of finance

10 Steps in the Rating Process



Analytical Methodology

Financial Review	Industry Review	Operational Review	Organisational Review	Management Review
Profitability	Competitive landscape	Underwriting expertise	Parent financial strength	Strategic vision
Investments and liquidity	Pricing trends	Distribution capabilities	Dividend requirements	Management quality
Loss reserve adequacy	Competitive advantage	Business mix	Financial flexibility	Depth and breadth of experience
Reinsurance utilisation	Barriers to entry	Market share	Strength of affiliates	Risk appetite
Catastrophe risk	Bargaining power	Operational scale	Strength of subsidiaries	Successful plan execution
Capital adequacy	Tail of losses	Expense efficiencies	Group synergies	Organisational structure
Financial flexibility	Regulatory environment	Brand recognition	Explicit support agreements	Corporate governance
Peer analysis	Accounting framework	IT capabilities	History of support	Financial projections

Analytical Methodology

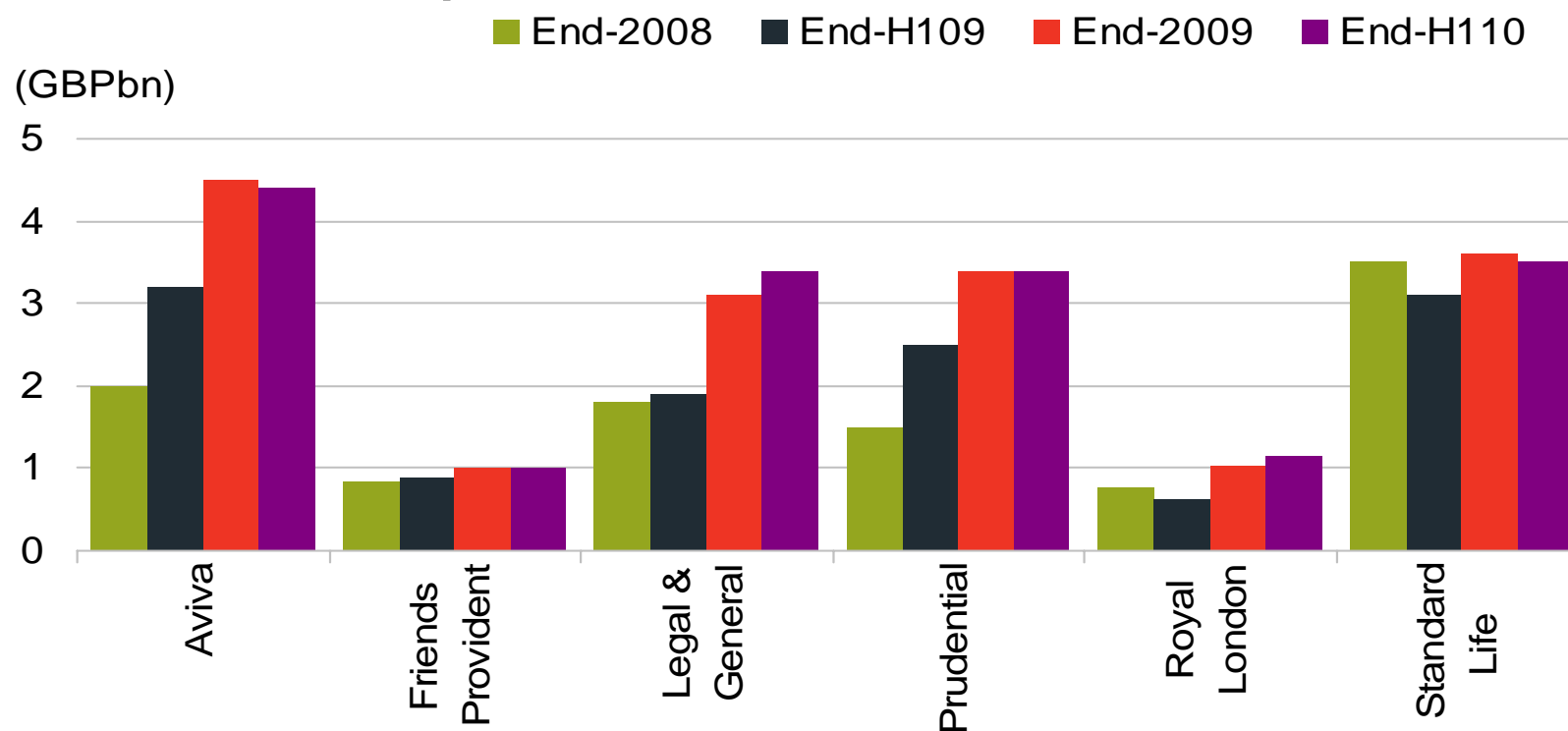
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UK Life Market – Metrics

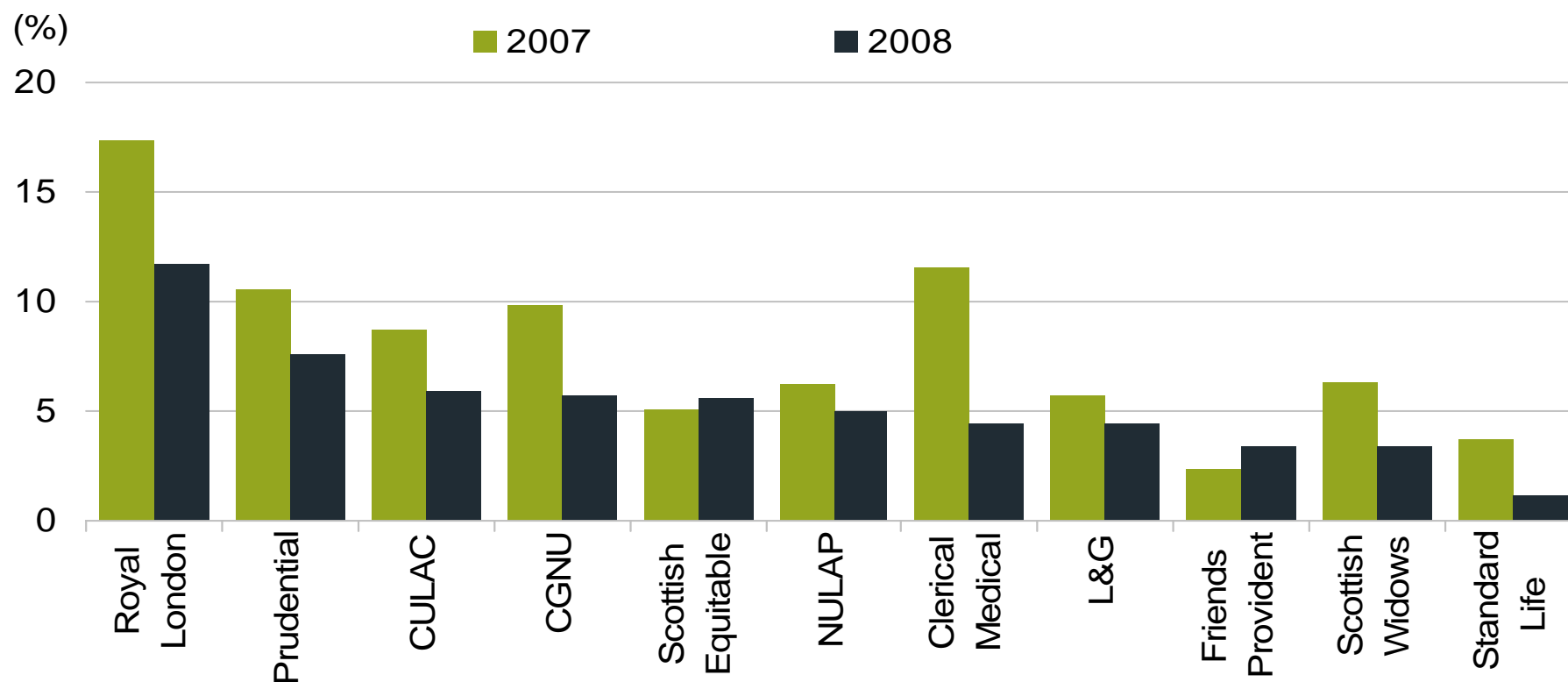
Regulatory Capital

IGD / FGD Surplus



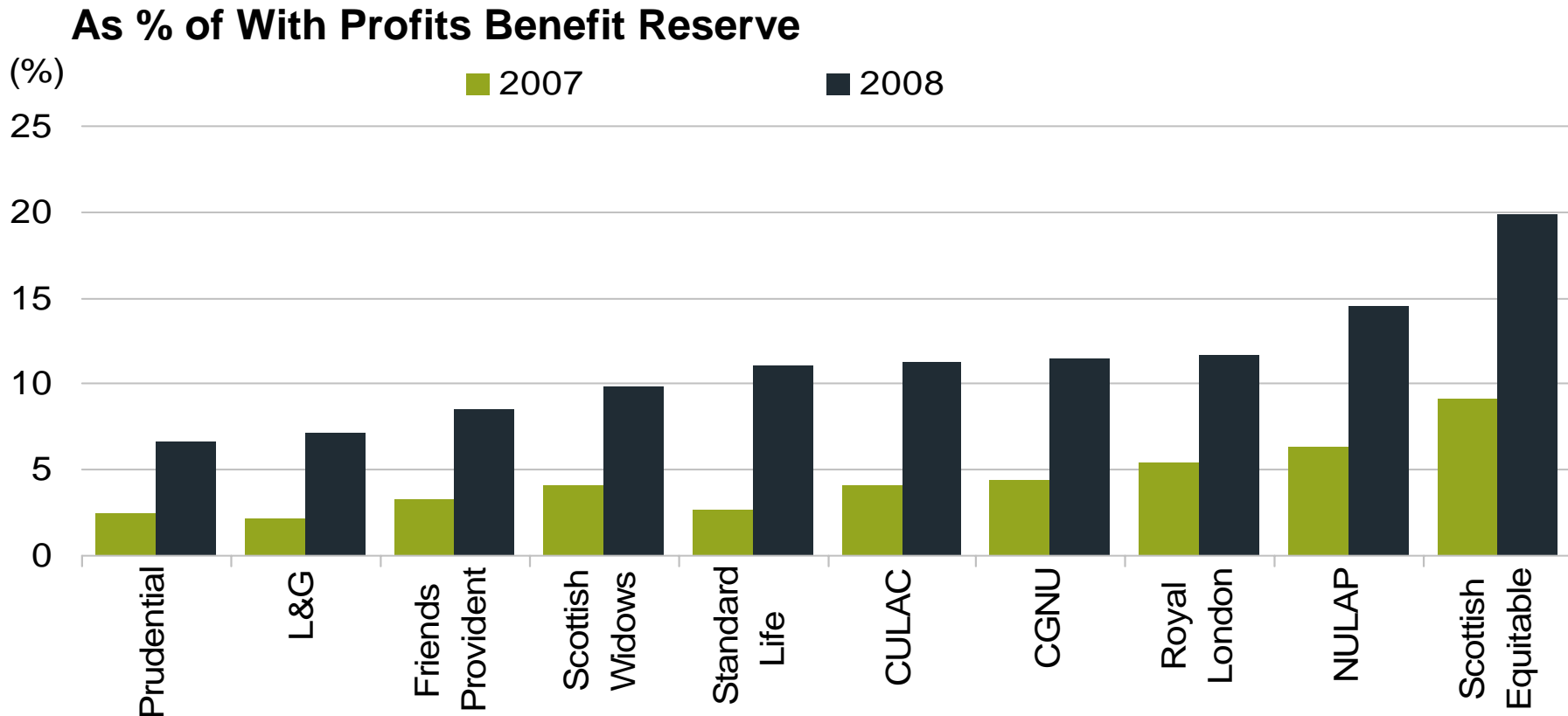
Source: Companies

WP Free Asset Ratios – Still a Risk



Source: Companies' FSA Returns, Fitch

WP Cost of Guarantees – Still a Risk



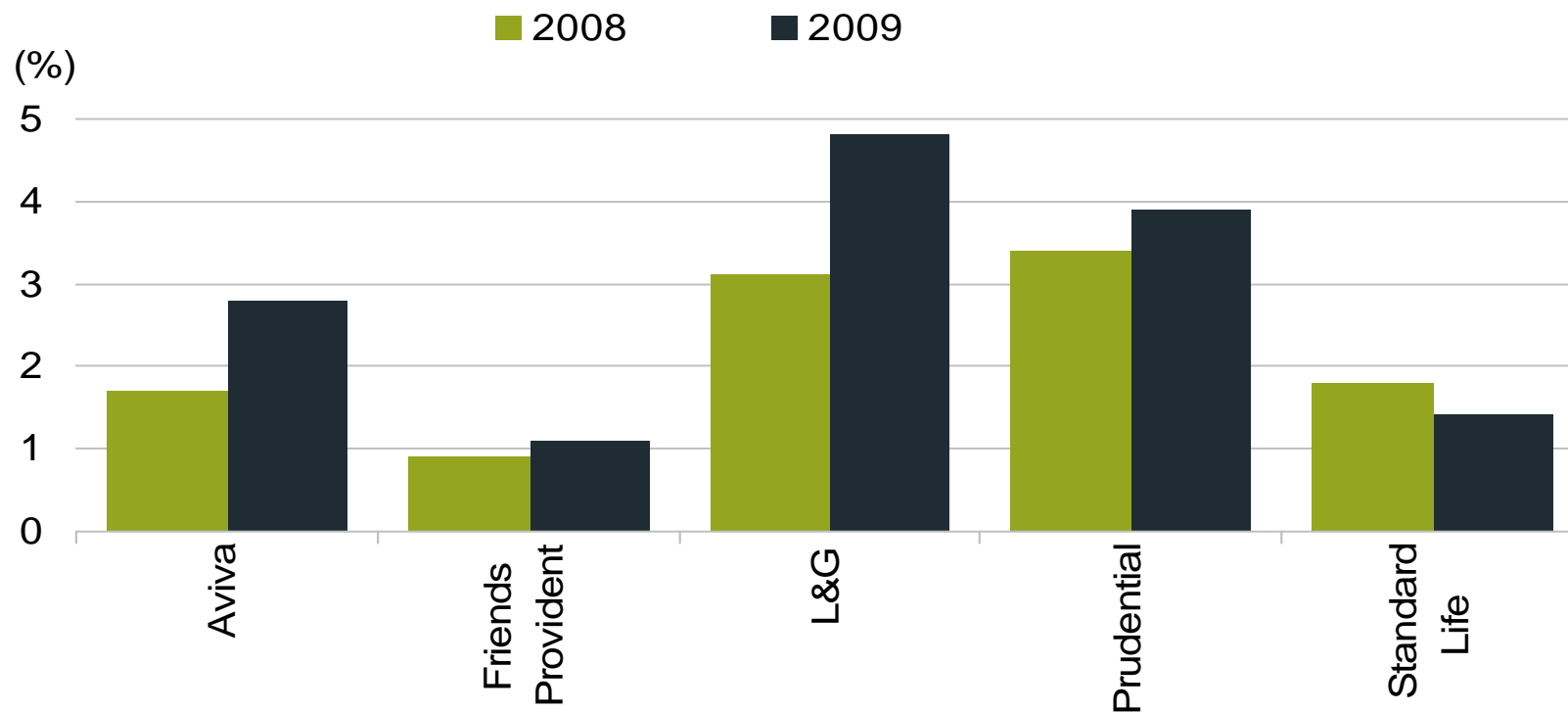
Source: Companies' FSA Returns, Fitch

Earnings – EV and IFRS

- MCEV → Inconsistency
- EV in credit analysis
 - Long-term profitability (VIF, VNB)
 - Risks, profit drivers
 - Adjust IFRS balance sheet to allow for VIF
- I(?!)FRS ...
- EV for long-term value
- IFRS for group balance sheet and cashflow

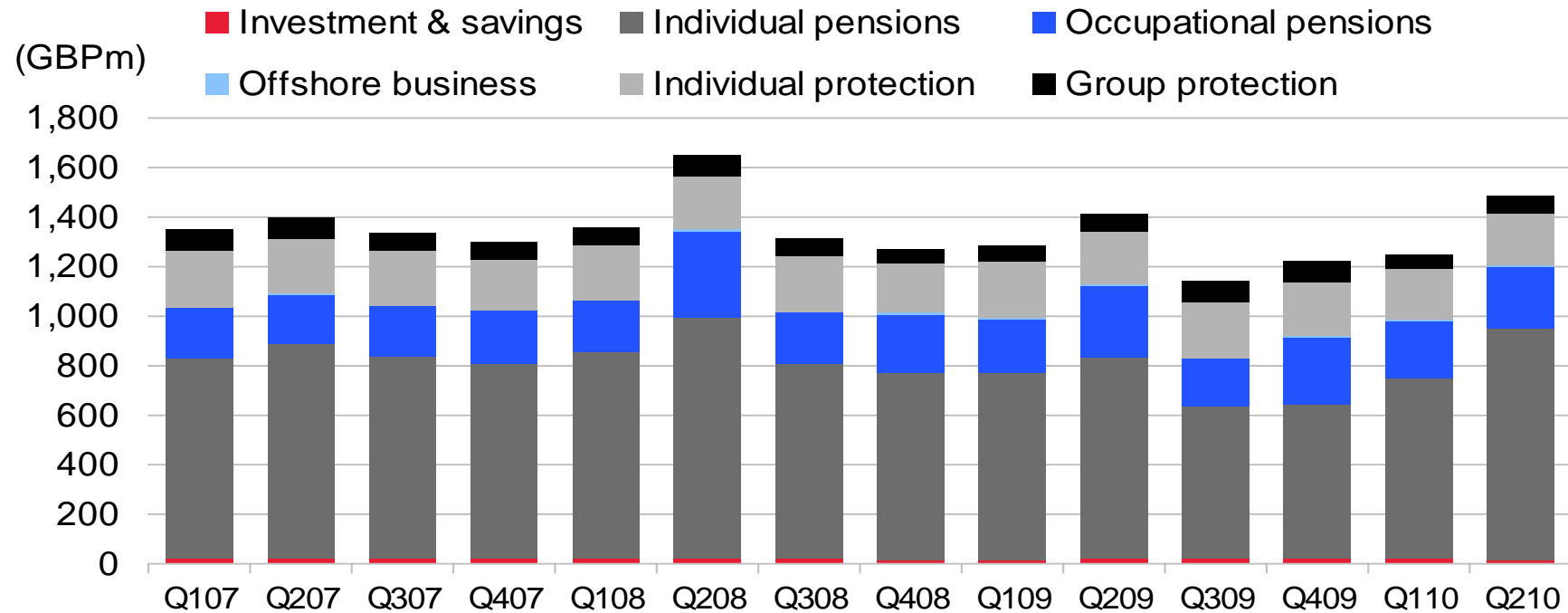
New Business Profit Margins

UK Life & Pensions (PVNPB Basis)



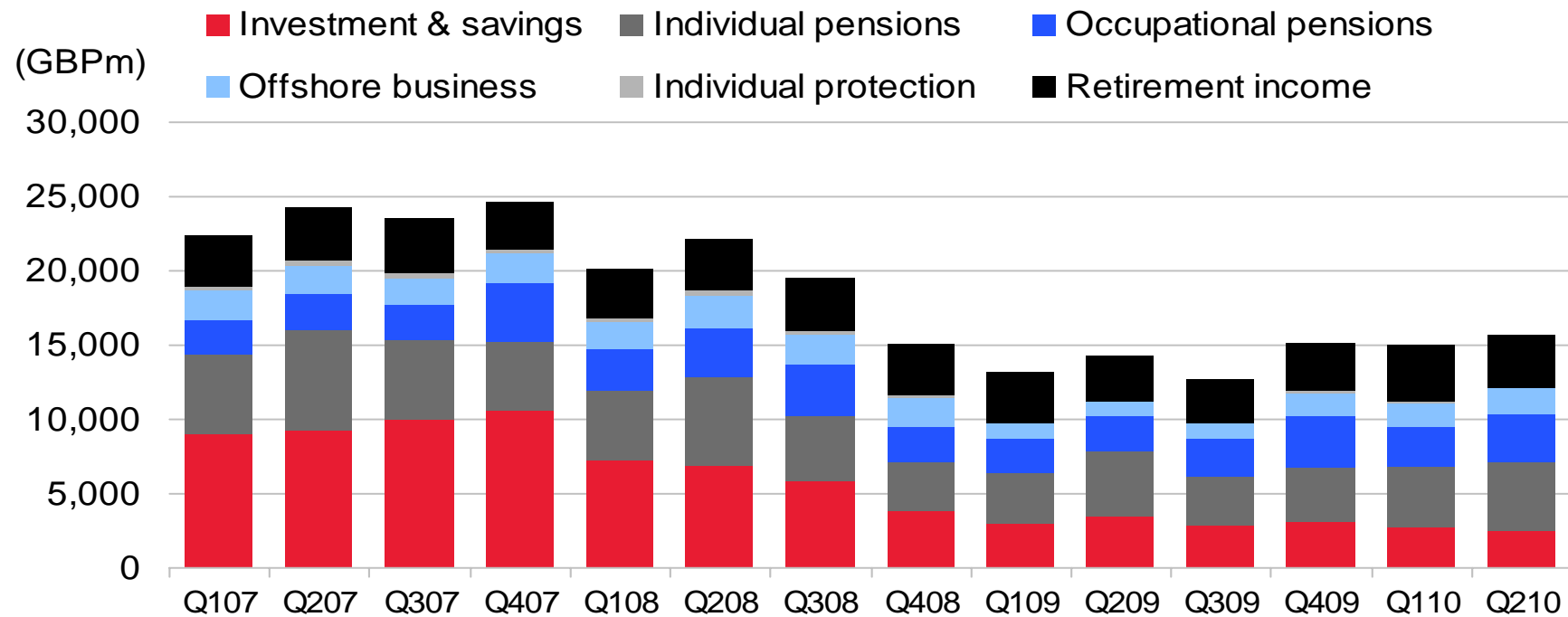
Source: Companies

Quarterly Sales – Regular Premium



Source: ABI

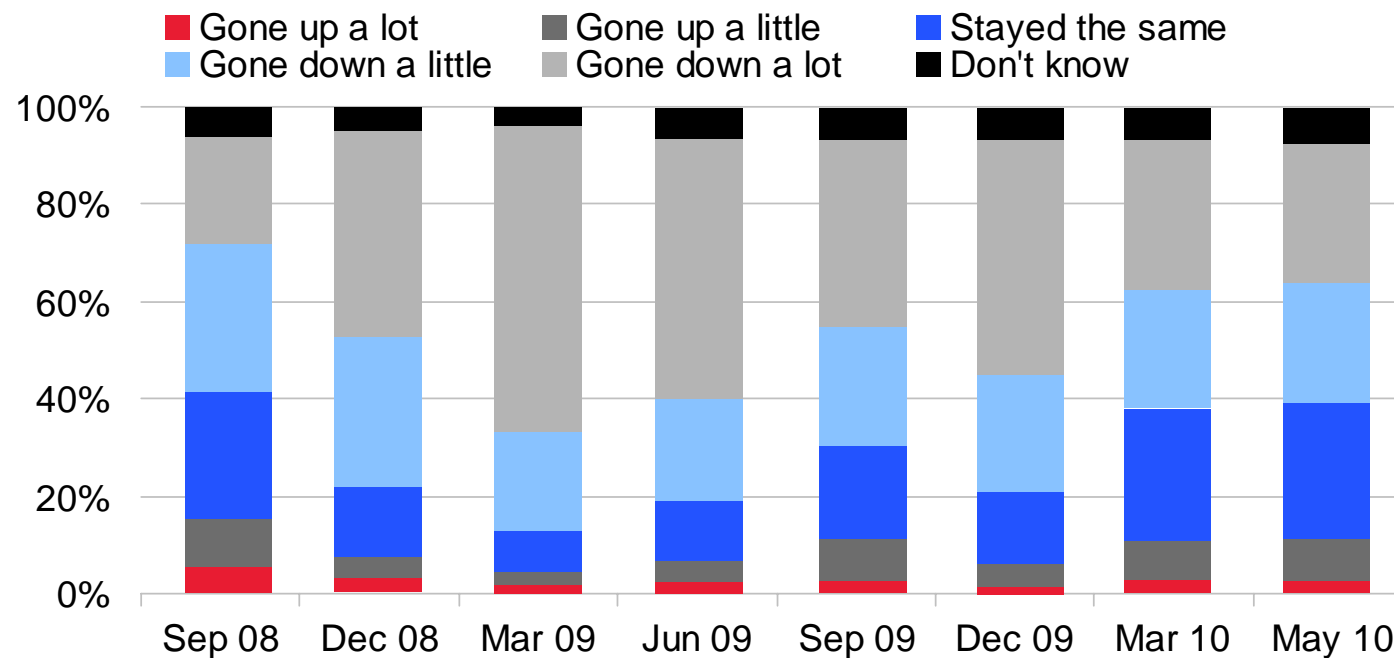
Quarterly Sales – Single Premium



Source: ABI

Consumer Confidence in UK Life

Compared to a year ago, do you think the benefits of saving (including saving for your pension) have...



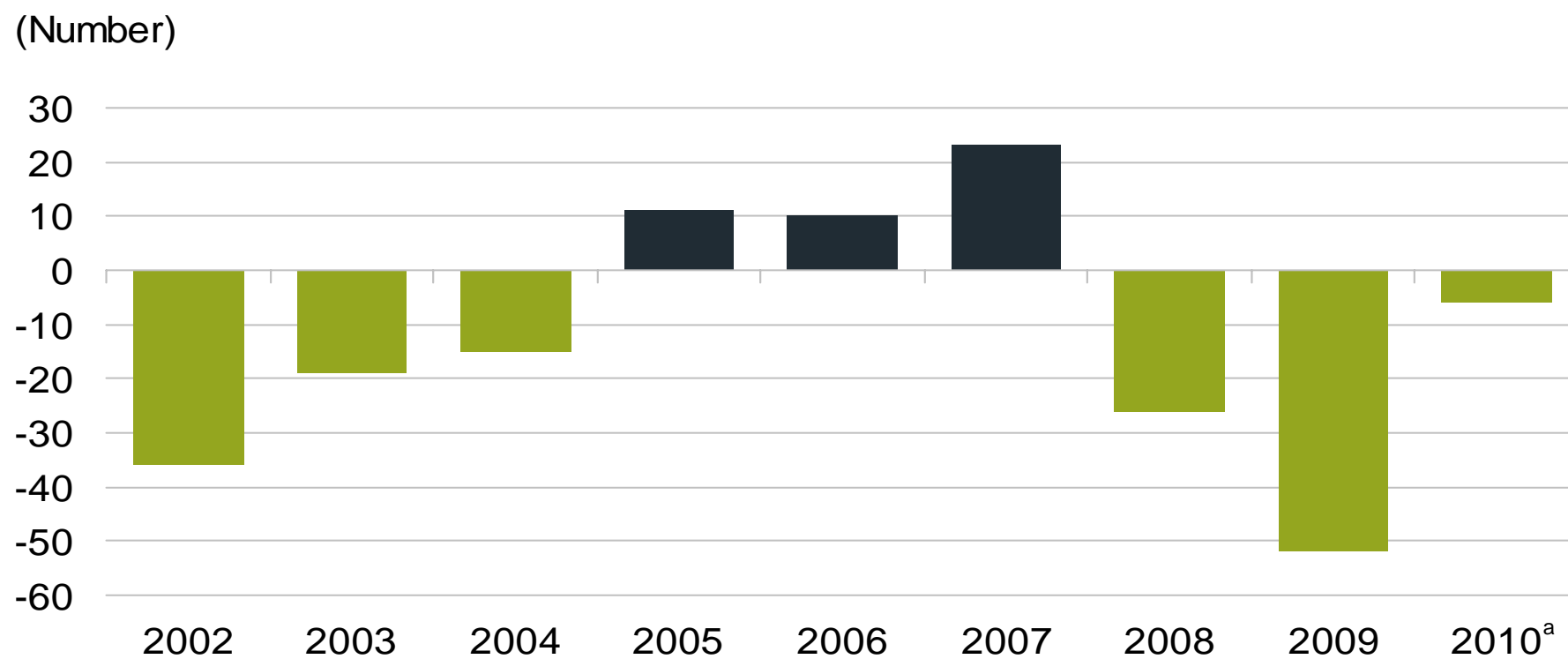
Sample sizes of at least 2,500

Source: ABI Savings and Protection survey

Agenda

Ratings Trends

Net Upgrades Less Downgrades



^a At 5 October 2010

Source: Fitch

What We Said a Year Ago ... **Update** (1)

- Simple movement from recession to recovery is not enough to change our rating outlooks to stable
- **Resilience of the industry has been the key driver**
- It is possible more ratings will need to first be downgraded before ratings stabilise
- **Did not happen in great numbers, but some rating actions**
- Even after we move into recovery, sustained strength of the recovery, and successfully addressing new issues like high inflation, are needed for ratings to stabilise
- **Recovery slow to date, but no emerging issues, as yet**

What We Said a Year Ago ... **Update** (2)

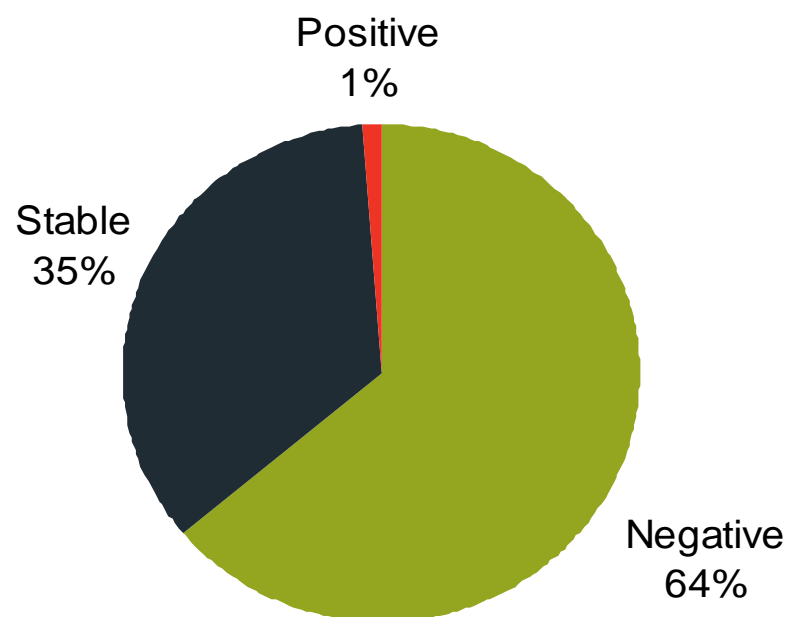
- A true opening up of capital markets at reasonable spreads and equity prices, to allow for renewed financial flexibility, is needed
- This has occurred to a large extent, although funding costs remain higher relative to pre-crisis levels
- A material retrenchment of unrealised investment losses, and greater comfort that losses to capital will be covered by our core Stress, is needed
- This has happened for many issuers. Capital positions are now as strong as before the crisis, or close to

What We Said a Year Ago ... **Update** (3)

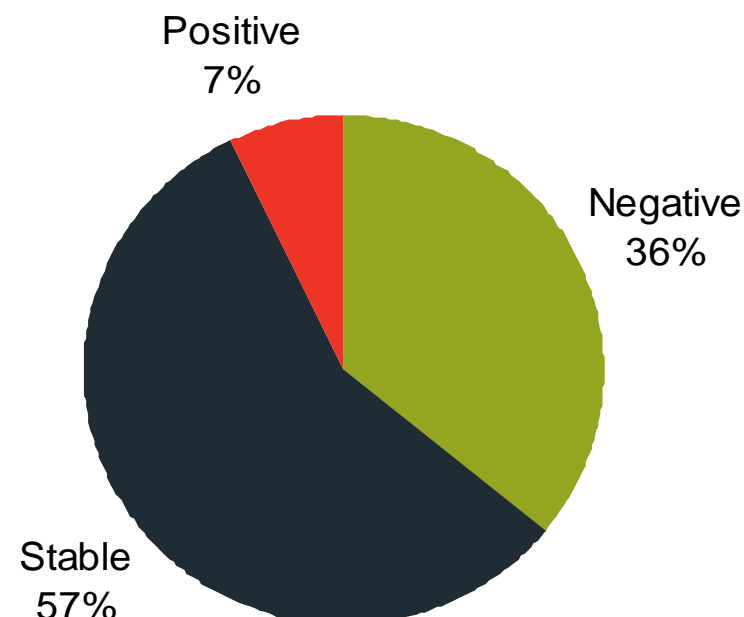
- As conditions improve, it is likely there may be “lagging” charges taken by companies that, if greater than expectations, could adversely pressure ratings
- **Not seen to any great extent, but do not rule out yet**
- Finally, any unique insurance-specific issues will need to be reasonably resolved before a sector will stabilise
- **Typically no major post-crisis issues have emerged – a positive for the industry. Reserving and claims inflation remain unknowns**

Fitch European Ratings – Outlooks/Watches

A Year Ago...














...And Now



Source: Fitch. Insurer Financial Strength ratings, 184 at 20 Oct 2009, and 193 at 5 Oct 2010

Market Outlooks by Key Sectors

		Current	Since	Prior	Since
UK Life		Stable	Oct 10	Negative	Oct 08
UK Non-Life		Stable	Mar 10	Negative	Oct 08
German Life		Stable	Oct 10	Negative	Oct 07
German Non-Life		Stable	May 10	Negative	Oct 07
French Life		Stable	Oct 10	Negative	Oct 08
French Non-Life		Negative	Oct 08	Stable	Oct 05
Italian Life		Stable	Oct 10	Negative	Feb 08
Italian Non-Life		Negative	Oct 08	Stable	Feb 07
Switzerland Life		Stable	Oct 10	Negative	Oct 08
Switzerland Non-Life		Stable	Oct 10	Negative	Oct 08
Reinsurance		Stable	Nov 09	Negative	Oct 08

Source: Fitch

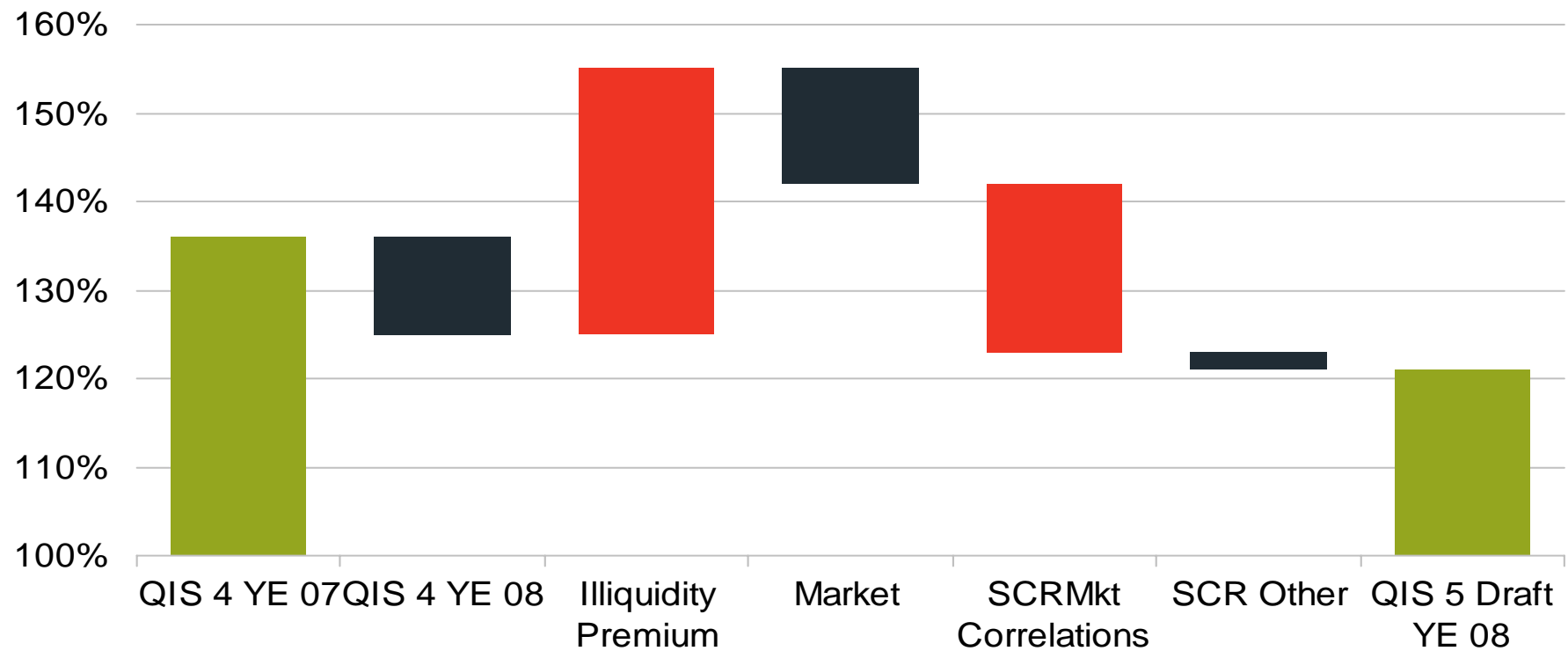
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Looking Ahead

Solvency II – UK Life Solvency Ratios

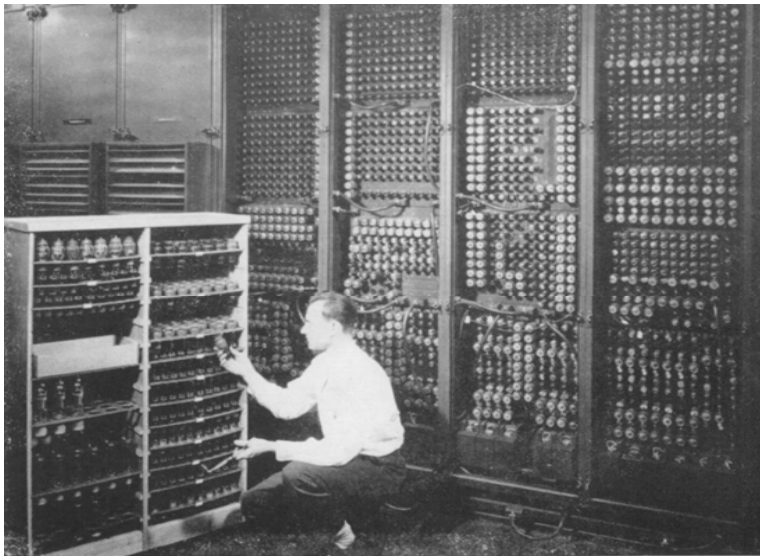
Breakdown from QIS 4 to Estimated QIS 5 (Draft Specifications)

(Solvency ratio)



Source: Milliman

Solvency II – Internal Models

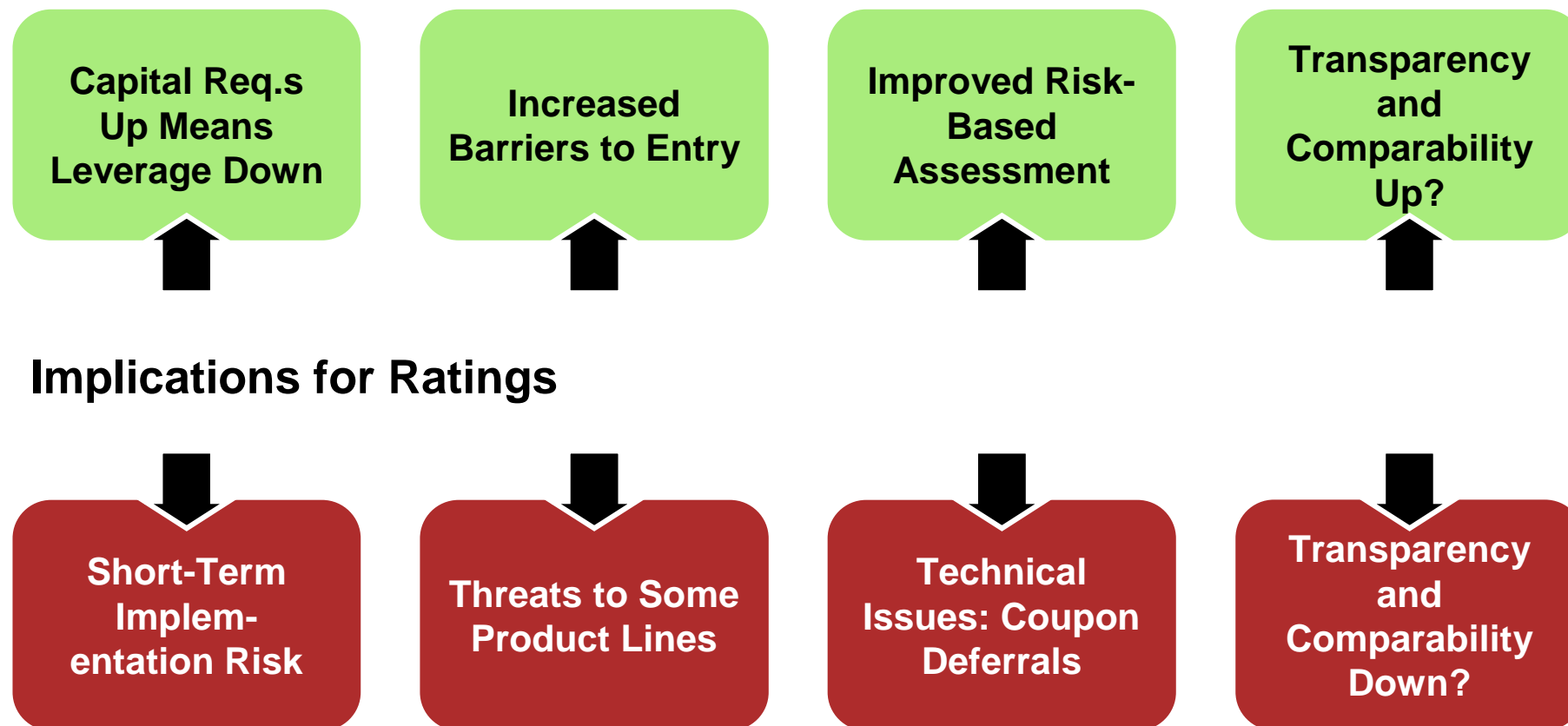


Replacing a bad tube meant checking among ENIAC's 19,000 possibilities.

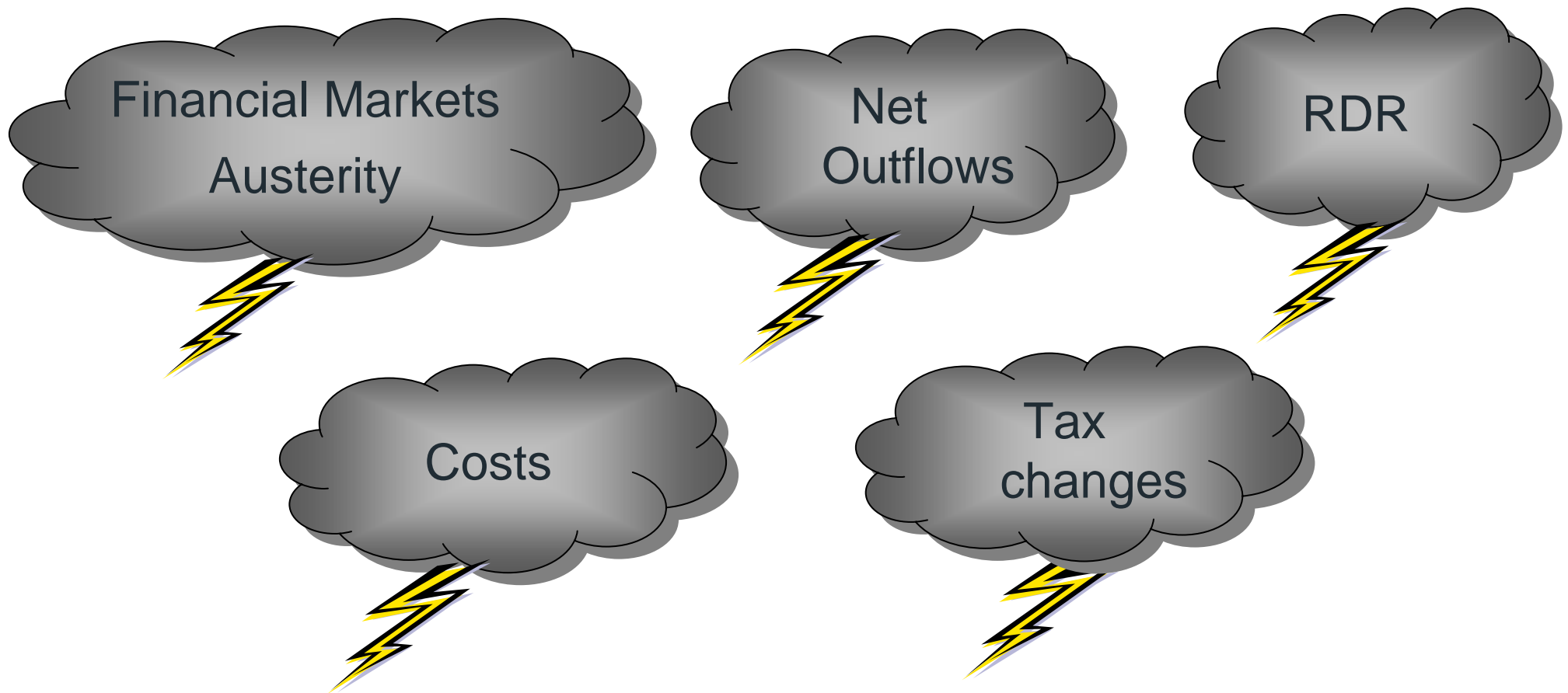
Given that each insurer writes different business, has a different risk profile, a different corporate structure, different operational processes and a different risk management framework, each internal model will be different and used in a different way (FSA DP 08/4).

Photo Source: US Army

Solvency II – Implications for Ratings



Challenges for UK Life – Solvency II, Plus ...



Challenges For UK Life – Visual Reminder



Predictions for 2011+

- Products
 - Annuity market in flux
 - Simpler savings products
- Distribution
 - Bancassurance, direct sales up, IFA sales down
- Regulatory/financial reporting
 - “QIS6”, “Solvency II(a)”
 - MCEV postponed for Solvency II
 - IFRS Phase 2 will be huge ...
 - Warchests + low margins + Solvency II → M&A

What Insurers May Not Want You to Know

- The whole truth
 - Headlines always good
 - Operating/underlying
 - “Good results = good management, bad results = investment markets”
 - Modelling “adjustments”
- Lapses/surrenders/outflows – invisible relative to sales figures
- Sensitivity to credit markets
- Solvency II
 - Not ready
 - Worst-case impacts
- Capital / M&A strategy
- They don’t like insurance!

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.

